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REASSESSING THE POLITICAL ECONOMY OF JOHN STUART MILL

*In this month's Liberty Matters online discussion we reassess the economic ideas of **John Stuart Mill** as found in his classic work Principles of Political Economy (1st ed. 1848, 7th ed. 1871) and other writings. In the Lead Essay by Steven Kates of the Royal Melbourne Institute of Technology it is argued that in the light of the evident failures of Keynesian economics to solve the problems of the boom and bust cycle, and that of ongoing high unemployment and economic stagnation, that we should go back to Mill's "Four Propositions on Capital" for enlightenment. In Kates's view there is "more insight into the operation of an economy than any of the Samuelson clones that have been published to explain what Keynes meant in trying to raise aggregate demand." The commentators are Nick Capaldi, the Legendre-Soulé Distinguished Chair in Business Ethics at Loyola University New Orleans; Richard M. Ebeling, the BB&T Distinguished Professor of Ethics and Free Enterprise Leadership at The Citadel in Charleston, South Carolina; and Sandra J. Peart, who is dean of the Jepson School of Leadership Studies at the University of Richmond.*

THE BEST TEST OF A SOUND ECONOMIST

by Steven Kates

This is how the major "macroeconomic" questions were understood in the time of John Stuart Mill:

- Given the productiveness of the economy, the higher the real wage, the lower the number of persons employed.
- The higher the underlying productiveness of the economy, the higher will be the level of employment for any given real wage (which is saying the same thing in a different way).
- Recessions are caused by maladjustments in the structure of supply relative to the structure of demand.
- To end recessions, it is necessary to allow such maladjustments to work themselves through.
- Trying to engineer recovery by public spending would only make matters worse.

With the publication of John Maynard Keynes's *General Theory* in 1936, all of these basic notions of economic management disappeared. Today if you pick up an introductory text, or even higher level texts in macro, this is what you are almost certain to find:

- Economies are driven by aggregate demand, the total level of spending across an economy.
- The higher the level of aggregate demand, the higher the level of employment.
- Neither the real wage nor relative costs have any significant bearing on the unemployment rate.
- Recessions are caused by a fall in aggregate demand.
- To end recessions it is necessary to increase aggregate demand.

There are clearly a number of profound changes that have affected economic theory since the publication of *The General Theory*. Here we will dwell on only a fraction of these, but these are the most significant:

- Today we focus on short-run employment creation rather than long-run wealth creation as the central aim of economic policy. The causes of economic growth are at best an afterthought.

- We focus on the flow of *newly produced* goods and services through the market (GDP) because that is how jobs are supposedly created. We seldom look at the economy as a whole or its underlying structure.
- We use money amounts to express economic relationships rather than conceive the real economy as an inventory of productive inputs, where some of those inputs are directed towards current consumption while others are directed towards raising the level of production at some stage in the future.
- We seldom if ever think of both consumer demand and investment as a drawing down on the productiveness of the economy.
- Consumption, investment, and government spending are thought of as equally positive influences since all three refer to the level of demand. What the actual spending is on seems to make no difference.
- Saving and investment are almost invariably thought of in money terms, whereas in previous times savings were thought of as actual items of capital, labor time, or anything used to produce and earn income.

Only an increase in aggregate demand can raise the equilibrium level of GDP to its full employment level. Allowing the economy to languish without government action to raise demand would lead to large numbers of individuals remaining unemployed for a much longer period of time than need otherwise be the case. Most importantly, adjustments to the real wage, or relative prices generally, cannot be expected to permit more employees to be hired, since it is the level of demand in aggregate that determines the number of persons employed across the economy.

John Stuart Mill

John Stuart Mill on Employment

The Keynesian position, and therefore the position found across the whole of macroeconomics today, was seen by pre-Keynesian economists as a fallacy of the highest order. This is John Stuart Mill's Fourth Proposition on Capital as set forth in 1848:

> What supports and employs productive labour, is the capital expended in setting it to work, and not the demand of purchasers for the produce of the labour when completed. **Demand for commodities is not demand for labour.** (emphasis added) [1]

If he were writing today, his point would be that a demand-side stimulus could not possibly add to the number of jobs. One might take this as just another piece of ancient advice from some bygone economist. On the other hand, it has now been six years since the fiscal stimulus was applied and no economy which had been subjected to a genuine Keynesian stimulus has had a recovery worthy of the name, with employment growth generally dismal. If one were to decide whether Mill or Keynes were right based on the evidence, there ought to be no doubt by now that Mill was almost certainly right and Keynes was almost certainly wrong.

Mill's Fourth Proposition was also described in 1876 as "the best test of a sound economist" (by Leslie Stephen in *History of English Thought in the Eighteenth Century*).[2] You could tell the true economists from the ones who knew little of value about how an economy worked by whether they understood and accepted that demand for commodities is not demand for labor. In classical times, just about every macroeconomist today would have been described as a fraud.

I have just published this year an article on Mill's Fourth Proposition, which is the first time since 1876 that it has been explained in a natural and straightforward way. [3] Richard Ebeling cited Mill's Fourth Proposition and my work in his Liberty Fund discussion on Böhm-Bawerk in April.[4] Other than that, you would have to go back to 1876 to find anyone else citing Mill's Fourth Proposition as part of a straightforward explanation of how an economy works. Those who have tried to make sense of Mill's Fourth Proposition have included Alfred Marshall, F.M. Taussig, A.C. Pigou, Allyn Young, F.A. Hayek, J.M. Keynes, Harry Johnson and Sam Hollander.[5]

Eugen von Böhm-Bawerk

A Personal Explanation

I will here insert a personal note since I think it helps explain why I find myself in such a unique position, while also helping to see the point that Mill was getting at himself. Economics today has prefabricated answers to every question, whereas in Mill's time, each of these issues was being brought up for discussion almost for the first time. It was in just this situation I found myself at the start of the 1980s.

In 1980 I was appointed as the economist in the industrial relations division of the Confederation of Australian Industry, which was the national organization representing employers in Australia.[6] Part of my job was to write submissions to our National Wage Case, an annual review of wage rates, which is a much more comprehensive issue than just the minimum wage. The Wage Case begins with a claim by the union movement for an increase in wages of some amount, which is debated before a tribunal made up of half a dozen industrial judges.

My CEO, who had been dealing with these issues for many years, gave me a copy of W.E.G Salter's *Productivity and Technical Change* (1960) as the basis for our economic submission.[7] Salter argued that in looking at a national economy, as a very good first approximation, the level of employment is dependent on national productivity in relation to the real wage. To maintain low unemployment, it was necessary to contain the growth in the real wage to the real growth in labor productivity. I spent 24 years in a wage-case environment and over the years found that relationship confirmed in every imaginable circumstance, from double-digit inflation to periods of virtually no price movements at all, in bad times and in good.

And as part of those same wage cases, the unions would argue that it was necessary to raise wages in order to stimulate demand. I have seldom come across a more obviously threadbare argument. But it also turned out that the argument I developed to refute this union claim was the same argument Mill had developed to deny that spending would promote employment. It is this argument that is today referred to as Say's Law.

It was only then, towards the end of 1982, that I came across Mill's *Principles of Political Economy*, and in particular Mill's Four Propositions on Capital. There I discovered the Fourth Proposition, which was what I had been arguing in the wage case. Although it may not be clear as one might like, here is Mill saying what I had been saying.

"The more or less of the labour itself" is Mill's term for "unemployment," a term which in 1848 had not yet been invented:

> The demand for commodities determines in what particular branch of production the labour and capital shall be employed; it determines the *direction* of the labour; but not **the more or less of the labour itself**, or of the maintenance or payment of the labour. These depend on the amount of the capital, or other funds directly devoted to the sustenance and remuneration of labour.[8]

This is such a different way of looking at things from how we look at such issues today that for someone whose first approach to economic theory is via modern macroeconomics, the ability to see the point becomes almost impossible. "The more or less of labour" is, however, according to Mill, determined by the amount of capital available for productive activities (i.e. national productivity), as well as the share of the economy that can be used to maintain labor at its accustomed standard of life (the average real wage).

Making Sense of Mill

A classical economist thought of the entire economy as one vast store of wealth which could be used to produce for present enjoyment, while the remainder of that store of wealth was used to generate further wealth. A classical economist was continuously aware of this legacy. Nothing bought in the present was the instantaneous result of some immediate decision to buy, but was, instead, the final result of some massive process that went back in time, encompassing the entire array of labor and inputs that had been essential so that the good or service could become available to purchase.

A freshly baked loaf of bread may have come into existence on some particular day. But its coming into existence at that particular moment was the result of a combination of the work of the baker that morning; the milling, possibly months before, that has produced the flour; the farmers who had grown and harvested the grain possibly a year earlier; the various transport networks that had brought the inputs together to a particular place where they could be combined; the electricity-generating capacity of long standing that had been needed to mix the ingredients; and on and on. This vast capital structure, as well as the skilled labor that had first built the capital and was then capable of using it productively, was essential so that those final touches could be added at the bakery that morning.

Since the publication of *The General Theory*, almost none of this is brought into consideration in examining the way an economy works. Since job numbers are, according to Keynesian theory, related to the level of demand at the present moment, the interest is in the latest set of activities and not the density of the infrastructure that lies behind. The nature of the economy taken as a whole is virtually ignored. An economy with 10 percent growth is seen as in some sense "doing better" than an economy with 2 percent growth, since the larger the growth rate, the faster the growth in employment.

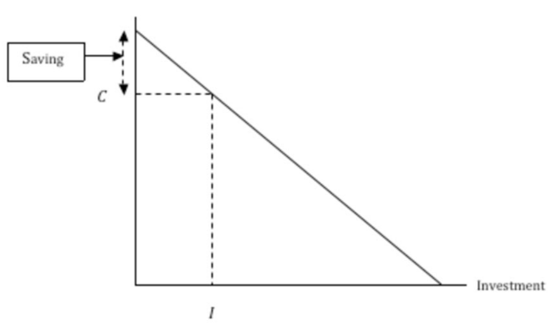
To help explain the classical position, examine the most primitive of all diagrams, the production possibility curve. A production possibility curve is usually presented at an early stage of an economics course. Typically, it picks two products and shows some kind of tradeoff between them, such as the guns and butter example used by Samuelson in his first edition .[9] The diagram is, however, more profound than it is usually taken to be since, if drawn appropriately and conceptualized properly, it allows one to understand more completely the point that classical economists tried to make.

The diagram, having become a staple in modern theory (cf. the first edition of Mankiw, who uses cars and computers),[10] has a presence that is unassailable for most attempts to reconstruct such an important element of classical theory, which was always by its very nature somewhat imprecise. Importantly, what has to be appreciated is that the two axes of a properly designed diagram must represent two forms of output whose production between them must exhaust the economy's entire ability to produce. Examples might include goods and services, or privately produced versus government-produced products.

It is also important to understand the conceptual difficulties in using this diagram, which is astonishingly abstract. The units on each axis are denominated in individual goods and services, which are the billions of items every modern economy is able to produce. Further, the diagrams cannot be drawn to scale given the relative magnitudes. The axes are denominated in the various forms of output that can be produced, while the interior of the curve is the entire economy from the smallest paper clip to the largest oil tanker. Absolutely nothing is denominated in money.

In the diagram below, the vertical axis shows forms of output whose production draws down on the resource base with no attempt made to replace what has been drawn down. These are described as forms of "consumption." Their production uses up resources, but what is produced is not intended to contribute to production at some future date. Resources are drawn down, products either consumed or services rendered, but the economy is now even less capable of producing for the future since resources have been used up while nothing has been created to replace what has been used up.

Production Possibility Curve – Consumption and Investment



The horizontal axis represents all forms of drawing down on the economy's resource base which are directed towards producing forms of output that will add onto the economy's productive base. These are referred to as "investment." These are forms of production intended to improve the economy's capital base or raise the skill levels of employees.

In the PPC shown, the concept is as it ought to be. Consumption and investment spending together totally exhaust the economy's potential. Either because of institutional limitations or because the economy cannot produce more than its potential, it is not possible to produce more than some combination on the curve itself.

To a classical economist, the issue was how to increase "the wealth of nations," that is, how to increase living standards. The answer would be that it was necessary to increase the area under the PPC by moving it up and to the right. The more capital there was, the more it might move, but even under the best of circumstances, it would move outward only very slowly. In bad times, there was nothing to stop it from moving inwards towards the origin.

The diagram also shows the conception related to saving and investment. Inside the PPC is everything within an economy that can be used to satisfy a human need, either directly, as with consumption goods such as a loaf of bread, or indirectly, such as with a ton of iron ore or a factory filled with tools and machines.

Some of what is found within an economy is used to produce consumer goods (such as bakers, flour and ovens) or already are consumer goods (the actual loaves of bread). And some of those resources are being used to produce capital goods that will eventually be used in the production process either to produce more capital or consumer goods.

The PPC diagram captures the meaning of saving and investment in classical times. An economy's infrastructure, which is an inheritance from the past, can either be used for immediate consumption or as inputs into future productive activities.

Saving, when understood as a proportion of the productive apparatus of the economy, is then exactly equal to the level of investment. That part of the entire productive apparatus of the economy that is not aimed toward improving the future productivity of the economy is used to provide consumer products in the present. Both, however, draw down on the productivity of the economy.

Understanding the Damage Keynesian Theory Has Caused

The damage that Keynesian theory has brought to economics has been overwhelmingly conceptual, but that is not in any way letting it off easy. The damage has occurred throughout the entire structure of how we think about the ways economies work and has therefore affected the policies we apply. The comparison with a Keynesian model can be shown by the different questions it asks and the way these questions are answered.

Adam Smith

The original Adam Smith question focused on how to raise our standard of living. We have now switched the focus from "the wealth of nations" to the "general theory of employment." It is jobs that are at the center of macroeconomics, using an association between production and employment that Mill and his contemporaries recognized as false.

Keynesian policies have been used on many occasions in many sets of circumstances in every part of the world, with the specific aim the reduction of unemployment and the restoration of growth. Such policies have always, and with no exception, failed.[11] We therefore have a division between the mainstream theories of two different eras: the economics of the middle part of the 19th century versus the economics that has predominated since 1936.

What cannot be argued is that Keynesian economics actually works in practice, since it never has. It is still possible to argue that Mill is also wrong, but at least with Mill, it is his economics that will tell you straight out that a Keynesian policy will fail. It is Mill who wrote that "demand for commodities is not demand for labour." It is Keynes who said that it is.

The following passage is taken directly from Keynes in the *The General Theory* and there has been no repudiation of this statement from his day to ours. It is, in fact, metaphorically speaking, the driving force behind every Keynesian stimulus that has ever been put in place.

> "To dig holes in the ground," paid for out of savings, will increase, not only employment, but the real national dividend of useful goods and services.[12]

This is Mill summing up his discussion on the possibility of demand deficiency as a cause of recession and unemployment.

> A theory so essentially self-contradictory cannot intrude itself without carrying confusion into the very heart of the subject, and making it impossible even to conceive with any distinctness many of the more complicated economical workings of society.[13]

We seem to have a completely false notion that economic theory moves only forward, that the latest is the best, and that past has been transcended. The reality is that the economics of Mill, even his 1848 first edition, will provide more insight into the operation of an economy than any of the Samuelson clones that have been published to explain what Keynes meant in trying to raise aggregate demand.

Endnotes

[1.] J.S. Mill, *Principles of Political Economy*. 7th ed. Edited by Ashley (1921), p. 79. The full passage reads: § 9. [Demand for commodities is not demand for labour] We now pass to a fourth fundamental theorem respecting

Capital, which is, perhaps, oftener overlooked or misconceived than even any of the foregoing. What supports and employs productive labour, is the capital expended in setting it to work, and not the demand of purchasers for the produce of the labour when completed. Demand for commodities is not demand for labour. The demand for commodities determines in what particular branch (of production the) labour and capital shall be employed; it determines the direction of the labour; but not the more or less of the labour itself, or of the maintenance or payment of the labour. (These depend) on the amount of the capital, or other funds directly devoted to the sustenance and remuneration of labour. </titles/102#Mill_0223-02_310>.

[2.] Sir Leslie Stephen, *History of English Thought in the Eighteenth Century*, Volume 2 (London: Smith, Elder, & Co., 1876), p. 297.

[3.] Kates, "Mill's Fourth Fundamental Proposition on Capital: A Paradox Explained." *Journal of the History of Economic Thought*, vol 37, 2015, 39-56.

[4.] Ebeling, Richard. 2015. "Assessing Böhm-Bawerk's Contribution to Economics after a Hundred Years" Liberty Fund, Liberty Matters online discussion (April 2015) </pages/lm-bawerk>.

[5.] As Richard Ebeling noted in his symposium on Böhm-Bawerk, while "there have been few thorough going defenders of Mill's four propositions in recent decades" (from the text), "the exception has been Steven Kates" (footnote 82).

[6.] The organization is now known as the Australian Chamber of Commerce and Industry, where I was the economist for 24 years, just as Ludwig von Mises was the economist for the Austrian Chamber of Commerce also for 24 years.

[7.] Salter, W.E.G. 1960. *Productivity and Technical Change*. University of Cambridge, Department of Applied Economics Monograph 6. Cambridge: Cambridge University Press.

[8.] J.S. Mill, *Principles of Political Economy*. 7th ed. Edited by Ashley (1921), p. 79.

[9.] Paul Samuelson in his first edition of *Economics: an Introductory Analysis* (1948), pp. 17-21.

[10.] Mankiw, *Principles of Economics* (2007), pp. 24-27.

[11.] Recovery does eventually happen, but the cycle has always been cyclical. No recovery has, however, been attributable to the Keynesian policies which had preceded the upturn, and indeed, most recoveries have been preceded by policies in which governments have attempted to bring their outlays into balance with their revenues.

[12.] Keynes, *The General Theory of Employment, Interest and Money* (1936, 1973, p. 220.

[13.] Mill, *Principles of Political Economy* (1871, 1921), p. 562. Online: </titles/243#Mill_0223-03_242>.

MILL, MACRO, POLITICAL ECONOMY, AND KEYNES

by Nicholas Capaldi

We are indebted to Kates's essay for a number of reasons: first, for calling attention to a long-neglected part of Mill's economics; second, for relating Mill to issues in contemporary macroeconomics; and third for reminding us how debate on those issues ultimately reflects fundamental philosophical disagreements in political economy.

Mill on Capital

In Book I, Chapter V, of the *Principles of Political Economy* Mill advances Four *Fundamental Propositions respecting Capital.*[14] The first proposition is that "industry is limited by capital" and therefore it is a *mistake* to believe "that laws and governments, without creating capital, could create industry." As an aside, this proposition alone should dispel the continuing misrepresentation of Mill as a socialist. Moreover,

> [t]here is not an opinion more general among mankind than this, that the unproductive expenditure of the rich is necessary to the employment of the poor. Before Adam Smith,

> the doctrine had hardly been questioned ... [namely, that] there would be no market for the commodities which the capital so created would produce. I conceive this to be one of the many errors arising in political economy…. [On the contrary] the limit of wealth is never deficiency of consumers, but of producers and productive power. Every addition to capital gives to labour either additional employment, or additional remuneration; enriches either the country, or the labouring class….
>
> A second fundamental theorem respecting Capital relates to the source from which it is derived. It is the result of saving [and hence] to increase capital there is another way besides consuming less, namely, to produce more.
>
> A third fundamental theorem respecting Capital … is, that although saved … it is nevertheless consumed…. To the vulgar, it is not at all apparent that what is saved is consumed. To them, everyone who saves, appears in the light of a person who hoards…. The person who expends his fortune in unproductive consumption, is looked upon as diffusing benefits all around; and is an object of so much favour, that some portion of the same popularity attaches even to him who spends what does not belong to him; who not only destroys his own capital, if he ever had any, but under pretence of borrowing, and on promise of repayment, possesses himself of capital belonging to others, and destroys that likewise.

This is a remarkably prescient condemnation of Keynesianism and sovereign debt.

> This popular error comes from attending to a small portion only of the consequences that flow from the saving or the spending; all the effects of either which are out of sight, being out of mind. The eye follows what is saved, into an imaginary strong-box, and there loses sight of it…. It is the invention of money which obscures, to an unpractised apprehension, the true character of these phenomena. Almost all expenditure being carried on by means of money, the money comes to be looked upon as the main feature in the transaction; and since that does not perish, but only changes hands, people overlook the destruction which takes place in the case of unproductive expenditure.… All the ordinary forms of language tend to disguise this…. Capital is kept in existence from age to age not by preservation, but by perpetual reproduction.

The fourth proposition, with due attribution to Say and Ricardo, is the one to which Kates refers. What "supports and employs productive labour, is the capital expended in setting it to work, and not the demand of purchasers for the produce of the labour when completed. Demand for commodities is not demand for labour. Demand for labor [job creation] depends upon "the amount of the capital, or other funds directly devoted to the sustenance of labour." We cannot increase demand – all we can do is shift resources from a to b. Mill observes as well that the same bad argument is used to justify welfare systems and graduated tax structures. More importantly, by ignoring the importance of wealth creation we injure the long-term well-being of everyone but most especially the poor.

Jean-Baptiste Say

Kates and Macroeconomics

As Kates observes, the transition from neoclassical economics as represented by such writers as Mill to contemporary Keynesian and neo-Keynesian macroeconomics is fundamentally a shift in focus from long-run wealth creation as the central aim of economic policy to short-run employment creation. The causes of economic growth are at best an afterthought. The shift in focus leads one to believe that recessions are caused by a fall in aggregate demand, and to end recessions it is necessary to increase aggregate demand.

Not only is Kates correct about this, but his way of putting it transcends the analogous contemporary debate between supply-side economics and demand-side economics, where the latter is technically speaking a form of Keynesianism. Classical economists opposed taxation as a form of theft (redistribution) but primarily because it undermined production. Contemporary demand-side economists agree with this but also make the claim that lower taxes (or manipulating the tax rate) will both help laborers and increase government revenue. In short, supply-siders, as I understand them, are also advocating government manipulation of the market.

Production (supply) is the key to economic prosperity. Consumption (demand) is a consequence. This is what Say's Law, as Mill pointed out, tells us: "A product is no sooner created, than it, from that instant, affords a market for other products to the full extent of its own value." In short, supply creates its own demand.[15]

However, what has happened, I suggest, is that democracy (politics) has so intruded upon economics, something that both Tocqueville and Mill warned about, that all political parties now feel called upon to advocate different but varying governmental programs to enhance a universal growth in prosperity. It no longer matters whether these programs succeed or fail. (There is endless debate on this that provides perpetual employment for many economists engaged in fantasy counterfactual history.) What seems to matter is the marketing of these proposals within the election cycle.

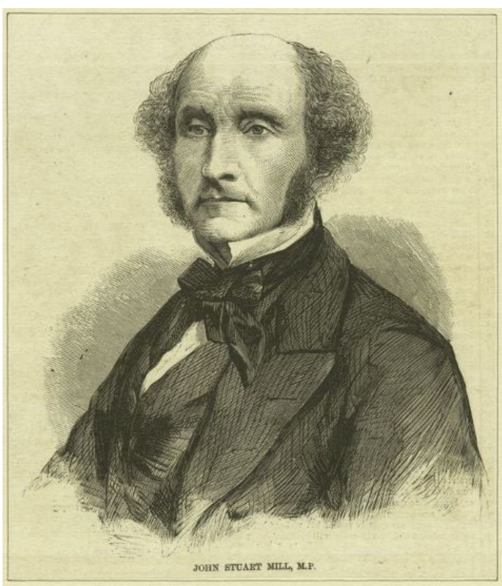
Alexis de Tocqueville

I am persuaded by Hayek that there is no such thing as market equilibrium if by that is meant a teleological endpoint or direction of economic activity. The market is neither a mechanism nor an organic entity (although it does bite back in the form of unintended consequences) but an unpredictable historically evolving entity. All attempts at manipulation reflect intellectual arrogance.

Mill and Political Economy

In general, Mill agrees with this. Even when Mill turns his attention to the distribution issue (social question) he never loses sight of the fact that changes in distribution affect productivity. Distribution, in his time, as Mill noted, was a product of historical accident not just market forces. It seems clear that distribution is always going to be to some extent a result of historical accident. Inequality never disappears, but the real issue is not equality but the potential for growth.

Curiously, Mill saw two social obstacles to growth: an “undeserving” rich and an “undeserving” poor. In Mill’s time, and it has been argued by no less a person than Keith Joseph even down to Thatcher, Great Britain seemed to be ruled by a primarily landed gentry rather than an entrepreneurial class. Although Mill was sympathetic to the laboring class, he had no illusions about their dysfunction – there was no romanticization of the laborers. Mill attacked the presumption that anyone should "rivet firmly in the minds of the labouring people the persuasion that it is the business of others to take care of their condition, without any self-control on their own part; [and] that whatever is possessed by other people, more than they possess, is a wrong to them, or at least a kind of stewardship, of which an account is to be rendered to them."[16] Mill opposed the elimination of private property, the elimination of competition, central planning, and even a worker's party. He most especially opposed a ruling class of technocrats as had been suggested by Saint-Simon and by arch-enemy Comte. Mill could imagine a world in which the dreaded classical economic stationary state would be palatable, but he never advocated a limit to further economic growth. "We cannot … foresee to what extent the modes of production may be altered, or the productiveness of labour increased, by future extensions of our knowledge of the laws of nature, suggesting new processes of industry of which we have at present no conception."[17]



John Stuart Mill

When Mill addressed the problem of distribution, he (a) advocated market solutions for the laborers in the form of competing worker cooperatives; (b) with regard to the taxation of wealth, Mill opposed a graduated income tax and advocated a flat tax -- otherwise we penalize thrift. He advocated a tax on inheritance, and although one could argue this was misguided, he did so in order to undermine large feudal estates but not large productive private industrial enterprises, primarily to encourage autonomy not equality; not to penalize the creation of wealth but to encourage a creative culture as opposed to a "rentier" culture. Even with the inheritance tax, a wealthy estate could avoid death duties by distributing the inheritance widely – thereby thwarting state confiscation of wealth.

Endnotes

[14.] Mill lays out his "Four Fundamental Propositions" at the beginning of Book I. Chap. V. "Fundamental Propositions Respecting Capital" in *The Collected Works of John Stuart Mill, Volume II - The Principles of Political Economy with Some of Their Applications to Social Philosophy (Books I-II)*, ed. John M. Robson, introduction by V.W. Bladen (Toronto: University of Toronto Press, London: Routledge and Kegan Paul, 1965). </titles/102#lf0223-02_label_787>.

[15.] See the Wikipedia articles:

- Production <https://en.wikipedia.org/wiki/Economic_production>;
- Supply <https://en.wikipedia.org/wiki/Supply_(economics)> ;
- Consumption <https://en.wikipedia.org/wiki/Consumption_(economics)>;
- Demand <https://en.wikipedia.org/wiki/Demand>;
- Say's Law <https://en.wikipedia.org/wiki/Say%27s_Law>.

[16.] From Letter 443. TO MACVEY NAPIER, 9th November 1844, in John Stuart Mill, *The Collected Works of John Stuart Mill, Volume XIII - The Earlier Letters of John Stuart Mill 1812-1848 Part II*, ed. Francis E. Mineka, Introduction by F.A. Hayek (Toronto: University of

Toronto Press, London: Routledge and Kegan Paul, 1963). </titles/250#lf0223-13_head_223>.

[17.] From BOOK II: DISTRIBUTION. CHAPTER I: Of Property, in John Stuart Mill, *The Collected Works of John Stuart Mill, Volume II - The Principles of Political Economy with Some of Their Applications to Social Philosophy (Books I-II)*, ed. John M. Robson, introduction by V.W. Bladen (Toronto: University of Toronto Press, London: Routledge and Kegan Paul, 1965). </titles/102#lf0223-02_label_1328>.

JOHN STUART MILL AND SAY'S "LAW OF MARKETS"

by Richard M. Ebeling

Steven Kates has been one of the leading and clearest expositors and defenders of the "classical economists" on the nature and interrelationships among savings, investment, employment, and growth.

And his most recent contributions on John Stuart Mill's "fourth fundamental proposition" on capital is no exception,[18] as so neatly shown in his opening essay to this "Liberty Matters" discussion focusing on "The Best Test of an Economist" being the understanding that a "demand for commodities is not a demand for labor."

Mill's contribution is no less important in relation to a proper understanding of Jean-Baptiste Say's "Law of Markets," especially as found in his restatement of Say's proposition, in his essay, "Of the Influence of Consumption on Production."[19]

The essence of Say's Law is that if we do not first produce we cannot consume; unless we first supply we cannot demand. In a system of division of labor in which we do not self-sufficiently produce all that we want through our own labor, we must successfully devote our energies to producing what others will take in trade from us in exchange for what we desire to acquire from them.[20]

Price Changes and Market Adjustment

But how much others are willing to take of our supply is dependent on the price at which we offer it to them. The higher we price our commodity, other things held equal, the less of it others will be willing to buy. The less we sell, the smaller the money income we earn; and the smaller the money income we earn, the smaller our financial means to demand and purchase what others offer for sale. Thus, if we want to sell all that we choose to produce we must price it correctly, that is, at a price sufficiently low that all we offer is cleared off the market by demanders. Pricing our goods or labor services too high, given other people's demands for them, will leave part of the supply of the good unsold and part of the labor services offered unemployed.

On the other hand, lowering the price at which we are willing to sell our commodity or services will, other things held equal, create a greater willingness on the part of others to buy more of our commodity or hire more of our labor services. By selling more, our money income can increase; and by increasing our money income, through correctly pricing our commodity or labor services, we increase our ability to demand what others have for sale.

Sometimes, admittedly, even lowering our price may not generate a large enough increase in the quantity demanded by others for our income to go up. Lowering the price may, in fact, result in our revenue or income going down. But this, too, is a law of the market: what we chose to supply is worth no more than what consumers are willing to pay for it.

This is the market's way of telling us that the commodity or particular labor skills we are offering are not in very great demand. It is the market's way of telling us that consumers value others things more highly. It is the market's way of telling us that the particular niche we have chosen in the division of labor is one in which our productive abilities or labor services are not worth as much as we had hoped. It is the market's way of telling us that we need to move our productive activities into other directions, where consumer demand is greater and our productive abilities may be valued more highly.

Can it happen that consumers may not spend all they have earned? Can it be the case that some of the money earned will be "hoarded," so there will be no greater demand for other goods, and hence no alternative line of production in which we might find remunerative employment? Would this be a case in which "aggregate demand" for goods in general would not be sufficient to buy all of the "aggregate supply" of goods and labor services offered?

The Demand for Money and the Fallacy of General Gluts

John Stuart Mill had already suggested the answers in his restatement and refinement of Say's Law of Markets. In his essay, "Of the Influence of Consumption on Production," Mill argued that as long as there are ends or wants that have not yet been satisfied, there is more work to be done. As long as producers adjust their supplies to reflect the actual demand for the particular goods that consumers wish to purchase, and as long as they price their supplies at prices consumers are willing to pay, there need be no unemployment of resources or labor. Thus, there can never be an excess supply of all things relative to the total demand for all things.

Mill emphasized that the introduction of money into the exchange process broke part of the immediate link between a decision to sell and a willingness to buy.

> Interchange by means of money is therefore, as has been observed, ultimately nothing but barter. But there is this difference – that in the case of barter, the selling and the buying are simultaneously confounded in one operation; you sell what you have, and buy what you want, by one indivisible act, and you cannot do one without doing the other.
>
> Now the effect of the employment of money, and even the utility of it, is that it enables this one act of interchange to be divided into two separate acts or operations; one of which may be performed now, and the other a year hence, or whenever it shall be most convenient. Although he who sells, really sells only to buy, he needs not buy at the same moment when he sells; and he does not therefore necessarily add to the immediate demand for one commodity when he adds to the supply of another."[21]

But Mill admits that there may be times when individuals, for various reasons, may choose to "hoard," or leave unspent in their cash holding, a greater proportion of their money income than is their usual practice. In this case, Mill argued, what is "called a general superabundance" of all goods is in reality "a superabundance of all commodities relative to money." In other words, if we accept that money, too, is a commodity like all other goods on the market for which there is a supply and demand, then there can appear a situation in which the demand to hold money increases relative to the demand for all the other things that money could buy. This means that all other goods are now in relative oversupply in comparison to that greater demand to hold money.[22]

To bring those other goods offered on the market into balance with the lower demands for them (i.e., given that increased demand to hold money and the decreased demand for other things), the prices of many of those other goods may have to decrease. Prices in general, in other words, must go down, until that point at which all the supplies of goods and labor services people wish to sell find buyers willing to purchase them. Sufficient flexibility and adjustability in prices to the actual demands for things on the market always assure that all those willing to sell and desiring to be employed can find work. This, also, is a law of the market.

When were these episodes of abnormal demands to hold larger than usual money balances likely to occur? Mill saw them in unsustainable periods "caused by speculation or by the currency,"[23] that is, following a time of inflationary monetary mismanagement. The task of sound economic policy, therefore, was to maintain a stable currency and a secure system of property rights.

Left to itself, the market process and necessary entrepreneurial adjustments in the face of uncertain change assured what today is called "full employment" and sustainable growth.

Endnotes

[18.] Steven Kates, "Mill's Fourth Fundamental Proposition on Capital: A Paradox Explained," *Journal of the History of Economic Thought*, Vol. 37, (2015), pp. 39-56.

[19.] John Stuart Mill, "Of the Influence of Consumption on Production," in *Essays on Some Unsettled Questions in Political Economy* (Clifton, NJ: Augustus M. Kelley [1844] 1974), pp. 47-74; Mill's discussion of Say's Law in his *Principles of Political Economy, with Some of Their Applications to Social Philosophy* (Fairfield, NJ: Augustus M. Kelley, [1871] 1976), pp. 556-63, while complementary to his earlier essay of 1844 is less clear on the nature and dynamics of money demand relative to the demand for other nonmonetary commodities as whole. Online version: </titles/244#lf0223-04_head_059>.

[20.] The most thorough explanation of the meaning and logic of Say's Law of Markets, as well as a critique of Keynes' misunderstanding and misinterpretation, is to be found in Steven Kates, *Say's Law and the Keynesian Revolution: How Macroeconomic Theory Lost Its Way* (Northampton, MA: Edward Elgar, 1998).

[21.] Mill, "On the Influence of Consumption on Production," p. 70.

[22.] Ibid., pp. 71-72.

[23.] Ibid., p. 67.

J. S. MILL AND THE TRANSITION TO MODERN ECONOMICS

by Sandra J. Peart

Steve Kates's provocative essay asks us to think about what we have lost in the transition to 20th century – or more specifically, Keynesian-style – economic analysis. His reference point, and mine, is the economics of John Stuart Mill. Accordingly, in what follows I shall describe a number of instances in which economists have moved from nuanced to overly simplified analyses, with less than stellar results. While Kates focuses on the macroeconomy, my essay will draw heavily on Mill's notion of individual behavior. The two are not entirely independent. Once we appreciate the institutional framing that is so important to Mill's work, we can better appreciate the cyclical adjustment mechanisms Kates discusses in his essay.

Let us first consider what sort of individual populates Mill's analysis. The policy implications of this will become immediately apparent: if the individual or groups of individuals are incapable, then policy at the macro level needs to account for this, to prod or stir people to the proper sort of economic activity. Quite the opposite, in Mill's view. His *Principles of Political Economy* made clear in every edition beginning with his first in 1848 that subject to rich education and information contexts, all people are capable of making economic and political choices. In his time a key question was whether Ireland was doomed to economic stagnation because the people there would never work hard or become productive; Mill rejected inherent racial, national, or ethnic "explanations" of outcomes specifically with reference to the Irish. He attacked statements that relied on "natural differences" in the course of discussing the impact of property rights on incentives in Ireland:

> Is it not, then, a bitter satire on the mode in which opinions are formed … to find public instructors of the greatest pretensions, imputing the backwardness of Irish industry, and the want of energy of the Irish people in improving their condition, to a peculiar indolence and insouciance in the Celtic race? Of all vulgar modes of escaping from the consideration of the effect of social and moral influences on the human mind, the most vulgar is that of attributing the diversities of conduct and character to inherent natural differences. [1848, p. 319].[24]

Later, W. R. Greg criticized Mill's position in the *Quarterly Review*; in Greg's view, the problem was an inherent inferiority that newly established property rights would fail to correct:

> "Make them peasant-proprietors," says Mr. Mill. But Mr. Mill forgets that, till you change the character of the Irish cottier, peasant-proprietorship would work no miracles.... Mr. Mill never deigns to consider that an Irishman is an Irishman, and not an average human being — an idiomatic and idiosyncratic, not an abstract, man. [Greg 1869, p. 78].[25]

Additional evidence of Mill's position as it relates to the rights of all people consists in his response to the controversy sparked by an administrative massacre in Jamaica. Shortly after, Mill was chosen to head the investigation into the violence, and his views on natural differences came to the attention of the founders of the new discipline of anthropology. The controversy then moved from the Irish to Africans.[26]

Harriet Taylor Mill

There is, in addition, Mill's position as it relates to women. Here again we find Mill articulating a clear position that institutional arrangements, rather than natural inferiority, had destined women to inferior outcomes, poverty, and dependence. Change institutions, he wrote, and women would advance to much different and superior outcomes. This position is sometimes attributed to the influence of his longtime friend and coauthor, Harriet Taylor, whom Mill married in 1851. There is, however, textual evidence that Mill came to this view before he and Taylor began their collaboration. Mill's early manuscript on the subject -- reprinted in full as chapter three of *Hayek on Mill: The Mill-Taylor Friendship and Related Writings*[27] -- confirms what Mill claimed in his *Autobiography*, that it was "so far from being the fact" that his views on the equality of the sexes were in any way influenced by Harriet Taylor.[28] On the contrary, Mill believed that his views on the subject attracted Harriet to him: "those convictions were among the earliest results of the application of my mind to political subjects, and the strength with which I held them was, I believe, more than anything else, the originating cause of the interest she felt for me."[29] Decades before Mill and Taylor worked on *The Subjection of Women*, Mill maintained that education was the means by which women would achieve independence:

> It is not law, but education and custom which make the difference [between men and women]. Women are so brought up, as not to be able to subsist in the mere physical sense, without a man to keep them: they are so brought up as not to be able to protect themselves against injury or insult, without some man on whom they have a special claim, to protect them: they are so brought up, as to have no vocation or useful office to fulfil in the world, remaining single; for all women who are educated [for anything except to *get* married, are educated] to *be* married, and what little they are taught deserving the name useful, is chiefly what in the ordinary course of things will not come into actual use, unless nor until they are married.[30]

The question of "what woman ought to be"[31] would be greatly altered by institutional change, including access to education and property. Mill's radical egalitarianism prevailed: "If nature has not made men and women unequal, still less ought the law to make them so."[32]

The foregoing suggests that amongst the "what was lost" category Kates's has so aptly put together for readers of these essays, one must also include something akin to institutions, the rules by which we govern ourselves and which constrain and influence our economic and other choices. Indeed, Kates's focus on the Production Possibility Curve drives home this point. As he writes, the PPC is "astonishingly abstract" and "profound." Absolutely. As economists in the 20th century collapsed the economic possibilities confronting a collectivity into a two-dimensional diagram, they removed from consideration much of the institutional structure that so preoccupied Mill and his fellow travelers, Adam Smith, James Mill, and T. R. Malthus. In so doing they allowed themselves to neglect the principle that rules governing economic and social activity also affect well-being and economic growth. They abstracted from the overarching institutional questions that preoccupied Mill and began instead to pursue only efficiency. To a large degree they neglected the idea that institutional arrangements affect where an economy locates relative to the abstraction of the production possibilities frontier. As they followed the logic of choice, they confidently predicted year after year and in spite of countervailing evidence that, because it was investing more and consuming less, the Soviet economy must be growing faster than and would soon overtake that of the United States.[33]

Adding institutions into the mix, one is led to the key set of debates in the 19th century concerning population growth and well-being. Not surprisingly, Mill was much preoccupied with population growth, first as it was greatly affected, in his view, by marriage arrangements and the ability of women to leave an ill-conceived marriage with property intact. In addition to his position on this question, for which Mill was sometimes harshly criticized (see the image below), the key question was what sorts of institutional arrangements – private versus communal property – would induce and enable the laboring classes to restrict their family size and thereby reduce human misery and want.

"Miss Mill joins the ladies"
Judy, 25 November, 1868, pp. 46-7

Mill closely examined the different distributional systems proposed by the Saint-Simonians and Charles Fourier. In his view, the current state of human nature and the consequent improbability of limiting population growth presented a key stumbling block to socialist schemes. In a market economy, where the cost of children was borne by parents, the material inducements to limiting numbers were strong. Under communism and the social arrangements advocated by Fourier and the Saint-Simonians, Mill believed these inducements would be much weakened. He concluded in favor of small-scale and voluntary experimentation – experiments, he wrote, that were "capable of being tried on a moderate scale":

> It is for experience to determine how far or how soon any one or more of the possible systems of community of property will be fitted to substitute itself for the "organization of industry" based on private ownership of land and capital. In the meantime we may, without attempting to limit the ultimate capabilities of human nature, affirm, that the political economist, for a considerable time to come, will be chiefly concerned with the conditions of existence and progress belonging to a society founded on private property and individual competition.[34]

In the event that private property persisted, Mill called for institutional changes, some rather vast (property rights extending to women) and some less so but nonetheless significant (restrictions on the amount one might inherit), alongside education to afford to all the means by which one might successfully exercise individual agency.

How do these remarks on Mill's economics relate to the statement about the demand for labour on which Steve Kates has focused? For Mill, any analysis of economic growth must be situated in the context of the institutional setting: the rate of growth of the demand for labor is determined in part by the rules and institutions that influence expected rates of return on any investment. For Mill, too, any attempt to solve a problem, such as the impoverishment of women or the Irish that fails to change the institutional setting, will be doomed to fail.

Endnotes

[24.] John Stuart Mill, *The Collected Works of John Stuart Mill,* Volume II - *The Principles of Political Economy with Some of Their Applications to Social Philosophy* (Books I-II), ed. John M. Robson, introduction by V.W. Bladen (Toronto: University of Toronto Press; London: Routledge and Kegan Paul, 1965).

[25.] Readers of the Econlib columns that David Levy and I have written will recall that Mill collided with the historian Thomas Carlyle over the issue of race; see Levy and Peart 2001, for a full account: http://www.econlib.org/library/Columns/LevyPeartdismal.html. On the administrative massacre in Jamaica see, <http://www.econlib.org/library/Columns/LevyPeartdismal3.html>.

[26.] For more detail, see Levy and Peart 2005, pp. 174-79.

[27.]*Hayek on Mill: The Mill-Taylor Friendship and Related Writings*, edited by Sandra J. Peart. Volume 16 of *The Collected Works of F. A. Hayek*, Bruce J. Caldwell, General Editor (Chicago: University of Chicago Press, 2015).

[28.] John Stuart Mill, *The Collected Works of John Stuart Mill,* Volume I – *Autobiography and Literary Essays [1824]*, ed. John M. Robson and Jack Stillinger, introduction by Lord Robbins (Toronto: University of Toronto Press, London: Routledge and Kegan Paul, 1981), p. 253. The correspondence between Harriet Taylor and Mill demonstrates that they agreed on these issues; in 1848 Taylor wrote to their friend and colleague, the editor of the *Monthly Repository,* W. J. Fox, that the "women question" was more significant than the "labour question" as it "goes deeper into the mental and moral characteristics of the race than the other & it is *the race* for which I am interested" (to W. J. Fox, 12 May 1848, *Hayek on Mill*, p.120).

[29.] Mill, *Autobiography*, p. 253.

[30.]*Hayek on Mill*, p. 62; on Harriet's influence on J. S. Mill, see the discussion in my editor's introduction to the volume, pp. xxxv-vi.

[31.] Ibid., p. 62.

[32.] [9] Ibid.

[33.] For a full account, see David M. Levy and Sandra J. Peart, "Soviet Growth and American Textbooks: An Endogenous Past." http://www.sciencedirect.com/science/article/pii/S0167268111000114

[34.] Mill, *Political* Economy, pp. 213-14.

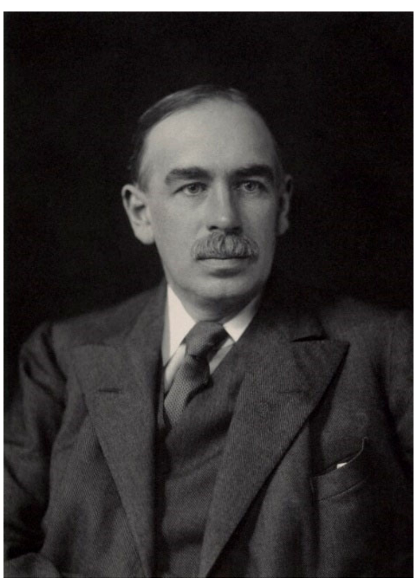
FIRST RESPONSE TO COMMENTS

by Steven Kates

I am genuinely grateful for the kind and generous comments that I have received from three of the most eminent scholars in the world on John Stuart Mill. We obviously cannot agree on everything, but we are certainly seeing the world in a very similar way. I would therefore like to extend their thoughts in a number of directions, recognizing that not everyone will agree with me here. But agree with me or not, these are what I think are the main issues.

The first for me is to note that Say's Law is the central economic issue of our time. Prior to the publication of *The General Theory*, every economist agreed with Mill that demand deficiency was never the cause of recession. They also all perfectly well understood that recessions were all too frequent and led to high rates of involuntary unemployment. What Say's Law said to them was never to think that the cause of recession could be found in too little spending or in oversaving. Such beliefs were the province of cranks. No one who had understood the nature of economies or how they worked would ever have believed such a thing. Modern macroeconomics is a classical economic fallacy.

This issue cannot be emphasized enough. There will, no doubt, be many who read these words and either disagree because they follow Keynes in believing an economy can enter recession because there is too little demand. Or there will be those who, even if they do agree that demand deficiency does not cause recessions, fail to see the significance for policy in the denial of variations in demand as the cause of variations in the level of activity. There are even those who, incredibly, cannot even understand that there are other reasons that an economy might go into recession that have absolutely nothing to do with variations in the level of aggregate demand.



John Maynard Keynes

The global financial crisis was not caused by a fall-off in demand, nor for that matter has any other recession at any time in history been caused that way. It was indeed a global crisis, but only in the United States was the cause domestic. It was only in the United States that the distortions that had been fed into the housing market by a series of government decisions overflowed into massive mortgage failures and a seizing up of credit. This was clearly unrelated to a Keynesian version of events where individuals chose not to spend but to save instead, so that the economy slowed with consequent multiplier effects.

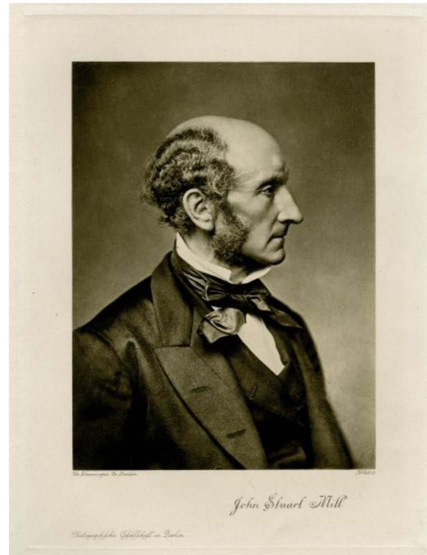
But even more so than in the United States is it impossible to blame the downturn on higher saving and a fall in demand. There could have been no domestic policy anywhere so perfect that their economy would not have been disrupted by the sudden freezing of credit on a global scale. If you lived in Asia or Europe, it is impossible to think of the cause of the recession and the rise in unemployment in any Keynesian way. Yes, certainly, one can say that once the problems had occurred, there was falling demand, but that is what all recessions look like. But to mistake the symptoms for the cause, and then treat the symptoms and not the cause, is a massive failure in policy.

The world's economies are not suffering from the effects of a fall in demand. They are suffering from the effects of the spending policies Keynesian theory tells governments to pursue if economies enter recession. It is debt and deficits that are the problem, not a financial system that is refusing to provide business credit. In fact, it is more than just the debt and deficits, but the entire structure of production of our economies, which have been badly distorted by government spending. Our entire supply chain - something never examined in a Keynesian model - is badly out of alignment with the demand for not just final goods and services, but throughout the entire economy, as one supplier after another, whose businesses had been "stimulated" by public spending, finds its sales are insufficient to maintain their current level of production.

This is what every economist before Keynes understood. Since demand deficiency is not the cause of recession, but only its symptom, then an economy cannot be resurrected from the demand side. They would all have understood that the stimulus could not possibly have worked to bring recovery and a return to full employment. Certainly there has been no recovery in any but a perfunctory sense, and there has not been a return to full employment anywhere. What is still hard for many to appreciate is that the nonrecovery was fully foreseeable using classical theory.

The second thing I wish to emphasize is that Mill's best and most complete discussion of Say's Law is found in his *Principles*. Mill's essay "Of the Influence of Production on Consumption" is only a partial statement. The full statement of his views are scattered over many parts of his *Principles,* found in specific chapters in Book I, Book II, and Book IV.[35] In particular, I am grateful to Professors Ebeling and Capaldi for drawing attention to Mill's Four Propositions on Capital, and in particular, the fourth, which is the categorical denial of all modern macro. Mill wrote: "demand for commodities is not demand for labour." What Mill and virtually all economists prior to Keynes understood, because of the way they approached the operation of an economy, was this: an increase in aggregate demand will not lead to an increase in total employment.

Nicholas Capaldi has provided Mill's four propositions from Book I, Chapter 5. The last proposition, at the time Mill wrote, needed virtually no emphasis to an economically literate audience of his time. Writing in 1848, Mill and his countrymen had just been through the first attempt to institute a Keynesian solution based on a prototype Keynesian theory that had been devised by Robert Malthus. Malthus had argued, publishing his own *Principles* in 1820,[36] in exactly the same way that Keynes would do, that recessions are caused by demand deficiency. This set off what is known as "the general glut debate," a glut being the term they would use for what we call excess supply. Everyone agreed you could have a particular glut, excess supply of some particular good or service. But they also agreed that there could not be a *general* glut, an excess supply of everything. It was not until the publication of *The General Theory* that this settled conclusion would be overturned. When Mill writes that demand for commodities is not demand for labour, he is stating what everyone by then had concluded to be absolutely valid.



John Stuart Mill

But let me take you to the second of Mill's propositions, which is now almost never mentioned within macroeconomics. It is that saving is what drives investment and growth. The more savings an economy generates, the faster it will grow. Modern macro has concluded that the largest problem during recessions is that we are saving too much. No economist is taught that the problem might be that our savings are being directed into non-value-adding areas of production. They are taught that there is too much saving going on and the imperative is for governments to blow away those excess savings on anything at all. It doesn't matter what, really. Productive is better, they say. But the need is to burn off those savings, which is why we end up with government-driven waste as the answer to a downturn.

No pre-Keynesian economist would have been so ignorant of the way in which an economy worked to have believed any such thing. It ought to be obvious nonsense that such an approach can lead only to the very kinds of problems we have today: slow growth, stagnant real incomes, and high unemployment. What a classical economist would have understood more than anything else was that burning away our saving in the way we have will leave us much less well off than we might otherwise have been.

These are technical issues that are no longer addressed by economists. Instead, those who think Say's Law is valid and crucial are treated as if they do not care about the unemployed or the poverty that recessions and slow growth cause. In actual fact, it is the Keynesians who are blind to the realities of the market and the way in which economies work. It is they whose policies are now a blight in every economy in the world. It is our mainstream Keynesian macro, which tells governments that more of this G spending will hasten recovery and lower unemployment, that is ruining lives.

Mill is almost impossible to read today because his economic presuppositions are so different from our own. But his economics is the economics that may still be found in the classical theory of the cycle, which disappeared in 1936. But it is to this economics that we must return - summarized conveniently in Haberler's *Prosperity and Depression*,[37] published the year after *The General Theory*. We can go on as we are, ruining our economies with Keynesian fallacies, or we can return to the classical theory of the cycle. You cannot prevent recessions from happening from time to time, but at least in this way we will know what to do whenever they arrive.

Endnotes

[35.] [The specific chapters in Book I, Book II, and Book IV will be cited later.]

[36.] See, Thomas Robert Malthus, *An Essay on the Principle of Population, or a View of its Past and Present Effects on Human Happiness; with an Inquiry into our Prospects respecting the Future Removal or Mitigation of the Evils which it Occasions* (London: John Murray 1826). 6th ed. 2 vols. </titles/1944>.

[37.] Gottfried Haberler, *Prosperity and Depression: A Theoretical Analysis of Cyclical Movements. Third Edition enlarged by Part III* (Lake Success, New York: United Nations, 1946). 1st ed. 1937. reprint of 1943 ed. Available online at the Mises Institute <https://mises.org/system/tdf/Prosperity%20and%20Depression_5.pdf?file=1&type=document>.

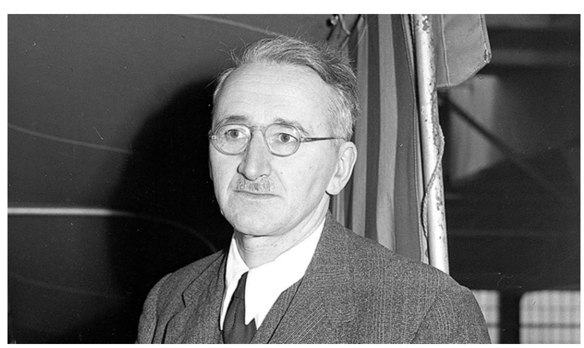
JOHN STUART MILL AND THE DANGERS FROM UNRESTRAINED GOVERNMENT. PART I

by Richard M. Ebeling

John Stuart Mill is notorious among classical liberals for his insistence in his *Principles of Political Economy* that while,

> "The laws and conditions of the Production of wealth partake of the character of physical truths" with "nothing optional or arbitrary in them . . . It is not so with the Distribution of wealth. That is a matter of human institution solely. The things once there, mankind, individually or collectively, can do with them as they like. They can place them at the disposal of whomsoever they please, and on whatever terms . . . The rules by which it is determined are what the opinions and feelings of the ruling portion of the community make them, and are very different in different ages and countries; and might be still more different if mankind so chose."[38]

Due to Mill's reasoning in support of this dichotomy between the laws of production and distribution, and his attempts to suggest that human nature toward work and collective effort might change in the future, Austrian economist, F. A. Hayek argued that Mill's "advocacy of distributive justice and a general sympathetic attitude towards socialist aspirations in some of his other writings, prepared the gradual transition of a large part of the liberal intellectuals to a moderate socialism."[39]



Friedrich von Hayek

And it is certainly the case that from the modern classical liberal/libertarian perspective, Mill's assertions and claims seem both conceptually unconvincing and experientially unfounded.[40]

In his *Principles*, Mill argued the case for numerous exceptions to the laissez-faire principle of governments being limited to the protection of life, liberty and peacefully acquired property. Most current-day classical liberals would no doubt find many or even most of these exceptions unpersuasive in the light of more than a century with government intervention in education, business regulation, the labor market, and welfare state "social safety nets."

Self-Interest and the Consequences of Government Intervention

But it would be unfair to Mill to assert that he had lapsed into a fully utopian la-la-land of malleable human nature in which social reality could be whatever the dreamer of a "better world" might desire.

He may have been open and even sympathetic to the idea that maybe someday human nature in the normal societal work environment might become more like a monastic brotherhood of collective sharing and selflessness. But in the world in which Mill lived he had no illusions about any such transformation in a reasonable horizon of time. He worked under the clear and evident assumption that individuals are guided by self-interest, that they attempt to improve their own circumstances as they define betterment, and they respond to the incentive structures within the institutional settings in which they find themselves.

Given the reality of human nature in the social world, Mill was insistent that, "though governments or nations have the power of deciding what institutions shall exist, they cannot arbitrarily determine how those institutions shall work."[41] The effects from changing how wealth was distributed in society were not under man's unlimited control through government edict, legislation or command. Or as he put it,

> "We have here to consider, not the causes, but the consequences, of the rules according to which wealth may be distributed . . . Human beings can control their own acts, but not the consequences of their acts either to themselves or to others. Society can subject the distribution of wealth to whatever rules it thinks best; but what practical results will flow from the operation of those rules must be discovered, like any other physical or mental truths, by observation and reasoning."[42]

He understood that the link between work and reward was strongest when the gains from effort were the property of the producer of wealth, and the resulting output might be negatively affected under prevailing human circumstances with a break in this linkage.

Individuals Know Their Own Interests Better Than Government

He also believed that individuals have a far greater understanding of their own surroundings in terms of enterprise decisions than any government agents and bureaucrats could ever possess. Even if one were to imagine that they possessed the same knowledge as the actors in the different corners of the division of labor, those representatives of the government would never have the same incentive to use that knowledge as productively and profitably as the separate individuals in the market arena.[43]

However, in fact, there is more knowledge in the minds of all the members of a society combined than any one or group of government officials could ever know or master, Mill pointed out. Thus, it was better to leave the use of such dispersed and personal knowledge to those who possessed it, rather than the government taking on commercial and enterprising tasks for which it was not competent.[44]

In addition, given the reality of self-interest on the part of all members of society, whether in the market or in government, Mill warned the presumption needed to be the constant danger of misuse and abuse of political power and governmental position.

Government the Greatest Threat to Person and Property

Essential for individual and social prosperity was security of person and property, Mill insisted. But there is always the eternal problem of who guards the people from the guardians meant to protect people's lives and possessions? Or as Mill expressed it:

> "By security I mean the completeness of the protection which society affords to its members. This consists of protection *by* the government and protection *against* the government. The latter is the most important.
>
> "Where a person known to possess anything worth taking away, can expect nothing but to have it torn from him, by every circumstance of tyrannical violence, by the agents of a rapacious government, it is not likely that many will exert themselves to produce much more than necessaries . . . The only insecurity which is altogether paralyzing to the entire energies of producers, is that arising from the government, or from persons invested with its authority . . .
>
> > "It is sufficient to remark, that the efficiency of industry may be expected to be great, in proportion as the fruits of industry are insured to the person exerting it; and that all social arrangements are conducive to useful exertion, according as they provide that the reward of every one for his labor shall be proportioned as much as possible to the benefit which it produces.
>
> "All laws and usages which . . . chain up the efforts of any part of the community in pursuit of their own good, or stand between efforts and their natural fruits . . . [tend] to make the aggregate productive powers of the community productive in a less degree than they would otherwise be."[45]

In the next installment of this post I will discuss two more important points raised by Mill, namely that even disirable government services should not be monopolized and the dangers which come from democracy and the need to limit the franchise.

Endnotes

[38.] John Stuart Mill, *Principles of Political Economy, with Some of Their Applications to Social Philosophy* (Fairfield, NJ: Augustus M. Kelley, [1909] 1976) pp. 199-200.

[39.] F. A. Hayek, "Liberalism" [1973] in *New Studies in Philosophy, Politics, Economics and the History of Ideas* (Chicago: University of Chicago Press, 1978), pp. 129-130; on Hayek's various and changing views of Mill's liberalism and shift toward socialism, see, Bruce Caldwell, "Hayek on Mill," *History of Political Economy* (Dec. 2008) pp. 689-704.

[40.] For a critique of Mill's argument concerning work under markets versus under collectivism, see, Ludwig von Mises, *Socialism: An Economic and Sociological Analysis* (Indianapolis: Liberal Classics, [1936] 1981), pp.154-159. Online: </titles/1060>; see, also, Ludwig von Mises, *Liberalism: The Classical Tradition* (Indianapolis: Liberty Fund [1927] 2005) pp. 153-154: "John Stuart Mill is an epigone of classical liberalism and, especially in his later years, under the influence of his wife, full of feeble compromises. He slips slowly into socialism and is the originator of the thoughtless confounding of liberal and socialist ideas that led to the decline of English liberalism . . . Without a thorough study of Mill it is impossible to understand the events of the last two generations, for Mill is the great advocate of socialism. All the arguments that could be advanced in favor of socialism are elaborated by him with loving care."

[41.] Mill, *Principles*, p. 21.

[42.] Ibid., p. 201.

[43.] Ibid., p. 957: "The ground of the practical principle of non-interference must here be, that most persons take a juster and more intelligent view of their own interest, and of the means of promoting it, than can either be prescribed to them by a general enactment of the legislature, or pointed out in the particular case by a public functionary."

[44.] Ibid., p. 947: "It must be remembered, besides, that even if a government were superior in intelligence and knowledge to any single individual in the nation, it must be inferior to all the individuals of the nation taken together. It can neither possess in itself, nor enlist in its service, more than a portion of the acquirements and capacities which the country contains, applicable to any given purpose." Thus, "the great majority of things are worse done by the intervention of the government, than the individuals most interested in the matter would do them, or cause them to be done, if left to themselves."

[45.] Ibid., p. 115.

RICARDO, MALTHUS, AND MILL

by Sandra Peart

Steve Kates's response to the discussion raises several new threads. I briefly take up the 19th-century discussion on general gluts.

Gluts

Mill's famous proposition about the demand for labor came as settled doctrine after a long discussion between David Ricardo and T. Robert Malthus. Perhaps the best secondary source on the discussion is the one I poured over as an undergraduate at the University of Toronto, *The Economics of David Ricardo* by Samuel Hollander (Toronto: University of Toronto Press, 1979). Full disclosure: Hollander later became my dissertation advisor.

Thomas Robert Malthus

Since Kates has an interest in linking this policy discussion to today's policy discussions – and I agree there are reasons to do so – I think it pertinent to add to our discussion some context for the Malthus-Ricardo conversation.

On Machinery

The question that bedeviled Ricardo and others early in the 19th century was whether a significant, prolonged decrease in the need for laborers as a result of widespread, even general, mechanization, such as was apparently occurring during the Industrial Revolution, warranted a pessimistic outlook for the future. As handloom weavers and others were displaced by mechanized means of production, political economists attempted to work through the analytics of whether growth would still mean that employment opportunities would abound. As Hollander puts it, "For the reabsorption of labour displaced by machinery, Ricardo relied in part upon increased demand for service labour out of net revenue and in part upon net accumulation. In this Ricardo in effect followed [Adam] Smith." (p. 373) Mill followed Ricardo's line of thought in this regard.

More than this, however, it is striking how in the context of the contemporary situation, the notion of general displacement still resonates with the public and with some intellectuals trained in economics. With each significant technological change—the assembly line, computers, robotics--that disrupts our society, worries emerge about whether we will generally need less labor going forward. And then the discussion begins as to what to do about it. I leave this latter for a future comment!

JOHN STUART MILL AND THE DANGERS FROM UNRESTRAINED GOVERNMENT. PART II

by Richard M. Ebeling

Continuing my previous post I would also like to point out the following concerns Mill had regarding unrestrained governent.

Even Desirable Government Serves Should Not be Monopolized

Though Mill may have concluded that government in a liberal society should extend its responsibilities beyond the narrower confines of a more strict laissez-faire policy, he nonetheless remained suspicious and indeed critical of any monopolization of such tasks.

For instance, he believed that state involvement in education was essential to assure the development of a generally literate, intelligent, and informed citizenry. But while he argued government funding and supplying of schools were desirable for a functioning and free society of reasoning and reasonable individuals, he was forcefully against the exclusion of educational competition.

Nothing was more to be feared that total government control over any facet of life that would threaten to stifle the creative, innovative and uniquely original ideas that only emerge from diverse and free minds able to think and experiment:

> "One thing must be strenuously insisted on: that the government must claim no monopoly for its education, either in the lower or in the higher branches . . . It is not endurable that a government should either *de jure* or *de facto*, have a complete control over the education of the people. To possess such a control, and to actually exert it, is to be despotic. A government that can mold the opinions and sentiments of the people from their youth onwards can do with them whatever it pleases.
>
> "Though a government, therefore, may, and in many cases ought to, establish schools and colleges, it must neither compel nor bribe any person to come to them; nor ought the power of individuals to set up rival establishments depend in any degree upon its authorization."[46]

Dangers from Democracy and the Need to Limit the Franchise

In his famous essay "On Liberty," Mill had warned about both the political tyranny of the minority and, now, in his "democratic" age the growing danger of a tyranny of the majority.[47] In the *Principles*, he emphasized the same point, arguing that, "Experience, however, proves that the depositories of power who are mere delegates of the people, that is of a majority, are quite as ready (when they think they can count on popular support) as any organs of oligarchy to assume arbitrary power, and encroach unduly on the liberty of private life."

Indeed, Mill suggested that a tyranny of the majority was potentially more dangerous than the monarchies or oligarchies of the past, since when "the people" assert their sovereignty there remain few if any of the intermediary institutions of society to protect and support the threatened individual from the abuse of the "masses."[48]

This danger of an unbridled voting majority taking advantage of their numbers to plunder others in society was an especial problem in democratic society, Mill warned. Therefore, in his 1859 book, *Reflections on Representative Government*, Mill argued that those who received "public assistance" (government welfare) should be denied the voting franchise for as long as they receive such tax-based financial support and livelihood.

Simply put, Mill reasoned that this creates an inescapable conflict of interest, in the ability of some to vote for the very government funds that are taxed away from others for their own benefit. Or as Mill expressed it:

> "It is important, that the assembly which votes the taxes, either general or local, should be elected exclusively by those who pay something towards the taxes imposed. Those who pay no taxes, disposing by their votes of other people's money, have every motive to be lavish and none to economize.
>
> "As far as money matters are concerned, any power of voting possessed by them is a violation of the fundamental principle of free government . . . It amounts to allowing them to put their hands into other people's pockets for any purpose which they think fit to call a public one."[49]

Mill went on to explain why he considered this to be especially true for those relying upon tax-based, redistributed welfare dependency, which in nineteenth century Great Britain was dispersed by the local parishes of the Church of England. Said Mill:

> "I regard it as required by first principles, that the receipt of parish relief should be a peremptory disqualification for the [voting] franchise. He who cannot by his labor suffice for his own support has no claim to the privilege of helping himself to the money of others . . .
>
> "Those to whom he is indebted for the continuance of his very existence may justly claim the exclusive management of those common concerns, to which he now brings nothing, or less than he takes away.
>
> "As a condition of the franchise, a term should be fixed, say five years previous to the registry, during which the applicant's name has not been on the parish books as a recipient of relief."[50]

I would suggest that the same argument could be extended, today, to all those who work for the government, for as long as they are employed by the government they are directly living off the taxed income and wealth of others.

If it is said that government employees pay taxes, too, the reply should be that if you receive a $100 salary from the government and pay in taxes, say, $30, you remain the net recipient of $70 of other people's money and are not a contributor to the costs of government.

Extending Mill's logic a little further, I think that the same case could be made that all those who live off government expenditures in the form of government contracts or subsidies, should likewise be excluded from voting for the same conflict of interest reasons.

Such individuals and their private enterprises may not be totally dependent upon government expenditures for their livelihood. A rule might be implemented that to be eligible for the right to vote: no individual or the private enterprise from which he draws an income should receive (just for purpose of example), say, more than 10 percent of his or her gross income from government spending of any sort.

If a form of Mill's voting restriction rule had been in affect 100 year ago, it is difficult to see how the government could ever have grown to the size and cost that it now has in society.

In turn, if there were any way to implement such a vote-restricting rule, it is equally hard to see how the current, gigantic interventionist-welfare state could long remain in existence. Government, no doubt, would soon be cut down to a far more limited and less intrusive size.

Endnotes

[46.] Mill, *Principles*, p. 956.

[47.] John Stuart Mill, "On Liberty" [1859] in *Collected Works of John Stuart Mill*, Vol. XVIII (Toronto: University of Toronto Press, 1977), pp. 213-310.

[48.] Mill, *Principles*, p. 945.

[49.] John Stuart Mill, *Consideradtions on Representative Government* [1861] in *Collected Works of John Stuart Mill*, Vol. XIX (Toronto: University of Toronto Press, 1977), p. 471.

[50.] Ibid., p. 472.

WHAT DID MILL UNDERSTAND AS "SOCIALISM"?

by Nicholas Capaldi

The question of Mill's relation to socialism continues to puzzle scholars. There are good reasons for this. Mill described himself in the *Principles of Political Economy* as an "Ideal Socialist," but later wrote in the *Chapters on Socialism* (1879) a scathing critique of socialism.[51]

The term "socialism" came into use around 1830 and was applied to three movements deriving respectively from Saint-Simon (1760-1825), Fourier (1772-1837), and Robert Owen (1771-1858) in England. These writers, referred to as "Utopian" Socialists, are the ones that Mill discussed most thoroughly and always had in mind. Saint-Simon himself (and later Auguste Comte) proposed having the entire social world organized and run by a technical elite. The society would be a thoroughgoing meritocracy. Fourier was a proponent of a workers cooperative consistent with private ownership of property and prices set by a market. Other French figures who influenced Mill's thinking on socialism were Pierre-Joseph Proudhon (1809-1865), advocate of producer's cooperatives without centralized control and Louis Blanc (1811-1882), another advocate of worker cooperatives, initially funded by the government, but thereafter independent of government control.

Karl Marx and Friedrich Engels

Utopian Socialism is the kind of socialism Marx and Engels rejected. In explaining why their manifesto was "Communist" and not "socialist," Engels said:

> By socialists, in 1847, were understood, on the one hand, the adherents of the various utopian systems: Owenites in England, Fourierists in France, both of them already reduced to the position of mere sects, and gradually dying out; on the other hand, the most multifarious social quacks, who, by all manners of tinkering, professed to redress, without any danger to capital and profit, all sorts of social grievances, in both cases men outside the working-class movement and looking rather to the 'educated' classes for support…. Thus socialism was, in 1847, a middle-class movement, communism a working class movement.[52]

Utopian socialists were critical of what capitalism meant in the 19th century: (1) the assumption that human beings were primarily motivated by self-interest narrowly understood; (2) a permanent (and adversarial) division in society between two classes: owners and workers; and (3) the assumption that class membership was determined exclusively by birth. Capitalism in the 20th and 21st centuries has come to mean something very different. In the contemporary context utopian socialists would not be considered socialists but capitalists. Marx and Engels would have understood this.

Mill identified with the utopian socialists. What this meant, first, is that he rejected psychological hedonism and egoism. Fourier was the great exponent of the idea that the natural passions properly directed (self-interest properly understood -- Tocqueville) resulted in social harmony. Second, Mill advocated cooperatives. Mill's "socialism" is the doctrine that workers should pool their savings and borrow on the open market in order to set up cooperatives, and everyone in a cooperative should be shareholders (Silicon Valley startup?) Associations of individuals who own property, e.g., modern corporations, would be "socialistic" in Mill's sense, but not in the contemporary context. The world in which Mill lived was one in which property was largely owned by a few individuals but primarily by families. Until 1855, Parliament had proscribed all but a few limited liability joint-stock companies. I note as well that Mill anticipated Hayek in maintaining that no one could foresee the future permutations of a market economy.

Endnotes

[51.] *The Collected Works of John Stuart Mill, Volume V - Essays on Economics and Society Part II,* ed. John M. Robson, introduction by Lord Robbins (Toronto: University of Toronto Press, London: Routledge and Kegan Paul, 1967). </titles/232#lf0223-05_head_048>.

[52.] Friedrich Engels, "Preface to the 1888 English Edition", *Manifesto of the Communist Party* (1848). Online at <https://www.marxists.org/archive/marx/works/1848/communist-manifesto/preface.htm>.

JOHN STUART MILL ON HUMAN NATURE, SELF-INTEREST, AND INSTITUTIONAL INCENTIVES

by Richard M. Ebeling

John Stuart Mill is notorious among classical liberals for his famous distinction between the "laws" of production and the choices a society can make about the distribution of what has been produced. Production is determined by and limited to what physical laws will permit. But it is in the hands of the community, Mill argued, to determine how what has been produced is ladled out among the members of society.

Ludwig von Mises

This lead prominent free market-liberals, like Ludwig von Mises and F. A. Hayek, to point out that due to Mill's formulation of this distinction, as well as his numerous rationales and defenses of various interventionist welfare state-type policies in his *Principles of Political Economy* and other writings, it is justifiable to assert that Mill was one of the leading thinkers who influenced the trend away from the older "laissez-faire" liberalism to the more "social" liberalism of the modern Progressive and Social Democratic movements in America and Europe.

In a reconsideration of Mill's wider contribution to political economy, however, it is important to point out that while he may have been sympathetic to the socialist hope and ideal that human nature may be transformable into a monastic brotherhood of collective sharing and selflessness, in the context of the world in which he lived and expected for the foreseeable future, this was not the case.

He took it for granted that individuals are guided by self-interest, that they act to improve their circumstances given how they define betterment, and that people respond in predictable ways to the incentive structures of the society in which they live.

Given the reality of human nature in the social world, Mill was insistent that, "though governments or nations have the power of deciding what institutions shall exist, they cannot arbitrarily determine how those institutions shall work."[53] The effects from changing how wealth was distributed in society were not under man's unlimited control through government edict, legislation or command. Or as he put it,

> We have here to consider, not the causes, but the consequences, of the rules according to which wealth may be distributed. . . . Human beings can control their own acts, but not the consequences of their acts either to themselves or to others. Society can subject the distribution of wealth to whatever rules it thinks best; but what practical results will flow from the operation of those rules must be discovered, like any other physical or mental truths, by observation and reasoning." [54]

He understood that the link between work and reward was strongest when the gains from effort were the property of the producer of wealth, and the resulting output might be negatively affected under prevailing human circumstances with a break in this linkage. Or has Mill expressed it, any policies or institutional changes that stood between an individual reaping the rewards of his own productive efforts tend "to make the aggregate productive powers of the community productive in a less degree than they would otherwise be." [55]

Thus, in the reality of the world in which Mill lived and evaluated the economic policies around him, he was very far from being a mindless utopian in la-la-land who believed in an infinitely malleable human nature in which social reality could be whatever the dreamer of a "better world" might desire.

Endnotes

[53.] *Principles*, p. 21. Preliminary Remarks </titles/102#Mill_0223-02_223> .

[54.] *Principles*, p. 201. Book II: Distribution, Chap. I Property </titles/102#Mill_0223-02_500> .

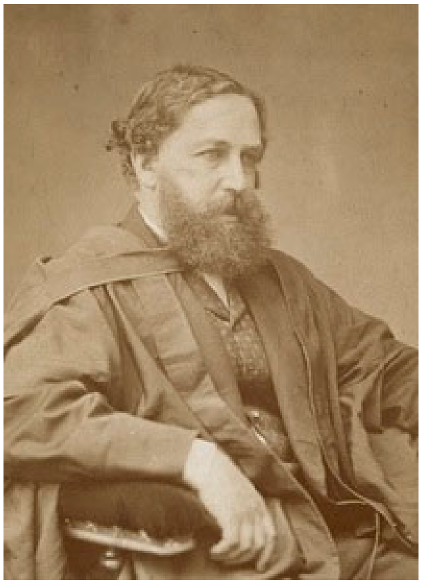
[55.] *Principles*, p. 115. Book I: Production, Chap. VII On What Depends the Degree of Productiveness of Productive Agents </titles/102#Mill_0223-02_359>.

LUMPS OF SOFT CLAY?

by Sandra J. Peart

There is much to agree with in the conversation so far. I would add three nuances for us to consider. First, on the purported separation of production and distribution in Mill, I have argued elsewhere and would here maintain that Hayek and many historians of economics were rather too quick to indict Mill.[56] Nowhere in the *Principles of Political Economy* does Mill suggest that changes in distributional arrangements will have no impact on production; much of his enterprise in the *Chapters on Socialism* is in fact designed to show precisely the opposite: that while distributional rules may be changed by people in ways that production is not malleable, there will be consequences when institutions are changed.

Second, as the contributors have noted Mill was much concerned with whether human nature might change and how. We are in agreement that incentives matter. What I should like to add to the mix here is that incentives, in Mill's view, can be either monetary or accrue in another, incommensurate dimension, approbation. For Mill – and he is the last major economist who works in this tradition until the rise of experimental economics brings it back to our attention – people care about the approval of those like them (and, to a lesser degree, those far from them in social and economic space). Indeed, human nature may respond more readily and more deeply to approval than to pecuniary rewards.



William Stanley Jevons

Later in the century an economist whose career partially overlapped that of Mill, William Stanley Jevons, closed off any possibility of people changing. Humans, he wrote in opposition to Mill, were more like "granite rocks" than the "lumps of soft clay" Mill had proposed:

> Human nature is one of the last things which can be called "pliable." Granite rocks can be more easily moulded than the poor savages that hide among them. We are all of us full of deep springs of unconquerable character, which education may in some degree soften or develop, but can neither create nor destroy. The mind can be shaped about as much as the body; it may be starved into feebleness, or fed and exercised into vigour and fullness; but we start always with inherent hereditary powers of growth.[57]

Endnotes

[56.] See my introduction to *Hayek on Mill: The Mill-Taylor Friendship and Related Writings* [Chicago: University of Chicago Press, 2015], p. xli.

[57.] William Stanley Jevons, "John Stuart Mill's Philosophy Tested. IV. Utilitarianism," *Contemporary Review*, vol. 36 (November), pp. 521-38.

ABOUT MILL'S 'SOCIALISM

by Steven Kates

First, Mill did not let the cat out of the bag that there were iron laws of production but no similar laws of distribution. Making such a common-sense distinction explicit did not invite others to nationalize industries or introduce central planning. Mill is not the father of socialism. He is amongst socialism's greatest enemies, in spite of what he might have said himself.

By insisting that there were laws of economics, Mill was explaining that there were limits to what could be done by political decree. Economic laws are no different from the law of gravity. They provide a theoretical structure of forged steel that determine what cannot be done and guidance towards an understanding of how economic policies must be designed if they are to create wealth and prosperity.

Mill's four propositions on capital provide some of these laws. Economic growth requires increased investment. Increased investment requires increased saving. Employment cannot be increased by increasing aggregate demand. These were constraints against which policy has to be framed.

Mill was writing in the middle of the 19th century. He had never actually seen a socialist economy in existence. What is therefore remarkable is that he was as explicit as Ludwig von Mises, who had seen such things, would one day be about the impossibility of running a successful economy from the center.[58] Instead, Mill wrote, "laissez-faire, in short, should be the general practice: every departure from it, unless required by some great good, is a certain evil."

Both Richard Ebeling and Nicholas Capaldi have noted Mill's emphatic opposition to individuals voting for a living. I see Mill's "socialism" as an early advocacy of the welfare state, in which the rules of the game were designed so that individuals could become productive and to that end might be assisted by actions taken by government. He left the question of the practicalities of socialism open as a matter of trial and error but cannot, in my view, be implicated as a defender of socialism in any of the forms ever experienced since his time.

This is the crucial point: there are some actions that cannot succeed because they are contradicted by economic laws. Therefore, if they are tried, they will not achieve their aims but will, instead, cause economic conditions to become worse.

Mill is very specific about a number of such economic laws that rule out many of the policies advocated by modern Keynesian macro models. Mill gets these things right, while Keynes, along with much of modern macroeconomic theory, gets them wrong. Indeed, I go further. I argue that not only are Mill's conclusions right, so too is his reasoning. In my view, you will learn more about how to manage an economy successfully by studying Mill than from any modern-day Paul Samuelson clone.

Endnotes

[58.] See, Ludwig von Mises, *Socialism: An Economic and Sociological Analysis*, trans. J. Kahane, Foreword by F.A. Hayek (Indianapolis: Liberty Fund, 1981). </titles/1060>.

MILL AND EXPERIMENTATION

by Sandra J. Peart

In his famous chapter on the Stationary State in his *Principles of Political Economy*,[59] Mill remarked that while present social and economic arrangements had much to recommend them in terms of generating economic growth, they still left much to be desired:

> I confess I am not charmed with the ideal of life held out by those who think that the normal state of human beings is that of struggling to get on; that the trampling, crushing, elbowing, and treading on each other's heels, which form the existing type of social life, are the most desirable lot of human kind, or anything but the disagreeable symptoms of one of the phases of industrial progress.[60]

Hence his willingness to examine additional forms of social arrangements.

In my last posting I remarked on one affinity between Mill and experimental economics: like experimental economists who have noted empirical regularities that emerge in language and other nonmonetary interactions, Mill worked in a tradition that allowed for nonmonetary incentives to influence human actions.

Here, I point to an additional affinity. Mill's economics was capacious enough to allow for actual experimentation in advance of hard and fast conclusions about the efficacy of one social arrangement over another. While, as I remarked in my last posting, Mill recognized that distributional changes would be associated with consequences for output and economic growth, the size of these consequences was as yet an empirical matter. In his *Principles of Political Economy* he concluded that while there was on balance much to recommend the system of private property that yielded so much economic growth in 19th-century England, experiments might be conducted in order to see whether other arrangements might also work. He laid out at least three conditions for these experiments. They must be adopted voluntarily by individuals who without coercion opted to try them out. They must be tried on a "moderate scale."[61] And, if they worked, they were to spread voluntarily, by example.

Endnotes

[59.] *Principles*, Book IV: Influence of the progress of Society on Production and Distribution, Chap. VI: "Of the Stationary State" </titles/243#lf0223-03_label_893>

[60.] *Principles*, Book IV: Influence of the progress of Society on Production and Distribution, Chap. VI: "Of the Stationary State" </titles/243#lf0223-03_label_896>

[61.] *Principles*, Book II: Distribution, Chap. I: Of Property </titles/102#Mill_0223-02_522>. The full quote is:

With regard to this, as to all other varieties of Socialism, the thing to be desired, and to which they have a just claim, is opportunity of trial. They are all capable of being tried on a moderate scale, and at no risk, either [214] personal or pecuniary, to any except those who try them.

UTILITARIANISM

by Nicholas Capaldi

Broadly speaking, utilitarianism is the view that social policy can be reduced to a kind of calculation of the consequences of alternative courses of action. Just exactly what is being calculated and how one measures those anticipated consequences are themselves matters of dispute among holders of utilitarianism. The well-documented problems with utility can be summarized as follows: we cannot appeal to consequences without knowing how to rank the impact of different approaches with regard to different moral interests (liberty, equality, prosperity, security, etc.); we cannot appeal to preference satisfaction unless one already grants how one will correct preferences and compare rational versus impassioned preferences, as well as calculate the discount rate for preferences over time; appeals to disinterested observers, hypothetical choosers, or hypothetical contractors will not avail because if such decisionmakers are truly disinterested, they will choose nothing; if we choose in a particular way, we must already be fitted out with a particular moral sense or a thin theory of the good; any intuition can be met with contrary intuitions; any particular balancing of claims can be countered with a different approach to achieving a balance; in order to appeal for guidance to any account of moral rationality on must already have secured content for that moral rationality. In short, it begs every question.

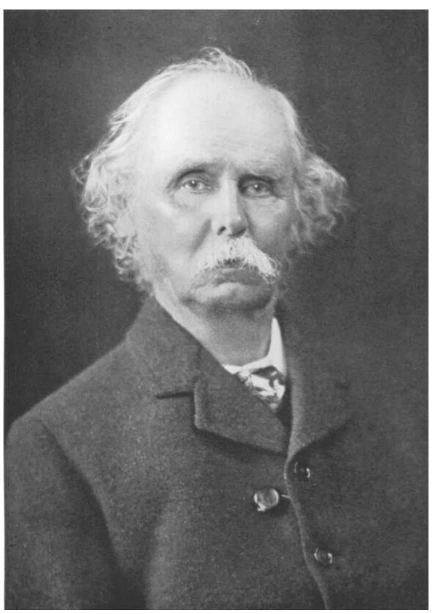
Jeremy Bentham

Jeremy Bentham was among the first to proclaim utilitarianism, and he influenced the development of economics in the latter half of the 19th century and the 20th century. Specifically, he influenced the development of economics as an allegedly pure science. A turn to economic science seems to presume that the case for economic liberty, and its relationship to political and social liberty, no longer has to be made. And it also does two other things: it suggests that the issue of liberty can be reduced to an efficiency issue, and it hides the problem that individual liberty needs to be reconciled with community good. It suggests that equality can be reduced to a collectivist issue, and it hides the problem that community good needs to be reconciled with individual liberty. We shall not discuss Bentham, but we do want to note that Bentham was in some ways the "grandfather" of macroeconomics. A.V. Dicey was the first to point out that Bentham's system evolved into a form of collectivism, thereby crossing the boundary between libertarian and democratic socialist versions of positivism. Bentham's principle of utility could give justification to collectivism: the majority was the poor, and the society should be organized for their benefit. In his book, *Lectures on the Relation Between Law and Public*

Opinion in England during the Nineteenth Century (1885), in Lecture IX, "The Debt of Collectivism to Benthamism," Dicey spells out how "the socialists of today have inherited a legislative dogma, a legislative instrument, and a legislative tendency from Benthamism."[62]

William Stanley Jevons (1835 –1882) was a Christian utilitarian who rightly observed that J.S. Mill was not a utilitarian and, worse yet, had abandoned Bentham's utilitarianism. Jevons, a mathematician and economist, devoted a large part of his carrier to arguing against Mill. He aimed to replace the influence of Mill's *Principles of Political Economy* with his own book, *A General Mathematical Theory of Political Economy* (1862).[63] It was this book that marked the advent of a purely mathematical economics.

Henry Sidgwick (1838-1900), economist and philosopher of ethics, wrote on political economy from a utilitarian perspective. Alfred Marshall, founder of the Cambridge School of economics, would describe Sidgwick as his "spiritual mother and father." It was Sidgwick who reluctantly admitted that there was no rational foundation to basic moral beliefs.



Alfred Marshall

Alfred Marshall (1842-1924) did succeed in replacing Mill with his own book, *Principles of Economics* (1890) .[64] Under the influence of Jevons and Sidgwick, he too was concerned with improving the condition of the working class. The Revolutions of 1848 had focused the attention of Mill and all subsequent British economists on the plight of the working class. Just as Smith had been forced to come to terms with Rousseau, so Marshall as well as his pupil and successor Keynes would be forced to do likewise.

Following Say, J.S. Mill had assumed along with all classical economists that the great issue in economics was how to increase "the wealth of nations," that is, how to increase living standards. The answer was to increase capital. Value depended upon capital. The higher the underlying productiveness of the economy, the higher will be the level of employment for any given real wage. In short, supply creates demand. As a consequence, "What supports and employs productive labor, is the capital expended in setting it to work, and not the demand of purchasers for the produce of the labor when completed. Demand for commodities is not demand for labor." (Fourth Proposition on Capital). Jevons challenged Mill and argued that value depended upon demand. Marshall combined these two positions and concluded that in the short run, supply cannot be changed and market value depends mainly on demand. This, as we shall see, leads directly to Keynes.

Endnotes

[62.] Albert Venn Dicey, *Lectures on the Relation between Law and Public Opinion in England during the Nineteenth Century, edited and with an Introduction by Richard VandeWetering* (Indianapolis: Liberty Fund, 2008). </titles/2119>.

[63.] William Stanley Jevons, "Notice of a General Mathematical Theory of Political Economy." *Report of the 32d meeting of the British Association for the Advancement of Science, held at Cambridge in October, 1862*. Reports of Sections, p. 158. London, 1863; and William Stanley Jevons, "Brief Account of a General Mathematical Theory of Political Economy," *Journal of the Statistical Society of London*, June 1866. Vol. xxix, pp. 282-287. London. Online at McMaster University, Archive for the History of Economic Thought

<http://socserv2.socsci.mcmaster.ca/~econ/ugcm/3ll3/jevons/mathem.txt>.

[64.] On Marshall see <https://en.wikipedia.org/wiki/Alfred_Marshall> and <https://en.wikipedia.org/wiki/Principles_of_Economics_(Marshall)>. Alfred Marshall, *Principles of Economics* (London: Macmillan and Co. 8th ed. 1920). </titles/1676>.

THE JEVONS TURN

by Sandra J. Peart

Steve Kates makes a strong case that we can learn more about sound economic policy from J. S. Mill than from J. M. Keynes. In one of my previous posts I mentioned a key intermediary figure, W. S. Jevons, and here I wish to return to him. This is because I think there is some important "filling in" to do in the narrative that traces economic views of policy from the mid-19th century through the mid-20th. I point here to two key intermediate steps: the late 19th-century turn away from laissez faire and the rise of new welfare economics in the early half of the 20th century.

William Stanley Jevons

Jevons as Intermediary

While William Stanley Jevons is often regarded as one of the three key pioneers of the marginal utility revolution, he was also heavily involved in policy analysis. His *The State in Relation to Labour* (1882) and the posthumously published *Methods of Social Reform* (New York: Kelley Reprint, 1965 [1883]) are replete with calls for government intervention to help the laboring poor and to "fix" their ongoing mistakes.[65] Jevons, like other early neoclassical economists, believed that the laboring poor were hopelessly myopic.[66] In his *Theory of Political Economy* (1871) he wrote about a "being of perfect good sense and foresight" whose consumption decisions and only whose consumption decisions followed his utility maximizing prescriptions; all others, without intervention to induce increased saving, violated his equilibrium prescriptions.[67] Thus, Jevons and his contemporaries paved the way for economists to depart from Mill's presumption that people were the best judges of their own interests and instead to propose ways to make people adhere to economic rationality.

The Rise of New Welfare Economics

A second development that also intersects with Keynesian-style policy analysis is the rise of new welfare economics. Here, in a nutshell economists gained warrant to sketch out apparent welfare-enhancing policies that depended on the possible compensation of losers by winners. Such an exercise represented a significant departure from the style of economic analysis that flourished up until the mid-19th century in which actual compensation was presumed. Classical economists thought about policy reform in the context of actual exchange among equals.

All of this is to suggest that economists in the mid-20th century assumed a more capacious role for direction, for specifying how people ought to behave, and for making suggestions as to how to achieve overall goals of economic growth and well-being. Perhaps one beneficial result of the financial crisis of 2008 and its aftermath is that at least some economists and the public at large have begun to reevaluate the basis on which claims to authoritative knowledge about how to direct the economy were based.

Endnotes

[65.] William Stanley Jevons, *The State in Relation to Labour* (London: Macmillan, 1882); and *Methods of Social Reform* (New York: Kelley Reprint, 1965 [1883]) online </titles/316>.

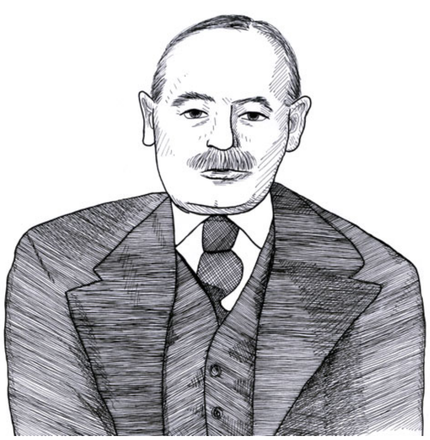
[66.] See Sandra J. Peart, "Irrationality and Intertemporal Choice in Early Neoclassical Economics," *Canadian Journal of Economics* 33 (1), 2003, 175-89.

[67.] William Stanley Jevons, *The Theory of Political Economy*, [London: Macmillan, 1871; fourth edition 1911], p. 72. Online 1888 3rd ed. </titles/625>.

REGARDING KEYNES

by Nicholas Capaldi

In the lecture *The End of Laissez Faire* (1926),[68] Keynes acknowledged not only the major philosophical shortcoming of utilitarianism but also that there could never be a satisfactory utilitarian response to the Rousseauian critique: "private and social interest do not coincide".[69] Even more important, in *The General Theory of Employment, Interest and Money* (1936), Keynes changed the focus of economics largely because of an "arbitrary and inequitable distribution of wealth and income." The focus is now on short-run employment creation rather than long-run wealth creation as the central aim of economic policy. The causes of economic growth are at best an afterthought.



John Maynard Keynes

Keynes argued that it was aggregate demand which determined economic activity. Inadequate aggregate demand leads to high unemployment. In order to moderate the "boom and bust" cycles of economic activity, and to achieve full employment, government regulation of the demand side of the economy was needed. For the market to reach its full potential (telos equilibrium), we need full employment. Because of price stickiness (workers often refuse to lower their wage demands), government needed to adjust aggregate demand and aggregate supply. One way in which government could stimulate demand in times of high unemployment was by spending on public works. Public works were not a form of redistribution; they were intrinsically valuable, indirect means to the creation of wealth, and a temporary measure for exceptional circumstances like the Great Depression. He did not advocate government spending financed by borrowing but insisted upon balanced budgets.

Keynes also had his version of "perpetual peace." If market economies can be managed successfully on the domestic level, then the same could be true internationally (e.g, a coordinated international monetary system). He advocated and worked tirelessly in the postwar period for a global market economy rather than the prevailing mercantilism. As Galbraith was later to comment (2002): "During the decades that happen to coincide with the rise of neoliberal ideology, with the breakdown of national sovereignties, and with the end of Keynesian policies in the global debt crisis of the early 1980s, inequality rose worldwide."[70]

Was Keynes a supporter of Lockean liberty or a Rousseauian egalitarian? In his own mind he was undoubtedly a Lockean. He was firmly committed to the Technological Project; he thought he was repairing the market economy based on his understanding of the relationship between demand and supply; he believed in limited government (opposing social democracy in favor of management by an intellectually and morally qualified elite); and he advocated world peace. The role of the state is not ownership of the means of production but management of investment (not production but distribution with the expectation that this would lead to full production); he supported the rule of law; and he most certainly presumed the sanctity of individual autonomy. To the extent that he acknowledged the social problem, his response was no different in kind from that of Smith or perhaps Mill – amelioration and evolution not revolution.

The success of the Technological Project had also encouraged the Enlightenment Project view that there could be a social technology. The latter was premised on the view that every effect had a cause, and therefore all human action is caused, including what we "mistakenly" think are free choices of the will. This was a problem with which Mill wrestled throughout his lifetime, but he came down on the side of believing in free will. Individuals were ultimately responsible for the choices they made.

Nevertheless, there was a gradual transition from the early 19th-century view that poverty was a moral problem involving individual responsibility (Mill and Charles Booth) to the 20th-century view, via the Fabians, that the poverty problem is really a social problem about the equality of the working class. Whereas early 19th-century Protestants had emphasized the difference between the "deserving" poor and the "undeserving" poor, in a post-Fabian world of neoclassical economics the poor were victims requiring social policies of reform. When one adds to this the traditional Christian commitment to solicitude for the poor, one can see the irresistible attraction to Christian utilitarianism. This greatly weakens faith in and commitment to individual freedom in the social, political, and economic realms.

Keynes and his immediate predecessors (as well as his successors) were unwilling to give full allegiance to individual autonomy. And in a world in which professionals prided themselves on being "scientific" and wanted economics to be a science, it was easier to acquiesce in a covert acceptance of determinism and not worry about the philosophical conundrums. Hayek, on the other hand, did not shy away from the equally difficult task of defending the freedom of the will in his philosophical works. Nevertheless, in his economic works, Hayek was content to focus on the incoherence and danger of social planning. Of course, Hayek will demolish Keynes. But it is important to identify the origins of the problem, and those origins do not include Mill.

Endnotes

[68.] John Maynard Keynes, *The end of laissez-faire* (Hogarth Press, 1926). This essay was based on the Sidney Ball Lecture given by Keynes at Oxford in November 1924 and on a lecture given by him at the University of Berlin in June, 1926. Online <http://www.panarchy.org/keynes/laissezfaire.1926.html>. Also see, *The Collected Writings of John Maynard Keynes. Volume 9, Essays in Persuasion* (Royal Economic Society, 1978), pp. 272-294.

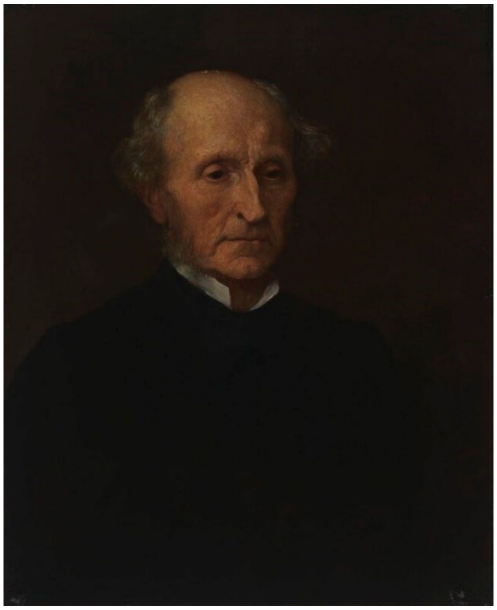
[69.] See also, John Maynard Keynes, "Am I a Liberal?" (1925) in *The Collected Writings of John Maynard Keynes. Volume 9, Essays in Persuasion*, pp. 295-306.

[70.] James K. Galbraith, "A perfect crime: Inequality in the age of globalization," *Daedalus*, 131 (1) (Winter 2002).

JOHN STUART MILL ON SLAVERY, HUMANITY, AND THE WAR BETWEEN THE STATES

by Richard M. Ebeling

It should, perhaps, not be too surprising that as an advocate of equal rights for women[71] and a defender of individual liberty against the tyrannies of either minorities or majorities, John Stuart Mill was, equally, a demander for the end to human slavery and its accompanying attitudes concerning associative relationships.



John Stuart Mill

Demanding Justice Against Unjust Government Acts

Even more so, he insisted on justice and humane treatment for all, regardless of whether they were black or white.[72] Thus, he participated in the famous "Jamaica Committee" of 1866, which demanded that those British political authorities responsible in 1865 for violently suppressing and killing black Jamaicans (including unarmed men, women and children) who were accused of participation in or sympathy for rebellion against the British crown, be placed on trial for murder. (Such well-known classical liberals of the day as John Bright, Herbert Spencer, and A. V. Dicey, and such other notables as Charles Darwin and Thomas Huxley joined him in this demand.)[73]

Mill praised "the great national revolt of the conscience of this country against slavery and the slave-trade," and those who participated in the antislavery movement in Great Britain, "who determined not to rest until the iniquity was extirpated: who made the destruction of it as much the business and the end of their lives." In Mill's opinion, "the persons who formed and executed it deserved to be numbered among those, not numerous in any age, who have led noble lives according to their lights, and laid on mankind a debt of permanent gratitude."[74]

At the same time, he heaped ridicule and contempt on those who presumed that Africans were inherently inferior to whites in terms of work habits and responsiveness to incentives, thus requiring a special white master and black servant relationship (in the face of the end to formal slavery) to assure that blacks in the British West Indies would be appropriately laboring and "productive."[75]

Southern Secession and Anti-Slavery Morality

When Mill turned his gaze to the conflict in America between the northern and southern states in two essays in 1862, he showed the same sympathies.[76] The first of the two essays is an appeal to the highest values of a belief in freedom and human dignity among the British people to not allow resentments, angers, and disapproval of various aspects in the American character, plus recent political disputes between the British and Union governments, to result in formal recognition or international support to the southern Confederate government.

At least strict neutrality should be the hallmark of British political policy so as to not tilt the balance in favor of a southern victory. But Mill was strident that morally the attitude should be to wish to see the defeat of the southern rebellion, for that was the only position "which becomes a people who are as sincere enemies of slavery as the English really are, and [who] have made as great sacrifices to put an end to it where they could."[77]

In Mill's eyes, the southern secession had little or nothing to do with free trade versus protectionism or the use of tariff revenues collected from southern states for "internal improvements" advancing the development of the northern or western states.[78]

It was pure and simply the preservation of a slave culture and slave society in the South from the loss of access in the "territories" not yet organized as states within the union to slave expansion, and a fear that if new states were admitted to the union over time as "free" states, it would mean the death knoll to slave-state influence and "balance" in the two Houses of Congress over time.

Secession Unjustified When Meant to Enslave Some

"Secession," Mill said, "may be laudable, and so may any other kind of insurrection, but it may also be an enormous crime" when its purpose is the preservation of holding a portion of their population in perpetual bondage. If secession was meant to be an expression of the will of the people, "Have the slaves been consulted? Has *their* will been counted as any part in the estimate of collective volition? They are are a part of the population. . . . Remember, *we* consider them to be human beings, entitled to human rights."[79] And he was greatly pleased when at last "at the expense of the best blood of the Free States, but to their immeasurable elevation in mental and moral worth, the curse of slavery has been cast out from the great American republic. . . ."[80]

For Mill, eliminating the scourge of slavery as a moral blight on humanity, far more than its economic disadvantages in that in general slave labor is less productive than free labor, is what justified his ethical support for the northern cause even when it involved abuses and overreaches beyond the actual powers assigned the Union government under the U.S. Constitution.

Whether such unconstitutional precedents in the name of Union victory might involve longer term consequences in terms of centralization of power at the expense of other liberties and restraints on political power were issues not included in the horizon of Mill's discussion.[81]

Endnotes

[71.] Editor: I have listed all of Mill's and Taylor's writings on women from the *Collected Works* at this page </pages/mill-and-taylor-on-women>.

[72.] John Stuart Mill, "Jamaica Committee: Public Documents (1866, 1868)" in in *The Collected Works of John Stuart Mill*, Vol. XXI (Toronto: Toronto University Press, 1984), p. 423: The Committee's "aim, besides upholding the obligation of justice and humanity towards all races beneath the Queen's sway, is to vindicate, by an appeal to judicial authority, the great legal and constitutional principles which have been violated in the late proceedings, and deserted by the Government."

[73.] See the excellent account of this episode by Bernard Semmel, *Democracy vs. Empire* (New York: Anchor Doubleday, 1962).

[74.] John Stuart Mill, "The Negro Questions" [1850] in *The Collected Works of John Stuart Mill*, Vol. XXI, p. 88.

[75.] Ibid., pp. 89-93; there was no "doctrine more damnable than one" that asserted that "one kind of human beings are born servants to another kind." A doctrine that tells the Negro: "You will have to be servants . . . to those who are born wiser than you, that are born lords of you – servants to the whites. . . ." If blacks seemed to lack certain social and economic qualities and characteristics observable in British whites, Mill suggested that the reasons are far more due to slavery, denial of education and development of those qualities and characteristics most likely to be developed when men are allowed to be free and responsible individuals, than anything inherent and different in the makeup of the blacks compared to whites.

[76.] John Stuart Mill, "The Contest in America" [February 1862] and "The Slave Power" [October 1862] in *The Collected Works of John Stuart Mill*, Vol. XXI, pp. 127-42 & 145-64. The latter essay was a detailed and highly complimentary review of John E. Cairnes, *The Slave Power: Its Character, Career and Probable Designs* (New York: Augustus M. Kelley [1862; 2d revised ed., 1863] 1968); Cairnes dedicated the book to John Stuart Mill. See also the concise summary of his own argument in John

E. Cairnes, "The Revolution in America" [1862] in *Political Essays* (New York: Augustus M. Kelley [1873] 1867) pp. 59-108.

[77.] Mill, "The Contest in America," pp. 128-29.

[78.] Mill, "The Slave Power, " p. 146.

[79.] Mill, "The Contest in America," pp. 137-138.

[80.] John Stuart Mill, *Principles of Political Economy, with Some of Their Applications to Social Philosophy* (Fairfield, NJ: Augustus M. Kelley, [1909] 1976). Pp. 254-55. Book II: Distribution, Chap. V: Of Slavery </titles/102#lf0223-02_footnote_nt_1020_ref>

[81.] See Jeffrey Rogers Hummel, *Emancipating Slaves, Enslaving Free Men: A History of the American Civil War* (New York: Open Court, 1996).

WITHOUT VALUE ADDING AT ITS CORE ECONOMIC THEORY IS LOST

by Steven Kates

My frustration has continually been that I cannot seem to convey Mill's vision in a way that others can understand.

He and the classics did not look at some part of the economy, they looked at all of it all the time all at once. Classical economics is almost all macro with only a touch of micro thrown in where needed. And they looked at the economy in real terms and brought the monetary side into the discussion only at the end.

An economy in the classical literature is the entire national workshop, all of it, all conceived at one and the same moment. Saving was that part of the whole that was devoted to producing capital goods for future productive use. Saving was investment. It could never be anything else.

No one in the interior could know which they were working on themselves. If someone was in the oil industry, they could not know whether what was being produced would end up in the hands of a consumer out for a Sunday drive, or in the hands of a manufacturer producing inputs into some other industry. But they could tell that they were trying to build up the economy's capital stock, which was what mattered most of all.

Moreover, the way it was looked at was as an economy in motion. There was no equilibrium moment where everything comes to a conceptual halt in some static framework. The economy as conceived was continuously changing and shifting, but also, if things were left to the market, advancing, creating a greater capacity to produce more output. If you read the classics, they are describing the economy we are all familiar with even to this day. Their writings are about economic growth and how to achieve it. They are about raising living standards and creating jobs. It is about actual people doing actual things. It is what you wish modern economics would teach but doesn't.

Adam Smith

A distinction we no longer make is between productive and unproductive labor. This is a notion we economists now deride since we seem to confuse value adding with utility, something no classical economist did. But productive labor – that is productive effort – in comparison with unproductive labor is the distinction between value-adding and nonvalue-adding activity. It is the distinction that is essential in Mill and the classics generally, perfectly explained in Adam Smith. Let me take you to the opening of Book II, Chapter III of *The Wealth of Nations*, which should be read in full. There may be more good sense in this chapter than in all the Keynesian-clone textbooks put together. This is from 1776. Where will you find its equal today?

> There is one sort of labour which adds to the value of the subject upon which it is bestowed: there is another which has no such effect. The former, as it produces a value, may be called productive; the latter, unproductive labour. Thus the labour of a manufacturer adds, generally, to the value of the materials which he works upon, that of his own maintenance, and of his master's profit. The labour of a menial servant, on the contrary, adds to the value of nothing.[82]

Modern economics thinks of the menial servant in the identical fashion as someone who is working on building an oil rig in the middle of the ocean. Each is just one more employed person earning an income that they can then spend. When we look at Y=C+I+G, we are looking only at final production and completely ignore the hinterland. We never ask, as Smith or Mill did, what the labor was actually producing, nor do we look at an economy's stock of existing capital assets or whether they are being increased.

I have tried to show my own division in the production possibility diagram in my first post. All economic activities draw down on our existing productivity. Some, however, more than replace what has been taken away, and it is these that allow an economy to move forward.

Productive and unproductive labor, as antique as it might sound, brought the imperative that economic activity in total had to be value-adding to the center of economic theory if it was to create growth and employment. It is the existence of the stock of capital and its increase that allows labor to be employed and real incomes to rise, not the increase in aggregate demand that comes only at the end.

Endnotes

[82.] Adam Smith, *The Wealth of Nations*, Book II, Chapter III: "Of the Accumulation of Capital, or of Productive and Unproductive Labour" in *An Inquiry into the Nature and Causes of the Wealth of Nations by Adam Smith, edited with an Introduction, Notes, Marginal Summary and an Enlarged Index by Edwin Cannan* (London: Methuen, 1904). Vol. 1.

SEEING THE ECONOMY AS SEEN BY MILL

by Steven Kates

A question I ask in class is whether a country with 10 percent growth last year has a higher standard of living than a country with 2 percent growth last year. They are all perfectly aware that the growth rate tells them nothing about living standards but cannot explain why. They cannot even tell you what was 10 percent higher.

This is the vision that has been lost: the ability to see the whole economy at once, not just what has been newly produced. What is missing most of all is an explicit discussion of entrepreneurs guided by the price system producing for the market, with the profit motive ensuring value-adding activity is as high as it can possibly be.

The core aim of economic activity, so far as classical economists were concerned, was to add to the stock of productive assets and in this way to allow the economy to expand. Mistakes could be made. But the importance of profitable activity, if an enterprise was to continue absorbing the economy's stock of capital assets and labour, was that the enterprise was continuously doing its best to use the resources at its command to produce higher levels of output that could be sold for prices higher than it had paid for its inputs.

After this, but only after this, one could look at the effect of money, which can, and often does, distort the entire process, providing false clues about where profitable activities might lie. The financial system is far from infallible, but provides an essential service in getting productive resources from those who do not wish to purchase to the full extent what their incomes will allow, and putting those resources into the hands of those who wish to purchase more than their incomes will allow.

Government spending in this vision is one more impediment to economic growth. Government for the most part is unproductive in the classical sense. Government spending almost invariably draws down on community productivity and seldom adds to it. The Keynesian belief that spending of itself drives the economy is an idea so fantastic to a classical economist that it would have been beyond belief that any such notion had ever entered into the collective heads of the profession.

The marginal revolution, with Jevons leading the way as others have noted, shifted the focus from the supply side to the demand side. There was still an appreciation of the structure of production, but it was overlaid with marginal utility as the guiding force in an economy. Jevons and many of his successors were so keen to improve the lives of the poor that they pushed redistribution to the front of the queue in thinking about the nature of economies and pushed the supply side into the background. Keynes would complete the process.

There may have been no economist, before or since, who wanted to do more for the poor and lowly paid than John Stuart Mill. But he wished to do it in the only way it has ever been possible, by deepening and broadening the capital structure of an economy. Anyone who believes that our living standards have been raised because of demand-side pressures has no idea how an economy works. It is the supply side that is all that matters, and it is only there that both wealth and jobs can and will be created.

Demand for commodities is not demand for labor. Entrepreneurial activity, driven by the search for profitable activities, is how both wealth and jobs are created. You will not find this stated in virtually any modern mainstream economics text. You can still find it elsewhere, but the best place to see it explained in full, even now, is in Mill's *Principles of Political Economy*, first published though it was in the revolutionary year of 1848.

MILL'S DEFENCE OF SAY'S LAW AND REFUTATION OF KEYNES

by Steven Kates

It has frequently been stated that Mill provided his best defense of Say's Law in his 1844 essay, "Of the Influence of Production on Consumption,"[83] when the reality is that it is much more powerfully and comprehensively stated in his *Principles*. The arguments are, however, spread over a number of sections of the book, but Mill's train of thought can be traced easily enough. His main discussion is found in Book III Chapter XIV, "Of Excess of Supply." He begins his explanation on the impossibility of demand deficiency across an economy – that is, the impossibility of a general glut – by noting it is a conception so absurd that he feels almost inadequate to state it in a way that those who support it will accept. And please recall that he is discussing what amounts to the whole of Keynesian macro:

> The doctrine appears to me to involve so much inconsistency in its very conception, that I feel considerable difficulty in giving any statement of it which shall be at once clear, and satisfactory to its supporters.[84]

Nevertheless, he develops the two possible arguments to show why demand deficiency is an absurdity. He looks first at whether demand deficiency might occur because incomes are not passed onto those who have helped produce so that there is not enough purchasing power to maintain demand. Then secondly – the Keynesian case – he looks at the argument that purchasing power is passed on as part of the production process, but where those who receive these incomes choose to save rather than spend. I commend the entire chapter to you as a fully satisfying and self-contained argument in and of itself. But in this note, I wish to widen the scope of where to look in the rest of the book to complete what Mill was trying to explain. And the best way I can think to do this is to follow the two footnotes in this chapter, which direct the reader to other parts of the book where the ideas expressed in this chapter are further developed.

In the first of the passages with a footnote reference, Mill points out that he had broached the subject earlier but could not fully explain everything that needed to be said until more had been discussed:

> Because this phenomenon of over-supply, and consequent inconvenience or loss to the producer or dealer, may exist in the case of any one commodity whatever, many persons, including some distinguished political economists, have thought that it may exist with regard to all commodities; that there may be a general over-production of wealth; a supply of commodities in the aggregate, surpassing the demand; and a consequent depressed condition of all classes of producers. Against this doctrine, of which Mr. Malthus and Dr. Chalmers in this country, and M. de Sismondi on the Continent, were the chief apostles, I have already contended in the First Book;**[FN1*]** but it was not possible, in that stage of our inquiry, to enter into a complete examination of an error (as I conceive) essentially grounded on a misunderstanding of the phenomena of Value and Price.[85]

The footnote [FN1*] reads, "Supra, pp. 66-8" (in the online Liberty Fund edition) which brings you to the discussion on the first of his Four Fundamental Propositions on Capital.[86] Indeed, all four propositions are relevant and round out the argument, culminating in the fourth, which reads, "demand for commodities is not demand for labour." The chapter on "Of Excess of Supply" argues that demand deficiency does not cause recession, while the referenced chapter on capital explicitly states that you cannot increase employee numbers by increasing aggregate demand.

There is then a second passage in the chapter "Of Excess of Supply," which also contains a footnote reference:

> This important feature in the economical progress of nations will receive full consideration and discussion in the succeeding Book.**[FN2*] . . . .** The true interpretation of the modern or present state of industrial economy is that there is hardly any amount of business which may not be done, if people will be content to do it on small profits. . . . Low profits, however, are a different thing from **deficiency of demand**." [87] [My bolding.]

The footnote [FN2] forwards the reader to Book IV, Chapter IV that deals with the question of low profitability. And there we find a passage that ought to have blown up right from the start Keynes's contention that an acceptance of Say's Law means one denies the possibility of involuntary unemployment. This is Mill describing, as accurately as anyone ever has, the devastation in the labor market caused by recession:

> Establishments are shut up, or kept working without any profit, **hands are discharged**, and numbers of persons in all ranks, **being deprived of their income**, and thrown for support on their savings, **find themselves**, after the crisis has passed away, **in a condition of more or less impoverishment**.[88] [My bolding.]

Bear in mind that not only does this passage exist, but the reader had been directed to it from a passage in which Mill had been explaining Say's Law! Say's Law was, of course, according to Keynes, the reason classical economists denied the very possibility of involuntary unemployment.

Reading the three sections of the *Principles* together we find Mill arguing:

1. recessions do occur and when they do the effect on the labor market is prolonged and devastating;
2. recessions are not caused by oversaving and demand deficiency;
3. recessions cannot be brought to an end by trying to increase aggregate demand.

That is as complete a rejection of Keynesian economics as one is likely to find, and it was stated in 1848. These propositions and their supporting arguments were with near unanimity accepted by the entire mainstream of the economics profession through until the publication of *The General Theory* in 1936. Since then they have almost entirely disappeared resulting in a loss in our ability to understand the nature of recessions or what needs to be done to bring recessions to a timely end.

Endnotes

[83.] "Of the Influence of Consumption on Production," *Essays on Some Unsettled Questions of Political Economy* (1844) in *The Collected Works of John Stuart Mill, Volume IV - Essays on Economics and Society Part I, ed. John M. Robson, Introduction by Lord Robbins* (Toronto: University of Toronto Press, London: Routledge and Kegan Paul, 1967). </titles/244#lf0223-04_head_059>.

[84.] *The Collected Works of John Stuart Mill*, Vol. III, *Principles of Political Economy*, Part II, Book III: Exchange, Chap. XIV. Of Excess of Supply </titles/243#lf0223-03_label_379>.

[85.] ibid.

[86.] Specifically, *Principles of Political Economy*, Book I: Production, Chap. V: Fundamental Propositions Respecting Capital, § 2. Industry is limited by Capital, but does not always come up to that limit </titles/102#lf0223-02_label_793>

[87.] *Principles of Political Economy*, Book IV: Influence of the Progress of Society on Production and Distribution, Chap. IV: Of the Tendency of Profits to a Minimum </titles/243#lf0223-03_label_820>.

[88.] *Principles of Political Economy,* Book IV: Influence of the Progress of Society on Production and Distribution, Chap. IV: Of the Tendency of Profits to a Minimum, § 5. Profits are prevented from reaching the minimum by commercial revulsions </titles/243#Mill_0223-03_580>.

PRIVATE PROPERTY: THE MISSING LINK IN JOHN STUART MILL'S DEFENSE OF LIBERTY

by Richard M. Ebeling

John Stuart Mill's 1859 essay "On Liberty" is one of the most enduring and powerful defenses of individual freedom ever penned.[89] In the broadest sense, Mill defines the range of a person's right to unrestrained liberty over his own choices as extending to that point at which his actions would infringe upon and violate the equal rights of other people to their freedom.

But one of the weakest point in Mill's defense of individual liberty is his failure to clearly align his case for human freedom with the right to private property and its use in all ways that do not violate the comparable individual rights of others.

Mill's Three Forms of Tyranny

Mill argued that there were, historically, three forms of tyranny that have endangered liberty through the ages. The oldest was the tyranny of the one or the few over the many. The one or the few determined how others might live and what they might say and do and, therefore, in what forms their human potential would be allowed to develop.

The newer form of tyranny, Mill said, was the rule of the many over the one. The revolt against the tyranny of the one or the few resulted in the growing idea that the people should rule themselves. Since the people, surely, could not tyrannize themselves, the unrestrained will of the people became the ideal of those who advocated unlimited democracy.

Mill also said that there was a third source of tyranny over the individual in society, and this was the tyranny of custom and tradition. Mill argued with great passion that societal customs and traditions could, indeed, very often be the worst tyranny of all. They were binding rules on conduct and belief that owed their force not to coercion but to their being the shared ideas of the right and proper held by the vast majority in the society.

Private property and the Free Market

What Mill does not give emphasis to or fully appreciate in his essay "On Liberty" is that what enables an individual to follow his own path even in the face of strong customs and traditions is the institution of private property and the free and voluntary relationships of the market economy.

Private property gives an individual ownership and control of a portion of the means of production through which he may then choose how and for what purposes he will live his life. In his home and on his property, in the free society, he can design his life to fit his values, ideals, and desires. What the customs of others consider eccentric can be lived as the norm and the normal on his own private property.

The advantage of the market economy is that an individual can choose how and in what form he will find his niche in the division of labor and the system of voluntary exchange to acquire those things that will enable him to fulfill his own vision of the good life and its purposes.

This will not come without a cost. To earn the income that permits him, as a consumer, to buy the things that will enable him to live, perhaps, an unconventional life may require him to work as a producer at tasks he finds irksome or unattractive.

On the other hand, he can choose to earn a living doing something he enjoys more, but then he may have to forgo the higher income that he could have earned if he had produced and supplied something that potential customers might have valued more highly.

Market Anonymity and Individual Liberty

The market economy also offers the individual a degree of anonymity that helps shield and guard him from prying eyes and the imposed values of others.

Rarely do the consumers of multitudes of market-supplied goods and services know or care about the values, beliefs, or lifestyles of those in the production processes who participate in bringing demanded commodities to the buying public.

A person can earn a living making a product to finance his personal vision of the good life, even when many of the buyers of his product would, perhaps, radically disapprove of the way he leads his life with the income he has earned serving their wants.

It is precisely this type of freedom that private property in the market economy makes possible to all its participants that arouses the disapproval and anger of those who resent the ability of some to flout the customs and traditions believed in and practiced by many if not most of the other members of society.

The danger to liberty arises when those who resent breaches of tradition cry for the use of government power to be used to impose obedience to custom. Only then does the tyranny of custom, as understood by Mill, become the coercion of the many over the few. Only then is freedom denied, indeed suffocated, by politically enforced conformity.

Endnotes

[89.] John Stuart Mill, "On Liberty" [1859] in *The Collected Works of John Stuart Mill, Volume XVIII - Essays on Politics and Society Part I*, ed. John M. Robson, Introduction by Alexander Brady (Toronto: University of Toronto Press, London: Routledge and Kegan Paul, 1977), pp. 213-310. Online: </titles/233#lf0223-18_head_051>.

A RESPONSE TO EBELING ON HARM

by Nicholas Capaldi

Mill concedes in *On Liberty* that the defense of private property (and the market economy in general) rests on somewhat different grounds.

Why?

Liberty in one's personal life (as opposed to the market) is sacrosanct as long as it does not harm others. Mill thinks there are cases where no one is harmed. If it harms others, then the proponents of interference must show (the onus is on them) that the interference itself does less harm. We are innocent until proven guilty.

Competition in the market economy inevitably creates short-term losers. The interests of other people are always involved. There is always harm in some sense. Here we must always show that the good consequences of a free market usually (90% of the time) outweigh the bad consequences. The onus is on the defenders of private property.

INDIVIDUAL RIGHTS VS. SOCIAL UTILITY: A REPLY TO CAPALDI ON "HARM"

by Richard Ebeling

John Stuart Mill's essay "On Liberty," like his other writings on social philosophy and economic policy, is grounded in his own modified version of utilitarianism.

He made very clear that he would "forego any advantage which could be derived to my argument from the idea of abstract right, as a thing independent of utility. I regard utility as the ultimate appeal on all ethical questions."[90] (Mill makes clear in the next sentence that he means what today is often called "rule" and not "act" utilitarianism.)

It is the same premise from which he reasons in his *Principles of Political Economy*, and leads him to insist that it is "society" that decides how what has been produced shall be distributed among the members.[91]

"Social Utility" Makes the Individual a Slave to the Collective

The individual shall be allowed to keep and/or have apportioned to him what the social collective decides to considered his. The individual is a material slave to the community of which he is a member.

In, "On Liberty," Mill truly expresses a deep and sincere belief that the individual should be absolutely free in thought, speech, and action as he chooses without molestation, as long as it does not involve harm to another.

And he reasons that individuals should be respected in this autonomy because of its social benefits to the society as a whole from free, open, and even highly unconventional thinking, living and acting.

The Ambiguities in the Notion of "Harm" to Society

But what is "harm" to another or to "society" as a whole, such that it would represent or reflect the limits to any individual's unmolested freedom of action?

Dr. Capaldi says,

> Competition in the market economy inevitably creates short-term losers. The interests of other people are always involved. There is always harm in some sense. Here we must always show that the good consequences of a free market usually (90% of the time) outweigh the bad consequences.

If I have been a meat eater and now discover the supposed ethical as well as the presumed nutritional benefit from becoming a vegetarian, my change in consumer demands brings "harm" to the butcher and the beef suppliers who, now, lose my business and see their profits diminish.

Suppose I live in a small community and my decreased demand for meat results in a one-third loss in the butcher's business and is sufficient to drive the butcher, given his costs of doing business, into bankruptcy.

On the other hand, since many consumers buy vegetables, the net gain in the grocer's business due to my new vegetarian diet is a mere 1 percent increase in his business and revenues.

On what basis can we calculate and say that the "harm" to the butcher and the beef ranchers is more or less than the "gain" to the green grocer and the fruit and vegetable farmers? And if the "harm" to the butcher and the cattle ranchers is found to be greater than the benefit to the grocer and the farmers, what is to be done?

Am I to be forced to continue paying for meat that I no longer want to eat so the butcher's and the ranchers' relative income positions are not negatively affected? Or are the grocer and the farmers to be taxed and have part of their additional revenues redistributed to the butcher and cattlemen to cushion the impact of my change in relative demand preferences?

The fact is that as long as people live in social interactions rather than in self-sufficient isolation there is little that any one of us may do that might not have, or cannot be interpreted as having, a "negative" or "positive" effect on one or more others.

Herbert Spencer pointed out the insolubility of this train of reasoning when he said that if we argue "a man is not at liberty . . . to do what may give unhappiness [negative social utility] to his neighbors, we find ourselves involved in complicated estimates of pleasures and pains, to the obvious peril of our conclusions."[92]

It is why, I would suggest, that several more modern proponents of classical liberalism have returned to some new variation of the "natural rights" tradition: precisely because it grounds its reasoning in the idea that rights (personal or property) are not gifts, choices, or permissions from the societal collective, but belong to the individual by nature, reason, or a higher source.

"Harm" to others through our individual actions is, often, in this alternative tradition, more clearly delineated as uses of force and fraud. This gives far less "space" for the wriggling room that permits expansions of government intrusions into the personal, social, and economic affairs of the members of any society by speaking of noncoercive "harms" that have far fewer objectively definable meanings.

Benjamin Constant

One final observation, if I may. Grounding our idea of individual liberty on the basis of either "natural rights" or "social utility" can greatly affect how men view their place in society. As the great French liberal Benjamin Constant expressed it:

> Say to a man: you have a right not to be put to death or arbitrarily plundered. You will give him quite another feeling of security and protection than you will by telling him: It is not useful for you to be put to death or arbitrarily plundered. . . . In speaking of right, you present an idea independent of any calculation. In speaking of utility, you seem to invite that the whole question

> be put in doubt, by subjecting it to a new verification."[93]

Endnotes

[90.] John Stuart Mill, "On Liberty" [1859] in *Collected Writings of John Stuart Mill*, Vol. VIII (Toronto: University of Toronto Press, 1977), p. 224. Online </titles/233>.

[91.] John Stuart Mill, *Principles of Political Economy, with Some of Their Applications to Social Philosophy* (Fairfield, NJ: Augustus M. Kelley [1909] 1976), pp. 200-01.

[92.] Herbert Spencer, *Social Statics: The Conditions Essential to Human Happiness Specified, and the First of Them Developed* (New York: Robert Schalkenbach Foundation [1851] 1970), p. 73. Online edition: Herbert Spencer, *Social Statics: or, The Conditions essential to Happiness specified, and the First of them Developed*, (London: John Chapman, 1851). </titles/273>.

[93.] Benjamin Constant, *Principles of Politics Applicable to a all Governments*, trans. Dennis O'Keeffe, ed. Etienne Hofmann, Introduction by Nicholas Capaldi (Indianapolis: Liberty Fund, 2003), p. 41. </titles/861>.

MILL AND THE MARGINAL REVOLUTION

by Steven Kates

This is the question posed:

> There seems to be an elephant in the room that no one has talked about, namely the marginal revolution of the 1870s. I would like to know to what extent does this revolution in understanding make some of JSM's economic views old fashioned, out of date, and beside the point?

The marginal revolution vastly changed the nature of economic theory, but not necessarily for the better. Most importantly, perhaps, it turned economics from a study of the national economy into a study of individual decisionmaking. It thus took economics from its original macro orientation – the wealth of nations – and turned it into a study of incremental changes at the micro level. The macro aspects of economic theory didn't disappear, but were relegated to the then-less-important and mainly secondary study of the theory of the cycle. Static equilibrium became the standard approach rather than the dynamic disequilibrium that was embedded within classical theory.

Second, the marginal revolution took economics from a study of the supply side and shaped it into a study that began, and for the most part remained, on the demand side. Marginal utility became the core which sought to explain how an individual's demands were prioritized. The supply side of the economy was then seen to conform to the structure of demand in an almost passive way. The Keynesian Revolution would complete the process by taking even the theory of the cycle from the supply side to the demand side. The marginal propensity to consume sounded much like the economics that was already common currency, even though an individualistic concept was being applied to the entire body of consumers.

Third, classical economics was conducted in words and concepts. The marginal revolution introduced not only elements which could never be observed (marginal utility), but was readymade for the mathematization of economic discourse. As Blaug pointed out, "the dominant role of the concept of substitution at the margin in the new economics accounts for the sudden appearance of explicitly mathematical reasoning."[94] It was all very well for Marshall to have left the math to the appendix. But no one familiar with modern theory would be unaware the extent to which mathematics (and the use of diagrams) now dominate. A modern economist could only with difficulty read Blaug, never mind Mill.

Lastly, let me touch on Mill's theory of value. I can see how Mill's discussion will seem hopeless to anyone brought up on modern economics. But the question he asked was different from the one we typically try to answer today, which is how do goods and services end up with a particular price. He asked what caused the prices of two goods to be different from each other. Why do you have to pay more for a Ferrari than a Ford? More than that, while we analyze supply and demand in terms of price, Mill used "value" on what we would now think of as the vertical axis. By thinking in terms of value rather than price, he was emphasizing that production in a market economy involved the determination of relative prices and was focused on exchange. By using the more anodyne "money price" on the vertical axis instead of value, we push to the background that something must be given up to get something else.

Mill is unquestionably "old fashioned," but his understanding is far from "out of date and beside the point." What he is, however, is unreadable. I, on the other hand, take enormous pleasure in reading Mill (in the same way and for the same reason that I enjoy Mises and Hayek) because he discusses an economy that is visible everywhere I go. I can hardly imagine a day when what he wrote will have been transcended and have become genuinely out of date. Much of what he writes is no longer of concern. His examples are so long-winded that it can drive you crazy unravelling what he has in mind. But we are also talking here about the man with the 19th century's highest IQ[95] who also suffered under the most extraordinarily rigorous education regime ever imposed on anyone.

I am an imperfect vehicle to explain what Mill meant, but then again so was he. His ideas were profound but also humane. In the political realm, his *On Liberty* and *On Utilitarianism* remain at the heart of our civilization. It is regrettable in my view that the same cannot be said about his economics as well.

Endnotes

[94.] Mark Blaug, *Economic Theory in Retrospect.* 2nd ed. (Homewood, Ill.: R. D. Irwin, 1968), p. 300.

[95.]"Estimated IQs of the Greatest Geniuses of the 15th-19th Centuries," From Catharine Morris Cox, *The Early Mental Traits of Three Hundred Geniuses* (Stanford University Press, 1926). At Assessment Psychology Online .

ON NATURAL RIGHTS AND HARM

by Nicholas Capaldi

Ebeling is correct that there is no utilitarian calculation that can provide us with definitive answers. Mill would agree and was not a utilitarian. That is why it is always necessary to restate the case for liberty.

Ebeling's appeal to "natural" rights is useless (nobody can agree on this metaphysics) and dangerous (it turns into unlimited "human" rights).

Mill is not ambiguous on the meaning of "harm." The "harm" that trumps all others is denying individuals the opportunity to decide for themselves.

Freedom trumps efficiency (philosophical point), and, as a matter of fact, enhances efficiency (inductive-historical argument that keeps us in business).

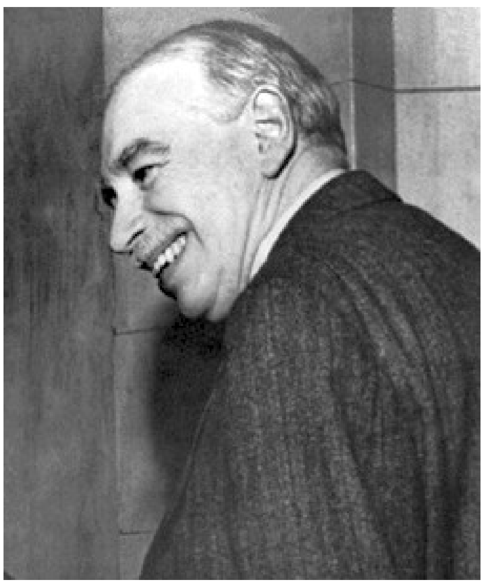
MILL VS. KEYNES ON AGGREGATE DEMAND

by Steven Kates

I came across Mill by accident in 1982 and was immediately convinced. I read his four fundamental propositions on capital and from that moment was no longer a Keynesian. There may be other paths to seeing the deadly flaws in modern macro, but that was mine. It is from Mill that I have derived these three conclusions:

1. Recessions do occur and when they do, the effect on the labor market is prolonged and devastating.
2. Recessions are not caused by oversaving and demand deficiency.
3. Recessions cannot be brought to an end by trying to increase aggregate demand.

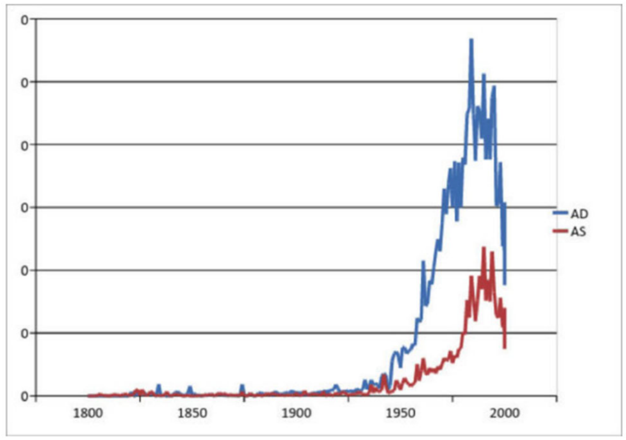
It is also a much debated question just what was revolutionary about the Keynesian Revolution. Laughably, it is now frequently said that Keynes introduced the notion of sticky wages. Apparently, Keynes's contribution has been reduced to an argument that the adjustment process out of recession might be hampered by the failure of wages to adjust quickly enough.



John Maynard Keynes

It is the diagram below on the frequency of use of the terms "aggregate demand" and "aggregate supply" that shows exactly the way in which *The General Theory* changed the study of economics and the business cycle.

The Frequency of Use of the Terms Aggregate Demand and Aggregate Supply From 1800 to 2007



Before 1936, neither the terms, nor the underlying concepts, "aggregate demand" and "aggregate supply" had any presence within mainstream economic theory. An economist was seen as a crank even to mention any such thing – see the fate of J.A. Hobson for an instructive example.[96]

Now, at the first sign of recession, the immediate place anyone looks to for a solution is the level of aggregate demand, with policies designed to raise aggregate demand to restore full employment.

If you think variations in aggregate demand are the cause recessions, or that increases in public spending will hasten recovery, you are a Keynesian. And the sad fact is that Keynesian theory remains the near-universal belief within the mainstream of the profession, even though on every occasion Keynesian policies have been applied, including the stimulus post-Global Financial Crisis, they have miserably failed.

It is Keynesian economics that is out of date. Even though you can find aggregate demand in almost every introductory textbook in the world, as well as in virtually every macro course you might care to name, it really is time we put Keynesian theory into that famous dustbin of history. Keynesian economics has created damage everywhere it has been applied, and it is time we rid ourselves of its presence.

Endnotes

[96.] See for example, John Atkinson Hobson, *The Evolution of Modern Capitalism: A Study of Machine Production.*

New and revised edition. (London: Walter Scott Publishing Co., 1906):

> "On the contrary, if we apply a similarly graduated fall of prices to two different classes of goods, we shall observe a widely different effect in the stimulation of consumption. A reduction of fifty per cent. in the price of one class of manufactured goods may treble or quadruple the consumption, while the same reduction in another class may increase the consumption by only twenty per cent. In the former case it is probable that the ultimate effect of the machinery which has produced the fall in expenses of production and in prices will be a considerable increase in the aggregate demand for labour, while in the latter case there will be a net displacement. It is therefore impossible to argue à priori that the ultimate effect of a particular introduction of machinery must be an increased demand for labour, and that the labour displaced by the machinery will be directly or indirectly absorbed in forwarding the increased production caused by machinery." p. 320.

SUMMING UP ON THE ECONOMICS OF JOHN STUART MILL

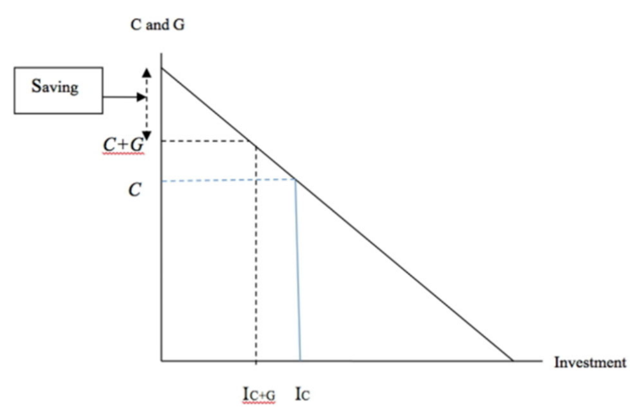
by Steven Kates

This will be my last attempt to explain my understanding of the economics of John Stuart Mill as part of this symposium. In doing so, let me say how grateful I am to the three other participants in this forum who have brought their own understanding of Mill to the table in a way that others will hopefully see how much there is to learn, not only from Mill but from pre-Keynesian economics in general. I would also wish to thank John Barkley Rosser, who from an opposite perspective took on the issues raised, which allowed us to have the most intense but for me enlightening discussion on the Coordination Problem website.[97] But mostly, I owe endless gratitude to Liberty Fund – David Hart and Sheldon Richman in particular – for allowing me this opportunity.

Let me summarize what I have been trying to explain.

And let me again put to use a production possibility curve, whose construction and conception I explained in the first of these articles. In the diagram, the interior of the production possibility curve represents the entire economy. The vertical axis shows forms of output whose production draws down on the resource base with no attempt made to replace what has been drawn down. These are described as "C and G," which consist of forms of consumer demand and most forms of government spending. Their production uses up resources, but what is produced is not intended to contribute to production at some future date. Resources are drawn down, products are consumed or services rendered. But when all of the production is completed, the economy is less capable of producing for the future since resources have been used up during the production process, while nothing has been created to replace what has been used up.

Production Possibility Curve – Consumption, Government Spending and Investment



The horizontal axis represents all forms of drawing down on the economy's resource base directed towards producing forms of output intended to add to the economy's productive base. There is I**C**, which is the level of investment that would take place if there were only consumer demand. I**C+G** is an even lower level of investment spending, because here both consumers and governments deplete the economy's resource base to satisfy their demands.

The level of saving is the proportion of the total economy that is available for maintaining the capital base as well as for new capital investment. The difference between total potential output, where the production possibility curve touches the vertical axis, and the total of consumption and government spending (C+G), is made up of the consumer goods and government services that could have been produced but were not. Saving is the productive potential left over after the economy's resources have been used to produce goods and services bought by consumers and governments.

In a classical model, saving can occur only because of the consumer and government goods and services that could have been produced but were not. The goods and services that were not produced and purchased for current usage permitted a proportion of the economy's existing resources to be used to maintain and extend the capital base. That saving consists of the massive proportion of the economy's resource base that is used to build capital, roughly represented by the triangle at the top of the production possibility curve. Saving does not occur only out of current production as in a typical macro model.

Adam Smith

Consumption to a classical economist literally meant using resources up. When Mill or Adam Smith discuss unproductive consumption, they are describing the using up of resources in ways that do not improve the future flow of output. Productive consumption, on the other hand, is the use of resources in ways that do improve the future flow of goods and services. Such consumption will include labor time, electricity consumed, machine hours taken up and everything else that was used up during their production. They were consumed in the process and are now gone. The actual workers, and much of the machinery, are still in existence, but their time and use has disappeared into whatever particular activities they were engaged in.

For myself, I find this approach clarifying, clear, and the proper basis for sound policy. Here are some of the insights highlighted by this approach bearing

1. while the ultimate aim of all economic activity is to create consumer goods and services, to do so requires a vast hinterland of productive inputs which constitute overwhelmingly the largest part of the economy;
2. resources are used up irrespective of whether or not what is produced is intended to be consumed in the present or to be used to increase the future flow of output;
3. in a stationary economy value created is equal to the value used up;
4. economic growth occurs when more value is created than is used up;
5. economic activities which do not at least replace the value that has been used up cause the economy to contract;
6. productive investments take time, often requiring many years before the requisite outlays are repaid in an addition to the economy's flow of goods and services;
7. productive investments are almost invariably based on entrepreneurial judgement;
8. unproductive activity in the classical sense draws down on existing resources in creating utility but

leaves nothing in return that can contribute to future rates of growth;

9. the level of productive investment cannot be increased by increasing the level of unproductive public spending – an economy cannot be made to grow by wasting its resources;
10. recessions are caused by distortions in the structure of production which occur within the interior of the production possibility curve, that is, within the interior of the economy;
11. recessions may also be caused by attempts to produce more than the economy is capable of producing, leading to unexpected input shortages, bottlenecks, and increased costs;
12. the most frequent but not the only cause of the distortions that lead to recession are disorders that occur within the monetary and financial system;
13. a Keynesian stimulus will not only never work, it will make things worse since it will almost invariably divert resources from productive uses to unproductive;
14. even worse, a Keynesian stimulus, working as it almost invariably does on the unproductive side of the economy, will create commercial pathways within the economy (a structure of production) which cause resources to be used in ways that are difficult to reverse without further economic disruption;
15. national saving is made up of resources, not money;
16. national saving is the use of resources to improve the underlying productivity of the economy;
17. thinking of saving only as money amounts will make a sound grasp of the underlying realities impossible;
18. recessions are never caused by decisions to save – both the owners of capital and the owners of labor are always keen to have the resources they own earning an income;
19. allowing resources to find their best uses through adjustments in relative prices must be the single most important element of policy, not only during recessions but in every phase of the cycle;
20. unemployed resources need time to find their most productive uses, which is as true for unemployed capital as it is for unemployed labor;
21. there are various policies governments may adopt to hasten the adjustment process during recessions, which may even include small increases in public spending;
22. business tax cuts and commercial interest-rate reductions are likely to be a useful positive approach in dealing with recession;
23. the one policy governments should never adopt is to attempt to end a recession by replacing private-sector expenditure with public expenditure;
24. there is no such thing as a multiplier process;
25. there is no such thing as a general glut.

Endnotes

[97.] "Mill > Keynes, so says Steven Kates", posted by Peter Boettke on July 06, 2015 on *Coordination Problem* <http://www.coordinationproblem.org/2015/07/mill-keynes-so-says-steven-kates.html>.

MILL ON REFORM AND COMPENSATION

by Sandra J. Peart

Professor Ebeling has provided ample evidence of Mill's antislavery position, including his role as speaker for the Jamaica Commission, which sought to punish Governor Eyre for his harsh treatment of former slaves in the Jamaican uprising. More information can be found in "The Secret History of the Dismal Science." Part III:

"The Governor Eyre Controversy".[98] The Judy cartoon posted previously, with the portrait of Eyre hanging behind Mill dressed as a woman, makes clear that Mill's role against Eyre was well known at the time!

It is worth noting that Mill's vision of reform is one which takes the status quo seriously, in a way that economists trained in the Kaldor-Hicks tradition rarely recognize.[99] For Mill, movement away from even a status quo that is immoral will require a trade, compensation. This was true no less for slavery than it was for other less radical reforms. Thus in his *Political Economy* Mill wrote:

> Whether the object [of reform] be education; a more efficient and accessible administration of justice, reforms of any kind, which, like the Slave Emancipation, require compensation to individual interests; every one of these things implies considerable expense, and many of them have again and again been prevented by the reluctance which, though ... the cost would be repaid, often a hundredfold, in more pecuniary advantage to the community generally.[100]

For Mill and for the politicians who worked out the elaborate trade for emancipation, it was necessary and indeed fitting that former slave owners would be compensated by an agreed-upon sugar tariff. For Mill's opponents, including Thomas Carlyle, it would be better to continue with slavery than to have British taxpayers pay for its abolition.

In contrast to the tradition of actual compensation, with the coming of new welfare economics, reforms could be pronounced efficient on the grounds that a compensation making all parties better off could be imagined; a reform for which compensation might be imagined to increase total happiness was said to be Kaldor-Hicks efficient. Such a change in economic analysis placed the economist in the role of advising policymakers on the basis of apparently expert knowledge about total welfare and the allotments that would accrue to various people.

Endnotes

[98.] David M. Levy and Sandra J. Peart, "The Secret History of the Dismal Science. Part III. The Governor Eyre Controversy," Econlib June 4, 2001. <http://www.econlib.org/library/Columns/LevyPeartdismal3.html>.

[99.] See, Kaldor, Nicholas. 1939. "Welfare Propositions of Economics and Interpersonal Comparisons of Utility," *Economic Journal* 49: 549-52; and Hicks, John R. 1939. "The Foundations of Welfare Economics," *Economic Journal* 49: 696-712.

[100.] J.S. Mill, *Principles of Political Economy*, p. 866. Book V: On the Influence of Government, Chap. VI: Comparison between direct and indirect taxation, </titles/243#lf0223-03_label_1314>.

THE JEVONIAN REVOLUTION IN ECONOMICS

by Sandra J. Peart

Professor Kates has emphatically and repeatedly shown us how Mill and his contemporaries viewed the world, seeing it whole, constantly in motion, changing and shifting. Rightly so. Two questions arise: First, what happened -- why isn't this how economists regard the world today, and does it matter? And second, does Mill have anything to teach us today?

The first of these is perhaps easier to answer than the second, and I'll set the second aside for another comment. Of course, *much* happened as economists moved from the mid- to the late-19th century, but one might point especially to two profound changes that were sustained well into the 20th century. From a focus on motion, change, and (I would add) complexity, economists such as William Stanley Jevons specified a simpler sort of analysis, one in which conditions for equilibrium were laid out for consumers and producers. The future of economics, Jevons wrote, depended on getting the equilibrium conditions specified first. Violations of equilibrium conditions did not call into question the operation of economic laws. Jevons wrote:

> In practice, no market ever long fulfills the theoretical conditions of equilibrium, because, from the various accidents of life and business, there are sure to be people every day compelled to sell, or having sudden inducements to buy. There is nearly always, again, the influence of prospective supply or demand, depending upon the political intelligence of the moment. Speculation complicates the action of the laws of supply and demand in a high degree, but does not in the least degree arrest their action or alter their nature. We shall never have a Science of Economics unless we learn to discern the operation of law even among the most perplexing complications and apparent interruptions.[101]

While a full perusal of Jevons's economics demonstrates that he by no means believed the world to be static or consumers and producers to be in a static equilibrium, he and his contemporaries wished to provide the mathematical description for equilibrium before turning to the harder problems of complexity and change. The simpler problems took over the analysis, and the harder problems took a back seat and became secondary. Equilibrium analysis prevailed. Kates remarks that Jevons shifted the analysis to demand. I agree, but I would add that he also and perhaps more significantly shifted our analysis to the study of equilibrium conditions.

I also return to a point that I made in a previous post. Among the significant developments late in the century, I would point to a decline in the belief that, left to their own resources, people will become self-reliant and, even more, improve their lot in life. While economists from Smith through Mill were convinced that the way forward was one of improvement, late in the century economists such as Jevons and Marshall, and then 20th-century Progressives such as Irving Fisher and A. C. Pigou became increasingly convinced that people needed to be told how to improve themselves.

Endnotes

[101.] Jevons, *Theory of Political Economy*, 1871, p. 111. Online version 3rd. ed.: William Stanley Jevons, *The Theory of Political Economy* (London: Macmillan, 1888) 3rd ed. </titles/625#Jevons_0237_257>.

THE RELEVANCE OF J. S. MILL

by Sandra J. Peart

Perhaps more than any economist of his achievements, Mill's stature in the profession has been underplayed. (George Stigler's account is, however, an exception, as Stigler clearly demonstrated Mill's originality and continued relevance.[102]) The question I posed in my last post, and one that Steve Kates asks us to consider, is what is there to learn from Mill? Kates has offered a number of answers to this: the emphasis on supply, on technological improvement, on improvement of any sort. To his insights I would add that Mill would have us focus on complexity. More than this, Mill urges us to be humble. He reminds us that complexity implies unpredictability for the scientist. If the world is as complex and shifting as Mill maintains it is, then it is enormously difficult for a scientist accurately to predict the effects of wide-scale reform.[103] For this reason reform must be agreed upon in a sometimes long and protracted discussion that may well entail compensation for those who lose as a result of the change. More than this, experimentation on a small scale becomes an essential tool for reform – the scientist observes what people actually do and in so doing gains confidence that x will work in situation y. Since situations often differ significantly, the scientist must then examine whether y' is close enough to y for x to work. If this is an accurate characterization of Mill's method, he was a very different sort of economist from those who teach in graduate programs or offer up policy advice today.

Endnotes

[102.] George Stigler, "The Nature and Role of Originality in Scientific Progress," *Economica* n.s., 22 (November 1955), pp. 293-302.

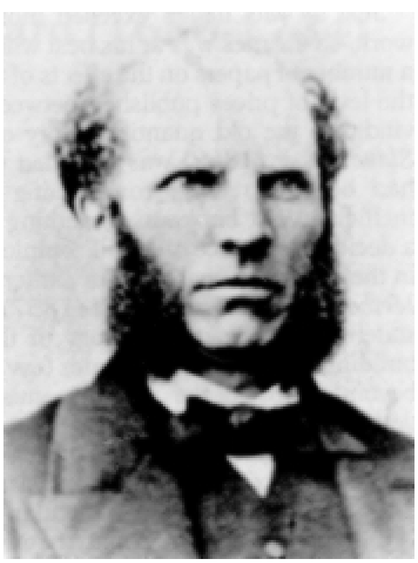
[103.] Samuel Hollander and Sandra J. Peart, "John Stuart Mill's Method in Principle and in Practice: A Review of the Evidence," *Journal of the History of Economic Thought* 21 (December 1999), pp. 369-97.

J. S. MILL, JOHN E. CAIRNES, AND THE MEANING OF AGGREGATE DEMAND AND SUPPLY

by Richard M. Ebeling

Dr. Kates is certainly correct when he observes in his comment on, "Mill vs. Keynes on Aggregate Demand," that "Before 1936, neither the terms, nor the underlying concepts, 'aggregate demand 'and 'aggregate supply' had any presence within mainstream economic theory."

Yet the terms were not totally alien to economic discourse, and in one case was explained in a way that was consistent with and not antagonistic to the logic of Mill's explanation of Say's "Law of Markets."



John E. Cairnes

This was in a chapter in John E. Cairnes's, *Some Leading Principles of Political Economy, Newly Expounded* (1874), in a chapter devoted to clarifying some aspects of the theory of "Supply and Demand."[104]

Cairnes (1823-1875) had been a professor of political economy at Queen's College, Galway, the University of Dublin, and at University College, London. He was well known for his detailed analysis of the gold discoveries in Australia in the 1850s, and their impact on world prices in terms of a "micro-economic" explanation of the nonneutral manner in the resulting inflationary process worked its way out around the globe in a time-sequential pattern.[105]

Cairnes argued:

> The fundamental truth to be seized in connection with Supply and Demand . . . is that, conceived as aggregates, as each comprising all the facts of that kind occurring in a given community, Supply and Demand are not independent phenomena, of which either may indefinitely increase or decrease irrespective of the other, but phenomena strictly connected and mutually dependent; so strictly connected and interdependent that (excluding temporary effects and contemplating them as permanent and normal facts) neither can increase nor decrease without necessitating and implying a corresponding increase or diminution of the other. Aggregate demand can not increase or diminish without entailing a corresponding increase or diminution of aggregate supply; nor can aggregate supply undergo a change without involving a corresponding change in aggregate demand.[106]

Cairnes asks us to first conceive of circumstances under barter exchange. Once there is division of labor, the supplying of any product the production of which has been specialized in represents a demand for other commodities against which it might be traded, since there is no other way what is demanded may be obtained other than by offering so other good in exchange for it.

Once a medium of exchange – money – is introduced into the exchange process, trade becomes a transaction between seemingly two distinct sides of the market: the offering of an object representing "general purchasing power" for specific commodities ("Demand") and the offering of specific commodities for the object representing "general purchasing power" ("Supply").

> And if we add up all that is offered on both sides of the market, aggregate Demand or aggregate Supply thus become possible ideas . . . Demand, as the desire for commodities or services seeking its end by an offer of general purchasing power; and Supply, as the desire for general purchasing power, seeking its end by an offer of specific commodities or services.[107]

As two distinct sides of the market, Cairnes says, it may seem that they can change independently of each other – a decrease or increase in Aggregate Demand separate from Aggregate Supply, and a decrease or increase in Aggregate Supply separate from Aggregate Demand.

However, assuming no increase (or decrease) in the quantity of money through which market transactions are undertaken, the only way there can be an increase in "aggregate demand" in terms of general purchasing power offered for desired commodities is first having been an increased "aggregate supply" offered for units of "general purchasing power" (money).

Or as Cairnes says:

> It is true, where we have a medium of exchange, we can form the conception of general Demand as distinct from general Supply. . . . But in point of truth and fact the two things are not separable. Purchasing power, in the last resort, owes its existence to the production of a commodity, and, the conditions of industry being given, can only be increased by increasing the quantity of commodities offered for sale; that is to say, [aggregate] Demand can only be increased by increasing [aggregate] Supply. . . . This, I repeat, is fundamental in the theory of exchange; and all assumptions to the contrary must be regarded as baseless and absurd.[108]

And, likewise, if there is a decrease in the offering of goods or services in exchange for units of money ("general purchasing power"), this reciprocally decreases demand in the economy. "If a given group of laborers and capitalists produce less . . . they have, as an aggregate, less to offer for sale," Cairnes reasoned, "and the diminution of general Supply would be exactly balanced by a corresponding diminution of general Demand."[109]

However, what can happen, and in a world of constant change will happen, is supply and demand for particular commodities being out of balance at the specific price at which the good may be bought and sold at a moment of time. The "normal" process in such situations, Cairnes argued, was for any respective excess demand or excess supply in a particular market to bring about a change in that good's price in the required direction to, over time, bring that market back into balance.

If there were to be a series of "excess supplies" for particular commodities at the given market prices, there could be appear to be an excess of "aggregate supply" over "aggregate demand." But this would be only the case in that the prices of those goods in excess supply had not, yet, been lowered sufficiently to earn the "general purchasing power" (money income) that would enable the suppliers of goods in excess amount to demand more of the goods they desire on the "aggregate demand" side of the market.[110]

And, finally, a long-run increase in "aggregate demand" can only come from a long-run growth in aggregate supply, which, in turn, can only result from the necessary accumulation of capital through savings and investment to expand production, increase the productivity of labor, and bringing about a rise in the wages of labor.[111]

Thus, in this very, very brief summary of John E. Cairnes's argument we find a complementary analysis to part of John Stuart Mill's exposition (though in the form, in places in *Some Leading Principles*, of an immanent criticism of some of Mill's reasoning in his *Principles of Political Economy*) with an explicit use of Aggregate

Demand and Aggregate Supply concepts, but with implications and conclusions very different than John Maynard Keynes's 60 years later.

Endnotes

[104.] John E. Cairnes, *Some Leading Principles of Political Economy, Newly Expounded* (New York: Augustus M. Kelley [1874] 1967), Chapter II, "Supply and Demand," pp. 22-42.

[105.] John E. Cairnes, *Essays on Political Economy* (New York: Augustus M. Kelley [1873] 1965), pp. 1-165. Cairnes was also recognized as a major contributor to economic methodology in the late 19th century with his book *The Character and Logical Method of Political Economy* (New York: Augustus M. Kelley [1875; 2d ed. 1888] 1965). Online version: John Elliot Cairnes, *The Character and Logical Method of Political Economy* (London: Macmillan, 1875 2nd ed). </titles/282>.

[106.] Cairnes, *Some Leading Principles of Political Economy*, p. 23.

[107.] Ibid., p. 25

[108.] Ibid., p. 31.

[109.] Ibid., p. 33; also, p. 36: "Thus, as I have shown, it is impossible for the general demand of a community to increase or diminish save through a corresponding increase or diminution of the general supply of commodities in that community."

[110.] Ibid., pp. 38-41.

[111.] Ibid., pp. 194-200.

ABOUT THE AUTHORS

Steven Kates is an associate professor of economics at RMIT University in Melbourne. He is an economist who, from the perspective of others, seems to specialize in the history of economic thought. From his own perspective, however, he has merely been doing the work of an economist by trying to explain to others the operation of a market economy based on the logic found within John Stuart Mill's 1848 *Principles of Political Economy*, suitably modified with a handful of discoveries made since that time, none of which were made by Keynes. He has written his own textbook based on these principles, which is now in its second edition, *Free Market Economics: An Introduction for the General Reader* (Elgar 2014). And oddly, although he worked for 24 years as the chief economist for the Australian Chamber of Commerce and Industry, because classical economic theory is so entirely sound and sensible, it never occurred to anyone, in spite of his many submissions and public presentations, where his theoretical position originated. It would never have crossed his mind, for example, that government stimulus spending would lead to recovery but, based on his classical understanding of the structure of our economies, was certain such increases in public spending would only make things worse.

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