Chapter 3: Justice in Economic History

Remove justice, and what are kingdoms but gangs of criminals on a large scale?

St. Augustine

The Recent History of Economic History

Economic ideas, like all things human, are best understood in the context of the history that produced them, because all human ideas are the products of some history. Prior to 1972, that would not have been a controversial statement, and it was generally required that graduate students of economics have at least one course in economic history. But in 1972, the University of Chicago dropped this requirement, and most major institutions followed suit. Underlying this decision was the belief that economics is a "hard" or "natural" science rather than a humane one. As a hard science, economics would be totally independent of any "cultural" or "humane" influences. Indeed, the most important economic history text was Joseph Schumpeter's *History of Economic Analysis*, and the very title hints at the problem: If economics was about analysis understood mainly in mathematical terms rather than empirical ones, than the usefulness of a "history" is problematic; if economics is merely a matter of selecting the right equations, then history is unnecessary since equations have no history.[1] Here we can see the continuation of the Enlightenment project to free all things from the past and root them firmly in the soil of pure rationality. But economics is a strange science to desire its freedom from history, since all of its data is historical, and its subject matter is human production, exchange, and consumption, things that are beyond doubt culturally conditioned.

The result of this shift in economic education is a generation (or two) of economists practicing in complete ignorance of the history of their art and likely to have less than a full understanding of the ideas which they purport to be using.[2] As Robert M. Solow noted:

> My impression is that the best and brightest in the profession proceed as if economics is the physics of society. There is a single universally valid model of the world. It only needs to be applied...We are socialized to the belief that there is one true model and that it can be discovered or imposed if only you will make the proper assumptions and impute validity to econometric results that are transparently lacking in power.[3]

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[1] Schumpeter passes over the economic history of the Roman Empire because it produced no economists. In doing so, he did not quite get his own joke. After all, if one of the longest periods of peace and prosperity in human history can be accomplished without the aid of economists, then perhaps it is the economists, and not the historians, who are superfluous. Joseph A. Schumpeter, *History of Economic Analysis* (New York: Oxford University Press, 1994).

[2] D. McCloskey, *The Secret Sins of Economics* (Chicago: Prickly Paradigm Press, 2002), 29-30.

3 Robert Solow, "Economic History and Economics," *American Economic Review* 75, no. 2 (1985): 330.

It is doubtful that economic ideas (or anything dealing with human activity) can be properly understood apart from the history in which those ideas are embedded and of which they are part and parcel. If we are going to seriously look at the relationship between justice and economics, we need to see how this relationship has been handled by economists in history.

The Preacher as Economist

Prior to the 15th century economics was normally discussed as a branch of ethics. The philosopher/theologian generally functioned as an economist because this was required to explicate the moral law. Hence we can call this period "the preacher as economist."[4] Of course, to explicate this "law," it was necessary to understand the "mechanics" of economics, which they did by inspecting the "natural law." However, this "natural law" is not a look at "raw" nature, as it came to mean in the 17th and 18th centuries, and certainly not a look at nature "red in tooth and claw." Rather, it was a view of nature bound up with a *teleology*; that is to say, a search for the true ends and purposes of natural things. These ends cannot be known "scientifically" but only "morally."

The idea of the "preacher as economist" can be gleaned from the economic work of two of the greatest "preachers," Aristotle and St. Thomas Aquinas. The former was perhaps the first to produce an economic treatise; the latter expanded Aristotle's work in a Christian context. Together, the Aristotelian-Scholastic view formed a consensus that lasted until the 16th century.

Aristotle

For Aristotle, justice is not just a part of virtue, but "virtue entire, nor is the contrary injustice a part of vice, but vice entire" (*Nicomachean Ethics*, 1139a, 10).[5] Justice underlies all the virtues and deals with the relations of man and man:

> And therefore justice is often thought to be the greatest of virtues, and "neither evening nor morning star" is so wonderful; and proverbially "in justice is every virtue comprehended." And it is complete virtue in its fullest sense, because it is the actual exercise of complete virtue. It is complete because he who posses it can exercise his virtue not only in himself, but towards his neighbor also (*Ethics*, 1129b, 25).

In is within this relationship of man to man, that is, within justice, that Aristotle locates economics. He presents a sophisticated analysis that includes a demand function, a distinction between use and exchange values, the function of money as the medium between value and demand (or "need") and usury, among

[4] This derives from a phrase originally used by George Stigler, "The Economist as Preacher." Stigler believed that the best economist wasn't the one who discovered the truth about economic reality, but the one who best persuaded others to his point of view. Truth becomes subordinate to persuasion or marketing. I am using "The preacher as economist" and "The economist as preacher" in quite a different sense from what Stigler intended, one much closer to John D. Mueller, *God and Money* (Washington D. C.: ISI Books, Forthcoming, 2006).

[5] Aristotle, "Nicomachean Ethics," in *Introduction to Aristotle*, ed. Richard McKeon (New York: Modern Library, 1947).

other things. Aristotle begins his reflection with the family, for "The family is the association established by nature for the supply of men's everyday wants" (*Politics*, 1252b, 11).[6] It is the family, and not the individual that is the starting point (contrary to modern economics) because only the family is self-sufficient; an individual in isolation can neither reproduce nor provide for himself (*Politics*, 1253a, 26). Man, for Aristotle, is a social being always using language and reason and always embedded in a cultural milieu.

Crucial to our consideration of justice are two distinctions, Distributive and Corrective justice and Natural and Unnatural exchange.

Distributive and Corrective Justice

Distributive justice deals with how society distributes its "common goods." Aristotle defines this as "things that fall to be divided among those who have a share in the constitution" (*Ethics*, 1130b, 31-33). This refers to the *common* goods of a state, a partnership, corporation, or some cooperative enterprise. For Aristotle, these things should be divided by "merit" based on contributions, but what constitutes this merit will be a matter that is determined culturally, "for democrats identify it with the status of freeman, supporters of oligarchy with wealth (or with noble birth), and supporters of aristocracy with excellence" (*Ethics*, 1131a, 25-29).

Corrective justice,[7] on the other hand, deals with "justice in exchange"; that is with transactions between individual men. In this case, justice consists in exchanging equal values, in "having an equal amount before and after the transaction" (*Ethics*, 1132b, 19-21). This "equality in exchange" is the origin of "just price" theories. The problem is how to determine what values are equal when dealing with dissimilar products, which is nearly always the case. To use Aristotle's example, how many pairs of shoes are equal to one house? The only way to know this is by "need," which many economists understand as the demand function mediated by money. Thus the demand for houses and shoes can be compared by looking at their prices and the two can be equated in terms of money. Money, however, is a social convention: "this is why it has the name money (*nomisma*)— because it exists not by nature but by law (*nomos*)" (*Ethics*, 1133a, 25-31). Thus the requirement for equality in exchange comes from the natural law, but the method of implementing it is legal or conventional. Although Aristotle uses money to make dissimilar items commensurate, he is not actually able to tell us

[6] Aristotle, "Politics," in *An Introduction to Aristotle*, ed. Richard McKeon (New York: The Modern Library, 1947).

[7] During the Middle Ages, the term "corrective" justice became "commutative" justice due to a mistranslation. The word Aristotle uses is (diórthotikós), "corrective" (LSJ). Although the term "commutative" has become more common, we will use the term "corrective" as closer to the original sense in Aristotle.

how to do that, and admits to reaching an impasse on the problem (*Ethics*, 1133b, 18-20).[8] The valuation problem, that is, *price*, still remains central to economics.

Distributive justice, then, is a distribution of the products of a group distributed to the members of the group, while corrective justice is between individuals. Distributive justice will be proportional to one's contribution to the group, and hence there can be unequal distributions based on unequal contributions. Corrective justice, on the other hand, will always involve equal amounts, like for like. The distinction between distributive and corrective justice remains central to economics, even if economists do not always recognize the connection. Neoclassical economists generally cast economic questions in terms of free exchanges, that is, in terms of corrective justice. Many other schools have a tendency to see things in terms of distributive justice. This makes a profound difference in how they answer the questions, even when using the same data. To take a concrete example, we can ask if factor shares— the amounts of compensation given to capital and labor— are a question of distributive justice or of corrective justice? If the former, the shares will be determined by merit, which is culturally determined; if the later, shares will fall under a calculation of the demand curves for labor and capital. Answering the question solely in terms of corrective justice suits the individualistic premises of neoclassicism because corrective justice is only concerned with exchanges between individuals; "social" questions do not intrude themselves. Therefore the notion of a social justice does not arise. Distributive justice, on the other hand, is always a matter of merit and contribution, questions which are answered in a social context. This distinction will therefore be a recurring theme in our examination of justice in economic history.

Natural and Unnatural Exchange

Also connected with justice is a "natural" limit on exchange. Aristotle recognizes that households need to have at least some wealth and property to survive (*Politics*, 1256b, 9). But wealth can be pursued in two ways: One way is to get the things we need to live, and the other is to get money itself. The former is a necessary part of household management (*Politics*, 1257b, 19-20), but the latter has no natural limit (*Politics*, 1258a, 1); in the former case, men trade for what they need and cease when they have enough; there is no point in acquiring more bread then you can use. But the latter case has no limit; money can be accumulated without end. This second type of exchange came about only after the use of money replaced barter.

> Hence some persons are led to believe that getting wealth is the object of household management, and the whole idea of their lives is that they ought... to increase their money without limit. The origin of this disposition in men is that they are intent upon living only, and not upon living well: and, as their desires are unlimited, they

8 Nicholas J. Theocarakis, *Nicomachean Ethics in Political Economy: From the Scholastics to the Neoclassicals* (2004 [cited December 21 2005]); available from http://www.het.gr/HET/pdf/dimosiefseis/Nicomachean_Ethics_PolEcon_JHEI.pdf.

> also desire that the means of gratifying them should be without limit (*Politics*, 1257b, 39ff).

The idea of some *limit* on exchanges strikes the modern person as strange, yet in an age of consumerism, consumption for its own sake and not to fulfill any real need, it is an idea worth recalling. Indeed, real wealth is impossible if we forget the reason for getting wealth in the first place.

St. Thomas Aquinas and the Scholastics

St. Thomas synthesized the work of Aristotle with a specifically Christian point of view to produce an economic view that reigned until the 17th century. Underlying the economic theories were two fundamental assumptions: "that economic interests were subordinate to the real business of life, which is salvation, and that economic conduct is on aspect of personal conduct, upon which, as on other parts of it, the rules of morality were binding."[9] Economic activity was regarded as a strong passion that needed restraint and boundaries; it needed to be put in its place, a place described by St. Thomas:

> It is lawful to desire temporal blessings, not putting them in first place, as though setting up our rest in them, but regarding them as aids to blessedness, inasmuch as they support our corporal life and serve as instruments for acts of virtue (*ST* II-II, 83, 6).[10]

Here we have a view of economics as *bounded*, as existing within some limits. For example, self-interest, the mainspring of modern economics, was neither unknown nor condemned by the scholastics. Indeed, it was required, since every man was required to provide for himself and his family.[11] However, self-interest was *limited* to providing the goods necessary for one's self and one's family only to the level called for by their "station in life"; beyond that, self-interest becomes the vice of greed.[12] The bounds of economics were given by Aristotle's idea of natural and unnatural exchange, the natural being that which supplies our needs, but the unnatural is for profit itself, unrelated to actual needs (*ST* II-II, 77, 4).

Thus Thomas combines two ideas, the idea of a proper "station in life" with the idea of justice in exchange to provide a synthesis between distributive and corrective justice. It is just this combination which, as we shall see, is often missing from neoclassical economics.[13] The idea of proper "stations" in life shows that

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[9] R. H. Tawney, *Religion and the Rise of Capitalism* (New York and Toronto: Mentor Books, 1954), 34.

[10] St. Thomas Aquinas, "Summa Theologica," (Allen, Texas: Christian Classics, 1981; reprint, 1981).

[11] Mary L. Hirschfeld, *Standard of Living and Economic Virtue: Building a Bridge between St. Thomas Aquinas and the 21st Century* (2005 [cited December 17 2005]); available from http://www.nd.edu/~econplcy/workshops/documents/jsce_paper.pdf.

[12] Ibid.

[13] Albino Barrera O. P., *Modern Catholic Social Documents and Political Economy* (Washington, D.C.: Georgetown University Press, 2001), 57.

equality was not a goal of Scholastic economics; while a race of sinless men could live from a common purse, communism was left behind in the garden.[14] The "stations in life" were embedded in a cultural milieu which required a hierarchy. The mechanism by which the Scholastics attempted to unite the distributive and allocative functions was the Just Price.

Just Price Theory

The Scholastics were aware of all the elements that go into modern pricing theory: utility, scarcity, supply and demand, costs, etc. However, they refused to reduce price to mere economic calculation. Most specifically, they refused the mainspring of modern pricing, utility, or "usefulness to the buyer." As one of the later Scholastics, Louis Molina, put it,

> That one may not accept a higher price by reason of the advantage of gain of the buyer is proved from the fact that the advantage is not something of the seller's but the buyer's; therefore the seller may not accept payment for it; otherwise he would sell what is not his (1759, *Disputation*, 348:6).[15]

Molina is repeating the words of Thomas from five centuries earlier, and the rejection of utility pricing is fairly consistent across the centuries dominated by Scholasticism. But if not utility, then what is the basis of the just price? For St. Thomas it is a matter of a price that "is neither more nor less than the worth of the thing" (*ST*, II-II, 77, 1). But the worth of a thing is "not fixed with mathematical precision," but "depends on a kind of estimate, so that a slight addition or subtraction would not seem to destroy the equality of justice" (*ST*, II-II, 77, 1,r. 1). Thomas does not explicate the basis of a just price because the practice is already a part of the economic system of his time and he assumes his audience already knows what he is talking about.[16] What seems hopelessly imprecise to us was more or less accepted as a "natural" part of the pricing system. Indeed, no pricing theory, right to our own day, has ever succeeded in being precise. What the Scholastics insisted on was that price reflect the wider social concerns expressed by the phrase, *common estimation*. Common estimation was not a result of market concerns, although it took those concerns into account. Rather, it was an ethical judgment about price that preceded the market; it was "an ethical judgment of at least the most influential members of the community."[17] [18] In general, the Scholastic writers preferred prices that were fixed

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[14] Jarrett Bede, *Social Theories of the Middle Ages: 1200-1500* (Westminster, Maryland: The Newman Book Club, 1942), 122.

[15] Bernard W. Dempsey S. J., "Ability to Pay," *Review of Social Economy* LXIII, no. 3 (2005): 341.

[16] George O'Brien, *An Essay on Medieval Economic Teaching* (Kitchner, Ontario: Batouche Books, 2001), 59.

[17] Ibid., 64.

[18] There have been attempts to equate the "common estimation" with the market price so that the just price is "just the price" fixed by the free market. See, for example, Alejandro A. Chafuen, *Faith and Liberty: The Economic Thought of the Late Scholastics* (New York: Lexington Books, 2003).However, this thesis is hard to credit, not only in the light of the specific denial of utility

by law with due account given to market conditions; but they were unwilling to give free reign to the market alone. The market was not sovereign, but constrained.

The primary factor in the common estimation was the wages of the workmen involved with the product, including the "worker" who is the merchant selling it. Just price theory was very much opposed to what is now called "economic profit"; the merchant was entitled to earn enough to support his station in life, but no more. His work deserves compensation, as does anyone's. At the same time, the worker was entitled to support adequate to his "station in life." Therefore wages were related to needs of the worker or the vendor, rather than on a utilitarian valuation of the output.[19] The idea of the just price, from an economic standpoint, was that there should be no wealth without work, and that prices would be driven to costs, including and especially the cost of labor. Therefore the just price theory is often considered a precursor of the "labor theory of value" favored by Adam Smith and David Ricardo.

The theory of the just price conformed to the general practice of the middle ages which was to have a "free market" in natural produce (wheat or wool, for example) while attempting to control the rate of profit and wages. This control was exercised through the guild system and through positive law by setting fixed prices. The guilds themselves were associations of masters and journeymen that were granted monopolies over some trade in a given area in return for the pledge of a consistent level of quality and a fair price. Being monopolies, they were carefully watched.

Thus the just price was an attempt to drive price to the costs of production and eliminate what we would now call "economic rents." Modern theory finds the notion of a just price somewhat quaint and, to the extent that prices were fixed by law or monopolies, somewhat threatening. However, it should be noted that both modern and medieval pricing make the same claims, namely the elimination of unjust profits or economic rents by driving prices to costs; it may be equated with what is called the "long-term equilibrium price."[20] But the medieval theory makes another claim missing from modern pricing, namely that both the merchant and the laborer will receive adequate compensation to support them in their station in life, a station assigned by cultural forces. There would not be equality, but neither would there be massive wealth on one hand or destitution on the other, but that some notion of the common good would rule all classes.

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pricing, but also for the fact that if common estimation and market price were the same, then the vast literature of the Scholastics on the subject would be merely tautological.

[19] Amintore Fanfani, *Catholicism, Protestantism, and Capitalism* (Norfolk, Virginia: IHS Press, 2003), 59.

[20] Hirschfeld, *Standard of Living and Economic Virtue.*

The Economist as Preacher

Between the 15th and the 18th centuries enormous changes had taken place in the economic life of Europe and most especially in England. Capitalism was by that time well established, but lacked a coherent theory to justify it. The ethical framework of medieval economics was under attack, but there was little to replace it. Or rather, what sought to replace it was a new concept which preached quite openly that "greed is good." This idea was most famously expressed in Bernard Mandeville's *Fable of the Bees: or Private Vices, Publick Benefits* (1714) "in which he put forth the seemingly strange paradox that the vices most despised in the older moral code... would result in the greatest public good."[21] Further, we see a complete reversal of Aristotle's distinction between natural and unnatural exchange. Whereas natural exchange aimed at providing the goods necessary to live, for which money was merely a means and not an end, the *summum bonum* of the new ethic was the unlimited earning of money for its own sake.[22]

Into this ethical vacuum came the sages of the Enlightenment. If the older sages made economics a colony of ethics, the divines of the Enlightenment tended to reverse that order. Recall that the problem of the Enlightenment was to root all explanations in some naturalistic principle, be it logic or human psychology or induction based on observations of nature. God would be known not through written revelation, but through the revelation of nature. Thus the economist served a dual role: he interpreted the economic stars to man and read therein the will of God. God, or nature, was still invoked as a final cause, but always operated through secondary causes which could be known "scientifically" and apart from any written revelation from the deity god-nature.[23] The major role for the "priests" of this god-nature was to answer the question raised by Mandeville: "How did 'private vices' become 'publick benefits'?" Without any conscious appeal to the common good, how could the common good result? For most of the classical and neoclassical economists, the market becomes a theodicy where god or nature is a Machiavellian sovereign who weaves long term benefits from purely private interests.[24] But as "nature and nature's God" are more thoroughly "understood," God himself becomes less necessary and nature becomes all we need to know. Thus the economist replaces the preacher. The "laws" of nature, interpreted by Enlightenment divines, become the hand of God in human affairs, and economics is raised to the level of ethics, if not actually surpassing them. The transitional figure in this process is Adam Smith (1723-1790). There were, of

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[21] E. K. Hunt, *History of Economic Thought: A Critical Perspective* (Armonk, New York and London, England: M. E. Sharpe, 2002; reprint, Updated 2nd edition), 33.

[22] Max Weber, *The Protestant Ethic and the Spirit of Capitalism*, trans. Talcott Parsons, 2nd Roxbury ed. (Los Angeles: Roxbury Publishing Co., 1998), 53.

[23] John Milbank, *Theology and Social Theory: Beyond Secular Reason* (Oxford: Blackwell Publishers, 1990), 39.

[24] Ibid., 37.

course, Enlightenment treatises on economics before Smith, but by popular acclaim he is regarded as the founder of "classical" economics.

Adam Smith

Smith was a professor of moral philosophy at the University of Glasgow and was part of the Scottish Enlightenment. He was a Stoic philosopher and not a particular fan of Christianity. But he was a bitter enemy of the mercantilist class and a friend to the working classes. His writings on economics were a response to the "Mercantile Pamphleteers," a group of writers who aimed to influence government policy in favor of the English merchant class. But Smith's real aim was to do for political economy what Newton had done for astronomy: reduce the seemingly endless complexity to a simple natural rule. As Newton had "tamed" gravity with the inverse square law, Smith hoped to find a similar law for political economy.[25] The problem was, however, that Smith found not one, but two "Newtonian" principles: The Labor Theory of Value and the "Invisible Hand" theory, and they were opposed to each other; one theory emphasizes conflict and the other emphasizes harmony.[26] Hence Smith ends up being an iconic figure to two opposed economic philosophies, capitalism and communism. In the invisible hand theory we have the foreshadowing of what will become "neoclassicism." But from the Labor Theory of Value [LTV] is born Marx's theory of capitalism.[27] We will take each theory in turn, and then try to discover why there are two of them.

The Labor Theory of Value

According to the LTV, the exchange value of a commodity is determined solely by the amount of labor required to produce that commodity.[28] This value forms a "natural" price and is the equilibrium price around which the actual market prices tend to fluctuate; the forces of supply and demand would push prices to this "natural price."[29] Thus labor forms a universal standard of value:

> Labour, therefore, it appears evidently, is the only universal, as well as the only accurate measure of value, or the only standard by which we can compare the values of different commodities at all times and at all places. (*Wealth of Nations, [WN]*, I.V, p.43)[30]

Although labor is the real standard of value, Smith points out that it is never purchased at full price, but treated as any other commodity (*WN*, I.VIII, p. 70). Smith notes that, "In that original state of things, which precedes both the appropriation of land and the accumulation of stock, the whole produce of

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25 Mueller, *God and Money*, 49.

26 Hunt, *History of Economic Thought*, 45.

27 Mueller, *God and Money*, 62.

28 Hunt, *History of Economic Thought*, 51.

29 Ibid., 53.

30 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Amherst, New York: Prometheus Books, 1991).

labour belongs to the labourer" (*WN*, I.VIII, p. 68). But, "As soon as the land of any country has all become private property, the landlords, like all other men, love to reap where they never sowed, and demand a rent even for its natural produce" (*WN*, I.VI, p. 52). Further, men stand in need of a "master" and an advance on materials and wages (*WN*, I.VIII, p. 69). Wages depend upon a contract, but the two parties are not equal in negotiating the wage contract. While masters can easily combine and the law does not prohibit such combinations, the law (at that time) prohibited them for workers. Masters can hold out longer than the workers (Ibid. p. 70). Thus Smith identifies *actual* wages as the result of a power relationship between masters and workers and not a result of purely "economic" forces.

Smith is often viewed as an unequivocal supporter of capitalism, a friend to business, the prophet of selfishness, and the mystic of the "invisible hand." John Mueller has labeled this picture of Smith "Smythology";[31] the real Smith is far more complex. For example, far from being a supporter of the mercantile interests, Smith was extremely suspicious of them:

> People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices. (*WN*, I.X, p. 137)

Smith believed that the interests of the merchants were generally contrary to the interests of the laboring and land-owning classes; while the fortunes of these two rise and fall with the fortunes of the country as a whole, it is the opposite for the merchants:

> But the rate of profit does not, like rent and wages, rise with prosperity, and fall with the declension, of the society. On the contrary, it is naturally low in rich, and high in poor countries, and it is always highest in countries which are going fastest to ruin. The interest of this third order, therefore, has not the same connexion with the general interest of society as that of the other two. (*WN*, I.XI, p. 219)

For Smith, the "liberal reward of labour" is crucial to the success of society:

> But what improves the circumstances of the greater part can never be regarded as an inconveniency to the whole. No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable. It is but equity, besides, that they who feed, cloath and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves tolerably well fed, cloathed and lodged. (*WN*, I.VIII, p. 83)

> The liberal reward of labour, as it encourages the propagation, so it increases the industry of the common people. The wages of labour are the encouragement of industry, which, like every other human quality, improves in proportion to the encouragement it receives. A plentiful subsistence increases the bodily strength of the labourer, and the comfortable hope of bettering his condition, and of ending his days perhaps in ease and plenty, animates him to exert that strength to the utmost. Where wages are high, accordingly, we shall always find the workmen more active, diligent,

[31] Mueller, *God and Money*, 45.

> and expeditious, than where they are low; in England, for example, than in Scotland... If masters would always listen to the dictates of reason and humanity, they have frequently occasion rather to moderate, than to animate the application of many of their workmen (*WN*, I.VIII, p. 86-87).

This passage gives us a clue to what Smith was doing with the LTV; it is a theory about *equity*, that is, about distributive justice. Smith was doing two things: First, he was attempting to find a principle for economics equivalent to Newton's inverse square law for gravity[32]; second, he was trying to establish the right of the worker to a sufficient wage based on pure natural law grounds in such a way that it could not be denied by reason or, one hopes, by employers. In explicating the LTV, Smith abandoned completely the idea of utility in pricing, something that had been connected to price theory since Aristotle. Further, his explication of the theory was totally inconsistent, and it would remain for later thinkers, such as David Ricardo and, more recently, Piero Sraffa to work out the details. Nevertheless, The Labor Theory of Value was influential in classical economics, so much so that John Stuart Mill (1806-1873) could say of it, "Happily, there is nothing in the laws of value which remain for this or any other future writer to clear up; the theory of the subject is complete."[33] But Mill did note the difficulty of distribution; the values returned to the laborer were nothing like the full values that the Labor Theory of Value indicated. This led Mill to conclude that while the laws of production "Partake of the character of physical truth," the laws of distribution are "of human institution solely" and could be made "different, if mankind so chose."[34]

The "Invisible Hand"

When Smith speaks of the LTV, the rhetoric is very much about social discord and class conflict. But Smith has a second theory, a theory of social harmony and economic welfare. This is the so-called "invisible hand" theory. The term originally appears in an earlier work, *The Theory of Moral Sentiments [TMS]*:

> [The rich] consume little more than the poor, and in spite of their natural selfishness and rapacity, though they mean only their own conveniency, though the sole end which they propose from the labours of all the thousands whom they employ, be the gratification of their own vain and insatiable desires, they divide with the poor the produce of all their improvements. They are led by an invisible hand to make nearly the same distribution of the necessaries of life, which would have been made, had the earth been divided into equal portions among all its inhabitants, and thus without intending it, without knowing it, advance the interest of the society, and afford means to the multiplication of the species... .In ease of body and peace of mind, all the different ranks of life are nearly upon a level, and the beggar, who suns himself by the

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[32] Ibid., 117.

[33] Richard T. Gill, *Evolution of Modern Economics* (Prentice-Hall, 1967), 51.

[34] Ibid., 31..

> side of the highway, possesses that security which kings are fighting for (*TMS*, IV.I, p. 249).[35]

In this view, the "security of kings and beggars" is equal, and all have an equitable share, a share that would be no different even if there were a more equitable distribution of property. Yet by the time Smith wrote the *Wealth of Nations*, he seems to have come to a different view. In the *Wealth of Nations*, the "invisible hand," which actually appears but once in the text, has a somewhat different meaning:

> By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it (*WN*, IV.II, p. 351-2).

Here the term is used in connection with foreign trade and only means invisibility from the government bureaucracy. Smith held that if each man would look after his own business, the interests of trade, foreign or domestic, would take of themselves. Smith had concluded that a government of, by, and for the mercantile classes did not benefit society. Everywhere Smith looked, he saw a system of subsidies, bounties, tariffs and restrictions all designed to grant privilege to the wealthy, and this fact filled him with righteous anger. The rich could no longer be depended on to make an equitable distribution of rewards, and government, he concluded, "is in reality instituted for the defense of the rich against the poor, or of those who have some property against those who have none at all" (*WN*, V.I.55); the rich had captured the government to such an extent that it nearly always favored them over the poor (*WN*, I.X, p. 151).

What does tie the two views of the "invisible hand" together is the idea of self-interest. As Smith expressed the idea:

> Whoever offers to another a bargain of any kind, proposes to do this. Give me that which I want, and you shall have this which you want, is the meaning of every such offer; and it is in this manner that we obtain from one another the far greater part of those good offices which we stand in need of. It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages (*WN*, I.II, p. 20).

The context of the passage is that of exchanges between individuals, or corrective justice. "Self-interest" here is simply descriptive of the reason people trade with each other. Nor was Smith the Prophet of Selfishness; rather, he makes a clear distinction between self-interest and "private interests" and always uses these

[35] Adam Smith, *The Theory of Moral Sentiments*, 6th ed., *The Conservative Leadership Series* (Washington, D.C.: Regnery Publishing Co., 1997), 249.

terms in opposite ways. Self-interest is merely a man taking care of his own business and is generally beneficial to the public good; private interests are the combination of merchants that attempt to seize monopoly power, subsidies, and other privileges from the government to the detriment of the public good. "Self-interest" for Adam Smith did not have the meaning that selfishness had for Mandeville or that it would later have for the utilitarian economists; these regarded selfishness as the only proper (or even possible) motive of human action. Self-interest had for Smith the same meaning it had for the Scholastics: the obligation each man had to take care of himself and his family through his own work and efforts. Since it was an exchange theory, it was also a theory of social harmony, since corrective justice (unlike distributive justice) is always an attempt to achieve equality in exchanges.

The Fragmentation of Economics

Many readers of Smith have noted a kind of schizophrenia in his work. For example, E. K. Hunt notes:

> When Smith examined capitalism form the vantage pint of production, he was lead to a class conflict view of the economy; when he examined it from the vantage point of exchange, he was lead to a social harmony view.[36]

But this was not schizophrenia; it was merely the recognition of the two kinds of justice which *must* be a part of any economic system. However, Smith could not join the two necessary halves of economic theory into a coherent whole. The unity that ancient and Medieval economists had attempted was now shattered, and this fragmentation was reflected in the divisions in the economists who followed Smith. They tended to view the economy either from a distributivist or social justice viewpoint, or from a corrective or social harmony viewpoint. On the one hand there were the *labor theorists*, who concentrated on the social aspects of production and exchange, and on the other there were the *utilitarians*, who concentrated on the individual aspects of exchange only.[37] The two traditions continued in parallel for the next hundred years, with each side talking about *either* Distributive or Corrective justice, but rarely about both. That is to say, they each talked about half the economy, and hence talked past each other. This continued for a hundred years until the neoclassicists, working with exchange theory alone, discarded distributive justice entirely. In the next chapter, we will examine each tradition in turn.

David Ricardo

Whereas Smith was a philosopher, David Ricardo (1772-1823) was an investor, one who had made a fortune in the stock market and retired at the age of 42 to write about economics. His viewpoint is very different from Smith's; whereas Smith always wrote from the vantage point of a philosopher in sympathy with the worker, Ricardo wrote from the vantage point of the investor, and his chief

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[36] Hunt, *History of Economic Thought*, 80.

[37] Ibid., 100.

concern was maximizing returns to investment. One important event that had happened between the times of Smith and Ricardo was the publication off Thomas Malthus's (1766-1834) *Essay on Population*, discussed in the next section. Ricardo combined Smith's analysis with Malthusian pessimism. Nevertheless his contributions to economic theory were substantial. Here we shall be concerned with just two of them, the Law of Rents and his refinement of the Labor Theory of Value.

It is important to understand the historical context of Ricardo's work. Industrialization had reduced the working class to subsistence levels by 1750; the standard of living deteriorated during the second half of the 18th century and any increase in the opening decades of the 19th century was slight at best.[38] The living conditions can be glimpsed from the report of a government official about slums in Glasgow:

> Although the outward appearance of these places was revolting, I was nevertheless unprepared for the filth and misery that were to be found inside. In some bedrooms we visited at night, we found a whole mass of humanity stretched on the floor. There were often 15 to 20 men and women huddled together, some being clothed and others being naked. There was hardly any furniture and the only thing which gave these holes the appearance of a dwelling was fire burning on the hearth.[39]

These conditions, however, were not really the concern of either Malthus or Ricardo, who both accepted them as the natural condition of the poor and part of the providence of God, who punished the poor for their improvidence and fecundity. Rather, they were concerned with a debate between the two wings of the English ruling class, the old landed gentry and the new industrialists. Malthus endeavored to show that high rents were justified and useful, while Ricardo, a representative of the capitalists, wanted to demonstrate that the landlords added nothing but cost. The specific occasion for their dispute was the debate over the Corn Laws, which imposed high tariffs on the importation of wheat, thereby raising the price of bread (the staple of the poor) and the rent on land.

The Law of Rents

David Ricardo developed the Law of Rents partially to validate Malthus's Theory of Population (the so-called *"Iron Law of Wages"*) and give it a stronger theoretical foundation. By the Law of Rents, the rent on any particular parcel of land will be equal to the difference in the product of that parcel and the product of the least productive parcel in use, that is its "marginal productivity."[40] For example, if one parcel A of land, the least productive in use, produces 1 bushel of wheat per acre, and another parcel, B, produces 3 bushels/acre, the rent on parcel B will be 2 bushels/acre, while A will command no rent at all. If a less productive

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[38] Ibid., 67.

[39] Ibid., 69.

[40] Garrick Small, *An Aristotelian Construction of the Social Economy of Land* (Sydney, Australia: University of Technology, Sydney, Australia, 2000), 252.

parcel of land, C, is put into production, perhaps because of population pressures, and that parcel produces only ½ bushel/acre, the rent on parcel A will rise to ½ bushel and on parcel B to 2½ bushels/acre. An increase in population would force marginal land into production, thereby raising the rents on all other tenants. The least productive land that can be used is that which provides subsistence, so that eventually, as more land is placed in production, wages will sink to subsistence levels. Indeed, it is not just wages, but all non-rent returns, both returns to labor and to capital, which are limited by the Law of Rents.

The Law of Rents rests on three assumptions: One, that land is necessary for production, that is, there is no substitute for land; two, that land has varying productivities; and, three, that demand is rational, informed, mobile, and driven by financial calculations of value.[41] Assumptions one and two seem to be self-evident. The third assumption is "no more than the assumption of a perfect market. If actual markets are near perfect, then this proposition will be true. Hence, the operation of Ricardo's rental relationship will be an indication of how closely an economy is to the perfect market ideal."[42] It would seem then that the Law of Rents should hold, at least in an idealized state. When all the land in a country is owned, then land forms a kind of monopoly and rents rise to absorb all the increased values that arise from productivity improvements or population increases. The landlord is rewarded not for any services he provides nor for anything he has done to the land, but merely for the fact of ownership. Ricardo concludes that since the Law of Rents demonstrates that the landlord absorbs any increases in productivity at the expense of both capital and labor, "the interest of the landlord is always opposed to the interest of every other class of society."[43]

Although Ricardo mentions the interests of the laborers, he is not really interested in them. In fact, by the *Iron Law of Wages*, the real wages of workers cannot be increased above subsistence (labor's "natural price") for any length of time. This is because as the real wages are increased, the population rises. This causes more marginal land to be put into production to provide food for the increased population, which, by the law of rents, raises the rent and hence decreases the *real* wages of the worker, leading to a cycle of misery, death, and decreasing population. The "Iron Law of Wages" has in practice turned out to be made of straw, and this was true even in Ricardo's own day; for example, population growth from 1820 to 1870 was 0.79%/year, but per capita income growth was 1.26%/year, an effect contrary to the predictions of the theory.[44] Indeed, wages and population have always been more likely to rise and fall together, rather than move in opposite directions. Yet, despite the lack of empirical evidence, the theory remains with us both in an unbroken line of dire predictions from Ricardo's day to our own, and in the theory of an equity-

[41] Ibid., 255.

[42] Ibid., 256.

[43] Hunt, *History of Economic Thought*, 96-7.

[44] Mueller, *God and Money*, 72.

efficiency trade-off, by which we are to believe that increases in wages at the lower end of the pay scale necessarily lead to increases in unemployment. However, what Ricardo had stumbled across in the Law of Rents was the theory of marginal utility as the limit on wages, of which the Law of Rents was merely a special case. It would be another fifty years until the "marginalist revolution" before anybody realized the implications of the law, but when they did, it changed economics forever.

On the basis of these arguments, Ricardo opposed the Corn Laws because they increased the price of bread and hence the cost of subsistence, and no one could reduce costs below subsistence wages for any great period of time. Ricardo's heart went out to the investor as Smith's had to the worker; profits must find their limit merely because the worker insists upon eating. The solution is to find a way to lower the cost of bread by importing wheat. This leads to the doctrine of comparative advantage, by which nations could profitably trade, "profit" here meaning "lowering the cost of subsistence and hence increasing the rate of profit."

The Labor Theory of Value

It was Adam Smith who originated the LTV, but he could never give it a consistent formulation because he could never quite account for the capital component of production. Ricardo solved this problem because he realized that capital— the tools and machinery of production— were merely the intermediate products of labor, created only because they contributed to the eventual production of a commodity for consumption.[45] Therefore capital is the embodiment of past labor in current production and always regresses to labor (and to other capital, which in turn regresses to labor).[46] Therefore capital is a series of "time-dated" labor inputs to production. Now all the outputs can be expressed in terms of labor that is expended either in the current period or past periods. This assumed that prices represented the cost of production;[47] this could be assumed if supply and demand worked to force prices to production costs.

If prices are always equal to the labor embodied in a product (including the past labor known as "capital") then profit must be equal to the total amount of labor to produce the whole product minus the portion required to produce the subsistence necessary for the laborer. For example, if a product had 10 hours of labor (and hence a price equivalent to 10 labor-hours), and four hours were required to pay for the subsistence of the laborer, then profit would be equal to six labor hours, minus land rents. Therefore there are but two ways to increase profits: lower the cost of subsistence, or lengthen the number of hours the laborer works. Ricardo's distributive theory assumes the worker is entitled to no more than subsistence.

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[45] Hunt, *History of Economic Thought*, 102.

[46] Small, *The Social Economy of Land*, 242.

[47] Hunt, *History of Economic Thought*, 104.

Although Ricardo used the LTV to defend high profits on the grounds that it added to capital accumulation, later labor theorists used it to justify higher wages, since profits were the surplus over subsistence, and there is no logical reason why all of these values should go to the employer. Therefore the capitalists abandoned the LTV and began to rely totally on the utilitarian arguments, arguments that generally excluded a theory of distributive justice. But those interested in distribution continued to use the LTV.

Karl Marx

It may seem odd that so long after the collapse of the major communist states, and the conversion of others into quasi-capitalist states, that it is necessary to discuss Karl Marx (1818-1883). Yet Marxists have not accepted that the Stalinist states were a real implementation of Marx's theories, and that only events unfolding in *capitalist* economies can validate or refute Marx's thought.[48] But however one treats the "test" of Marxist economics, the great joke about Marx is that he *accepted* the capitalist system as a necessary development in human progress; he looked beyond capitalism to a later stage in development that would inevitably correct the defects of capitalism, but his critique of capitalism presupposed his acceptance of it. He was an enthusiastic supporter of large-scale production and economic concentration of the means of production. These laid the groundwork for socialist state, and the capitalist phase could not be avoided. Marx had a mystical view of history. In his view, history had a hidden purpose and moved inevitably towards it consummation in the victory of the communism. Thus for Marx, the atheist, history became a substitute for god. If, as Marx believed, religion was the opiate of the people, history was the opiate of the Marxists. The great value of capitalism, for Marx, was that it destroyed the previous religious culture and hence prepared mankind for the next stage in its development.[49] As capitalism had destroyed religion, communism would destroy capitalism in the final consummation of a mystical notion of history.

Marx was profoundly influenced by Adam Smith and David Ricardo. He reasoned that if Smith was correct that all values were traceable to labor, and Ricardo correct about subsistence wages, then the capitalists' share, that is, the difference between the price and subsistence wages, was a "surplus value" that belonged to the capitalist merely by virtue of his being a capitalist. Hence capitalism was inherently the exploitation of workers by the taking of the "surplus value." Marx, writing from within capitalism, was in fact able to make real contributions to economic theory. He refined Ricardo's LTV, giving it a more precise formulation, and contributed to the understanding of business cycles and depressions, a topic which had mystified, and continues to mystify, the utilitarian economists. Marx was a great admirer of capitalist industrial technique. He believed that sheer volume of output would render the question of just

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[48] Ibid., 245.

[49] Christopher Lasch, *The True and Only Heaven: Progress and Its Critics* (New York and London: W. W. Norton & Company, 1991), 150.

distribution redundant and that for the new man, with all of his material needs easily satisfied, the last barriers to autonomous freedom would be removed.[50] Therefore justice, as such, was not really the aim of Marxism; volume production would solve the problem.

More profound than his effect on capitalism was Marx's effect on socialism. Before Marx, "socialism" was a diverse set of movements which, in general, sought to restore to the worker the rights he had enjoyed in the pre-capitalist era. In general, these movements did not look to the state, but to voluntary associations; they were quite different form the "modern" notions of socialism, being, if anything, mostly opposed to state power on the whole rather than supportive of it. Guild socialists and syndicalists, for example, looked to forms of association which would annihilate the sharp distinction between "owner" and "worker" that was the centerpiece of capitalism. Marxism displaced these "socialisms" with "scientific" socialism that relied solely on gaining control of the state and the government bureaucracy. As G. D. H. Cole put it,

> Marx had "infected" socialists with an "economic fatalism" which made them acquiesce in centralization and top-down control of industry as an unavoidable precondition of economic efficiency. Instead of taking concrete steps to counter hierarchical authority in the workplace, they staked everything on the hope that socialist parties could gain control of the state.[51]

Marxism may have scared capitalism, but it destroyed socialism, or at least any rival form of socialism. Socialism became a kind of "state capitalism," with bureaucrats replacing industrialists as the real owners of capital and lords of production and "Socialism" acquired the meaning is has today. The real test of Marxism is not with the communist tyrannies, but with the "Fabian" socialists who gained control of much of Western Europe. As a consequence, socialism in the West morphed into a form of Keynesian welfare economics, which was itself a variety of neoclassicism.

After Marxism swamps all the other labor theorists, the movement losses much of its vigor. The LTV itself would not become a consistent theory until the work of Piero Sraffa (1898-1983). But by then, leadership in economics had passed to another group.

The Utilitarians

Despite the prestige of Smith and Ricardo, LTV was not the only theory of value, or even the predominant one. LTV was an attempt to hold on to the values of the old order, most especially the idea that there should be no wealth without work. Merely owning capital could not be a moral basis for wealth; only putting it to use in work could justify rewards. But the labor theorists were swimming against the tide. As we showed in the last chapter, "values" were losing their objective character and becoming a matter of mere personal preference. The hedonism of

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[50] Milbank, *Theology and Social Theory*, 202.

[51] Lasch, *The True and Only Heaven*, 318.

Bentham was becoming the utilitarianism of economics, where "value" becomes nothing more than the market correlation of individual preferences, and egotism was the only valid motivation for action. Hence the utilitarians concentrated on economics as the science of exchanges. Specifically, they purged economics of any notions of a labor theory of value and any notion of distributive justice. They reduced all value, indeed all human action, to a rational calculation of utility.[52] All "normative" considerations are ruled out in advance. "Justice," insofar as it figures in utilitarian economics at all, merely means voluntary exchanges, and liberty is no more than freedom to exchange goods.

Thomas Malthus

Thomas Malthus (1766-1834) is most famous for his theory of population. In fact, he has two such theories, one predicated on there being too many workers and the other predicated on there being too few.

Malthus's thesis was very simple: "Population, when unchecked, increases in geometrical ratio. Subsistence increases only in arithmetic ratio."[53] The "check" on population was starvation, the limit of what the land could produce. For Malthus, the "liberal reward of labor" would lead only to the poor reproducing faster than the food supply with the inevitable result of starvation for some and low wages for all:

> A man who is born into a world already possessed, if he cannot get subsistence from his parents on whom he has a just demand, and if the society do not want his labour, has no claim of *right* to the smallest portion of the food, and, in fact, has no business to be where he is. At nature's mighty feast there is no vacant cover for him. She tells him to be gone, and will quickly execute her own orders... [54]

Malthus was equally clear on the solution. Instead of working to ameliorate poverty, the authorities should increase it and work to raise the mortality rates among the poor:

> 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 diseases.[55]

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[52] E. K. Hunt, "The Normative Foundations of Social Theory: An Essay on the Criteria Defining Social Economics," *Review of Social Economy* LXIII, no. 3 (2005): 432.

[53] Gertrude Himmelfarb, *The Idea of Poverty: England in the Early Industrial Age* (London and Boston: Faber and Faber, 1984), 105.

[54] Ibid., 122.

[55] Hunt, *History of Economic Thought*, 78-9.

Malthus's *Essay on Population* (1798) swept England and the continent with its apparent simplicity and logic. It inspired Charles Darwin to formulate his theory of evolution, and variations of this theory remain popular today—despite the contrary evidence—and especially in dealing with less developed countries.[56] But it also turned economics, so optimistic under Adam Smith, into the "dismal science," a calculation of limitations where resources were scarce and only misery abundant.[57] Malthus justified this "melancholy hue" of his work with a theodicy: Misery and vice were the necessary conditions to rouse man from the "torpor and corruption" that were the "original sin of man."[58] Poverty in this account is not the result of oppression or injustice, but of the unalterable Will of God operating on the incontinence of the poor. Of course, it has not the same effect on the rich. For the rich, all those extra mouths to feed become the limit on the returns to capital; there will be starvation for the poor and inconvenience for the rich.

Malthus had a second theory of population as well, one connected to his analysis of "gluts" (we would say "depressions"). It seemed obvious that such gluts could only be the result of an insufficient demand. Malthus believed that the cause of this insufficiency of demand was that as capitalism progressed, there was a tendency for capitalists to receive too much income. But these excessive profits needed to find investments if there was not to be a shortage of demand. However, new investments required new workers, and it was obvious that the supply of workers could not be expanded as fast as the growth in capital, since it takes 16 to 18 years to bring new workers into the market; in other words, there were too few workers to absorb the new capital. When Malthus examined the shortage in spending, he found that the workers already spent all they earned. The capitalists, however, were too busy accumulating to be able to properly spend their fortunes. But landlords, Malthus observed, were gentleman of leisure. Since their income was from rent, which required no effort, they could spend their time consuming. Therefore high rents would make up for the insufficiency in demand caused by the too rapid accumulation of capital combined with the too slow growth of the workforce.[59]

The constant in the two theories is high rents. In the first instance, high rents help to keep down the "excess population" and in the second high rents work to make up aggregate demand caused by a lack of population. And while we may be tempted to smile at the self-serving nature of these theories, the fact is that the justification of economic rent remains an embarrassment to economic theory right up to the present time.

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[56] Ibid., 79.

[57] Milbank, *Theology and Social Theory*, 42.

[58] Himmelfarb, *The Idea of Poverty*, 107. The importance of original sin to economics will become a key tenant of the neo-conservative theology of economics. See Michael Novak, *The Spirit of Democratic Capitalism* (New York: Simon & Schuster, 1982), 349-51.

[59] Hunt, *History of Economic Thought*, 86-87.

Jean Baptiste Say

The industrialization of England led to widespread discontent and labor unrest. The wealthy in England had before them the example of the French Revolution and became increasingly alarmed. They attempted to suppress worker's movements by outlawing unions. This left the workers with no legal means of resistance; hence they resorted to illegal means. Riots and "sabotage" (jamming a sabot, or wooden shoe, into the machinery to wreck it) increased. Upheavals occurred in 1811-13, 1815-17, 1819, 1826, 1829-35, 1838-42, 1843-44, and 1846-48. Most of these were spontaneous manifestations of an utterly wretched working class.[60] England was in a state of low-level but near continuous civil war. The authorities responded as authorities do in a state of war: with utter ruthlessness. Sabotage was made a capital offense, and laws against unions were enforced with ferocity. Furthermore, economic depressions occurred with appalling regularity, making the situation of the poor, desperate even in good times, even worse.

In such conditions, the task for the utilitarian economists, who were all defenders of the system, was to show that the wealth of the industrialists was just, the low wages fair, and that the gluts were at best temporary phenomenon which would pass quickly. Typical of these economists was Jean-Baptiste Say (1767-1832). Say's Law of Markets, usually stated as "supply creates its own demand," is considered by many as "essential to any defense of free markets."[61] What the law says is that a free market will always adjust *automatically* to an equilibrium in which all resources, including labor, were fully employed.[62] As a consequence, there could be no "gluts" or depressions. Any appearance of gluts would be illusory. While there may appear to be too much of one product, what is actually happening is that its price is too high, while the price of some other commodity must therefore be too low. Since this is simply a pricing question, the market in its wisdom will automatically correct the problem; the price of one commodity will be raised and the price of the other lowered. As Say put it, "If there is an overstock, of many kinds of goods, it is because other goods are not produced in sufficient quantities." "That [commodity] which sells above its cost of production will induce a part of the producers of the other commodity to the production of... [the higher-priced commodity] until the productive services are equally paid by both."[63] Say had proved, by unaided reason alone, that the depressions which caused so much misery were in fact impossible. Whether or not one considers Say's method to have been effective, the idea of finding an "automatic" way of achieving equilibrium would remain part of the utilitarian agenda.

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[60] Ibid., 155.

[61] Larry J. Sechrest, *Jean Baptiste Say: Neglected Champion of Laissez-Faire* (Ludwig von Mises Institute, [cited December 28, 2005); available from http://www.mises.org/content/JEAN-BAPTISTE.asp.

[62] Hunt, *History of Economic Thought*, 138.

[63] Ibid., 139.

Nassau Senior

Nassau Senior (1790-1864) was perhaps the most influential economist of his day. While most of his specific analysis has been rejected, the agenda he established for utilitarian economics became the basis of what would later be known as the "marginalist revolution." Key points of Senior's agenda were to show that markets were "self-adjusting" and "gluts" were impossible; to free economics from any considerations of "value" (the "methodological" question); and to find a way to reduce the three sources of income—rent, profit, and wages—to one common principle.

Gluts

Like Say, Senior believed that gluts were impossible. Since the desire for wealth was insatiable, the idea that there could be "too much" on the market was nonsensical. Both Say and Ricardo had made much the same argument, but they at least recognized that such gluts, impossible as they were, had in fact occurred. Senior, however, did not seem to take notice of the actual economic crises that did happen in his lifetime; he simply ignored them.[64] Senior seemed unable to believe that while desire might be infinite, cash might be in short supply.

Methodology

Senior believed that economics should not be concerned with social welfare, since this would involve the economist in normative and ethical considerations; economics should be concerned only with wealth, not happiness. Therefore economics could not be based on the ends or purposes of an economy, since that would involve ethical questions. Rather, the "science" should be rooted in "a very few general propositions, the result of observation, or consciousness, and scarcely requiring proof, or even formal statement."[65] Senior selected four propositions which in his mind "scarcely required proof": All men desire more wealth with as little sacrifice as possible; Malthus's law of population; industrial production can be indefinitely increased; farm production, on the other hand, is subject to diminishing returns for each additional unit of labor.[66]

There are two problems with Senior's "scientific" principles. The first is that they are not scientific. The principle of a science gives a rule or measure to which all objects in that sciences are subject. Thus gravity provides a foundational principle for physics in that the relationship of all massive objects can be measured by the rule of gravity. Senior's principles would not seem to do this. In the second place, they are arbitrary; there seem to be other principles which are far more "foundational" that could just as easily have been selected. For example, it seems obvious that he could have selected this principle: "A society must produce enough food, clothing, shelter, and other goods, so as to support its

[64] Ibid., 147.

[65] Ibid., 143.

[66] Ibid., 145.

members and provide for the continuation of the race." This would seem both to be more fundamental and to provide a measure for the success of the economy.[67] What really happens in a methodology like Senior's is that the "principles" are in fact selected to support conclusions already reached; the pretense of "science" is merely a cover for one's own bias.

Distribution of Incomes

Senior's big challenge was to provide a justification for rent and profits. His strategy was to show that all the factors of production—land, labor, and capital—derived their incomes from the same principle. If this were so, then there could be no reason for one group to attack the basis of the income of another group, or grounds for complaint about one's own income. Profits, Senior claimed, were a reward for abstinence; the rich were rich because they abstained from pleasures, hoarded their cash, and invested wisely. The hardest of these to justify was rent. Rent for both Smith and Ricardo was a suspicious category, since it seemed to be a payment based not on any work the landlord did, other then collect the rent, but for a merely legal form, ownership. But recall that Smith and Ricardo were still wedded to the medieval idea that wealth should arise only from work. For Senior, rent was unproblematic; it was simply "the revenue spontaneously offered by nature."[68] Senior accepted the division of property uncritically. Senior then went on to show that profit was really rent "as soon as the capital, from which a given revenue arises, has become, whether by gift or by inheritance, the property of a person to whose abstinence and exertions it did not owe its creation." Finally, Senior claimed that wages were just another form of rent given to the laborer as the "proprietor of a natural agent"[69] (that is, his ability to work.)

Senior's method meant that he was forced to reverse himself, conceding that profit was *not* a reward for abstinence, at least not for the current recipients. Further, wages are not a form of rent; no one is paid for their *ability* to work, but only for the work they actually do. But although Senior's attempt was a failure, the quest for a single principle of income would occupy a major place in utilitarian economics. Before that quest could be fulfilled, the utilitarians had to go through one more step, the "marginalist revolution."

The New Poor Law of 1834

The "Poor Laws" were England's welfare system. The were established in the 16th century and necessitated by the fact that so many of the peasantry were thrown off the land and into the cities, cities that could not provide all of them with adequate work, that revolution was a constant threat. Then as now, "welfare" systems engender resentment both on the part of those forced to pay for it and

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[67] Of course, it will be pointed out that the principle is itself "value-laden," since it suggests that men "ought" to be fed and the race "ought" to continue. As it turns out, all principled statements about men and their institutions are value-laden.

[68] Hunt, *History of Economic Thought*, 150.

[69] Ibid.

those forced to depend on it. Senior more than resented the laws, he wished to see them abolished, along with all publicly supported relief. He felt that the poor were merely lazy, and the Poor Laws supported that laziness. Only by degrading the poor could they be forced to work, never mind that there was not enough work to employ them. Senior felt that the poor must be excluded from political life and repressed by military power, if necessary:

> There seem to be only three means of governing a densely peopled country in which [the poor] form the large majority. One is to exclude them from political life. This is our English policy.... Another is the existence among them of a blind devotion to the laws and customs of the country... .A third plan is to rely on military power— to arm and discipline the higher and middle classes, and to support them by a regular army trained to implicit obedience.[70]

In 1834, these laws, which already gave only meager support to the poor, were re-written under Senior's direction to further stigmatize poverty. The new law forced all the poor to go to the workhouse where they would live in appalling conditions, work from sunup to sundown, wear prison clothing, and be fed a diet substantially less than that afforded by the lowest wage offered in the free market. "Outdoor" relief (support apart from the workhouse) was outlawed, and families were broken apart and forced into the workhouse as a punishment for destitution. Senior felt that such harsh measures were necessary because of "the threat of an arrogant laboring class, resorting to strikes, violence, and combinations [unions], a threat to the foundations not merely of wealth, but of existence itself."[71] Such was the tone and temper of utilitarian economics in the 19th century. The tone would shift with the coming of the marginal revolution; one wonders if the temper ever will.

Summary

From the beginnings of conscious reflection on economics, there was a unity of ethics and economics, in thought if not always in practice. Aristotle discussed economics in his *Ethics* and in *Politics*, and considered them part and parcel of each other. He also recognized two "sides" to justice, the distributive and the corrective. The latter includes the exchange economy and is more or less constant in every culture. But the former, distributive justice, is irreducibly cultural, and this kind of justice, which includes the process of production and distribution, will vary with the ethical orientation of the particular society.

The synthesis of ethics and economics, distributive and corrective justice, held sway until the 16th century, but under the pressure of the new mercantilist class, this synthesis began to give way. Virtue was no longer seen as necessary to the economic order. Indeed, new individualist notions of man, and especially man as primarily an egotist, engendered the view that vice, and not virtue, was the proper foundation of economic activity, an idea that leads to Mandeville's paradox of

[70] Ibid., 142.

[71] Ibid., 140.

private vices as the base of public benefits. This is the state of affairs towards the end of the 18th century, when Adam Smith begins his reflections on the economic order. Smith is a moral philosopher and well aware of the unities in Aristotle and the scholastics. He is unwilling to abandon either corrective or distributive justice. Unfortunately, he is not able to unite them under a single theory, but ends up with two incompatible theories, the Labor Theory of Value and the "Invisible Hand" theories; the former corresponds to a distributive principle and the latter to a corrective principle.

The economists of the 19th century tended to emphasize one of these theories, to the exclusion of the other. Thus there was a fragmentation of economic thought, with neither side being able to produce a consistent, comprehensive, and coherent theory. Nevertheless, utilitarian theories begin to dominate, theories which call for the complete divorce of ethics and economics and a "scientific" basis. In general, the utilitarians exclude all notions of distributive justice. But they, no more then the labor theorists, were able to define this "science." This sets the scene for the next stage in the development of economic theories, the marginalist revolution.

Chapter 4: The Disappearance of Justice

There is no such thing as "society."

--Margaret Thatcher

The Marginalist Revolution

Marginal Utility

Utilitarian economics required four things that classical economics could not provide. The first was a theory of equilibrium which was "automatic"; it was necessary to show that the market would quickly move to correct any imbalances between supply and demand. Say had attempted this task in his law of markets, but the task looked incomplete. The second was Senior's project of finding a single principle for all sources of income— land, labor and capital— that is to say, the distribution principle. The third project, also from Senior, was to provide a "scientific" or "natural law" basis for economics which would forever remove it from the realm of philosophy and ethics. Finally, economics needed a coherent price theory, one that did not depend on distributive justice. Neither the labor theory of value nor total utility was able to provide this. Utility, for all the fervor of its supporters, was no more successful than the labor theory of value in explaining economic realities.

It was this last category, price theory, which proved to be the key to the whole problem. Many economists hit upon the solution more or less at the same time, including W. S. Jevons, (1835-1882), Léon Walras (1834-1910), Carl Menger (1840-1921), and Alfred Marshall (1842-1924). The solution was to use not *total* utility, but *marginal* utility— that is, the value of the last increment. This marginal increment is not as valuable (or "useful") as the next to last increment. Marginal utility has a charming simplicity about it. Think of being thirsty. At such times a glass of water or soda will have a certain value to you which can be expressed as the price you are willing to pay. But after the first glass, the second is much less valuable, and the third has no value at all. Each successive increment has a *marginal* utility, that is, the change in utility from each successive increment can be expressed mathematically as the first derivative of total utility. Marginal utility proved to be a universal solvent, washing away all the problems of classical economics and fulfilling the agenda laid out by Say and Senior.

<u>Marginal Utility in Exchanges</u>

W. S. Jevons applied this principle to a general theory of exchange. Underlying his general theory was a theory of the human person based on Bentham's hedonism. As Jevons put it, "Bentham's ideas... are... the starting point of this work." "I have attempted to treat economy as a calculus of pleasure and pain and have sketched out... the form which the science must ultimately take."[72] This assumption is important because marginal utility only makes sense if people

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[72] Ibid., 251.

normally act to maximize their "marginal" pleasures. In any other theory of the human person, marginal utility would be extremely limited. But assuming such a model of human behavior, then one could easily show that such "humans" would be forever comparing prices and utilities at the margin and adjusting their purchases to maximize their pleasures. For example, if one had two commodities, x and y, and could only get another x by giving up some y, then one could compare the ratios of one's own subjectively determined marginal utilities for the products, MU_x/MU_y, with the prices of the two commodities, P_x/P_y. If the ratio $MU_x/MU_y > P_x/P_y$ then one could gain some utility by trading some x for some y. The process of comparing utilities and prices would continue until the person had exhausted the gains possible by exchange.[73] This application of the equations of differential calculus to questions of human behavior was considered a great advance; the "invisible hand" of Adam Smith acquired a visible mathematics.[74]

Carl Menger used this same explanation to explicate the laws of supply and demand. All consumer prices were ultimately determined by marginal utility through Menger's Law of Demand: The quantity of a commodity that people were willing to purchase depended on the price, and the quantity demanded and the price were inversely related to each other. The higher the price the lower the volume, and the reverse. Economics now had what it had lacked, a coherent theory of prices. This was something that neither the labor theorists nor the "total" utilitarians could supply, and it did not depend, like medieval theory, on a cultural variable such as one's "station in life."

General Equilibrium

By applying marginal utility through a complex set of mathematics, the details of which need not concern us here, Léon Walras was able to show the existence of a general equilibrium model under conditions of perfect competition involving a large number of small firms. This means that there would be full employment of all resources, including labor, and that supply would equal demand in every market. Of course proving the existence of such a model and proving it actually worked in practice are different things. If is obvious that people are willing to exchange at non-market-clearing prices from the simple fact that people do not know what such prices are. Therefore Walras posited the existence of a "crier" who would announce all the prices. Buyers and sellers would then announce their intentions to trade at the announced prices, but if this was not the equilibrium price, then the crier would announce a new set of prices. This process would continue until the equilibrium prices were discovered, and only then would trade take place.[75] Despite the obvious drawbacks of the model, it has been a central part of economic theory ever since it was developed. Walras himself recognized the weakness of the solution, but believed that the economy would find equilibrium by a process of "groping"

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[73] Ibid., 253.

[74] Paul Ormerod, *The Death of Economics* (New York: John Wiley & Sons, Inc., 1994), 52.

[75] Ibid., 87.

Distribution of Incomes

However, there was a problem. In order to make marginal utility work, it was necessary to treat the three factors of classical economics, land, labor and capital, under the same mathematics; that is, they had to be treated as *homogeneous* quantities. But quite obviously, they are not, not in the real world. They are *heterogeneous*. Land is not labor, and labor is not capital. Empirically these are three different things that operate according to different laws. Capital, for example, refers to man made things that can be extended and substituted. That is, the supply of capital goods can, in principle, always be extended, you can always make more of it. Further, one kind of capital can, in principle, be substituted for another; if there is a shortage of commodity "A", you can usually substitute some other commodity in greater supply. Land, on the other hand, is a fixed commodity whose supply cannot be increased and for which there is no substitute. And the worker— a human being— differs from the other two factors in ways too obvious to mention. Land is no substitute for men. Machines may be substituted for workers only when an employer requires mere physical exertion. But if the requirement is qualitative, if what is required is creativity, innovation, expertise, management, etc., then only humans can provide these. How then could these heterogeneous commodities be described under the same mathematics?

The problem was "solved" by John Bates Clark (1847-1938). Clark set himself the task of solving the problem raised by Nassau Senior; that is, showing that all incomes— wages, profits, and rents— originate from the same principle. On the opening page of his textbook, *The Distribution of Wealth*, he declared:

> It is the purpose of this work to show that the distribution of the income of society is controlled by a natural law, and that this law, if it worked without friction, would give to every agent of production the amount of wealth which that agent creates.[76]

Clark's solution was to treat capital as an abstraction with no actual *physical* content. Capital-goods were, of course, physical entities— machines, tools, buildings— and these things were always consumed in the process of production. But capital itself was indestructible, perpetual, fluid, and mobile.[77] Capital is no more than continuity of ownership, with the precise content of the things "owned" constantly changing. What applies to capital comes to be applied to all factors. There are no landlords, laborers or capitalists, only owners of inputs labeled *a*, *b*, *c*, and so on. Hence you would get a production function $x = f(a, b, c \ldots)$.[78] The system of mathematics is perfected by making a clean break with any actual reality. There were no longer such things as shovels and men and plots of land; these were mere appearance only. In reality, they were all just little bits of the capital fund, with each little bit expressed in the formulas as *a*, *b*,... *z*.

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[76] John Bates Clark, *The Distribution of Wealth: A Theory of Wages, Interest, and Profits* (New York: Augustus M. Kelly, 1899; reprint, 1965), v.

[77] Hunt, *History of Economic Thought*, 309.

[78] Ibid., 429.

Clark went on to show that in a profit maximizing firm each of these bits gets employed until it reaches it marginal product, that is, the value of the last unit which can be profitably employed. Under conditions of perfect competition, all resources will be employed and each resource will receive the value of its marginal product, which is deemed to be the "amount of wealth that the agent creates." Further, these factor payments exhaust the value of the total output, meaning that no surplus values are created. In other words, there is no such thing as "profit." As Clark explained it:

> Normal prices are no-profit prices. They afford wages for all the labor that is involved in producing the goods, including the labor of superintending the mills, managing the finances... and doing all the work of directing the policy of the business. Beyond this, there is no return, if prices stand at their normal rate; and the reason for this is that *entrepreneurs* compete with each other in selling their goods, and so reduce prices to the no-net-profit level.[79]

This is the equivalent of saying that the normal level of profit for entrepreneurs is the same as their marginal product as employees, that is, that the employer makes no more than the employee.[80]

Clark's theory had an astounding result: justice was no longer a virtue, a matter of human intentionality, but the unavoidable result of an "automatic" and mechanical system. Distributive justice disappears into the logic of exchange; corrective justice supplies the place of distributive justice, but only when people are working to maximize their own self-interest. Presumably, a person *not* working in their own self-interest, say Mother Theresa, would destroy the logic of exchange and actually be working against justice. The order established by Aristotle and St. Thomas, in which distributive justice precedes the corrective (rewards must be distributed before they are exchanged) is reversed, and Mandeville's paradox of "*Private Vices; Publick Benefits*" is given a mathematical form. Justice itself is no longer about right relationships between a man and his neighbor, but relationships between men mediated only by money; it is no longer about the right relationship, but about the right price.

Neoclassicism

Marginality became the major analytic tool of economics: marginal costs, marginal products, marginal revenues, etc., everything could be described in terms of numbers and analyzed in terms of margins. In fact, enthusiasm for the concept was such that some believed that all things could be explained by marginal utility. For example, Ludwig von Mises wrote a great tome on what he calls *Praxeology*, in which he argues that not only the economy, but also love, sex, society, and everything else can be explained in terms of human selfishness working through marginal utility. In Mises, marginal utility becomes not just a physical principle,

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[79] Clark, *The Distribution of Wealth*, 111.

[80] Joan Robinson, "Euler's Theorem and the Problem of Distribution," *The Economic Journal* 44, no. 175 (1934): 399.

but a psychological and anthropological one, indeed the mainspring of all human action.[81] This new system of economics, though it bore some continuity with classical economics, was so different that it got a new name, *neoclassicism*.

Marginal utility allowed the complete realization of Nassau Senior's project. Economics is no longer a branch of moral philosophy, but a *science*. The economist could now becomes a "scientist" and be free from any purely moral considerations. Economics had at last found its "Newtonian" principle; as inertia explained all physical movements, marginal utility could explain all market movements. As Jevons put it, the lack of a "perfect system of statistics ... is the only ... obstacle in the way of making economics an exact science"; once the statistics have been gathered, the generalization of laws from them "will render economics a science as exact as many of the physical sciences."[82] However, as we saw with Clark, it could become a "physical" science only by divorcing it from anything physical. Only by severing the connection with the empirical world could economics become pure mathematics.

As a "science" it is, as its supporters claim, a science of exchange only. Even production is viewed as "an exchange with nature."[83] Price, equilibrium, and incomes could all be explained, and explained by corrective justice alone, without resorting to the troublesome cultural implications that are always involved with distributive justice. Indeed, the individual never need concern him or herself with justice, since it operates automatically; it arises solely from the individualistic pursuit of hedonistically conceived self-interest. Moreover, this change in economics tracked the change in society at large and in the philosophical fashions we have already traced. The philosophic subjectivism that formed the basis of Emotivism was mirrored by the methodological individualism of neoclassicism. It is in fact a radical individualism that roots the entire theory.

Individualism

For the entire system to function people must be conceived of as utility-maximizing individuals; this is the *methodological individualism* upon which the whole structure rests. However, this cannot be a conclusion of economics; rather it is a metaphysical assumption that is prior to economics and, as such, is beyond question from the standpoint of neoclassicism.[84] Economists simply are not trained in the fields which give insight to human actions. Statements about how human beings are come from other sources, generally theology, philosophy, psychology, and introspection. These give answers to the human question that are

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[81] See Chapter 11.

[82] James E. Alvey, "A Short History of Economics as a Moral Science," *Journal of Markets and Morality* 2, no. 1 (Spring, 1999): 62.

[83] One wonders how nature assures that she is getting a fair price, and who negotiates the contracts in her behalf.

[84] Lawrence A. Boland, *The Principles of Economics: Some Lies My Teachers Told Me* (London and New York: Routledge, 1992), 17.

problematic for the use of hedonism as a foundation. Theology will have very little to do with hedonism, while for philosophy it is but one small stream in the great river of human thought, and a muddy one at that. Psychology simply refuses to confirm the existence of the person as a utility maximizer with well-ordered scales of preferences. Rather, as we saw with Maslow, persons have a dense and complex scale of needs which relate them to themselves, to others, and to the eternal order, and these needs cannot easily be reduced to mere "utility."

But our most immediate knowledge of the human person comes from introspection, from taking an honest look at ourselves. For man is both the subject and the object of his study. When we look in the mirror, we see two things: an egotist, and someone who is embarrassed by his egotism. With respect to the first quality, we would be able to confirm all the findings of neoclassicism, were it not for the presence of the second quality. For none of us like to think of ourselves as pure egotists, but will attempt to rationalize our actions, even (or especially) our worst actions, in terms of doing it for somebody else's benefit. Even neoclassicism attempts to justify itself on the grounds that its *Private Vices* lead inevitably to *Publick Benefits*.

The neoclassicist is likely to respond at this point that the individual is the only source of action because only individuals act. He is likely to reiterate, along with Margaret Thatcher, that "there is no such thing as society" and we cannot refer any decision to that non-existent entity. But as strange as that statement is from the head of English society, it is no less strange from anyone who owes his origins to a family and his social position to the existence of a society. It is quite true that we only see actions in individuals, but it would be a mistake to conclude that these are the actions of *autonomous* individuals, rather than individuals fully situated in a cultural and social matrix which influences, and often wholly determines, their choices. When a businessman puts on a coat and tie in the morning, he is not making a purely "free" choice, but is fulfilling certain social expectations imposed on a man in his social position. He may "autonomously" choose the color of the tie, but not the fact of the tie; that is a social constraint.

Natural Law

John Bates Clark was convinced that he had found a "natural law" solution to all the problems of economics, one that was a direct insight into the Divine Law.[85] Such a view would be free of any purely cultural constraints or system of values. It would be, like the inverse square law, universally valid and binding on all peoples. But can "natural law" be applied to human systems in this way; can there be a "value-free" law for humans?

The answer to this question depends on one's view of natural law. The older view of natural law situated it within a discernment of the meanings of things, that is, within their *natures* and *ends*. Thus, natural law would always involve a

[85] Robert H. Nelson, *Economics as Religion: From Samuelson to Chicago and Beyond* (University Park, Pennsylvania: The Pennsylvania State University Press, 2001), 102.

teleology, a perception of final meaning, but such perceptions involve philosophical, theological, and cultural questions. The Enlightenment version of natural law sought to divorce natural law from any moral or theological authority. Is this actually possible?

Let us take a simple deduction from "nature": "Lions eat lambs; therefore the strong prey on the weak!" The conclusion would seem to be an unavoidable deduction from the indubitably factual premise, a pure instance of a "natural law," blissfully free of any moral or theological foundation. But in fact it contains a hidden assumption: the premise concerns animals, but the conclusion is applied to men. Is this valid? Yes, if man is no more than an animal; no, if man transcends the animals. If the latter is true, then natural law can never be just a "reading" of nature, but must be guided by a consideration of the end and nature of man. Can the issue be resolved one way or another by an appeal to pure reason? No, because both views rest on a purely theological foundation. Man may or may not be just an advanced animal and nothing more. Certainly, he is an advanced animal, but the status of the "something more" cannot be proved— or disproved. Certainly, both men and lions enjoy a leg of lamb for lunch; quite possibly, speech is no more than an advanced form of roaring or baying. There is simply no "proof" that men transcend, or do not transcend, the animals; it is a matter of faith and faith alone. Therefore, the question of whether the proposition is a valid deduction from natural law depends not on the raw "facts" (which cannot be disputed) but on the theology by which one reads those facts. And this will be true for every statement which purports to be a conclusion from natural law. The only question is whether the values are explicit or hidden; if the latter, men will delude themselves into thinking that their thinking is "value-free," when in fact it is a mere attempt to impose their values on others. The solution is never to proclaim a "value-free" conclusion, but to make the values that underlie the conclusion explicit.

At a more practical level, we find all of our economic terms firmly embedded in cultural terms; any attempt to idealize the economy in terms of pure number, let's say an "ideal production function," turns out to be a purely cultural exercise. For example, in this ideal function, how many hours per week does the worker work? Forty? That is the result of a particular historical circumstance and something dictated by no "natural" law. Will the formula assume private property? But there are many types of land tenure systems are possible (see the next chapter). Will sanctity of contract be assumed? Or will contract depend on violence, as it does in places were the government is weak and the mafias strong? And so forth. Nearly every "pure" number in the formula will be shown to have a cultural basis. The project of the Enlightenment, in economics no less than in morality, fails once again; the real cannot be divorced from the moral, and our perception of the world cannot be divorced from faith.

Equity and Equilibrium

It is not the claims of a bogus scientism or natural law which make neoclassicism interesting. Rather it is its specifically moral claims which command our attention. For indeed neoclassicism, despite its claims to be value-free, makes some quite specifically moral claims, and it is these claims which require us to dig deeper to see its true basis. What neoclassicism claims is that it is the "perfect system of natural liberty," which is able to deliver an abundance of goods at a price which is *exactly* equal to the cost of production, including fair remuneration for all the economic actors, workers and investors alike. Indeed, since there are no profits, no economics rents, returns to both worker and investor are normalized so as to eliminate any great differences between the two and to guarantee a good life to all who come under its care. Further, it promises equilibrium and stability, the ability to adjust and heal itself and return quickly from any departures from the balance of supply and demand, while providing full employment for all who wish to work.

What is remarkable about these claims is that they embody precisely the hopes of the ancient and medieval economists: a society free of rents, providing equity and equilibrium to all its citizens. Whatever one may think of the methods and arguments for or against neoclassicism, it is clear that they have chosen the correct goals and standards. And it is according to these standards— its own— that neoclassicism must be judged. It requires no outside source, no extrinsic critique; its own goals are sufficiently lofty, serious, and humane. In the coming chapters, we will evaluate neoclassicism, but we will do so by referring only to the standards that neoclassicism sets for itself.

The Keynesian Revolution

A World in Turmoil

One of the major promises of capitalist theory is that of equilibrium, its ability to quickly adjust imbalances between supply and demand, and thus avoid the economic shocks known as depressions or recessions, or simply "gluts." But in fact, as capitalism became more predominant, it became less stable, not more so. In the United States, for example, there were only two severe economic crises in the first half of the 19th century (beginning in1819 and 1837). But in the 2nd half of that century, the crises increased in both number and severity, with five major shocks (1854, 1857, 1873, 1884, and 1893). The experience in England was similar, only more severe. In the first half of the 19th century England experienced four crises (beginning in 1815, 1825, 1836, and 1847), but that number increased to six in the last half (1857, 1866, 1873, 1882, 1890, and 1900). By the 20th century, the situation had grown even worse, with frequent depressions culminating in the Great Depression of the 1930's.[86]

Thus it was clear that despite the advances in economics, the models did not seem well related to actual business conditions, which continued to have seemingly intractable problems of business cycles, chronic unemployment and poverty. The economic engine seemed to be rather selective in its workings and favored the rich over the poor, which was contrary to its predictions of equity. Neoclassical theory

[86] Hunt, *History of Economic Thought*, 402.

was having difficulty explaining it all, much less coming up with a remedy. Capitalism was losing its grip on the people. The communists had come to power in Russia, while Fascism and Nazism ruled in Spain, Italy and Germany. Socialism was on the rise across Europe, and the world seemed headed for war.

It is in the midst of the crisis of the Great Depression that John Maynard Keynes (1883-1946) does his theorizing and comes up not just with an explanation, but with policy prescriptions that have become embedded, for better or worse, in the policies of every single developed country. Although Keynes is often considered a radical, the truth is that he accepted the neoclassical model nearly without change:

> Our criticism of the accepted classical theory of economics has consisted not so much in finding logical flaws in its analysis as in pointing out that its tacit assumptions are seldom or never satisfied, with the result that it cannot solve the economic problems of the actual world.[87]

The Failure of Equilibrium

When Keynes mentions solving the economic problems of the actual world, he means giving policy prescriptions to governments. Neoclassicism could not or would not do this, since the theory allowed for only a minimal economic role for governments. Indeed, neoclassicism had difficulty even recognizing the problem, since the theory of an automatic, self-adjusting equilibrium did not account for the frequent depressions, nor did it recognize any involuntary unemployment. According to the theory, labor, like any other commodity, had a market-clearing price, and full employment could always be achieved by lowering the wage of the worker and increasing the profit of the entrepreneur. Therefore whenever unemployment existed, it was only because the workers refused to take the wage cuts necessary to bring the wage rate into equality with the marginal product of labor, and hence it was always *voluntary* unemployment. Keynes did not dissent from this analysis[88] but he pointed out that there was another way to lower the wage rate: The price of goods could be increased while the wage rate was held constant, that is, by inflation. Workers who would not often agree to a pay cut might accept inflation more peaceably.[89]

Inflation can be easily influenced by government policy when the government controls the money supply. And it was Keynes's intention to "select those variables which can be deliberately controlled or managed by central authority in the kind of system in which we actually live."[90] In other words, Keynes was attempting to identify the tools by which the government could effectively manage the economy

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[87] John Maynard Keynes, *The General Theory of Employment, Interest, and Money* (San Diego, New York, London: Harcourt, Inc., 1964), 378. What Keynes refers to as "classical" theories, we now label "neoclassical."

[88] Ibid., 17.

[89] Ibid., 264.

[90] Ibid., 247.

in the hopes of eliminating the disastrous business cycles which had plagued the system. In contrast to other neoclassical economists, Keynes recognized that the economic system did not automatically provide equilibrium and stability, but rather,

> it seems capable of remaining in a chronic condition of sub-normal activity for a considerable period without any marked tendency towards either recovery or collapse. Moreover, the evidence indicates that full, or even approximately full, employment is of rare and short-lived occurrence.[91]

Implicit in Keynes's writing is the notion that equilibrium is not *automatic* but *intentional*, that is, equilibrium could only result from policies deliberately designed to bring it about; it could not be left to *laissez-faire*.[92] Equilibrium at full employment only occurred in a very rare and special case of the relationship of the propensity to spend and the inducement to invest.[93] Note that "propensity" and "inducement" are terms drawn more from psychology than from economics. Keynes's insight was that equilibrium depended on the psychology of markets and on distributive justice. It is in these areas that Keynes makes his unique contributions to economic theory.

The Psychology of Markets

The human person had been shrunk by neoclassical theory to a mere shirker and egotist. A shirker, because he desired only wealth without work (Nassau Senior),[94] and because work itself was considered such a great disutility that only the greatest inducements could overcome the "aversion" to work. As Jeremy Bentham put it, "Aversion is the emotion— the only emotion— which *labour*, taken by itself, is qualified to produce*...* *love of labour* is a contradiction in terms."[95] These inducements consisted of the prospect of high profits for owners of capital and the threat of starvation for those who owned only their own labor.

Keynes recognized that markets were made of human decisions and could not be understood apart from the human person. He had a more complex notion of the person and his effect on the market. Therefore Keynes introduced four terms that were purely psychological in character: the *marginal propensity to consume*, the *marginal propensity to save*, *liquidity-preference*, and *market expectations*. The first two terms governed how much people were willing to spend or save out of their incomes, and varied with the level of income. The lower the income, the greater the propensity to spend, but this propensity is diminished as one's income increases. These factors helped determine *effective demand* (the amount that could actually be purchased, sometimes called *aggregate demand*) in the economy. The liquidity-

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[91] Ibid., 249-50.

[92] Ibid., 339.

[93] Ibid., 28.

[94] Hunt, *History of Economic Thought*, 145.

[95] Ibid., 132.

preference determined the demand for money and was made up of three motives: The transactions-motive, which is the need for cash for current business and personal expenses; the precautionary motive, the desire for excess cash to meet contingencies, and; the speculative-motive, which has the object "of securing profit from knowing better than the market what the future will bring forth."[96] The liquidity-preference (demand for money) interacts with the supply of money to determine interest rates. Market expectations are simply the expected future yields from capital assets[97] and are equivalent to the Marginal Efficiency of Capital. Together, these factors influence nearly every other economic term, and interact in complex ways to produce the shape of the market, and especially to produce the business cycle.

<u>The Business Cycle</u>

In contrast to the theory of a stationary equilibrium of neoclassicism, Keynes proposed a theory of shifting equilibrium "meaning by the latter the theory of a system in which changing views about the future are capable of influencing the present situation."[98] It was (and is) indisputable that economies go through cycles of euphoria and depression, of boom and bust. The major culprit, according to Keynes, is a sudden change in the *Marginal Efficiency of Capital* [MEC] (that is, the discounted present value of a capital asset, the amount of money one expects to receive in the future for the purchase of a capital asset today). Of course, the MEC is highly dependent on market expectations, but the basis of such expectations is highly speculative and uncertain.[99] When the MEC is above the interest rate, money flows easily into a market. After all, if one expects an asset to pay, say, 10%/annum and can borrow the money to acquire it for 5%, it makes sense to invest. Eventually the market becomes "over-bought" and when the inevitable disillusionment sets in, it falls with "sudden and catastrophic force."[100] The MEC falls so rapidly (being no more than a measure of optimism) that it falls below the interest rate, hence no one wishes to invest. Keynes described the process thus:

> It is an essential characteristic of the boom that investments which will in fact yield, say, 2 per cent. in conditions of full employment are made in expectation of a yield of, say, 6 per cent., and are valued accordingly. When the disillusion comes, this expectation is replaced by a contrary "error of pessimism", with the result that the investments, which would in fact yield 2 per cent. in conditions of full employment, are expected to yield less than nothing; and the resulting collapse of new investment then leads to a state of unemployment in which the investments... in fact yield less

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96 Keynes, *The General Theory*, 170.

97 Ibid., 247.

98 Ibid., 293.

99 Ibid., 315.

100 Ibid., 316.

> than nothing. We reach a condition where there is a shortage of houses, but where nevertheless no one can afford to live in the houses that there are.[101]

In other words, as euphoria turns to pessimism, the market psychology creates the conditions which make the pessimistic predictions actual conditions. Investors rush for the exits to avoid getting caught in a collapse, and thereby create the very collapse they would avoid. There are runs on banks that would otherwise be sound, as fear encourages people to withdraw their funds. Yet, there is no shortage of capital, labor, demand, or any other purely "economic" factor, but only a shortage of the faith which keeps the whole system together. Keynes argued that in conditions of *laissez-faire*, it would be impossible to avoid panics without a far-reaching change in market psychology, and such a change is unlikely to come about spontaneously.[102]

The interest rate, meanwhile, increases because a collapse in the MEC precipitates a sharp increase in the liquidity-preference; that is to say, people would rather have cash then investments. This gap between the interest rates and the MEC is the major cause of the cycle. The neoclassical theories, however, tended to confound the two numbers[103] and hence could provide no coherent explanation for the repeated failures of equilibrium.

The sudden fall of the MEC also impacts the marginal propensity to consume,[104] which causes a further drop in demand, which leads to a further round of lay-offs, and so forth. Further, the decline in output is accompanied by a reduction in working capital, which is a further element of disinvestment, one that may be very large.[105]

The neoclassical solution to crises is to maintain a "flexible wage policy," *i.e.* simply make pay cuts. The lowered wages will lower production costs, increase the volume of employment, and thereby stimulate effective demand,[106] and employment is uniquely correlated to effective demand. But as Keynes pointed out:

> Moreover, the contention that the unemployment which characterises a depression is due to a refusal by labour to accept a reduction of money-wages is not clearly supported by the facts. It is not very plausible to assert that unemployment in the United States in 1932 was due either to labour obstinately refusing to accept a reduction of money-wages... Labour is not more truculent in the depression than in the boom— far from it. Nor is its physical productivity less. These facts from

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[101] Ibid., 321-22.

[102] Ibid., 320.

[103] Ibid., 352. This distinction is crucial to Keynes's analysis of usury; see chapter 10.

[104] Ibid., 319.

[105] Ibid., 318.

[106] Ibid., 258.

> experience are a *prima facie* ground for questioning the adequacy of the classical analysis.[107]

The question is far more complex than neoclassicism allows. Lowering wages would have a variety of effects, some of which would increase and some of which would decrease effective demand.[108] A moderate decrease in wages would likely have no effect, while an immoderate one would likely shatter confidence and destabilize the situation even further. In any case, the expectation of lowered wages, or outright job loss, would be likely to lower the propensity to consume and thereby lower effective demand. Further, only under socialism could a flexible wage policy be administered and would not be practical in a system of free bargaining.[109] What governments can do is work through a flexible monetary policy, which analytically comes to the same thing; wages could remain the same while the money supply was increased, and with it, prices.[110] But whatever strategy is adopted, Keynes was clear that government action was necessary to ensure full employment. He was convinced of the need for central controls to bring about an adjustment between the propensity to consume and the inducement to invest.[111]

The remedy for an economy in the midst of a crisis was very simple: the government could simply borrow money and spend it to raise effective demand. It would be best to spend the money on socially useful projects, such as housing for the poor. But in any case it should spend money at times when money wasn't being spent in sufficient quantities. If necessary, the Treasury could fill old bottles with banknotes, bury them in disused mines, cover them up with rubbish from the town dump, and then sell the "mining" leases to private companies to dig them up again.[112] Anything to get the "money pump" going again.

Equity and Equilibrium

Keynes's ultimate goals were greater than just making minor adjustments during depressions; his real interest was in distributive justice, but not just from the moral perspective, but from the view of practical economics. The remedy for the business cycle "would lie in various measures to increase the propensity to consume by the redistribution of incomes or otherwise."[113] His point was that vast differences in wealth and poverty were themselves the cause of unemployment and depressions. This was based on the practical and undeniable proposition that the wealthy had a lower marginal propensity to consume then did the poor.[114]

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[107] Ibid., 9.

[108] Ibid., 262-5.

[109] Ibid., 265.

[110] Ibid., 267.

[111] Ibid., 379.

[112] Ibid., 129.

[113] Ibid., 324.

[114] Ibid., 31.

Thus purchasing power would be lost to the economy, and with this loss comes the loss of employment. Thus in the face of vast inequalities, equilibrium was impossible. It is here that Keynes locates the primary failure of neoclassicism: "The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes."[115]

Keynes also wished to increase the stock of capital to the point where it ceased to be scarce.[116] This would eliminate the scarcity premium on capital and be the "euthanasia of the rentier," those who earned an income not by work but merely by the ownership of an asset, which involves "no genuine sacrifice."[117]

In this concern with distributive justice, Keynes was not aiming at a perfect equality:

> For my own part, I believe that there is social and psychological justification for significant inequalities of incomes and wealth, but not for such large disparities as exist to-day. There are valuable human activities which require the motive of money-making and the environment of private wealth-ownership for their full fruition.[118]

Nor was he attacking the individualist base of neoclassicism:

> Let us stop for a moment to remind ourselves what these advantages [of individualism] are. They are partly advantages of efficiency? the advantages of decentralisation and of the play of self-interest. The advantage to efficiency of the decentralisation of decisions and of individual responsibility is even greater, perhaps, than the nineteenth century supposed; and the reaction against the appeal to self-interest may have gone too far. But, above all, individualism, if it can be purged of its defects and its abuses, is the best safeguard of personal liberty in the sense that, compared with any other system, it greatly widens the field for the exercise of personal choice.[119]

What Keynes was doing was showing the technical connection between *equity* and *equilibrium*, between distributive justice and corrective justice. Just as Aristotle concluded, distributive justice was a *social* question, which would require involvement of the social institutions, such as government, to achieve. Deliberate policies to redistribute income, thereby raising the propensity to spend, and controlling the supply of money, thereby decreasing the cost of capital, were necessary to ensure full employment, stability, and social peace. Nor would these measures be prejudicial to the capitalist (except for the pure *rentier*) since the growth of wealth, and of the economy, depended on the propensity to consume, a propensity that was hampered by vast inequalities.[120] What Keynes did was to join

[115] Ibid., 372.

[116] Ibid., 325.

[117] Ibid., 376.

[118] Ibid., 374.

[119] Ibid., 380.

[120] Ibid., 374.

the individualist and the social concerns, because man is both an individual and a social being, and no theory that appeals to the social alone (Socialism) or the individual alone (neoclassicism) can ever be sufficient, either intellectually or economically.

It is precisely this aspect of Keynes's work that causes his critics so much consternation. Yet one wonders why. The predictions of J. B. Clark's *The Distribution of Wealth*, the standard neoclassical text on the matter, are exactly the same as Keynes's: namely, incomes for both capitalist and worker normalized to each other, the elimination of economic profits (rents), a stable economy, and full employment.[121] In other words, both systems of thought have equity and equilibrium as their goals. The dispute therefore is not about ends, but about means. The neoclassical economists exclude distributive justice and believe that all the good effects can come about accidentally, without anybody intending justice. They look to "automatic" laws that operate apart from human intentionality.

Yet the results of this "automatic" system have not been as promised. The more "libertarian" the economy has been, the more unstable, the more inequitable, and the more miserable it has been. Libertarian and instability have gone hand in hand, with the more of the one leading to more of the other, and no amount of theorizing can change the sad facts of history. The experience of the 18th, 19th, and the first part of the 20th centuries, when utilitarian ideals held sway, speak more clearly than can any tome or textbook. A theory is justified by its results, and measured by what it promises. Just as Communism failed to dissolve governments and bring prosperity and equality to the people, as promised, and so must be condemned on its own ground, so too has utilitarianism failed to dissolve the vast differences between wealth and poverty or brought economic stability, and so must be judged on its own terms. The words of the poet Oliver Goldsmith still hold as true today as they did in the 18th century, when he witnessed the growing accumulation of wealth and the destruction of the English working class:

> Ill fares the land, to hast'ning ill a prey,
> Where wealth accumulates, and men decay;
> Princes and Lords may flourish, or may fade:
> A breath can make them, as a breath has made;
> But a bold peasantry, their country's pride,
> When once destroyed can never be supplied.

The Impact of Keynes

Shortly after Keynes published *The General Theory* (1935), World War II broke out. The world's misfortune was, in a sense, Keynes's fortune because it immediately necessitated the expansion of government expenditures, putting his ideas to an immediate test. The results were judged to be spectacularly successful. Since the War, Keynes's prescriptions have become an integral part of the economy of nearly every advanced nation. In 1946, Congress passed the "Employment Act" which required the government to use its taxing, borrowing,

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[121] Clark, *The Distribution of Wealth*, 16.

and spending powers to maintain full employment, and Keynesianism was thereby legally mandated.[122] And there can be little doubt that since his policies have been so widely implemented, depressions have become more mild (reflected by the name "recessions") and less frequent than in the days of pure neoclassicism.

Some of Keynes's critics accuse him of being a socialist, but the truth is otherwise. The fact is that the hopes of Socialism have died in the Keynesian synthesis of neoclassicism and distributive justice. Since the War, Western economies have been not precisely "free market," but "managed" economies, to a greater or lesser degree, a policy "that brought the sensational novelty of mass affluence to the peoples of the United States, Western Europe, Japan, and all the other countries that followed their path."[123] The Conservative economist Milton Friedman somewhat impishly suggested that "We're all Keynesians now!" Judging by the number of regimes that have adopted the theory, in whole or in part, Keynesianism is the most successful economic theory since Adam Smith. The most conservative governments (e.g., Reagan and both Bushes) pursue Keynesian strategies as aggressively as do liberal ones, if not more so. There is also a certain irony in the fact that Alan Greenspan, a Libertarian economist and a former intimate of the radical Libertarian, Ayn Rand, now heads the Federal Reserve Board, which is institutional Keynesianism.

Still, the results have not been an unmixed blessing. In the first place, the easiest way to accomplish the recycling of funds has been through military expenditures, through the growth of what President Eisenhower called the "military-industrial complex." Some have therefore charged that Keynes has encouraged a militarism that was no part of his intent. In fact, it has not been a real militarism, which would at least involve the virtues of discipline and courage, but a corporate shadow of it which calls for much in the way of subsidy and nothing in the way of sacrifice, except sacrifices on the part of the young men and women sent to a succession of foreign wars.

Further, Keynes's redistributive policies concerned only the redistribution of income. He was certainly aware of the need for spreading the ownership of capital, but he could provide no policies in that direction. Income redistribution will always require a vast and intrusive government bureaucracy to collect and disperse the funds. In the process, it tends to make each person a mere client of the state rather than a true citizen; where subsidies are to be given or funds paid, the idea of a common good, so crucial to Keynesian analysis, dissolves into a war of economic interests and often spurious "rights." And once these bureaucracies and mechanisms are in place, there is every likelihood that they will be captured by the most powerful corporate forces, who then use them as their private preserves, setting up a sort of reverse Keynesianism, transferring funds from the middle class to the rich. And further still, the vast government intrusion into

[122] Hunt, *History of Economic Thought*, 417.

[123] Edward Luttwak, *Turbo-Capitalism: Winners and Losers in the Global Economy* (New York: Harper Collins, 1999), 27.

business seems to work *in favor* of large business and *against* small businessmen, because the cost of regulation is small relative to big business and large relative to small businesses.

Finally, there is the serious question of whether Keynesian policies can be maintained in the face of mounting debts. These debts are not a necessary part of Keynes's prescriptions, because the debts built up in bad times were to be repaid in good times. But such debts may be a practical consequence, since it is politically easier for governments to incur debts than to repay them. The age of Keynes may be coming to a close simply because we can no longer afford it. But what can possibly replace it without returning us to the days of economic turmoil and misery? There can be little doubt that in an age of war, communism, fascism, and turmoil, Keynes saved capitalism for the capitalists. The question now is whether capitalism can be saved from Keynes.

Utility Triumphant

Chicago and Austria

Despite the success of Keynesian policies in stabilizing the capitalist system there was an inevitable counter-attack on the part of utilitarian economics. Or perhaps it is more accurate to say that *because* of the success of Keynesianism, there was a counter-attack; after all, it is difficult to preach the automatic stability of the free market in a time when so many people are out of work. But after the crisis has passed, it is again possible to renew the attack. Beginning in the 70's, neoclassical economists, especially those of the Austrian and Chicago schools, began to displace the Keynesian consensus that had arisen after the war. By the 80's and 90's they were ascendant in the centers of economic orthodoxy, the major universities, the government, and in a series of well-funded "think tanks." They were aided in this effort not merely by the force of their arguments, but by the rise of "neo-conservatism," a marriage of liberal ideology and evangelical morality (see Chapter 12).

The leading economist of this period is Milton Friedman, a "Chicago" economist and Nobel Prize winner. Friedman is a radical libertarian who advocates the abolition of corporate taxes, the graduated income tax, free public schools, regulations on the purity of food and drugs, the licensing of doctors, the post office, government relief for natural disasters, minimum wage laws, laws against usury, and laws prohibiting heroin, cocaine, and the like.[124] Both the Chicago and Austrian schools of thought would probably agree on most of Friedman's prescriptions, since both reduce man to a "utility-maximizer," and both view economics purely as the "science of exchange" (that is, corrective justice). Even production, which is surely a part of economics, is viewed as an "exchange with nature." One wonders how nature negotiates the terms of the exchange, or just what she receives in return for giving up her food, fiber, and mineral wealth. Beyond that, the differences between the two schools are subtle,

[124] Hunt, *History of Economic Thought*, 467.

although the fights are bitter. Austrians tend to be rationalists, deducing their beliefs (in the manner of Senior) from "first principles" regarded as "fundamental." Chicagoans tend to be more empirical, though they also accept "utility" as a metaphysically "given" principle. In this debate, we can see the Enlightenment fragmentation of the rationalist and empiricist approaches being played out before our eyes. Indeed, both are "modernist" philosophies, which D. McCloskey (herself a Chicago-school economist, though a dissenting one) describes in these terms:

> Modernism promises knowledge free from doubt, metaphysics, morals, and personal conviction; what it delivers merely renames as Scientific Method the scientist's and especially the economic scientist's metaphysics, morals, and personal convictions. It cannot, and should not, deliver what it promises. Scientific knowledge is no different from other personal knowledge. Trying to make it different, instead of simply better, is the death of science.[125]

Some at least of the Austrians would object to being described in these terms because they see themselves as highly ethical. However, they exclude ethics from economics itself; ethics are to be confined to the "moral-cultural" system which should support capitalism without actually modifying or affecting any of the economic system's principles or assumptions;[126] hence there are no practical differences. Perhaps the most basic way to see the differences in the schools, such as they are, is to look at their attitudes to something really basic. Something like sex, for example.

Sex, Marriage, and Utility

In order for utilitarianism to be a self-consistent view of man, then it must define *all* human activities, including sex and marriage, in terms of utility. Most economists have mostly avoided the implications of this, but recently the Chicagoans have faced the issue squarely. For if there really are no such things as objective values and man really is naught but a utility maximizer, then the difference between the criminal and the law abiding citizen is not in their moral character, or so the Nobel Prize winning Chicagoan Gary Becker argues, but in the fact that their "benefits and costs differ." "Frauds, thefts, etc., do not involve a true social cost but are simply transfers, with the loss to the victims being compensated by equal gains to criminals."[127] Criminal activities therefore provide a social value in gains to the offenders and should be treated as any other industry that creates a "diseconomy" to others, such as factories that produce smoke and other public nuisances.[128]

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[125] D. McCloskey, "The Rhetoric of Economics," *Journal of Economic Literature* 21 (1983): 488.

[126] Novak, *The Spirit of Democratic Capitalism*, 185.

[127] Nelson, *Economics as Religion*, 173.

[128] Ibid.

The same analysis can be extended to sex. Richard Mackenzie and Gordon Tullock point out, in good Chicago fashion, that "sex is a service produced and procured" like any other product. Hence, for utility-maximizing individuals:

> It follows that the quantity of sex demanded is an inverse function of the price... the rational individual will consume sex up to the point that the marginal benefits equal the marginal costs.... If the price of sex rises relative to other goods, the consumer will "rationally" choose to consume more of other goods and less sex. (Ice cream... can substitute for sex if the relative price requires it.)[129]

Gary Becker extends this utility-maximizing analysis of sex to love and marriage:

> It can be said that Mi [man i] loves Fj [female j] if her welfare enters his utility function... Clearly, Mi can benefit from such a match with Fj, because he could then have a more favorable effect on her welfare— and thereby on his own utility— and because the commodities measuring "contact" with Fj can be produced more cheaply when they are matched than when Mi has to seek an "illicit" relationship with Fj.[130]

Richard Posner, a follower of Becker's, carries this line of argument to its logical conclusion. Commenting on prostitution and marriage, he says "The difference is not fundamental."[131] Responding to this Chicago analysis, the Austrian Robert Nelson points out that woman were traditionally held as property, which has an economic advantage:

> The incentive of the owner (husband) to invest in the human capital of the wife may be much greater when the wife is not free to leave to take a better offer— just as owned cars are often treated much better than rented cars. The wife in turn is likely to be much more devoted to the welfare of her owner (husband) when she knows she has no place else to go.[132]

Such is the quality of the "debate" between Austria and Chicago. In either case, decent married women and mothers end up regarded as prostitutes, property, or both; decent husbands and fathers become merely their clients or their pimps. The problem becomes clearer when we look at Jennifer Roback Morse's *Love and Economics*. Ms. Morse is a former Chicago economist who emigrated to the Austrian view after she had a child. Her book is a beautifully written account of love, marriage, and parenting, and a polemic against what she calls the "*Laissez-faire* family." Had the book been entitled simply *Love*, there would be no problem; but she added *and Economics*. Yet her outlook has no impact on her economic views whatsoever, and she even denies that it can.[133] Marriage remains for her, as for the Chicagoans, a purely private matter with no impact on the

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[129] Hunt, *History of Economic Thought*, 472.

[130] Nelson, *Economics as Religion*, 178.

[131] Ibid., 180.

[132] Ibid., 183.

[133] Jennifer Roback Morse, *Love and Economics* (Dallas: Spence Publishing Company, 2001), 229.

"value-free" nature of economics. What Morse and all the utilitarians fail to realize is that there are no "neutral" social institutions, economic or otherwise. They reward some behaviors and punish others. If "utility is all," then marriage must be about utility; if egotism is the only force then we must force egotism into the bedroom. If "love" gives you "utility," that's well and good, but it remains a "private" choice with no more privileged position in economics than any other private choice.

One might easily find the Chicago analysis repugnant, yet one is forced to concede that it is internally self-consistent and intellectually honest; if man really is naught but a pleasure maximizer, then surely love and marriage must come under that analysis. The Austrians, on the other hand, merely wish to have their cake and eat it too; they want to treat man as an egotist in the marketplace and an altruist at home; they preach both value-free institutions *and* the importance of values, but only on the "private" level. This schizophrenic view of man is simply not tenable and constitutes a mere intellectual evasion. Or to carry the baking analogy further, the Chicagoans would lace the economic cake with the arsenic of egotism; the Austrians have no objection to the poison, but want the cake to have a moralistic icing. In either case, it would be wise to skip dessert.

The Disappearance of Justice

The trajectory we have traced in economic history moves from economics as a moral endeavor to economics as a "pure" and "value-free" science; "justice" disappears as a specific concern of economics. Instead of economics being evaluated in terms of ethics, ethics, even sexual ethics, are evaluated in terms of mathematics, the mere relation of utilities between "M_i" and "F_j." This movement entails a breaking of the unity of distributive and corrective justice and staking all on corrective justice alone. One wonders why it is so necessary for the utilitarians to confine economics to the study of exchanges. After all, exchange, corrective justice, has been well understood since the time of Aristotle, and there seems to be little to be gained from translating Aristotle from Greek into calculus. As a mere logical necessity and empirical fact, production and distribution are prior to exchange; nothing can be exchanged until something is produced and the output dispersed. So what is going on?

The narrowing of justice does make sense if we view it against the background of the narrowing of the human person into an "autonomous individual" that took place during the Enlightenment. Both utilitarian economics and hedonistic philosophies were part and parcel of the same movement. Distributive justice deals with social relations, and "society" was a suspicious category for the Enlightenment sages. Margaret Thatcher is completely in line with the Enlightenment spirit when she proclaims that "There is no such thing as society," only autonomous individuals freely contracting with each other to maximize their individual utilities.

Exchange has another advantage that fits well with the Enlightenment prejudices. It can be easily quantified and reduced to mathematics. This makes it a perfect candidate for *"Hume's Fork,"*[134] by which anything that was not reducible to numbers should be "committed to the flames." Since distributive justice always involves an ethical and social judgment, not reducible to "number," then by utilitarian reckoning, it could only be "sophistry and illusion."

However, it was not so easy to get rid of distributive justice; its absence leaves a yawning gap in economic theory that cannot be covered up by mere appeals to freedom of exchange. Hence the importance of the project of Nassau Senior and J. B. Clark to show that a just distribution will result from mere corrective justice alone. No human intervention or concern with justice is necessary because it is an "automatic" process; just as sure as the stars keep their courses without ever "intending" to do so, so too must justice find us so long as no one intends that it should. Of course, this day of just distribution must wait upon the day of perfect equilibrium, which is the day of secular salvation promised by neoclassical economics. Like The Second Coming, it is a long time in coming; but like that Second Coming, it will be a day of justice. But whether it comes or no, it is important that distributive justice be "swallowed up" by corrective justice; otherwise you will have to introduce considerations of the human person and his social context that are impermissible in utilitarian thought.

We must be grateful for Becker, Posner, Morse, and McKenzie for showing us the logical outcomes of a pure utilitarian economy. No arguments against the system would be as damaging as their arguments in favor of it. And at this point, we must make a choice: Either we must accept Becker's analysis of the human person, and all the economics that flow from it, or we must seek another model and with it another economics. We will not be permitted, if we are honest, to take the Austrian evasion, to force the person to divide his time between being an egotist and an altruist. Rather, we must recognize that being "economic man" is a part of being man, and that the "parts" must comprise a whole. The burden of the remainder of this book will be to examine man through teachings of historical Christianity, and to attempt to discern the implications of these teachings for the economic and business order. This will *not* be a task of "inventing" an economic system, but of examining practices which have worked or are working and to see how they can be or are being applied to the modern situation. Or, to put the task another way, to see how the call of Christ relates to the Vocation of Business.

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[134] "If we take in our hand any volume; of divinity or school metaphysics, for instance; let us ask, Does it contain any abstract reasoning concerning quantity or number? No. Does it contain any experimental reasoning concerning matter of fact and existence? No. Commit it then to the flames: for it can contain nothing but sophistry and illusion." (David Hume, *Enquiry Concerning Human Understanding*)

Chapter 5: Property, Culture and Economics

[Property is] that sole and despotic dominion which one man claims and exercises over the things of the world, in total exclusion of the right of any individual in the universe.

Blackstone's Dictionary of Law

Property as the Foundation of Wealth

All wealth begins as a gift from the Earth. This is true even with "low hanging fruit," which still requires human labor and ingenuity to harvest the gift and make it productive; the earth itself is the indispensable beginning of all life and all the sustenance that life requires. Thus the primary "capital" has always been the earth. The concept of "capital" becomes complex and embraces all sorts of things, including money, equities, intellectual property, machinery, etc., but all capital and wealth are still founded on the land. Therefore the distribution and possession of the land is the key element in the distribution of wealth.

All wealth is distributed based on some rule of property, either property in land, in goods, or in one's own labor. But basic to everything else will be property in land. Even in the infinite expanse of "cyber-space" one needs a place to place the server, some ground to bury the cable or set the tower. Therefore we must deal with the question of property before we deal with anything else touching on our material well-being. Societies distribute property according to their understanding of what "property" means and what "justice" means. The concept of justice controls the meaning of "property." The idea that there could be different meanings comes as a surprise to us, since we regard the concept as self-evident. And indeed, there is something self-evident about private property: that which we make should belong to us, and this idea is more or less constant throughout all societies and cultures. But there is a kind of property that we do not make: land, air, water, mineral wealth, the electro-magnetic spectrum, etc. Who "owns" such property and how did they come into possession of it? The property in things *given* is fundamentally different from the property in things made by man; this kind of ownership is a social relationship, and always different in different cultures. Further, it will determine, more than any other factor, all other economic relations within a society. Indeed, we normally name economic systems after the form of property ownership that dominates in that society. So, for example, capitalism, socialism, feudalism, tribalism, all refer to different ways of owning land.

Therefore, any rational exploration of justice, and the economic and business systems that implement justice, must begin with a study of how the society governs land ownership. Such ownership is prior to any production or exchange, and the first thing a society must distribute is the land. Every society will make this distribution according to its own notions of justice, notions that vary from culture to culture. However, underneath these varying notions are some themes and issues that play themselves out in every culture as it develops through its history. The most basic theme is the distinction between ownership and use.

Ownership and Use

The classic position on ownership of the land in Catholic Social Teaching comes from St. Thomas Aquinas. For Thomas, there is no particular reason why a "particular piece of land should belong to one man more than another" (*ST* II-II, q. 57, A. 3). Nevertheless, St. Thomas gives an excellent defense of private property:

> [Private property] is necessary to human life for three reasons. First because every man is more careful to procure what is for himself alone than that which is common to many or to all: since each one would shirk the labor and leave to another that which concerns the community, as happens where there is a great number of servants. Secondly, because human affairs are conducted in more orderly fashion if each man is charged with taking care of some particular thing himself, whereas there would be confusion if everyone had to look after any one thing indeterminately. Thirdly, because a more peaceful state is ensured to man if each one is contented with his own. Hence it is to be observed that quarrels arise more frequently where there is no division of things possessed. (*ST* II-II, q. 66, A. 3)

The thing to note about this defense is that it is *pragmatic*: things just work better when there is private ownership. But then Thomas identifies a second aspect of property, its use. He writes, "The second thing that is competent to man with regard to external things is their use. In this respect man ought to possess external things, not as his own, but as common, so that, to wit, he is ready to communicate them to others in their need" (Ibid.).

Thus Thomas identifies two aspects of property: *ownership* and *use*. One dictates a *private* aspect of property and the other a *public* or *common* aspect. What is the relationship between these two aspects? According to Thomas,

> Community of goods is ascribed to the natural law, not that the natural law dictates that all things should be possessed in common and that nothing should be possessed as one's own: but because the division of possessions is not according to the natural law, but rather arose out of human agreement which belongs to the positive law... Hence the ownership of possessions is not contrary to the natural law, but an addition thereto devised by human reason. (Ibid., ad 3)

Indeed, the common claims on property are so strong that theft is allowed in cases of need: "In cases of need all things are common property, so that there would seem to be no sin in taking another's property, for need has made it common" (*ST* II-II, q. 66, a. 7, sc).

For St. Thomas, then, there is a common aspect of property that is governed by the natural law and a private aspect which is governed by positive law, or prudence. Now we can better understand Thomas's pragmatic defense of private property: it is a method, governed only by prudence, of insuring that the "natural" common values of property will be available to all; it is a way to ensure that property will be properly developed so as to be useful to the whole community, since property always needs to be developed in some sense in order that its values be made available to men. Now, if St. Thomas is correct, we would expect to see in the history of property ownership a variety of prudential methods based on the interplay of the common and private values in land. Further, we would expect that these various methods of ownership and use will vary according to how cultures perceive the "natural" law as it applies to justice. We will test this thesis by looking at four different systems of ownership: The "Sabbath Land" of the Old Testament, the "private" system of the Greek city-states, the feudal land of the Middle Ages, and our own system of modern Capitalism.

Property and Culture

Sabbath Land

If religion and economics are separate and distinct things, you would never know it from reading the Bible. The Old Testament especially is an "economic" document which specifies a system of land ownership (indeed, several systems) and calls for "justice" from nearly every page. The land is a primary theological and economic category in the Old Testament, particularly the "Promised Land."[135] The Bible does not present us with a series of moral abstractions, but embodies its strictures in concrete situations, specifically in the way the people are to relate to the land. As the faith of the ancient Hebrews waxes and wanes, so too does their relationship with the land. For this reason, we find not *one* system of land ownership in the Bible, but six.[136] The oldest of these is the Sabbath Land codes found in Leviticus 25-26, Deuteronomy 15, and Exodus 23.[137]

Taken together, these chapters present a picture of the land as bound by the Sabbath. That is to say, not only do the inhabitants of the land observe the Sabbath, but the land does as well; the land itself rests one year in a week of years. The overriding premise of this system is *covenant*, an agreement between God and man with obligations on both sides. An overview of the covenant is given in Leviticus 25, while chapter 26 provides a series of blessings for keeping the covenant (3-13) and a series of curses for violating it (14-39). Both the blessings and the curses relate primarily to the land, it fruitfulness and security, and only derivatively to the inhabitants. Among the blessings we find that the Lord promises that the land will receive rain in due season (26:4), the threshing will overtake the vintage (5), dangerous animals will be removed (6), and the land shall be secure from attack (6-8). But chief among the blessings is the physical presence of the Lord: "And I will walk among you, and will be your God, and you shall be my people" (12). The curses, however, outweigh the blessings "seven-fold" (21) and include disease, famine, loss of political independence, wild beasts, and exile.

The central premise of the covenant is that the land cannot be sold because it cannot be owned: "The land shall not be sold in perpetuity, for the land is mine; with me you are but aliens and tenants" (Lv 25:23). Even this tenancy of the land does not reside so much in individuals as in the clan or tribe, and the kinsmen always retain the right to "redeem" the land (that is, buy it back after a "sale").[138] Here we see most clearly the distinction between modern and Levitical notions of land ownership; while in the modern world, the

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[135] Walter Brueggemann, *The Land* (Minneapolis, Minnesota: Fortress Press, 1977), 4.

[136] Norman C. Habel, *The Land Is Mine: Six Biblical Land Ideologies* (Minneapolis, Minnesota: Fortress Press, 1995).

[137] All Biblical quotations are from the New American Bible.

[138] This applies to agricultural land only; the regulations for city land are different, and the right of redemption expires after a year, and such land is exempt from the jubilee.

individual is sovereign over his own land, in Leviticus the land cannot be alienated from the clan or tribe, and the individual himself is a mere "tenant" even though he holds a life-time tenancy.

The specific terms of the "lease" required that the Hebrews:

1. Not sell the land in perpetuity. Rather, it could only be leased to another for up to seven years. Even then, the kinfolk of the one leasing the land had the right to "redeem" it. But whether or not it was redeemed, the land had to be returned to its owners every Sabbath (seventh) year.
2. Permanent slavery for Hebrews was forbidden; those placed in debt servitude had to be freed every seventh year.
3. Every seventh year the land had to lie fallow, the "land Sabbath." This probably referred to a normal crop rotation system rather than *all* the land being uncultivated in one year.
4. The poor had the right to harvest whatever grew on the fallow fields, as well as the right to glean the other fields. Thus the land provided work and sustenance for both for the "owners" and those who owned no land at all.
5. Since "ownership" of the land was vested not in individuals, but rather in the clan or tribe, the current tenants merely used the land and "possessed" only as much as they could use themselves. There was no concept of land as a capital asset which one could hoard or exchange for a profit. In fact, the only way to draw income from the land was by personal labor,[139] and as such, the land was available to both "rich" and "poor" members of the extended family or tribe.

This system of land tenure rested upon the Hebrew view of the purpose of life. The ancient Hebrews had only the vaguest notion of an "after-life," a concept that came much later to the Hebrew religion; rather, the land *itself* was the promise. A peaceful life on their own land, free from foreign rule, with each man tending his own vines was the ideal; "salvation" meant having a home and living by one's own efforts. The land itself was not a "commodity" to be bought and sold, but a gift from God for all generations, not just the current one. The Sabbath land system is typical of tribal land ownership systems found throughout history, including the tribal cultures of our own day. To put the matter into modern terms, "one could consider the land the joint property of all members of the tribe, past, present and future, with present members having only a leasehold interest."[140]

We can see from the story of Naboth's vineyard (1 Kings 21) that the ideals of the Sabbath land system were not just pious admonitions, but rather were a functioning system. King Ahab desires a field belonging to Naboth and offers to buy it from him. But Naboth will not sell because, as he tells the king, "The Lord forbid that I should give you my ancestral heritage" (v4). Naboth cannot sell the land because he does not "own" it; he is merely the current user of the land. On this basis, the commoner can stand his ground (literally) against a king. The king can do nothing but return to his palace and sulk.

[139] Small, *The Social Economy of Land*, 116.

[140] Ibid., 118.

However, the king has a wife named Jezebel who is not a Jewish but a Canaanite princess, a foreigner from a land where the king's word is law and all land belongs to the king; hence she is amazed at her husband's weakness. "A fine ruler of Israel you are!" she taunts him (v7). Taking matters into her own hands, she has Naboth framed on a charge of blasphemy and killed. Ahab then takes possession of Naboth's field. But as he does, he is confronted by the prophet Elijah, who accuses him, "After murdering, do you also take possession?" It seems the violation of the land laws was as abhorrent as the murder. The story testifies to the persistence of the old laws.

Nevertheless, the laws were sufficiently disregarded so that land and power were being concentrated in fewer and fewer hands, which caused an angry response from the prophets, such as when Isaiah says, "Woe to you who join house to house and field to field until you are left to dwell alone in the midst of the land" (Is 5:8). The final chapter comes when the kingdom of Jerusalem is besieged by the Babylonians under Nebuchadnezzar. The Prophet Jeremiah tells King Zedikiah that the key to lifting the siege is to free the slaves. The Hebrews promise to do so, and immediately Jerusalem's ally, the Pharaoh Hophra, takes the field against Nebuchadnezzar, who lifts the siege to face the new threat. Seeing the Babylonians depart, the nobles renege on their promise and fail to actually free the slaves. In the meantime, Hophra takes one look at Nebuchadnezzar's army and changes his mind; his army retreats to Egypt and Nebuchadnezzar resumes the siege. Jeremiah tells them what the result will be:

> Therefore, thus says the LORD: You have not obeyed me by proclaiming liberty, every one to his brother and to his neighbor; behold, I proclaim to you liberty to the sword, to pestilence, and to famine, says the LORD. I will make you a horror to all the kingdoms of the earth. (Jer. 34:16-17)

And that is exactly what happens.

Hebrew society, like any other, did not remain static, nor did its spiritual life. The spirituality that supported the Sabbath codes was weakened by internal stresses and by long contact with the more urbane culture of Babylon. After the return from exile, the Sabbath laws were re-written into the Jubilee codes, codes more "sympathetic" to private wealth. These re-written codes are similar in form to the Sabbath codes, but the year of freedom occurs not every seventh year, but every seven times seventh year. Thus land can be leased and slavery imposed for forty-nine years, or pretty much for one's whole adult life. Further the right to harvest the fallow fields was taken from the poor and retained by the owners. This all constitutes a "privatization" of property rights and follows closely the trajectory that will repeat itself time and again throughout history: the gradual accumulation of property in the hands of a few, and the "privatizing" of what had previously been common rights to the land.[141] We can see this pattern at a later stage in looking at the Aristotle's Athens.

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[141] Garrick Small, "Contemporary Problems in Property in the Light of the Economic Thought of St. Thomas Aquinas," in *Congresso Tomista Internazionale* (Rome: 2003), 8.

Aristotle's Athens

The ancient Greeks, like the ancient Hebrews, were a tribal people and had a system of land ownership not too very different from the Hebrews with ownership vested in the family or tribe.[142] But by the time of Plato and Aristotle, new and private forms of property were rising. "Young Greeks recognized that their standard of living could be enhanced by buying land privately and working it. The product from this enterprise did not have to be shared with relatives."[143] Plato regarded this kind of ownership as vulgar and forbade it to the "guardians" of his ideal republic. Aristotle, however, took the opposite tack, arguing that property was a practical necessity. Why did this "privatization" of property become practical and necessary when it had not existed before? The answer lies in the transition from a rural and tribal society to a city-state. The great problem with tribal societies is tribal rivalries and warfare. Such warfare can be disastrous, the ruination of whole societies, as we can see today in Africa or in parts of the Middle East. The challenge of the city-state was to channel the strife into economic competition, which sustains agriculture and trade,[144] and to provide for the support of a military class which becomes the aristocracy. For Aristotle, the warriors should be the land owners. He accepted private property, but only when connected with an obligation for common use in the form of defense and production.[145]

This privatization of property, and the consequent concentration of wealth, was connected with what might be called a privatization and concentration of virtue and happiness. Full happiness could only come from the practice of virtue, and full virtue was limited to the aristocrats; slaves, women, children, artisans, the poor, the ugly are all barred from full happiness and the exercise of complete virtue.[146] Since being an aristocrat was an accident of birth, happiness was a matter of "moral luck" and available in its fullness to only a lucky few. This might be called a kind of Pagan Predestinationism, in which a few are preordained to happiness (or at least its possibility) while the rest are condemned to various degrees of unhappiness, with the slave at the bottom of the heap. Slavery was in fact a cornerstone of Greek economics and fit in well with the conception of morality. Indeed, the moral, cultural, and economic systems are always intertwined and interdependent. The Greek system maintained both the common and private aspects of property but emphasized the private, as opposed to tribal systems, which emphasized the communal.

We can see a trajectory of movement from more communal values to more individual values in both the Greek and Hebrew societies, with a complete privatization of land and a disregard of communal values as the society deteriorates. This happened to the Hebrews before their exile and to the Greeks before their fall to the Romans. In the same way, Roman property follows this same pattern. Towards the end of the Empire, land

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[142] Small, *The Social Economy of Land*, 143-4.

[143] Ibid., 144.

[144] Milbank, *Theology and Social Theory*, 333.

[145] Small, *The Social Economy of Land*, 145.

[146] Milbank, *Theology and Social Theory*, 351.

tended to be concentrated as soldiers on extended active duty lost title to their land, and the power and influence of the landowners grew while the free farmers declined in number and significance right up to the collapse of the Empire.[147] However, the Middle Ages are able to reverse the trajectory in new and interesting ways.

The Middle Ages

The barbarian invasions gave impetus to the concentration of land as the need for defense increased. The former free soldiers and farmers became serfs (slaves) on their own land. Europe entered a dark age from about the 5th to the 9th centuries; there was a near total loss of trade and commerce, of government, even of the domestic arts, such as farming; security became the primary concern. Life expectancy declined to perhaps as little as 24 years, while crop yields plummeted, some say to as little as five grains per head;[148] while that number is unlikely, it was certainly true that farming declined. Part of the decline had to do with the fact that the northern lands required different techniques than the Mediterranean farms; the soils were rich but heavier and harder to work; the available "scratch" plows, for example, made little impression on the soil and the existing harnesses constricted the horses' chests which limited the amount of weight they could pull. What were needed were new methods and even a new economics.

And that is precisely what happened. As Europe emerged from the Dark Ages around the 9th and 10th centuries, there was a technological explosion. It was not one invention, but dozens of little ones such as the moldboard plow, the horse collar, three-crop rotation, the use of legumes, the spiked harrow, and horseshoes.[149] Farms became very productive once again. The increased production meant a revival in population and trade, not to mention improvements in the health of the people. By the 11th century, for example, the average height for European men reached 5'8"; it began to decline after that and men did not again reach that stature until the 20th century,[150] contradicting the popular view that life in the Middle Ages was "nasty, brutish, and short." This increased productivity raises a question of why problems in farming that had existed for centuries suddenly were solved in so short a period of time. What was at the root of the trend towards innovation and constant improvement? To understand this development we must understand the system of medieval land tenure, the feudal system.

As we noted previously, at the start of the Dark Ages the mass of men had been reduced to slavery. But slavery, especially when it is so widespread, has both military and economic drawbacks. In the first place, slaves do not make good soldiers; it matters little to them what language the master speaks, and they are not likely to risk their lives over the issue. In an era of warfare this is a serious shortcoming. Nor do slaves make good workers: they may work for free, but as long as the master gets all of the values above bare subsistence, they will not work harder than subsistence requires and are not likely to invest

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[147] Small, *The Social Economy of Land*, 124.

[148] Fernand Braudel, *The Structures of Everyday Life*, vol. 1 (New York: Harper and Row, 1982), 120.

[149] Francis Oakley, *The Medieval Experience* (Toronto: University of Toronto Press, 1988), 83.

[150] Richard Steckel, "New Light on The "Dark Ages:" The Remarkably Tall Stature of Northern European Men During the Medieval Era," *Social Science History* 28, no. 2 (2004).

the effort in innovation or experimentation on which improved output depends. If the estates were to progress, they could only do so by granting a measure of freedom, both political and economic, to the slaves. Thus it gradually happened that by the 9th or 10th century the term "*servus*" no longer meant a slave but a serf and very nearly a peasant.[151]

To understand how this happened, we need to look at land ownership. The predominant form of land ownership was in "fief." All title was held by the King as the representative of the people who in turn granted estates for a fee (fief). This "fee" was not a "rent" in our sense of the term, but a complex system of rights and responsibilities. We have extensive records from these estates because the bailiffs, a combination of CEO/accountant for the estate, were required to give detailed accounts of the estate, thousands of which still exist. The estates were divided into three portions. The first of these was the demesne or the domain which was the Lord's private farm, usually occupied by the bailiff. This might consist in about a third of the land. Another portion was that worked by the serfs and cottagers and owned by them in all but name. The third portion was the commons, on which both the Lord and the serfs had certain rights.[152]

Each serf held about 12 acres of land in tenancy.[153] His rent was largely in goods and in labor. He was required to pay ½ *d*. on November 12 along with a peck of wheat, 4 bushels of oats, 3 hens. At Christmas, he must pay a cock and two hens, and 2 *d*. worth of bread. At Michaelmas (September 29) he would pay a peck of seed wheat. In addition, he must plow, sow, and till half an acre of the lord's land, work three days at harvest, and do such work as required by the bailiff, which could be several days/week. Compare this with the expected yields from his land of 13 bushels/acre of wheat or 20 of barley, 16 of oats, or 14 of peas. The cottagers paid between 1*s* 2*d* and 2*s* for their cottages and were required to work at haymaking one or two days for ½ *d*/day. They were also to work four days at harvest during which they were fed at the Lord's Table. During the rest of the year they were free laborers, usually employed on the estate for money.

In return, the Lord was expected to maintain the infrastructure of the estate (roads, canals, bridges, etc.), provide for the defense and the policing of the estate and hold courts for minor offenses and disputes. In addition, the lord owned the mill which everybody was required to use for grinding his grain, for a fee, and the brewery at which everybody made their beer, also for a fee. Finally, the lord had the best pastureland and the right to all the oak and ash trees, which could be cut only with his permission.

The key factor in the transformation was a change in the division of the produce of the estate between the master and the serfs. After this change, the serfs gave the master only a set of fixed dues to the master, mostly in goods and service, and kept the rest for themselves. This meant that any improvements in productivity would go to the serf rather than the lord. The servile condition implied by the term "serf" had all but disappeared, and the tenant regarded the land as his own. True, he could not sell it, but neither could

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[151] Hilaire Belloc, *The Servile State* (Indianapolis, Indiana: Liberty Classics, 1977; reprint, 1913), 47.

[152] Ibid., 44-5.

[153] The figures for the fees and services come from James E. Thorold Rogers, *Six Centuries of Work and Wages: The History of English Labour* (Kitchner, Ontario: Batouche Books, 2001), 37-45.

he be evicted, and he could pass his title, such as it was, to his sons. What improvements he made to the property accrued to his own benefit. Under such conditions, men willingly worked and eagerly improved the land. These rents were not economic, but customary; what would later become the so-called Law of Rents, by which the landlord got the benefits of all values above that produced on the worst piece of land, held no sway. The rents were not based on the value of the land, but on the value of the services provided to the land.[154] Adam Smith correctly identified the fees not as "rents" at all, but as taxes, that is, what someone pays the ruling authority for police protection, infrastructure, etc.[155] In an economic sense, there were no rents at all. This explains the great improvement in agricultural technique and productiveness. For when people can keep the output of their industry, they get very industrious indeed, and very creative. It is no small irony that great economic results were obtained by ignoring what would later be called the "laws" of economics. It is clear from the records that there was a security and fixity of tenure and well-distributed property. The picture we have of a few who owned the land and the many who worked it in misery is simply not correct. The peasantry was prosperous, secure in their land, well-fed and, if Professor Steckel is correct, tall.

The expansion of farming also meant the revival of town life and with it the revival of trade and industry, for there can be no town life unless there is a surplus of food to support it. The industry in the towns was organized into *guilds*:

> A Guild was a society partly co-operative, but in the main composed of private owners of capital whose corporation was self-governing, and was designed to check competition between its members: to prevent the growth of one at the expense of the other. Above all, most jealously did the Guild safeguard the division of property, so that there should be formed within its ranks no proletariat upon the one side and no monopolizing capitalist upon the other.[156]

The guild controlled all production within the towns and was made up of both the workers and the owners. Being a "worker" in a trade was itself a temporary condition; after a period of apprenticeship all the workers could become masters.[157] Note that the guild did not actually do away with competition, but merely competition on price; the masters still competed on matters such as quality, artistry, and service. Trade and industry flourished under this system and great wealth was created, as can be ascertained by the amount of surplus available for projects such as cathedrals, castles, public buildings, roads, and canals.

What emerges is not a simple political/economic hierarchy, but a complex system of multiple authorities reflecting a moral equality within a political hierarchy. The guilds, the towns, the estate, and the religious authorities, all had their own laws, rights, and

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[154] Bede, *Social Theories of the Middle Ages: 1200-1500*, 139.

[155] Rogers, *Six Centuries of Work*, 56.

[156] Belloc, *The Servile State*, 49.

[157] This system survives at the college level. We spend four years getting a bachelor's degree and a further three to get a master's because this was the length of time for an apprentice to become first a "journeyman" and then a "master." The "colleges" were originally guilds of scholars who earned their livings by teaching.

customary rules which were regarded as more or less "sacred" and could not easily be tampered with by other authorities. Everyone, from the peasant to the aristocrat, was conscious of his rights and willing to assert them against all threats. Property was well distributed so that even the meanest peasant had rights to the common lands. Although legal "ownership" was vested in the sovereign, actual ownership was vested in the lords, the tenants, and the townsmen. The system not only created a vast amount of wealth, but distributed it well to high and low alike. The system of customary rents, rather than economic ones, worked well. However, the system began to evolve from one of labor rent to one of cash rents. Landlords preferred to receive, and peasant preferred to pay, cash in lieu of service.

By the middle of the 14th century, there was very little of the old serfdom remaining. At first, this worked well for both sides, but things changed rapidly after the plague (1348), which reduced the population of England by one-third.[158] Wages rose rapidly and the cash commutations for service were no longer sufficient to hire replacements. Attempts to force the serfs to labor on the old terms failed, since workers could just flee the estate with the assurance that they would find work at high wages elsewhere.[159] The high wages meant that the remaining serfs could buy their freedom and he could pay a money rent for his farm, which led to the rise of the yeoman-farmer. As the wages rose, and the profits of the old system declined, the landlords attempted to re-impose serfdom, but with little success. Indeed, wages were so high that in 1351 the Statute of Laborers attempted to cap the wages at pre-plague rates and imposed treble damages on Lords who paid more than the statutory rate.[160] However, the law had little effect; demand for labor was high and the peasant had too many alternatives.

> The labourers gained all that the landlords lost, and could extort what terms they liked from the necessities of their employers. This attitude was meant by the Statute of Labourers... The attempt failed. Year after year, almost century after century, the Parliament complained that the Statute of Labourers was not kept, re-enacted it, strove to make it effective, were baffled, adopted new and harsher expedients, and were disappointed."[161]

By the end of the 15th century, wages had reached their highest level; a peasant could provide food for his family for a whole year by 15 weeks of work, and a craftsman by 10 weeks.[162] England enjoyed, for a century or more, the novel experience of general prosperity with high wages and full employment. It was no accident that such a system developed in Christian Europe, for it well reflected the values of the Medieval Church. For Christianity the end of life was not in this world, as it was for the Hebrews and the Greeks, but in the next. Therefore mere accumulation could not be part of the final end. Moreover, this end, union with God, was available to rich and poor alike; there was a moral equality even in the face of social inequality. In such circumstances, slavery withers

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[158] Rogers, *Six Centuries of Work*, 223.

[159] G. M. Trevelyan, *Illustrated English Social History, Volume One* (Harmondsworth, England: Penguin Books, 1964), 31.

[160] Rogers, *Six Centuries of Work*, 227.

[161] Ibid., 250.

[162] Ibid., 389.

and dies and the classes tend to converge. Since the kings had lost their divine status, they could no longer be absolute monarchs (as they were before and would later become) but were hedged in by a system of rights at all levels of society.

However, there were problems developing. The move from service to cash also meant a move from a society based on custom to one based purely on money.[163] The new system also affected the revenues of the crown, which were based on the old "suit and service" system. When Richard II imposed a poll-tax in 1381, in keeping with the new cash economy, there was a wide-spread rebellion under Wat Tyler[164] that nearly succeeded in establishing popular government in England.

The Modern Era

The 16th century opened with England in prosperity, a prosperity that was well distributed to workers and farmers through high wages for the one and low fees for the other. By the end of that century, wages had collapsed and vast numbers of peasants had been dispossessed from the land to become a landless proletariat in the cities. A system of "welfare" became necessary, in the form of the "poor laws," to support a rapidly growing underclass. Obviously, some catastrophe had intervened to change the character of England and the balance of economic and social forces. That catastrophe was the seizure of the monasteries (1536) and a new view of property. This seizure itself was in line with a growing discontent among landowners with the feudal system. They wanted to obtain not merely customary fees but the full economic values of the land for themselves. To do this, they would have to break the power of the working and peasant classes. Further, large tracts of land had been taken out of the feudal system, both by the monasteries and by grants to individuals, and became "freeholds" paying no fees to the crown. This meant that the revenue which formally flowed from these lands had to be made up by increased taxation.[165]

By the 16th century, the Church controlled fully a third of the land in England making the Church the single largest landowner aside from the king himself. The Church's lands supported not only the monasteries themselves, but were part of the charitable and educational infrastructure. The universities, for example, were largely supported by scholarships funded by the Church so that the collapse of the monasteries very nearly meant the collapse of the universities. The monasteries were also a part of the pension system, by which "corrodies" were purchased from abbeys. The were a kind of annuity, in which a sum of money would be given to the monastery in return for the right to be supported by the monks for the rest of a beneficiary's life.

The Dissolution of the Monasteries was not the result of the Protestant Reformation; it was the cause. King Henry VIII regarded himself as a Catholic, and indeed persecuted dissenters with the same zeal as had his father. Rather, it was the work of a combination of factors. The first was the growing resentment of the power of the clergy and of abbots who seemed more interested in wealth than in religion. Anti-clerical Catholics hoped that

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163 Trevelyan, *English Social History*, 33.

164 Ibid., 37.

165 Small, *The Social Economy of Land*, 129.

seizure would allow the funds to be used for education and public improvements. Their hopes would be thoroughly disappointed. The second factor was the profligacy of the King, who had emptied his treasury and sought to refill it by confiscation. The third group were the who hoped to get the land on easy terms, which in fact they did.[166]

It should be noted that the seizure of the monasteries, by itself, did not actually change things in England. Had the king merely taken over the Church lands, he would have become the richest and most powerful force in England, and perhaps in Europe. But the life of the peasants would not have changed all that much; instead of paying fees to the officers of the Church, they would have paid them to the officers of the King, and things would have proceeded as before. But in point of fact, the King did not actually get the land.[167] The King was in no sense an absolute monarch; his bill had to pass the parliament, and parliamentarians then were like parliamentarians now: each member had his own price.[168] Each member of Parliament (and they were all drawn from the land-owning class) had his eye on some tract of land that he had coveted and, as the price of his vote, he got it, often for a price of pennies on the pound. Instead of refilling his treasury, the King spent his capital and ended up as poor as before.[169] The wealth that should have flowed to the king passed through his hands and into the hands of a new class. This land owning class already owned outright in the demesnes a fourth to a third of all the village land. Now a further fifth to third was added to that, making them the masters of half the land in England.[170]

Nor was that all. The land-owners wanted to *enclose* the village commons, that is, take them out of common ownership and make them "private" property. "Enclosure" was a movement that had been undertaken in a small way prior to the seizures and which had been roundly condemned by the King's Chancellor, Sir Thomas More. But with the removal of More and the change in the balance of power, there was little to check the disappearance of the commons into private hands.[171]

Adding to the woes of the working class, Henry VIII sought further remedy for his finances by debasing the currency. Workers found that the prices for everything but their wages increased, doubling and then doubling again. Henry and his successors reduced the

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[166] Trevelyan, *English Social History*, 208.

[167] Belloc, *The Servile State*, 64.

[168] Ibid., 66.

[169] Tawney, *Religion and the Rise of Capitalism*, 120.

[170] Belloc, *The Servile State*, 64.

[171] Which leads to the lament:

"*We hang the man and flog the woman,*

Who steals the goose from off the common;

But let the greater villain loose,

Who steals the common from the goose."

value of the coinage by as much as 60% before the old measure was restored by Queen Elizabeth a century later.[172]

The looting of English land continued through the reign of Henry VIII's weak successor, a sickly child, so that by the beginning of the reign of Queen Mary, there was a powerful class of capitalists, weak and impoverished crown, and a degraded and landless peasantry; power in England had passed to a new group of men. the dispossession of a large number of former peasants resulted in the creation of a landless proletariat, who clogged the cities in a search for work or turned to brigandage on the highways; further, there was a century of civil wars culminating in the Revolution of 1660 as the new landowning class asserted its power; finally, and perhaps most importantly, the common people had lost their bargaining power on wages. Henry had unwittingly accomplished what the Statute of Laborers could not; wages were finally limited not by the law but by the economic system.[173] A century before the seizures, the peasant could provision his family by 15 weeks of work and the artisan by 10; by 1543, it took the peasant 40 weeks of work and the artisan 32.[174]

Society passed from a system of well-distributed land at easy rents to a system of consolidated estates rented on the unfavorable terms[175] of what would later be known as the Law of Rents. It amounted to a "new conquest of England."[176] The intense land speculation forced a rise in land prices and the new owners had to squeeze every penny from the tenants to make the land pay. Thus with the new owners of England came a new attitude. When some peasants objected to the seizure of their common lands, the new landlord told them:

> Do ye not know that the King's Grace hath put down all the houses of monks, friars and nuns? Therefore now is the time come that we gentlemen will pull down the houses of such poor knaves as ye be.[177]

With the new owners of England came a new view of property. The fine balance between common and individual values gave way to a purely "private" notion of property; the feudal system, which enmeshed property in a complex relationship of rights and responsibilities, becomes an *allodial* system, where property is held free of any obligations. While we accept this today without any critique, in fact it took some doing to "sell" it to a public that still remembered the commons and the system of customary duties. Moreover there is always the problem of how one gets original title to land. You and I hold a piece of property most likely by right of purchase. But how did the first person come into exclusive control of that property? Obviously the land originally belonged to no one but was common to all. The philosopher of the new view of property was John Locke (1632-1704). He begins, as St. Thomas does, with a common view of

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172 Rogers, *Six Centuries of Work*, 343.

173 Ibid., 344.

174 Ibid., 389.

175 Trevelyan, *English Social History*, 232.

176 Rogers, *Six Centuries of Work*, 445.

177 Tawney, *Religion and the Rise of Capitalism*, 120.

property but moves to the question of how to take property out of its common use and put it in a purely private domain, free of any common responsibilities. His answer was to appeal to the "property" we all have in our own labor:

> Though the Earth and all inferior Creatures be common to all Men, yet every Man has a Property in his own Person. This no Body has any Right to but himself. The Labour of his Body, and the Work of his Hands, we may say, are properly his. Whatsoever then he removes out of the State that nature hath provided, and left it in, he have mixed his Labour with, and joyned to it something that is his own, and thereby makes it his Property.[178]

By working the land, then, one takes it out of "common" use and makes it private property. Moreover it becomes *radically* private, with no public obligations whatsoever; the obligations implied by St. Thomas's view of common use do not apply.[179] Finally, for Locke not only does one's personal labor entitle him to take land from the common domain, but the labor of any under one's control does as well. This means that ownership is now in principle infinite with no natural limitations whatsoever. For Thomas, private property was a conventional arrangement intended to further the common good; for Locke, the reverse is true: ownership is natural and any "communal" values were purely conventional, a matter of positive law; the connection to the common good disappears entirely and all values are purely individualistic. Note how well this accords with the new individualism that becomes the hallmark of the Enlightenment. Recall also how the Enlightenment fragmented human experience while reducing all values to the purely logical or psychological. Thus the communal and personal nature of property, connected to some degree in every civilization, is now fragmented, and the only values are the satisfaction of personal desires freely determined by the individual.

Property and Economics

Economic Rent

We have previously seen that while classical economics recognized that the income from land (rent) was different from the income from either labor or man-made capital, neoclassical theory attempted to treat all sources of income as springing from marginal utility. At equilibrium, this would drive all prices to costs and eliminate any economic profit. But this is simply not possible when it comes to property in land; land will always collect an economic rent. *Economic rent* is a payment to a factor of production or input in excess of that which is needed to keep it employed in its current use. Another way to think of economic rent is that it is collected on a fixed resource which is not consumed in the transaction. Neoclassicism claims, like all economic systems, to be able to eliminate economic rent, for the most part. When we are dealing with man-made capital items, this is likely true. If a maker of widgets is in a position to charge economic rent for his product, that is, when there are excess profits, other entrepreneurs will be attracted to the widget business, thereby raising the supply and lowering the price until the economic rent is eliminated. But land cannot be manufactured. It has neither production nor

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[178] Small, *The Social Economy of Land*, 149.

[179] Ibid.

depreciation costs, hence *all* payments for land will be in excess of its production and depreciation costs. If economic efficiency means paying no more for an asset that that which is required to keep it in production, then economic rent is the precise measure of economic inefficiency. Therefore, the question of economic efficiency cannot be addressed apart from the question of economic rent. We have just seen how the use of non-economic (customary) rents in medieval England caused an explosion of creativity and economic expansion. Later (chapter 14) we will see how the elimination of rents had similar effects in modern day Taiwan, Korea, and Japan.

Property ownership confers another advantage related to economic rent, that of the *unearned increment*. The price of raw land (not including the improvements to the land) is not determined by the land itself, but by what happens to the surrounding properties. Think about buying a plot of raw land in a sparsely populated area near a large city. As time goes on, there is a tendency for the population to expand and for development to find its way to the outlying areas. As the population increases and surrounding tracts get developed, the price of the land rises, and it does so without the owner having to do anything to the land whatsoever. This increase in value constitutes the unearned increment, an amount accruing to the land with no effort on the part of the owner.

Insofar as equilibrium depends on efficiency, land rents will constitute an irreducible element of inefficiency in the economy. The effects of this inefficiency will be vastly exaggerated by the concentration of land ownership. Societies that have a small landowning class will have high rates of poverty, unemployment, and underemployment, a fact that may be easily verified since there are, alas, many such economies both present and past. Further, what is true for land is also true for capital; the more it is concentrated in ownership, the more difficult will be the tasks of development, equity, and equilibrium. Thus to a large extent the distribution of incomes in a given society will be largely determined by the distribution of property. This fact has profound implications

The Mystification of Property

To most people, and to most ages, "property" refers to something physical in the real world. However, property no longer has this meaning within economics; it losses any purely physical properties to become a pure abstraction and, we might say, a purely mystical concept. Recall that J. B. Clark had drained capital of its actual content so that it became no more than "continuity of ownership," a kind of "transmigration";[180] ownership rather than use becomes the determining factor. As Hernando de Soto points out in *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, "capital" now becomes not a "thing," but a "representational system" where "we can disengage the resource from its burdensome material constraints."[181] A house, then, is not capital, but only the deed to the house, "an economic concept *about* the house, embodied in a legal representation."[182] In other words, property becomes a purely *cultural* construct

[180] Clark, *The Distribution of Wealth*, 120.

[181] Hernando De Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000), 49.

[182] Ibid., 50.

with a merely tenuous connection with reality; the "reality" becomes the deed, the actual house being no more than a footnote to the deed.

The cultural nature of "capital" becomes more evident when we see what happens when a capitalist system is suddenly imposed on pre-existing systems in both the so-called "third world" and the former communist countries. We tend to view these people as desperately poor because they have no capital. The poverty is indeed widespread, but so is their capital. As de Soto points out, not only do the poor save, but the value of their savings is immense— forty times all the foreign aid received throughout the world since 1945.[183] The poor have houses, land, machinery, farm implements, and other things commonly thought of as capital, but they do not have capital in the capitalistic sense. For example, in Peru, the value of extra-legally held real estate amounts to $74 billion, or five times the total valuation of the Lima Stock Exchange, 14 times the value of foreign investment, and 11 times the value of all government enterprises.[184] Yet, in order for a claim to land to be registered in Peru, 728 steps are required, a process beyond the means or patience of most of the peasant entrepreneurs.[185] Thus the "new" capitalistic system becomes a means of social control and exclusion.

Through most of the world, the "extra-legal" segment of the economy is as large or larger than the legal segment. The poor trade houses and land, have informal banking systems, produce goods on their farms or in their workshops, but are still not capitalists. Not for want of trying, but because of deliberate exclusion. More than anything, what separates the capitalist from the non-capitalist is not the actual existence of capital, but the social and cultural constructs that surround Western notions of capital and property.

A Question of Values

We have come to view all arguments about property as arguments between an absolute ownership as embodied in Capitalism or "public" ownership as embodied in Socialism. But the historical question is far more complex, always being some combination of the two. The particular combinations are not given by an abstract vision of economics, but by the vision the society has of the end and purpose of Man and society; it is in view of its final values that a society allocates the relative public and private values of land. R. H. Tawney put the case like this:

> [The Scholastics] while justifying [private property] on grounds of experience and expediency, insisted that its use was limited at every turn by the rights of the community and the obligations of charity... Society is a hierarchy of rights and duties. Law exists to enforce the second, as much as to protect the first. Property is not a mere aggregation of economic privileges, but a responsible office. Its *raison d'être* is not only income, but service. It is to secure its owner such means, and no more than such means, as may enable him to perform those duties.[186]

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183 Ibid., 5.

184 Ibid., 33-4.

185 Ibid., 191.

186 Tawney, *Religion and the Rise of Capitalism*, 127-8.

Thus we see in a highly communal society like the ancient Hebrews a communal view of land with ownership in the tribe and use in the family; moreover, it is a view of moral equality that lets the commoner stand his ground even against the king. For the Greeks, the ideal was an aristocratic one, where the private values are more emphasized, yet the communal values are present in the form of the support of the soldier and the advancement of commerce. For the people of the Middle Ages, there was "public" ownership with private use circumscribed by custom with a diffusion of rights and responsibilities throughout all levels of society. For our own age, the question of the relative merits have been fragmented into two opposing views, one that makes absolute either the individual values (Capitalism) or the communal values (Socialism). In actual practice, in both "Socialist" and "Capitalist" countries, this means a strong view of the "private" nature of property with the communal values recovered by taxation. All of these views were "economic," in the sense that they established viable and relatively stable economies that produced great wealth for their citizens.

Economics, then, emerges as a tool by which people and societies provide for their material needs within a certain moral framework. People, and societies, are *relatively* free to choose their own ends and to build the kinds of systems that support those goals. The answer is not given in advance by an abstract economics, but freely chosen and discovered through actual practice.

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