

ETHICS AND THE ECONOMICS OF ADAM SMITH AND J.S. MILL:
ON THE MORAL SIGNIFICANCE OF CLASSICAL ECONOMICS

by

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To my parents, my wife and my son



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ABSTRACT

This work examines some of the effects that developments in economic theory might have had on concepts of economic justice that are associated with it. For instance, concepts like desert which seemed to have dominated human thought on economic justice since Aristotle had disappeared almost entirely from present-day discussions of the subject. One possible explanation to it is the emergence of general equilibrium as a dominant feature of economic theory. In it, the idea of simultaneity erases all traces of causality between agents' activities and outcome. Thus the elusiveness of responsibility becomes detrimental to any theory of desert. But whether or not the demise of desert theories should follow from such developments in economic analysis also depends on what is meant by general equilibrium as well as on what is meant by desert. It matters a great deal whether the idea of general equilibrium is a perception of the real world or, a rationalistic tool of analysis. While the Walrasian notion of general equilibrium seems close to the latter, the 'empiricist' tradition of liberal classical economics implies a tendency to the former. However, in view of such a difference in the epistemological foundations, the whole idea of general equilibrium is open to different interpretations altogether. Classical economics, as represented by Adam Smith and J.S. Mill is a good example of models of general equilibrium where moral responsibility cannot be evaded. Indeed, in the ethical analysis of these models—conducted by the same people who suggested them—the role of desert was prominent. Contrary to the general belief that classical economists advocated natural liberty for its moral goodness as much as for its economic efficiency, analysis by desert reveals a serious moral inadequacy of natural liberty. This, in turn, may explain the discrepancy between the received view and the fact that the works of classical economists are sometimes full with moral apprehensions about natural liberty.

To reach such conclusions there is a need to re-interpret the works of Smith and Mill at both levels of economics and ethics. The bulk of this work is devoted to that purpose. A new interpretation of Smith's ethics is being offered. It is based on the consistency of human character and on the existence of some 'rationalistic' considerations in his work. Such an interpretation offers an alternative (and more comprehensive) solution to what became to be known as the Adam Smith's problem (old and new). Also, the application of his moral theory to the analysis of actions implies that a correlation must exist between intention and consequences. Thus the moral significance of the proposed spill-over of beneficence derived from the 'invisible hand' mechanism, is questioned. A new interpretation of Smith's economic follows where 'pre-market demand' relates the capitalists' decisions on saving to equilibrium prices. A distinction that has a moral significance is

then being drawn between 'market-price' and 'natural price'.

The study of Mill's methodology serves as a foundation to interpret some apparent contradictions in his moral theory (the relationship between Utilitarianism and Liberty). Ethology, which is the theory of character formation plays a major role in it. Coupled with Mill's theories of Free-will and Individuality, it is possible to establish a solution to the problems of Utilitarianism and Liberty without expanding the concept of utility. Similar principles are then introduced to Mill's discussion of economic justice. The principle of individuality is being presented in the form of Mill's principle of 'proportional remuneration'. A discussion of his theories of property follows and then, the question of the meaning of 'proportional remuneration' is being put forward. Before, however, an exposition of Mill's economic model in the framework of 'cost of production' general equilibrium is being offered. Then, the principle of proportional remuneration is being investigated. It is also related to a much wider question of the role and meaning of the labour theory of value in classical economics.

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PART I

ETHICS-ECONOMICS RELATIONSHIP: AN INTRODUCTION

1. GENERAL INTRODUCTION

This work is part of a wider research programme which is aimed at examining how concepts of economic justice are affected by developments in economic theory. More broadly defined, the context of this work is an investigation into the question of the relationship between ethics and economics. It is, however, confined to the study of these relationships in the context of classical economics alone.

What motivated this study is an observation whereby a concept of economic justice that seemed to have dominated human thought since Aristotle (and probably even earlier than that) had disappeared almost entirely from present discussions of the subject. I refer here to the concept of desert.¹

Presumably there are many reasons for that and some of which may appear to rest entirely in the domain of internal developments within ethics and philosophy in general. Some however, by nature of the subject, must be associated with changes in economic theory and the

¹The lost status of desert is discussed in more details in section (a) below. It should also be made clear that what I mean by desert is not a theory of entitlement derived from some natural qualities. Rather, I mean a concept of remuneration that is associated with efforts or deeds or, to generalise, with choice.

subsequent change in the role and meanings of various economic concepts. One such reason, for instance, may be the emergence of Walrasian general equilibrium as a dominant framework of economic theory. In it the idea of simultaneity erases all traces of causality and thus makes it difficult, if not impossible, to associate any outcome with a particular activity (or choice) of any economic agent. Any theory of desert, therefore, will become intractable in such an economic setting.

There are, of course, other reasons and I will discuss what motivated this work in more details in the next section of this general introduction. What is however clear is that the task in front of us involves examining the correlation between developments in economic theory and the applicability to economics of various ethical concepts. Associating changes in economic theory to changes in the corresponding ethical discourse may, in principle, depend on two major features of such a change. One is a change in the subject matter of economics and the other, a fundamental change in methodology (and in particular, epistemology).

A change in the subject matter of economics may be a result of real changes in the world that surrounds us. These changes may be social, technological or both. They could, for instance, be changes in the economic significance of class distinctions. A change from an exchange economy with a very low division of labour where class distinction has no economic meaning, say, by way of its relation to modes of production, to an economy with a relatively high degree of division of labour where class distinctions and economic roles are

closely related². Naturally what might have been considered as morally good, or just, in an exchange economy where class distinction has social meaning other than economical, cannot be the same as what might be thought of as morally acceptable in an environment where class distinction is marked by its economic significance.

At the level of methodological fundamentals the problem is perhaps easier to define. What we want to look at is whether or not there are some intrinsic relationships between the nature of economic theory and the nature of ethics. In particular, we would like to examine the epistemic content of economic propositions before we can apply to them ethical concepts which might have different epistemic significance.

For instance, if an economic model has been constructed on the foundation of 'classical empiricism'³ then obviously the epistemological content of the assumptions must be empirical. In other words, the assumptions are a description of the world. In such a case, would it be reasonable to apply concepts of justice that are derived in a 'rationalistic'⁴ manner?.

When one associates economics with 'classical empiricism' one is not

² I will show later in this chapter that such a change can be observed as we move from the partial equilibrium analysis of Aristotle through a similar, but nevertheless distinct, analysis of St. Thomas of Aquinas to the emergence of classical economics where the class distinction and its affect on production became the focus of interest.

³ By 'classical empiricism' I mean the empirical tradition of Locke and Hume.

⁴Here I refer mainly to the Cartesian-Kantian tradition.

just saying something about the nature of economics, one is also saying something about the human mind. About how we perceive the world, how we form concepts, ideas etc.. This, I believe, cannot be entirely unrelated to how we form moral concepts, or ideas.

If we look at the Walrasian model and the subsequent treatment of it by Pareto, many serious questions of the methodological type arise. I believe that I can show that Walras was first and foremost a 'rationalist'; almost of a Cartesian kind.⁵ What then, one may ask, is the meaning of Pareto-Optimality in the context of his model. Clearly it is a concept of efficiency in terms of utilities. However, if utility is a 'rational' construction or, as Friedman (1956) puts it, an 'as if' statement, it is not a description of the world. Thus to argue that an allocation is Pareto-optimal does not tell us much about the real circumstances of the individuals involved. It only says that 'rational beings' --who do not really exist-- cannot get a better deal without someone becoming worse off. But as people themselves are not necessarily 'rational' Pareto-Optimality is meaningful only if we argue that people tend to be 'rational' or that they 'should' be 'rational'. As neither of these is self-evident Pareto-Optimality is not the firmest foundation for a theory like Welfare Economics whose main concern are the circumstances of individuals within the economic system.

⁵Namely with little belief in any kind of direct relationship between the creation of the mind and their extension in the real world. So much so that he had to resort to a different model altogether in order to examine the relationship between his 'ideal' model and its possible extension in the world of matter. I refer here to the Tatonnement which, by the way, failed to fulfil its purpose.

This, of course, is not an argument against the use of 'rational' methods or against the 'as-if' argument. The usefulness of such constructions for the purpose of predictions cannot be denied. But whether 'prediction' implies 'explanation' is yet another serious hurdle to overcome. Ethical arguments in any case, when applied to economics, must be based on an understanding of the economic world rather than on the powers of its prediction mechanism.

All these are tremendously difficult and important issues, in particular, as we advance towards the 20th century where the problems of epistemology became much more complex. They are, however, beyond the scope of this particular study but they must be borne in mind throughout the reading of this work.

The reason why this work cannot cover the above issues is that much work was involved in the very first step of this ambitious programme. To analyze the association of changes in economic theory with changes in the conception of economic justice one must be able to establish first that a particular economic system corresponds to particular ethical ideas. Then, one must be able to establish that a change in economic theory has indeed come about and what is the nature of this change. Then, one must examine whether this change imposes a change in the ethics that is applicable to the new economic system. An imposition that may be a result of a change in either the role of economic variables due to changes in the subject matter or, due to a change in the meaning of these variables (a change in their epistemic content). Alternatively, one must examine whether the concepts of ethics used in the past are still applicable to the new

system.

Perhaps the most significant and comprehensive change in the structure and nature of economic theory took place in the transition from the classical to the neo-classical paradigms. The first step, therefore, is to establish the application of ethics to economics in the context of classical economics. It is to this end -- the moral significance of classical economics-- that this dissertation is dedicated.

The two immediate questions that arise are (a) what does one mean by 'classical economics' and, (b) which moral system should be associated with it. In the case of the classical school -under any reasonable definition- the answer to the second question seems to be almost straightforward. Most of the great scholars who wrote on economics also wrote on ethics, and usually they did so as part of a more comprehensive view of the social sciences. Thus, it will be sufficient to investigate the relationship between and across their own ethics and economics to see whether there are some intrinsic relationships between ethics in general and their classical models of economics.

As for the first question I will follow the convention. When I write about the 'classical school' I will refer here to what might be generally define as the 'liberal' tradition of 'classical economics'. By this I mean that I shall concentrate on the two major scholars whose writings are directly associated with the advocacy of free-trade (or natural liberty); Adam Smith and J.S. Mill. I also

imply by this that I shall exclude from my analysis a comprehensive discussion of other traditions, like the Marxian one, that are associated with classical economics. I will not, however, ignore this branch of classical economics altogether. In the analysis of how the theory has developed from Smith to Mill, I will also spend some time discussing and questioning whether the road to Mill is, as is usually implied, diametrically opposed to the one that leads to Marx, at least from the moral point of view.

Adam Smith and J.S. Mill were great scholars about whom a lot has already been said. While reading through their works I occasionally found myself at odds with the received view about their interpretations. Therefore, I had to devote some time to establish my own interpretation of some aspects of their works. Consequently, the reader will feel that there are a few digressions from the line of argument that was portrayed above. As I said before, this work is only a very first step, even a preliminary one, in my research programme. It should therefore be seen only as a novel exploration of Smith and Mill from the particular point of view of the relationship between their ethics and economics.

On the whole I believe that I have succeeded in establishing three major general propositions. One, that within the classical paradigm of which Smith and Mill are representatives, the framework of analysis is that of general equilibrium.⁶ However, unlike the

⁶This may not be a novelty in as much as Smith is concerned but it is, by way of interpretation, in Mill's case. There is also a difference between the model applied to Mill and the one that is applied to Smith. In the case of the former, the novelty of my interpretation is that it is not based on a kind of input-output

accepted view, this general equilibrium is different in meaning and structure from the modern notion of its counterpart. Second, that Smith and Mill cannot be seen as utilitarians in the accepted sense of the word. And that each of them, in a different manner, thought of desert as the key principle of economic justice. This, I believe, is a natural conclusion from the way they perceive and formalise the economic model. Also, in that context, both scholars who were fundamentally (but not entirely) empiricists drew obvious and strong relationships between morals and economics through their analysis of human nature. Namely, what it is that dominates people's moral opinion is not unrelated to what dominates their pursuit of their own interest. But whether their actual actions, or the state of nature, affect their natural features and consequently, their moral opinions etc., is not very clear. In the case of Smith such a full cycle of the human character is not considered but is not logically inconsistent with his general theory of human nature. In Mill the dynamic perception of the human character is explicitly acknowledged through his references to a theory of Ethology. Unfortunately, he failed to develop this theory. However, through some logical extrapolation ethology can play a significant role in explaining some of the difficulties in his ethics though the features of the emerging character can only be speculated. The third conclusion, following the second one, is that it is false to believe that these scholars thought of natural liberty in the sense we understand it today as morally desirable.

Naturally these are only the general conclusions. There are many more

model rather that demand plays an unexpectedly significant role.

additional points to be made in the particular context of each scholar but I do not wish to give a full account here. Each part of this work will open with an introduction that will be specific to the scholar who is being analyzed. I will explain their the reason why I chose each of them and what are the major problems with their interpretations from the ethics-economics relationship point of view. I will, nevertheless, offer now a very brief outline of the work's structure and then, in section (a) of this introduction, I will give a general account of what motivated and directed this work. I will discuss there the general problems of theories of desert in the context of the neo-classical paradigm as well as try to establish the dominance of desert theories in the past. This section can be skipped without seriously affecting the purpose of this particular dissertation.

The first part of this work deals with Adam Smith. At first, his methodology is being discussed and a point is being made about some 'scholastic' ideas that still exist in Smith's perception of the world. This discussion leads to a new interpretation of Smith's moral theory which is based on his theory of human nature. Under this interpretation the 'Adam Smith Problem' (the TMS-WN relationship) is easily solved. Also, the application of his moral theory to the analysis of actions implies that a correlation must exist between intention and consequences. Thus the moral significance of the proposed spill-over of beneficence derived from the 'invisible hand' mechanism, is questioned. A new interpretation of Smith's economic model is then offered. According to this interpretation, where 'pre-market demand' relates the capitalists' decisions on saving to

equilibrium prices, a distinction that has a moral significance is being made between 'market-price' and 'natural price'.

A section is devoted to a general discussion of how the epistemological foundation can serve as a tool to study the evolvement of ethics-economics relationship between the times of Adam Smith and Leon Walras. In particular, some considerations are given to the question of framework. A distinction is being offered between the Walrasian notion of General equilibrium (a form of simultaneous equations) and a classical idea of it where causality is more easy to detect. The moral implications of these two different approaches is then only partially discussed.

The study of Mill's methodology serves as a foundation to interpret some apparent contradictions in his moral theory (the relationship between Utilitarianism and Liberty). It seems that the key to Mill's work is the neglected Ethology. Given Mill's theory of the Free-will, I suggest that Liberty, or Individuality, is not even a principle of justice as it is a pre-requisite for moral accountability. The fact that people's characters evolve (ethology) means that whether or not they have a free-will depend on the state of their individuality. Having no individuality means that people do not have a free will and thus are not morally responsible. Hence, even without expanding the principle of utility, one can offer an 'exogenous' (to morality) and consistent explanation to the theory of Liberty.

In the last two sections, I explore the implications of Mill's moral theory to his economics. First, the principle of individuality is

being presented in the form of Mill's principle of 'proportional remuneration'. A discussion of his theories of property follows and then, the question of the meaning of 'proportional remuneration' is being put forward. Before, however, an exposition of Mill's economic model in the framework of 'cost of production' general equilibrium is being offered. Then, as an extrapolation, the principle of proportional remuneration is being investigated. It is also related to a much general question of the role and meaning of the labour theory of value in classical economics.

(a) The Lost Status of Desert: Motivation and Background

Before plunging into the depth of analyzing Smith and Mill I would like to share with the reader some of the general thoughts which motivated and directed this research programme. The following section, therefore, should not be seen as the final product of any research rather as the initial point; the point of questioning and reflection. Therefore it is not an integral part of the work and the reader may, if s/he so wishes, to skip it without affecting the integrity of this work.

As I said before it was the poor status of desert -- a remuneration principle that is associated with efforts and deeds-- against the background of its past dominance that has intrigued me first. There might indeed be many reasons why desert has almost disappeared from the agenda of economic justice debates but there are surely some

which are strongly associated with the structure of economic theory.

(i) Economic Theory and Moral Principles.

Two such reasons for the decline of desert theories in economics might have been the emergence of Walrasian General Equilibrium as the dominant framework of economic theory and; the dominance of Utility theory in individuals' behaviour analysis as well as in the subsequent analysis of ethics-economics relationship. Walrasian General Equilibrium means, first of all, complete inter-dependence between all those variables which we consider to be 'economic variables'. This, in other words, also means that we cannot detect clear causal relationships between those variables. If everything is being determined simultaneously then what one gets cannot be the direct result of what one does. Moreover, as one is at the same time a seller and a buyer, the possible advantages of his position in one market will be balanced by the disadvantages he might incur in the other market and vice versa. Hence there is nothing of great insight about effort-outcome relationship that we can learn in such an economic setting. Partial equilibrium analysis, which on the face of it seems the proper framework for any theory of desert, is a technical modification that can generate no ethical argument of any substance.

One may also wonder how, in principle, can anyone associate effort (provided that it can be measured) with remuneration in any neo-classical paradigm. After all, what dominates modern economic

analysis is the subjective attitudes of all economic agents. That is, if, say, labour is a measure of objective effort, equilibrium implies that the disutilities of labour were outweighed by the utilities derived from the remuneration (the bundle of goods).

To use a less Cardinal terminology, a bundle with so much remuneration and so much labour is preferred to any other possible combination. Desert, if meaningful at all, is therefore embodied in the concept of utility (or preferences). This, I believe, is the second reason for the elimination of desert from the ethics-economics agenda.⁷

Whether the mere use of the theory of utility (in its ordinal form) in economics has moral implications is yet again another serious question. What is, however, quite clear is that even without utilitarian moral considerations, desert and the theory of utility,

⁷Scepticism about how well does the concept of utility express the individual's welfare (or, as Hicks called it 'the ends of the economics life') has been pointed out by economists like Hicks(1959) and Sen(1987). Hicks wrote : "this characteristic feature [welfare economics] can be described as a belief that ends [of economic life] can be adequately expressed in terms of 'utility functions' or 'indifference maps' that are 'revealed on the market', or could be so revealed under suitable conditions. That we need some such constructions as these I do not deny. Our basic concepts, Production and Distribution themselves, make no adequate sense without them;...But...I have become more and more conscious of the artificiality of these assumptions. They are simplifications, by which we beat reality into a form which makes it tractable to economic analysis; they are not more than that. In our role as economic technicians, we cannot do without them; but as soon as we aspire to be something more than technicians, we must see them for the shaky supports that they are."(Hicks, 1959, p. x).

My criticism, however, goes beyond this. Not only that it is possible that we do not capture with utility theory all what constitutes the individual's perception of his or her welfare, but it might in itself contradict some basic principles that we might have about the internal composition of the bundle of economic variables which depicts our circumstances.

as a behavioural premise, do not coincide. A theory of desert is a theory whereby people have a view about the desired relationship between effort and remuneration. This, in other words, is a moral 'principle' that relates to the internal composition of the vector of economic variables. As such, it is not a continuous idea in the space of those economic variables. Namely, either there is some proportion between remuneration and effort or there is none. The axioms of 'completeness' and 'continuity' of individual's ordering imply that any 'principle' concerning the internal order becomes vacuous to a great extent.

3

These axioms generate an important aspect in the theory of individuals behaviour; substitutability. If a particular vector of efforts and remuneration is preferred over the other there exists a set of vectors with, obviously, different proportions of effort to remuneration so that the individual is indifferent between them. In other words, substitutability implies that every principle can be compromised or undermined. It will, in my view, be thoroughly inconsistent to represent an individual's preferences in a utility function if he has a principle that is concerned with the internal composition of the domain of his preferences.

meaning not clear

Some would argue that the problem of 'principles' in the theory of individuals' behaviour is merely a problem of Lexicographic ordering. As such, it is a known problem in economic theory and though such orderings cannot be represented in a utility functional form there are ways to deal with it. However, this is not exactly the same as the point I was making. Let us look at a lexicographical ordering in

the space of leisure [l_0] (an inverse measure to labour efforts) and x which is a composite consumption bundle. Lexicographical ordering means that for two bundles a , and b :

- a is preferred over b if either (i) $l_0^a > l_0^b$
 or (ii) $l_0^a = l_0^b$ and $x_a > x_b$

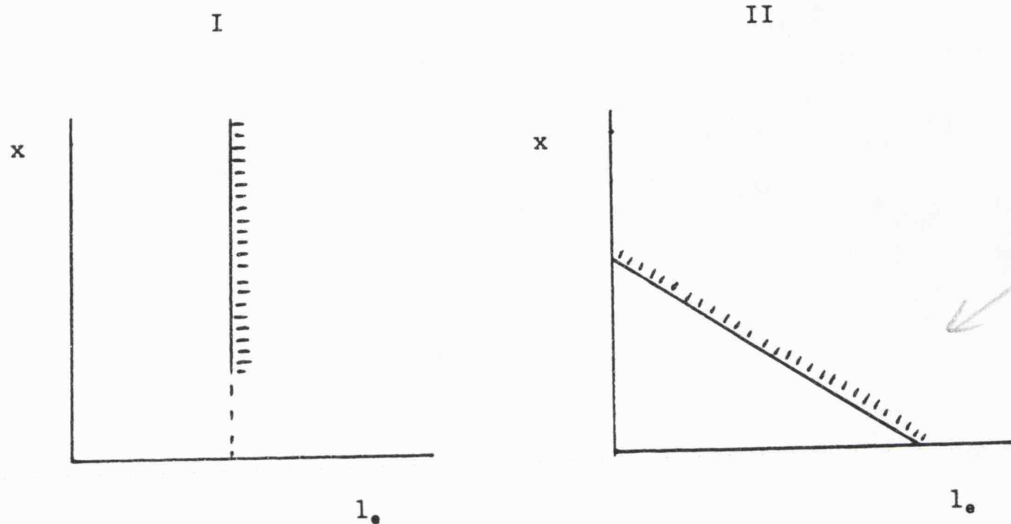


Figure I depicts Lexicographic preferences and figure II depicts a 'principle'. Clearly the problem of I is that the 'continuity' axiom is being violated but this is not necessarily so in II. The sloped line in II depicts the principle in the sense that everywhere above it the person feels as if his principle (his moral demand) is satisfied, everywhere below it is violated.⁸ The line itself represents the acceptable substitutions between effort and consumption. It is difficult to say that these substitutions are part of the individual's preferences. They are more than that, they reflect a principle. Crossing that line will not bring about a less preferred bundle, it will bring about a furious and frustrated

Describe II mode.

?
What is II?

Depicts on which way he effort

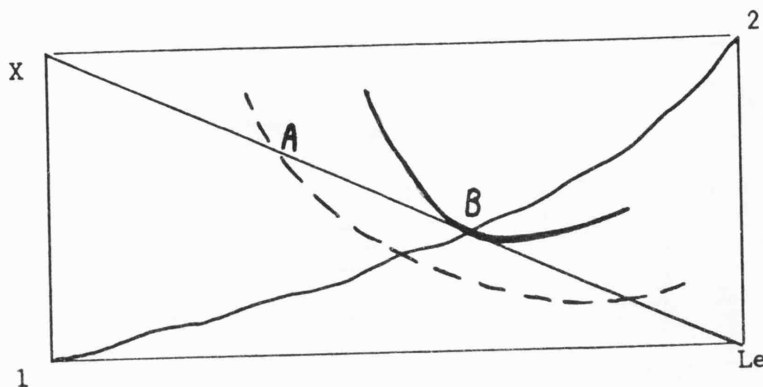
⁸ It should be noted that the position of that line is not independent of the general circumstances of society.

individual. There is, according to standard theory, no way, accept
cardinality, to distinguish between the preferences of the individual
when his claim for desert has been satisfied and when it has been
violated⁹. If, then, being on the 'principle line' means that we are
at a 'pre-rational' stage, then the set upon which preferences in the
normal sense are defined is an open set. In that case, like in
Lexicographic ordering we have a problem of 'continuity' on top of
the problem that part of the set of choices is not subject to the
normal preferences scheme. If, however, we include the principle line
in the set which generates representable preferences then there is
no problem of 'continuity'. The problem of 'completeness' however
remains unresolved. Any solution resorting to a separable form of a
general utility function will preserve substitutability and will
therefore be no significant improvement. Therefore, the problem we
have here is much more complex than the problem of lexicographic
orderings.

At the level of social choice and general equilibrium this is a much
more serious problem. Assume an economy with two individuals who have
in their bundles commodity (say, x) and leisure (with homogeneous
skills). The production function is homogenous of degree 1:

⁹Perhaps a somewhat similar case can be seen in the 'trade
independence axiom' (TIA) in general equilibrium analysis. This axiom
is relevant to the examination of whether general equilibrium - a
situation in which everyone is believed to have at least not worsen
his conditions- is consistent with famine (see Cole and Hammond
(1986)). It means that in the initial state people have enough
endowment so to ensure their survival. The intuition here is that if
the TIA does not hold, then it is unlikely that individual will
behave in a rational manner. A desperate person is not necessarily
rational. Thus, the behavioural assumptions will hold no more and
the whole analysis might collapse. In the principle case one may say
that people are not willing to consider rational behaviour (like, for
instance, substitution) before something else is being satisfied.

$$X = \alpha(L_1 + L_2)$$



The diagonal is line along which output is being distributed according to each individual's effort (labour inputs)¹⁰. Clearly there is a single point where the diagonal crosses the contract curve. Namely, there is a point where proportional remuneration is Pareto-efficient. Moreover, for a distribution which satisfies the principle of proportional remuneration, there exists an initial allocation such that the satisfaction of the principle is consistent with a competitive equilibrium.¹¹

So have I complained in vain? The answer is no. Let A be any point on the diagonal and B the point of Pareto-efficiency on that

¹⁰When abilities are different then the problem becomes more complex as the size of the box changes continuously. I will give a more rigorous account in the Appendix to the last section in this work but the relevant conclusions don't change.

¹¹ Recall however that in terms of individuals' choice the upper triangle is the domain of choice of individual 1 where his principle of remuneration is satisfied. Similarly, the lower triangle has the same meaning to individual 2. But the lower triangle is entirely in the domain where 1's principle of desert is violated. Similarly the domain of 1's choice is where 2's principle is violated.

diagonal. To argue that B is Pareto-efficient we have to say that there is a utility level associated with it. The indifference curve at B must also be higher (for 1) than the one that goes through A. Hence, for B to be Pareto-efficient it must mean that we cannot move to A without someone being worse off. If, however, both individuals have a principle of proportional remuneration then in what way are they worse off at A? The principle is satisfied and as for anyone of them the preferences over the 'principle violating triangle' are far from being the smooth representable ones, there is no meaning to these indifferent curves in the first place. Their preferences may be normal when the principle is satisfied but these sub-sets are not at all in the domain of social choice.

Of course, this is so because I assumed Homogeneity of degree 1 in the production function. If, however, this was not the case principles of desert may not be so inconsistent (conceptually) with Pareto- efficiency. On the other hand, the problem of defining proportional remuneration will become more difficult. If now we have a production function of the type¹²:

$$X = \alpha(L_1 + L_2) + K$$

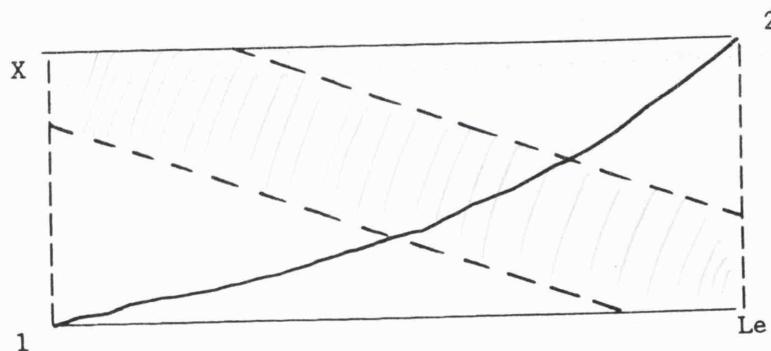
then using a method derived from the Euler equation to denote the share of labourers in output will not be as straightforward as it would have been in the previous case. In the previous case, where

¹² The reader will appreciate that I have chosen a rather awkward kind of production function but this is simply to make the point in a straightforward manner. The discussion would not have changed had I chosen a kind of Cobb-Douglas production function where the sum of powers is greater or less than unity.

constant returns to scale were present, the share of each individual in the total output was:

$$S_1 = \alpha L_1; S_2 = \alpha L_2$$

Now under the new production function this may still be the intuitive share of each individual but it certainly does not explain the whole output. Assuming that K is an exogenous feature which does not belong to anyone we can still argue that S_i represent that shares of the individuals' contributions. Now, however, we shall have the case where each individual's proportional remuneration line lies apart as in the following diagram:



Now, the shaded area is an area in which the 'normal preferences' of each individual prevail (their principles have been satisfied). Thus, any point on the contract curve within this domain has its normal meaning¹³.

¹³It is a situation where we can say that people have received what is considered to be their share in production and they compete for the share which is generally attributed to technology. If ownership of technology is also specified, then we are back at our original story.

On the face of it, it seems that in such a case one can really accommodate desert and Pareto-efficiency¹⁴ by using some kind of lexicographic moral ordering. Namely, saying that social choice is such that proportional remuneration must be satisfied first and only then, can we apply the Pareto criterion¹⁵. In the above diagram it means that we know, a-priori, that the socially desired outcome will be within the shaded area. Applying Pareto to it means that it will be on the contract curve within that area.

There is an example of another principle which seems to have been doing well in the context of traditional economic analysis. It is the Rawlsian 'difference principle' or the Maximin. It seems to me, however, that the acceptability of Rawls's 'difference principle' is founded on the assumption whereby the Maximin itself is a 'rational' choice. This choice, made by individuals behind the 'veil of ignorance' in the space of 'primary goods', makes the Maximin compatible with the most fundamental premise of contemporary economic theory. Namely, by assuming that individuals' preferences over the 'primary goods' space are properly behaving preferences the rationality of individual in the full space of economic variable must inevitably be an extension of that rationality. The deduction of the 'difference principle' therefore is based on the same logic of

¹⁴By which I mean the whole theory of representable preferences.

¹⁵By lexicographical moral ordering I mean an ex-post analysis. Namely, we may allow the final distribution to occur anywhere in the above diagram. Given the general assumptions about competition this is likely to be on the contract curve. Only then we ask ourselves whether the allocation is socially desirable. The answer to it reflects lexicographic moral ordering which is super-imposed ex-post on a normal ordering. Namely, we require from the desired allocation (to distinguish from the merely feasible one) to satisfy proportional remuneration first, and then Pareto-optimum.

Pareto- efficiency.

In the case of desert principles this logical extension is far from being obvious. Though there is a scope where traditional economic analysis can help in choosing the desired outcome (the shaded area in the above diagram) there is a serious question mark on why should we adhere to any principle of desert in the first place. If we are willing to accept substitution between effort and consumption in general why should we insist on some kind of proportional remuneration. If we observe people to have principles of the desert kind it must mean that they are not rational. If so, what is the meaning of the Pareto-criterion to non-rational beings?

So well does the Rawlsian principle fit into the framework of contemporary analysis that in order for it to co-exist with the Pareto criterion we can mend social choice theory and think of a social welfare functional which escapes the problem of social welfare functions and allows us to think of it as a lexicographic ordering in the space of moral theories. The 'Leximin' principle (Sen (1976)) is an example to such a case. We give the Maximin principle priority but once it is satisfied, we can go back to use the Pareto criterion. As at both level of choice -the level of choosing the moral principle of the Maximin and the level of regular economic performance- we have smooth and well behaved preferences it is the rational construction which plays the important role.

But while it might make sense to establish the 'difference principle' on a rational construction (as it is a hypothetical situation in any

case) the meaning of such a construction¹⁶ in the context of activity (and hence, Pareto) is much less obvious. If people are not, as a matter of fact, rational then Pareto efficiency is, at best, a prescription which tells people about the benefits of rationality. In other words, 'rationality' as a construction for what ought to be makes sense. As a prescription that says that if people were 'rational' then the ought to have been would have anyway come about, it does not form a very appealing method of constructing moral ideas. Thus, although both the 'Difference principle' and Pareto-efficiency are based on 'rationality', they are not necessarily an extension of one another.

In the case of desert the problem is even more serious. If we expect that the behavioral foundation of economics and ethics to be the same, desert and Pareto cannot go together. If rationality¹⁷ is required to establish the principle of desert, it cannot do so due to the lack of substitutability between effort and consumption.

A last note on this subject is concerned with the relationship between economics and desert theories of the kind mentioned by Nozick (1974). The difference between what I refer here to theories of desert and the Nozick configuration is quite big. In Nozick we

¹⁶ In the sense of epistemic content. Namely we have a social judgement that is based on rationality which might not exist in the real world.

¹⁷ I mean rationality as a set of axioms which define preferences as being rational, not the school of 'rationality' which relates to a kind of epistemology. As a matter of fact it is within the 'rational' school that principles of desert are likely to arise; like the right to the fruits of one's labour which is based on some kind of ownership of the self.

concentrate on the initial position. Given that any legitimate exchange is morally approved, rationality implies that if the initial endowment is at point A in the above Edgeworth Box then it is quite conceivable that the process will end somewhere where the proportional remuneration principle does not hold. In such a case I can ask again why is the desert of any relevance in the initial state if people are willing to exchange it for something else. In other words, rational people don't believe in desert theories.

?
The point is not entirely clear, but I see that it exists.

All these questions that are raised in this sub section are questions of great importance to any current discussion of ethics-economics relationship. In this work, however, I will not deal with these issues beyond what I have just said. Here, as I said before I will concentrate on whether or not a particular system generates a particular kind of ethical discourse. In view of all that, the fact that classical economics with its form of general equilibrium generate a theory of economic justice which is based on desert is of great significance. In the work that follows this dissertation and which I have already begun, the issues of this section will come to the forefront. The major conclusion of the above is that the dominance of utility theory in individual's behaviour analysis excludes a part of what might have been considered as a concept of economic justice. As a matter of fact, together with the Walrasian concept of General Equilibrium it has excluded from the domain of ethical discussions of economics an idea that has been there [almost] ever since.

(ii) A Brief History

How dominant had been the principle of desert in the conception of justice throughout the history of Western thought can easily be established by looking at two major figures like Aristotle and St. Thomas of Aquinas. There can be little doubt about the prominence of St. Thomas of Aquinas within the Scholastic era which dominated the intellectual arena of the Middle Ages. Nor can there be any question about the influence that Aristotle exerted on St. Thomas of Aquinas.

Though looking at these two scholars alone is by no mean a pretention to capture the whole of the complexity of human thought throughout Antiquity and the Middle Ages, one cannot deny that they are sources of some authority to the general trends in the history of ideas. As this section is merely devoted to point out a general trend which constitutes part of what motivated this work, I will not try to defend this choice any further. For the same reason I not offer a comprehensive treatment of these scholars work. I will only concentrate on showing that justice in general, and when applied to economics in particular, is dominated by the idea of desert.

The Greek word for justice- dika- meant originally 'due share'¹⁸. But for the ancient Greeks it meant 'the due share distributed by 'moira'' (fate) which, in other words, is strongly related to people's character within the framework of some kind of a godly design. Later on, this Homeric notion was transferred to the 'city-state'. Both Plato and Aristotle saw the concept of justice as rising from a

¹⁸see a discussion in Spengler, p.79.

↑ note a better
expect or
fresh etymology!

similar notion of 'due-share' even though it was now confined to the framework of the 'city-state' and its general governing laws.

Just, to Aristotle, means lawful and fair (Nic. Eth. Book V, 1129a21-b6). Fairness here means not to take advantage of another, which, in other words, means not taking more than one's share. But what Aristotle means by one's share is a very difficult and peculiar idea. One's share is determined primarily by one's personal characteristics. Thus, things may be intrinsically good¹⁹ but they may not be good for this particular character. For instance, giving wealth beyond one's needs if one is prodigal is, in Aristotle eyes, giving him more than his share.

This is an interesting idea which associates some notion of efficiency with what is a 'due share'. Indeed, in his Politics, there is a whole section where Aristotle discusses the different roles people have in the household and the respective moral virtues that they will have or need (Politics, Book I xiii, 1259b18-1260b24). Namely, moral virtues are associated with one's role in society. Consequently as there are many roles in society there are different merits and a distribution of wealth and other things should be according to a principle of 'proportionate equality'. A distribution whereby having a greater share is related to having greater merits (Politics, Book III xii, 1282b14-1283a22).

Already we can see that the most fundamental perception of justice is associated with some kind of desert. It is, however, not the kind

¹⁹and I refrain from discussing why and how.

of desert which I have in mind because it is not associated with any kind of actions or deed. Rather it depends on personal characteristics which may be entirely outside the domain of a person's free choice (like birth, for instance). Nevertheless it is a principle of justice which distinguishes between individuals. Perhaps instead of desert we should call such theory of justice a theory of 'merits' but in any case it is not a principle for which the difference between individuals is insignificant.

But Aristotle was not indifferent to the actual behaviour of individuals. The first step in that direction can be seen within the context of distributive justice but with reference to the distribution of political power and privileges. Here, argues Aristotle, political power should be distributed in proportion to 'value received'. Namely, power should be distributed according to each individual's contribution to the general purpose for which the state exists (Politics, III ix, 1280a7-1281a10).

There is an even stronger argument why desert, in the sense of remuneration for deeds, plays a role in Aristotle's theory. It is the distinction he makes between 'distributive' and 'rectificatory' justice (Nic. Eth. V, 1131b14-1132a2). Today when we talk about economic justice we immediately refer to 'distributive' justice. In the case of Aristotle this was far from being the case. 'Distributive' justice deals with distribution of anything according to merits or, to be more specific, social status. It deals with the distribution of honours, privileges, political powers as much as it deals with wealth. But wealth here is not understood as an economic

variable rather as a social variable which is necessary to support moral virtues and the advancement of the 'good' life.

Economics in Aristotle is mainly confined to the problem of exchange. Resources allocation and final distributions can hardly be seen as a mere economic problem. Under the domain of 'rectificatory' justice come all kind of voluntary transactions "e.g., selling, buying, lending at interest, pledging, lending without interest, depositing and letting.." (Nic.Eth. V 1130b32-1131a22). Thus the problem of economic justice is a problem of 'rectificatory' justice.

As the actions here are voluntary, economic justice in such a framework cannot be a procedural idea. Namely it cannot be the actual freedom to exchange which generates the notion of justice. Rather it is the outcome, or the price that emerges, which constitutes the subject of justice. Hence, the problem of economic justice is the problem of the 'just price'.

The literature on the interpretation of Aristotle's 'just price' is quite extensive. I do not wish to go through the various arguments but I do think that it is quite obvious that the 'just price' bears the mark of proportional remuneration²⁰. 'Proportional reciprocation is the basis of all fair exchange' writes Aristotle but it is unclear what is really meant by it. Any transaction, according to Aristotle,

²⁰ Even Schumpeter who argues that Aristotle's, as well as St. Thomas's 'just price' is the simple competitive price, agrees that by implication it may be a cost related price. On the whole I disagree with Schumpeter's interpretation but I can see why he reached his conclusion. As will become clearer later, it is all a matter of interpreting 'demand'.

may end with a 'gain' to someone and a 'loss' to another where 'gain' ('loss') is to have more (less) than one's share²¹. But by this more or less Aristotle is referring to what one had at the beginning of the process. But what does it mean to have more or less than one's share in that sense?

Why do they exchange?

Some would argue that this is a kind of a labour theory of value where the relative price reflects the relative difficulty in production. An idea which is usually based on the following statement: "There will be reciprocity, then, when the products have been equated, so that the as the farmer is to the shoemaker, so is the product of the shoemaker to the product of the farmer." (Ibid, V 1133a31). But this is not so straightforward as it appears. According to Aristotle the thing which brings about the execution of a proposed exchange is the coincidence of demands (Ibid, V 1133a31-b19). To some extent there is a hint of Walras' Law in all that because Aristotle demands that for exchange to take place the seller who has a demand for other goods must expect his demand to be met before he will part from his merchandise²². But what matters for us in this story is the definition of demand.

More a hint to Smith's basic exchange stuff.

Demand is not explicitly spelled out but what one can understand from

²¹One should be careful not to confuse the word 'gain' with a 'utility gain' in standard economic theory. Here 'gain' is measured in real terms.

²² According to B.J. Gordon 'Aristotle And the Development of Value Theory' *Quarterly Journal of Economics* Vol.LXXVIII February 1964 pp. 115-128, both relative cost and relative utility determine the exchange rate. I must admit, however, that I find the interpretation of Aristotle's 'demand' as 'utility' wholly unconvincing.

Aristotle's writings is that demand, actually, is 'needs'²³. These needs can be interpreted narrowly to mean 'the needs for reproduction' and hence a labour theory of value will follow. But in general, for Aristotle needs are not only those directly associated with the process of production but also those which arise due to one's social position. In such a case, the relation between the farmer and the shoemaker is not the ratio of their labour (effort) but it is this plus a whole range of other needs completely independent of the production circumstances of any commodity.

But which ever definition of demand we choose to accept we will always end up with a theory of the 'just price' where the key issue is proportional remuneration. As the needs arising from production are in the demand in any case, it cannot be said that the proportional remuneration is independent of effort. An abolition of the systems where merits were intrinsic to social classes will strip the theory to become such that will suggest the labour value as the 'just price'.

By the acknowledgement that it is possible that in a voluntary exchange prices will emerge such that someone will get 'more than his due share' while someone else will get 'less than his due share' Aristotle suggests that the just price does not always prevail. To the extent that his 'model' is a general equilibrium one (in the

²³ Commentators like J.T. Noonan(1957) and J.J. Spengler(1955) see in Aristotle's use of 'demand' as an indication that prices have nothing to do with 'cost of production'. I believe this view to be false but this is obviously not the place to develop such an argument. It will become evident from my exposition why, in my view, demand can be interpreted as related to 'cost of production'.

sense that coincidence of all needs precede actual exchange) prices will always be at their 'just' level. Obviously, though his 'model' may suggest some general equilibrium property, Aristotle saw it as a partial equilibrium analysis. In such a framework it is not inconceivable to end up with an 'unjust' price. But whatever system we choose, the 'just price' is the key concept of 'economic justice' in Aristotle and, it is a concept based on desert.

The Aristotelian notion of the 'just price' was carried into the Middle Ages by one of its most clear representatives; St. Thomas of Aquinas. There are two major sources for St. Thomas of Aquinas' views of the 'just price'. One is in his Commentary on the Nicomachean Ethics (CNE)²⁴. The other is in his Summa Theological (ST)²⁵.

It is a question of considerable interest to examine how the sphere of economic activities had developed since Aristotle's times to St. Thomas's days. It could have shed some light on the differences that exist between the two scholars' perceptions of economic justice. It seems to me, however, that the changes were not as great, in essence, as one could have expected. There were obviously changes in the form of ownership and the organisation of society but in terms of modes of production it seems to me that the changes were not of great significance. Consequently the focus of economic activity remained exchange at a moderate level of division of labour with no reference at all to relationships in production.

²⁴which can be found in Volume I of the Library of Living Catholic Thought series, Henry Regnery Company, Chicago, 1964.

²⁵a translation by J.E. Welldon in: A.E. Monroe Early Economic Thought, Harvard University Press, 1951.

Indeed, from the study of St. Thomas's comments on Aristotle's ethics it appears that he accepted, in principle, Aristotle's definition of the 'just price'. In his Commentary he makes the vague parts of Aristotle more explicit. "In order to have just exchange, as many sandals must be exchanged for one house...as the builder...exceeds the shoemaker in his labour and cost..."(CNE V ix p.426). And as Hollander(1977) points out, according to St. Thomas demand is merely used as a general statement about what generates exchange²⁶. So that what comes out of this interpretation is that there are now no qualification to the statement that the 'just price' is a 'cost of production' (or labour theory of value under some interpretations). From that I conclude that the principle of desert, as a principle of economic justice was upheld by St. Thomas of Aquinas.

However, some may argue that the fact that St. Thomas has interpreted Aristotle correctly does not mean that he also agreed with these views. In the Summa Theological St. Thomas refers very clearly to the fact that market forces may move demand and supply in such a way that the price may not reflect cost of production. But then he gives a long moral defence to such fluctuations on the ground of the same principle as before; the principle of desert. "Gains, however, which is the end of trading, though it does not logically involve anything honourable or necessary, does not logically involve anything sinful or contrary to virtue; hence there is no reason why gain may not be directed to some necessary or even honourable end; and so trading

²⁶I, personally, as shown above prefer to think of 'demand' as 'needs' in a general sense such that generate a clearing of the markets rather than just as a general statement about the nature of exchange.

will be rendered lawful; as when a man uses moderate gains acquired in trade for the support of his household, or even to help the needy; or even when a man devotes himself to trade for the public welfare, lest there be a lack of things necessary for the life of the country; and seeks gain, not as an end, but as a REWARD FOR HIS EFFORTS."(ST p.63, my italic).

There is, of course, the problem of relationship between market price and cost of production price. Whether or not there is an explicit connection between them in the works of St. Thomas is an unresolved debate. I tend to accept Hollander(1977)'s view on that matter to the extent that there is no evidence to show how market price relate to cost of production. I do, however, believe that a logical construction can be made if we interpret demand as the extended notion of 'needs' as I did in the case of Aristotle²⁷.

But all this does not affect my major conclusion that the principle of economic justice that dominated a significant period of time in the development of human thought had been that of the 'just price'. This, in turn, had almost invariably been associated with the concept of desert.

The emergence of the 'classical school' in economics has brought

²⁷A possible explanation to the move from the Aristotelian cost of production price to a market price can be the change in the meaning of demand. In Aristotle demand included 'needs' that were generated by social status. In the middle ages some of those 'needs' disappeared. Consequently, that part of 'needs' beyond those required for reproduction became wants as we understand them today. Hence, a coincidence of these wants did not, immediately, generate the Aristotelian conclusion about the just price reflecting the relative efforts.

about a change in both the subject matter of the discipline as well as in methodology. The change in the subject matter is reflected by the shift to a problem of reproduction; the production and distribution of surplus. Consequently the theory of value is now dominated by relationships in production. The decisions made by the owners of the surplus (the capitalists) affect the wages (and sometimes the numbers) of labourers in the next period. Consequently the rate of profit and relative prices are determined by these relationships²⁸. This, of course, does not mean that the 'classical' economists were unaware of the market mechanism. On the contrary, quite vivid descriptions of it appear in most classical writings including Smith, Marx and Mill. But it was the circumstances of production which dominated the natural value, the value around which market prices oscillate. And thus, in their capacity as magnetic field, these circumstances became the focus of economic investigation and therefore, the focus of attention to any kind of ethical discussions of economic issues.

But it was not only the subject matter of economics that seemed to have changed with the emergence of the classical school, methodological fundamentals too have undergone significant changes. The rise of sciences and in particular, of experimental sciences, had changed the focus of philosophy. Two major schools now dominated the scene, the 'rationalists' and the 'empiricists', and the focal issue became to be that of the meaning and accumulation of knowledge. But in spite of all these sweeping changes it will be incorrect to assume

²⁸This is, of course, a grossly simplified interpretation of classical economics which nevertheless captures the aspects of it with which we are interested.

that no traces at all were left of Scholastic or Aristotelian thinking. In particular this is true at the early stages of classical economics²⁹.

But the Scholastic left-overs are by no mean a necessary condition for principles of desert to be carried on into the ethics of classical economics. There is, as a matter of fact, nothing inherent in the changes I have mentioned above to suggest that concepts of desert are not applicable to the 'new' framework of economic analysis. Indeed, I will show in this work that in principle, the concepts of economic justice that are associated with classical economics are fundamentally concepts of desert.

²⁹I will show later on how the scholastic interpretation of Universals plays a role in Smith's methodology. I will also show that to some extent the 'labour theory of value' can be seen as scholastic relic. Namely that labour values are the Universals of relative prices. Though it is not inconceivable in the case of Smith, it will be difficult to accept in the case of Mill. Nevertheless, I will point out to several lapses in Mill's adherence to the 'empiricist' tradition which he so vigorously advocated.

PART II

**THE MORAL SIGNIFICANCE OF THE ECONOMICS OF
ADAM SMITH**

1. INTRODUCTION

Adam Smith seems to be the right place to begin an investigation into the relationship between morals and economics. Not only is he prominent as one of the founders of economics as an independent discipline (and in particular as a founder of the classical school), but also he was first, and foremost, a moral philosopher.

Besides being the natural starting point there are two other reasons why the construction of ethics-economics relationship in Adam Smith is of considerable importance. Firstly, being part of the Scottish Enlightenment, Adam Smith conceived philosophy in general, and moral philosophy in particular, as science. Thus, at least from the methodological point of view, a common ground has been formed for the examination of economics and ethics. Which means that a considerable obstacle in the investigation of their inter-relationships has now been removed. The second reason is a matter of substance. Adam Smith has not been acknowledged only for his contributions to economic analysis. He has also been considered as the prime promoter of the idea that 'natural liberty', based on self-interest, is morally good. A proposition that is widely accepted by economists but that is still debated among some of Adam Smith scholars.

One of the reasons that this last proposition is of relevance today, the era of neo-classicism, is that its application to economics has been extended to the present conception of economics with little qualifications. Obviously it is related to how Smith's economics is being perceived today. In spite of him being a classical economist, many contemporary scholars start their papers -- about thoroughly neo- classical matters -- by quoting Smith. There is, on the whole, a feeling that Adam Smith's model is larger than the classical paradigm. That it contains all the seeds of contemporary analysis. More importantly, this idea is also extended to his framework of analysis and by implication, Smith's methodology and the modern one are thought to be virtually the same¹. Consequently, his moral decrees in what concerns economics are as applicable to the modern paradigm as they were to his own model.

Lausanne
#modern

Adam Smith published two major works; the Theory of Moral Sentiments (TMS) in 1759 and the Wealth of Nations (WN) in 1776. His other writings (unpublished) are collected in three volumes; Lectures on Jurisprudence (LJ), Essays on Philosophical Subjects (EPS) and Lectures on Rhetoric and Belles Lettres (LRBL)². On the face of it

¹Robbins, for instance, goes as far as to suggest that Smith's system stands "in harmony, with the most refined apparatus of the modern School of Lausanne" (Robbins, 1935. pp. 68-9). As for the importance of the framework of analysis and methodology to the applicability to economics of ethical concepts see the general introduction and chapter 2 in part 3 below. It is nevertheless quite clear that no matter what reservations one may have about the 'empiricist' nature of Smith's methodology, it is fundamentally different from the Walrasian 'rationalist' approach. It is this awkward imposition of a 'rationalistic' framework on an 'empirical' model that generates the unacceptability of the extension of Smith's proposed defence of natural liberty into the neo-classical paradigm.

² I do not mention here the collection of his correspondence as I am less interested in the twists and turns of his mind as I am in trying to construct (logically) a coherent theory out of his works.

there seems to be a clear division of labour here. The TMS is Smith's moral theory³ and the WN is his economic analysis. The question of ethics-economics relationship, therefore, is the question of relating the TMS to the WN. Apparently, this has not been a very easy task even though one would not expect to find serious problems of consistency as Smith himself edited the sixth edition of the TMS to appear in 1790; fourteen years after the WN.

As I said before, there is a widely believed view that Adam Smith advocated natural liberty that is based on self-interest for its moral goodness as much as for its efficiency. Indeed, for anyone who reads his Wealth of Nations (WN) this seems to be almost self-evident⁴. However, when one reads Smith's moral theory in the Theory of Moral Sentiments (TMS), it becomes less so. If natural liberty based on self-interest is to be morally good, so must be self-interest itself. But when one finds in the TMS statements of the

³And its social consequences.

⁴On the occasion of the bicentennial of the Wealth of Nations J.M. Buchanan wrote: "...Adam Smith's system of natural liberty, interpreted as his idealized paradigm for social order, embodies justice as well as economic efficiency." (Buchanan, 1978. p.77). On a similar occasion, G. Stigler, is quoted to have said: "I bring greetings from Adam Smith who is alive and well and is living in Chicago" (in Meek, 1977. p.3). Which means both that Smith had morally praised the economic system of 'natural liberty' as well as that his moral assessment can be applied to the neo-classical paradigm without any reservation. R.Meek, who quotes Stigler, goes on to say that: "Smith's great message of good cheer-that competitive capitalism is, if not the best of all economic systems, at any rate the best of all possible systems..." (Ibid, p.4). M. Friedman whose views on natural liberty need no proof has taken Smith's ideas ad absurdum. With complete disregard to the quite relevant order of the two works, he sees the WN as a model that can easily be applied to Smith's moral analysis. He wrote "...on the moral level, Smith regarded sympathy as a pervasive human characteristic, but it was unlimited and thus had to be economized. He would have argued that the invisible hand of the market was far more effective than the visible hand of government in mobilizing, not only material resources for immediate self-seeking ends, but also sympathy for unselfish charitable ends." (Friedman, 1978. p.18).

kind "that to feel much for others and little for ourselves....constitutes the perfection of human nature"[TMS p.25], one begins to wonder whether indeed this is the case. If it is benevolence, and not self-interest, that constitutes Smith's notion of the morally good character, the moral status of his system of natural liberty based on self-interest, becomes rather dubious.

But it is not only Smith's apprehensive approach towards self-interest that makes the reader of the TMS sceptical. It is also Smith's dismissive views of the meaning of 'wealth' as well as his approach to its natural distribution (i.e. the distribution that results from natural liberty). Wealth is trifle, he argues, but its apparent appeal serves as a mean by which nature deceives people to want it, pursue it and consequently advance the purpose of nature: the multiplication of the species. However, people's interest are not necessarily the same as those of nature: "...man is by Nature directed to correct, in some measure, the distribution of things which [nature] herself would otherwise have made." [TMS p.168]⁵. Which means two things. One, that the smooth functioning of nature (the distribution that results from natural liberty) is not necessarily consistent with what people might perceive as the desired distribution. Secondly, that what people think as desirable may be a result of the deception by nature. In that case, it is clear that Smith the observer does not agree with it. In other words, Smith's

⁵ It should be noted that Smith uses three concepts of nature: 'nature of things', 'nature of sentiments' and 'Nature'. The first two are the more frequently used and they refer to the physical world and the spiritual world of mankind respectively. The third form, Nature, is probably the uniting force which is God or, as some would interpret it, the 'Great Design'. This matter is discussed more carefully below.

theory of morals may not be only a positive description of how people form moral opinions. It may as well be a prescription.

All these imply that the harmonious relationship between the TMS and the moral implications of the WN does not really exist. Indeed, the unease about whether Smith's ethics supports a moral advocacy of natural liberty is (or at least, was) widely shared. However, most dealings with the problem were confined to the moral vindication of self-interest. The analysis of the ethics of natural distributions appeared to have been entirely dominated by it. Little attention was paid to the very simple fact that the analysis of natural distributions follows the analysis of actions. Here, where two (or more) individuals are involved the vindication of self-interest will no be sufficient for the moral approval of the final distribution.

At first, the discrepancies between the TMS and the WN were explained as a problem of consistent premises. Some German scholars⁶ thought that in the TMS Smith had believed people to be pre- dominantly benevolent. By the time he wrote the WN he must have changed his mind. Now he thought them to be self-interested. There is, therefore, an inherent contradiction between the two theories.

That part is!
The Germans' position, which became to be known as 'Das Adam Smith Problem', can be dismissed on the ground that had Smith really changed his mind he would not have edited the TMS in 1790 without

⁶ Notably B. Hildebrand (1848), Carl A.G. Knies (1853) and Witold von Skarzynski (1878).

changing its major premise. The generally accepted view⁷ is that the TMS and the WN are perfectly consistent in their premises with regard to human nature because they are based on entirely different, and apparently unrelated, features of the human character. The TMS is an analysis based on 'sympathy', i.e. people's disposition to put themselves in other people's place (what today we might call empathy); the WN on the other hand, is an analysis based on people's motivations to act. Motivations and dispositions are not the same thing and therefore, there cannot be any inherent contradiction between Smith's perception of the human character in these two theories.


Moral opinions, according to the received view, are generated by people's disposition to feel 'sympathy'. They experience a particular kind of pleasure (pain) if they feel harmony (dissonance) in their sentiments. Namely, they derive pleasure from feeling that they would have felt the same had they been in place of the subject of approbation. Upon this pleasure or pain, the harmony or dissonance of sentiments, people form their moral opinions.

The imaginary change of places with other individuals depends on how much can one really put himself in another person's position. By trying to do so, the process of 'sympathizing' generates a kind of an 'impartial spectator'. It is the agreement or disagreement of the 'impartial spectator's' sentiments with those of the subject of approbation which is the real source of moral judgement.

⁷Macfie (1967), Campbell (1971), Winch (1978), Skinner (1979) and Raphael (1985).

It is then argued that any 'impartial spectator' could feel the same as another if he confronts moderate expressions of sentiments. Thus, by defining self-interest as prudence, i.e. a moderate expression of one's natural urge to care for one's self, self-interest is something any 'impartial spectator' would approve of. Hence, self-interest is morally good. If, then, self-interest is morally approved so should be the natural distribution which is associated with it. In particular, as such a distribution remunerates prudence (frugality and industry in other words) it means that the good is properly remunerated.

While all this may explain why the TMS and the WN are consistent from the moral point of view, it fails to explain the numerous occasions in the TMS (and even in the WN) where Smith expresses apprehension about self-interest and about the natural distribution of things. Indeed, there are now scholars who while accepting the received view's solution to the problem of inconsistent premises, are still uncomfortable with the conclusion with respect to moral propositions. Heilbroner (1982) for instance, argues that Smith's theory cannot be seen but as a reiteration of Mandeville's 'Private vice, Public benefits'. He explains the inconsistencies between the above theory and Smith's apprehensions by arguing that Smith speaks in two voices; the 'empirical observer' and the 'moral instructor'. Evensky (1987) argues that according to Smith people are inherently flawed. The moral goodness is in the system of natural liberty itself as it is a reflection of the 'Great Design'. Hence, as human character is flawed, natural liberty where everyone pursues his own ends is a kind of a 'second best' moral theory.



There are, in principle, two possible explanations to the discrepancies between (a) the moral vindication of self-interest on the grounds of its moderation and, (b) the explicit apprehensions Smith has about it. One is to argue that Smith's moral theory is not a 'naturalistic/positivistic' (N/P) theory. The other is an explanation within such a perception of his methodology.

△
was exact
is not?

When one looks at the received view's interpretation of Smith's ethics one can see how strongly it is motivated by the belief that Smith's theory is N/P. By 'naturalistic' I mean a theory where morals is a matter of sentiments or instincts rather than reason. By 'positivistic' I mean that it only describes how people, as a matter of fact, form their moral opinion. Naturally, if self-interest is morally good because it is a moderate expression of a natural urge. And because moderation is something which can generate a sense of harmony within any 'spectator'. Then moral approbation is entirely in the domain of how people actually form their moral opinion (which is based on some kind of a harmonious sensation). In other words, it is a N/P theory.

as oppo
to what?

Some take this approach even further. They consider the TMS to be a kind of ethology. Namely, a theory of socialization which explains the emergence of the character in the WN. Ethics here is merely instrumental: Sympathy is a disposition that leads individuals to derive some kind of pleasure from an imaginary change of places where they feel that they would have felt (or behaved) the same as others. Coupled with a natural desire to be morally approved, the disposition to 'sympathize' also explains how we tend to adopt particular forms

of behaviour. In particular, as we feel that we can always sympathize with a moderate expression of sentiments, we believe that others will also approve of our moderation. Hence, the want to be approved of will direct us to choose moderation as a principle of our behaviour. Prudence being a moderate expression of our natural drive to care for ourselves, is an obvious and natural pattern of behaviour. We are self-interested because self-interest is morally good. The WN then takes the character that emerged from the TMS and examines its social consequences. These consequences only prove that there is a complete harmony between our moral sense and the functioning of nature (natural liberty).

This positive/'naturalistic' view of Smith's ethics is not only appealing in its elegance but it also seems to fit our expectations from a scholar who was a pillar of what we call the Scottish Enlightenment. Nevertheless as such it still fails to explain some crucial problems in the TMS. In particular it fails to account for the places where Smith expresses his apprehensions about self-interest and where he appears to criticize people's judgements. For instance, when analyzing the deception of nature which leads people to see merit in wealth Smith argues that this is a false impression; that it is, as it were, a deception. How, however, can Smith judge such a thing? If his theory is descriptive in nature then the way people feel is the only criterion to what is morally good and bad. Smith's comments here and in many other places to the same effect are a clear indication that there is a hidden benchmark for moral analysis which is not necessarily embedded in what people actually think.

But there is a way to try and defend this approach. It is the distinction Smith makes between what is morally good and what is merely proper. Many present-days scholars would agree that Smith was not really enthusiastic about self-interest. They would argue, nevertheless, that it still fits into the positive framework of his theory. The 'sympathy' that people may feel with any sentiment only tells us about propriety. Namely, that the particular sentiment that is experienced by the subject of approbation suits well his circumstances and therefore, is proper. But there is a distinction between something which is proper and that which is good. The latter will require some admiration as well as approval. Self-restraint and moderation are the keys to approval but the degree of it will either invoke admiration or not. To eat when we feel an urge to do so, argues Smith, is proper but by no means admirable.

Hence, self-interest is the proper way to deal with the natural urge to care for one's self, but it is not necessarily what constitutes the morally good character. The morally good way will involve self-denial and sacrifice. If this is so there are two serious problems. One is that very few things may be morally good and the other, that given the different tastes people may have, what invokes admiration may be a matter of taste.

When Smith discusses theories of morals in general he states two major questions to be answered: "First, wherein does virtue consist?...And, secondly, by what power or faculty in the mind is it, that this character, whatever it be, is recommended to us?" [TMS p.265]. The answer to the second question is 'sympathy' and the idea

of the 'impartial spectator'. The answer to the first question is also clear; it is in propriety that virtue lies. Propriety has nothing to do with admiration. It is therefore difficult to accept the distinction between proper and admirable as the source of difference between the moral good and, say, what is merely just.

Moreover, the moderation of the natural urge to care for one's self cannot be thought of as mere propriety. Surely if the urge exist and prudence means to hold back it is not at all the same as 'to eat when one is hungry'. It should be compared to 'how much to eat when one is hungry'. Of course if one just follows his urge he would become a knave. The fact that he is prudent means that he exercises great restraint. Hence, as self-interest cannot be interpreted as mere propriety but rather as an admirable conquest of one's natural drive, the apprehensions Smith has about it cannot be explained by this distinction. Therefore, it must be a problem with the N/P approach to his ethics.

Beside all these difficulties there is still the problem of transition from the vindication of self-interest to the moral approval of natural liberty. A vindication of self-interest may be a necessary condition for the moral approbation of natural distributions (i.e. distributions that are associated with natural liberty) but it is by no mean a sufficient one. What is quite striking is that Smith's moral analysis is focused on the analysis of actions rather than merely on sentiments. It involves propriety of sentiments but it also deals with the question of merit. It is not sufficient to say that an action was motivated by a sentiment

which was approved. The approval of the sentiments aroused in the person who, as it were, had been acted upon depends on the action that was chosen by the actor⁸. Thus some correlation is required between intentions (motivations that arise from approved sentiments) and the actual outcome. Consequently the moral significance of unintended good becomes a complicated issue. In particular, this is so when we come to consider questions of spill-overs.

In what follows I propose a re-examination of the whole of Smith's work. I would like to argue in favour of some 'rationalistic' considerations in Smith's methodology. These have two major manifestation. One in the unity of human nature⁹ and the other, in the rational considerations that are involved in the concept of the 'impartial spectator'.

The unity of human nature, which could have been simply deduced from Smith's general belief in the unity of nature, implies that even though 'self-interest' may be a motive and 'sympathy' a disposition, there must be a consistent relationship between them. Thus, the solution to the Adam Smith problem whereby 'sympathy' is divorced

⁸It is perhaps interesting to note that the principle of moderation by which virtue is defined is a similar idea to the Aristotelean 'lying in the mean' principle (Nic. Eth. p.101). However, even there the analysis of morality does not end with moderation. It is immediately followed by a discussion of 'responsibility' (p.111). Similarly, in Hume where 'sympathy' in a similar sense is being used for the purpose of moral approbation, it is the proposed consequences which matter most. He wrote: "qualities acquire our approbation, because of their tendency to the good of mankind." (Hume, Treatise. p.627).

⁹This is a rational consideration because the unity is based on the assumption that there is a Universal to human characters. This Universal is 'the interest they have in the others'. As such, a Universal is not contradicting 'empiricism' but if we treat it as substance, it becomes a Scholastic idea. In any case, I will discuss it more elaborately later on.

from 'self-interest' on virtue of them being two distinct (unrelated) features of human character, is being questioned.

In the 'impartial spectator' the idea of 'rationality' comes through the 'impartiality' requirement. To be 'impartial' is not a simple thing. It requires some effort on the part of the observer which makes it difficult to accept that self-interested people will indeed put so much effort to see the other person's point of view. It also requires some knowledge of the world in order to be able to establish whether a particular choice of action fits the intended approved sentiment. Therefore, the truly 'impartial spectator' is an exercise in reason rather than sentiments. Though it is a logical extension of the actual way people form their moral opinion (and thus not entirely un-empirical), it is also a model by which Smith is capable to perform as a 'moral instructor'.

The part of the thesis on Adam Smith is organised in the following way. In chapter 2 I will discuss the reasons for introducing 'rational' considerations into the analysis of Smith. It will also include some general notes on his methodology.

Chapter 3 will concentrate on Smith's theory of human character. I will discuss there whether the received view as if self-interest as prudence is being vindicated stands the 'unity of human nature' test. Namely, whether a character that is prudent in his pursuit of his own interest is also consistent with a morally desirable 'other-regarding' behaviour. I will also investigate whether the character behind the WN is indeed the one we call prudent in the TMS.

Then an extrapolation will be performed where I will investigate the methods people form their moral opinion as a function of what dominates their character. I will show there that the self-interested character may be inclined to judge by other available methods rather than through 'sympathy' (for instance, through utility). The judgement by these methods will morally vindicate natural liberty that is based on self-interest. Smith's opinion, however, would have been that this kind of moral judgement reflects a corrupt sense of morality.

Chapter 4 will be an exposition of Smith's moral analysis of actions. It will deal with the analysis of final distributions that are associated with natural liberty given that self-interest has been morally vindicated. I will argue there that Smith's theory of the morally desirable distribution is a theory of desert. People should be remunerated according to their intentions. Consequently, as proportionality means that one should be remunerated according to what one intended to achieve, spill-overs are no source for remuneration. The systems of natural liberty, it is then argued, cannot achieve a higher degree of moral approbation than mere 'justice' in the Smithian sense of the word¹⁰.

Chapter 5 is a new exposition of Smith's economic system. It is a general equilibrium system where demand plays a significant role. The model I will suggest have the following features. It is a sort of a

¹⁰Justice in Smith's deontological theory is all those things which are consistent with the viability conditions of society. It is therefore, the lowest level of moral approbation which is consistent with the existence of society.

surplus approach theory, namely, that what determines values and distribution (of surplus), is the exchange of surplus. Now, as my model is a two sector model, surplus means the output that is above what is needed, from the particular commodity, for its reproduction.

It is a Sraffa-Leontief like model, in the sense that commodities are produced by means of other commodities. The model I will suggest is a general equilibrium model. I do so because I believe that it properly reflects Smith's intention. Though his analysis of price determination is carried out in the partial equilibrium framework of analysis, the majority of the book implies a general equilibrium approach. In particular, Smith's system is such that distribution and values are simultaneously determined, so that there seems to be no real reason why a general equilibrium approach should not be employed. As it is a system of 'surplus' distribution, there is part of the demand which is pre-market determined. Therefore, it is not a Walrasian general equilibrium and simultaneity is not part of it. Hence, causality is easy to detect and therefore, moral responsibilities.

In this two-sector, general equilibrium model, I will try to show that coincidence of wants (equilibrium) which generates a distribution of surplus, isn't always beneficent. Obviously, the accumulation of capital will be an important factor. I will suggest a way in which the expansion path of the 'net surplus', which is also a condition for beneficence, can be introduced into the analysis of price determination, thus, distinguishing between equilibria that are beneficent, and those which are not.

I will also show, that unlike the convention, at least the structure of demand plays an important role in determining equilibrium. Then I shall argue that the natural price, in Smith's analysis does not reflect a long run price, but, a beneficent equilibrium. In that sense, the natural price is a just price, but, not necessarily a good price.

2. A NOTE ON SMITH'S METHODOLOGY.

Moral philosophy, for Smith, was not much different from any other natural philosophy (what we would now a days call science). "Philosophy", he said : " is the science of connecting principles of nature,...[It], by representing the invisible chains which bind together all disjointed objects, endeavour[s] to introduce order in this chaos..."[EPS-HA, p.45]¹.

In that respect he was following the tradition of the 18th century. There, science and philosophy were frequently interchanged when referring to an effort to understand nature in general, and human nature in particular. Therefore it would be useful to begin our analysis of his moral theory (or, maybe better called: system) with some notes on his methodology.

There are mainly two sources for that inquiry. First, his article on the different forms of discourse(Lectures on Rhetoric and Belles Lettres(LRBL)) allows us to deduce his scientific method from his form of presentation. The other is a collection of three articles the title of each of them begins with : "The Principles which Lead and

¹ EPS stands for the Essays on Philosophical Subjects and HA stands for the History of Astronomy in it.

Direct Philosophical Enquiries Illustrated By...".

In these articles, as their titles indicate, Smith presents and illustrates some of his ideas on methodology. In spite of them being incomplete and unpublished papers they nonetheless constitute a good source to the understanding of Smith's scientific method. For various reasons most writers on Smith's methodology have taken into account only the most complete of these articles: the one in which the principles of philosophical enquiries are illustrated by the History of Astronomy [EPS-HA pp.33-105]. I will maintain that some of the ideas presented in the other articles are as valid as those in the one on Astronomy. I will also argue that these ideas are particularly relevant to his social and economic theories.

Let us begin with the Lectures on Rhetoric and Belles Lettres (LRBL) where methods of inquiry are reflected in the forms of discourse. The basic distinction Smith makes in this article is between what he calls 'historical narrative' and what he named 'rhetoric'.

The 'historical narrative' discourse proposes : "barely to relate some facts.....to put before us the arguments on both sides of the question in their true light, giving each its proper degree of influence, and has it in view to persuade no further than the arguments themselves appear convincing." [LRBL p.58]. On the other hand there is the 'rhetoric' discourse that proposes : "to prove some proposition.....[and] endeavour by all means to persuade us.." [LRBL p.58].

It is quite obvious that any sort of philosophical or scientific system will fall under the category of 'rhetoric' discourses. In fact it is the other way around. All discourses that are presented in that 'rhetorical' fashion reflect an attempt to construct a philosophical (scientific) system, or theory. Indeed the relevant writings of Smith do fall under this category and thus we are able to look upon them as scientific theories.

The 'rhetorical' discourse itself is subdivided into two methods, producing a much clearer picture of his form of presentation. First, we have the 'Newtonian method' where : "we lay down one or a very few principles by which we explain the several rules or phenomena, connecting one with the other in a natural order" [LRBL p.139].

Secondly, we have what Smith calls the 'Aristotelian method' where : "we begin with telling that we are to explain such and such things, and for each advance a principle either different or the same with those which went before" [LRBL p.139].

It seems to me that the 'Newtonian method' of discourse is the more prevalent one in Smith's works. The Theory of Moral Sentiments (TMS) is a distinct example of it. First we have an exposition of the principle behind the whole system: the principle of 'sympathy'. Then it is being used to connect certain phenomena like, for instance, moral opinions, class structure, self-interested behaviour etc.. The Wealth of Nations (WN) too follows that line of presentation. Again the principle behind the system, the division of labour, is presented at the beginning and together with what motivates it (the propensity

to barter and exchange), the rules connecting different phenomena are being displayed. Even the three articles illustrating the principles of philosophical enquiries are constructed in the same manner. The system which is being investigated there, is the system of scientific inquiries.

We may conclude now that even from the mere form of discourse it seems that both his economic as well as moral systems are scientific systems and thus, there exist a common ground to investigate their interrelationship. The next step will be to explore the nature of scientific systems.

There are three illustration of philosophical enquiries; first in the "History of Astronomy"[EPS pp.33-105], second in the "History of Ancient Physics"[EPS pp.106-117] and thirdly in the "History of Logics and Metaphysics"[EPS pp.118-129]. In each one of them the first part is devoted to some general remarks that are made by Smith himself about the task of scientific inquiry. It is his conception of science that is portrayed at the outset of each article and only then he goes on to show how it reflects in the history of science. Indeed it is in the first illustration, the one on astronomy, where Smith gives the introduction to the general problem (or phenomenon) of scientific inquiry. But this does not mean that the points made in the other two illustrations are less significant. In both the History of Physics and the History of Metaphysics Smith advances the historical account with his own remarks on methodology. Some of them are elaboration of ideas presented in the History of Astronomy, and some 'new' ideas that arise due to different degrees of complexity,

which emerge as the subject matter of our investigation 'descends' from the investigation of Heaven to the investigation of earth.

Thinking on the trio as a whole, one can very clearly draw the logic of their arrangement. Namely, the degree of the complexity of the subject under investigation. But this might have been just a coincidence. Even though the Heavens have just a few objects (hence, in Smith's view, a lower degree of complexity), their influence over the faculties in human beings which promote philosophical investigation (admiration, wonder and surprise) are stronger (EPS-HA p.48].

Nevertheless, though it is clear that in Smith's view the effects of Heaven were stronger on motivation, human inquiry has descended to Earth only to find that it is a much more complex task. "From arranging and methodizing the System of the Heavens, philosophy descended to the consideration of the inferior parts of Nature, of the Earth.....[But] [i]f the imagination, therefore, when it considered the appearances in the Heavens, was often perplexed, and driven out of its natural career; it would be much more exposed to the same embarrassment when it directed its attention to the objects which the Earth presented it..."[EPS-HAP p.106]².

In the History of Astronomy Smith presents us with some basics of what he considered to be a scientific theory:

(a) it must have a principle which will unify all those apparently irregular phenomena.

²HAP stands for History of Ancient Physics.

(b) it must be a simple system that would put our mind at ease.

(c) it must be based on familiar qualities³.

The need to deduce familiar qualities, operations and laws of succession, is already presented in the History of Astronomy. However the search for familiar qualities was a negligible part of 'methodizing the Heavens' as there were only few objects involved. Consequently, finding the familiar qualities was not an issue of great importance that can be illustrated by the History of Astronomy. But it does have an important role in 'methodizing the Earth' as on the earth, according to Smith, the amount of objects exceeds significantly those which are in Heavens.

The principles and characteristics of such an inquiry where the subject matter is complex indeed are the more relevant ones to his TMS and WN. They are, however, more carefully analyzed in Smith's other two illustrations of methods of scientific inquiries; the History of Ancient Physics and the History of Logic and Metaphysics.

The reason that these articles were neglected has probably something to do with Smith's performance as a Historian. It is considered that even though his account on astronomy leaves something to be desired, it is still far better than those presented in his other articles⁴. But, from the point of view of studying Smith methodology it is completely irrelevant whether his historical accounts are correct or

³ These characteristics are put forward in sections 1 & 2 in the History of Astronomy. [EPS pp.34-7].

⁴ A discussion of this issue can be found in the general introduction, by Raphael and Skinner, to the EPS (p.2). They also refer to Schumpeter.

not. What is important is what he called, the principles of enquiry. It does not matter whether they are demonstrated in a true or false story. What counts is what is being demonstrated. Therefore, one can not be satisfied with what is deduced on Smith's methodology from his article on Astronomy alone. One must also take into account, when analyzing 'earthy' phenomena, what Smith thought of scientific methods in this context.

There is indeed a significant addition to his methodology in the other two articles. This addition, that is derived from the complexity of the system of earth, is worth quoting at some length. "In every body, therefore, whether simple or mixed, there were evidently two principles, whose combination constituted the whole nature of a particular body. The first was the Stuff, or subject matter, out of which it was made; the second was the Species, the Specific Essence, the Essential, or, as the schoolmen have called it, the substantial form of the Body.....In every case therefore, Species or Universals, and not individual, are the object of Philosophy.....As it was the business of Physics, or Natural Philosophy, to determine wherein consisted the Nature and Essence of every particular Species of things, in order to connect together all the different events that occur in the material world; so there were two other sciences, which, though they had originally arisen out of that system of Natural philosophy I have just been describing, were, however, apprehended to go before it, in the order in which knowledge of Nature OUGHT to be communicated. The first of these, Metaphysics, considered the general nature of Universals....The second of these,

Logics.." [EPS-HALM pp.118-120]⁵.

This argument appears to be in complete accordance with what is suggested in the History of Astronomy⁶. Namely, that there is a need to classify matter according to familiar qualities. The only addition here is that we must analyze these qualities separately. Metaphysics, for Smith, the Theory of Universals, is a theory, the domain of which is not the matter itself but its classification. This does not mean that there is no connection between the different theories or that the universals are based on some a- priori notion. Even in Hume we can find assertions of the following type : "...I must distinguish in the imagination betwixt the principles which are permanent, irresistible, and universal...And the principles that are changeable, weak and irregular.." ⁷. That is to say that we have, in fact, two distinct levels of analysis. In both of them there are principles, the role of which is to connect the different phenomena. The rules that are derived from them may be permanent in character ,or temporary.

From Smith's point of view, therefore, a scientific investigation of everything, and in particular, earthy matters, is conducted in two different levels. One, the level of the subject matter- the level of the nature of things - where the rules might be changing, and the other is the level of the Universals; namely, that familiar quality that is common to all the subject matter that is under investigation.

⁵HALM stands for History of Ancient Logic and Metaphysics.

⁶EPS-HA pp.38-9.

⁷Hume, D. A TREATISE OF HUMAN NATURE p.274.

In his economic system one may consider the notion of natural price as part of the Universals analysis (and I do not refer here to the natural price in its 'long-run equilibrium' interpretation), while market price may reflect the analysis of the subject matter.

In his moral analysis this distinction is even more clear. The level of the subject matter is the level of the observed behaviour of human being. Namely, people's moral opinion that is based on their actual disposition to 'sympathize'. The Universal, however, the familiar quality that is common to all mankind, in different degrees, is the emotional meaning of sympathy. Namely, what it is in human being that determines how much effort are they willing to put into trying and see the other from a true 'impartial spectator's' point of view.

The investigation of its permanent rules constitute what Smith called Metaphysics, or 'nature of sentiments'. In the account of Smith's life given by D. Steward, which was helped by one of Smith's students J. Millar, he describes the convention of moral philosophy at that time to be : "The science of Ethics has been divided by modern writers into two parts; the one comprehending the theory of Morals, and the other its practical doctrines"[EPS p278]. It seems as if this distinction falls very well under the one just made; that is, the part of the moral system which is theory, is the one that is at the level of 'universals': the level of permanent, while practice falls under the category of the changeable relations, the rules of matter.

What we learn from all that is that though Smith was, in principle, an 'empiricist' in the sense that the subject matter of any

investigation was to be known to us through observation, he nevertheless adhered to some semi-rationalistic ideas⁸. Universals are not necessarily 'rational' even though one can always argue that at the level of analyzing human beings one cannot think of a universal which is observable. But what makes Smith's approach semi-rationalistic is the fact that he is willing to treat those universals as subject matter in themselves. This was precisely the essence (forgive the expression) of the Scholastic approach.

The main question is, however, whether or not we can observe these distinctions in Smith's work. The answer, in my view, is yes. Not only that the distinctions exist, they are almost the only means by which one can explain the apparent contradictions in his writings.

The 'principles' in human nature upon which Smith bases his two theories are 'sympathy' and the 'propensity to exchange and barter'⁹, or, the 'principle of persuasion'¹⁰. Both these 'principles' are strongly dependent and correlated with a person's attitude towards the others. 'Sympathy' is his disposition to put himself in another person's place and the propensity to exchange reflects a person's drive, or need, to trade with another. His ability to bargain depends on how well he can persuade the other.

⁸In an 'empiricist' sense I should use the word 'Classification' rather than universals. But this is only a semantic difference in what concerns my purpose.

⁹Why it is that I believe this to be the principle of the WN rather than 'self-interest' will be explained below. In any case, either this propensity or 'self-interest' will serve the purpose of what I have to say here.

¹⁰In the Lectures on Jurisprudence (LJ) Smith argues that the real foundation of this propensity is the 'principle of persuasion' in human nature [LJ pp.493-4].

I maintain that both these 'principles' are a reflection of the same fundamental in human nature. I call this fundamental, 'the Interest In Others' that people have regardless of the particular constitution of their characters. 'Sympathy' is clearly a reflection of people's interest in the others. It is, however, a reflection of it and not the interest in others itself. This can be seen by the existence of different degrees of 'sympathy' which, I believe, is a reflection of the different form that this fundamental takes in different people. I will show later on that Smith was aware of two important modifications. One, that people's particular character interferes in their 'sympathy'. Namely that when an individual is trying to be the 'impartial spectator' his effort depends on his personality. It is not an effortless process to reach true 'impartiality' and therefore, a person with little interest in the others will be less inclined to put into the imaginary change of places the required effort for 'impartiality'. It is the difference between asking the question 'what would I have felt (and done) had I been the other person in his predicament' and asking one's self 'what would I have felt (and done) had I been in his predicament'.

The other modification is concerned with the role of utility in forming people's opinions. Sometimes, Smith argues, people tend to confuse aesthetics with morality. They are so impressed by the beauty of, say, a system, that they believe that it must be morally good [TMS p.185]. The same tension exists in Smith's Lectures on Jurisprudence (LJ) where he discusses people's social sense (acceptance of authority). There seems to be a substitution between 'utility' and 'sympathy' (the origin of authority). The more one has

from the one, the less he has from the other¹¹. When 'sympathy' is dominant the social organisation will tend to be authoritative, when 'utility' dominates, a less authoritative organisation can subsist [LJ pp.401-2].

Given that 'utility' is an effortless method of forming a moral opinion it is not inconceivable that people with low interest in the others will tend to form their moral opinion by utility. Hence, 'sympathy' is not the interest in others itself but an expression of the particular form that this fundamental (universal) takes in each individual.

The propensity to exchange and barter and the 'principle of persuasion' which is behind it are too a reflection of the interest people have in others. The brewer and the baker do it from self-love. Namely, they have no interest in the other apart from being a source of commodities and services to them. But they succeed in their bargaining because the one persuades the other that the deal is such where you "give me what I want, and I shall give you what you want" [LJ p.493]. But if the two individuals had different characters they might not have reached agreement on similar terms of trade. If an individual has a positive interest in the others he might be persuaded to exchange for the 'cost of production'. For instance, in the Deer and Beaver case [WN p.65-6] where there is no capital accumulation Smith argues that the only acceptable rule of exchange is according to labour inputs (effort). But for that norm of

¹¹Again, all these points will be properly explored below. It is nevertheless important to present them here as they intend to give the sense of Smith's use of Universals.

behaviour to prevail and to have persuasion power we must establish whether and why it became a social norm. The mere idea of persuasion depends on conventions and other side-products of social organisation. People's acceptance of these conventions is a crucial input to the process of bargaining and in itself, depends on people's disposition towards others (and the social organisation).

As I said before the mere analysis through universals is by no means a reflection of 'rationalism'. It is the treatment of it as substance which takes us away from pure 'empiricism'. In the case of Smith this treatment appears in the form of the 'moral instructor' who deduces his prescriptions from an abstraction of the 'impartial spectator'. This abstraction is an analysis of an 'imaginary change of places' that is performed by an imaginary human being who has only the interest of the others at heart. 'Interest in the others' as an independent quality generates, through its impartiality, Smith's benchmark for moral analysis. It explains then what are the grounds for Smith's criticism of individual's actual judgement. It is simply that his moral theory is not a 'naturalistic-positive' one. Rather, it is a delicate combination of 'empiricism' and 'semi-rationalistic' ideas. It thus makes his theory much more rich and interesting.

It also helps to explain the meaning of the 'labour theory of value' in Adam Smith. It is by no means based on the assumption that labour is the universal of commodities and therefore, commodities relate to each other, as a matter of fact, according to labour ratios. Rather it is through the universal of 'interest in the others' that in a pre- capital-accumulation stage the social convention of the

'impartial spectator' will be that it is right to exchange commodities according to their labour ratios. The labour theory of value, therefore, is not a positive theory of exchange values. It is, rather, a normative, or conventional, theory of exchange¹². Of course one needs to explore what happens when capital accumulation begins. Whether labour values can still play the role of the normative benchmark without a metaphysical conception of commodities the intrinsic value of which is comprised of past and present labour.

The idea of a universal in Smith's perception of the human nature can also be supported for two other reasons. One is the influence of Newton on Smith's perception of the world. In particular, his influence on Smith's belief in unity in nature. The Universal in such a case helps to relate the various aspects of human nature that are being examined by his various theories. Also there is Smith's discussion of the problem of describing human characters. In the next two chapters I will explore the consequences of the 'rationalistic' aspects of Smith's theory on the moral values of self-interest and natural liberty. The Universal (the unity of human nature) and the manifestation of 'rationalism' in the idea of the 'impartial spectator' will play there a significant role.

¹²A different kind of argument in support of the 'labour theory of value' being approved by the 'impartial spectator' can be found in Young (1986). It is also interesting to note that the idea that exchange should reflect labour ratios is not unrelated to Smith's discussion of property right. In Smith's discussion of property rights in the Hunters' stage he says: "All agree that it is a breach of property to break in on the chase of a wild beast which another has started, tho' some are of opinion that if another should wound the beast in it's flight he is entitles to a share, as he rendered the taking it more easy on the whole." [LJ pp.459-60]. Which means that the 'labour theory of value' is also somewhat hidden behind a right which is strongly related to conventions about social organisation. These conventions are bound to be dependent on people's disposition towards the others.

3. THE MORAL ANALYSIS OF SELF-INTEREST: A STUDY INTO SMITH'S ANALYSIS OF THE HUMAN CHARACTER.

The question of the inter-relations between Smith's analysis of morals and economics is basically the question of relationship between the Theory of Moral Sentiments (TMS) and the Wealth of Nation (WN). The problem of relating the two books has two distinct dimensions. One is the question of whether or not the premises regarding human nature in these two theories are consistent with one another (and I will call it the level of suppositions). The other is the problem of whether the moral propositions of the one theory are compatible with the moral implications of the other. In particular, whether or not Adam Smith offers a consistent proposition regarding the moral values of self-interest and natural liberty (and I will call it the level of propositions).

In the introduction to this part of my work I have given several reasons why worries were expressed about the consistency of the two theories. I will not repeat it here. I would like, however, to examine the development of the problem and its proposed solutions

through the prisma of the universal, i.e., the unity of human nature¹. I would like to point out to the reader that the vindication of self-interest, which this chapter is all about, does not constitute a sufficient condition for the moral advocacy of natural liberty. This latter problem will be dealt with in Chapter 4.

(a) The 'Adam Smith Problem' and the Theory of Human Nature.

As mentioned in the introduction the tension between the moral status of self-interest in the TMS and its moral implications in the WN -- which became to be known as the 'Adam Smith problem' -- was confined almost entirely to the level of suppositions about human nature. Some Germans had interpreted the apparent discrepancy between the role and value of self-interest in the two theories as a problem of Smith's consistent perception of the human character. In the TMS, they argued, he thought mankind to be pre-dominantly benevolent. By the time he wrote the WN, according to those scholars, he had changed his mind about it. Now he thought them to be pre-dominantly

¹To that end, some of the points that were made in the introduction will be repeated in section (a) below. It is important to repeat these points for the completeness of the argument. In the Introduction I have presented the Adam Smith problem (and its accepted solution) at the level suppositions. Once this had been settled, we moved to discuss a possible reconciliation of the moral propositions that are generated by the two theories from the point of view of interpreting the nature of Smith's theory. Namely, we discussed the question whether interpreting his theory as 'Naturalistic' and 'Positivistic' can yield a moral vindication of self-interest that will be consistent with the apparent advocacy of natural liberty that is based upon it in the WN. Such an approach deals with the Adam Smith Problem in a segregated manner. Here I suggest to tie together the solution to the problem that was posed by the Germans (at the level of suppositions) with the solution of the problem at the level of propositions. The crucial point here is Smith's perception of the human nature. It is therefore necessary to repeat some of the points for the completeness of the argument and I beg the reader to bear with me.

self-interested which, they argued, is precisely the selfish character that is so clearly deplored in the TMS. The difference in the role and meaning of self-interest in the TMS and the WN, therefore, is a reflection of this change of mind.

Modern commentators like Macfie (1967), Campbell (1971), Winch (1978), Skinner (1979) and Raphael (1985) rejected this explanation. In fact, they deny the existence of any problem at all in the TMS-WN relationship. The received view is that the German scholars thought that there was a problem because they had mis-interpreted 'sympathy', the 'principle' behind the TMS. They understood that 'principle' to mean that the most dominant feature of human nature is that of benevolence. Thus, it was inconsistent with the character behind the WN who seemed to be dominated by self-interest.

However, argue modern commentators, the 'principles' of the TMS and the WN are not at all in competition with one another. Self-interest, the apparent principle behind the WN, is a description of people's motivations to act. 'Sympathy', the principle behind the TMS, is merely a description of another - distinct- feature of the human character. It is the disposition people have to put themselves in other people's place. They also derive a particular kind of pleasure from such an imaginary change of places if they experience harmony of sentiments. Namely, if they feel that they would have felt the same had they been in place of another. It is upon this pleasure, rooted in such an ability, or disposition (which we might call today empathy) that people form their moral opinions. Their motives to actions are an entirely different matter; they spring from a

different aspect of human nature altogether. Self-interest, quite clearly, is a quality mainly ascribed to motives. It can only be understood as a description of that particular aspect of human nature and it has nothing to do with other dispositions that people may or may not have. Therefore, there is no inherent contradiction between the premises of his two theories².

The solution to the problem posed by the Germans was in the method of character description. The Germans described a character by a single general tenor of behaviour which, presumably, captured all its various aspects. If named after its manifestation in motives a character can indeed be either benevolent, selfish or malevolent. Modern commentators, on the other hand, understand Smith's perception

² Macfie and Raphael, in their introduction to the Glasgow edition of the TMS, insist that these two faculties in human nature are entirely different. "Sympathy is the core of Smith's explanation of moral JUDGEMENT. The motive to action is an entirely different matter"(p.21). Raphael (1985), goes even further to draw a connection between the different (almost exclusive) spheres of human nature and their different (and again, almost exclusive) social meanings. "The social bond created by sympathy and imagination...is quite different from the social bonds of mutual dependence... The social bond of sympathy and imagination leads to our code of ethics and to a good part of our code of law. Economic behaviour has to be explained in terms of self-interest"(Raphael, 1985. p.94). Nevertheless, the distinction between the two aspects of human character to which 'sympathy' and 'self-interest' ascribe remain, to some extent, obscure. Even among modern commentators the interpretations of 'sympathy' seem to vary. At the one end 'sympathy' is being interpreted as a merely technical word; completely divorced from any emotion. (Thus, cannot contradict motives which necessarily involve emotions). Campbell (1971), for instance, wrote that 'sympathy' is Smith's "word for agreement, coincidence or harmony of sentiments...It cannot be said that Smith's concept of sympathy accords with the normal meaning of the term"(Campbell, 1971. p.94). On the other hand there are those who found it more difficult to see 'sympathy' as an idea which is unrelated to emotions. Macfie (1967), for instance, wrote that "for Smith sympathy was the effective cement of society....Sympathy is then an emotion, and an unselfish emotion"(Macfie 1967. p. 57). And A. Skinner (1979) wrote that the process by which we morally judge, "involves a complex of abilities and propensities which include sympathy, imagination, reason, and reflection"(Skinner, 1979. p.49) where sympathy denotes an emotional disposition. All this implies that even in terms of their own solutions the divorce of 'self-interest' from 'sympathy' according to the received view is not intuitively clear.

of the human character as more complex. How he is characterized in one particular aspect of his nature does not tell us anything about its other components. The TMS and the WN depict different features of the human character and they are therefore complementary social theories that are based on complementary aspects of the human character.

But solving the problem at the level of suppositions still leaves open the question of whether or not Adam Smith offers a consistent proposition regarding the moral value of self-interest and natural liberty. Obviously, this is wide ranging issue which is concerned with the moral analysis not only of self-interest but also of efficiency and the relationship between motives and outcomes. As I mentioned earlier I will deal with this problem in Chapter 4. Here I will confine myself to the analysis of Smith's moral vindication of self-interest. A vindication that is necessary (but by no means sufficient) to render the implied advocacy of natural liberty consistent from the moral point of view.

The apparent problem at the level of propositions seemed to have been that selfishness is clearly condemned in the TMS and that self-interest, distinct from 'sympathy' as it may be, can easily be regarded as a form of selfish behaviour. Hence the first and immediate task was to disassociate self-interest from selfishness. This too appeared to have been a problem of character description. Indeed the same technique of character description that was used to solve the problem that was posed by the Germans is now used to do just that: to divorce self-interest from selfishness and to open the

way for its moral vindication.

According to the Germans, self-interest (or the character behind the WN) is a form of selfishness even if we think of self-interest as a description of motives alone. The reason is quite straightforward. When we describe a character by a single tenor of behaviour we expect it to manifest itself in all possible expressions of a person's character. In particular, we expect to find its appearance in what motivates human actions. As a description by a single tenor of behaviour does not leave many options besides benevolence, selfishness and malevolence, self-interest must be the expression of selfishness in motives.

To that extent, the complex method of character description as applied so far (i.e. to the problem of 'sympathy'-self-interest relationship) will not be very helpful. What we have done so far is to divorce self-interest (or the character behind the WN) from 'sympathy' by saying that 'sympathy' is not a motive and thus has nothing to do with self-interest or, for that matter, with benevolence. However, if self-interest is a quality describing motives in general it means that people are motivated to act in whatever they do by their own interest alone. As moderate a sentiment as it may be it will be extremely difficult to argue that self-interest is not to conceive the others "upon account of our own private good or bad fortune"[TMS p.40] which is Smith's definition of selfishness. In such a case we cannot ignore its clear condemnation in the TMS.

However, we can circumvent the problem by applying yet again our complex perception of human nature and distinguish between various kinds of motives. For one we can follow Smith's own advice and look at the motive-side of a character as comprised of 'own-regarding' and 'other-regarding' behaviours [TMS p.212]. There are natural urges in both of them and self-interest here may be a quality of only one kind of motives. In particular it may describe the way one deals with one's natural urge to care for one's self. According to the accepted view self-interest is nothing else but the moderate expression of this particular natural urge. It is, then, what Smith called Prudence.

The appeal of this approach is quite clear. By virtue of this complex method of character description, self-interest in itself does not exclude the existence of other dispositions or even motives. It therefore allows 'sympathy' and self-interest to co-exist while at the same time it isolates self-interest as a separated object of moral approbation. Viewed in this way it is rather easy to establish that the self-restraint and moderation of the natural urge to care for one's self is morally approved³. Coupled with the beneficial outcome of the free expression of self-interest as portrayed in the WN the TMS and the WN are consistent not only in terms of their suppositions on human nature, they are also compatible in terms of their moral propositions.

³It is so because prudence is a moderate expression of the natural urge to care for one's self. According to the TMS, the 'impartial spectator' will tend to 'sympathize' and hence approve of all sentiments when moderately expressed. Whether such an Aristotelean concept of the moral good is applicable to Smith is discussed in the introduction.

It is quite clear that the moral vindication of self-interest is an essential part of the consistency argument that dominates the received view. But there is a growing dissatisfaction with the moral vindication of self-interest as is generally accepted. Heilbroner (1982) and Evensky (1987) are such examples. Their efforts to reconcile the two theories are based on the assumption that self-interest has not really been vindicated. In Heilbroner it is his insistence that we should read Smith's work as a reiteration of Mandeville's 'Private Vices, Public Benefits'. Evensky argues that for Smith self-interest must have been an inherent flaw in the human character. Advocating natural liberty is consistent with it because the minimization of interference from flawed human beings will bring us as close as possible to the 'ideal' of the Great Design which Evensky attributes to Smith.

The numerous occasions where Smith shows explicit and implicit apprehension about the self-interested character simply don't fit the generally accepted interpretation. Indeed, many of those who adhere to the received view will agree that though self-interest, as prudence, is unquestionably approved⁴ it does not mean that the full character of those who act in such a way is also vindicated. After all, with the complex perception of human character the prudent care

⁴Some would argue that even prudence does not constitute Smith's idea of the morally good because of the distinction between mere propriety and virtue. Mere propriety is 'to eat when we feel the urge'. Virtue requires that there will be some admiration to the degree of self-restraint. However according to Smith nature deceives mankind to believe that wealth, the remuneration of the prudent (frugal and industrious), is a reward to true virtues. If Smith's theory is 'naturalistic' and 'positive' as is the received view then there is no way he could call this a deception. If people feel that self-interest is virtuous because it is associated with such great rewards then so it is. Smith the observer has no mean of claiming otherwise. See the Introduction and Chapter 2 for a more detailed discussion of this.

for one's self does not tell us anything about the 'other-regarding' aspect of a character. The knave's character is prudent but by no means morally desirable. It can thus be argued that as the WN explores only the harmonious interaction of people's 'own-regard' (self-interest) behaviour, the advocacy of natural liberty that is implied by it is perfectly consistent, from the moral point of view, with the TMS.

However, such a conclusion relies heavily on accepting a proposition about the human character which I find unpalatable from the point of view of Smith's theory as much as from a personal point of view. This proposition is that the method of a complex perception of the human character implies that the various features of it are not related to one another in a coherent way. At the level of suppositions about human nature it meant that 'sympathy' had nothing to do with motives and was therefore consistent with whatever kind of motives we attribute to the character behind the WN. At the level of moral propositions it means that the moderate expression of one's urge to care for one's self has no bearings whatsoever on his 'other-regarding' sentiments and behaviour. A knave as well as an indolent person have the same kind of morally approved prudence in their pursuit of their own-interests.

While the distinction between 'sympathy' and self-interest may not, on the face of it, appear outrageous, the divorce of one's 'own-regard' from one's 'other-regarding' behaviour seems to be wholly unacceptable. It is, therefore, the purpose of this chapter to establish a consistent relationship between the various aspects

of a person's character and to examine its consequences to the interpretation of the TMS-WN relationship. This examination will be carried out at two distinct levels. One is the internal consistency of the motive-side of a character. Namely, how do the 'own-regard' and the 'other-regard' relate to each other and what are the moral consequences of it for the vindication of self-interest or the character behind the WN. The other level is the question of the internal consistency of 'sympathy' and the self-interested character.

In the second section I will discuss the various methods of description that Smith accounts for in his Lectures on Rhetoric and Belles Lettres (LRBL). I will show that the view according to which the TMS and the WN are based on conflicting perceptions of the human character (the Germans view), is as a legitimate a choice of method as that which is implied by the generally accepted view. I will also point to the fact that two out of the three methods which Smith advances in the LRBL have an explicit assumption about the unity of human character. A proposition that can be confirmed by a reference to Smith's writings on methodology.

Obviously the proper test to any choice of method is whether it produces a coherent relationship between the two theories. While the failure of the Germans' approach is evident, that of the modern interpretation has not seriously been discussed. In the third section I propose that the method that is implied by the received view still does not really vindicate self-interest and therefore leaves the problem of Adam Smith at the level of propositions unresolved. By relating the various aspects of a person's character in a consistent

manner it will become meaningless to discuss the moral status of prudence alone. Any proposition we make about how people care for themselves will, in such a framework, inevitably imply something about their 'other regarding' behaviour. In any case, I will argue, the character behind the WN can by no means be considered as a 'one-dimensional' character. The moral vindication of prudence is therefore, insufficient for its general vindication.

The fourth section of the chapter is something of an extrapolation. Unlike the argument about the relationship between 'own-regard' and 'other regarding' behaviours, there is no explicit dealing in Smith with the question that is raised here. What I do in this section is to try and establish a consistent relationship between 'sympathy' and 'self-interest'. I will show that 'sympathy' is not a fixed characteristic of human nature. That people use it differently according to the general nature of their character which, obviously, also affects their behaviour in their pursuit of their own interest. The moral judgements that are produced under the different circumstances, therefore, vary considerably. I will argue that it is only the 'self-interested' characters that will see virtue in 'self-interested' characters. In as much as Smith's moral theory is a description of how people form their moral opinion it explains why people might advocate natural liberty when observing human nature to be self-interested. But from the point of view of Smith the 'observer', this kind of judgement is corrupt and wrong. When properly judged, self-interest only merits the title of being a 'just' in the sense that it does not endanger the ability of society to subsist.

(b)Methods of Character Description.

As we saw earlier, one can learn a lot about Smith's methodology by looking at his methods of discourse. Similarly we can learn much about Smith's perception of human nature by examining his methods of character description. There are basically three methods of character description that were considered by Smith according to the lectures notes entitled Lectures on Rhetoric and Belles Lettres (LRBL). These are the 'direct method', the 'general indirect method' and the 'particular indirect method'. I will show now how the 'Adam Smith problem' (i.e., the Germans perception of human nature as opposed to the modern one) corresponds to Smith's methods of character description. I will also show that two out of the three methods have an explicit assumption about the unity of human nature. The third does not have such an explicit assumption but deducing that human nature is thus fragmented does not really follow. I will show in the next section that this third method creates many consistency problems at the level of Smith's moral proposition. First, however, let us examine these methods.

To begin with, Smith gives a general account of the two main methods of describing a quality of any object : "That way of expressing any quality of an object which does it by describing the several parts

that constitute the quality we want to express, may be called the direct method. When, again, we do it by -describing the effects this quality produces on those who behold it, may be called the indirect method"[LRBL p.67 my italics]. (these are also distinguished as the 'internal' and the 'external' methods). Notice that the 'direct' method differs from the 'indirect' one in two respects. First, in the 'direct method' the quality is described by a set of properties (its several parts) while in the 'indirect method' we describe the quality by its cumulative effect. Secondly, in the 'direct method' we describe the different components themselves while in the 'indirect method' we describe things by their external effects. In our case, the quality we are interested in is the quality of human character. When applied to it, the direct method is "when we relate the various parts of which it consists, what mixture of each particular passion or turn of mind there is in the person"[LRBL p.78]. That is, a character is a composition of a set of properties like, for instance, wisdom, courage, honesty etc. We distinguish between characters by the different mixture of these properties.

The indirect method, on the other hand, is where we "relate the effects it produces on the outward behaviour and conduct of the person"[p.80]. For instance we may say that a person is harmful (malevolent), careless or bad tempered. The 'indirect method' is again subdivided: to the 'General' and 'particular' methods. We may describe a character in the 'indirect' method (by its effects on the others) "either by relating the general tenor of conduct which the person follows, which we may call the general method, or by descending into particulars and pointing out how he would act in such

and such instances: this we may call the particular method".[p.80]. So we may say that a person is benevolent, and thus describing him by the general tenor of conduct, or we may say specifically how his benevolence is being expressed in different circumstances. But in both the general and particular methods we refer to the effect that the different aspects of human character produce (the indirect method). In the case of the former it is the cumulative effect while in the particular method it is the effect on the beholder of the various expressions of that character.

The 'particular indirect method' may, in some circumstances, be confused with the 'direct method'. In both cases we describe a character by a set of properties. The difference, then, lies in that the 'direct method' describes the intrinsic value of particular properties while in the 'particular method' we describe a set of behaviours that should stem from the same cumulative effect by which we distinguish between different characters.

To sum up, the three methods are as follows:

'Direct Method': when a character is presented as a set of features which are described by their intrinsic value rather than by their effects on others.

'General Indirect Method': when a character is described by the cumulative effect it creates on the observer.

'Particular Indirect Method': when the cumulative effect that the character creates on the observer is broken down to the effects on

the observer that is created by the various aspect of the character¹.

There are two instances in the reading of Smith where the character description plays an important role. First, in arguing that the TMS and the WN are not based on contradicting assumptions about the human nature. Namely that 'sympathy' and 'self-interest' are not competitive descriptions of the same thing. Second, in proposing that self-interest is morally good because it should not be read as selfishness but as prudence.

Clearly, for 'sympathy' not to compete with self-interest on the description of the basic emotional disposition of a character, we must stick to the 'direct method' of character description. To see that, let me now examine the opening statement of the TMS. There, in the spirit of the 'Newtonian Method' of discourse, Smith puts forward the 'principle' behind his moral theory. "How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it." [TMS p.9].

¹On the face of it one may argue that the only difference between the 'particular indirect method' and the 'direct method' is in the origin of description. Namely, that both these methods imply that the character is a set of properties only that in the former they are described by their external effect on the observer while in the latter they are described from the point of view of their intrinsic value (like, say, IQ as an intrinsic measure for wisdom). However, this is not the case. Smith is very clear that in the 'indirect method' there is a general impression created by the character. Thus we can describe this general impression as such or to descend into the various expression of the same thing. It is through this descendance that I have concluded that in the 'particular indirect method' the unity assumption that is so clear in the 'general method' is preserved.

It can now be interpreted in two different ways:

- a. no matter how busy people are with themselves, they always have a positive interest in the fortunes of others. Namely, their interest in themselves does not mean that they do not have an interest in the fortunes of others.
- b. the selfish appearance of people is misleading. Actually, they are benevolently disposed. The happiness of others is as important to them as their own.

The difference between these two interpretation is in the way the human character is being described. In the first case (interpretation (a)) the character of man is perceived as composed of two independent aspects: the motive to action and the interest he has in the happiness of (or feelings towards) others. Interpretation (b), on the other hand, is based on the assumption that the human character is described by a single feature: its disposition towards the others. The way he feels about the others or the interest he has in their happiness, reflects the whole constitution of a person. In particular, his actions and the motive behind them must also be affected by the same thing: the degree of interest he has in others. Thus, to depict the essence of a character it would suffice to describe only his motives; in such a case, he is either benevolent, or selfish or malevolent. Smith's opening statement is therefore interpreted as saying that sometimes we only appear to act out of selfishness (no interest in the others at all) but the truth is that we do have a positive interest in others' happiness. This positive interest, when manifested through actions, means benevolence.

So the German interpretation of the 'principle' in the TMS is in the line of Smith's 'general indirect method' of character description. A character is described by its cumulative effects. And this effect, as perceived by those who behold, is his interest in the fortunes of others as reflected through his actions. 'Sympathy' therefore, is to be understood as a description of this emotional disposition. Obviously, it means a high interest in the fortunes of others. When manifested in actions, this degree of interest means benevolence and thus, is inconsistent with self-interest. Even without going into details regarding what self-interest really is, it obviously reflects much less interest in the fortunes of others than is implied by 'sympathy'. Hence, as characters are perceived in the 'indirect method', via the degree of interest they have in the fortunes of others, 'self-interest' and 'sympathy' correspond to different degrees of those 'fellow-feelings'.

But there are two other ways of interpreting Smith perception of the human character. The 'direct method' and the 'particular indirect method'. I have already mentioned that these two methods may be, sometimes, confused. For in both of them we describe a character by a set of properties. The difference between them, however, is significant. First, in the 'direct method' we describe the intrinsic value of the particular property (like, for instance, wisdom) while in the 'particular indirect method' we describe it by the effects it produces on those who behold. Secondly, and more importantly, in the 'direct method' we do not find any inherent relationship between the different components of the human character. In the 'particular indirect method', on the other hand, we are actually describing the

different expressions of the same thing.

Bearing in mind Smith's search for unity the 'particular indirect method' seems to me to be the more appropriated method. However, it seems as if the convention has chosen the 'direct method' as the solution to the problem posed by the Germans. That is to say, 'sympathy' and 'self-interest' are perceived as describing two distinct faculties of the human character. I will show now that if we choose to stick to this character description we shall run into difficulties in arguing that self-interest is morally good.

(c) The Consistency of the Charitable Self-interested Character.

In the following section I will try to show that to use the 'direct method' of character description does not really solve the problem of the TMS-WN relationship. It does help in arguing that the fact that people employ 'sympathy' to judge morally does not, in itself, contradict their self-interested behaviour. However, when we come to the question whether self-interest is morally good, so that the moral propositions of the TMS will not contradict the moral implications of the WN, the same method itself creates an obstacle.

To begin with, however, it would be useful to discuss the question of what is really meant by self-interest.

The Definition of Self-interest: There are mainly two interpretation to the meaning of self-interest in the writings of Adam Smith.

(a) Self-interest means selfishness, or self-love.

(b) Self-interest means prudence.

(a) Selfishness or selfish behaviour, according to Smith is "when [sentiments of others are] conceived upon account of our own private good or bad fortune" [TMS p.40]. Or more generally, when our behaviour

is determined according to its proposed contribution to our own happiness.

(b) Prudence, according to Smith, is the 'virtue' of caring for one's self. "The care of the health, of the fortune, of the rank and reputation of the individual, the objects upon which his comfort and happiness in this life are supposed principally to depend, is considered as the proper business of that virtue which is commonly called Prudence"[TMS p.213]. Note that 'virtue' here does not represent a moral judgement. It denotes a certain feature of human character that may or may not be virtuous. (This can easily be proved for at some point Smith discusses the 'improper' and the 'proper' prudence. Obviously, if prudence can be 'improper' it cannot be at the same time virtuous by definition). So self-interest, according to this approach, is that part in our nature that directs us to the care of those things which affect us.

The Difference between them: The most obvious distinction between these two perceptions of self-interest is that the one uses it as a description of the human character as a whole, while the other perceives self-interest as a description of one single aspect of the human character. In terms of Smith's discussion of the different ways to describe a character, clearly selfishness corresponds to the 'general indirect method' while prudence, to the 'direct method'. That is, selfishness (the 'general indirect method') is a description of the general tenor of behaviour. Prudence, on the other hand (the 'direct method') is an account of a single aspect of human character.

Indeed, when Smith discusses human character he decomposes the analysis into two main parts : " When we consider the character of any individual, we naturally view it under two different aspects; first, as it may affect his own happiness; and secondly, as it may affect that of the other people." [TMS p.212]. Prudence, quite clearly, belongs only to the category of the 'own-regarding' aspect of human character. Not surprising therefore, modern commentators who used Smith's 'direct method', perceive self-interest as prudence. The German scholars, who followed the 'general indirect method' perceived self-interest as selfishness.

There are now two questions that must immediately follow. One has to do with the moral accountability of the different forms of character description. That is, whether a single component of a character when 'directly' described, is morally accountable. The other has to do with the nature of the 'self-interested' character that we observe in the WN. Namely, even if prudence corresponds to self-interest, is this the only feature of the human nature by which Smith describes the character of the WN?. Or in other words, is the WN an analysis of people's interaction only in as much as it concerns their pursuit of their own good?.

The moral accountability of prudence and selfishness: There is hardly any problem in ascribing a moral value to selfishness. As it is a general description of the human character, it reflects the person's behaviour in any of his encounters with the world that surrounds him. It describes how he will feel and act in what concerns his own happiness as well as in what concerns the happiness of the others.

Everything will be determined according to its effect on this person's own happiness. Thus, Smith's moral judgement is very harsh and conclusive : "The heart of every impartial spectator rejects all fellow feeling with the selfishness of his motives, and he [the actor] is the proper object of the highest disapprobation." [TMS p.78].

However, as far as prudence is concerned, we must bear in mind that it only depicts one aspect of the human character. Can we pass a judgement on a person according to that single aspect of his behaviour?. Indeed, when Smith comes to assess that quality his judgement seems to be quite reserved: "Prudence, in short, when directed merely to the care of the health, of the fortune, and of the rank and reputation of the individual, though it is regarded as a most respectable and even, in some degree, as an amiable and agreeable quality, yet it never is considered as one, either of the most endearing, or the most ennobling of the virtues. It commands a certain cold esteem, but seems not entitled to any ardent love or admiration." [TMS p.216]¹.

Obviously, the moral judgement of a character, described in a 'direct method', must take into account the other components of that character. In Smith's case, the character of man is now decomposed into the two specific forms of the 'own-regarding' and the 'other-

¹It is true that Smith's reservations about prudence may result from its being merely proper. Namely, that it is not a great restraint or self-denial that should command admiration. I personally don't accept this interpretation for two reasons. One is that if the natural urge to care for one's self is so great then moderation of it should reflect great restraint. And the other, that as will be shown below, Smith's qualifications are entirely related to the other aspect of human nature with which prudence is associated.

regarding' aspects. Thus, a moral judgement of any character must consider the 'own regarding' as well as the 'other regarding' aspects of it. Indeed, the description of the virtuous man follows precisely this qualification. "The man who acts according to the rules of perfect prudence, of strict justice, and of proper benevolence, may be said to be perfectly virtuous." [TMS p.237].

That is, perfect prudence describes the person's virtuous behaviour so far as it affects only his own happiness. Proper benevolence and strict justice, on the other hand, describe his virtuous behaviour as much as it affects the others' happiness. But can a person be perfectly prudent and improperly benevolent? If so, what will be the moral value of such a character?. Moreover, can a person, as a matter of fact, be perfectly prudent and perfectly benevolent?. Isn't there a hidden impossibility in Smith's description of the virtuous character? Or, perhaps, perfect prudence means to have a very moderate interest in one's own happiness. In that case, is it really self-interest?

The fact that prudence alone (i.e. a person's behaviour as far as his own happiness is concerned) cannot generate the virtuous character is only too obvious in Smith's own analysis of it. When he comes to pass a moral judgement on it, he is obliged to distinguish between three 'sorts' of prudence. Prudence that is 'directed merely to the care of one's self', prudence that is 'directed to greater and nobler purposes than the care for one's self' (which he calls 'superior prudence') and prudence which is 'the mere want to take care of one's self' (which he calls 'imprudence').

By doing so, Smith had actually incorporated into the one aspect of human character, the circumstances of the other. Thus, he distinguishes between three sorts of characters who are prudent in their 'own regard' but who differ in their 'other regard' aspect of their character. The 'superior prudence' is when "Prudence is...combined with many greater and more splendid virtues, with valour, with extensive and strong benevolence..."[TMS p.216]. Prudence as such (or mere prudence) prevails when the person's full intentions are "directed to the care of the health, of the fortune, and of the rank and reputation of the individual..". And 'imprudence' is when a person's intentions are concentrated on "the mere want of the capacity to take care of one's self".

Obviously, superior prudence differs from the other two as it incorporates 'strong benevolence' which is clearly a feature of the 'other-regarding' aspect of human character. Also mere prudence and imprudence differ in terms of their considerations to the others. Mere prudence means also that one cares about his reputation. Consequently he will do nothing to hurt the others or to cause them to dislike him. Imprudence, on the other hand means that the person only cares for himself and has no regard whatsoever to rank or reputation. Thus he may be inclined to hurt the others if they come between him and the successful implementation of his own happiness. Note however that in all three cases the person is considered as prudent in terms of his care for himself. Even 'imprudence' (which is somewhat confusing) means that as far as his own happiness is concerned the person is prudent. "The artful knave" writes Smith "whose dexterity and address exempt him...from punishment or

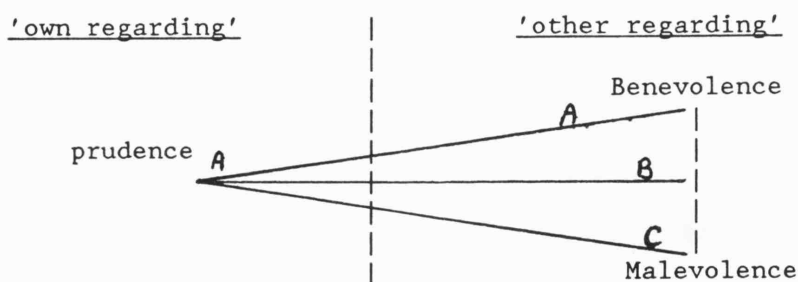
distinct detection, is too often received in the world with an indulgence which he by no means deserves"[TMS p.216]. That is to say that the fact that someone is industrious and frugal (in short, prudent) does not make him good, bad or mediocre. It is the 'other-regarding' aspect of his character that determines his moral value.

In the following diagram I have tried to depict Smith's perception of the human character. It is composed, in the spirit of the 'direct method', of two aspects: the other regarding and the own regarding. Apparently, throughout the whole analysis of the 'own regarding' aspect of the human character (part 6 section 1 in the TMS), Smith uses only one pattern of behaviour to characterize it: prudence. That is, although he distinguishes between characters according to the other features that are associated with the prudent 'own regard', he does not distinguish between the possible difference in the expressions of prudent behaviour. Consequently, the 'own-regarding' aspect of the human character has no scope and is depicted by a single discrete point which represents a fixed degree of prudence².

The 'other regarding' aspect of human character is defined in terms

²Namely, although Smith distinguishes between 'superior prudence', 'mere prudence' and 'imprudence' he does so only through the association of prudence with other features of character. He does not, however, suggest in what way does the combination of say, prudence with benevolence, affect the meaning of the prudent care for one's self. In other words, the point I'm making here is that although Smith distinguishes between the various characters that pursuit their own needs prudently through their other characteristics, he does not explain whether the 'own regard' behaviour of the different types of character is the same or it varies too. The 'artful knave' and the 'Great legislator' are different in their attitude towards the other; how it affects their prudent care for themselves is not very clear.

of what a person intends to the others : "The character of every individual, so far as it can affect the happiness of other people, must do so by its disposition either to hurt or to benefit them" [TMS p.218]. We may say that the want to benefit reflects a positive interest in the others as well as the want to harm reflects a negative interest in the others. In between, naturally, there are those who wish neither to harm nor to benefit anyone else. Those people have no- interest in the others whatsoever. So the 'other regarding' aspect of the human character is depicted as a continuous sequence from the highest direct positive interest in the others (benevolence) to the highest direct negative interest in the others (malevolence). Naturally, in the middle we find no-direct-interest in the others which actually means that if the person considers the others at all, it will only be in as much as they affect himself (or his reputation). That is to say that the interest he might have in the others is entirely in the domain of his care for his reputation which is part of his 'own regard'. From the point of view of the 'other regard' it means that he has no direct interest in the others.



Now we may depict the different complete characters which are accountable for moral assessment. Line A in the above diagram depicts the 'superior prudent' person whom Smith believes constitute the

morally good character. Line B depicts the person who is prudent but has no-interest in the others. The only interest he has is to safeguard his own happiness by not causing harm to anyone else which may affect his reputation.

Line C depicts the morally bad character whose prudence is soured (imprudence). It is a person who may be prudent in his care for his own happiness and yet, he is malevolent and would not mind harming others in order to advance his own happiness. It is the artful knave which is depicted by line C.

In short, lines A, B and C distinguish between what Smith labelled as imprudence, mere prudence and superior (or perfect) prudence and we can thus clearly see that prudence in itself cannot be the subject of a moral debate. It is only the complete character that can be morally judged and what it is that determines that moral judgement is the interest a person has in the happiness of the others. If self-interest means no-direct-interest in the others, then it corresponds to line B. It certainly does not constitute the idea of the morally good character.

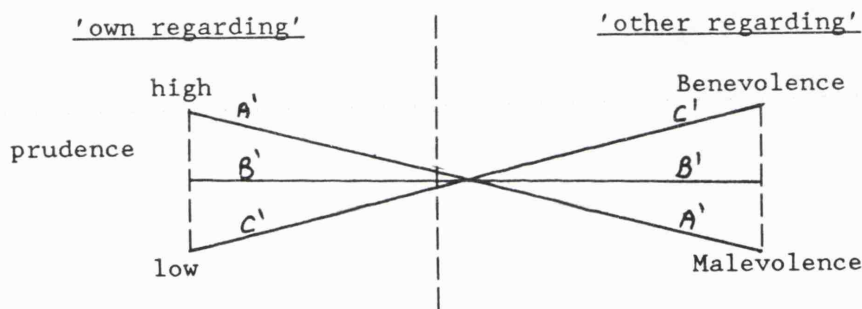
To summarize this point: in Smith's discussion of prudence he begins by defining prudence as the care for one's self. Then he continues to point out that every impartial spectator can go along with the effort to improve one's own conditions. However, he then continues to point out that the fact that we may approve of prudence, is of no real consequences when we come to assess, morally, a person's character. This, of course, is obvious because prudence constitutes

only one section of the human character. He then distinguishes between prudence that prevails with different aspects of the other section of human character. On these complete characters he is able to pass a moral judgement: "As prudence combined with other virtues, constitutes the noblest; so imprudence combined with other vices, constitutes the vilest of all character"[TMS p.217]

Modern commentators rejected selfishness as a description of self-interest because it was evident that Smith had morally deplored it. It would have been inconsistent with the conventional interpretation of Smith's work if self-interest could be proved as morally foul. Prudence, on the other hand, seemed to have had more glorious prospects in providing the moral support for advocating natural liberty that is based upon it. However, as I have already shown, though prudence in itself can be thought of as morally approved, it does not mean that people who employ it are morally good. In fact, the moral value of prudence is meaningless if not specified with the 'other regarding' aspect of the human character. But modern commentators might insist that the fact that we can morally approve of prudence as such is sufficient to establish the moral support for its advocacy. However, if we examine the nature of this moral approval we shall soon find out that this path too does not lead to the enshrining of prudence as Smith's idea of the moral good.

In Smith's moral system we approve of a sentiment because of the pleasure we feel when realizing that it coincides with what we feel. Also, we have a natural tendency to feel harmonious with moderate expressions of all sentiments. Thus, if prudence is perceived as a

moderate expression of the natural dictate to care for ourselves, it should also become morally good. However, it would also mean that there is more than one way of caring for one's own. If so, one may now wonder about the relationship between the way a person conducts his affairs in as much as it affects his own happiness, and the interest he might have in the fortunes of others. In terms of Smith's analysis of the human character it would mean that a person's 'own regard' can no longer be considered as a fixed degree like what we have shown in the above diagram. It would have to be that the care for one's own is a sentiment, the intensity of which can vary from high to low.



Prudence, in this case, is only the middle point of that sequence. It is only the moderate expression of the 'own regard' aspect of the human character. Now, let us try and construct a plausible relationship between the two aspects that comprise the human character. Surely if the intensity of one's care for one's self is high, very little attention can be left in him for the 'other regarding' aspect of his character. Thus, it will correspond to very little interest in the fortunes of others. This, in turn, means that like the 'artful knave' the person will be ready to harm others in

order to satisfy the strong urge to satisfy his own happiness. He cares so much for himself that he does not even regard reputation and rank as worthy ends.

So there is some sort of an inverse relationship between the intensity of the urge to care for one's own and the interest he has in the fortunes of others. Therefore, in terms of moral judgement, line A' (the combination of a high degree of interest in one's own together with a very low interest in the others (malevolence)) constitutes Smith's notion of the bad character ('imprudence'). Line B' (the combination of a moderate expression of the care for one's own together with indifference towards the others) constitutes the morally acceptable ('mere prudence'). Line C', accordingly, where low level of interest in one's own is combined with a high level of interest in the others constitutes Smith's notion of the morally good character ('superior prudence' - "to feel much for others and little for ourselves....constitutes the perfection of human nature.[TMS p.25]).

The meaning of prudence as a moderate expression of one's natural urge to care for one's self gets now a new meaning. It is the Aristotelian mean; something that lies between two extreme. Moderation in the sense of self-restraint prevails here anywhere between the middle and the low intensity of one's own regard³. Coupled with its logically association with having little interest

³In any case, as line B' depicts Smith's idea of 'mere prudence', it means that the moderate interest that a person has in others is entirely due to his worries about his own reputation. This is not a very noble reason to have other people's interest at heart.

in the others invokes two major criticisms. One is that now we can say that the character as a whole does not fit the morally good character but it does fit propriety. The other, perhaps the more serious one, is that in fact, the character depicted by line B' is not really different from Smith's idea of the selfish character.

"There is", argues Smith "a considerable difference between virtue and mere propriety; between those qualities and actions which deserve to be admired and celebrated, and those which simply deserve to be approved of. . . . to eat when we are hungry, is certainly, upon ordinary occasions, perfectly right and proper, and cannot miss being approved of as such by everybody. Nothing, however, could be more absurd than to say it was virtuous." [TMS p.25]. In a comment earlier I said that I do not believe that the 'cold esteem' that is associated with prudence reflects its being merely proper. Now I seem to argue that it does. The difference is important. Before, prudence was a single point. You could either yield to the natural drive or be prudent. Now, however, as the care for one's self is a sequence going from high to low (which also associates the care for one's self with the 'other regarding' aspect of his nature in a more distinctive manner), prudence is not a great self-restraint given the low care for one's self which is associated with high interest in the others. On that point it would seem rather odd to morally advocate something that is based on mere propriety.

The other major criticism relates to the complete character that emerges from this analysis. The self-interested character of the WN is probably the one depicted by line B' above. To judge according

to Professor Stigler, the character behind the WN is the utility maximizer man. "Man is eternally a utility-maximizer, in his home, in his office- be it public or private- in his church, in his scientific work, in short everywhere" (Stigler, 1982. p.35).

In terms of Smith's analysis this corresponds nicely to Smith's definition of selfishness, "when [sentiments of others are] conceived upon account of our own private good or bad fortune"[TMS p.40]. And the moral judgement of that character is very clear indeed. Hence, if we think that the character behind the WN is Stigler's utility maximizer, we have a problem at our hands. Namely, Smith's advocacy of natural liberty means advocating selfishness which is, upon his own account, a moral vice.

Now, line B' correspond in Smith's complete analysis of character to what he named 'mere prudence'. As such 'mere prudence' would yield the same conclusions as in the case of the utility maximizer. This is so, because mere prudence means that the interest we might have in the others stems from the care for our reputation. Namely, we perceive the others only in as much as they affect our own happiness. Thus, mere prudence and selfishness are almost the same thing (sort of a utility maximization where reputation is a parameter). However, we must admit that here Smith's analysis is not very consistent. Selfishness is most clearly deplored but mere prudence seems to gain some 'cold esteem' though not enough to become the moral good. At any rate, either way we are still far from the required result, i.e. that the self-interested character of the WN constitutes the moral good as implied by the received

view.

The received view is that the moral proposition of the TMS is consistent with the WN because self-interest, as prudence, should be examined in isolation from the 'other regarding' aspects of his character. Prudence is a moderate sentiment with which we can identify and it tells us nothing about the person's other characteristics. We saw, I hope, the implausibility of this assertion in the context of his moral theory. There is another point, however, that is crucial to the received view. That is that the character behind the WN is also a 'one-dimensional' character. Namely, that the WN is an exposition of the interactions of only one aspect of human characters.

There are basically two principles in the WN. One is the 'propensity to truck barter and exchange' (which is founded on the principle of 'persuasion'). The other is the drive to 'better one's conditions'.

The drive to 'better one's condition' is probably the best reflection of 'prudence' in the context of the WN. Frugality and industry (the characteristics of prudence) are essentials for that purpose. The question is whether this is a quality that can be seen as entirely in the domain of the 'own regard' and thus allowing the WN to focus on the 'one dimension' of people's character that is also considered as such as morally good. However, "An augmentation of fortune is the mean by which the greater part of men propose and wish to better their conditions" [WN p.341].

Considering the fact that one cannot augment his fortune without proper division of labour, one's action to better his conditions must necessarily involve other people. Thus, even if all his actions in relations to other people are concentrated on his own fortune, he is necessarily expressing an attitude towards their happiness. This attitude comes forward in his dealings with other people in exchange and production.

As for the propensity to truck, barter and exchange Smith has a very clear view of it. "To perform any thing, or to give any thing, without a reward is always generous and noble, but to barter one thing for another is mean." [LJ p.527]. Obviously what brings about Smith intuitive judgement here is the fact that this propensity is inherently related to the 'other regarding' aspect of a person's character. By this two things are revealed. Not only that the character behind the WN is not the convenient 'one-dimensional' character who can be consistently related to the moral approval of prudence, Smith explicitly (though on intuitive grounds) denounces the fundamental in human nature that drives the system of natural liberty on moral grounds.

When, on the other hand, we extend the character in the WN to include both 'own regard' as well as 'other regarding' principles we end up with the 'mere prudent' character which is far from being the morally good character.

Whatever modification we make, it remains clear that the character that prevails in the WN is by no means of the 'superior prudence'

kind. Thus, it is always less than what Smith considers as the morally good character. Consequently, Smith advocacy of natural liberty that is based on self-interest cannot be based on the idea that self-interest constitutes the notion of moral good.



(d) An Extrapolation: The Effects of Personal Characteristics on Moral Judgement.

So far we saw that the two methods (direct and general indirect) of character description leave many unsolved problems regarding the consistent relationship between the TMS and the WN. In the 'general indirect' method we confronted problems at both levels of suppositions and propositions. 'Sympathy' and 'self-interest' were considered as contradicting descriptions of human nature, and the self-interested person, hailed in the WN, was no other than the deplorable selfish character in the TMS.

In the 'direct method' we solved the problem at the level of suppositions but we are still confronted with problems at the level of propositions. The only way to establish 'self-interest' as morally good is by divorcing 'own-regarding' behaviour from 'other regarding' attitudes. There is indeed nothing in the 'direct method' to suggest that the various aspects of a person's character should relate to each other in a consistent manner. However two problems emerge. One, that treating 'own regard' in isolation is meaningful (for consistency purposes) only if the character behind the WN can also be seen in the same light. However, it is quite clear that the character behind the WN is by no means a 'one-dimensional' character.

The other serious problem is that Smith himself seems to reject this approach quite explicitly. Distinguishing between different kinds (or degrees) of 'prudence' by their association with 'other regarding' aspects means that Smith considered the human character in a more coherent way. When, however, the different aspects of a person's character are brought together we are moving closer to the 'particular indirect method'. The only difference between the two methods is that we still look at the various aspects from their intrinsic point of view (in the 'direct method') rather than from the cumulative effect that they produce on the beholder.

Indeed, I have already argued in favour of Smith's unified perception of nature in general and of human nature in particular. The result of it in terms of moral propositions is that 'self-interest' is a character which lies somewhere between being 'merely proper' and being morally denounced as a form of selfishness. The WN, in that case, is an 'empirical' examination of the interaction of such characters. It cannot, however, be advocated from a moral point of view. This dichotomy between the moral status of 'self-interest' and its efficiency in generating wealth can be an explanation to Smith's ambiguous approach to it. The confusing statements that he makes about self-interest can be a result of an honest confusion. But for that to be true there must be some moral merit in the efficiency of natural liberty that stands in conflict with the moral value of self-interest.

If we allow for that then we end-up arguing that Smith's system is

logically incoherent. The merits of efficiency should have been present in the first assessment of 'self-interest'. However, I believe that we can overcome this problem by giving a different account of Smith's work. If we extend the 'particular indirect method' to deal with the relationship between 'sympathy' (the mean of forming a moral opinion) and 'self-interest' we will find an explanation which leaves Smith's theory logically intact.

The main issue here is to deal with the problem of discrepancies between what Smith considered to be morally good and what he believed to be the public perception of it. If we find a way to distinguish between the 'moral instructor' and the 'empirical observer' we can explain why self-interest (and wealth) may appear sometime as morally good and as almost a form of vice in other occasions. To do that we must move from the problem of 'own-regard' - 'other regard' relationship to a more fundamental level of the human character. The relationship that exists between people's character as depicted in the 'own-regard'-'other regard' space, and the way they form their moral opinions. In other words, it is the problem of 'sympathy' - 'self-interest' relationship.

Smith himself did not deal with this problem explicitly and therefore, this section is an extrapolation¹. However, as I said

¹The purpose of such an extrapolation is to show that a consistent dealing with Smith's work can settle some apparent inconsistencies. While it is clear that Smith did not pursue this analysis himself, he might have had it at the back of his mind but then again, he might not. For the purpose of this study I care more about the coherence of his theory than I do about whether or not he himself grasped all the meanings and consequences of his theory. The 'real test' of such an extrapolation would have been if I could have convinced Smith that it follows from his theory. Otherwise, its test is in its ability to shed light on some unexplained inconsistencies. Succeeding

earlier there is plenty of evidence to suggest that Smith distinguished between the way people actually form their moral opinion, and how they should have done it². The key player here

in so doing makes it a valid interpretation of Smith's theory as any other effort to settle the problems in his texts. The whole issue of "reconstructionalism" and its role in my analysis is dealt with in more details in Part III chapter 1 section 3.

² But it is not only that there is a distinction between the 'moral instructor' and the 'empirical observer', Smith believes that people's actual judgement is affected by their character and is sometimes, corrupt. For instance, let us take the tendency to identify with the rich, which is a result of the pleasantness of joy. Surely, he is describing here a natural tendency, something in the domain of practice; of the 'nature of things'. But, already in the same paragraph he makes it clear that he is not very happy about it. He insinuates there, that he cannot see any substance behind that tendency: "Do they imagine that their stomach is better, or their sleep sounder in a palace than in a cottage? The contrary has been so often observed, and, indeed, is so very obvious.." [TMS p.50]. Obviously this does not make the tendency itself unnatural, it is in a different level that his perplexion occur.

Through the whole TMS, one cannot avoid the impression that a certain tension exists between what is natural (what is the practice) and what is also moral. It becomes even more clear when the natural consequences (the formation of ranks in society) of the natural tendency to sympathize with the pleasant, is being examined: "That kings are the servants of the people, to be obeyed, resisted, disposed, or punished, as the public convenience may require is the DOCTRINE of REASON and PHILOSOPHY; but it is NOT the DOCTRINE of NATURE" [TMS p.53]. (my italics). Therefore, it seems rather clear that the practical way we form our moral opinion, by the degree of accordance of sentiments, cannot be considered as the whole system of morals. There must be a different level of analysis, from which, Smith deduces his criticism of the prevailing morality.

The fact that actual 'sympathy', felt by people, will not be the source of proper moral judgement becomes evident from the existence of two expressions: corruption and perfection.

These words should be meaningless in a moral theory that is merely devoted to explain how moral approbation is actually formed. They can have meaning only if there is some system, or ideal, with which to compare the practice of morality. "This disposition to admire, and almost worship, the rich and the powerful, and to despise, or, at least, to neglect persons of poor and mean condition, though necessary both to establish and maintain the distinction of ranks and the order of society, is, at the same time, the great and most universal cause of corruption of our moral sentiment." [TMS p.61].

The existence of that 'objective' system can be derived not only from the fact that a natural tendency can be corrupt, but also, that regardless of what is the prevailing nature of mankind, there is a perfection of it: "and hence it is, that to feel much for others and little for ourselves.....constitutes the PERFECTION of human NATURE" [TMS p.25].

Eventually, this tension between the natural and moral is spelled out: "But though man is thus employed to alter that distribution of things which natural events would make, if left to themselves;.....The natural course of things

is the idea of the 'impartial spectator' and in particular, the meaning of 'impartiality'. There can be little doubt that for Smith the proper moral judgement is when one sees the other from a truly 'impartial' point of view. And there is no doubt that he forms his ideal on how he observed people to behave. However, the fact that people might think that they were judging through an 'impartial observer' does not mean that they are actually doing it in a proper way.

As I show below he was quite sceptical about people's ability to become more than just 'spectators'. This does not mean that they are not trying to be 'impartial', or that they feel that their judgement is not really impartial, but it is an effort to achieve 'impartiality'. Some of them are incapable and some are not so inclined. The purpose of this section, therefore, is to investigate how a person's character may interfere in his ability to achieve true 'impartiality'. And, to examine how it affects the subsequent moral judgement that will be generated by those individuals. Consequently, the same model of moral judgement can explain the actual moral opinion, its 'ideal' and the discrepancies between them. In the last part of this section I will take this idea even further. If a person's character may interfere in his tendency to become truly impartial, it might as well interfere in the method of forming a moral opinion. In other words, a person's character may affect his use of 'sympathy' to form his moral opinion. Sometimes, it is easier

can not be entirely controlled by the impotent endeavour of man: the current is too rapid and too strong for him to stop it; and though the rules which direct it appear to have been established for the wisest and best purposes, they sometimes produce effects which shock all his natural sentiments." [TMS p.168]. This last point is discussed also in chapter 4.

to be taken by the 'beauty of the system' rather than engage one's self in a costly (in terms of time and effort) imaginary change of places.

The 'particular indirect method' of character description is first of all an 'indirect method'. Namely, a character is described by its cumulative effects as perceived by those who behold. However, unlike the 'general indirect method', it allows for several expressions of the same effect. That is, a character is not described by a single tenor of behaviour but, by a set of its expressions in different circumstances. If, for instance, we consider a person's attitude towards the others as the cumulative effect of the different components of his character (as perceived by those who behold) then we can see it in his dealings with his own affairs as much as in his direct dealings with the others. The 'own-regard' and the 'other regarding' aspects of human character, as I have tried to establish in the previous section, become the two sides of the same coin. In the same way, a person's approach to morals (the subject of the TMS) and his approach to actions (the subject of the WN) also become related in one way or another. In this section I will try to establish a relationship between moral judgement and a person's character. Consequently, we shall also discover the relationship between a person's morals and his motives to actions.

From the opening statement of the TMS, where Smith presents us with the 'principle' of his theory, it is quite clear that the part in human nature that dominates his moral theory is the interest people have in the fortunes of others: "...there are evidently some

principles in [man's] nature, which interest him in the fortune of others.."[TMS p.9]. It also means that it is by this particular interest that Smith describes human nature. Namely that it is a quality that prevails in all human beings (otherwise it could not have served as a principle) and that people are distinguished by the different degrees of this quality. Some characters may reflect a high positive interest in the fortune of others and some, a highly negative one. Some, indeed, may reflect a very little interest altogether.

The quality of Interest in Others (IIO) may have two different expressions. It may manifest itself through sentiments as such (sympathy), or, in actions (motives). The interest in others as manifested through action, is reflected by the intention, or motive to action ("by [the] disposition either to hurt or to benefit "[TMS p.218]). Thus a high positive interest means the want to benefit (benevolence) while the high negative interest means the want to hurt (malevolence). In between, there exists a point where Interest in Others is at zero, which means, no-interest-in-the others whatsoever. Neither the want to benefit nor the wish to harm. In other words, the only interest that such a character reflects is self-interest.

Let me now explore in more details the other aspect of interest in the others: the side of sentiments and sympathy. The IIO as expressed through sentiments, in Smith's analysis, is the tendency to identify with the sentiments of the other. "That we often derive sorrow from the sorrow of others, is a matter of fact too obvious to require any instances to prove it"[TMS p.9]. But "As we have no

immediate experience of what other men feel", we do so by an imaginary change of places with the person we observe. We consider ourselves in his position and we try to experience through our own senses what he might be feeling. We realize harmony if our sentiments coincides with his (and this is what Smith called 'sympathy' and I will call 'technical harmony') and dissonance if they don't.

However, the effects of harmony (or dissonance) that are being felt by the person who observes depend, to some extent, on his own natural constitution. "The imaginary change of situation...is but momentary. The thought of their [,the observers',] own safety...continually intrudes itself upon them" [TMS p.21]. That is to say that a person's experience of the imaginary process is not at all independent of his own disposition. And in particular on his disposition towards (interest in-) the fortunes of the other. Hence whether or not the harmony we discover with the sentiment of the other is agreeable to us depends on the nature of that sentiment as well as on our disposition towards the fact that the other is experiencing it. For instance, whether or not we feel harmonious (in the sense that the harmony is agreeable to us) with the other's sorrow or joy depends on the existence, or absence, of envy. "If there is any envy in the case....our propensity to sympathize with sorrow must be very strong, and our inclination to sympathize with joy very weak"[TMS p.44]. When we observe the sorrow of another person and we try to experience it through our own emotions (the imaginary change of places), it is painful to us. But if the observer has a negative interest in the fortunes of the other (where

envy is more likely to prevail), the realization that this pain has befallen his 'rival' gives rise to a great pleasure. Thus, though the observer feels that he would have felt the same as the person who is being observed ('technical harmony'), his direct sentiments towards the other contradict the pain that he derives from the imaginary process. Because the former are much more real sentiments than those that are being experienced through imagination, they are also the more dominant ones. Consequently, the envious person (or the one that has a negative IIO) will find the sorrow of another, when rightly felt (in the sense that the observer would have felt the same had he been in his place), more pleasant than painful. Thus, he will find it easier to 'sympathize' with sorrow.

If, on the other hand, the observer has a positive interest in the fortunes of others (the case of no-envy), the realization that the pain he experiences has befallen his fellow-man gives rise to a terrible distress. Thus, his direct feelings are in complete harmony with those that he derives from the imaginary process. Consequently, the non-envious person will find sorrow, when rightly felt, most unpleasant. He will therefore find it more difficult to 'sympathize' with it. But there is another case of non-envy which is significantly different. The case of no-interest-in-the-fortunes of others (or, self-interest). When the observer has a positive IIO, his direct emotions enhances the pain he experiences through the imaginary change of places. When he has no such positive interest (but also no negative interest), the fact that the other is experiencing this pain will be of no significance. From the observer's point of view he is quite indifferent to the sorrow (or joy) of another. Thus, the

pain that is being transferred in the imaginary process does not seem to get hold on any of the direct sentiments of the observer. It will hence dissolve rather quickly and will hardly be felt by the observer. Of course, one may also ask whether such a person will bother at all to exert himself to an imaginary change of places in the first place. At present, however, we assumed that he does but I shall deal with this point later on.

On this tendency to identify with the sentiments of the other Smith constructed his moral theory. We morally approve, or disapprove, of anything according to whether it invokes harmony of sentiments, or dissonance. But it is not upon the mere harmony (or dissonance) that we morally approve or disapprove. It is upon the pleasure we have in finding such a coincidence of sentiments with someone else. However, this pleasant, or unpleasant, feelings, as I have shown above, do not reflect the simple sense of pleasure like the one derived from utility. It is a much more complex notion of pleasure. In fact, it is comprised of two different sorts of pleasures. First, the pleasure we derive from realizing that we would have felt the same as another, had we been in his place: "nothing pleases us more than to observe in other men a fellow-feeling with all the emotions of our own breast; nor are we ever so much shocked as by the appearance of the contrary." [TMS p.13]. And the important feature of this sort of pleasure is that it is independent of the nature of sentiment in question. Namely, that the pleasure we gain from realizing that we would have felt the same as the subject of approbation in case of a pleasant sentiment, is the same as the one we would have experienced in the case of an unpleasant sentiment.

The second sort of pleasure, on the other hand, depends on the nature of sentiment in question as well as on the observer's disposition towards the other. Thus the other's sorrow, or joy, gives rise to pleasure or pain according to whether or not we have a positive or negative interest in their fortune.

Therefore, if we find 't. harmony' in sentiments that are a natural cause of pleasure to us (the other's happiness, or joy, in the case of 'no-envy' and his sorrow in the case of 'envy'), we shall obviously approve of the actions and circumstances that have brought them about. We are experiencing what I shall call 'pleasant harmony'; a harmony within ourselves. That is, a consistent composition of the pleasures that are being derived from the imaginary process.

If, however, we find 't. harmony' in sentiments that are a natural cause of unhappiness, we are, in fact experiencing within ourselves an 'unpleasant harmony'. The pleasure derived from 't. harmony' is being contrasted by the pain derived from the sentiment in question. This, in turn, means that within ourselves we experience 'dissonance'. We cannot approve of the actions and circumstances that have brought those justified (in the sense that we would have felt the same) unpleasant feelings.

In the same way, if we find 't. dissonance' with sentiments that are a natural cause of unpleasantness we approve of the circumstances that brought them about. (If, for instance, there is no envy, we would approve of the circumstances that have brought about sorrow with which we experience 't. dissonance'. Namely, sorrow that we

would not have felt had we been in place of the subject of approbation). So 'unpleasant dissonance', which means 'harmony' within ourselves (between the two components of pleasure that are involved in the process), gives rise to moral approval.

If, on the other hand, we felt 't. dissonance' with the pleasant sentiments, we would disapprove of the circumstances that have brought them about. (If, again, there is no envy, we would disapprove of the circumstances that have brought about happiness that we would not have felt had we been in place of the subject of approbation). The 'pleasant dissonance' means a 'dissonance' within ourselves and thus, moral disapproval.

So moral approval, in Smith's system, depends on the consistency between the pleasure gained from observing the other experiencing the particular sentiment and the pleasure gained from experiencing 'technical harmony':

The effects of the other's experience as perceived from the point of view of the observer

		Pleasant	Unpleasant
The result of the imaginary change of places	t. harmony	Moral Appr. (harmony)	Moral Dissap. (dissonance)
	t. dissonance	Moral Dissap. (dissoance)	Moral Appr. (harmony)

We have now seen that at least the pleasure that is derived from

observing the other experience a particular sort of sentiment depends on the nature of the observer's character. Hence, we can already conclude that the actual moral judgement, in Smith's theory, also depends on it. But it is not only this aspect of moral judgement that depends on human nature. Also whether or not we realize 't. harmony', and derive pleasure from it, depends on the nature of the characters involved.

Generally speaking any person will find it easier to feel 't. harmony' with a person of a similar character. When a benevolent person comes to judge any other person's behaviour he would most likely have felt and acted the same if the other person was benevolent too. If, on the other hand, the observed person is malevolently disposed it is most unlikely that the benevolent observer would have felt, or acted, the same. The further is the observed person's character from that of the observer's character (on the malevolent-benevolent sequence), the less likely it becomes for the observer to find 't. harmony' with the observed person.

Consider now a society which is comprised of self-interested people. Also, suppose that it is as beneficent as indicated by the WN. Namely, that everyone in this society is constantly improving his conditions. Consequently, everyone's happiness increases continuously.

The self-interested observer, and indeed each member of that society, will consider this situation as morally good. Simply because he would have felt and acted the same as any other member of society had he

been in their position. However, this would have been his moral verdict even if the outcome of this state was harmful. For the self-interested observer, or member of society, this is also the highest level of moral approbation that he is capable of. As a self-interested person derives nothing from seeing others happy or sad, his complete moral judgement depends on the degree of 't. harmony' that he experiences. Regardless of the consequences, he will most likely experience the highest level of 't. harmony' when observing another self-interested person.

For a benevolent observer, on the other hand, this state of affairs will not invoke the highest level of moral approbation. His moral approbation is based on an accumulated sense of pleasure. The higher is that pleasure, the higher becomes the degree of moral approbation.

Obviously, he will feel some pleasure from seeing other people enjoy as a result of the cumulative activity of society. However, he will find no 't. harmony' (or 't. dissonance' for that matter) with the self-interested subjects of approbation. He will thus experience less pleasure than, say, if members of society were benevolent as well. In other words, in the scale of morals of a benevolent person, the self-interested person who unintentionally causes beneficence has a moral value which still falls short from what one may call the moral good.

The question that immediately arises is whether or not the moral judgement of the benevolent person is more valid than that of the

self-interested person. The answer to this question is indeed a complicated one. It involves the question of whether or not there is any meaning, in Smith's system, to a 'proper' (or ideal) way of moral judgement. Or, that his system is entirely 'naturalistic' in the sense that moral judgement is determined by instincts (or sentiments) rather than by rational dictates. We saw already in the previous chapter that 'rational' consideration were not unrelated to Smith's work. We shall see in the next chapter how the 'rationalistic' nature of his work is interpreted in his model of the 'impartial spectator'. At present I will only say that even without this question it is rather clear that as a matter of fact people's judgement will depend on their character.

It is also possible to show that in Smith's view it is the judgement of the benevolent person which is the proper one. To begin with, the moral judgement of the self-interested person suffers from a serious problem of consistency as far as an objective observer is concerned. If an objective observer looks at the actions of a self-interested person he can only see whether it produced harm or beneficence. Surely he would expect the moral judgement of actions that have produced pain and misery to be different from those which have produced beneficence. However, the self-interested person will judge only according to whether or not he finds 't. harmony' with the actor. The outcome is entirely insignificant. He will mark the self-interested person's action as morally good whether it produced harm or beneficence. This, very clearly, is against what Smith considered moral judgement to be based on. "The sentiment or affection of the heart from which any action proceeds, and upon which its whole virtue

or vice must ultimately depend, may be considered...in two different relations; first, in relation to the cause which excites it...;and secondly, in relation to the end which it proposes, or the effects which it tends to produce"[TMS p.18/67 my italic]. But it does not seem reasonable to suppose that anyone, as selfish as may be, will be so indifferent to the actual outcome of actions when he comes to assess them morally.

One may argue, however, that this is only the result of applying to the self-interested person a practice of moral judgement which he does not actually use. Namely the self-interested person, who has no interest in the others, may not judge by an imaginary change of places (the process of 'sympathy') altogether. After all, for anyone to judge from the 'impartial spectator's' point of view he must have some interest in what happens to the other. For the 'impartial' imaginary change of places to take place, one must exert himself to see the subject of approbation's point of view. Why would someone with no interest in the others whatsoever bother at all and exert himself to an imaginary change of places?

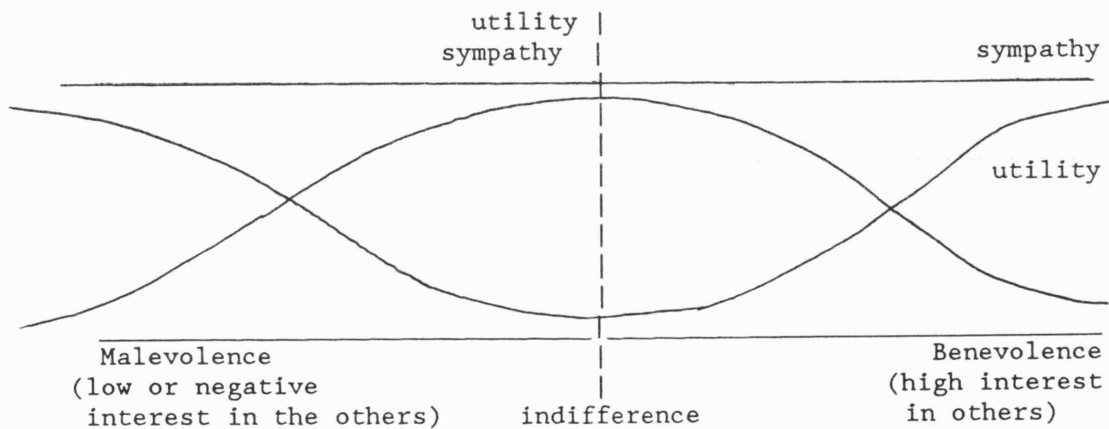
So it seems as if the character of a person affects not only his moral judgement as such (as discussed above), but also the way he actually forms his moral opinion. Those who have some kind of interest in the fortunes of others will be more inclined to judge by the imaginary change of places ('sympathy'), those who don't will probably judge in a different fashion. This other fashion is 'utility' or, the 'beauty of the system'.

Whatever is the nature of Smith's ethics one thing seems to be quite clear- that practical moral judgement depends on some sense of pleasure. So far we have mentioned two sorts of pleasure. One, the pleasure from 't. harmony', and the other, the pleasure from seeing another person's happiness (or mis-fortune). But Smith devotes a whole section in his TMS to another sense of pleasure- utility.

It would be interesting to note that in another place, where Smith discusses the formation of societies, he writes: "There are two principles which induce men to enter into civil society,...the principles of authority and utility.". Both these principles, in Smith's view, explain the social existence because they explain people's obedience to different sorts of authority. Obviously, they are complementary. The principle of 'authority' "arises from our sympathy with our superiors...we admire their happy situation, enter into it with pleasure, and endeavour to promote it." [LJ p.401]. Namely, people's readiness to accept authority is based on their disposition to 'sympathize' with it. The principle of utility, on the other hand, explains obedience because of the 'love of systems'. That is "we take pleasure in beholding the perfection of so beautiful and grand system, and we are uneasy till we remove any obstruction that can in the least disturb or encumber the regularity of its motions." [TMS p.185]. In other words, it is the pleasure we gain from the beauty of the system that is the source of our loyalty and obedience. Precisely as is the pleasure we gain from 'sympathizing' with our 'superior'.

Now as these two faculties of pleasure are complementary, the greater

becomes the one, the less we have from the other. If a person has a high interest in the others, he will (a) be more inclined to feel 'sympathy' with other members of society; (b) be less inclined to be impressed by systems as a whole. The fortunes of individuals will have a greater effect on him than the 'contrivance and beauty of the system'. A person who has no interest in the others will reflect precisely the opposite. The following graph illustrates this relationship. The character of an individual --depicted in the benevolent-malevolent sequence-- determines the composition of his dispositions to derive pleasure from 'sympathy' and from 'utility'³.



The extremely benevolent person will have a greater capacity to 'sympathy' and will hardly be impressed by the mere 'beauty of the system'. The extremely malevolent person will have the same constitution though with reversed signs. The selfish person will have

³I assume here, quite crudely, that the composition of the two aspects in a person's character must add up to unity. Namely, a benevolent person employs 'sympathy' in 90% of his judgements (or observations) of the others while only 10% of such an activity is affected by utility. In 90% of the cases the benevolent person will judge people by trying to put himself in their position. In 10% he will judge them by the general impression that the system will have on him.

little patients to contemplate other's points of view and he will therefore be more impressed by the 'beauty of the system'. Others will have bits of both. They will be able to 'sympathize' and they will judge through an imaginary change of places but their judgement might be affected (to some extent) by the 'contrivance of nature'.


The fact that utility may sometimes take the place of 'sympathy' in determining moral opinion is very clearly considered by Smith. "From a certain spirit of system....from a certain love of art and contrivance, we sometimes seem to value the means more than the end, and to be eager to promote the happiness of our fellow-creatures, rather from a view to perfect and improve a certain beautiful and orderly system, than from any immediate sense or feeling of what they either suffer or enjoy"[TMS p.185].

However, though he is aware of the existence of the two principles in human nature he is also very clear in arguing that utility ought not to be the source of our moral opinion. He writes "it seems impossible that the approbation of virtue should be a sentiment of the same kind with that by which we approve of a convenient and well contrived building; "[TMS. p.188].

Nevertheless, in our analysis it seems as if the self-interested person will indeed refer to this particular kind of pleasure as a moral guide. He will consider the system explored in the WN as the moral good because of its extremely appealing beauty. A benevolent observer, on the other hand, will determine its moral value far below from what he considers as the ultimate moral good.

Thus, when a self-interested person hails the system of natural liberty that is based on self-interest, he does so from the wrong reasons. In Smith's view, his sense of moral is corrupt.

Conclusion of Chapter 3

When the German scholars had coined the term 'Das Adam Smith Problem' they were not entirely in the wrong. They had mis-interpreted Smith's concept of 'sympathy' but they were right in sensing that the moral value of self-interest, in the TMS, does not seem to accommodate its glorious position in the WN. 

Modern commentators rejected the existence of any problem between the moral status of self-interest in the Smith's moral theory and the implied moral standards of it in his economic theory. Their argument is based on interpreting the self-interested character of the WN as the prudent character of the TMS. Prudence, according to those commentators, is the moderate expression of a natural drive to better one's own conditions (the care for one's self). Now, in Smith's moral theory, moral judgement is based on 'sympathy' - the feeling that one would have felt and acted the same as the subject of approbation had

he been in his place. Moderate sentiments, argue those modern commentators, is something that it is easy to feel harmonious with. Thus prudence, the moderate expression of one's care for one's self, becomes morally good.

In this chapter I have tried to show that this is not the case. I have argued that in order for the principle of 'sympathy' not to contradict the prevalent self-interest motive in human nature, modern commentators have implicitly used Smith's 'direct method' of character description. Consequently, prudence (or self-interest) becomes only a partial description of the human character. As such, it is insufficient to crown self-interest as morally good. Smith's 'artful knave' certainly complies with prudence as described in the WN (industry and frugality). However, no-one will argue that in Smith's moral system he becomes morally good.

Therefore, I suggested to look at Smith's other method of character description- the 'particular indirect method'. I have tried to construct a consistent relationship between people's interest in themselves and their interest in the others. From this relationship it became apparent that the moderate expression of the care for one's self corresponds, in Smith's view, to the selfish character. This, I maintain, does not mark it as a bad character but it is certainly far from Smith's ideal of the morally good character- the 'superior prudence'.

Then, I have shown that if self-interest is related to people's interest in the fortunes of others, then moral judgement itself

becomes dependent on what motivate human actions. I have then shown that a self-interested society, such as described by the WN, will be considered as morally good only by self-interested people. Benevolent people will not consider it as morally bad but again, it will fall short of what they would have considered as morally good.

Then, we took the effects of a person's character on his moral judgement one step further. We saw that Smith distinguished between two sorts of pleasure that may produce moral judgement- 'sympathy' and 'utility'. He also made it clear that in his view the latter is a corrupt sense of morality.

We then saw that it is the self-interested character that will be most inclined to judge by utility. He will consider natural liberty that is based on self-interest as morally good mainly because of the 'beauty of the system'. Therefore, his moral praise to that system, according to Smith, is a corrupt one.

4. The Moral Analysis of Natural Liberty.

In the previous chapter we have discussed the moral significance of 'self-interest' which, I argued, is only a necessary condition for the moral vindication of natural liberty. This, however, is not the view which is widely shared. To most modern commentators the problems with the moral status of natural liberty (in Smith's work) are entirely due to the difficulties with the moral value of self-interest. The 'Public Benefits' of natural liberty, or the efficiency of natural liberty in the production of wealth, is so evident that to resolve any possible paradox in Smith's moral approach to it we only need to prevent self-interest from being interpreted as the 'Private Vice'.

Some scholars would argue that even this is superfluous as efficiency as such is sufficient for the moral approval of natural liberty.

"The Wealth of Nations" writes Stigler "is a stupendous palace erected upon the granite of self-interest". It explores how "The immensely powerful force of self-interest guides resources to their most efficient uses..and [that] it enriches the nation which gives it free rein."(Stigler,1982. p.136). This, however, is not merely a positive statement on Stigler's part. Efficiency as such, he argues, "has been the main prescription of normative economists"

over the last two hundred years.(Stigler, 1982.p.7)¹. The distribution of income, according to Stigler, was in Smith's view a "matter for the market to decide"(p.11). Namely, it was not in itself a subject of separate ethical considerations.

Most commentators, however, do not take such an extreme view. For them, the morality of natural liberty is closely (perhaps too much) associated with the moral value of self-interest. If self-interest is morally good there is no reason to believe that its free expression should yield any other kind of moral judgement. In particular it should be true if the most significant result of its free rein is beneficent.

But is it really true that the moral vindication of self-interest is sufficient to render natural liberty as morally good? Some scholars, mainly those who are not absolutely convinced that self-interest had really been vindicated, will find it difficult to accept. Young(1986) thinks that after solving the 'old' Adam Smith problem --that of consistent premises-- we have to address a 'new' problem. This 'new' problem is whether or not the moral advocacy of natural liberty can be supported by Smith's moral theory. Naturally if the vindication of self-interest was sufficient to pass judgement over natural liberty there wouldn't have been a 'new' problem at all.

Young's approach, however, does not deal with the question of

¹ In my introduction to Smith I gave another example to this view. It was Friedman's argument about the role of efficiency (through the invisible hand) in directing people's 'sympathy'. It meant that even what we considered the mean by which moral opinions are being formed is dominated by the efficiency requirement.

relationship between self-interest and natural liberty. In his case, he is simply trying to apply the mechanism of the 'impartial spectator' in order to establish whether exchange under natural liberty can be morally approved. He does not, however, tell us exactly how the 'impartial spectator' forms an opinion about any particular exchange. He simply bases his analysis on some general attributes to the presumed character of the 'impartial spectator' like, for instance, that he is a 'social conscience'. Namely, that the 'impartial spectator' will judge the exchange from the point of view of the good of society rather than the self-interest of the participating individuals. (Young, 1986. pp. 366-7). Obviously it all depends on what is the good of society which, in my view, will be considered differently if we think of Smith's moral theory as a 'positive' or 'idealistic' theory. In any case, as will be shown below the 'impartial spectator' in my interpretation is a much more well defined measure than it is in Young's analysis.

Commentators like Heilbroner (1982) and Evensky (1987) are examples to the 'new' Adam Smith problem. They are struggling with the moral meaning of natural liberty given that self-interest is not accepted as morally good. According to Heilbroner there is no solution in such a case and we end-up with a Mandeville's problem of 'private vice, public benefits'. Obviously it means that natural liberty has moral merits of its own (public good) but as they cannot be reconciled with the vice of self-interest there is no way to determine whether natural liberty based on self-interest is morally good.

Evensky(1987) offers a solution to this problem by shifting the focus of moral evaluation from self-interest to natural liberty. According to his interpretation natural liberty is a 'second best' moral good. Namely, given that the Great Design, which encompasses the idea of God and the morally good, is manifested in the smooth functioning of nature, natural liberty is part of that moral goodness². However, human nature is inherently flawed. Hence, the best to be done under such circumstances is to reduce the evil influences of the flawed human character only to its most elementary and vital expressions (self-interest). Consequently, the smooth functioning of nature which is marred by the flawed characters that lives within it, becomes the closest to the 'ideal' but it still falls short of it. It is, therefore, a 'second best' morality.

To some extent, Stigler's view and that of Evensky are similar. The Great Design and the harmony of nature is considered in Evensky as the ideal. As such, the efficiency of natural liberty, reflected in this harmony, is the foundation of the morally good organization which is almost the same argument as that of Stigler. Nevertheless, unlike Stigler, Evensky does not ignore the problematic status of self-interest. Hence, the solution he offered was to reduce the moral value of natural liberty to a second best solution. For Stigler, as well as many others, natural liberty is a first best solution. Not so much because self-interest can be proved morally good as for the efficient consequences of natural liberty.

²But not in the sense that natural liberty itself is morally good. Rather, it is through the fact that natural liberty allows those things which are intrinsically good to emerge.

That such a conclusion is completely unacceptable from Smith's point of view is fairly easy to establish. It can be drawn from his discussions of the meaning of Wealth (in the production of which natural liberty is efficient) and his disapproval of the distribution of income which is associated with natural liberty. The former is at the "highest degree contemptible and trifling"(TMS p.183). As for the latter, "man is by Nature directed to correct, in some measure, the distribution of things which [nature] herself would otherwise have made"(TMS p.168). If natural liberty is morally good either in its own right or because of the moral vindication of self-interest, why and according to which principles should one correct the natural distribution of things?

Fortunately Smith does not leave open the question of how should man correct the distribution of income that is associated with natural liberty. For instance, when he discusses the discrepancy between the actual and desired distribution he writes: "The industrious knave cultivates the soil; the indolent good man leaves it uncultivated. Who ought to reap the harvest? who starves and who lives in plenty? The natural course of things decides in favour of the knave; the natural sentiments of mankind in favour of the man of virtue"[TMS p.168]³.

³Notice that there are three references to nature in the above passage. I have discussed it before but I will nevertheless remind the reader of them. One is the 'nature of things' which refers to the material world and in particular, the functioning of natural liberty. The other is the 'nature of sentiments' which is associated with the level of moral judgements. It entails within it two different aspects of moral evaluations; the practised one and the 'ideal' one. The last concept of nature is with capital N. This is the unified ideal of the material world and the world of sentiments. It can be seen as capturing the idea of Deity or, the Great Design.

Two conclusions are quite immediate. One, that the natural distribution, the one associated with the efficiency of natural liberty, is not consistent with what we would morally consider as appropriate. The other, that the desired distribution relates to personal qualities. In other words, it all means that the desired distribution reflects the idea of reward (in wealth) to morally good personal qualities. Namely, the moral value of natural liberty does not depend on the wealth it produces but on whether or not it is being distributed according to some principles of remuneration. These, it will be shown, may not always be consistent with the efficiency of natural liberty.

It is also evident from Smith's economic analysis that the personal quality that, as a matter of fact, is most rewarded by natural liberty is that of self-interest. Therefore, it seems that the only thing to do in order to vindicate the natural distribution of income is to show that self-interest is virtuous. As such, the 'natural sentiments of mankind would favour it and want to see it crowned with wealth'. And this is why most commentators have focused their attention on the morality of 'self-interest'.

To remind the reader, according to Smith we shall morally approve of anything according to whether we feel 'sympathy' with it. Namely, that we would have felt the same as the subject of approbation had we been in his place. In a very much Aristotelian tradition, it is then argued that Smith considered any moderate expression of sentiments as something with which we can always find 'sympathy'. Now, as nature's most fundamental drive is to care for one's self,

a self-restraint (moderate) expression of it should command respect and thus, be crowned as virtuous. As self-interest is being interpreted as this moderate sentiment (prudence, or the rational utility maximizer) it is also morally good. Therefore, its being remunerated in the natural process of income distribution is consistent with good morals.

The whole of the previous chapter is devoted to contest this proposition. But even if self-interest was to be considered virtuous, it would still be insufficient for the argument that the natural distribution of income (and thus, efficiency) is morally good. Indeed, we saw that the desired distribution should associate reward with virtue. However, the implementation of such a principle in a system is not quite straightforward. A system, and in particular an economic system, is more likely to be characterized by what motivates people to act and their subsequent actions and inter-actions, rather than as a collection of people with particular personal qualities. The moral vindication of self-interest was based entirely on the analysis of it as a sentiment; as a personal quality. A moderate expression of a strong natural urge. However, there is a significant difference between analyzing sentiments as such and motives-to-action that spring from these sentiments. The fact, to use a literary example, that Pierre Bezukov, in Tolstoy's 'War and Peace', may have been a good character, or that he sympathized with his peasants, does not make the system of serfdom, or indeed his actions as a landlord, morally good.

To begin with, in case of an action one must measure his 'sympathy'

with the actor against his 'sympathy' with the person who, as it were, is being acted upon. Consequently, a simple analysis of 'sympathy' will not suffice. Moderation, in such a case, will certainly not be sufficient to show that an action, sprung from a self-interested motive, is morally good. It will tell us nothing at all on whether the sentiments of the person who was acted upon are justified in the sense that we, or the 'impartial spectator', would have felt as he does. To do that, one needs to know more about the process by which a person implements his intentions and thus affects the other's circumstances. In other words, one must add to the analysis the question of the actor's responsibility to the outcome of his actions⁴.

The analysis of the morality of actions in general, and its economic significance in particular, is the subject of this chapter. I will show that for a motive to be morally good, and thus, command reward, the intention of the actor must stand in some proportion to the actual outcome. An outcome, it must be stated, is measured here in terms of its beneficence to the person who has been acted upon.

In the next section I will present the theory of the single action. I will show there that we have in fact a much more complex notion of morality. That is, a notion of morals where we can rank moral goodness on a continuous scale from the very bad one to the most desirable one. In particular, it will highlight the fact that a morally just system is not a great virtue in Smith's ethics. This,

⁴To remind the reader this is also the case in Aristotle theory where moderation is the key to virtue. See chapter 1.

of course, is not so surprising bearing in mind the deontological nature of it⁵.

In the section that follows I propose a closer look at self-interested actions. We shall see there that the moral value of such actions depends on the beneficence of the outcome. As wealth is the actual result of a self-interested economic action, I investigate there Smith's view of its beneficence.

In Rousseau's Discourse on Inequality⁶ he argued that the commercial society, where division of labour (efficiency) prevails, is bound to create inequalities. Smith, on the other hand, argued that the 'invisible hand' will keep the distribution of subsistence intact. This, because the stomach of the rich is not greater from that of a poor. Thus, in order to analyze the true beneficence of efficiency, we must examine the possibility of a spill-over of the benefit from the direct participants in the action of production to other members of the economy. To this, the beneficence of efficiency, is the last section devoted.

⁵In a deontological moral system, unlike a teleological one, the analysis of justice is independent of the analysis of the moral good.

⁶"but from the instance one man needed the help of another....equality disappeared" (Rousseau, 1968. p.116).

(a) The Theory of Actions and Four Categories of Moral Judgements.

Let me begin with some of the general remarks concerning Smith's moral system that we have discussed before. It is generally accepted that Smith's moral system, like Hume and Hutcheson's, is a 'naturalistic' one. Namely, that moral judgement is based on instincts, or sentiments, rather than on reason. People judge others according to whether or not they feel 'sympathy' with them. That is, they approve of someone's feeling according to whether they would have felt the same, had they been in place of the subject of approbation. However, while exercising this imaginary change of places, the observer must exert and bring himself to the position of an 'impartial spectator'. So that his direct relation with anything related to the subject of approbation will not affect his moral judgement.

The idea of the 'impartial spectator', in my view, is one of the proofs that Smith's system is by no means 'naturalistic'. On the one hand it is indeed drawn as an abstraction of the way people actually judge (through sentiments). On the other hand, however, it is also an 'ideal'- a model- which obviously is rational.

That people will tend to judge by some sort of an imaginary change

of places is only too clear to Smith for him to bother and prove it (if at all possible). But this will only put people in the position of a spectator, but not necessarily an 'impartial' one. It is in Smith's 'demand' for 'impartiality' that one can find the roots of a semi-rational moral theory. A person ought to exert himself and to try and view the other's position from the other's point of view as best as possible. Now to do that it is certainly not sufficient to have the natural tendency for the imaginary change of places. The observer must apply considerable reason in order to properly understand the circumstances of his subject of approbation. This, of course, does not mean that Smith thought people actually do that. However, the idea of the 'impartial spectator' creates a reference point for actual moral judgement. The difference between the actual moral judgement and what a real 'impartial spectator' would have said is precisely the difference between the praxis of morals and its ideal. It is also the reason why in many parts of Smith's Theory of Moral Sentiments he allows himself to comment on people's moral judgement. As we shall see later on, it is upon this 'ideal' that Smith can argue that people's sense of morality concerning wealth, is false. Had it really been a 'naturalistic' moral theory, Smith's own opinions would have had the same status as other people's opinion.

Generally speaking, the idea of 'impartiality' combines two major objectivity conditions. One, that no personal relation will affect moral judgement. And the other, complete information about the circumstances of the subject of approbation. Let us now examine the meaning of 'impartiality' when actions are concerned.

In the analysis of actions, the observer is supposed to judge according to a combined sentiment. His 'sympathy' with the actor and, as he is not supposed to take any side, his 'sympathy' with the person who is being acted upon. But in order for the observer to know whether or not he would feel as do those who are involved in the action, he must consider their circumstances. The proper examination of the circumstances of the person who is being acted upon is where objectivity, or 'impartiality', is of particular importance. The reason for that is that the circumstances of the person who was acted upon are a result of the actor's choice of action. This, in turn, may be a rational choice where his action can be considered as a successful implementation of the actor's intentions (i.e. that the a-priori probability of achieving the intended outcome by the chosen action was very high). Or, it can be an irrational choice where the action had a very low a-priori probability of achieving the actor's intention. Or, as it were, it can be a mere accident (i.e. that the probability of achieving the intended outcome was high but the action failed to produce its expected effect). To know all that, however, one must have quite a good knowledge of nature at least in as much as the a-priori probabilities of the outcome of particular actions can be known.

Let me first present Smith's idea of the action by decomposing it. A certain person l , creates an action A . He does so because of various reasons. Let us denote those reasons by α . Action A is therefore the result of sentiments (or emotions) in l that were invoked by circumstances α .

While performing A, a second person, 2, is affected by it. 2, as well has sentiments, which are invoked by action- A, and by his particular circumstances which we'll denote by β . These sentiments, in 2, are also an incentive to a sub-action that has a particular quality: reward or punishment. It is the actor's desert, if you wish, and I have marked it by D.

Now we may draw the complete cycle of action which, according to Smith, is the subject of our moral judgement.:

$$\begin{array}{c} S^1(\alpha) \text{-----} \rightarrow A \text{-----} \rightarrow S^2(\beta, A) \\ \text{<-----D-----} | \end{array}$$

Read: sentiments $S^1(\alpha)$, invoked by α , initiated action A, which inflicted 2 in such a manner that aroused $S^2(\beta, A)$ so that he would have liked to sub-act <----D----|.

The first stage of that cycle : $S^1(\alpha) \text{----} \rightarrow A$ is the subject of what Smith calls propriety. Namely, the question of approval of the relation between circumstances, motive (sentiment) and subsequent action.

$S^2(\beta, A) \text{---D---} \rightarrow 1$ is the subject of the theory of desert (merit and demerit). Namely, the propriety of the sentiments that are felt by the person who was acted upon. (Notice that an important part of the cycle, the successful implementation of the action ($A \text{-----} \rightarrow S^2(\beta, A)$), is not directly analyzed. Nevertheless, it is completely reflected in the theory of desert which, naturally, entails the final judgement on the complete cycle of action).

In our analysis, as in Smith's, we are interested in motives in as much as they affect the others. Hence, motives are defined in terms of what they propose to do to others, i.e. from benevolence to malevolence. Self-interest, naturally, means that the actor intends nothing for the other. (note, however, that Smith's analysis is in a discrete form. At a later stage, I shall extrapolate his model to include continuous degrees of effect as well as intentions). Actions too are defined in terms of their consequences to the others. That is to say, from the beneficent to the harmful.

The first part of the 'action cycle' is the circumstances that turn into sentiments and consequently, into actions. It is the subject of propriety.

(i) Propriety: "In the suitability or unsuitability, in the proportion or disproportion which the affection seems to bear to the cause or object which excites it, consists the propriety or impropriety, the decency or ingratitude of the consequent action" [TMS p.18].

The key word in propriety is 'suitability'. Namely, whether the sentiment, S, that was invoked by circumstances, stands in some relation to them. In other words, that it is not exaggerated. To tell us this, we must bring ourselves to the position of an 'impartial spectator'. Then we can see whether we would have felt the same had we been in place of the subject of approbation. If there is a coincidence of sentiments between the 'impartial spectator' and the

subject of approbation, then there is 'suitability'. Notice that to some extent, Smith's idea of the 'impartial spectator' resembles the Kantian 'Universal test'¹. A sentiment is suitable to the circumstances that invoked it only if everyone, in that position, would have felt the same. But this is not the only 'suitability' that is required by propriety.

Now that we know that a person's feelings are reasonable in relation to the circumstances that invoked them, we must ask whether the action that followed was suitable to the sentiments that invoked it. To see that, again, we must resort to the idea of the 'impartial spectator'. We ask ourselves whether or not, had we been in place of the subject of approbation, we would have acted in the same way. Now the idea of 'impartiality' does not mean only to have no direct relations to anything that is related to the action. It also means to have the knowledge of the proposed consequences of any action. Hence, occasionally we may feel that we could 'sympathize' with resentment, or anger, of another person. However, when transformed into action we might find that the proposed outcome of the action stands in no relation to the sentiment it expresses.

Here too, it seems, we may find some resemblance to the Kantian idea of the 'universal test'. It appears that in Smith's view the 'impartial spectator' should examine the proposed action on a much wider scale than the immediate results of a single action.

For instance, in the case of resentment and hate, Smith believes that

¹See Kant Ground Work of the Metaphysic of Morals, p.88.

an 'impartial spectator' may feel 'sympathy' with the subject of approbation. (i.e. everyone would have felt the same). Nevertheless, as far as implementing this hate, or resentment, into a harming action he is quite adamant. "There can be no proper motive for hurting our neighbour....which mankind can go along with"[TMS p.82]. Namely, though we may approve of someone's feelings in particular circumstances, we confront, all of a sudden, a sort of a 'categorical imperative'. Now it is a 'categorical imperative' because the reason Smith believes that an 'impartial spectator' will never consider a harmful action as suitable to the approved resentment, is its 'universal test'. "Society" writes Smith "cannot subsist among those who are at all times ready to hurt and injure one another"[TMS p.86].

So obviously the reason for rejecting the harmful action is its global significance. If everyone was acting in such a way all the time, society could not subsist. In other words, in Smith's system, the 'suitability' of an action to the sentiment that invoked it is examined at two levels. One, whether or not it has an 'a-priori' high probability of successfully implementing the sentiment in question. The other, the global significance of such an action.

The second part of the 'action cycle' is the desert analysis. It is the analysis of the 'suitability' of the sentiments felt by the person who is being acted upon. Naturally, the 'suitability' of his sentiments will give the action its final moral judgement. Obviously, it will also incorporate the analysis of the suitability of the choice of action to its intention. After all, the consequences of the action now become part of the circumstances of the person who

is being acted upon.

(ii)Merit and Demerit:" and that upon the beneficial or hurtful effects which the affection proposes or tends to produce, depends the merit or demerit, the good or ill desert of the action to which it gives occasion"[TMS p.67]. Merit, therefore, is:" To be the proper and approved object either of gratitude or resentment, which naturally seems proper, and is approved of...when the heart of every impartial spectator entirely sympathizes with them"[TMS p.69].

In the analysis of desert, we examine the consequences of the action. It is the $S^2(\beta, A) \rightarrow D$ part of the action cycle.

As I have already said, Smith defines actions in terms of their consequences, namely, from the beneficent to the harmful outcome. But unlike the person who acts, the sentiments of the person who is at the other end of the action cycle are categorized into two types: Gratitude and Resentment (see TMS pp.67-68). Now, these sentiments are the 'motives' for the sub-action of desert. And as the sentiments are so well defined, so are the actions that comprise desert. They are either reward, punishment, or null.

Gratitude is a feeling that will be felt by the person who is being acted upon when the outcome of the action was beneficial to him. Resentment when the outcome was hurtful. Obviously it is possible to consider situation where individuals behave differently. Namely that they might feel resentment in spite of the beneficent outcome. All this is basically taken care of by the argument β of S^2 . It will be

up to the 'impartial spectator' to determine whether or not his particular circumstances allow a reversed respond from what an innocent observer might expect. Beside these, one must also consider the situation where neither gratitude nor resentment are felt but I shall leave it till later on.

Nevertheless, whether gratitude, or resentment, are duly felt depends on whether or not the action that has brought about those outcomes was 'proper'. Namely, whether the sentiments that invoked it were 'suitable' to their circumstances (α). And, whether the choice of action was appropriate. "It is to be observed" writes Smith, "that, how beneficial soever on the one hand, or how hurtful soever on the other, the actions or intentions of the person who acts may have been to the person who is, if I may say so, acted upon, yet if in the one case these appears to have been no propriety in the motives of the agent, if we cannot enter into the affections which influenced his conduct, we have little sympathy with the gratitude of the person who receives the benefit; or if, in the other case, there appears to have been no impropriety in the motives of the agent, if, on the contrary, the affections which influenced his conduct are such as we must necessarily enter into, we can have no sort of sympathy with the resentment of the person who suffers." [TMS pp.71-72].

Hence, to understand merit we have to consider the cycle of action as a whole. Let us therefore, recapitulate:

$$S^1(\alpha) \text{-----} \rightarrow A \text{-----} \rightarrow S^2(\beta, A)$$

< *****

Propriety is the moral analysis (or judgement) of the suitability

of the triangle: circumstances-sentiments/motives-action i.e.
 $S^1(\alpha) \rightarrow A$. Merit and demerit is the analysis of the
circumstances- sentiments/motives-reaction of the person that was
"acted upon" : $S^2(\beta, A)$.

$S^2(\beta, A)$ may have two values: Gratitude or Resentment. But the value of
 $S^2(\beta, A)$ is determined by the consequences of the action A. (denoted by
 \rightarrow). Desert, (\rightarrow) may have three values: Reward, Punishment
or Nothing.

We are now confronted with four possibilities:

- (a) $S^1(\alpha) \rightarrow$ approved & $S^2(\beta, A) = G \rightarrow G$ is approved.
- (b) $S^1(\alpha) \rightarrow$ disapproved & $S^2(\beta, A) = G \rightarrow G$ is disapproved.
- (c) $S^1(\alpha) \rightarrow$ approved & $S^2(\beta, A) = R \rightarrow R$ is disapproved.
- (d) $S^1(\alpha) \rightarrow$ disapproved & $S^2(\beta, A) = R \rightarrow R$ is approved.

Where G and R represents Gratitude and Resentment respectively. The
approval or disapproval of G and R are somewhat more complex. They
represent the 'impartial spectator's' approval (or disapproval) of
the second person's response in action. Namely, the 'impartial
spectator' may feel that he would have felt the same as the person
who was acted upon due to this person's own circumstances. However,
given the nature of the action and the objective nature of the
outcome he might not approve of the second person's acting on his
sentiments.

Also, we know that:

	Reward	if $S^2(\beta, A) = G$ and approved
Desert-	Punishment	if $S^2(\beta, A) = R$ and approved
	Nothing	otherwise

Though desert can get three values, it is the four categories from above that produces the moral grading. Namely, there is a moral difference between two possibilities of the value: nothing, in desert. Let us look more closely at the four possible states.

(a) $S^1(\alpha) \rightarrow A$, approved & $S^2(\beta, A) = G$ approved.

That is to say that the sentiment and choice of action were approved, and indeed were successful in implementing the actor's intentions. We may call this action- Good.

(c) $S^1(\alpha) \rightarrow A$, approved & $S^2(\beta, A) = R$ disapproved.

The sentiment and choice of action were approved but they appeared to be unsuccessful. Because the choice of action was approved, it means that the reason for failure must be accidental, thus, the action can be a right action, but not a good one. Another explanation is that a person may feel resentment even if the approved action was successful. The reason, then, for the resentment is due to β , the second person's circumstances. In such a case, the 'impartial spectator' may approve of the actual resentment in the sense that he might have felt the same. However, he will not approve of person 2's acting on it. Thus, for the sake of brevity it is the same as if he hadn't approved of the sensation of resentment.

(b) $S^1(\alpha) \rightarrow A$, disapproved & $S^2(\beta, A) = G$ disapproved.

There was impropriety in the motive, namely, either the sentiment with regard to the environment (α) itself, or the choice of action were not approved. Therefore, the beneficent outcome of the action is accidental, or undue. We can say that no harm was done but it was still wrong either just to feel the way the actor felt or to act the way he did. This action we may title as a wrong action.

(d) $S^1(\alpha) \rightarrow A$, disapproved & $S^2(\beta, A) = R$ approved.

The impropriety of the motive or an irrational choice of action ended in harming another person. This is a Bad action.

So we have a sequence from the good to the bad. Every good action is also right but not every right action implies good. In the same manner, every bad action is necessarily wrong but a wrong action is not necessarily bad.

Smith's system, therefore, is a deontological theory. A theory where the right is being determined independently of its contribution to the moral good. In a teleological moral theory, like, for instance, Utilitarianism, something is right only if it is also morally good. In Smith's case, however, an action can be defined as right even when its consequences were harmful. This, in turn, will give the concept of justice a different meaning from what might have been implied in a teleological framework. There, justice and moral good are strongly inter-related. In other words, it will be possible to

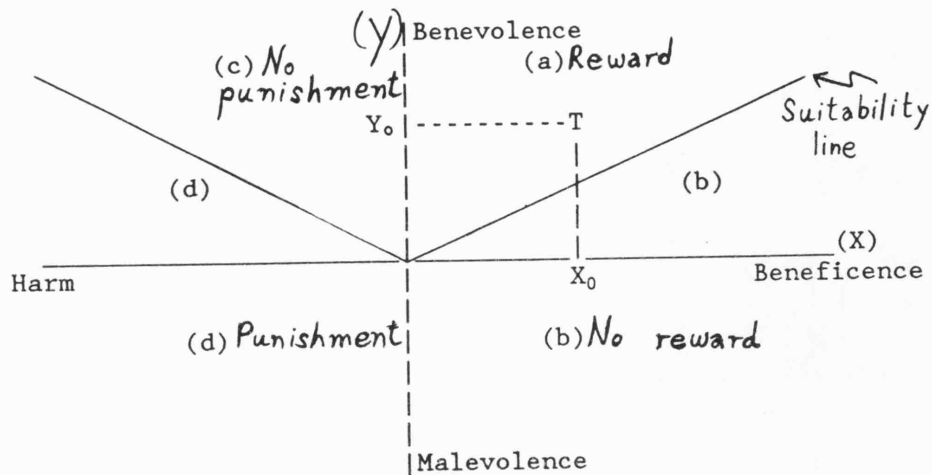
argue that an economic system, perceived as a set of actions, is just and yet, not morally good.

Let me now extend the analysis to the continuous case which will be more helpful in analyzing self-interest. Motives (y) can be normalized according to their degree of benevolence and defined over the interval $[-1,1]$; $y=1$ means benevolence, $y=-1$ means malevolence, and $y=0$ means self-interest alone. In the same fashion we may define actions (x), in terms of their consequences to the others, as spanning from extreme beneficence ($x=1$), to extreme harm ($x=-1$).

Now, propriety means that two conditions are fulfilled. One, that the sentiments (or intentions) are 'suitable' to the circumstances that invoked them. The other, that the choice of action was rational in the sense that it had a high 'a-priori' probability of successfully implementing the actor's intentions. But from the 'impartial spectator's' point of view there was an additional condition for approving of a sentiment becoming an action (motive). The global considerations. Namely, that actions (and intentions) that are a threat to society if habitually pursued by its members, cannot be approved. Therefore, there is one 'a-priori' condition on the moral approval of a motive; that it does not aim at hurting anyone.

In the figure below, let the horizontal axis (x) denote the actual consequences of the action, and the vertical axis (y) the motive.

figure 1



A point in the plain (like T) will then read: a motive that reflects degree Y_0 of intended beneficence produced an action that ended up with X_0 degree of beneficence. Now, when we choose the action which reflects the motive Y_0 , it can account for the beneficial outcome only up to some degree. Any point to the right of that line, cannot be explained by the mere intention. This line represents the outcome that can be explained by the actor's design. It seems as if Smith's intentions, in the discrete treatment of the problem, was exactly the same, namely, that if the outcome does not reflect the intention, it cannot be subject either of reward or punishment.

The 'suitability line' in the first orthant draws the line of responsibility. To the left of it, the whole level of beneficence can be accounted for by the intended action. Thus, it can be considered as the intended outcome, and call for a reward. (which, in turn, makes it a good action). Every point to the right of the 'suitability line' indicates that the level of beneficence exceeds so much the intention, that the latter cannot be considered

responsible for it, and hence, no reward is due. The action, therefore, despite its beneficence, cannot be considered as a good action.

There are basically two reasons for that occurrence; one, we chose an action that was not appropriated to our intentions, or, the outcome was a result of fortune (no design). In the first case, it means that there was no propriety (in its extended meaning); we chose an action which did not reflect our intentions so that our design was not proper. Thus, gratitude cannot be approved. In the other case, the gratitude belongs to nature, or fortune, which, according to Smith, cannot be an object of moral approbation. Note that when Smith discusses the influence of fortune, he is very clear that it is the role of the 'impartial spectator' to correct our natural tendencies to sympathize with the agreeable, when it results from fortune. (see TMS pp.92-108).

The precise position of the 'suitability line' is not necessarily at the 45° . It also depends on how much of an accidental outcome we accept so that the actor can still be held responsible. Namely, if the degree of benevolence in the intention was, say $y=.5$, then we may say that when the degree of beneficence of the outcome does not exceed say, $x=.6$, then the whole of its beneficence can still be attributed in its entirety to the actor's intention.

If we look at the fourth orthant, we shall find a similar story. When high beneficence was intended, and small harm resulted, it is within the range of reasonable chance. However, if harm substantially

exceeds the level at which even if all the benevolent intentions were reversed to harmful intentions, and successfully implemented, it can no more be attributed to chance, something in the choice of action was improper. There is a limit to the degree of harm that can be explained by fortune. Once it exceeds that limit, the actor must become responsible, or better phrased, irresponsible through negligence. Therefore, any point to the left of the 'suitability line', must call for a punishment.

As to orthants 2 & 3, there seems to be no interest in them as it was rather clear that while we might approve of sentiments of resentment, we can never approve of them as motives. The reason was, that society cannot subsist when we practice malevolence. Therefore, whatever the choice of action is going to be, we shall never approve of the motive. Thus, orthant 2, which represents improper malevolent motive, and a beneficent outcome, will indicate that the choice of action was as improper as the intention (with regard to its suitability to the motive), thus, no reward is due. In the 3rd orthant, successful malevolence calls for punishment.

The main point to be deduced from this analysis is that the mere beneficent outcome, does not secure the moral good rating. If a system of economics is to be considered as a good one, it cannot rely only on the promised beneficent outcome. It must prove proportionality as well. Moreover, note that for the low level of benevolence (self-interest), when in conjunction with a low level of harm, it already becomes bad, and calls for punishment. Thus, it is crucial to prove that the outcome of the economic system is

indeed beneficial, with no slips whatsoever to the harmful zone.

Appendix: A Note on Justice

We saw that the analysis of Smith produced four categories of morals. We termed them as Good, Right, Wrong and Bad. We also saw that good implies right and bad implies wrong, but, right and wrong do not imply good and bad respectively.

In a utilitarian, or any other consequentialist theory, a right action would be an action that implies good. Therefore, as justice is more concerned with right, it is naturally connected with the good of the system. In our case, however, this does not hold.

Smith's process of approbation included both sentiments and reason. When he grouped the relevant sentiments, those we can more easily enter to, he classified them not according to the degree of their pleasantness, but, according to their proposed impact on the existence and well being of society.

He called the benevolent intention as social, the malevolent as unsocial, and the selfish as neither social, nor unsocial. Within each group of these sentiments there are circumstances where an 'impartial spectator' could find agreement of sentiments. Even resentment, which is an unsocial sentiment, can be something we agree with provided that it is moderately expressed. But as for actions,

the possible agreement with the sentiments that are invoked by some circumstances does not imply the moral approval of any actions that is derived from it. This moral approbation, as I said before, is a matter of rational considerations. In particular, in Smith's case, these considerations are the proposed social consequences.

"It is thus that man, who can subsist only in society, was fitted by nature to that situation for which he was made. All the members of human society stand in need of each others assistance, and are likewise exposed to mutual injuries. Where the necessary assistance is reciprocally afforded from love, from gratitude, from friendship, and esteem, the society flourishes and is happy..... But though the necessary assistance should not be afforded from such generous and disinterested motives, though among the different members of the society there should be no mutual love and affection, the society, though LESS HAPPY and agreeable, will not necessarily be dissolved. Society may subsist among different men, as among different merchants, from a sense of its utility, without any mutual love or affection;.....Society, however, can not subsist among those who are at all times ready to hurt and injure one another." [TMS pp.85-86].

That is to say that as long as the proposed outcome of an action is beneficent, or at least not harmful, society can subsist. It cannot subsist when the habitual practice proposes a harmful result.

The theory of justice in Smith's analysis, is a theory of social preservation. It has nothing to do with questions of moral good. It only serves as a safeguard to society. The meaning of justice, in

Smith's theory, is the compulsion of one sort of desert: punishment. Reward, on the other hand, is not compulsory. The reason for this difference is obvious. It is the level of danger to the existence of society. The social consequences of the habitual practice of malevolence are disastrous while if no due reward is distributed society will be less agreeable but will not dissolve. Therefore, all sets of motives that are malevolent, are unjust and call for punishment. All the other motives are just simply because they do not endanger the mere existence of the social fabric. Therefore, to say that a system, in Smith's terminology, is just, means very little from the moral point of view.

(b) The Self-Interested Action.

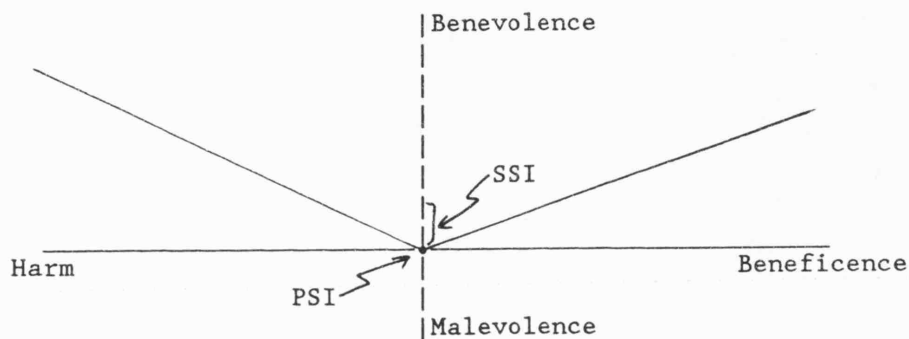
Of all the sentiments and motives considered in Smith's analysis, self-interest is the most important one. It is so, because it seems that Smith assumed it to be the most dominant sentiment. It is also the most relevant to our analysis of the morals of his economic system. In what follows we shall be discussing the moral significance of the habitual practice of self-interest.

Following our previous analysis, the moral meaning of self-interest depends on its propriety as well as on its consequences. In figure 2 (which reproduces our continuous model for moral analysis), we depict two definitions of self-interest. One, which I call 'point-self-interest' (PSI), is where self-interest means to have no-interest in the others whatsoever. Namely that as a motive to action, it intends nothing to the others. We may call this one, selfishness. The other definition will perhaps be closer to the accepted view where self-interest is perceived as a moderate expression of one's care for one's self (or, 'prudence'). That is, a self-interested person may as well wish to do some good to the others. Hence, in terms of our analysis, his motive now, will reflect a small degree of benevolence. It is obviously a much wider definition. We allow selfishness as well as some low degree of benevolence to represent the motive of self-interest. I call this

wider definition 'segmental-self-interest' (SSI)¹.

Let us begin with the first definition (PSI). Self-interest, in such a case, means that the actor intends nothing to the other. Hence, a successful implementation of this intention would mean that the action has produced nothing for the other ($x=0$) (which of course does not mean that it hasn't produced anything for the actor).

figure. 2



Therefore, point-self-interest (selfishness), when successful, will yield an action at the point $(0,0)$. Paradoxically, this action is a morally good action. From propriety point of view one can easily imagine the circumstances where a person feels that he wants to do only for himself and nothing for the other. After all, according to Smith this is one of the most strongest natural urges. It is therefore quite plausible that an 'impartial spectator' would have felt the same in such circumstances. As for the other part of

¹I choose to look at a segment rather than simply a point where there is some positive interest in the others in order to generalize. Within the segment of SSI can come all views of self-interest.

propriety- the rational choice of action- it too, indicates propriety. When the outcome was neither beneficial nor harmful to the others, the action could not have better reflected the motive (intentions). Also from the global considerations, taken by the real impartial (well informed) 'impartial spectator', there is no problem at all. An habitual use of these sort of actions does not seem to menace the social existence.

There is, however, one difference between what we considered as morally good and this particular action. There is neither gratitude nor resentment here. Hence, to some extent, this action has no moral dimension at all, as it has not affected anyone else but the actor. Nevertheless, for consistency purposes we may say that this sort of actions and consequences is morally good. (We may always say that if the intention was successfully implemented then the actor has already received a reward to which no-one seems to object).

There is another reason why we cannot really assume that a situation where self-interested people aim and achieve exactly what they want as morally good. Apart from the lack of any sense of gratitude or resentment in the system there is the question whether the successful implementation of their self-interested motive depends on what others do. It is not inconceivable that a successful implementation of a self-interested motive depends on the others being self-interested as well. It is clear that the idea of natural liberty as a harmonious machine is precisely the general interdependence of people's behaviours. In that case, we cannot really think of the successful implementation of one's intention in an isolated manner.

If all individuals are self-interested in a similar manner² then we might say that each of them acknowledges the others contribution to his success in implementing his own intentions. However, as they are all of similar nature, their gratitude are similar and they can simply waive their demand for remuneration and be content with their own achievements. If, on the other hand, they are of different nature, it is not quite clear that waiving one's demand for reward will be consistent with one's character. Thus, if the self-interested person succeeds because of the other's benevolence, the 'impartial spectator' would expect the benevolent person to be remunerated. Otherwise, there is a danger that benevolence, which Smith thought of as a key to a better social existence, will disappear.

In any case, it is unlikely that the self-interested person will feel obliged to reward the benevolent person. It is also reasonable to assume that the benevolent person will be in a worse off than the self-interested person. Such a configuration is a good enough reason for any 'impartial spectator' to disapprove of successful implementations of self-interested intentions.

If, now, the same self-interested motive is being implemented through an action that has a high probability to result beneficent, its proposed outcome stands in no proportion to the motive. As the beneficence of the outcome cannot be attributed to the intention,

²We saw before that what is meant by self-interest is not so straightforward. Also, as will be shown later, in Smith's economic analysis there is a clear distinction between the manifestation of self-interest among the capitalists and its manifestation among the labourers.

there is no propriety in the action. Any gratitude that might be felt by the beneficiaries, should be bestowed upon the forces that have really brought about the beneficial outcome. But alas, nature is not a proper object of morals.

Thus, the final judgement of such an action will be that it is a 'wrong' action. Not a moral vice, but certainly not a morally good action. (Note that a morally 'wrong' action is when no reward is justified, but neither is any punishment due).

Consider now the segmental-self-interest (or what others may call prudence- a moderated expression of self-interest). This means that in the motive of self-interest there might be some degree of benevolence. Hence, at some degrees of beneficent outcome a self-interested action may gain the title of a morally good action. Nevertheless, it will be good only if the outcome does not exceed the intention by too much (and falls in area b in fig. 2). The more efficient we consider the economic system that is based on self-interest to be in producing wealth, the less likely it becomes that we could consider it as morally good.

Though it does sound a little bit awkward one must bear in mind that moral has to do with people, not with nature. We would never think of the water cycle in nature, for instance, as a morally good system just because it benefits us. In the same manner, even though a self-interested system may yield beneficial outcome, it is still the work of nature, and not of human intentions. Thus as no reward is due, from the moral point of view the system cannot be considered as

good.

In figure 2 we can see the conditions for self-interest to be morally good. These are mainly two: (a) the outcome should be beneficent; and (b) the beneficence of the outcome (to others) should not exceed the intended benevolence by more than some agreed degree (the 'suitability line'). Nevertheless, because the degree of intended benevolence is so low in the self-interested case, a very low degree of harm is sufficient to turn this sort of motive into a moral vice! (area (d) in figure 2). Hence, the moral acceptability of self-interest is very delicate. It depends heavily on its being beneficent to at least some small degrees.

There are two implicit assumptions that we have made throughout our analysis. First, that as a sentiment self-interest is something we may always approve of. Very much in line with the convention. Nevertheless it was not sufficient to morally vindicate it as a motive to action. It only means that we approve of the sentiments S^1 that were invoked by circumstances (α). But propriety does not only consist of the approval of $S^1(\alpha)$. It also depends on its implementation into action; i.e. $S^1(\alpha) \rightarrow A$. Indeed, the lack of propriety that we suggested was entirely due to the lack of proportionality ('suitability') between the intention and the outcome of the chosen action. The second assumption was that the outcome of self-interest is indeed beneficent.

We dealt with the first assumption in chapter 3. We shall, however, accept that as a mere sentiment, detached from the analysis of human

character, it is something an 'impartial spectator' could have gone along with. However, if the sentiment is not analyzed in the context of human character, it must be analyzed in the context of actions that are derived from it (which is precisely what the WN is all about). Otherwise, it will become morally insignificant. For our purposes, the assumption that as a sentiment self-interest is morally approved is valid as it is only part of the analysis of propriety. But whether it makes self-interest a morally good motive depends on our second assumption; i.e. its beneficence.

So far we only stressed the importance of the outcome of actions to the moral analysis of motives. However, we have not really discussed the meaning of a 'beneficent outcome', the key to the moral vindication of self-interest. In the economic context it is quite clear what people usually mean by the beneficence of self-interest in the framework of natural liberty. It is that such a system is the best, the most efficient one, in creating wealth. But surely, it is not the mere production of wealth that can give rise to beneficence or to people's sense of gratitude. It is its distribution.

An important feature of natural liberty is that together with the efficient production of wealth, there is always a distribution of it to go along with. This distribution which would come about if things were left for themselves, is what Smith called the 'natural distribution' of things. Let me now, very briefly, examine Smith's views on the beneficence of wealth as such and, the beneficence of the natural distribution of it. In my view, it is in his approach to these issues that his ambiguous approach to self-interest and

natural liberty can best be seen.

Smith's argument goes as follows. Wealth as such, argues Smith, is at the "highest degree contemptible and trifling"[TMS p.183]. But nature creates a deception so that it will appear more favourable. Smith writes that "we rarely view [wealth] in this abstract and philosophical light. We naturally confound it in our imagination with the order, the regular and harmonious movement of the system, the machine or oeconomy by means of which it is produced. The pleasures of wealth and greatness, when considered in this complex view, strike the imagination as something grand and beautiful and noble, of which the attainment is well worth all the toil and anxiety which we are so apt to bestow upon it. And it is well that nature imposes upon us in this manner. It is this deception which rouses and keeps in continual motion the industry of mankind".[TMS p.183].

But why, one may wonder, would nature want to encourage the production of something which is so trifle and contemptible. Obviously, because it promotes its own ends- the preservation and multiplication of the species. Because of the deception, mankind strive for wealth : "...and thus without intending it, without knowing it, advance the interest of the society, and afford means to the MULTIPLICATION OF THE SPECIES".[TMS p.185](my italics).

Naturally, for the 'deception' of nature to work; that is, for people to become industrious in order to gain the apparent benefits of wealth, a connection between industry and wealth must be constructed in the human mind. Thus, the natural distribution of wealth must be

so that industry will be rewarded.

So we have a system where people, acting upon their self-interest, are engaged in producing wealth because it appears to them as beneficent. (And to some extent it is indeed so). In this system, reward goes to the industrious person rather than to anyone else. However, argues Smith, this distribution of wealth isn't consistent with the human moral sentiments.

Nevertheless, in order to understand Smith's argument we must come back to the idea that his moral system is comprised of an 'ideal' which is distinct from the praxis. The fact that Smith considered wealth as trifle does not mean that people actually share that view. Apparently, the deception of nature seems to be working fine. People do believe that wealth is not trifle and they also think that wherever there is wealth, there must be virtue. "Magnanimity, generosity, and justice command so high a degree of admiration, that we desire to see them crowned with wealth, and power, and honours of every kind". But, argues Smith, wealth and power are nature's rewards to different sorts of human qualities altogether. Wealth and power, according to Smith, are "the natural consequences of prudence, industry, and application; qualities with which [magnanimity and generosity] are not inseparably connected". [TMS p.167].

Consequently, in practice people may consider the natural distribution as morally good. It is only the really impartial 'impartial spectator', a person like Smith, who can see that this,

perhaps, is not how things ought to have been.

The bottom line of all this is that Smith considered the natural distribution of things to be inconsistent with moral dictates. Those which are derived from the model of moral approbation (the fully informed 'impartial spectator'). Nevertheless, he suggests, it is quite possible that in practice, ordinary people will be deceived by nature to believe that it is morally good.

But it seems that Smith's analysis is quite vague. After all, the reason he believes that the natural distribution is not consistent with morals is because it seems as if reward is going to the wrong place. However, the place is wrong, according to Smith simply because he has an a-priori idea who should be rewarded; i.e. the morally good character. But in the analysis of actions this is all beside the point. Merit or demerit, in Smith's own system, depends on the moral value of actions not of characters. There, if a character is morally good (which probably means that the motive is approved) it is far from being sufficient to grant him rewards of any kind. Propriety is also about choosing the suitable action. Consequently, even if self-interest is a morally good character, it does not follow that the reward of wealth should go to these people.

In order to really see whether or not the production and natural distribution of wealth are beneficent we must examine more carefully the actions of wealth production. This is the subject of the next section.

(c) Spillovers and the Beneficence of Natural Distributions.

Let us begin by specifying what we mean by an economic action (or actions) that is the subject of moral assessment. The first two things that come into mind are exchange and production. But while relationships between the different agents (or social classes) that are involved in the process of production seem to be a natural (or perhaps traditional) subject of moral debate, exchange as such seems to have been more difficult to analyze. Can we really say that in an action of exchange there is a person who acts and another who is being acted upon?

According to J. Viner(1972) there isn't much point in a moral analysis of exchange in the framework of Smith's analysis. The reason is that exchange is a very impersonal action. The 'social distance' between the participants is so great that none of them will feel 'sympathy' with the other. Namely, neither of the bargaining side will have the tendency to feel as the other had he been in his place. Hence, as moral judgement depends on 'sympathy', no moral opinion will be formed. Young (1985 & 1986), on the other hand, argues against Viner's assertion. In his view, even when the 'social distance' is large, 'sympathy' may still be felt by strangers provided that they meet face to face. Consequently, a

sense of moral approval or disapproval will emerge at both ends of the deal.

In my view, however, there is a stronger case for moral assessing exchange even though the 'social distance' may be great. As I argued before, the 'impartial spectator' is an ideal as much as it is a description of how people actually form a moral opinion. Namely, it is a model of how to form a 'proper' moral judgement about anything at all. As such it may very well be applied into situations where people do not have an immediate sense of 'sympathy' or, morality. Viner's argument is that there is no moral value in exchange because the actual participants don't employ 'sympathy'. This, however, does not mean that we cannot conceive an 'impartial spectator' who will pass a judgement on both sides of the bargain. When a burglar breaks into a house he probably has no idea of who lives there. Does this mean that because of his social distance from the people who, as it were, are being acted upon his action is now value-free?. Obviously not.

But there is another reason why, at least in Smith's case, exchange cannot be seen as so impersonal. It is because of the meaning of prices in his economic system. Surely we can agree that the action of production (the owner-employee relationship) cannot be thought of as entirely impersonal. Now, as in Smith's theory prices reflect the distribution of income between all participants in the production process, it is by definition that exchange, where actual prices are being set, is subject to moral investigation. Not so much, however, from the point of view of the direct participants in

the process of exchange as from the point of view of the general distribution of income that is implied by it.

There are mainly two ways to investigate the morals of exchange. One, in the tradition of Walras (and Nozick), where the moral value of exchange depends on the institutional arrangements. That is, that any exchange (and price) reached under the morally approved arrangement are morally good. Walras, for instance, considered the market price that is determined under perfectly competitive conditions as morally just because no-one was making any real profits (in terms of the numeraire) on expense of others¹. Here, every market price is just provided that the freedom and perfectibility of the market are preserved.

On the other hand, we can consider the morality of a market in its success in bringing about the price that we a-priori (to exchange) define as morally good. Like, for instance, cost of production theories, or labour theories of value.

The Aristotelian based scholastic concept of the 'just price' is an example to such a case. There is still a disagreement whether either Aristotle or St. Thomas Aquinas thought the 'just price' to be any market price². However, there is enough evidence in the writings of both these scholars to suggest that the 'just price' is in fact the cost of production price. Naturally, in such a case, the moral

¹See in Jaffe (1980) for the reference on Walras. It must be noted, however, that Walras' perception of economic justice was much more complex. I hope to publish soon a careful discussion of it.

²See discussion in the General Introduction section (a)- (ii).

reference point (the 'just price') is now being determined by the mode of production. The moral merits of exchange are then reduced to the success or failure of its institution to produce the 'just price' as the market price.

As Smith's value theory is believed to have been a 'cost of production' theory³, it is the action of production that becomes the heart of the moral investigation of his economic theory. In other words, it is the relationship between the capitalist and the labourer which constitutes the two sides of the actions. However, as both of them act and are being acted upon simultaneously, the problem becomes more complex.

From what has been said in the previous sections it should be clear now that the morality of self-interested actions depends primarily on the beneficence of the outcome. It cannot really become a moral good but the beneficence is essential to salvage self-interested actions from becoming vice. The questions that we shall have to deal with now are (a) when is a final distribution beneficent and (b), which determines (a), whether we can distinguish after all between those who act and those who are being acted upon.

Let me now, gradually, develop a picture of economic actions. I will also try to show that though we are in a situation where everyone acts and is being acted upon, the distribution of ownership gives some distinct insights into who really acts and who is really been

³A proposition that needs modification as I will endeavour to show in chapter 5.

acted upon.

(i) General Beneficence.

A person, the capitalists, from self-interest, advances materials to the action of production. Another person, the labourer, again, from self-interest, brings his labour to the process of production. Both of them act and are acted upon at the same time, and the outcome of their action is a certain level of wealth.

Suppose now, that they produced wheat, does the mere extraction of wheat from the land indicates a beneficial outcome to their action?. Obviously not, even not in terms of nature's plan for the preservation of the species. The first thing we should inquire is whether this quantity is more or less than it takes to produce it. Surely when we began the action, we must have had some quantity of the product, otherwise we could not have produced it⁴.

If the quantity that came out of the act of production is less than what is needed for its reproduction, the action cannot be considered as beneficial. In this particular action the amount of seeds and subsistence of the next period can not remain the same. If we do not cut subsistence then we must reduce the seeds, hence, the next period

⁴In our case we needed the wheat to serve as seeds as well as the food for the capitalist and labourer, during the period of production. By food to the people involved in the process of production, I mean the level of physical subsistence.

will yield even less output. At some stage we shall have to give up some of our food as well. In the long run, if the trend continues, neither the capitalist, nor the worker will be able to maintain the same level of consumption, thus, though wheat is still extracted from the land, the action of its production cannot be considered as beneficial in its outcome. From nature's point of view it is disastrous as well. With less wealth than earlier, the species will disappear.

When the quantity produced is exactly sufficient to what is needed for its reproduction (including the subsistence of the labourer and capitalist), we may say that the action has had no effect ($X=0$)⁵. From nature's point of view, this action will preserve the species but will not multiply it.

Only when surplus is produced, it is guaranteed that the species will advance in quantity. However, from the moral point of view the question of whether the action can be considered as beneficial is not yet settled. For that we need to explore more carefully the question who acts and who is acted upon.

⁵Note that we are examining the beneficence of the action, which is a dynamic concept, rather than the beneficence of the situation. Someone may feel grateful for what he has in comparison to what he might have had. Nevertheless, the action itself hasn't brought about any change in his conditions. There is no reason to suppose that as a result of a stationary state a person will attribute his position to actions which merely preserve what he has already been enjoying before.

(ii) Ownership and the distinction between acting and being acted upon.

If a surplus has been produced, the person who initiated the action, the capitalist (who, for reasons that are not under consideration at present, owns the outcome) can decide to consume the whole surplus himself. He will, obviously, be able to increase his family and advance the race but the other person, the labourer, will remain in the same state as before. (he might even be worse off, according to the capitalist's whim, if he was already above subsistence). Hence, the action will certainly raise the feelings of gratitude in the capitalist and, at the same time, it might even raise the resentment of the labourer if his level of consumption was decreased. (I shall assume that when surplus prevails, no capitalist will reduce his labourer's wages below subsistence).

On the face of it, the situation seems undetermined, however, we must look again into the description of the action in order to solve this problem. If indeed we had two persons who are acting and acted upon at the same time, the question of who owns, or who ought to have received, nature's remuneration; i.e. the total produce, should have been left open or, at least discussed more carefully. However, we have an exogenous constraint that dictates that the produce of the action 'belongs' to the initiator of the action (the capitalist).

The distribution of it becomes a separated action. An action where the person who acts is the capitalist, and the person who is acted upon is the labourer. In other words, the capitalist's benefits are mainly due to the work of nature which is not an object of morals. Those of the labourer depends on nature as well as on human decisions. Therefore, whether an action of production, of which the 'action' of distribution is an integral part, is beneficent or not depends on the labourer's feelings. As he is the one who is ultimately acted upon, it is his sense of gratitude which indicate a beneficent outcome. As the complete produce goes through the capitalist, it is unlikely that he will bestow benefits on the labourer, while harming himself. Hence, the beneficence of the worker, necessarily implies the beneficence of the capitalist but, it does not hold the other way around.

We may return now to the question whether an action where the capitalist (the initiator of the action), who was rewarded by nature for his dexterity and, who leaves the wages of his labourer at their previous (or even, subsistence) level, is beneficent or not. Well, the answer depends on the use that the capitalist will do of his surplus. He might not share it with his labourer, the one that participated in the production of his surplus, but, at the same time, as his stomach isn't larger than that of the poor person, he is bound to share the surplus with another labourer whose services he might require⁶. Does this mean that the outcome is beneficent?.

⁶"It is to no purpose that the proud and unfeeling landlord views his extensive fields, and without a thought for the wants of his brethern in imagination consumes himself the whole harvest that grows upon them....The capacity of his stomach bears no proportion to the immensity of his desires, and will receive no more than that of the meanest peasant. The rest he is

To begin with, we must acknowledge that the analysis of the relationship between those who are involved directly in the action is insufficient to determine the real effect of the action. If the capitalist does not share his surplus with the person who was involved in producing it, there must be another action involved. The action in which he exchanges the surplus for some sort of labour, which Smith named as unproductive labour. (namely, labour that does not produce any surplus). Obviously, the outcomes of both actions (the production and exchange of surplus) are interdependent. Therefore, we shall have to extend the framework of analysis so that we can measure the complete effect of the actions of production and exchange. (By the action of production I also mean the productive labourer's remuneration. I refer to it as part of production because the subsistence of the productive labourer is part of the reproduction of the whole process. Obviously, the capitalist can share the surplus with his own labourer, and increase his wages above subsistence, but, as it might affect production (in terms of productivity) I shall not discuss it here. This sort of analysis must be carried out in a more complete model of Smith's economic system. For the moment, we may distinguish between the remuneration of the productive labour, as part of production, while, the unproductive labourer receives his remuneration in the process of

obliged to distribute among those, who prepare in the nicest manner, that little which he himself makes use of.....The produce of the soil maintains at all times nearly that number of inhabitants which it is capable of maintaining. The rich only select from the heap what is most precious and agreeable. They consume little more than the poor,....They are led by an invisible hand to make nearly the same distribution of the necessaries of life, which would have been made, had the earth been divided into equal portions among all its inhabitants".[TMS p.184-5].

the exchange of surplus).

In short, as the beneficence of a single action may spill-over beyond the direct participants in the original process, we have to consider these effects as well. On the one hand we have the initiators of actions, those who own the benefits that are bestowed by nature. And, on the other hand, we have the labourers (of all kind) who are engaged in either mere exchange (in the case of the unproductive labour) or, in a complex action of production and remuneration. Now, as we consider the complete system, the question is whether or not the process of the invisible hand guarantees a beneficent outcome to the production of surplus?.

Consider now the following case. In an economy there are 20 capitalists, and 80 labourers, and the product is wheat, a unit of which is produced by .1 units of labour, and .5 units of wheat. In order to subsist through one period, a person needs 1 unit of wheat. In the initial state, the economy was producing 200 units of wheat. (namely, 20 labourers are productive and 60 unproductive, if employed at all). From the point of view of reproduction, to maintain the same level of output, the capitalists will have to put aside 100 units of wheat, as seeds, and 20 units of wheat as subsistence for the required labour input. Adding to it their own subsistence, (20) the surplus that remains is 60 units of wheat. If the capitalists will use their surplus for 'luxurious' consumption, they can employ 60 unproductive labourers. Note however, that no one can subsist on 'luxurious' consumption. Indeed, though wealth is unequally

distributed (80 people in the economy have only the level of subsistence, and 20 have, in terms of wheat, their subsistence + other trivial convenience), necessities of life (subsistence) are equally distributed (everyone, at the end of the process of production and exchange, has only 1 unit of wheat). This economy will not be able to maintain more people in these circumstances.

At first sight, the only reason for gratitude on part of the labourers is that they are alive and have something to eat. As time elapses, in this stationary state, there is no room for any more gratitude. The first set of actions (the functioning of the system at the first period) raised gratitude because it changed the labourers' position from hunger to subsistence. But, once they have reached subsistence, there seems to be no reason for gratitude as they get nothing in addition though the actions are repeated. So, the set of actions that generate the stationary state, though produce surplus and distribute life's necessities in an equal way, don't seem to be the cause of any gratitude. In particular when comparing to a different distribution of wealth which would have been consistent with the above state.

If, for instance, every member of society had 2 units of wheat (equal distribution of wealth), he would be able to produce, as an independent producer, 2 units. Though he only works .2 of his time, he needs for subsistence 1 unit of wheat. Hence, he is being left with no surplus. From the point of view of those who were labourer in the previous situation this must be much better. Under equal distribution of wealth with no division of labour (autarky) they

will receive the same net-income (subsistence) as before but with much less work on their part. Surely there is no cause for gratitude among the labourers if we compare their previous conditions with the present one.

From the point of view of the ex-capitalists, they are now worse off. Though they still have their subsistence as before (for their stomach isn't larger than that of the poor) they simply cannot have any extra convenience. Luxury consumption and unproductive labour cease to be an economic variable. (Maybe now, because most people have more spare time, they will want to entertain each other. However, as they don't have any surplus, it will all have to be on voluntary basis).

It is clear that the economy as a whole may lose much from autarky. The production of surplus when properly used, may give rise to growth that wouldn't be possible under autarky. Nevertheless, in the above example the only thing that the economy loses from autarky is the luxury and convenience of the rich. The labourers, however, whose gratitude is essential in making the system beneficent, are, at best, completely indifferent to both institutions in the above example. In fact they will prefer autarky over the commercial society. Consequently, not only that they will not feel gratitude under the above commercial arrangement, they might feel resentment.

There is another reason why the labourers will not consider the stationary state of subsistence as a cause for gratitude. In the Wealth of Nations, Smith writes the following observation: "A man must always live by his work, and his wages must at least be

sufficient to maintain him. They must even upon most occasion be somewhat more; otherwise it would be impossible for him to bring up a family, and the race of such workmen could not last beyond the first generation." [WN p.85]. Namely, that in the above described situation, which follows his line of argument in the Theory of Moral Sentiments, if subsistence means the amount of wheat that is needed to maintain the worker himself, this economy will not last more than a generation. Obviously, in face of such grim prospects, no one will argue that the outcome raises gratitude, or indeed, is beneficent.

However, if we allow a more liberal interpretation of subsistence, namely that it is enough for the multiplication of the species, we shall still not find it as a cause for gratitude. In the next period there will be more people in the economy. Competition for work will cause a decline in the level of wages, perhaps even below subsistence. For this not to happen, output must increase too. Recall, however, that in our example the surplus of 60 units went as subsistence to the unproductive labourers. If, instead, the capitalists would have wanted to invest it in order to increase output for the next period, they would have needed some of the surplus as raw material (seeds). Consequently, there would not be enough subsistence for all the labourers in the economy. Hence, either way will leave the workers resentful. In the first case because their wages fell and their subsistence undermined (in the second, or third, period). In the other, because most of them do not experience any change in their wages from the previous period but some of them, do not have enough for subsistence.

From all this we may conclude that the mere production of surplus (wealth) is by no mean in itself a beneficent outcome. The fact that it may distribute subsistence in an equal manner is completely insignificant to the question of beneficence. Thus, the self-interested economic action may become a moral vice even when it seems to be creating wealth.

There is no doubt that in the Theory of Moral Sentiments, Smith is trying to make the case for the beneficence of the invisible-hand-mechanism. However, this case is being reviewed and modified in the Wealth of Nations where he very simply argues that the beneficence of the system is possible, but it does not lie in the mere creation of surplus (or by the mere division of labour). This is, in my view, the real meaning of Smith's distinction between the 'dull' (stationary) state and the 'cheerful' (progress) one.

We may conclude now that the beneficence of the complex action that constitutes the economic system has two main properties. First, it is measured by the gratitude one would expect from the labourers. Secondly, this gratitude, or resentment, is a result of an actual change or an expected change in the labourers' circumstances.

Hence, a distribution is beneficent only if at least one of the workers (hence, all capitalists) is better off and no one is worse off. (There are obviously no tools to compare gains and losses of different workers). To some extent it is a similar notion to Rawls' principle of justice. There, a distribution is morally better if, in comparison to the state of equality, every one is better off. (in the

modified version, it is enough that the worst off will become better, to make the distribution morally better). In Smith's analysis, as we regard labourers as those who are worst off in society, an improvement in their conditions will yield beneficence. From whatever state we begin, a system of self-interest will not become unjust, if the workers, who are the least in society, have a reason to feel gratitude through an improvement in their conditions. However, unlike Rawls, the fact that the system is just is of much less moral significance than it is in Rawls' analysis.

Conclusion of Chapter 4

I have tried to establish in this chapter that the moral good, if exists, of self-interest is dubious. At best, it is good in as much as society may subsist, but there is nothing in the system itself that assures us that this fragile moral good can last. Indeed, if we look at Smith's 'dull' and 'cheerful' phases we may find that the former is correlated with moral bad whereas the latter, is merely a 'just' situation which, in Smith's theory, is not so conveniently related to the idea of moral good.

Samuelson's(1977) 'vindication' of Smith's economic model ensures that in the long run, at the stationary state, the economy will

reach the state in which no beneficence will occur and the habitual practice of self-interest will become 'suitable' to its outcome. However, it will be at the least possible level of moral approbation. Samuelson's analysis may be interpreted to suggest that the only thing a system of natural liberty may offer us, is 'justice' as distinct as it is, in Smith's model, from moral good. There is, however, the question of how good a description of Smith's model is Samuelson's 'vindication' (see, for instance, Reid (1987)). At any rate, this is a subject for a different investigation altogether.

5. IMPLEMENTING SMITH'S MORAL ANALYSIS TO HIS ECONOMIC SYSTEM

(a) Introduction

The purpose of this chapter is twofold. To offer a somewhat novel interpretation of Smith's economic system and, to analyze the machinery by which the beneficence of the system --which is essential to prevent it from becoming a moral vice-- comes about. The two, obviously, are not entirely unrelated.

There are two general points which are important for both the modelling of Smith's economics as well as for the purpose of establishing its moral significance. One is the symmetry, or asymmetry, in the positions of the various economic groups which constitute the economic system. The other is a more technical question which relates to the choice of framework for the economic analysis. This latter issue is subdivided into specific questions of the kind of whether to use the general or partial equilibrium framework of analysis; whether to use the framework of growth models with equilibrium or disequilibrium paths, or the more Sraffian 'cost

of production' systems which focus on inter-sectoral relationship and the continuous preservation of equilibrium prices.

(i) The Moral Consequences of A-Symmetry in what Motivates the Different Economic Agents.

Let us begin with the less technical problem: the problem of the relative positions of the groups which comprise the economic environment. By 'relative position' I mean the difference (if exists) in what motivates the various groups and the subsequent effects of their actions on the whole system.

In the previous chapter (section (b) in particular) we have analyzed the moral significance of a self-interest motivated action. We saw that such actions pose a particular problem in their moral evaluation. If a self-interested action is successful it means that the actor has received what he wanted without affecting anyone else. If indeed the achievements of the actor's goal was carried out without anyone else being acted upon then we might indeed say that there is proportionality between motive and outcome and the action might be crowned as morally good¹.

¹This, of course, depend on our approval of self-interest as a sentiment as such. We saw in chapter 3 that this is far from being obvious. I nevertheless assumed it to be morally approved to show that even then, the

However, such a statement had to be qualified immediately. For the morally good action to prevail, in distinction from the mere Smithian 'just' action, 'merit' and 'demerit' are important too. Namely, the fact that the action does not raise any gratitude from someone else implies that it is less than morally good. As a matter of fact such an action does not involve more than the actor himself and thus there are really no grounds at all for any moral judgement.

Within a system (a set of actions), however, the story is somewhat different. Some would argue that a self-interest based system is a system where all participants act out of self-interest (namely, each intends nothing to another) and that they are all successful in achieving their own ends (which are, presumably, rational ends). Hence, as all motives are the same everybody is acting and being acted upon in the same manner.

However, it is clear that this idea of efficiency which is strongly associated with natural liberty, means that each individual was successful only because other people behaved in the way they did. But it is not any way which others might choose to behave that will render the self-interested actions successful, it is the fact that others behave in the same way which brings about this harmony of wants². Consequently it is as if each individual's self-interest

morality of natural liberty in Smith is questionable.

²Unless, of course, we assume that rationality also implies that the individual takes into consideration the others' behaviours. This, of course, is not the standard analysis and it is certainly not what is implied by Smith's idea of prudence. Such an idea, however, does exist in contemporary analysis in the form of rational expectations.

generated the other's successful implementation of it. From the moral point of view it means that each individual's action created benefit to the other. The proper distribution that should emerge is where everybody is rewarded for his contribution to the others' successful implementation of their wants. But as they are all motivated by the same thing and they are equally successful in its pursuit, they owe each other the same and thus, it is as if their mutual rewards are balanced out and the immediate outcome of natural liberty is the morally desirable distribution.

However for the same reason why some might think of a single self-interested action as morally good, the system of self-interested actions is being deprived of such an evaluation. The reason is that there is no proportionality between what the individuals intend to the others and what they achieve for them through their own behaviour. They intend nothing for the others but through their pursuit of their own interest they achieve, unintentionally, a lot for them. They affect each others' success in pursuing what they intend for themselves. Hence, at best, this system can still be only 'just' in the Smithian sense of the word. Namely, it can be accepted because it does not menace the social existence but is far from being a morally desired system.

The question that will arise is whether or not there is beneficence in such a situation. If everybody acted and was acted upon in the same manner the final distribution can be justified on the grounds that either the mutual rewards were balanced or, that there is no room for reward to anybody as there was no beneficence.

Whether we can see at all the beneficence of the system (of the others' activities) in the success of the self-interested person depends on the similarity of their motivation. If a benevolent person allows the self-interested one to achieve even more than he had hoped for while the former finds joy only in his success to benefit the others, the natural distribution of things is wholly unacceptable³. Both individuals acted and were acted upon. The self-interested person intended nothing for the other and indeed achieved nothing real for him; the benevolent character intended good and achieved it. The final distribution, however, depends on the second aspect of the action cycle: reward and punishment. The self-interested person received real benefit from the benevolent person's action and he should therefore reward him. A distribution that does not satisfy this condition is less than morally good.

But the reasons why the final distribution may not be morally acceptable does not depend only on having different motivations. Even the expressions of similar motivation, when their effects on the model are diverse, will render the final distribution as unacceptable. In such a case we will not be able to say that the successful implementation of the self-interest of one group depends on the other group's pursuit of self-interest in the same way that the latter's success depends on the former's behaviour.

³It is important to point out that by distribution of things Smith means real goods, not utilities. The fact that the benevolent person wanted the self-interested one to be happy and he himself is therefore happy is completely outside the domain of Smith's analysis of reward and punishment.

To a great extent it is all part of the question of who acts and who is being acted upon. Before establishing this we cannot hope to be able to say anything about the beneficence of the system. In the previous chapter we have dealt with this problem by introducing asymmetry between the two groups (capitalists and labourers)⁴ that is entirely due to the legal arrangement by which the capitalists own the final product. The motivation, however, of both sides appeared to have been the same; i.e. self-interest. This, in turn, may lead to some debates about who really acts and who is being acted upon which may entirely depend on the point of time where we start our analysis. Namely, do we start it by the labourer coming to the capitalist and offering him to exchange his labour for wages and then the capitalist is being acted upon or the other way around? There is no intrinsic reason to prefer one arrangement over the other as both labourers and capitalists act for the same reason. The meaning of beneficence will be completely different under these two perceptions of economic relationship.

Indeed it is the general belief that in Smith's system all participants behave in the same manner that will cause people to doubt the analysis of beneficence that is based on the capitalists acting on the labourers (as assumed in the last section of the previous chapter). One may even argue that the idea that economic actions are simply exchanges among equals can be traced to Smith's evolutionary approach to social development (the 'four stages' theory). In other words, when in the rude stage people start to

⁴For the sake of simplicity and without loss of generality I shall leave landlords out of my discussion.

specialize and create surpluses they are all both labourers and capitalists. They face each other in the exchange of these surpluses as equals. In such a case, the difference in classes emerges due to the imprudence of some of these people who will not accumulate but consume everything immediately. In the next stage, those who have accumulated will be in a different position than those who haven't. But the question is whether an assumption that class distinction has emerged from pure self-interest means that the next generation of the imprudent people are on equal terms with their prudent counterparts⁵. I doubt it.

As a matter of fact this is a too sterile description of the emergence of classes in Smith's theory anyway. It had not been only the accumulation of capital which brought about a class distinctions, the acquisition of land also played a significant role. Thus, even if we believed the story where it is imprudence (a form of self-interest) which generated some class distinctions the fact that there is a third, unrelated, reason means that we cannot directly relate the predicament of the new generations of labourers to their forefathers behaviour.

I therefore believe that there is an a-symmetry in Smith's perception of the expressions of self-interest among the different classes. If we say, for instance, that labourers don't save but procreate instead while the capitalists do save then we have somewhat different expressions of self-interest. The coincidence of wants, which is what

⁵In legal terms this will be the problem of inheritance which I'd rather leave out.

natural liberty is all about, has different dimensions if the wants (or drives) are not the same.

There is, in my view, a profound a-symmetry between the labourers and the capitalists for both reasons of the status of motivations and effects on the model. The common denominator of what motivates the capitalists and the labourers is the desire to 'better their condition'. Some would argue that here it is where the definition of self-interest starts and ends. I thoroughly disagree. As we said earlier there is a significant moral difference between the different expressions of prudence. One can wish to better his condition within a general context of society and thus be 'perfectly prudent'⁶. One can care for himself so much that the only reason why he may consider the others' position is because he worries about his reputation. And, of course, one can desire to better one's condition at the expense of the others. Therefore, to say that all characters in the WN are motivated by the desire to better their condition is not very meaningful.

If we look at the capitalists we shall find that Smith's description of their behaviour is dominated by words like 'parsimony' and 'frugality' [WN IIIi] which are the same words he used in the TMS to define prudence. He describes the two principles which dominate the capitalists in the following way: "the principle, which prompts to expense, is the passion for present enjoyment; which.....is in general only momentary and occasional. But the principle which

⁶The three categories of prudence are discussed in chapter 3 above. Perfect prudence is when one pursues his own affairs with greater attention to the position of others.

prompts to save, is the desire of bettering our condition.." [WN p.341]. Though it seems as if the capitalist has two kinds of motivation, there is, as a matter of fact, only one. His decision to save is not independent from his decision to consume. Therefore, it is the strength of his rational behaviour in his effort to better his conditions which will eventually determine how much he saves and how much he consumes.

On the labourers' side the problem is much more complex. If we take Smith's assertion that it is savings which is the reflection of the desire to better one's condition then labourers have no such desire as they don't save. We may, of course, be more liberal in our interpretation and say that the decision to save, for the labourers, is the decision to use the wages above their own subsistence to increase their family [WN p.85]. It is as if the choice that labourers confront is the choice between consuming the difference between actual wages and their own subsistence by themselves, or to use it to feed an extended family.

On the face of it, it seems as if under this liberal interpretation of labourers motivations we have similar kind of motivations from the two social classes. The labourers want to better their condition by using any surplus to procreate (and thus increase the production potential of the system). The capitalists too want to improve their condition by using the surplus to enhance the potential of the economy. However no one can fail to see the immediate difference here. What ever the labourers do they do not alter their personal predicament. The capitalist can at the same time improve his own

consumption together with savings. Indeed it is the expectation for a better future in terms of consumption which is what 'bettering one's condition' is all about. This is certainly not the case of the labourers.

An alternative view of motivation in Smith's model can focus on the division of labour. More than anything it is the division of labour which is the tool of improvement⁷. Now both capitalists and labourers affect the division of labour. When Smith describes it he writes about it in terms of the ingenuity of labourers. However, this ingenuity is fuelled by the accumulation of capital. Therefore, the division of labour depends on the behaviour of labourers and capitalists. Can we say now that the effect of each of these groups on the division of labour is a reflection of the same kind of motivation? The answer is not.

The capitalists decide to accumulate according to a rational desire to improve their conditions. They will affect the division of labour by that decision. The labourers, on the other hand, cannot be thought of as making rational decisions about the division of labour. The productivity of labour may be a result of having more capital (in which case it is independent of the labourers decision)

⁷Like in his TMS, the 'Newtonian Method' of discourse is present in his WN. The main principle of the theory, the principle "by which we explain the several rules or phenomena, connecting one with the other in a natural order" is laid down in the first chapter[LRBL p.139].(It is also discussed in EPS-HA p.45 as well as in Campbell (1971) p.31). The apparent principle behind the :".improvement,in the productive powers of labour,and the order, according to which its produce is naturally distributed among the different ranks and conditions of men in the society"[WN p.11], is the Division of Labour. Behind it lies the human propensity to truck barter and exchange. Thus we can always say that the effect of any group's position on the general situation depend on its relations to the division of labour.

but it might too be a result of labourers' own dexterity. While the former is an improvement in productivity which entirely due to the capitalists rational decision making, the latter can hardly be described as a rational behaviour.

Smith himself was not quite sure about whether the division of labour was a result of calculated pursuit of self-interest or just an instinct of human nature. " The division of labour, from which so many advantages are derived, is not originally the effect of any human wisdom, which foresees and intends that general opulence to which it gives occasion. It is the necessary, though very slow and gradual consequence of a certain propensity in human nature which has in view no such extensive utility; the propensity to truck, barter, and exchange one thing for another".[WN p.25].

All the above means one major thing; that what motivates the capitalists is a different thing from that which motivates the labourers. Therefore, the interactions between labourers and capitalists cannot be thought of as the exchange among equals. Though it is very difficult to characterize what it is that motivates labourers one can argue that it is a much less a calculated self-interested motive than that of the capitalists. One can argue one of two: either that the improvement in the labourers' own circumstances is perceived by them in terms of family size and therefore, though not directed to the capitalists, it is a benevolent sentiment. Or, that it is much less a rational drive; almost an animal kind of survival instinct. Therefore words like prudence will not be very appropriate to describe their behaviour.

Either way there can be little doubt that the key to the moral assessment of the system is the beneficence of labourers. If their behaviour reflects benevolence then the key issue will be how the self-interested actions of the capitalists are affected by the labourers' benevolence. The desired distribution will require that the capitalists reward the labourers for it.

If, on the other hand, labourers' actions are merely instincts, it means that we cannot really think of the labourers as acting because the sentiment which motivates them is an instinct with which there is no question of finding 'sympathy'. Their behaviour therefore, is to a great extent part of the system itself. Thus the only kind of rational interaction takes place among the capitalists themselves. The labourers are at all times being acted upon and their beneficence, therefore, is the only key to the moral evaluation of the economic system.

(ii) The Modelling Implications.

At the beginning of this chapter I said that the question of symmetry has two dimensions. One is the moral dimension where we examined whether we can determine who acts and who is being acted upon by analyzing the nature of what motives the different classes. The other dimension is whether there is symmetry in the role and effects of each class activities regardless of their nature.

In any economic model we may find symmetry or a-symmetry in the role and effects of various agents' behaviour. This, of course, does not mean that the psychological foundations of these behaviours are symmetrical or a-symmetrical too. But there is a reason why I find it important to contrast the view about the a-symmetry in the psychological foundations with the symmetry in the role and effects of these behaviours that usually prevails in the modelling of classical economics. This is that the idea of natural liberty, which is partly what these models are trying to capture, does depend on the symmetry or a-symmetry of the psychological foundations⁸.

The efficiency of natural liberty also means the coincidence of wants. If there is a-symmetry in the psychological foundations we may find ourselves describing a system where the wants of one group are fulfilled because it can manipulate the needs of the other. This, of course, does not mean that the other groups may not have wants which are different from their needs. In such a case, the coincidence of wants will be deceptive. It will only be the wants of the one groups which are consistent with the needs of the other one but no more than that.

For the purpose of moral investigation this is indeed very crucial. If we have a system where some people act out of choice and some out of necessity we cannot say that those who act out of choice were in

⁸Apart from this there is also the moral aspect of an action. Recall that there is a significant difference between the morally desired distribution when wants and roles are symmetric and when they are not. If people with similar intentions create different benefits to others according to their position in the model, the distribution of rewards should be different than in the case where all affect each other in the same fashion.

any way been acted upon. Similarly, we cannot say that those who act out of need have acted in a way which put their action on the same moral footing as those who have acted out of choice.

Now if we say that in Smith capitalists and labourers act for the same reasons then we are saying that both of them act and are being acted upon in a similar way. Natural liberty, in such a case, will be the coincidence of their wants and any model which captures the balance of these wants as the determinant of its equilibrium is loyal to the spirit of Smith's writings. To analyze the moral significance of such natural liberty we will have to resort to the kind of legal arrangements of the previous chapter; i.e. to determine who acts and who is being acted upon according to who owns the final product.

On the other hand, if we say that the capitalists act rationally and out of self-interest while the labourers act on their needs (through their instincts) we cannot say that both of them act and are being acted upon in the same way. Clearly it is the capitalists who act (according to our definition of action) and the labourers are being acted upon. The labourers desperate need to survive is part of nature upon which the capitalists act, it is part of the system. To capture, then, the coincidence of wants is to ask whether the wants of all capitalists among themselves coincide. And not to ask whether their collective wants coincide with the collective need of individuals.

As I will show now the focus of most formal expositions of classical economics is on the coincidence of wants between the capitalists as

a collective and the labourers as a collective. To that extent, I believe that these models do not suit Smith's work. There are other reasons for that but I will come back to them later.

Let us now examine more carefully what is meant by a-symmetry and the imbalance of motivations and effects between labourers and capitalists. For that purpose we will consider two trivial examples which, I believe, capture the major attitudes towards modelling classical economics. Of course I do not wish to imply by this that one can attribute one, or two, kinds of a model to all classical economists. I do, however, believe that there is a workable distinction between the different approaches to classical economic analysis. One approach is more neo-classical in character and it usually takes the form of growth models with diminishing marginal productivity of land⁹. The focus of analysis of these types of models are the relative shares and their development over time. Once a multi sector analysis is being introduced, everything becomes so complex to a degree, sometimes, of indeterminacy¹⁰.

⁹Not surprisingly this approach is much more prevalent with respect to Ricardo (and Malthus) than it is in connection with Smith or Mill. See, for instance, Kaldor(1956) Blaug (1958 & 1978), Pasinetti (1960 & 1981), Caravale and Tosato (1980), and Casarosa (1985). A more general use of this approach to classical economics can be found in Eltis (1984). There are, of course, those who believe that what is true to Ricardo is true to Adam Smith (for instance, Hollander (1979) and by implication Hicks and Hollander (1977) who deal with Ricardo's growth model should be relevant to Smith too. Samuelson (1977 & 1978) is another example of someone who believes that modelling classical economics can be generalized in terms of Ricardo's Corn Model. Reid (1987) explores the fallacy behind Samuelson's vindication of Smith through the use of a kind of Ricardian Corn model.

¹⁰Also, the importance of the theory of value in such a context is not very clear. Kaldor (1956) and Pasinetti (1960) are quite explicit about the separation of the theory of value from that of distribution. Morishima (1989), on the other hand, is trying to combine the Sraffian approach (discussed below) with the theory of growth.

The other kind of approach is a more Sraffian one in the sense that the focus of analysis are the price equilibrium conditions which need to be satisfied continuously. In other words, in the centre of attention are the inter-sectoral relationship and their expression in the problem of value. A solution to this problem also means the determination of the rate of growth through the determination of the rate of profits¹¹.

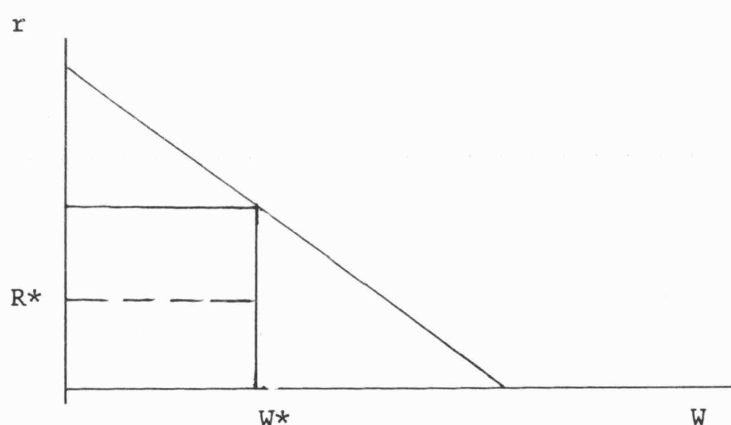
The role of human nature in many interpretations of Smith's economic system has, to some extent, been degenerated. From the complex character which is comprised of a propensity to exchange, a drive to better its own condition and a blend of 'own-regard' - 'other regard' dispositions, the human character has been reduced by many to a simple 'utility/profit maximizer'. As such, its main role is in shifting capital from a less profitable to a more profitable employments and to drive prices to their natural rates.

In the context of a 'cost of production' theory which focuses on the inter-sectoral relationship the pursuit of self-interest on the part of the two groups is as follows: the capitalists affect the model by their decisions on how much of their surplus to consume immediately; the labourers, whose wages depend on that decision, affect the model by either keeping wages at their subsistence level (through procreation) or, through the division of labour in as much as it is subject to their rational (or conscious) choice.

¹¹See, for instance, Morishima (1989) Roncaglia (1978), Sraffa (1960), Steedman (1977) and, to a limited extent, Walsh and Gram (1980).

In a multi sector model the effects of such improvements in the productivity of labour may not be of great significance anyway. The determinants of the rate of profits are a complicated mixture between all the technological components. And though the rise in the number of workers might mean more profits, it depends on the relationship between the changes in total output and the changes in the rate of profit¹².

If we look at the inverse relationship between wages and the rate of profits we can clarify this point.



W^* is the subsistence level of wages. The 'cost of production' model solves the relative prices and the profit rate for any level of W . Now as wages depend in Smith's analysis on demand and supply one can argue that what determines the level of wages (and thus the rest of the relevant variables¹³) is the self-interest of the capitalists

¹²Notice that I do not refer here to profits as a function of wages (which we assume at their subsistence level). Rather we are asking whether we can establish a clear effect of division of labour as such on profits.

¹³Including growth which is closely associated with the rate of profit.

(who form the demand) and that of the labourers. Hence, natural liberty is the coincidence of these symmetrical wants. But there is an additional aspect to the theory of wages and that is that labourers will tend to increase their numbers and thus drive wages to their subsistence level (or their natural rate as is commonly believed).

This makes the symmetry even more clear. The decisions of the capitalists do not affect wages but the number of labourers. Thus, if the rational want of labourers is to increase their numbers the capitalists bring about a successful implementation of the labourers own desires. Similarly, as the labourers increase in numbers and wages remain at subsistence levels, the rate of profit may be unchanged [$r(W^*)$] but total profits will rise. Thus, the pursuit of the labourers' own interest brings about the successful implementation of the capitalists' own interests.

Even if the division of labour is a decision variable of the labourers then the symmetry remains. By the improvements in their productivity the wages-rate-of-profits frontier will move outwards. Hence, though the labourers still earn their subsistence wages the rate of profits as well as total profits will go up. This means the number of labourers will rise (which is the successful implementation of their desires) and the capitalists too will feel satisfaction.

But this cannot last forever. A kind of traditional explanation for

the shift towards (W^*, R^*) ¹⁴ is the one that deals with the rise in subsistence wages as the price of food goes up and we move towards less fertile land. This, however, depends on whether W are nominal or real wages. If I assume them to be in real term¹⁵ the frontier will not move in a specific direction as a result of a fall in productivity of land affects the productivity of labour. But labour inputs vary among the various commodities. What matters here is the relative changes rather than the absolute ones. If, however, we follow Morishima's (1989) argument then the effect of less fertile land means a total change in the system which can then generate the inward shift of the wages-rate-of-profit frontier. I am, nevertheless, sceptical about the applicability of such Ricardian arguments to Smith's economic analysis.

Therefore, the 'cost of production' approach assumes symmetry in the role and significance of both classes. This symmetry prevails in the labour market where what drives the demand for labour is the same thing which drives its supply. Everything depend on it and there is nothing in the pursuit of self-interest of the one group that dominates the other. What drives wages to their natural rate is the self-interest of the labourers and what drives the capitalists earning to their natural rate (if anything) are the exogenous conditions of land productivity together with the capitalists' own self-interest.

¹⁴*denotes subsistence levels. There is, of course, no such necessity in Smith as there is in Ricardo. I will discuss it below.

¹⁵If wages are not taken in their real term the inverse relationship between profit and wages is not always secured. See my discussion in part 3 chapter 2.

In view of what I said before about the lack of symmetry, in Smith, between what drives the capitalists and the labourers I find this kind of exposition as deceptive. It does not capture the specific nature of class relationships and therefore, the idea of what natural liberty means is misleading. If we do believe that class relationships are important to the understanding of both the normative and positive side of classical economics, then such expositions are not very helpful. When the two classes (capitalists and labourers) have symmetrical positions in the sense that they are driven by the same psychological principles and that their actions have similar weight in the model, the efficiency of natural liberty is in the balancing act between the two classes. In other words, it is all in the relationship between wages and profit.

If, however, the positions of the two classes are not symmetrical then the focus of analysis (positive and normative) should shift from the coincidence of wants across classes to the coincidence of wants within the decisive class. In such a case a non cost of production theory of value will become the focus of analysis. Apparently the other major approach to classical economics --the growth models approach-- suffers from a similar problem: it too entails a symmetry between labourers and capitalists.

Let us follow a simplified version of a one-sector type of a Ricardian Corn model¹⁶. Y, say Corn, is produced according to the following production function:

¹⁶I follow here Casarosa 1985.

$$Y = f(L)$$

where L is the number of labourers. $f'(L) > 0$, $f''(L) < 0$.

The maximum wages that capitalists are willing to pay are:

$$w = f'(L) / (1+r^*)$$

where r^* is the subsistence rate of profit¹⁷.

It means that the 'marginal product of labour' "is not...equal to wages, but to the sum of wages and profits..."(Kaldor, 1956.p.84). It is so, presumably, because of Ricardo's differential rent. Namely, as we employ more labour we have a fall in their productivity (because of less fertile lands). The difference between the output in both types of land is the rent. It is, nevertheless, not very accurate unless we believe that every increase in the number of labourers corresponds to a move to a less fertile land. I am not very convinced about it. Morishima (1989) rightly criticizes the association of differential rent with the marginal productivity of an aggregated production function.

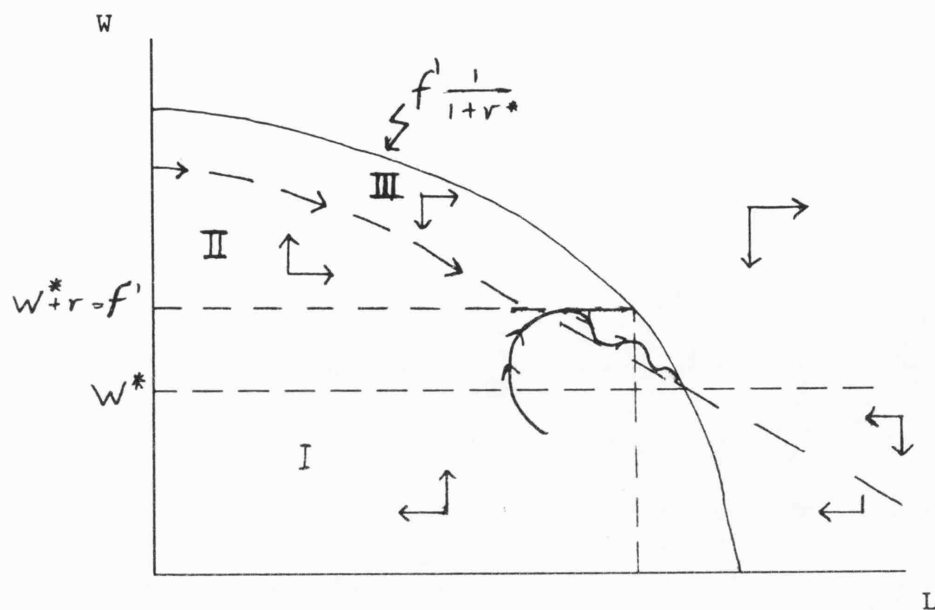
Anyway, if indeed marginal product is the sum of wages and profits then the actual rate of profit will be:

$$r = [f'(L) - w] / w$$

where w are the actual wages.

The following graph depicts the relationship between wages and Labourers.

¹⁷Obviously the subsistence rate of profit should itself be a function of output -a point that is ignored by many writers- but I feel that for the purpose of what I have to say it will not be of great significance.



Notice that what appears as the Marginal Product curve is not really that but the marginal product multiplied by a constant $[1/(1+r^*)]$. Therefore, its slope reflects the marginal product of labour but, and this is important, its position depends on what capitalists consider their minimum rate of profit to be (r^*) . In other words, unlike subsistence level of wages it is not very clear what it is that will drive profits to their subsistence level. If a standard of living emerges among the capitalists it is not inconceivable that they will stop accumulating at a level of profit which is above their subsistence¹⁸.

Assume now that:

¹⁸It is true that one can argue that what determines the subsistence level of wages is also a wider concept than physiological existence. In such a case the position of the labourers and the capitalists might become symmetrical as it implies that labourers choose and therefore, save in order to improve their conditions. However, this is not what appears to be implied by Smith. Subsistence here should be read from an absolute-biological approach. And even if we consider subsistence as a socially defined principle it will still be different from what the capitalists will consider as their 'subsistence' profit by virtue of the different segments of society against which the 'standards' are being determined.

$$\dot{L}/L = G[(w-w^*)/w^*]$$

where w and w^* are wages and subsistence wages respectively. Also:

$$\dot{K}/K = F(r-r^*) \quad \text{where} \quad r = [f'(L) - w]/w$$

where K is capital stock, r and r^* are the actual and 'subsistence' rates of profit. By assuming that $W=wL$ and $K=W$ we get the following equation to describe the equilibrium path:

$$\dot{w}/w = \dot{K}/K - \dot{L}/L = F(r-r^*) - G[(w-w^*)/w^*]$$

In area I in the above graph capital accumulation is positive and labourers numbers fall; hence there is a rise in wages. In area II both capital is being accumulated and labourers' number increases. However, whether this mean a rise, a fall or unchanged wage level depend on the levels of capital accumulation and of population growth (namely $F(.) \diamond G(.)$).

The level of w depends on the size of the propulation. The rate of change depends on the rate of growth. For any size of population there will be a wage level for which the situation will be stationary (until the size of population and capital changes). This is depictes along the dashed line. In areas II and III both capital is being accumulated and population rises. However, in area II $\dot{K}/K > \dot{L}/L$ which means that $\dot{w}/w > 0$ while in area III $\dot{K}/K < \dot{L}/L$ which means that $\dot{w}/w < 0$.

To depict the equilibrium path in the space of w and L we simply need to take a closer look at the equilibrium conditions. Clearly the dynamic equilibrium condition is going to be:

$$\dot{w}/w = \dot{K}/K - \dot{L}/L = F(r-r^*) - G[(w-w^*)/w^*] = 0$$

For any level of L it will give us the wage level for which capital

We can denote this wage level as w^* . By differentiating and solving the above condition we can get that:

$$dw^*/dL = 0^{19}$$

which explains the slope of the dashed line²⁰.

Now, the symmetry between labourers and capitalists prevails in their respective ability to manipulate (as a group) the final stationary point S. The capitalists determine r^* which positions the Marginal Product curve in the L,w space. The labourers affect the position of S by determining the level of w^* . If r^* and w^* were both a matter of some kind of rational considerations then the model would have captured correctly the class relationships and its effect on the determination of economic (and social) variables.

However, it does not seem plausible that the reproduction considerations of a group which does not save and does not think much

¹⁹The condition in full is:

$$F[(f'(L)-w)/w-r^*]-G[(w-w^*)/w^*]=0$$

Differentiating:

$$dw\left[\frac{\partial F}{\partial r}\frac{\partial r}{\partial w}-\frac{\partial G}{\partial w}\frac{1}{w^*}\right]+dL\left[\frac{\partial F}{\partial r}\frac{\partial r}{\partial L}-\frac{\partial G}{\partial w}\frac{\partial w}{\partial L}\right]=0$$

Clearly $\frac{\partial F}{\partial r} > 0$; $\frac{\partial G}{\partial w} > 0$

Also:

$$\frac{\partial r}{\partial w} = \frac{-w^2 - (f' - w)}{w^2} < 0 ; \quad \frac{\partial r}{\partial L} = \frac{[f'' - \frac{\partial w}{\partial L}]w - \frac{\partial w}{\partial L}[f' - w]}{w^2} = 0$$

Where $\frac{\partial w}{\partial L} = f''(1+r^*)^{-1} < 0$ ($f'' < 0$)

²⁰It should be noticed, however, that this is not a stable path. Whenever we reach a point on the dashed line wage level is unchanged but the population increases in numbers (the rate of growth of population is positive and equals to the rate of capital accumulation). Hence, as the labourers number increase, wages will fall. The heavy line depicts these circumstances. I do not go further into the details of the stability problem as it is not my major concern. I am interested mainly in the point S to which we will converge anyway.

in terms of 'improving their conditions' can be thought of as 'rational considerations'. On the other hand, it is almost inevitable that the decision on r^* (when to stop accumulating) which is made by individuals who are constantly thinking of how to 'improve their conditions' (and that is why they save) will be a rational one.

Thus although the psychological foundations of the decisions made by the capitalists is significantly different from those of the labourers, each of the group exerts the same power in the determination of the model. As a result, natural liberty here means that the economy will move towards a point like S in the above diagram. But such a point is where coincidence of wants is being reduced to where nobody achieves more than mere existence. Although it does fit into one of Smith's descriptions (the famous 'dull' state) it fails to describe the others as well as it has serious moral implications. Because of the symmetry between the two groups, the responsibility for the 'dull' state lies equally with both groups. This is not a very logical result given what we have said already about the a-symmetry that is implied by Smith's analysis.

So we saw that in both the 'cost of production' and the 'growth models' approaches there is a fundamental symmetry in the role and effects of the behaviour of capitalists and labourers. This, naturally, does not mean that these models are wrong. As I said before we may have symmetry in role and effect in spite of an a-symmetry in the psychological foundations. What is however clear is that the idea of natural liberty as a harmonizing mechanism of wants has been trivialized. Instead of harmony of wants we only see

how the rational wants of the capitalists can manipulate the system given the needs of the labourers²¹.

Therefore, these two approaches do not capture, in my view, the real problem of coincidence of wants. Given the a-symmetry between capitalists and labourers, the coincidence of wants can only be tested if it prevails among the capitalists themselves rather than between them, collectively, and the labourers.

The question of coincidence of wants among the capitalists has a distinct economic significance. As the difference among capitalists reflects the difference among sectors, the coincidence of their wants means that the focus of analysis should be the inter-sectoral relationship.

Indeed, it is this problem which cause so much difficulties in the efforts to model Smith's work. We saw already that a Sraffian 'cost of production' approach does capture the inter-sectoral balance but it does so on the assumption of symmetry in wants. The collective treatment of capitalists and labourers meant that the coincidence of wants appeared in the labour market where wages were determined. These, in turn, determined a single rate of profit and thus, a single rate of growth. It is this assumption which does not suit Smith's

²¹One may argue here that in the growth example it is the capitalists who are being manipulated to a subsistence level of profits at the stationary state. However, while this may be true to the Ricardian model it is less evident in Smith. As population grows and capital accumulate there is a rise in productivity which, in terms of the above model, means that the MP function will shift outward. Indeed this is one of the technical reason why I do not wish to use these kind of models.

discussion of economics.

To capture the idea of the 'invisible hand' in Smith's analysis we have to focus on those actions which are matters of choice. Only the capitalists makes such choices; the activity of labourers is given. Therefore, we need to analyze what are the conditions under which the decisions about savings and consumption among the capitalists coincide. Obviously as there is division of labour for a capitalist, who owns the surplus of a particular commodity, to be able to employ the capital he intended to save, he will need to exchange some of it to get what is required for production from the other capitalists. Hence, the coincidence of wants among the capitalists already imposes a particular price system. Only when all these decisions are compatible will the capitalist proceed to buy the required labour. Hence what happens to labour is a simple result of the agreement of wants among the capitalists.

Allow me now to move forward and deal with the choice of model and its exposition in a more detailed way.

(b)The Theory of Value and Distribution Revisited

So far I have put forward an argument about modelling Smith's work which is based on the idea that the model should capture the essence of natural liberty. Given the a-symmetry in what motivates the labourers and the capitalists, natural liberty is being trivialized if what it means is the coincidence of wants on the part of capitalists and labourers taken collectively. Therefore, if one of Smith's major contribution is to be his conception of the working of natural liberty we cannot accept such trivial exposition as being true to his work. Consequently, the focus of attention should be the non-trivial coincidence of wants which only makes sense if it deals with wants among those who have (or can afford to have) calculated ends.

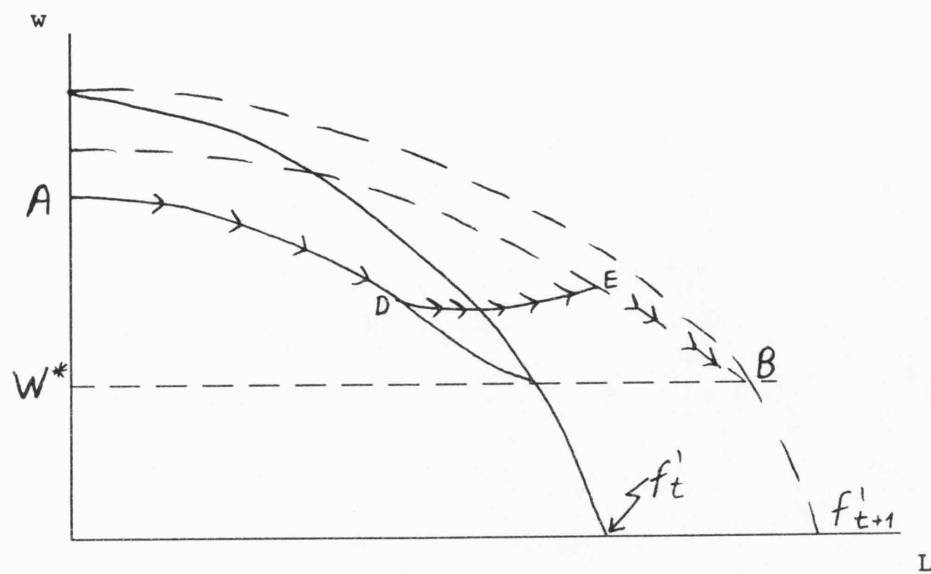
Apart from that argument which is more concerned with the moral evaluation of Smith's economic systems there are two other major points which convinced me that the two types of approach mentioned in the previous section would not fit to describe Smith's economic system. It is division of labour and inter-sectoral relations which sometime take the form of different growth rates in different sectors.

The Wealth of Nations is a vast book. It covers a huge range of subjects, some of which have completely dropped out from the agenda of economic theory. It seems, therefore, as if the general approach to Smith's analysis is more selective. Namely, different parts of his analysis are being presented, separately, while the interrelation between these parts is neglected.

Most, I believe, will argue that he offered mainly a theory of capital accumulation and growth. Inevitably they will concentrate on aggregated growth type model of the kind discussed above¹. A few would maintain that Smith's major contribution to classical economics is his 'cost of production' (or adding-up as Sraffa calls it) theory of value. Others will insist that he had proved the superiority of the coincidence of wants over central planning, or, that he originated the labour theory of value, etc..

Each of the two types of models that I have mentioned above runs into difficulty if we consider Smith's division of labour and multi-sectoral analysis. The growth type of models have both these difficulties. Allow me now to reproduce the diagram of the growth model I have used in the previous section but while assuming that this time the 'marginal productivity' curve is true to its name (i.e. with no particular reference to the subsistence rate of profit):

¹See these models in connection with Smith in, Adelman (1961), Higgins (1959), Barkai (1969), Eltis (1975 &1984), Samuelson (1977 &1978).



Most of the growth models by the authors mentioned above apply to Smith a kind of a Ricardian Corn model. There are, obviously, two major difficulties. One, that it is an aggregated model which does not capture the idea of inter-sectoral relationship². And secondly, the role of diminishing return is dominant and the division of labour is conspicuously absent.

Let me start with the second problem. Reid (1987) criticizes Samuelson (1977) which presented a similar kind of exposition of the Smithian model. Reid's general argument is that we should accept the exogenous limitations that land fertility imposes on us but that the marginal productivity of labour is also a function of its division. Hence, as we accumulate and consequently population grows, the position of the marginal product curve should move outwards. In the above diagram it means that the marginal product curve is a function of capital accumulation.

²See a discussion in Reid (1987) and in Walsh and Gram (1980).

To defend the diminishing return caused by land Reid quotes Smith. "In a country which had acquired that full completeness of riches which the nature of its soil and climate, and its situation with respect to other countries allowed it to acquire....both the wages of labour and the profits of stock would probably be very low.." [WN p.111]. But this, in my view, is nowhere near to suggest the assumption of a continuously falling marginal product of labour which dominates the economic analysis. The reason why this country will not advance is because population will not rise and thus further division of labour will not be possible: "that country being already fully peopled, that number [of labourers] could never be augmented". Moreover, the first line after the paragraph that was quoted by Reid says: "But perhaps no country has ever yet arrived at this degree of opulence". Which means that as far as the relevant analysis is concerned we should not take any notice of a possible situation where the country is full.

But even if we agree to the idea that the economy works within effective boundaries of diminishing returns can the dynamic development of the model capture Smith's main conclusions?. According to Smith, whenever there is accumulation labour, wages will rise. Hence the equilibrium path depicted in the above diagram (AB)³ is inconsistent with Smith's analysis though it is, perhaps, consistent with the 'fixed wages' assumption that is attributed to Ricardo. Even

³The line AB is a movement along the equilibrium paths discussed in the previous section. For each Marginal Product curve there is a downward sloping curve which depicts the relationship between w and L when the rate of accumulation is equal to the rate of population growth. As the Marginal Product curves shift outward, so do the equilibrium paths. The arrowed dashed line ADEB is describing the movement from one such path to another.

if we follow Reid and we push the marginal product line outwards as we go along, the 'cheerful' stage will indeed prevail (DE). But who said that the order of development is the following: a 'dull' phase, a 'cheerful' phase and again, a 'dull' phase?

Reid is also trying to deal with the problems of sectoral analysis, division of labour and growth theory in the context of Young (1928)-Kaldor (1972). As these models use utility for social choice I will not discuss them here. In spite of Reid's effort to justify his use of these models on the ground that Hollander (1973. ch.4) has convinced him that there are questions of choice in Smith's analysis, I believe that he has gone too far even in neo-classical terms. Of course there are questions of choice in Smith's analysis and Hollander was right to point them out. However, it does not follow that individual choice can so easily be aggregated to a social choice. Not even in Smith.

On the whole, when the growth models try to deal with more than one sector they run into serious difficulties. In Pasinetti's analysis (1960), for instance, the conclusions are that the shares of rent, wages and profits in the total income change as capital is being accumulated according to the relative share of employment in the two sectors. Obviously there is no particular reason to expect the relative share of employment in the two industries to develop in a particular way⁴.

⁴See discussions of these problems in the context of Ricardo's model in Pasinetti (1960) and in Caravale and Tosato (1980. ch.6).

Another reason why I find the above approach as un-suitable for the case of Adam Smith is that the relationship between the theory of value and the theory of growth and capital accumulation is not very clear. According to Pasinetti, "The Ricardian model....contains a theory of value which is completely... independent of distribution."(Pasinetti, 1960. pp.84-5). How true a statement it is is difficult to assert and it certainly is not in the scope of this work. Nevertheless, it is sufficient that such a statement can be made in a somewhat convincing manner to make one wonder whether such a model can suit Smith's analysis.

This point brings us to the other approach where the theory of value is the focus of analysis and where growth and accumulation are derived from the equilibrium circumstances. However, the technical solvability of such models depends on the existence of a uniform rate of profit. This implies a single rate of growth which, as it were, contradicts an almost convention with regard to Adam Smith. Namely, that the rate of growth in the different sectors may be different. Indeed, Walsh and Gram (1980) who, in general, follow this line of Sraffian interpretation, have abandoned the analysis of Smith for precisely this reason.

Although Smith discussed the tendency of rates of profit to uniformity it is (a) not very clear what precisely he meant by this and, (b) it rules out general equilibrium in market prices when the rate of profit is not uniform. (I will discuss the issue in more detail below).

What I mean by that is that if equilibrium prevails only when the rates of profits conform to uniformity, most of the time the economy cannot be at general equilibrium. In other words, general equilibrium prevails only at the level of 'natural rates' while at market prices this is not the case. Adding to it the embedded symmetry between the classes and the whole idea of natural liberty in the sense of a continuous coincidence of wants becomes obscured.

For all these reasons I do not find the above approaches to the analysis of Smith very convincing. Mainly, I must admit, because of the implications of the symmetry in the nature and role of what motivates the different groups which is embedded in them.

On the more economic side it is the segregated approach to Smith's theory of value and capital accumulation which is hidden in the above types of models which makes them not suitable to the analysis of Smith. In my analysis I will try to bring together his theory of value and distribution, and his theory of capital accumulation. The decisions that are made by the capitalists about the usages of the surplus they own will obviously affect capital accumulation. But given the interdependence between the sectors, whether they are successful in implementing their plans depend on the coincidence of their wants. This, in turn, must be determined through the market. But while the use of Sraffian models demands a uniform rate of profit, in my approach this will not be necessary. Market clearing will be consistent with different rates of growth. As growth and the beneficence of labourers are closely related a clear relationship between the decisions of the capitalists and the circumstances of the

labourers can be established.

Obviously I mean by this that I adhere to a form of a general equilibrium interpretation of classical economics. The use of a two sectors approach will be helpful as it will lend meaning to the idea of balanced growth (which is an important issue in Smith's analysis). At the same time it will reduce the complexity of the model without ignoring its important features. What I mean by that is that in a multi sector analysis one can acknowledge the existence of division of labour without really dealing with it. It is so when division of labour is a phenomenon across the board. The capital labour ratios do not have to be immediately affected. All this is true, of course, as long as we are not investigating volumes of productions or the likes.

It is my view that general equilibrium (in a particular form) is in the essence of Smith's analysis. Not the least because the nature of beneficence which is mainly associated with the idea of the invisible hand (discussed in the TMS). The whole task of the invisible hand is to be the mechanism by which wants coincides. What determines one variable will flow through the system, affect other variables and consequently will affect the same variable that generated the process. Lord Robbins went even so far as to argue that Smith's system stands "in harmony, with the most refined apparatus of the modern School of Lausanne"(Robbins 1935. pp68-9)⁵.

⁵A similar approach can be found in Hollander (1973) p.20 and Walsh and Gram (1980) p.62.


It is true that the first book, where he originally developed his theory of value and distribution, is mainly described in a partial equilibrium framework of analysis. However, even when analyzing prices in that partial equilibrium framework, the prices themselves seem to withhold a more general significance.: "...so that [the price] of all commodities which compose the whole annual produce of the labour of every country, taken complexly, must resolve itself into the same three parts, and be parcelled out among different inhabitants of the country, either as the wages of their labour, the profits of their stock, or the rent of their land"[WN p.69].

Moreover, it is mainly book 1 that really points at a partial equilibrium analysis, the others are less well defined in that respect. However, one should bear in mind that it is the first book that holds most of Smith's early writings (before his visit to France). It is hard to tell how much of an effort he had exerted to update this book but, even simple things like the distinction between 'stock' in general and 'capital' in particular, seem to be confused there. Therefore, at least from the point of view of the framework of analysis, we must not be too influenced by the fact that his famous price mechanism of this book is described in partial equilibrium terms.

There are quite a few scholars who believe that classical economics should be analyzed in the framework of general equilibrium. Hollander (1973 and 1987), Walsh and Gram (1980) and Morishima (1989) are a few examples. However, one must be very careful with what one means by 'general equilibrium'. I wish to point out now that my interpretation

of the 'classical general equilibrium' differs significantly from modern notions of it. I believe that the other scholars' formulations imply too that they employ a different concept of general equilibrium though I am not quite sure whether they would accept my assertion. However, I do not want to digress right now. A full discussion of the meaning and moral implications of the different conceptions of general equilibrium appears below (part III chapter 2).

One last point before we carry on. Some might argue that the proper way of constructing a model for classical economists is by satisfying their major propositions. Namely, the test of the model is in how it supports the explicit propositions that were made by those scholars. I do not agree with this approach. A scholar might have contributed to the understanding of the subject matter through observations which might not be consistent with the conclusions that he draws from it. To argue, then, that a proper model for Smith is only the one that upholds his propositions is, in my view, too narrow minded and not very instructive. Though at one stage I criticized the growth models for a similar reason (their conclusions with respect to the 'dull' and 'cheerful' stages) this was by no means my main reason to reject them. On the contrary, I rejected them because in my view they do not capture the essence of Smith's perception of natural liberty. Because they are too busy in trying to reconstruct his conclusions rather than to concentrate on his assumptions.



(c) The Model

Let us turn now to my description of Smith's economic model. The model I intend to suggest is one that is based on Smith's observation that the heart of the economic system is the creation of surplus, and its exchange.

This assertion is very simply derived from the meaning of the division of labour, which is the consequence of the propensity to barter and exchange. "When the division of labour has been thoroughly established, it is but a very small part of man's wants which the produce of his own labour can supply. He supplies the far greater part of them by exchanging that surplus part of the produce of his own labour, which is over and above his own consumption, for such parts of the produce of other men's labour as he has occasion for [WN p.37].

So, the exchange is made in terms of surplus and not of the whole product of the country. Even though in the commercial state of society the self-consumption (that part of our own product that we consume) becomes very small, we still exchange only surplus, namely, the output that is above what we need from our own product, for reproduction. Some will argue that it is this observation that

distinguishes classical economics from the resources allocation neo-classical paradigm but I will refrain from this argument in this work¹.

So, the main characteristics of my model are that it is a two sectors model where commodities are produced by means of other commodities², that it is a general equilibrium framework, and, that it is a surplus approach. As I said before I will drop rents from my analysis and also, I will ignore that which Smith called fixed capital. This is a real model and therefore prices will be measured in terms of other commodities."Every commodity besides, is more frequently exchanged for, and thereby compared with, other commodities than labour. It is more natural, therefore, to estimate the exchangeable value by the quantity of some other commodity than by that of the labour which it can purchase"[WN p.49].

Thus we are to construct an economy in which surpluses are exchanged and prices are measured in real terms. From the technological side we may follow the tradition of fixed proportions production process. It is, however, important to note that the degree of the division of labour, which actually gives us the technological coefficients, depends not only on the extend of the market but also, and more importantly, on the accumulation of capital. Hence, if we are to say

¹an elaborated discussion of it can be found in Walsh & Gram (1980) pp.304-7.

²Some may find this Sraffian characteristic as not typical of classical economics. I agree that it might not have been characteristic to Ricardo but it certainly has been typical of Smith. I refer the reader to Smith's beautiful discussion of town and country relationship in Book 3 chapter 1. Although the key issue here is balanced growth the reasons for it are precisely the interdependence of the two sectors on one another.

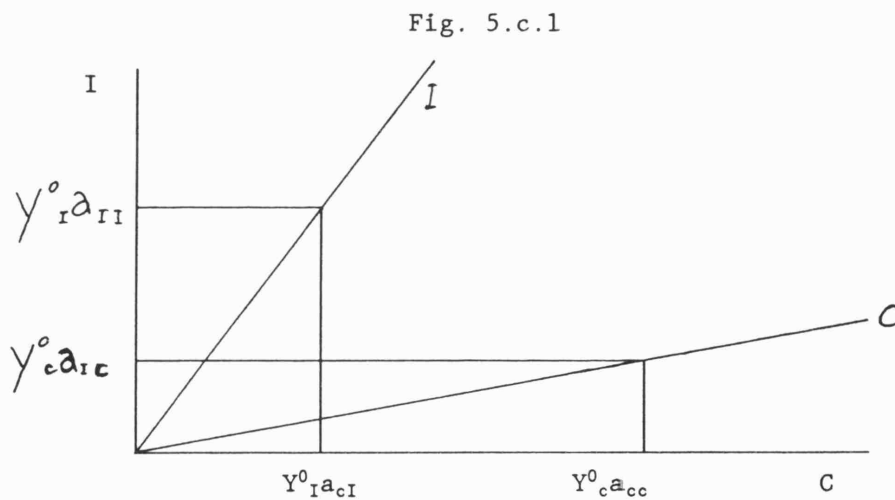
anything in the long run we must incorporate this feature of Smith's economy. However, the two sectors model will enable us to say something about the long run without incorporating an explicit relationship between capital accumulation and the technological coefficients. Quite a lot will depend on the relative dependence of each sector on the other, and this, in turn, does not have to change even when a greater division of labour affects the technological coefficients.

Let there be a two sector closed economy where C, corn, represents the agricultural sector and I, (iron) represents Industry. A is the technology matrix as follows:

$$A = \begin{pmatrix} a_{cc} & a_{cI} \\ a_{Ic} & a_{II} \end{pmatrix}$$

A is productive. (that is, there is a vector X^* , $X^* > 0$, so that $AX^* < X^*$).

Figure 5.c.1 depicts the technology in the plane of the different levels of input.



Where Y^0_c and Y^0_I are the total (gross) production of each of the sector.

The C and I rays depicts the level of input required for each level of gross production. Hence to produce Y_c^0 of C we need $Y_c^0 a_{cc}$ units of C and $Y_c^0 a_{Ic}$ units of I. In Smith's terminology, $Y_c^0 a_{cc}$ and $Y_c^0 a_{Ic}$ may be considered as the circulating capital of C. a_{cc} represents the amount of corn (or agricultural product as a whole) needed for the production of one unit of corn. This amount consists of the 'material'; namely the amount of seeds needed for the production of one unit, as well as the amount of corn needed for the subsistence of the amount of labour required to turn the seeds into a unit output. In the same manner we can generalize with regard to all the coefficients. Iron here does not represent fixed capital but rather a kind of industrial output which is consumed in the process of production of both Iron and Corn. This is indeed the way Smith regarded circulating capital: "The circulating capital consist in this manner, of the provisions, materials, and finished work of all kinds"[WN(c) p.266].

The circulating capital is in fact part of the total stock from which the capitalist will provide material and subsistence for his workers during the period of production. Surely he will provide for himself as well as for his workers during the same period. We may regard that part of his consumption which is at the level of his own subsistence, as part of that circulating capital which is represented by a_{cc} .

Obviously every choice of inputs that is not depicted by the 'gross production' lines reflects inefficiency. The question, however, is what can we say about the choice of combinations between C and I. As

the two sectors are interdependent, there must be some correlation between what is produced in one and what can be produced in the other.

We may describe this interdependence in the following inequalities:

$$\begin{aligned} Y_c a_{cc} + Y_I a_{cI} &\leq Y_c \\ Y_c a_{Ic} + Y_I a_{II} &\leq Y_I \end{aligned}$$

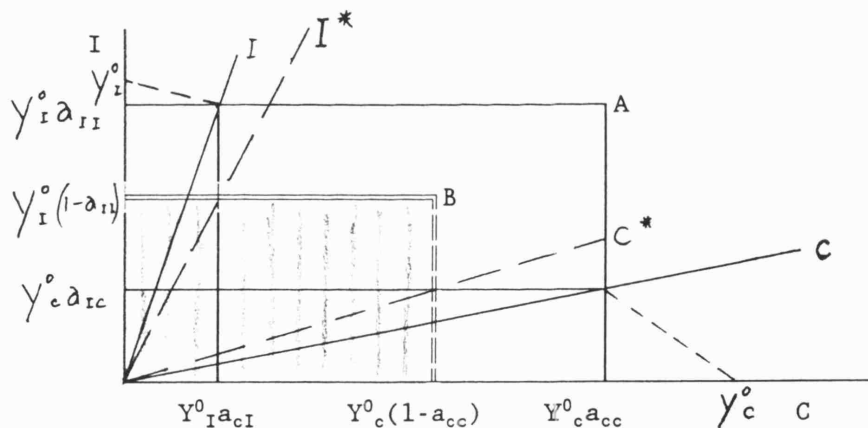
Which also means that:

$$\begin{aligned} Y_I a_{cI} &\leq (1 - a_{cc}) Y_c \\ Y_c a_{Ic} &\leq (1 - a_{II}) Y_I \end{aligned}$$

The meaning of these inequalities is that the amount of one's sector product required by the other sector for reproduction cannot exceed what is left in that sector after what is needed for its own reproduction has been deducted.

The right hand expressions reflect what I shall call the 'own surplus' of the industries. They are depicted in figure 5.c.2 below.

figure 5.c.2



C* and I* are the lines of the 'own surplus'. At point A the two sectors produce Y_i^0 $i=C, I$. We shall measure their relative position

by the input of their own product (the coordinates of A are $Y_c^0 a_{cc}$ and $Y_I^0 a_{II}$).

Point B depicts the 'own surplus' produced in that state. In order to continue and produce the same level of output sector I will need $Y_I^0 a_{cI}$ of C and sector C will need $Y_c^0 a_{Ic}$ of I. From the point of view of the economy as a whole the 'real net' is only what is there above what is needed for the reproduction of both industries. We can denote this 'real net' as:

$$\begin{aligned} NS^c &= Y_c(1 - a_{cc}) - Y_I a_{cI} \\ NS^I &= Y_I(1 - a_{II}) - Y_c a_{Ic} \end{aligned}$$

where NS is the 'net-surplus'.

The conditions for economic viability of the system are exactly that the above expressions will be positive. The C* and I* lines enable us to see that viability prevails when the shaded area exists. The level of each sector's requirement for reproduction from the other sector, must be smaller than its 'own surplus'.

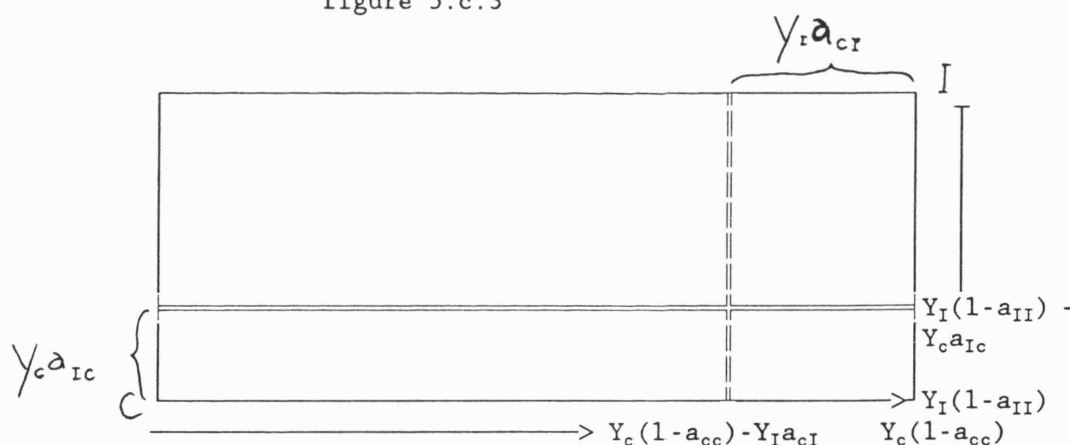
The position of the 'own surplus' lines is determined by technology; namely, according to whether $(1 - a_{ii})$ is greater, equal or smaller than a_{ii} , $i=C, I$. For our purposes it is completely insignificant whether the 'own surplus' lines lie to the right, to the left, or even coincide, with the process lines. To a great extent we will ignore the process lines altogether and only concentrate of the 'own surplus' lines.

The subject of some sort of rational considerations in this model is

the 'own-surplus' that the capitalists have. They will have to decide how much to consume and how much to save according to the balance they strike between the passions of today and the desire to better one's conditions. It is not because they legally own the surplus that they are different from labourers, it is because their reaction to the existence of surplus is different. Labourers too may find their wages above subsistence (hence surplus) but they cannot afford to deliberate about it and the use they put it to is quite automatic. Thus by concentrating on the coincidence of wants among capitalists alone I uphold the a-symmetry between capitalists and labourers and I give a less trivial meaning to the invisible hand.

In each sector the capitalists will leave for themselves that part of their own product which they need for reproduction, the rest, they will bring to the market for exchange. Therefore, point B in figure 5.c.3 sets the exchange box of the market.

figure 5.c.3



In figure 5.c.3 the exchange box is presented in a manner of an Edgeworth box. The left bottom is the origin of sector C and at the

top right side, the origin of the I industry. The 'real net surplus'; namely, the surplus that is left in the economy once what was needed for reproduction is put aside, becomes the upper left rectangular (it is the same as the shaded area in fig. 5.c.2).

Basically, the size of the box depends on technology. However, we are to consider the 'self-consumption' that might occur. In other words, a capitalist can use his own product not only for his reproduction but also for a superfluous consumption. This consumption is not his subsistence as we included his subsistence in the technology parameters, but something that is above that level and that for which he does not have to exchange.

Nevertheless, Smith argued, as quoted above, that as the division of labour is the source of exchange, the more advanced it is the less likely will it be to any one to satisfy his wants from his own product. Thus, we may neglect that parameter and leave to technology alone to set the size of the exchange box³.

In the mere fact that the economy can reproduce itself, there is no source of beneficence, either from the moral point of view, or from nature's point of view⁴. In order for beneficence to occur there is a need for at least someone of those who were acted upon, to improve his situation. This can only happen if the real net surplus is being accumulated.

³Generally speaking the size of the box should be determined by $(1 - a_{11} - \lambda_1)$, where λ_1 is the luxurious consumption of one's own product. However, we shall assume without any loss of generality that $\lambda_1=0$.

⁴See the last section of chapter 4.

Accumulation can be manifested in two different ways. One is by an increase in productive labourers' wages which will lead to an increase in their productivity. The other by hiring more labourers to work with additional materials. Either way, the process' lines remains the same. We know that a_{cc} denotes the amount of corn needed for the production of one unit of corn. When the labourers' productivity is higher due to the increase in wages, there might be a need for less workers to produce one unit of corn, but their wages (in real terms) are such that we cannot tell what will happen to a_{cc} . We might as well assume that it, as well as other such coefficients, will remain unchanged.

If all the net surplus is spent on unproductive labour (or 'luxurious consumption') all labourers will receive their subsistence and the economy can survive in such a stationary state for a long while. Only through accumulation of surplus, the possibility of a rise in wages arises. Only then, the chance of beneficence prevails. However, accumulation, as such, is not always beneficent. Obviously, if one sector accumulates his whole net surplus, and the other one consumes it all, the sector that accumulated will not be able to fulfil his intentions and thus the economy will not progress.

To analyze the circumstances of a 'beneficial' accumulation let us first connect the distribution of the net surplus and the progress of the economy.

figure 5.c.4 (a)

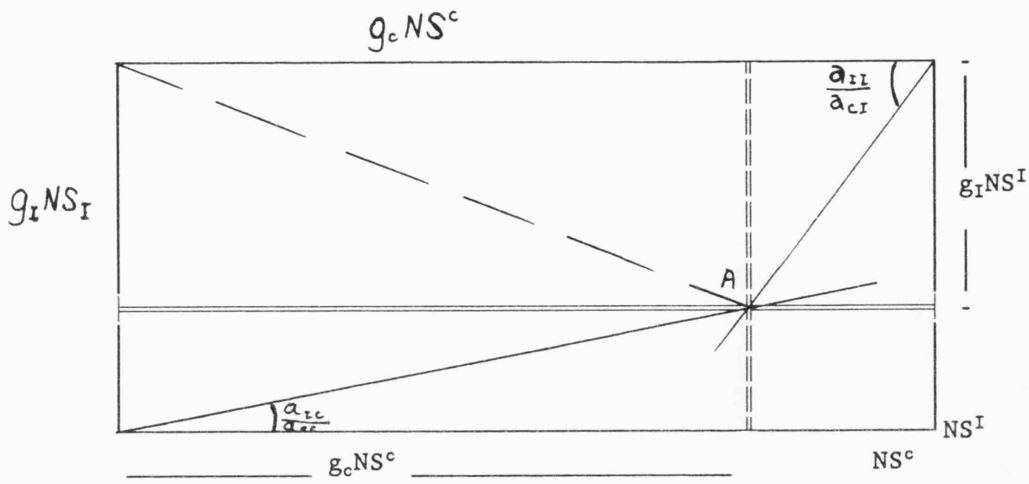
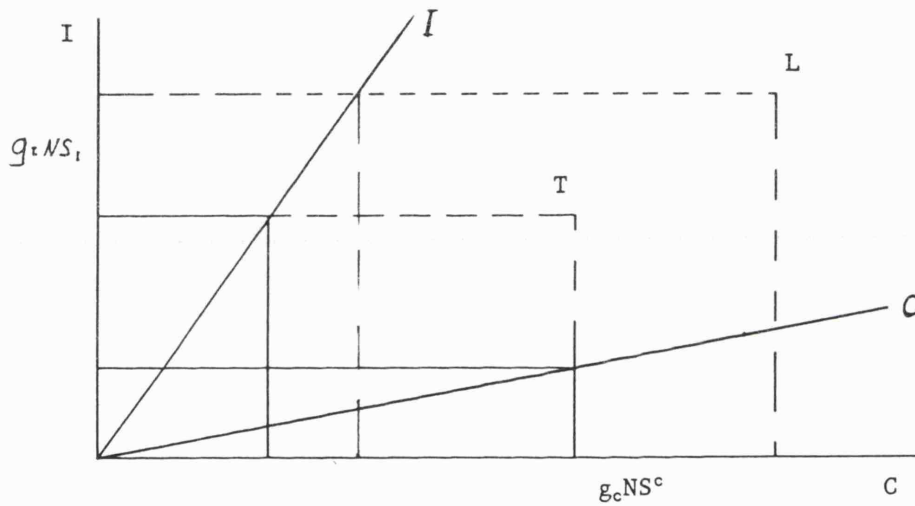


figure 5.c.4 (b)



In figure 5.c.4(a) only the real net surplus box is depicted. The 'net surpluses' in the economy are:

$$NS_t^C = Y_C^t(1 - a_{CC}) - Y_I^t a_{CI}$$

$$NS_t^I = Y_I^t(1 - a_{II}) - Y_C^t a_{IC}$$

where the index t denotes the period.

Let g_i , $i = C, I$ denote the rate of the net surplus that a producer decides to devote for accumulation. If $g_i NS^i$, $i = C, I$, is what each sector decides to accumulate they will have to accommodate that

accumulation with the necessary amount of the other sector's product. To see that, I have introduced the process lines of each sector at its origin. The amount of the other sector product that each sector will need to achieve its own plans to accumulate will be $[g_i NS_t^i / a_{ii}] a_{ji}$, $i, j = C, I$.

Clearly if a sector accumulates successfully the volume of his output in the next period will rise by:

$$g_i NS_t^i / a_{ii}$$

At point A in figure 5.c.4(a) we can find a situation where the whole real net surplus was accumulated successfully. In the following period, therefore, the level of input of each sector will increase in exactly what they have accumulated, and the economy will progress from point T to point L in figure 5.c.4(b) (note that these are the process lines and not the 'own surplus' lines.).

The question now is whether this progress in the level of production is also an improvement in the levels of the real net surplus. After all, from the moral and nature's point of view it is the progress of the real net that gives rise to beneficent outcomes. Let us now examine the conditions for the real net surplus to improve.

First, recall that the level of production at the second period will be:

$$Y_i^t + g_i \frac{NS_t^i}{a_{ii}} = Y_i^{t+1}$$

Thus, the net surplus of the second period will yield:

$$\begin{aligned}
(1) NS_{t+1}^i &= (Y_i^t + g_i \frac{NS_t^i}{a_{ii}}) (1 - a_{ii}) - (Y_j^t + g_j \frac{NS_t^j}{a_{jj}}) a_{ij} \\
&= Y_i (1 - a_{ii}) - Y_j a_{ij} + g_i NS_t^i \frac{(1 - a_{ii})}{a_{ii}} - g_j NS_t^j \frac{a_{ij}}{a_{jj}}
\end{aligned}$$

as, $Y_i(1 - a_{ii}) - Y_j a_{ij} = NS_t^i$, (1) is reduced to:

$$NS_{t+1}^i = NS_t^i [1 + g_i \frac{(1 - a_{ii})}{a_{ii}}] - g_j NS_t^j \frac{a_{ij}}{a_{jj}}$$

$i, j = C, I$.

In order for the real net surplus to increase, we should show when:

$$(2) \frac{NS_{t+1}^c}{NS_t^c} \geq 1; \frac{NS_{t+1}^I}{NS_t^I} \geq 1$$

Substituting (1) into (2) will yield:

$$(3) \frac{NS_{t+1}^c}{NS_t^c} = 1 + g_c \frac{(1 - a_{cc})}{a_{cc}} - g_I \frac{NS_t^I}{NS_t^c} \frac{a_{cI}}{a_{II}} \geq 1$$

$$(4) \frac{NS_{t+1}^I}{NS_t^I} = 1 + g_I \frac{(1 - a_{II})}{a_{II}} - g_c \frac{NS_t^c}{NS_t^I} \frac{a_{Ic}}{a_{cc}} \geq 1$$

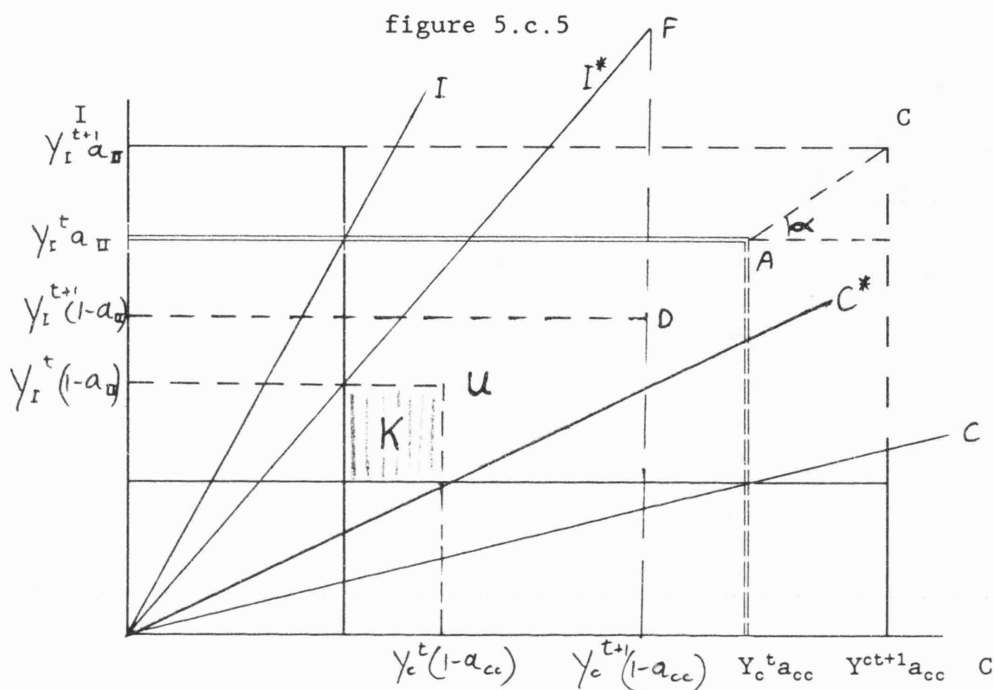
Dividing (3) and (4) with g_c and g_I respectively, and rearranging:

$$(3)' \frac{a_{II}}{a_{cI}} \frac{(1 - a_{cc})}{a_{cc}} \geq \frac{g_I NS_t^I}{g_c NS_t^c}$$

$$(4)' \frac{a_{Ic}}{a_{cc}} \frac{a_{II}}{(1 - a_{II})} \leq \frac{g_I NS_t^I}{g_c NS_t^c}$$

The right hand expression is exactly the slope of the expansion path in terms of inputs which is depicted in figure 5.c.4(b) (between point T and L). a_{II}/a_{cI} is the slope of I's process line. In our example $(1 - a_{cc}) > a_{cc}$, thus, meaning that the slope of the expansion path should be smaller than that of I's process line. In the same manner, it appears as a requirement for that slope to be greater than that of the C process line. I shall therefore maintain that condition (3)' and (4)' are actually a limitation on the expansion path of the real net surplus.

Figure 5.c.5 depicts the different expansion paths. Point A is the level of inputs employed in the first period. B is the correspondent exchange box, with the shaded area as the real net surplus box.



When all the net surplus was devoted to accumulation (as in fig.5.c.4(a)), the input of the next period would become larger in the same amount accumulated. The economy progressed to point C, where D defines the relevant exchange box with the correspondent shaded box of real net surplus. The expansion path, in terms of inputs, is the line between A and C, the slope of which is exactly the right hand expression in (3)' and (4)'. The expansion path of the real net surplus can be described as the line connecting B and D.

If the expansion path of the real net surplus were to advance towards point F in the figure, it would mean that in one sector, at least,

no net surplus exists. Hence, the economy will not be able to accumulate any more. This stagnation will obviously become harmful from both moral and nature's point of view and it will be entirely the result of the choices made by the capitalists. It will mean that there is nothing in natural liberty itself to prevent the system from collapsing into a stationary state without any need for exogenous limitations by the productivity of land.

We saw before the meaning of a simultaneous growth in terms of the process lines. Let me show now the conditions for the 'surplus expansion path' (the line between B and D in the above figure) to avoid reaching point F. Obviously the restrictions on the position of this expansion path with respect to the 'own surplus' lines are equivalent to those restricting the position of the total output expansion path.

The slope of the net surplus expansion line (between B and D for instance) is:

$$(5) \frac{Y_I^{t+1}(1-a_{II}) - Y_I^t(1-a_{II})}{Y_C^{t+1}(1-a_{cc}) - Y_C^t(1-a_{cc})}$$

We already saw that:

$$Y_I^{t+1} = Y_I^t + g_I \frac{NS_t^I}{a_{II}}$$

and:

$$Y_C^{t+1} = Y_C^t + g_C \frac{NS_t^C}{a_{cc}}$$

Substituting into (5):

$$\frac{g_I NS^I (1-a_{II}) a_{cc}}{g_C NS^C (1-a_{cc}) a_{II}}$$

The slope of the 'own surplus' lines are:

$$\frac{a_{Ic}}{(1-a_{cc})}; \frac{(1-a_{II})}{a_{cI}}$$

We are to show now that:

$$(6) \frac{a_{Ic}}{(1-a_{cc})} \leq \frac{g_I NS^I}{g_c NS^c} \frac{(1-a_{II})}{(1-a_{cc})} \frac{a_{cc}}{a_{II}}$$

$$(7) \frac{(1-a_{II})}{a_{cI}} \geq \frac{g_I NS^I}{g_c NS^c} \frac{(1-a_{II})}{(1-a_{cc})} \frac{a_{cc}}{a_{II}}$$

rearranging:

$$(6)' \frac{a_{Ic}}{a_{cc}} \frac{a_{II}}{(1-a_{II})} \leq \frac{g_I NS^I}{g_c NS^c}$$

$$(7)' \frac{a_{II}}{a_{cI}} \frac{(1-a_{cc})}{a_{cc}} \geq \frac{g_I NS^I}{g_c NS^c}$$

Which are exactly (3)' and (4)'.

Accumulation, therefore, is not enough to guarantee a beneficial outcome of the process of exchange. Even though we might find at certain stages the economy progressing (as well as net surplus), the fact that it is aiming towards a point similar to F in the above figure, means that this progress is only temporary. Any rise in wages and population will inevitably be reversed once the economy reaches point F.

The important features of the model just presented, are the information, at any stage, of the direction of the economy. An economy can be progressing at a certain moment, but, if the direction of this progress is such that, at some stage, there will be no correspondence of wants with regard to accumulation, the outcome of this system could not be considered as beneficent.

Now, if we consider the influence of the division of labour, which is also a function of the accumulation, then, because of the two sectors, the relative positions of the 'own surplus' lines might not be changed at all. Of course, an extended analysis will have to incorporate the influence of the division of labour, as a function of the accumulation, on the position of the 'own surplus' lines. At present, however, I do not think that if we consider the position of the lines as unaffected by the division of labour, that we are seriously distorting Smith's perception of it.

We may say now that the conditions for beneficence are spelled out. Indeed they reflect Smith's observation of the importance of balanced growth to the advancement of opulence. (see his discussion of it in chapter 1 of book 3 pp. 376-9). But, on the other hand, they differentiate between progress that entails an assured beneficence, and progress, that at best can count on changes in the circumstances, to ensure beneficence.

On a more general note the above kind of treatment of Smith allows us to deal with cheerful and dull state without having to commit ourselves to a Ricardian Corn model. In the Ricardian model it was not really the question of interaction between the social classes which brings about the Smithian dull state. It was almost entirely due to the exogenous limitations of lands. Here, as in Smith, the dull and cheerful states are seen as a result of particular interactions between the wants that prevail in society.

Obviously this is not all the story and we have to see what happens

in the case of incompatible accumulation plans which might lead to the dull state. For this we will have to examine the role of prices in such a system.

(d) Equilibrium, Demand structure and The Role of Prices.

In the previous section, the long term significance of any possible result of the economic process was put forward. It was mainly stressed that it is not the viability of the economy (its ability to reproduce) that brings about the required beneficence.

Now I shall turn to analyze some of the mechanistic aspects of Smith's theory; namely, how a certain allocation of surplus is being brought about. In Smith's discussion of the invisible hand in the TMS[pp.183-185] he is describing some kind of a trickle down theory. The capitalists have to decide what to do with their surplus which is above what is needed for reproduction. In Smith's words, they have to decide between employing productive and unproductive labour. In such a way, argues Smith, although an equal distribution of wealth (in his terminology: income) is not brought about, at least there is an equal distribution of needs.

Bearing in mind that the multiplication of the species may be a need of the labourers, then whether or not it is satisfied depends on the proportion of that surplus that goes to productive labour. If all goes to unproductive labourers then we are at a stationary state

where there is no beneficence whatsoever ¹. If, however, the capitalists decide to employ productive labour then wages will have to go up (to increase the circle of productive labourers) and beneficence already began.

But this is only a partial description of the functioning of natural liberty. Adding to this story Smith's distinction between the calculated want of the capitalist, the desperate need of the labourer and the interdependence between sectors, and the problem of the invisible hand changes significantly. Now it is not just the harmony between the capitalists and the labourers which should be considered. Also we have (a) to look at the mechanism that harmonizes wants among the capitalists and which are subject to some kind of rational decision; and (b) to ask whether in view of the sector interdependence it is sufficient to assume that capitalists want to save (and thus bring about a rise in wages) in order to establish beneficence.

Obviously, the most important instrument of this mechanism is the price. The price, in a neo-classical (if I may call it so) system, is the key to the allocation of resources. In Smith, and probably in the classical school in general, prices are the tool for the distribution of surplus.

While defending the general equilibrium approach in the beginning of this chapter I have already pointed out that the three components of

¹ Recall that beneficence will be felt by the labourers if they can improve their position. As the need to multiply is dominant in their rank, beneficence and an increase in wages are synonyms.

prices reflect that distribution of surplus. In other words, it contains three components of surplus: reproduction², accumulation and consumption.

Smith's discussion of price theory is sometimes confusing and leaves many questions unresolved. It is, in my view, spread over three chapters in the WN: chapters 5-7. In chapter 5 --of the real and nominal price of commodities-- Smith puts forwards what he believes to be the 'meaning of price'. "The real price of every thing, what it really costs to the man who wants to acquire it, is the toil and trouble of acquiring it. What every thing is really worth to the man who has acquired it, and who wants to dispose of it or exchange it for something else, is the toil and trouble which it can save to himself, and which it can impose upon other people." [WN.p.47].

Namely, once the division of labour has been established, people need to exchange their surpluses for what they want. They have obviously toiled and laboured to produce the surplus and it is worth to them its toil and labour equivalent. Naturally, some of Smith's readers thought that he was trying to develop a labour theory of value. A view that can be supported by many more quotes from the WN.³ However, it is also quite evident that a 'cost of production' approach is implied in chapters 6 and 7 where he discussed natural and market prices and their components.

²To remind the reader, the surplus of one sector contains what is required for the reproduction of the other sector.

³See a discussion of the issue in Meek (1956) pp.45-81.

Although I agree that Smith did not have a labour theory of value as a theory of price determination, I do believe that labour (and labour values) constitute an important part of his theory. It is particularly true with respect to the moral analysis of it. Some scholars, like Blaug(1985) for instance, raised the point that labour in Smith is a measure for social welfare rather than a determinant of prices. Though a possible explanation it is not the only one. It is certainly not so appealing as to justify its generalization through Ricardo and Mill to the whole of the classical school. It reflects more, I believe, the justified annoyance of modern readers with the obscure meanings of labour theories that keep coming up in the writings of classical economists though in the end they do not seem to explain prices in general (or, as some might argue, anything at all). However, the fact remains that classical economists related to it, wrote about it, and some of them believed in it. We cannot explain it by inventing a role for it which will remove it from the centre of economic analysis. It is true that chapter 5 starts with a statement about what is wealth. This does not mean that the purpose of the entire chapter (entitled 'of the real and nominal price of commodities') was to explore an aggregate measure for wealth.

By saying that labour --the real toil and trouble of production-- is a measure of the well-being of society the focus of labour theories moves from the disaggregated form of values to an aggregated measure of welfare. According to Blaug, the meaning of it is that Smith used nominal wages as the deflator of national income to measure social well-being in the sense of how much effort was involved in the complete production process. But this aggregate measure too, like the

labour theory of value, ceases to be a meaningful measure once accumulation and profits are being introduced. However, from the point of view of those who are tired of the obscurity of the labour theory of value the goal has been achieved. First, labour was removed from the discussion of prices and introduced at the aggregate level. Secondly, as an aggregated measure of welfare it was crowned as a mistake (when accumulation is introduced). But as it is far from the heart of Smith's economic analysis (the theory of value) it allows to ignore labour values in his analysis altogether.

There are, I admit, a lot of ambiguities in Chapter 5. However, one cannot ignore the kind of quotes I brought above where it is evident that Smith thought that labour ratios have something to do with prices⁴. He certainly thought it to be true in the 'rude stage'.

⁴As a matter of fact the use of labour as a welfare measure as Blaug suggests is not very far from suggesting a labour theory of value but with a different meaning than explaining price determination. Let A be the coefficients matrix and α the vector of labour inputs. w is the money wage rate and P is the price vector. If chapter 5 is all about using nominal wages as a deflator then what we get is that labour values are a disaggregated proxy to social welfare, or, to use Smith's words, the true toil and trouble. If $P = PA + \alpha w$ and we divide everything by w we get: $P/w = \alpha(I-A)^{-1} = (\zeta_1, \zeta_2, \dots, \zeta_n)$. That these are the same labour values one will get by using the idea of embodied labour when the rate of profit is zero is quite obvious. Let Z be the vector of labour values. $Z = ZA + \alpha$ and thus, $Z = (I-A)^{-1}\alpha$ which is precisely the same vector $(\zeta_1, \zeta_2, \dots, \zeta_n)$ as before. Indeed, this is also a measure of national income under modern definitions (i.e. the sum of value added = generated income). If the gross output is the vector X and the net output is Y , $(I-A)X = Y$. $X = (I-A)^{-1}Y$ and as we have the constraint of $\alpha X = L$ (the total number of labourers) then we get $\alpha(I-A)^{-1}Y = L$. Substituting Z we get $ZY = L$. Multiplying by w and we get $PY = wL$. But this is only true if profits are not expressed in terms of 'technological cost' (the subsistence needed for the capitalists as part of the technological coefficients) but in terms of interest rates. If there is a positive interest rate then labour values will not be a good measure to national income. This, however, does not mean that they cannot be a good measure to what Smith called the real 'toil and trouble'. So Blaug's story does not really rescue us from the vacuous meaning of the labour theory of value. Rightly or wrongly if Smith considered nominal wages as the deflator of income to measure social welfare he must have considered labour values as the disaggregated form of it. The deviation of actual prices from their labour value should have implications with respect

Now, to argue that the whole discussion of the 'rude stage' is aimed at finding a unit for measurement irrespective to the process of exchange is not serious. What Smith was clearly trying to do is to understand the essence of prices rather than anything else.

So why is it that Smith writes about labour theory of value (explicitly and implicitly -see the previous footnote) and then moves on to a 'cost of production' theory of prices. The answer, in my view, is similar to the one I gave when discussing the apparent inconsistency in his human nature analysis. Labour (or effort) is, to Smith, the universal of exchange. It is the thing which underlines and affect exchange but it does not have to be its determinant.

Though it is a universal in the scholastic tradition⁵ it is not a simple one. Labour, to Smith, is not an intrinsic feature of commodities. They are not comprised of labour. It is simply that people's disposition in any exchange is motivated by the relative labour inputs, or, which is the same, by the relative 'toil and labour'. Notice that in the quote above Smith describes what a commodity means to a seller and what it means to a buyer. Unlike Marx, Smith does not discuss the question of what is a commodity.

to social welfare. Thus, unintentionally, this kind of argument supports my assertion (which will be discussed later on) that labour values has a kind of moral significance. It should be noted, however, that the deviation from labour values is not in one direction; it depends on the actual rate of profit as well as on capital/labour compositions in the various sectors. Of course, Blaug acknowledges that Smith was wrong but this will not alter the fact that Smith thought that the labour theory of value had a meaning which is obviously other than determining prices. What then, is that meaning?

⁵See chapter 2 above.

Therefore, if two people meet to exchange commodities they would have liked to exchange according to those rules. This is what the 'rude stage' example shows. To some extent it is a form of subjective price theory but the subjective feelings are not those of pleasure rather, they are those of expediency and 'fairness'⁶.

This is perfectly consistent with arguing that in the end, prices are determined by other things as well. So, one may argue, what do we need the labour theory of value anyway? Well, we may indeed not need it to explain prices but we might need it to explain the significance of the circumstances when prices are determined by labour values or, the deviation of prices from labour values. We can always say that Smith felt that labour ratios are in the essence of exchange but that for some reasons, they do not determine its values. We can then investigate those reasons. On the other hand, we shall see that the terminology of labour values is used again in connection with the natural price. If indeed at the natural price profits converge to a rate of profit which is very low indeed, we may find, under some circumstances, that at natural rates, prices can be explained by labour values. But then, of course, we will have to determine what natural rates are all about. This, I will do later on.

In our model, as will soon be seen, prices are not measured in terms of labour. They are measured in terms of a commodity numeraire. This,

⁶See Young(1986) for a discussion of why the labour theory of the rude stage is morally approved. Some would argue that this subjective feeling may be the disutility of labour but general idea does not mean that we can think about it in terms of a utility function as we understand it today.

at least in the short run, is quite acceptable on Smith. "But though labour be the real measure of the exchangeable value of all commodities, it is not that, by which their value is commonly estimated.....Every commodity besides, is more frequently exchanged for, and thereby compared with, other commodities than with labour. It is more natural, therefore, to estimate its exchangeable value by the quantity of some other commodity than by that of the labour which it can purchase"[WN pp.47-9].

As I said, it is accustomed to view Smith's price as a 'cost of production' system⁷, or, as Sraffa called it, an adding up system⁸. Schumpeter went even further to say that the whole episode of the labour theory of value is merely a detour from the tradition prevailing in Smith's theory⁹.

If we see Smith's work as a kind of a general equilibrium model then 'cost of production' systems will not be good enough. The system will only be solvable if wages are pre-determined and profits conform to a single rate. This, however, does not seem to suit Smith's system where unequal rates of profits (and growth) are allowed.

In itself, this is not a reason to suppose that Smith did not mean to have a 'cost of production' system of pricing. What it does mean is that there must be a distinction between prices which comply with

⁷See, for instance, Blaug (1985)

⁸See his introduction to vol.1 of WORKS AND CORRESPONDENCE OF DAVID RICARDO (1951).

⁹Schumpeter, 1954. p.568.

the technical requirements of uniform rates of profits and those which do not. One way of going about it is to assume first that rates of profit tend to uniformity as they approach their 'natural rate'. Thus, the system is solvable at its natural rates which, in other words, means that general equilibrium prevails only in natural prices. In market prices the system is in disequilibrium.

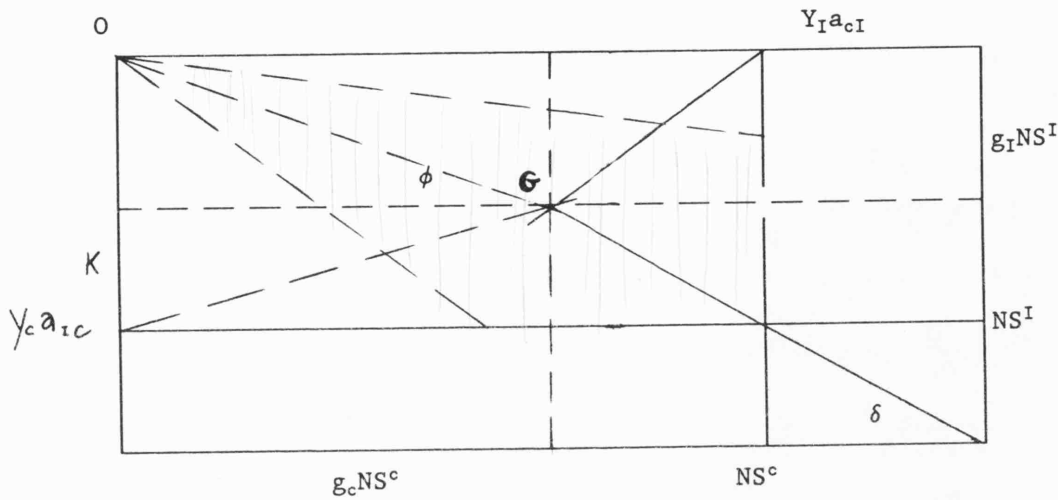
What it is that drives profits to their natural rate is the decline in prospects. This, as I mentioned before, is true when the economy has reached a state of completeness which Smith himself admitted to be far from being a real occurrence. And as Smith argues that sometimes prices may stay at their market levels for centuries, the idea of natural liberty in the sense of coincidence of wants becomes vacuous.

Therefore, I would like to offer a system where market general equilibrium prevails. Then, we will be able to make meaningful statements about the difference between market price equilibrium and natural price equilibrium.

Equilibrium: Coincidence of Wants and Uniqueness

Let us now examine more carefully the exchange box presented in the previous section.

figure 5.d.1



The producers enjoy the 'own surplus' of $Y_c(1 - a_{cc})$ and $Y_I(1 - a_{II})$ for C and I respectively. However, while they can simply put aside their own contribution for their reproduction ($g_i NS^i$, $i=C,I$), they still need the other sector's goods for reproduction ($g_i NS^i a_{ji}/a_{ii}$, $i=C,I$). This defines the upper left rectangular as the real net surplus. This net surplus will be used either for consumption or for accumulation, but unlike consumption, the decision on accumulation must be synchronized with the other sector's plans in order for it to succeed. The process lines in the real net surplus rectangular shows exactly how much of the other sector's good will be required for each decision of accumulation.

If sector's C capitalists decide to accumulate $g_c NS^c$, they will bring to the market only: $Y_c(1 - a_{cc}) - g_c NS^c$ which is also:

$$Y_I a_{cI} + (1 - g_c) NS^c$$

Thus, the actual exchange box is reduced to the box at the right

bottom of G in figure 5.d.1. If the I sector's plan coincide with those of C; namely that they bring into the market exactly what is require by C for reproduction and accumulation, and so does C (point G in figure 5.d.1), the price in terms of commodities will necessarily become:

$$P = \frac{Y_c a_{Ic} + (1 - g_I) NS^I}{Y_I a_{cI} + (1 - g_c) NS^c}$$

Which is the price of C in terms of I , and is exactly the slope δ in figure 5.d.1. That is to say that point G is equilibrium if the price which prevails is δ .

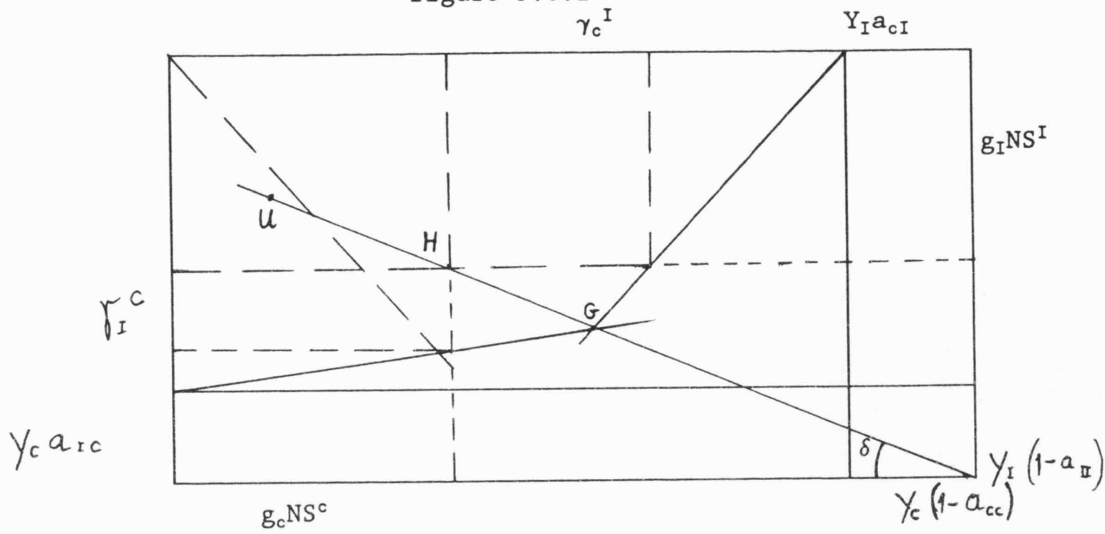
The slope of the diagonal of the most upper left rectangular that is created by G, $\phi = g_I NS^I / g_c NS^c$, is exactly the slope of the conditioned expansion path of the previous section. The conditions for a growth in the net-surplus of both sectors were:

$$\frac{a_{Ic}}{a_{cc}} \left(\frac{a_{II}}{1 - a_{II}} \right) \leq \frac{g_I NS^I}{g_c NS^c} \leq \frac{a_{II}}{a_{cI}} \left(\frac{1 - a_{cc}}{a_{cc}} \right)$$

And they are depicted by the rays originating from 0 in figure 5.d.1. The shaded area reflects an allocation of accumulation that not only will yield an increase in production for one period, but a continual increase in the real net of the economy. But G is not the only equilibrium that is consistent with the price δ .

Let us examine point H in figure 5.d.2.

figure 5.d.2



The two sectors have decided, separately, to accumulate, $g_i NS^i, i=C, I$. This is a smaller amount than that intended before. The exchange box, now, becomes the rectangular at the right hand bottom of point H. The amounts of each product that was brought into the market is now, substantially greater. Hence, it could obviously accommodate a decision for less accumulation.

Thus, after the exchange was completed, each of the sectors, found himself with the other sector's good that he did not need for accumulation, He will then consume it. (Mark that the difference in consumption or accumulation of the net surplus is described by Smith as the difference between the employment of productive and unproductive labourers).

γ_I^c, γ_c^I denotes the level of consumption. Surely one will use one's own surplus for superfluous consumption. This will influence the size of the exchange box. For the sake of brevity I neglected that aspect which could become more interesting as the decision for one's own

product consumption, the demand for 'luxurious' consumption from the other sector, and the prices become related. However, this is a task for a different work. At present, I shall keep ignoring that aspect of the theory, that even though not argued by Smith, seems to be a reasonable extension of it.

So, we see now that the price δ supports many equilibria. We may observe that all the points along that line to the right of G(fig.5.d.2) represents dissonance of wants. Therefore they can not be considered as equilibria points. (they represents excess demand as what is needed by each sector to support its accumulation plans will always be greater than what is brought to the market).

All the points along the price line that are to the left of G represents equilibria points. However, even though point U (in fig.5.d.2) is equilibrium when price δ prevails, it is differently assessed than points like H or G. At U, there is indeed a positive accumulation but the proportions are such that it will lead, soon enough, to a stand still. The conditions of continual growth are not satisfied.

Another distinction that can be made with regard to the different equilibria that a certain price supports, is the general rate of growth of the economy. Clearly, this rate increases as we descend towards point G where it is the highest possible as the total surplus is efficiently allocated to reproduction and accumulation alone.

Throughout the above discussion I assumed that the decisions were

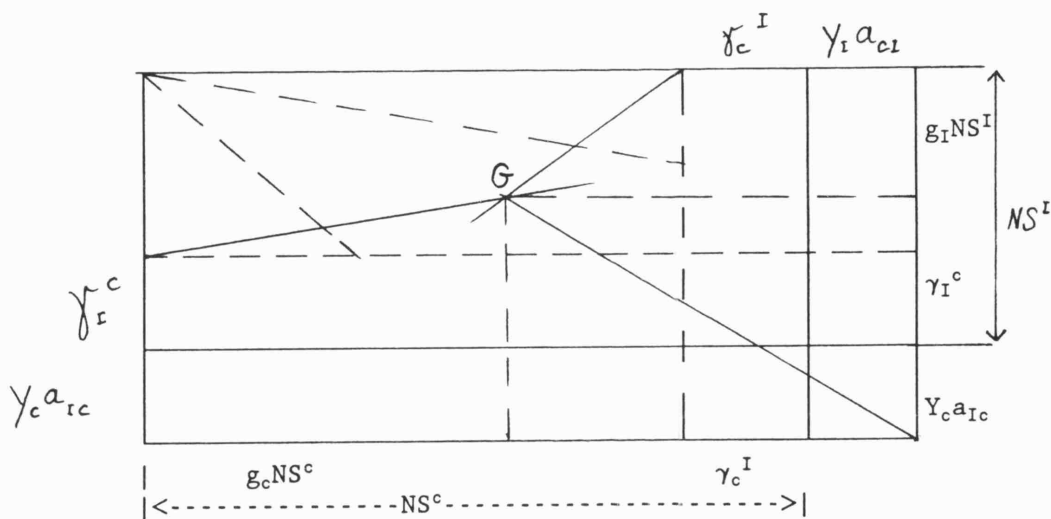
taken only with regard to reproduction and accumulation. The 'luxurious' consumption (that consumption that is above subsistence) became a residual.

This, of course, is not the only way to look at it. In fact, we shall soon see that Smith had something to say on the demand structure. Obviously, any supposition, like that the pre-market decisions are taken only with regard to reproduction and accumulation, is an assertion on the demand, the structure of which seems to be crucial.

Any other plausible way to go about it might, altogether, yield different conclusions. Before devoting some space to the structure of demand, let us see the immediate difference in results. The other option, therefore, is that the pre-market decision are made with regard to luxurious consumption, it is only the accumulation that becomes residual. Obviously, if the accumulation is the residual, the question of efficiency will become crucial.

Figure 5.d.3 depicts the new circumstances:

figure 5.d.3



Once the levels of luxurious consumption (γ^{cI} , γ_I^c) are set, there is, actually, a unique equilibrium at point G. At any other points the wants will not coincide. Every point on and above the process lines will yield excess supply, any point below, excess demand. So there is a single price, for any set demand for luxurious consumption, which yields equilibrium. What will, though determine its long term consequences, is the relative volume of the pre-fixed demand for luxurious consumption.

Constructing the Demand in Smith's Analysis

Let me now, devote some time to what can be understood as an assertion on demand. It is, to me, rather clear that Smith saw the importance of demand in setting the price, in particular in the general framework which is not very clear from his partial equilibrium approach, as portrayed in chapter 7 of book 1.

There are three usages, thus demand, of the surplus: reproduction, consumption and accumulation. If we look at the demand for C in our model it will take the form:

$$C^d = Y_I a_{cI} + g_I NS^I \frac{a_{cI}}{a_{II}} + \gamma_c^I$$

Where $g_I NS^I a_{cI} / a_{II}$ represents the amount of C needed to accommodate the decision to accumulate $g_I NS^I$ of I.

Throughout the whole Wealth of Nations, the aspect of reproduction is assumed to be crucial. Without loss of generality, I will assume that the demand for reproduction is fixed, that is, it is set

before the exchange begins and will not alter with prices. It is quite reasonable to suppose that the demand for subsistence to feed the labour needed for reproduction will be inelastic. Either because it is the capitalist who is aware of his own predicament if he fails to reproduce or, because it is the labourers themselves who face an even grimmer prospect if they fail to secure their demand.

We should, then concentrate on the use of the real net surplus. This subject is extensively discussed in the chapter on the accumulation of capital (chapter 3 book 2). The distinction between consumption and accumulation is done there by the employment of productive or unproductive labourers. The main source for that consumption and accumulation is the profits (and rents which we ignore).

What motivates demand, in Smith theory, is, again, a certain quality of human nature; a certain passion. The principle which "prompts to expense, is the passion for present enjoyment" (expense is to be understood as consumption; the employment of unproductive labour). "But the principle which prompts to save [namely, to accumulate or to employ productive labour], is the desire of bettering our conditions" [WN p.341].

Smith does not offer us a very accurate account of what regulates the relationship between these two contradicting passions. He does maintain, though, that they do prevail together. No matter how pleased a person can be at a certain situation, he will always desire to better his conditions, thus, it seems as if a certain priority is given to the momentarily passion, though, the want to

accumulate will be there. This inclination towards the momentarily pleasures, which is very consistent with the poor status human nature had in Smith eyes, is spelt out when discussing the use to be made of the surplus by those who have it. "They might.. maintain indifferently either productive or unproductive hands. They seem however, to have some predilection for the latter. The expense of a great lord feeds generally more idle than industrious people." [WN p.333].

There are, thus, two main features in Smith's view of demand. First it is at least in part, motivated by passions that can not be regulated by the system and that are ex-ante to the system. Namely, passions that are less susceptible to price changes; similar to the argument that the demand of labourers for subsistence is independent of the price. Both are needs which are less controlled by reason but it should be clear that unlike labourers, the capitalists can afford not to have these needs satisfied. Second, that if we are to set the different components of demand in a certain order regarding their dependence on the price system, we may argue that Smith saw the reproduction and superfluous consumption as the pre-fixed demand, and accumulation, as a residual. The desire to better our conditions, according to Smith can be satisfied with the mere existence of some accumulation, whereas the passion for consumption seems more likely to affect the volume of demand before even coming to the market.

It is therefore, the second presentation of the general equilibrium solution that is in the line of Smith's writings; namely, that the levels of consumption (γ_c^I , γ_I^c) are fixed before the exchange begins,

and the actual levels of accumulation is set by the market. It is thus the task of the market and prices to set these residual, which depends on technology, in an efficient manner. In such a case the demand function for C as described before is a function of price in the following way:

$$C^d(P) = Y_I a_{cI} + g_I(P) NS^I \frac{a_{cI}}{a_{II}} + \gamma_c^I$$

Let us, now, descend from the general equilibrium level to the partial equilibrium framework to look more closely on the process of exchange in the light of the above observations. The analysis will differ somewhat from the exact analysis of Smith in chapter 7 of book 1 however, its spirit will prevail.

Figure 5.d.4 depicts the demand for C under the assertion that the fixed arguments of it are the reproduction and consumption, and that a certain level of accumulation is planned but will be determined by prices.

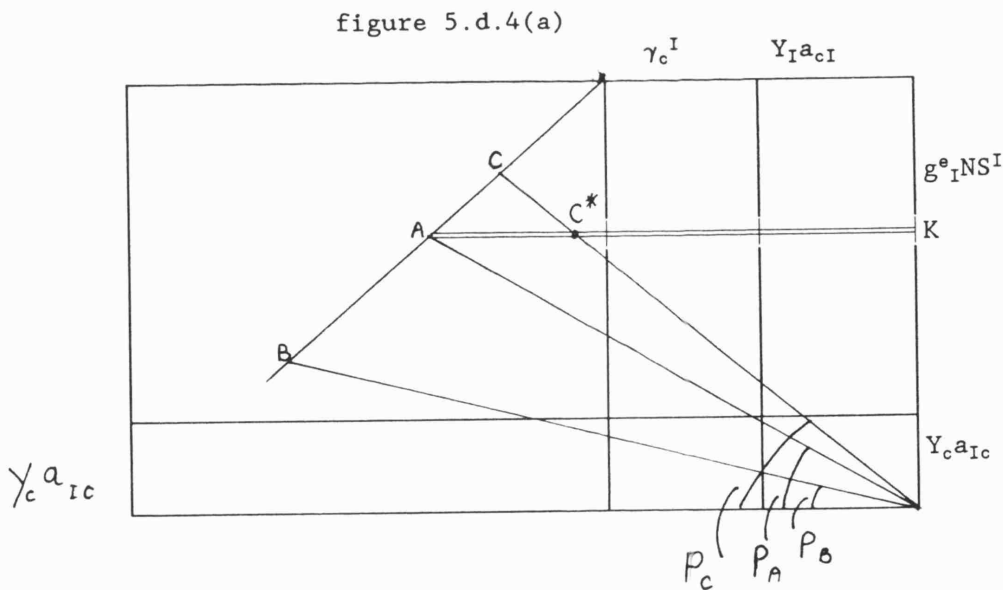
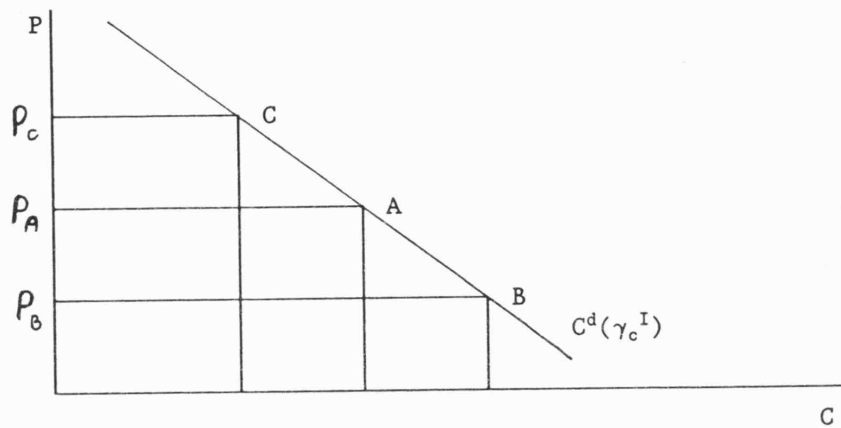


figure 5.d.4 (b)



While it is implied that accumulation is eventually, residual, this, in turn, does not mean that there is no a-priori notion of what is expected to be accumulated. In some respect we may even say that in Smith analysis, there must be a hidden assumption about expectations.

Before coming into the market, not only the levels of consumption and reproduction are fixed, also a certain idea of what we would have liked to accumulate which is reflected in the portion of our own product that we devote for accumulation. Hence, if the producers of I decided to accumulate $g_I^{\circ}NS^I$ of their product, they expect to get $(g_I^{\circ}NS^I a_{cI})/a_{II}$ on top of what they want for reproduction $(Y_I a_{cI})$ and consumption (γ_c^I) .

This pre-market formation of the demand is, in some respect, a similar idea to what Smith called the 'effectual demand'. It is a demand that is determined outside of the market and which, in parts, depends on technology (the demand for reproduction goods). Equilibrium will certainly depend on how the quantity that is

actually brought into the market relates to this pre-set demand.

The pre-market demand, in figure 5.d.4(a), is depicted by the segment AK. The actual demand will obviously depend on the price. Therefore, as we said before the demand is a composition of pre-market (or autonomous) components and those which depend on prices:

$$C^d(P) = Y_I a_{cI} + g_I(P) N S^I \frac{a_{cI}}{a_{II}} + \gamma_c^I$$

where $g_I' < 0$.

If the price that prevails is P_A , they will get exactly what they expected. If the price of C, in terms of I, increases to $P_C (> P_A)$, then, for what they brought to exchange they can get a smaller amount than they expected to get (C^*). However, knowing that if they get less for accumulation, they can reduce the amount they have put aside for it, thus, increasing the level of their own product to be exchanged (supply of I) and moving to point C.

If the price is lower than what they have expected it to be they can always increase the level of accumulation (point B) by reducing the supply of their own product I. We can now draw that demand schedule in figure 5.d.4(b) where the position of the curve depends on the level of consumption, and of the expected level of accumulation (g_I^*).

We can immediately derive the supply of I which corresponds to the producers' of I behaviour in the market for C. We saw that $g_I' < 0$ and the supply of I will be their total surplus minus what they need for

accumulation:

$$I^s(P) = Y_I(1 - a_{II}) - g_I(P)NS^I$$

As $g_I' < 0$, the supply of I is positively correlated with P.

In a similar way we can analyze the behaviour of the producers of C and get the following equations for their demand of I and supply of C.

$$I^d(P) = Y_c a_{Ic} + g_c(P)NS^c \frac{a_{Ic}}{a_{cc}} + \gamma_I^c$$

$$C^s(P) = Y_c(1 - a_{cc}) - g_c(P)NS^c$$

given that $g_c'(P) > 0$.

Figure 5.d.5(a) depicts the partial equilibrium settings in markets C and I. Clearly we can see that there might be a problem of stability in this model. As long as the supply of C and I are steeper than the respective demand curves, equilibrium will be stable. I'm afraid that there is nothing of great significance in the conditions for stability and I will save the reader the trouble of going through it. Let us assume that the conditions for stability prevail. The existence of a unique general equilibrium is shown in conjunction with figure 5.d.5(b).

figure 5.d.5.(a)

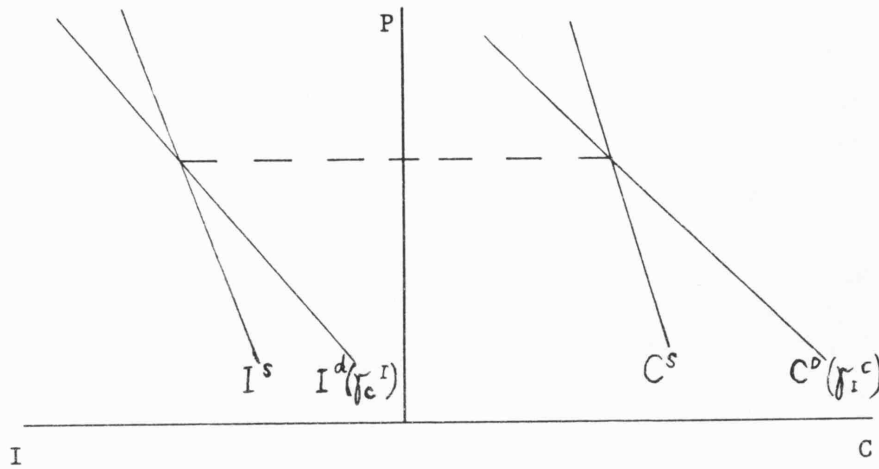
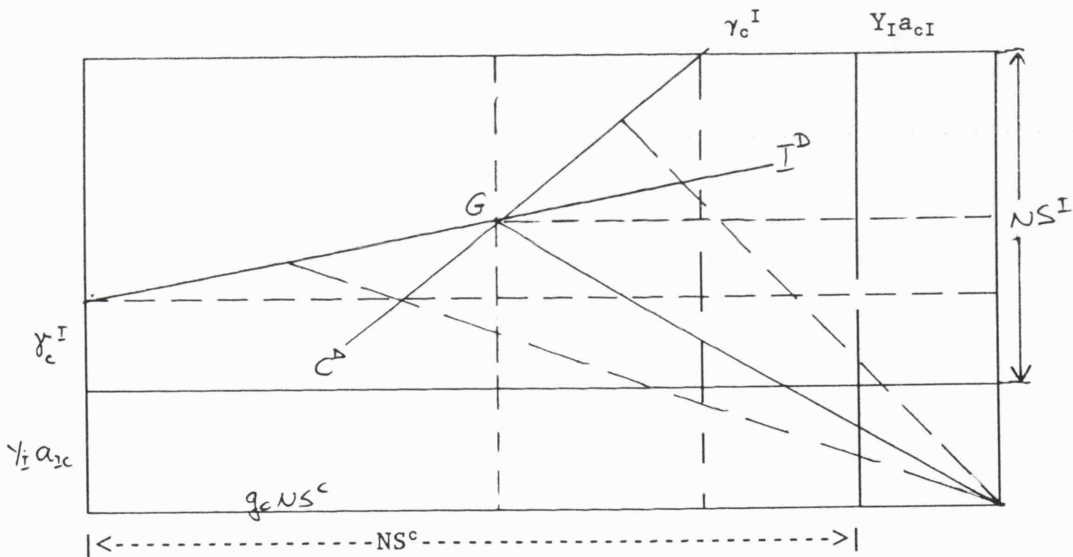


figure 5.d.5 (b)



The demand and supply of each sector are depicted by the process lines. At any other point of G the sum of the adjusted wants does not coincide.

We can now write the equilibrium equation in the two markets:

$$C^d(P) = Y_I a_{cI} + \gamma_c^I + g_I(P) NS^I \frac{a_{cI}}{a_{II}} = Y_c(1 - a_{cc}) - g_c(P) NS^c = C^s(P)$$

$$I^d(P) = Y_c a_{Ic} + \gamma_I^c + g_c(P) NS^c \frac{a_{Ic}}{a_{cc}} = Y_I(1 - a_{II}) - g_I(P) NS^I = I^s(P)$$

Which can be rewritten as:

$$NS^c - \gamma_c^I = g_c NS^c + g_I NS^I \frac{a_{cI}}{a_{II}}$$

$$NS^I - \gamma_I^c = g_c NS^c \frac{a_{Ic}}{a_{cc}} + g_I NS^I$$

Solving and assuming (for the Cramer method) that:

$$A = NS^c NS^I - (NS^c \frac{a_{Ic}}{a_{cc}}) (NS^I \frac{a_{cI}}{a_{II}}) \neq 0$$

We get the equilibrium growth rates:

$$g_c = [(NS^c - \gamma_c^I) NS^I - (NS^I - \gamma_I^c) NS^I \frac{a_{cI}}{a_{II}}] A^{-1}$$

$$g_I = [(NS^I - \gamma_I^c) NS^c - (NS^c - \gamma_c^I) NS^c \frac{a_{Ic}}{a_{cc}}] A^{-1}$$

By simple comparative statics we can see that the equilibrium growth rate of each sector is inversely related to the other sectors' planned luxurious consumption and positively related to its own luxurious consumption. This means that what we have here are the seeds of the moral disapproval of natural liberty.

Given the above results it is clear that what we have here is a kind of a prisoner dilemma. Each sector who wants very much to consume luxurious goods but at the same time to better its conditions through growth. By increasing its demand for these luxurious consumption (unproductive labourers) of the other sector's goods each sector can expect to enjoy both worlds. A higher luxurious consumption and a higher rate of growth. Performed simultaneously, they can drive the

economy to a very low rate of growth which, in the end, will harm all of them. The effect to labourers, obviously, are quite catastrophic.

To round up the argument, let us have a quick glance at the circumstances where luxurious consumption is not pre-determined. Only some plan for accumulation precedes the actual exchange. Figure 5.d.6 presents these circumstances.

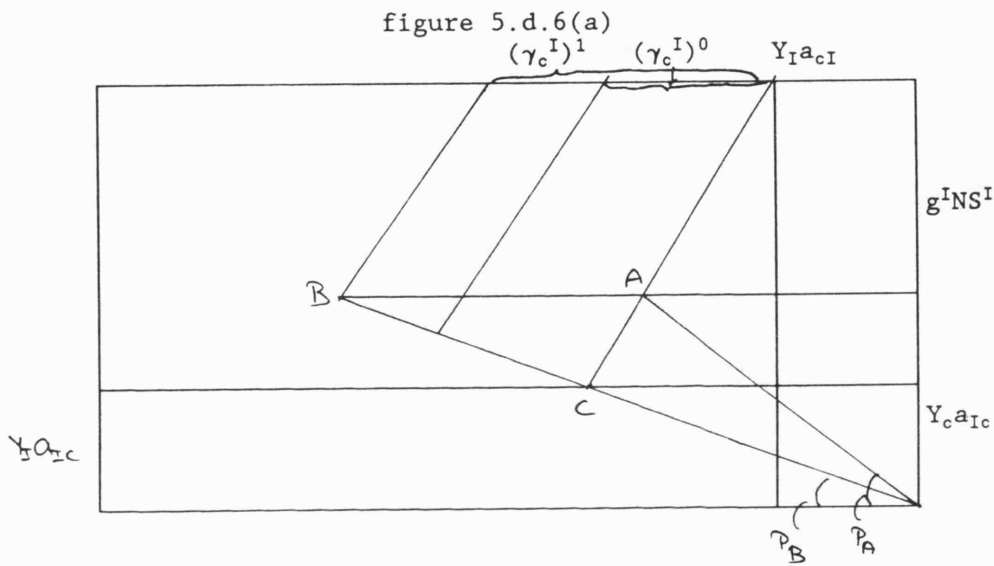
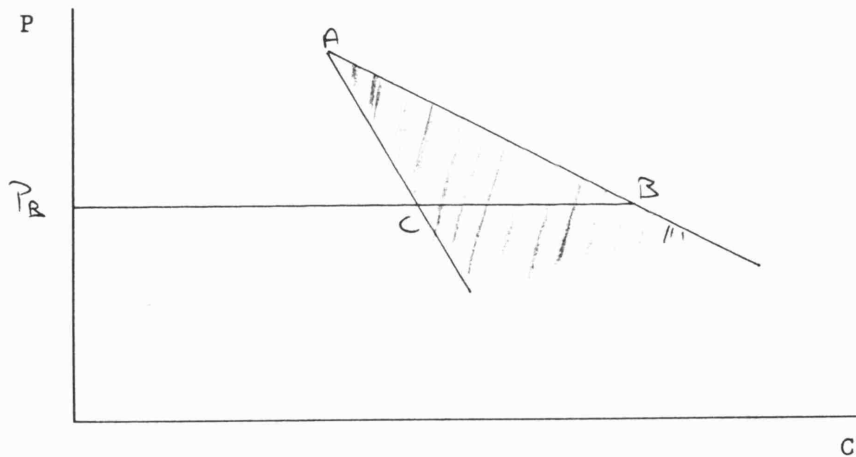


figure 5.d.6(b)



At point A in figure 5.d.6(a), if the price was P_A , the pre-intended demand would be fulfilled. The difference between this pre-intended

demand and the previous one is that there is no set level of consumption but there is a pre-set level of planned accumulation. Thus, at A the whole of the own surplus of I's producers will be turned to productive labour, namely, reproduction and accumulation.

If the actual price will become P_B , there are three possibilities. Either they will consume the whole addition of C they gained from the same amount of I, which they, sort of, brought into the market (point B), or, use it to increase accumulation (point C), or any combination between them (along the segment BC).

Therefore, for any price, there is a set of levels of actual demand as depicted in figure 5.d.6(b). Obviously, as we already saw, the equilibrium in such circumstances is not unique. As I have already stressed, it is the other configuration of demand that is more in the spirit of Smith argument. Hence, a unique equilibrium is the result of Smith analysis taken from the general equilibrium point of view. However, this result does not in itself guarantee the beneficial outcome of the system. Only under certain conditions (in our case set of consumption levels) the continual growth, which is the heart of the beneficial significance of his system, can be promised. The mere action of the 'invisible hand' will yield equilibrium, but not necessarily, beneficence. The uniqueness of the result calls for a better explanation of how the decisions on consumption and accumulation are made.

Two points are left to be shortly examined, the uniform rate of profit and the natural price.

(e) The Uniform Rate Of Profit.

The assumption of a uniform rate of profit is a crucial supposition in many of the dealings with classical economics in general and Smith's economics in particular. In any Sraffian type of 'cost of production' analysis this assumption will appear to be necessary if we are to solve, somehow, the price system. In particular, when demand has no role.

There are two main issues here. One is whether the circumstances of 'perfect liberty' really indicate that the uniform rate of profit will prevail. And the other is, how are prices determined without this assumption.

In the previous section I have tried to answer the second question. I argued there that though the role of demand is difficult to trace in his partial equilibrium analysis, it becomes more apparent in the general equilibrium framework of analysis. We saw there that equilibrium prices can be characterized even without the uniform rate of profit. Indeed, the general convention according to which there should be different growth rates in different sectors implies that rates of profit should not be the same. Before dealing with the meaning of all that let us concentrate on the first question, namely, on whether a uniform rate of profit is a natural outcome of the

system of 'perfect liberty'.

The most powerful source for the assertion of a uniform rate of profit is, no doubt, the following quotation. "The whole of the advantages and disadvantages of the different employments of labour and stock must, in the same neighbourhood, be either perfectly equal or continually tending to equality. If in the same neighbourhood, there was any employment evidently either more or less advantageous than the rest, so many people would crowd into it in the one case, and so many would desert it in the other, that its advantages would soon return to the level of the other employment." [WN p.116].

But then he goes on to argue that the fact is that the profits on stock, or the wages of labour do differ substantially. But not only because of false policies that limit the realm of perfect liberty. "But this difference arises partly from certain circumstances in the employments themselves, which, either really, or at least in the imaginations of men,....;and partly from the policy." [WN p.116].

So, it is not just bad policy that might create differences in rates of return, it may sometimes prevail where there is 'perfect liberty'. These circumstances are no less natural than the circumstances that give rise to the mechanism of the 'invisible hand'. Namely, they are characteristics of human nature precisely like self-interest.

Indeed, rate of profits are hard to tell and they are much less

influenced by the different circumstances than wages. However, they are affected by some important circumstances. "Of the five circumstances, therefore, which vary the wages of labour, two only affect the profits of stock; the agreeableness or disagreeableness of the business, and the risk or security with which it is attended." [WN p.128]. In particular, they vary with risk. The risk aversion, in the same person, according to Smith, varies itself in different stages of the life of the same person. He would obviously turn his stock not only according to where its rate of return is higher, but also in accordance with his age.

I therefore maintain that the assumption of a uniform rate of return does not prevail in Smith's theory. He did think that a tendency to a uniform rate of profits existed but he suggested nothing about the degree of equality it might reach. It is also significantly different from the argument about the differential wages.

The disutilities that are being caused in the different employments are the same to everybody. Anyone who works in an unpleasant job will experience similar degrees of inconvenience. However, the employments of capital do not depend on the particular circumstances of each venture alone. It also depends on the different dispositions that people might have towards, say, risk. A risk averse capitalist will not employ his capital in a risky project even if the earnings are high. It is possible to think of a situation where in spite the high return some capitalists will avoid moving into that employment of capital. Consequently they will earn a different rate of return as those who are engaged in more risky jobs.

Whatever one thinks I believe that it can be agreed that even if profits rates tend to uniformity they are, most of the time, different. In such a case, the use of a Sraffian 'cost of production' method of analysis means that general equilibrium prevails only when the rates of profit are equal. Namely, general equilibrium is a concept that is associated with 'natural rates' but not with deviations from it. Like in the growth models I have discussed before, the burden of Smith's perception of 'natural liberty' is not so much in the harmony of wants itself as it is in showing that the system will reach a state where harmony prevails. In the model presented in the previous section I have suggested to integrate the two. Namely, the harmony of wants at any one time (even without a uniform rate of profit) is present together with the powers that might drive the system to its 'natural rates'.

Let us examine now the significant of the uniform rate assumption to the model of the previous section. In terms of our model the rate of profit of the two sectors are the following ones:

$$r^c = \frac{PY_c(1-a_{cc}) - Y_c a_{Ic}}{PY_c a_{cc} + Y_c a_{Ic}}$$

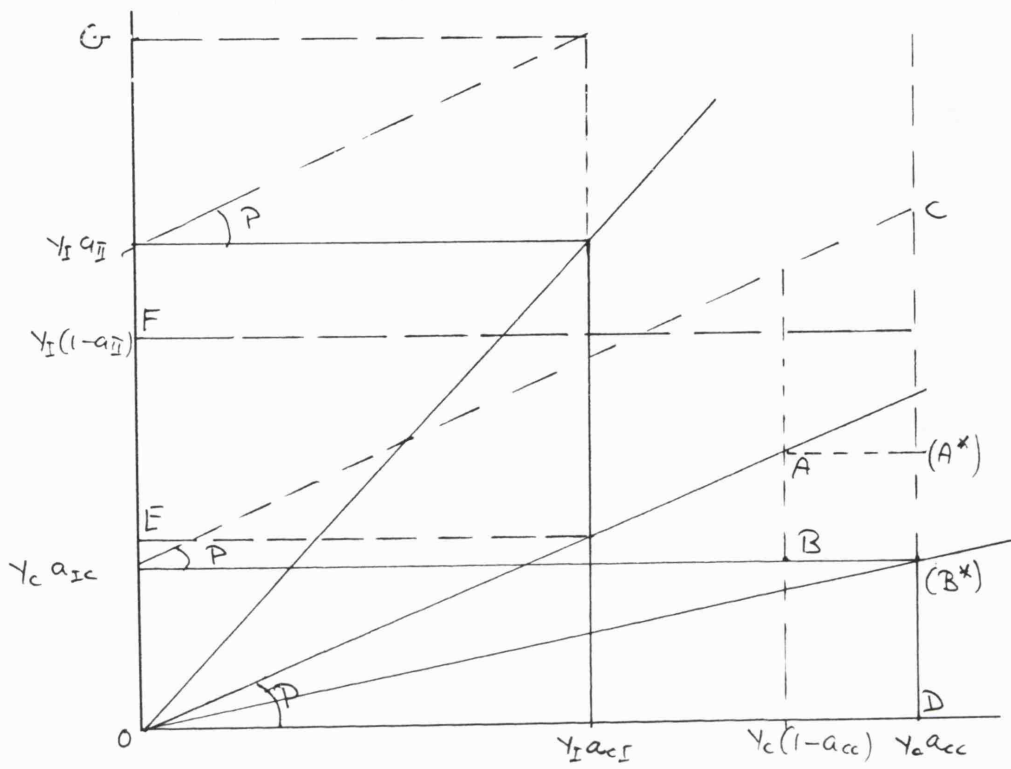
$$r^I = \frac{Y_I(1-a_{II}) - PY_I a_{cI}}{Y_I a_{II} + PY_I a_{cI}}$$

Figure 5.e.1(a)-(b) is over in the next page and it depicts the instances where profit rates are different (a) and equal (b). It is easy to see that the rate of profits as written above has the following geometrical representation:

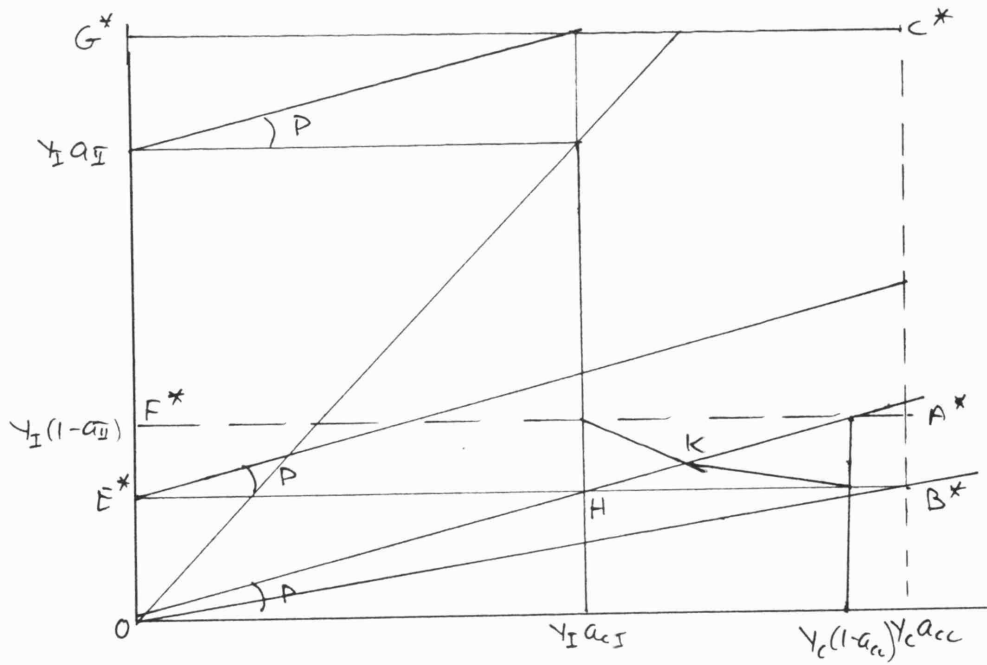
$$r^c = \frac{\overline{AB}}{\overline{CD}} ; \quad r^I = \frac{\overline{EF}}{\overline{GO}}$$

Figure 5.e.1

(a)



(b)



In figure (b) we can see the equivalent positions marked with (*). There it is clear that profit rates are equal. It is easy to see that what it means in that the price will coincide with the diagonal of the exchange box the two nodes of which are O and A*. The question is, however, whether or not the price should go through point H too. The answer is yes¹.

In our case the equality of rates means that both the numerator and denominators are the same (which, by the way is the only way to reach such equality as the rates of profit are inversely related). Hence, equating the numerators will yield that the price should satisfy:

$$P = \frac{Y_I(1-a_{II}) - Y_c a_{Ic}}{Y_c(1-a_{cc}) - Y_I a_{cI}} = \frac{NS^I}{NS^c}$$

This also means that the slope of the line between A* and K equals the price. This slope, we saw earlier, is precisely:

$$\frac{g_I NS^I}{g_c NS^c} = P$$

Hence, as could be expected, equal rates of profit means equal rates of growth. Notice that the fact that the price coincides with the diagonal of the exchange box means that whenever there is growth it is balanced and therefore, net surpluses will rise over time. However, there is nothing in the uniform rate of profit to tell us what rate it is going to be. We saw in the previous section that as far as equilibrium is concerned the same price can suit many demand

¹The importance of this point will be discussed in the next section. The only comment I would like to make now is that in our exposition the idea of 'cost of production' pricing presents itself when the price equals to the rate of exchange between what each sector requires from the other sector for reproduction.

configuration. Namely, there exist a whole range of levels of the pre-determined demand for luxurious consumption which is consistent with this price. Equilibrium, then, will be somewhere along the KA^* line in figure 5.e.1(b). The closer we get to A^* the lower will be the rate of accumulation that is associated with it. Hence, whenever there is a uniform rate of profit the beneficence of the system will prevail provided that we are not at A^* . However, there are different degrees of beneficence according to how high the rate of accumulation really is. Recall that beneficence meant that when there is accumulation there is a rise in the wages of productive labourers. Their sense of gratitude is the sole measure of beneficence as they are those who are being acted upon.

(f) The Concept of The Natural Price.

Most classical economists wrote about the natural price one way or another. So did Adam Smith. The meaning of this concept and its distinction from the market price are not as simple as many would like us to believe. Many would argue that the distinction between the natural and market price is a simple distinction between the short and the long run prices. I tend to disagree. In my view the natural price differs from the market price in its moral significance. I would like to argue now that the natural price, in the framework that we have presented above, is a composition of two things; the reflection of 'real cost' and the long run consequences of it to growth.

Let us first look at the definition of the natural price. "When the price of any commodity is neither more nor less than what is sufficient to pay the rent of the land, the wages of the labour, and the profits of the stock employed in raising, preparing, and bringing it to market, according to their natural rates, the commodity is then sold for what may be called its natural price....The commodity is then sold precisely for what it is worth, or for what it really costs the person who brings it to market." [WN p.72].

There are two components to this definition; one, that the natural price is the price of a commodity when all its arguments are in their natural rate. The other, that the natural price is "precisely what it is worth" or what it "really costs" the person to produce it and bring it to the market.

The first argument, naturally, leaves us baffled. There is no definition of what is to be called the natural rate of wages, profit or rent. The second argument sounds exactly like Smith's definition of prices in general (see section (c) above where the necessary references are being produced). Namely, that prices reflect the toil and trouble of producing and bringing a commodity to the market. If prices, in general, reflect the 'toil and trouble', and the natural price is what it 'really costs', then natural price is just another name for prices in general.

Some would argue that such a description of natural price may imply that Smith considered the labour values as the natural price. I personally don't agree with it but I do not think that the reasons for rejecting it are that labour values don't explain prices. The fact that he uses the same terminology to discuss the natural price as he did when he presented the concept of prices implies that natural prices are the essential prices. Even if we think of Smith's chapter 5 as a discussion of social welfare where labour is the measure of the true toil and trouble, then natural prices are those prices which reflect this true toil and trouble. Obviously, labour values when there is profit will not explain national income but Smith might still believe that they reflect the true price (though

not the true wealth). The question is whether or not labour values are not explaining actual prices even when profits are at their natural rate.

In any case, I do not believe that the argument as if the fact that labour values do not determine relative prices makes them meaningless. After all, natural prices, according to Smith are also not seen very frequently. "The natural price" writes Smith, "is , as it were, the central price, to which the prices of all commodities are continually gravitating. Different accidents may sometimes keep them suspended a good deal above it, and sometimes force them down even somewhat below it. But whatever may be the obstacles which hinder them from settling in this centre of repose and continuance, they are constantly tending towards it." [WN p.75].

Unlike gravitation, there is something in his description that can lead one to think that the natural price, though the centre of prices, may actually never prevail; it is like an unfrictioned pendulum that was once moved from its 'natural equilibrium', and though will never return there, her position is always influenced by it. In the same way, natural price can be a price which may never prevail, but market prices will always stand in some relation to it.

There is, however, another approach which regards the natural price as the long run price. The price that will prevail in the long run process of adjustment of supply and demand, and which will be the cost of production price. Marshall thought that it may be considered as the long run price only when assuming a stationary state, thus,

implying that for any structural circumstances, there is a price that would have prevailed, were we confronted with the same circumstances for a long period of time (Marshall, 1952. p.347). M. Dobb interpreted these rates as the theoretical rates that would prevail if we lived in 'perfect liberty' (Dobb, 1978. p.43).

It seems as if under this interpretation, the natural price is to be understood as the equilibrium price of perfect competition. But perfect competition can not be simply interpreted as 'perfect liberty'. I have already shown that although perfect liberty prevailed, there might be natural circumstances to prevent economic variables from converging to what is expected of them in a model of perfect competition. For instance, I do not think that there need to be any problem with the conditions of 'perfect liberty' when the rates of profits do not converge to unity. There might be a problem with diversity in human nature but surely no one (before Hotelling) will expect human characteristics to become the same as an indicator for 'perfect liberty'.

So there is something of both approaches in Smith's discussion of the natural price. It contains elements of being a true measure for the 'toil and trouble' and at the same time, it has this long-run meaning. The latter, however, not in the sense of being the price to which market prices converge but rather in the sense of a magnetic field.

The first thing to examine, therefore, is what it really costs to produce a commodity. From the point of view of the wage component of

the price it seems rather simple. The subsistence of the workers , as well as the allocation of materials, is always what it 'really' costs to produce a certain commodity. What seems more difficult is the natural rate of profit. In the same line of argument, namely. that what it 'really' cost to use a labourer is his subsistence, the natural profit should be what it really costs to reproduce the capitalist. "His profit, besides, is his revenue, the proper fund of his subsistence. As, while he is preparing and bringing the goods to market, he advances to his workmen their wages, or their subsistence; so he advances to himself, in the same manner, his own subsistence.[WN p.73].

If the natural rate of wages and profits is the subsistence level of the individual involved, one may argue that labour values coincide with actual prices and they make labour the measure of national income. This is so because in such a case we can write the subsistence of the capitalist as part of the 'cost of production', say, part of the corn coefficient. In such a case the interest rate which represented the rate of profit before will become 0 and then it is clear that (a) labour values coincide with prices and (b) that national income can be measured by population.

Nevertheless I do not think that labour theory of value is what Smith had in mind when he discussed natural price. My view is that the natural price is determined according to its proposed consequences.

If the natural price is according to the natural rates of wages and profits in the above sense, where is the surplus (which follows from

the division of labour) and how is it being distributed. When discussing prices Smith was very clear that the prices reflect the general distribution of the whole annual produce of a land. If so, prices that reflect no surplus can prevail only when the economy stagnates. This could not have been his intention.

Stripping the natural price off its surplus components, even though a logical mistake, can be interpreted that Smith argued that the natural price is the price that prevails when the surplus, is not used for consumption. Namely, that the capitalist consumes only what is needed for his reproduction while the rest is being accumulated. This approach will coincide with another reference that Smith made about the significance of the natural price. "What ever therefore keeps goods above their natural price for a permanency, diminishes nation's opulence....As what raises the market price above the natural one diminishes public opulence, so what brings it down below it has the same effect." [LJ p.498].

Therefore, I believe that natural price is neither the labour value nor the long run equilibrium. Rather, it is the price which advances society the most. Let us discuss now its two major features; namely its relation to the 'real cost' of production and its affect on the advancement of society.

What does it really cost to produce, in our model, a unit of C and of I. Surely it is a_{cC} units of C and a_{IC} units of I that are required to produce a unit of C. In the same way it is a_{II} units of I and a_{CI} units of C that are required to produce a unit of I.

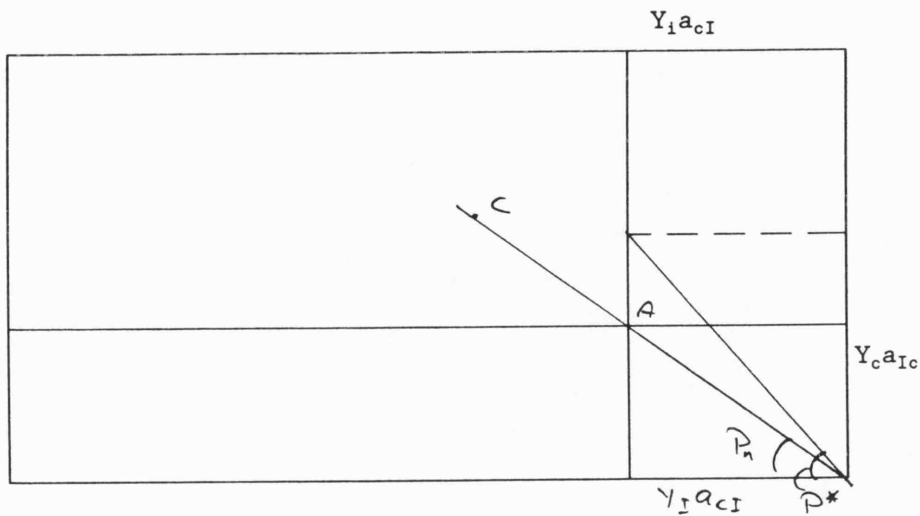
Not all of that is being purchased through the market. Each sector can ensure his own share in the process of reproduction. What becomes the role of the price is to ensure that each sector gets what it needs for reproduction from the other sector, without having to reduce his produce below the level of its own reproduction.

When Smith discusses the natural price as the price that pays what it 'really costs' to produce, he probably meant, what is needed for reproduction. If something was not needed for reproduction it could not have been a part of what it really costs.

In our framework of analysis the natural price that reflects the real costs must be such that under no circumstances will it be possible not to reproduce. Namely the price should be such that even if one sector decides to consume his whole net surplus, the other sector will still be able to buy what it needs for reproduction. In figure 5.f.1 this point is depicted at A.

While we can assume that each sector will endeavour to bring to the market at least the amount he needs to exchange in order to be able to reproduce, only point A guarantees that this motivation will yield both sectors with what it really cost them. P_n , is thus, the natural price.

figure 5.f.1



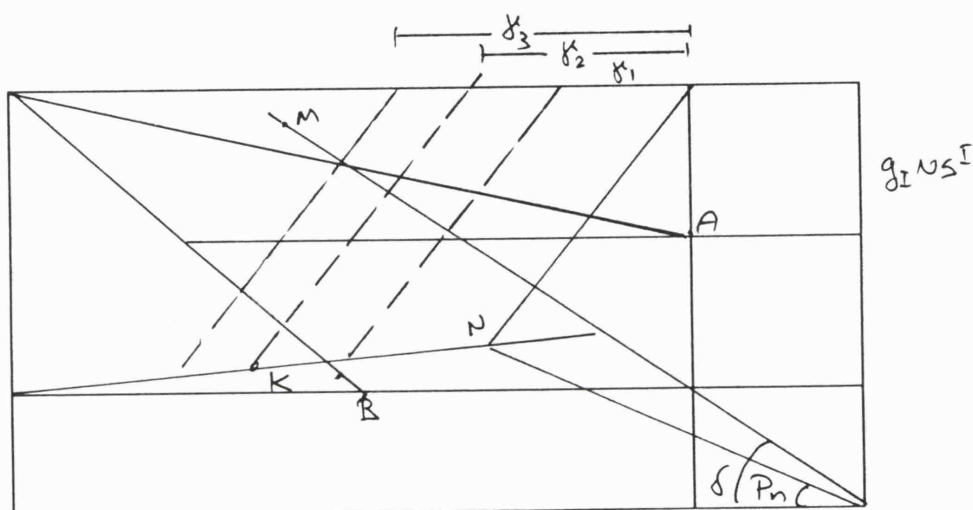
Obviously, Smith's assertion that the price will consist only of what is necessary for reproduction (in terms of materials and subsistence) is inconsistent with his own definition of prices. However, in our model we can make some sense out of it. The price P_n is a natural price in the sense that it reflects exactly the price ratio when only what is needed to reproduction (the real price) is exchanged. But the unavoidable surplus still exists and must be exchanged, thus, reflected in the components of the price. Any allocation of surplus, like point C in figure 5.f.1 for instance, will depict an allocation of surplus that is supported by the natural price.

Note that in this model the natural price is necessarily the same as the price that would prevail under a uniform rate of profit. However, unlike the 'cost of production' method of analysis where this is the only equilibrium state, in our model we allow for general equilibrium even if the rates of profits are not the same and the price is not at its natural rate.

Let us now, turn to the second feature of the natural price, the progress of opulence. Natural price is the price which advances the economy the most. While price in our model is a mechanism to allocate surplus, its expression as a natural price can be determined as the price where the whole surplus is being used for accumulation on a long term growth path.

In figure 5.f.2 we depict the relevant part of the model:

figure 5.f.2



In figure 5.f.2 we can see the process line, that serves as demand indicator, at different levels of consumption. It becomes a heavy line within the triangle ABC where the continual growth conditions are satisfied.

As the level of pre-fixed consumption increases, the equilibrium point (like N) shifts inward. If the rise in consumption is only on the part of one sector the economy will quickly reach an equilibrium which is outside the prolonged growth path and indeed, outside of the area where net-surpluses of both sectors rise continuously. The

rise in labourers wages will be temporary and in the end the economy will stagnate and there will be no beneficence in the system.

If the rise in consumption is balanced then the equilibrium will move inward within the triangle ABC. As it approaches point C the level of accumulation has diminished so much that no rise in productive labourers wages will occur and beneficence will be absent. The maximum growth possible is when we reach equilibrium at N. There, there is no luxurious consumption and as the whole surplus is used to raise labourers wages it is the highest possible beneficence of the system.

However, although the description of the price that supports N seems becoming to Smith's idea of the natural price, it might be a price that does not satisfy the 'real cost' requirement in a different sense. The price which supports N is such that the return to labourers and capitalists is precisely what they need for reproduction. But if we think of a price that reflects 'real cost' as the price which will exchange precisely what each sector needs for reproduction (and not for investment) then it must go through point R. However a price that satisfies this condition (like δ for instance), may support a distribution M which is as bad as K.

Thus, it seems that we have to choose. In the line of thinking that the natural price should be a source of distinction between different equilibria outcome, we may choose to extend the concept to include all those solutions that are consistent with continual growth (the beneficent outcomes). It does make the definition substantially

broader but it seems to be more in the line of what Smith considered natural prices to show. We may now summarize that the notion of the natural price as the price that reflects the real costs, does not necessarily coincide with its being the indicator of advancement (thus, a mark of a beneficent outcome). Even to a lesser degree it coincides with the maximum accumulation.

Only when the uniform rate of profit is present and the price that prevails is also the natural price (under very restricted conditions), we may say that the idea of 'real cost' coincides with the extended interpretation of the price as an indicator of progress.

A Brief Conclusion to Part 2

The context within which I have investigated Smith's work was laid down in Part 1. The general purpose, to remind the reader, is to examine whether developments in the conception of economic justice are strongly related to development in economic theory. For that purpose it is important to establish first that different schools in economics do have particular (and different) concepts of economic justice.

I chose to begin with Adam Smith for two major reasons. One, that he is considered as the breaking point of economics from ethics. The other, that he is considered by contemporary economists as a great advocate of 'perfect liberty' for its moral significance as much as for its efficiency.

My major conclusions in as much as the general context is concerned are two. First, that natural liberty is not considered as a morally good system. It is considered to be a system which is consistent with social viability and is, therefore, a 'just' system in precisely this very sense. Second, that the principle of moral evaluation of what is relevant to economics (i.e. actions) is a principle of desert. It is not, however, a principle of effort remuneration but rather a system where the merits of an action are in the proportionality between intention and outcome. The sense of gratitude and the rewards that are therefore due are the principles upon which the morally good distribution should be based.

To be able to apply these ideas to economic analysis there was a need to establish who acts and who is being acted upon in an economic system. In that respect the question of framework of analysis becomes of great significance. What acting and being acted upon means in a partial equilibrium setting is distinctly different from what it means in a general equilibrium framework.

In that respect is it quite clear to me that Smith's analysis is a general equilibrium analysis. It is not, however, the same concept as the modern notion of general equilibrium. There is interdependence but there is no simultaneity. While some may argue that these are not major differences, they are, and I will elaborate about it later on, as far as moral considerations are concerned.

Using my particular exposition of Smith's economics we have established that the idea of beneficence is strongly associated with the idea of balanced growth. But even then, given the nature of motivations on the part of those who bring about this beneficence (the self-interested capitalists) they will not render the system as morally good but merely as 'just' in the sense of social viability.

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PART III

I N T E R L U D E

1. INTERLUDE

The aim of this part of my work is to discuss in more general terms some of the questions arising from the effort to establish the moral significance of classical economics. It also aims to serve as a general introduction to the part on Mill.

There are three such issues which I feel need some clarification.

These are:

- (a) the problem of framework and its moral significance;
- (b) the role and meaning of the labour theory of value and;
- (c) the method of investigation.

These are all quite serious questions and obviously strongly related though it may not seem so on the face of it. Each of these issues requires a separate dissertation but as they all are at the back of my, and I'm sure the reader's, mind. I have therefore decided to devote some time to discuss these things explicitly so that the reader can see my point of view although he might not agree with me. I do not, in any way, suggest that I, or anyone else for that matter, have exhausted these subjects. As for myself I don't even think that I have reached a full understanding of them. Consequently I have brought them under the umbrella of what I call an interlude.

But it should not be seen as a break in the line of this work. These questions are of great importance and my view of them explains the structure of this work.

In the first chapter we will discuss in rather general terms what might be the implications of the difference in framework of analysis. We shall look at possible explanations to the use of labour theories of value and, I will say a few words with respect to the method of investigating past ideas. In particular as in my analysis of Mill which follows this part I will employ a bit of 'analytical reconstructionalism' which to some of you may not be so appealing.

(a) On the Question of Framework 1: Frameworks and Concepts.

Between the times of Adam Smith and Leon Walras there seem to have been two major changes in economic analysis. One is the emergence of subjective theories of values and the other, which is more particular to the case of Walras, is the dominance of general equilibrium analysis.

By saying this, I am also implying that classical economics was dominated by two different features; one, an objective theory of value and the other, a partial equilibrium framework of analysis. While the proposition that classical theories of value were objective theories, namely, theories where prices are dominated by

the production circumstances, will raise little objection, the one about the framework of analysis will encounter considerable opposition.

According to some scholars, and in particular Hollander (1985, 1987) Morishima (1989) and Walsh and Gram (1980), classical economics is a general equilibrium system. A system where everything is being determined simultaneously¹. No less than it is in the neo-classical tradition. In fact, in the previous part of this work (the section on Smith) I too seem to have implied a similar proposition. I have argued there that Smith's system should be understood as a general equilibrium analysis rather than a partial equilibrium one.

However, my interpretation of Smith's 'general equilibrium' is distinctly different from the concept that is being employed by Walras and contemporary theories. It is by no means a system where all economic variables are being determined simultaneously. A causal relationship between the various decisions made by different economic agents, can easily be drawn. Subsequently, moral responsibilities will also be easier to assign.

¹I would like to clarify what is meant here by simultaneity and I will come back to the subject in the next part. Obviously general equilibrium means any interdependence of economic variables. To present them in a form of simultaneous equation is always possible and indeed was one of Walras' major contributions. Nevertheless, when we do so we are giving up something which might be of importance to moral analysis: the chain of causes. This chain will be meaningless if the cycle is neatly closed and if each agent's position in the system is the same. In other words, the chain does not tell us anything if all participants have a symmetric position in terms of what motivates them and the degree of influence that they have on the model. If, however, there is a built in a-symmetry then the chain of causes may indeed be interesting even though in the end everything is inter-related.

But it is not only my interpretation that is distinct from contemporary notions of general equilibrium. I believe, and I will show it later on, that what scholars like Hollander or Morishima believe to be a 'general equilibrium' analysis of classical economics is closer to my interpretation of 'classical general equilibrium' than it is to the modern conception of it (the Walrasian one).

Thus, the mere claim that classical economic systems are systems of general equilibrium does not bring them closer to modern economic analysis. No more than the claim that 'cost of production' in classical theories (and in particular in Mill) is the Marshallian long-run equilibrium prices; given the question mark hanging on the neo-classical character of Marshall's economics (Mirowski, 1983)².

The question is, from the point of view of this work, whether it is of any importance at all that a particular economic system is being presented in a one or another framework of analysis. And, which is almost the same thing, whether or not there is any correlation between the apparent directions that economic analysis had been taking. In other words, whether there is a connection between the move towards Walrasian general equilibrium and the shift towards more subjective theories of value.

Regardless of how we perceive classical economics, I think that we can agree that the direct dealing with value theory is usually done

²The doubts with respect to how neo-classical Marshall might have been have nothing to do with his obvious subjective theory of value. It has to do with the framework of analysis. Namely, with the relationship, in the long-run, between demand and prices.

in an apparent partial equilibrium framework of analysis. Indeed, although I have argued for a particular general equilibrium interpretation of Smith I admitted that his dealing with value theory in Book 1 appears to be in a partial equilibrium setting. Obviously it does not mean that this should be the final word on which framework of analysis is suitable but it must have affected the classicists understanding of prices.

In a partial equilibrium analysis, where the focus of exchange is on produced goods³, the role of effort and cost is very great indeed. We will tend to interpret a price of commodity only with direct relations to what it means to bring its exchange about. Inevitably we will have to acknowledge the a-symmetry between the buyer of a produced commodity and its producer. The latter appears to have worked hard and the former simply enjoys himself⁴. Consequently, we might tend to see in the price (or wish to see in it) a reflection of that effort.

If, however, we know that the seller of a commodity in one market is the buyer of another commodity in another market we might be less inclined to see the price as a reflection only of the specific circumstances of this commodity production process. Our tendency to relate effort to price will then diminish.

To some extent this is precisely what I did in the part on Adam

³Notice that even in the Smith's rude stage the exchange is made between produced (sort to speak) goods.

⁴In the rude state both have worked and indeed it seems natural to compare their efforts.

Smith. It is clear to me that Smith's discussion of labour values in chapter 5 of book 1 reflects his view of prices from a partial equilibrium perspective. However, once we have established the general interdependence of his economic variables (through books 2-3), the determinants of prices become a different thing altogether. The equilibrium prices in the system developed in the previous part have nothing to do with effort. It is in Smith's view of the natural price where he is trying to bring together what determine prices with what he believes to be the nature of prices. In other words, the natural price can be seen as an effort to reconcile the view of prices from the partial equilibrium angle with its general equilibrium determinants.

In any case, whatever one may think about the distinction between partial and general equilibrium analysis I would like to insist that at least from the moral point of view such a distinction is of great importance. Two systems of general interdependence have different implications if the positions of the various agents in the one are similar and in the other, inherently different.

The long standing moral indicator of the 'just price', the study of which was dominated by the study of relationship between the buyer and the seller, will lose all its traditional significance if everybody plays all roles. A buyer in one market is a seller in another; his disadvantages in the one market can be compensated by the advantages he gains, for precisely the same reasons, in another market. In particular when what is at stake is only the extent of benefits people extract from their various exchange activities.

We may indeed have new interpretations to the 'just price'. We may follow Nozick and determine the 'just price' as the one that follows a fair exchange (a voluntary one). However, while such an argument may appear with no qualifications in a partial equilibrium setting it might not be the case in general equilibrium. If everything is simultaneously interdependent then the 'just price' which supports the procedures of exchange cannot be seen in such an isolated manner.

What it will mean is that when a 'just' initial distribution exists then, any exchange that satisfies the required conditions will be just. In other words, it is like saying that for any initial distribution there exist a final distribution which is supported by the 'just price'. In other words, the procedural 'just price', in general equilibrium where unique solutions exist, can be expressed in terms of the relationship between the initial and the final distribution.

In a general equilibrium framework we may think of three subjects of moral investigation: the initial distribution, the process of exchange and, the final distribution. What simultaneity in general equilibrium implies is that you can say very little on exchange as such. Unless one has an idea of what is the final distribution which is morally desirable one will need to form an opinion on two out of the three subjects I have mentioned above. The Nozick type of procedural justice, as I have said above, has the initial distribution as well as rules of exchange in the domain of its moral

function. But a theory of the 'just price' which only looks at exchange will be meaningless.

For instance, we may wish to confine procedural justice only to actions (and not distributions) and thus confine ourselves to a discussion of effort (actions) remuneration. We may choose the only requirement of procedural justice to be that exchange will be based on voluntary actions. In such a case, as there is no anchor either in the initial distribution (actions should not be confused with abilities) or in the final one, the 'just' price in the general equilibrium setting will become vacuous. There is a multitude of prices which satisfy that condition and that we cannot begin to characterize as they are inevitably associated with particular distributions. Similarly, an Aristotelian idea of proportional remuneration, to take an example of what may be meant in the traditional conception of the 'just price', will be lost entirely in such a framework.

But general interdependence does not have to be a simultaneous one. If, like in the case of Adam Smith, there is some causal relationship between the decisions of the different economic agents, the story is quite different. Prices in Smith reflect the capitalists' choice of how much to save (or return as circulating capital). Given the labour supply, that amount that will be saved will determine the wages of labourers in the next period. As in Smith some of those decisions are made by the capitalists before exchange takes place, prices therefore, do not determine wages but they reflect those decisions. Thus, we can judge prices according to what they imply will happen

to wages (remuneration).

But, one may wonder, is it at all a system of general equilibrium? Doesn't a sequential analysis imply a 'partial equilibrium' analysis at each point of time?. The answer is that it is a general equilibrium analysis because there is interdependence between all economic variables. The decisions on wages, conditioned by a theory of how wages affect the division of labour, will determine what I called the 'net-surplus' (or net profits). It is on these grounds that the capitalists make their decisions and from there, the cycle repeats itself. But unlike what is implied by simultaneity, the positions of the agent here are not symmetrical.

The decisions made by the capitalists reflect rational considerations. Those made by the labourers are quite mechanical. Hence, though there must be harmony between this mechanical behaviour and the rational behaviour of the capitalists, the harmony which matters from the moral point of view is only the one among the capitalists themselves. Given the condition that actions need to produce beneficence in order to be at least 'just' (in the Smithian sense of the word), and, the a-symmetry between labourers and capitalists (which makes the former the subject of all actions), then the decisions by the capitalists will determine whether or not there is beneficence. The price that emerges from such a situation may be called a 'just price'.

This 'just price' in the framework of interdependence where the roles and positions are not symmetric has escaped the problem of having an

implicit judgement about the relationships between initial and final distributions. Instead, it constructs a relationship between actions and final distributions. It thus combines the traditional view of the 'just price' as a reflection of the proper 'proportional remuneration' with that which follow from the general equilibrium analysis (i.e., the price which supports the desired final distribution). It simply relates actions (or intentions) rather than the initial distribution) to the final distribution. This would not have been possible had the complete interdependence of the system been captured by the idea simultaneous equations..

In view of the moral significance of the choice of framework I have therefore decided to extend my analysis of classical economics and to include a discussion of J.S. Mill as well. There are mainly two reasons for that. First, too many lines of continuity are being drawn between Smith and Walras (Schumpeter, 1954, p.189, Jaffe 1977, Robbins 1935 pp.68-9, Negishi, 1985, p.11 Hollander, 1977), thus, shedding some doubts on how representative of his own school has Adam Smith really been. Even when I consider the differences between the framework of general equilibrium that I have attributed to him and the Walrasian system, I can see why some may still argue that my interpretation of Smith excludes him from what is generally accepted as classical economics.

If we agree that 'cost of production' is the typical classical theory of value, then my model of Smith's economics certainly does not comply. The decisions of the capitalists, not cost of production, determines values in my model. And though one can argue that those

decisions themselves are a kind of simultaneous determination of the wages of next period (the cost of production), it is nevertheless a linkage formed through the means of demand side analysis. In other words, it is through the means of demand (and implied subjectivity) that I tie the ends in the Smithian model.

In my view this has no effects on the 'classical' nature of his analysis but nevertheless, in order not to be accused of avoiding the true classical model, I have decided to turn to Mill. His 'Principles' could easily be considered as the most updated representation of main stream classical economics. Some kind of a summary of the state of the art. It was certainly Mill's own purpose in writing the 'Principles'.

Nevertheless, many would argue that such characterization of his own work was mere modesty. His own contributions to classical economic analysis, it is argued, are no less significant than the immense task of tying all ends together.

What ever is the case, the importance of the 'Principles' in classical economics cannot be overstated. It was, as Schumpeter described it, "not only the most successful treatise of the period...but also qualifies well for the role of the period's classic work in our sense of the word."(Schumpeter 1954. p.527). Its success "was sweeping and much more general, also much more evenly distributed over all countries in which economics received attention, than was that of Ricardo's [work]."(ibid, p.533).

The second reason why I have decided to extend my analysis to Mill is his prominence in moral theory as well as in methodology. Not only changes in the structure of economic theory can generate a difference in the moral nature of an economic system. Also a change in the theory of morals is likely to alter the moral values that one attaches to the circumstances and consequences of a given economic system. From the methodological point of view it might be interesting to see whether there is any relation between changes in moral theory and changes in economic analysis.

In that respect, Mill has produced important writings in logic and methodology as well as in ethics. In them there is a reflection of many of the major developments in the intellectual environment of the time. Which makes Mill the perfect candidate for an investigation into the changes in classical economics theory viewed from the wider context of changes in the general philosophical environment.

Mill is also interesting for us from two specific points of view. These are the general context of his framework of analysis (i.e. his perception of the social sciences) and his moral theory. From the point of view of ethics, Mill seems to be famous for two doctrines that to some, would appear contradicting; his Utilitarianism and his writings on Liberty. I will obviously deal with this problem but what matters from our point of view is that his theory is (a) distinct, according to my interpretation, from that of Smith. Thus, making the question of the moral significance of classical economics as a school more interesting. And (b) that through variants of it, Utilitarianism has been carried on to quite a lot of contemporary discussions in

normative economics. Hence, Mill becomes an interesting intersection point between classical economic analysis and modern approach to questions of normative economics.

I have pointed out before that the choice of framework of analysis may have some moral implications. I would also like to argue that the difference in moral implications can also be explained by the fact that the different frameworks reflect a much more profound difference in the scholars 'Weltanschauung'.

General or partial equilibrium, therefore, should not be viewed as mere technical methods, rather as reflecting one's view on the nature of relationships between the various economic variables. And how one perceives the relationship between those variables and the other social, or natural, factors (and theories).

There can be little doubt that for Adam Smith the study of the social sciences was not different from the study of natural phenomena. J.S. Mill, however, saw a great difference between these two fields of investigation. Not only in terms of what are the appropriate method of investigation, but also because of the profound difference in the nature of social and natural phenomena. For Smith, social phenomena were not different from the complex world of matter to which the physicist had to apply himself. Thus, the great harmony of nature can easily be applied to society. But it must be noted that it is a harmony that prevails everywhere and not only at the aggregate level

of nature, or society⁵.

For Mill, on the other hand, the complexity of society was a reason to be sceptical about human abilities to establish clear causal relations. And though he would have agreed with Smith that society as a whole, like a big organism, has its own harmony, he would not have agreed that each of society's organs has a self-contained harmony of its own. Simply because the different aspects of social life are so strongly interwoven.

Naturally, the perception of society will play an important role in the choice of framework for its study. And it was this that brought me to argue in part 2 of this work for a general equilibrium interpretation of Smith's work. It is for the same reason that the case of Mill is so different. His perception of economics as comprised of both natural (production) and social (distribution and exchange) sciences creates many confusions. In the framework of the natural sciences (or the experimental ones) causal relationship according to Mill, are easy to establish. It is thus the interaction

⁵Newtonians laws, for instance, were considered as applying to the Universe as a whole as much as to all its sub-divisions and indeed, smallest particulars. Notwithstanding Hume's problem of induction, the general harmony can, therefore, be seen as merely a summation of the harmonies at the particular level. In the same way, for Smith, the invisible hand mechanism is a manifestation of the idea of harmony in the 'sub-section of the universe' called economic activities (or the production of wealth). It means that as part of the general harmony, economic variables reach a certain harmony between them, with no significant reference to non-economic variables. It is, perhaps, like the Stoic notion of the Pneuma. The harmony of the universe is perceived through its compliance to a particular law. Like the pneuma, when going through matter defines them, so does the law of nature, when applied to anything, will achieve harmony. This is an entirely different idea than a 'geological' concept of equilibrium. At the local area there might be dis-equilibrium though in the whole of the earth this will not be the case.

of labour with matter that generates commodities. All produced commodities, therefore, can be measured, and compared with one another in terms of their cause- labour. And if we consider a system where commodities are used in the production of other commodities, we can establish a general interdependence of all commodities in terms of the labour (past and present) used in their production.

But this apparent idea of general equilibrium (with a cost of production flavour) runs into great difficulties once handed over to social institutions like, for instance, the institution of exchange. Society, as we said before, is perceived by Mill as extremely complex. In fact, there is no reason, according to Mill, to assume that economic variables are determined only by other economic variables⁶. The effects of other social factors (like, for instance, education which affects the theory of character formation (ethology), which, in turn could affect the concept of the 'economic man' and consequently the theory of demand) cannot be ignored. Therefore, the idea of an economically confined general equilibrium will be difficult to apply. What determines the price of one commodity is affected not only by what determines the price of another, but also on other social considerations.

⁶I am sure that the reader will now feel that I am ignoring completely the concept of 'ceteris paribus'. I do not. I will discuss this point later on at two levels, one, the simple interpretation of ceteris paribus and the other, Mill's interpretation of it. I would only say here that it is hardly conceivable of a theory to assume as ceteris paribus those variables which it believes to have strong affects on those variables which are being investigated. Thus there is an implicit assumption that we know the other variables to be less significant than those we actually analyze.

One of the most important implications of the choice of framework is on the theory of value and on its relationship with the theory of distribution. It must be clear, however, that general equilibrium approach does not necessarily imply a complete inter-dependence of distribution and value theories. For instance, in the 'cost of production' approach, wages are usually assumed as pre-determined (usually at their subsistence level). Thus, even though a 'factor price frontier' type of relationship between wages and profits can be established through the theory of value, there is by no means an inter-dependence between them. On the other hand, 'partial equilibrium' does not mean lack of dependence. One can think of a set of markets where prices are being determined independently of one another and yet, the sum total of those markets will yield distributional values.

Indeed, one of the question that we shall have to deal with is what do we mean precisely by general or partial equilibrium. Whether inter-dependence alone is general equilibrium or some forms of a one-way causalities may also qualify. In any case, the effects of the choice of framework will be considerable. In the case of Smith, to give an example, the choice of general equilibrium has transformed the system from a 'partial equilibrium' cost of production theory of value, to a theory where consumption decisions of the capitalists (i.e. saving decisions) will have distributional consequences which will also affect prices. To some extent, I believe, it implies that Smith's theory of distribution was not so far from a form of a Keynesian theory, or, perhaps even more accurately, a Kalecki one (there too, distributional shares were

dominated by the saving decisions of the capitalists alone (see in Kaldor (1960) and Kalecki (1942)).

Having said all that means that the task in front of us is still quite immense. I will obviously discuss in more details the question of the framework of analysis but as far as the general conclusions regarding classical economics, I will have to defer that until much later. In my work on Mill I will try to show how this distinction between the frameworks of analysis can make the whole difference.

(b) On the Question of Framework 2: Framework and Epistemology - A Note

In the section above I maintained that the framework of analysis might have some implications about the applicability of some ethical concepts to economic analysis and I will discuss them more carefully in part 3. I will also argue that the difference between classical economics and the Walrasian paradigm will not be that the former is a partial equilibrium analysis while the latter is a general equilibrium analysis. Rather, the difference will be in the conception of general equilibrium.

Some might argue that such distinctions are not very relevant as they simply reflect methods of dealing with a problem the structure of which may be agreed on all. For instance, one may argue that the simultaneity of general equilibrium is merely a technical thing. That it is virtually the same as a kind of sequential interdependence

between economic variables (which is more what classical equilibrium is all about). They will argue that Walras' contribution to equilibrium analysis is the idea to solve the interdependence problem of economics by the use of simultaneous equations. This, of course, does not mean that he thought the world to be like that. Similarly, it can be argued that we can always choose a small enough unit of time such that even what appears as simultaneous will have a causal relation over time.

However, this is not what it is all about though I agree that it could have been. The difference between the classicists' conception of general equilibrium and the Walrasian conception of it are deeply rooted in the difference in the epistemological foundations of the two schools. While the classical school can be said to be dominated by 'classical empiricism' the Walrasian approach is definitely 'rationalistic' in nature.

In the case of Adam Smith, for instance, the sequential nature of his conception of general equilibrium is rooted in the a-symmetry between the capitalists and Labourers. No matter how close in time are the decisions made by the capitalists (with respect to the usage of their surplus) and those made by the labourers (to increase their number or affect the division of labour in as much as it a decision variable), the causality is enshrined in the fundamental difference in the nature of their decisions. This difference, however, is based entirely on what Smith observed to be the behaviour of the different classes.

Paradoxically enough Adam Smith was not aware of the problem of induction that is associated with 'classical empiricism' and that was raised by his friend Hume. Walras, on the other hand, worked within a particular kind of solution to this problem: the 'rationalist' solution. He could have 'easily' reached the idea of simultaneous equations because he perceived knowledge in a different way. In his *L' Economie Politique et La Justice* he discussed the notion of causality in connection with exchange. In order for a meaningful causal relation to appear in Walras we would expect utility to be the cause of value. Only if it is so then we can say that the behaviour of one individual caused prices to change and thus, affected another individual. But Walras does not consider utility as the cause of value. Very much in line with Descartes (1988. pp.178-180) he calls utility the genus of exchange value. The differential of value is scarcity. Hence it is scarcity which moulds and shapes the differences in exchange value but scarcity is not a decision parameter of individuals. Moreover, according to Walras causality is given by perpetual sequence and proportional relationship between the two facts⁷. Such conditions will be difficult to satisfy in a sequential general equilibrium where there is a-symmetry between the various agents.

Simultaneous equations were the right choice for Walras as he assumed (a) that all economic agents act similarly and with similar effect and (b) that all of them are dominated by a third cause, scarcity. Now scarcity as a cause, it should be noted, does not change and

⁷"Concomitance perpetuelle des deux faits, proportionnalite constante de l'un a l'autre, telles sont les conditions d'un rapport des causalite qu' on puisse admettre". (Walras, 1860. p.9).

cannot be affected by the activity of the economy. Though some may argue that the production of capital goods and technological improvement mean that scarcity does change, it will not be true according to Walras' interpretation of it. When we describe an intertemporal optimization problem we do not (and we cannot technically) allow for the utility functions to change. But if scarcity is the cause and utility is its differential then it means that each period there should be a new set of utility functions reflecting the changes in scarcity.

In the classical case (in the context of the 'cost of production'), however, this is not so. Wages play the role of scarcity. Once wages are determined the prices and profits are set. But here, wages too are affected by the system. Hence, the 'cause' (or perhaps the 'transitory cause') and effect are interrelated.

Similarly the meaning of choosing a small enough unit of time in order to obtain causality will suffer from the immense difficulty of the meaning of time in such framework. In particular it will be the case of Walras who, in my view, followed Descartes but was convincing himself that he is reconciling the various schools. All this, I'm afraid, is only the tip of the iceberg of a dangerous subject. I will not deal with it here. The only point I was trying to make is that there is a fundamental difference in the perception of the world on the part of 'empiricists' and 'rationalists' and therefore, I'm not convinced that Walras was simply successful in something that economists were trying to do for a century before him. In my view he understood the world differently.

Whether or not different epistemologies imply significant differences in moral theories is yet again a vast topic to be left out. Nevertheless I do feel that by the mere difference in the conception of the economic world and the nature of relationship between its components we can learn a lot about the changes in what is considered to be the subject matter of economic justice analysis.

(c) Sub-division of Classical Economics and the Labour Theory of Value.

From the point of view of the inter-relation between the developments of economic theory and concepts of economic justice, the question of the general framework (political and philosophical) is of considerable importance. In that sense between the times of Adam Smith and Leon Walras classical economics appears to have developed in two different directions. One direction was within the framework of what is considered in general as liberalism, the other, within the framework of what I shall now generally name as socialism. I believe that J.S. Mill and Karl Marx are good examples of these different trends⁸.

⁸Though Mill and Marx were contemporaries, they seem to have related very little to each other. As Duncan(1973) puts it "they were contemporaries who, despite their significance as the theorists and organizers of very different schools and movements, paid very little attention to each other"(p.1). This lack of attention provoked various explanations. One of them accused Marx of having plagiarised Mill's political economy (Balassa (1959) which is quite astonishing an accusation if we consider them to be of rival schools.

To some, this would appear as an aberration. They would argue that there can be little doubt about the 'true' nature of classical economics. That most of what we call classical economics had been written within the tradition of liberalism. They will probably point out that in the most fundamental aspect of economic theory- the theory of value- Marxian economics differ significantly from classical economics. In the essence of Marxian theories stands the labour theory of value. Classical economics, it will be argued, was dominated by a distinctly different theory of value; a 'cost of production' theory of value. Thus, the whole episode of the labour theory of value as well as the theories that are founded on it, though they may have merits of their own, should, from the point of view of classical economics be considered as a mere detour from its natural development (see for instance Schumpeter, 1954 p.568). Nevertheless, in view of what I believe to be the unsettled question as to how much of classical economics is the labour theory of value, one cannot doubt that Marxian economic theory is at least a legitimate offspring of that tradition.

Indeed, the question of the theory of value is the key to the understanding of the different nature of economic theories. If we accept the generally shared view that the theory of value associated with classical economics is a 'cost of production' theory of value, then Marxian economics may seem as a mere aberration. However, if

Evans(1989) deals with these questions and 'absolve' Marx from this accusation. Nevertheless, in view of their competing doctrines, there still remains a puzzle why hadn't Marx attacked Mill's theory. The explanation as if Marx hadn't really finished the Capital and that he would have discussed Mill's Principles had he had the chance to do so, is, in my view quite flimsy. If indeed their doctrines were antagonistic then in view of Mill's prominence Marx would have opened his economic analysis by criticizing Mill.

we extend the characterization of classical theory of value to be a theory of 'objective effort' or, an index of the difficulty of attainment, as opposed to the 'subjective' neo-classical theory, then a labour theory of value cannot be considered as aberration.

Moreover, there is also the question of what is really meant by a labour theory of value. For Ricardo the labour theory of value was a proposition about what it is that determines prices. Hence, the question is really whether or not prices are proportional to labour values; or, in other words, whether relative prices reflect labour inputs. Some would argue that this is also the case in Marx's theory which is the reason why the problem of transformation became so crucial. If then, it can be proved⁹ that prices do not reflect the labour theory of value, it becomes an empty concept.

However, this is not the only possible interpretation to the role and significance of the labour theory of value in classical economics. Instead of being the regulator of prices, labour can be seen as the origin, or meaning of values in a more abstract fashion. Indeed, even though it is agreed that Smith's theory of value, for instance, is a 'cost of production' theory, there is enough evidence in his writing to support the argument that a labour theory of value had crossed his mind. In fact, there can be no doubt that in Smith's description of the 'rude stage of society' values were proportional to labour inputs. Why, one may wonder, does he bother at all to

⁹There are many proofs based on the Ricardian-Marxian qualification that the proposition only holds if the capital to labour ratio in each industry is the same. I will however deal with these proofs when I discuss the problem of labour theories in the last section of this part.

discuss a theory which he then considered to be of no consequence? What, in other words, is the purpose of exploring the theory of value in the 'rude' state of society if not for the purpose of extracting its most essential arguments?

Even Ricardo, who quite clearly modifies the conditions for the proportionality of labour values to prices, does not seem to abandon it himself. The explanation in his case is rather simple; though labour inputs do not determine prices, the changes in them seem to be in accordance with the changes in relative prices (or what became to be known as the 93% labour theory of value). Nevertheless it remains unclear why it matters at all, that changes in relative prices correspond to changes in labour values if what determines prices is something completely different.

There are two other interpretations which, in my view, are not unrelated. One is the one I have discussed above. Namely, that while analyzing prices in a partial equilibrium analysis it seems intuitively appealing to characterize prices according to their attainment difficulties. When the two hunters meet it is still a partial equilibrium analysis and as we know nothing about their wants and needs or, for that matter, their activities in other markets, what can be a measure for exchange other than labour inputs?

The other is an explanation put forward by Blaug (1985) which I have already discussed earlier. This explanation is that Smith's view of labour was a measure of welfare. Not only was Smith interested in the national income but he wanted to see the true toil and trouble that

were involved in producing it. Therefore, he suggested nominal wages as the deflator to the national income. Viewed in this way it is clear that Smith never thought of labour theories of value.

I thoroughly agree that Smith did not see in a labour theory a mechanism which explains prices. I also agree that he saw in labour -- in the true toil and trouble-- the real measure of welfare. But this does not mean that he hasn't considered the same measure at a disaggregated level. Namely, that he hasn't thought of the labour value of a commodity as reflecting the true 'toil and trouble' of producing this commodity. This does not mean that he thought actual prices to be determined by it but on the other hand it is not an empty concept. If we know what the true 'toil and trouble' of producing a commodity is we can, perhaps, understand what it means to deviate from it, as is bound to happen. It certainly is not a worse explanation than to argue that labour values are wrong measures of social welfare.

On the whole, however, it is clear that discussions of labour values dominate classical economics. However, once we understand that the purpose of it was not to explain prices (except Ricardo), we must try and see what was the other meaning of it. A measure to social welfare is indeed a possible explanation and it is, in my view, an equivalent one to that where labour values are the measure of the 'true' cost of production.

It is, apparently, easier to explain the meaning of a labour theory of value that does not regulate prices, in a 'rationalistic'

framework rather than in an 'empirical' one. In the former, ideas, or concepts, may exist with a very complex relation, and sometimes none at all, to observed phenomena. Thus, as prices are the observed phenomenon, labour values may be the unobserved one (in particular if we refer to past labour). Eventually, the problem will be to determine the meaning of this dual system and to analyze the conditions and significance of the divergence of one system from the other. In the 'empirical' tradition, however, there is no room for a labour theory of value if it is not closely correlated with an observed phenomenon, like prices.

Notwithstanding the difficulties and complexities of Marx's methodology, I believe that it is possible to generalize and categorize his work within the rationalistic tradition (or to be more precise, within its special branch of German Historicism)¹⁰. Hence, in such a framework it is meaningful to consider labour (indeed, abstract labour) as the universal of produced commodities- as the intrinsic value of things- without being inconsistent with the lack of its observed influence. In the case of Smith, who is believed to be a 'classical empiricist', a labour theory of value that does not regulate prices may prove irrelevant. However, in the previous part of my work I have argued that Smith's methodology was by no means free from, at least, 'Scholastic rationalism'. Thus, a way is being made to explain the role of the labour theory of value in his system even when it does not regulate prices.

¹⁰I do not wish here to go into the details of the problem of Marx's methodology. I admit that it is an over simplification but as far as my particular purpose is concerned, it is served. I also do not think that I do Marx in-justice as this may be a possible interpretation of it.

In a rationalistic framework, the role of labour as the universal of all produced commodities may have some important moral implications. Particularly when theories of right and entitlement are being discussed. If, for instance, a proposition is being made about one's right to one's fruits of labour (a proposition made by both Mill and Walras)¹¹ a labour theory of value may prove very helpful. To begin with, it may offer an explanation as to why observed prices deviate from a labour theory of value. At the same time, and in view of that, it might itself become a measure for some concepts of a 'just price'. An economy, then, might be judged according to its deviation from it.

In an 'empirical' framework, however, this is much more difficult. First, there is no epistemic content to the proposition about the labour value of things. Thus, a labour theory of value would only have any significance if it could be proved that it regulates and dominates observed prices. Even then, from the moral point of view it will probably be of no great consequence in view of the Humean dictate that no 'ought' statement can be derived from the 'is'.

In Smith, however, labour values do play a moral role. If labour values are the social welfare measure of true 'toil and trouble' it means that whenever the system deviates from labour value (when there is accumulation and profit) the labour measure is greater than the one measured by the 'true labour values'. Hence, the dictate of

¹¹ This is in itself an astonishing thing. A theory of right from which such a proposition is being derived can hardly qualify as utilitarian. Indeed, that was one of the reasons I began searching for the true meaning of Mill's moral and social philosophy.

moral is to increase the number of people so that it will catch up with the number reached by deflating national income by nominal wages. Therefore, the 'natural price', interpreted as the price which is associated with the highest rate of balanced growth, is the 'just' price as when it prevails there is a rise in population.

There is a reason why I have focused the reader's attention on the labour theory of value. It is because it seems to me that the confusions, and sometimes mis-understandings, of the role and meaning of the labour theory of value is also the reason for some of the confusion with respect to the moral significance of classical economics. I believe that understanding why those scholars who seem to have neglected the labour theory of value as explaining relative prices but kept writing as if they adhered to it, is the key to the understanding of the moral implications of their economic theories.

(d) A Note On 'Reconstructionalism'

Explaining the origin (methodologically as well as historically) of our present concepts of economic justice is, in my view, a task with great contemporary relevance.

From this point of view it was of great importance to establish the

difference in framework between classical and neo-classical analysis. Namely, to discuss the different notions of general equilibrium and to investigate the moral consequences of this difference. (The problem of causality and moral responsibility). It is also important to establish Mill's theory of economic justice even though he had not discussed it explicitly. For that purpose I had a choice. To bring together the Logician, the moral Philosopher and the Economist in J.S. Mill and thus be blamed for 'reconstructionalism'. Alternatively, I could have simply collect Mill's moral assertions with respect to economic issues and to establish on it his theory of economic justice.

There are, in my view, two different ways to look at the nature of any attempt to analyze past theories (as distinct from historical analysis of 'facts'). One way is through its aim, the other, through the means of that investigation. Suppose now that there are only two kinds of such investigations which some may title as 'historical' and 'analytical' reconstructions (which in my view is not a very meaningful distinction as any reconstruction bears the seeds of an analytical investigation). To distinguish between them through their aims is to say that 'historical' reconstruction aims at explaining apparent 'factual' contradictions in the past. (In the case of the history of ideas 'facts' should be interpreted as statements or propositions.). An 'analytical' reconstruction, accordingly could be interpreted as a reconstruction of past ideas for the purpose of explaining present difficulties (either theoretical or factual). It is a kind revival theories (like Sraffa (1960), for instance).

To distinguish between the two methods by their means is to say that 'historical' reconstruction is based on evidence found in the past. Namely, in the case of ideas, that a contradiction in propositions can be settled only through further investigation into the author's other manuscripts. However, it must be noted, such a reconstruction can only be resolved if one finds an explicit explanation to the contradiction in question. Otherwise, one needs either to employ some analytical tools or, to decide between the opposing statements according to their appearance in time.

'Analytical' reconstruction, viewed from its means, is an investigation that resolves such problems by using the logic as employed by the original author. From this point of view these two methods answer two different questions. One is, what did he really say?, the other, what could he have meant?. For anyone who is interested in the history of ideas as an expression of the development of human knowledge, the only interesting question is the second one.

Now, while the two interpretations of 'historical' reconstruction are quite consistent, it is not so with 'analytical' reconstruction. If 'analytical' reconstruction is, according to its 'means' definition, based on past logic, what good is it for the purpose of explaining contemporary problems (its 'aims' definition)? Why not apply present logic to it? Well, the answer to this question depends on whether one believes in progress. Of course, this cannot be the case of theories which have a clear experimental side to them. The social sciences, however, are certainly not this case.

There are quite a few problems with applying 'historical' reconstruction to analyze the theory of economic justice in Mill. First of all, some very important propositions which appear in Mill's Principles are not obvious extensions of his moral theory. So much so that one really begins to wonder which moral principles should be applied to Mill's economic analysis. The most obvious example is the principle of 'proportional remuneration'; the assertion that everyone has the right to the fruits of one's effort, labour or abstinence.

The immediate application of that principle appears to some to be Mill's objection to Rent. However, this idea is not so simple. Indeed, Mill argues that "this principle [of proportional remuneration] cannot apply to what is not the produce of labour, the raw material of the earth".(Principle, p.230). However, he offers an 'economic' justification for allowing rent as otherwise, no cultivation will take place. Like Ricardo, he objects to the taxation of rent (beyond what is the common practice) on the grounds that it is impossible to tell which part of the rent is due to improvements (and then it is virtually profit) and which isn't.

So what emerges from all that is that Mill sees a great difference between moral and economic justification. Indeed, in his Liberty he even argues that the justification of Free Trade cannot be grounded on the idea of individuality which is the most important fundamental in Mill's moral theory. So how does expediency relate to ethics? Well, in spite of his Utilitarianism, expediency is only a secondary consideration. In his discussion on property Mill argues

that society may choose to organise itself in different ways. For each he contrives the principles which, one can show, follow from his theory of individuality. Then, he says, when comparing two perfectly ethical systems, they will be tested according to how well they perform.

This, in principle, is not a very meaningful distinction between ethics and economic expediency. For each system, according to Mill, reflects different kinds of human development so that it is not really that we choose from a set of possible worlds, rather, the state of the individual dictates a certain social organization. As far as these organizations are efficient he seems to have little doubt that they all are, if properly organized.

Mill's explicit support of free-trade is also accompanied by serious criticism of the effects of competition on the diversity (and thus, individuality) of society. Moreover, in *Liberty*, he is quite explicit about that fact that exchange is in the domain of social interference. The only reason why he objects to it is that its particular purpose (efficiency) is better achieved without such intervention.

In order to establish whether free-trade is also morally good, one must examine whether the principles which should dominate its 'ideal', have an extension in the real world of economics as Mill described it. For that purpose, I needed again to resort to 'analytical' reconstruction. By establishing a relationship between the principle of proportional remuneration and classical economics,

I will be able in the future to see what happened to a similar principle when it comes from a different philosophical background and is applied to a completely novel idea of economic analysis: the Walrasian system.

As the principle of proportional remuneration dominated the history of economic justice, it is of great interest to see how and why it disappeared almost completely from present day analysis of economic justice. Some would argue that the whole problem of Mill's view of proportional remuneration and its application to economics can be analyzed through his treatment of Rent. However the only thing we may get out of it is that Mill did believe in the principle as he (as well as Smith and Ricardo) was apprehensive about the rights of rent. But this we know already. The question is how can the principle be generalized in a consistent manner to the other components of society.

For that purpose I will have to resort to some 'analytical reconstruction' and I can only hope that the reader can see its merits.

2. A Walk in The Woods: Some Reflections on General and Partial Equilibrium in the General Context of Classical Economics.

In principle, the question of whether classical economics should be discussed in a 'partial' or, 'general' equilibrium frameworks depends on what we believe to be the distinction between the two frameworks. As such, it is a subject that is beyond the scope of my present work but nevertheless, I would like to say a few words about it in connection with our particular task¹. Surely if not all economic variables are inter-related it must have some effects on the subject of economic justice. In particular, as the case of Mill appears to be, when the theory of value is consciously (may be wrongly) being disassociated from the theory of distribution.

(a) *The Problem of Definition.*

Basically, or perhaps only technically, equilibrium is the simultaneous determination of a set of variables. At one place,

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¹I would like to remind the reader that this is all part of the interlude. I do not pretend to have even started dealing with the full complexities surrounding the concepts of 'general' and 'partial' equilibrium. What I do want to investigate is how do different conceptions of equilibrium affect the role and meaning of prices. In turn, this will have important implications to the moral analysis of economics. It is mainly to that end that this chapter is devoted.

Hicks(1983) wrote that "equilibrium is relative to the things that we are prepared to treat as exogenous."(p.39). Which basically means that the only way to distinguish between different types of equilibria is through the numbers of variables that we consider simultaneously. However, the ability to choose any number of variables means that at any one time there exists a set of variables we believe to be related and, out of which we choose those to be considered endogenously and those to be considered exogenously. Surely, there would be no point at all in mentioning exogenous variables had we not had any idea about the nature of their relations (or interactions) with the variables we chose to analyze. Thus, the existence of general equilibrium is pre-supposed. It comes to practice when we consider all variables simultaneously².

Obviously, the question that immediately follows is what do we mean by 'all variables'. If we mean by that the set of all economic variables then the idea of general equilibrium means that we believe that all economic variables are inter-related. Partial equilibrium analysis in such a case, which really adheres to the true meaning of the word, is merely a technical concept. It is an analysis of the simultaneous determination of one, or some variables out of the set with the underlying assumption that all economic variables are completely inter-dependent. Partial equilibrium in such a setting

²We must be careful with what is meant by 'all' variables. We can think (and I'll discuss it below) of variables in a hierarchy form. That is, we may have several sets of variables which are distinguished by the number of variables in them. Those in the lower order will influence the other but not necessarily the other way around. Within each such set there is complete interdependence. When I refer to 'all' variables I mean, at this stage, all the variables in a self-contained set which is also the lowest order of these sets.

is indeed just a technical term with no significant insight of its own regarding the fundamental nature of economic phenomena.

Hence if we believe 'all' economic variables to be all those things which have a price then a general equilibrium approach will mean to denote, say, the demand for each good as a function of all prices:

$$(1) \quad D_i = D_i(P_1, \dots, P_n).$$

In a 'partial' equilibrium analysis we will write the same demand function as:

$$(2) \quad D_i = D_i(P_1, \dots, P_i).$$

Clearly what we are saying here is that we think prices P_1, \dots, P_i to be of greater significance to the market of the commodity in question than the rest of the prices. We cannot, in principle, construct (2) before knowing anything about (1).

What does it mean, one may ask, to say that (1) is a true description of the demand for this commodity? The answer must be in some fundamental assumption about the system. Namely, that markets are inter-related through economic agents. Equation (1) is true because we assume that each individual has preferences over the whole set of goods (completeness assumption). Hence, each individual has an active interest in all markets and if there is a change in one of them it will affect his behaviour in all the others. Each

individual, then, has an equal role in the system.

If, however, by the set of all variable we do not mean all economic variables then even a simultaneous analysis of all variables that we believe to be related, cannot be considered as general equilibrium. The word general will be mis-leading. Naturally, if we consider a 'general' equilibrium of an economic system, we imply by it that all economic variables are inter-related. As by defining the set of 'all' variables to include less than all economic variables, our analysis is by nature-partial equilibrium. It tells us nothing about the determination of some economic variables which we have knowingly excluded from the set of 'all' variables. Economics, in such a case, will be a set of sets which are not necessarily related to one another. Within each set we may choose to analyze all or part of the variables simultaneously but this will not invoke a meaningful distinction (other than linguistic) between partial and general equilibrium.

So far, however, there was an underlying assumption that dominated our analysis; that of inter-relations. This, of course, is fundamental to modern interpretations of general equilibrium. From Walras via Debreu to Arrow and Hahn, the basic feature of general equilibrium is the complete interdependence of all economic variables. Thus, as all of them are being determined simultaneously, the problem of causality gets a new and untractable dimension (an interesting discussion of it can be found in Simon (1953))³.

³ The problem of whether simultaneous equations are good tools for the purpose of estimation reflects the debate about how we perceive the real world. T.C Liu (1960), for instance, attacked simultaneous equations on the

However, what would the case be if we supposed economics to be comprised of more than one set of variables. Namely, that not all economic variables are inter-dependent?

The nature of economic analysis in such a case will depend on the relationship between the sets. If, for instance, they are completely independent from one another, then economic analysis is conducted in a 'partial' equilibrium framework even if within each group of variables we may analyze the simultaneous determination of all of the variables. If, however, there is some causal relationship between them, say, the equilibrium values of one group affect the equilibrium values of another group but not the other way around we may run into some difficulties regarding our 'definitions'. Can we consider it as a general or partial equilibrium conception of the economic system?. On the one hand, there seems to be a sort of causality flowing in one direction; binding, as it were, all economic variables in a chain of causation but nevertheless, no inter-dependence exists. On the other hand, part of the economic variables are determined independently of other economic variables; can we really call it 'general equilibrium'?

grounds that the world, as a matter of fact, is much more simultaneous (interdependent) than we can imagine. As a result, any set of simultaneous equations for the purpose of estimation will be underidentified. But at the theoretical level simultaneous equations will be the right method of analysis. H. Wold (1957) on the other hand, argued against simultaneous equations on the grounds that in reality there are unilateral causations. Hence the rejection of simultaneous equations in this case will be at the theoretical level as well. Of course this does not mean that all variables may not be interdependent in one way or another. In any case, this debate is beyond the scope of this work but what I would like to stress is that simultaneity is not just a technical matter. It reflects a much more serious problem; that of our perception of the world.

To some extent, this latter case is the case of 'classical economics' and, in my view, one of the reasons for confusion regarding its nature. Those variables which on the whole, seem to be determined separately are the values of remuneration and in particular, the remuneration of labour. Once determined, they affect the theory of value but only in as much as 'cost of production' values are the gravitation point around which actual prices oscillate. However, changes in actual prices do not seem to have an affect on remuneration. The reason for that is that there is no way to relate actual deviation of prices from their 'cost of production' as these are caused by changes in demands which are not explicitly inter-related.

The difference between a Walrasian system and a classical one can also be seen through the parameters of the solution. In Walras, the parameters of the solutions are the technological coefficient (of production and consumption). In the 'cost of production' system the parameters are also technological except one; wages. Now there is, from a normative analysis point of view, a big difference between parameters which are 'decision' dependent and those which are 'given'. In Walras the parameters are given. In the 'classical' analysis we can agree that at least one is a 'decision' parameter⁴. Wages, if not taken at their subsistence level, are an equilibrium result (of the labour market) which appears to be independent of the price system to which determination it contributes.

⁴By decision I mean a parameter which depends on the cumulative behaviour of economic agents.

Thus, the 'classical' system (unlike the Walrasian one) is hierarchical in terms of its economic variables. And though this does not mean that we cannot present the price system as a set of simultaneous equations, it cannot be thought of as a description of the same kind of world.

Even if we thought of the behaviour of the labourers as being technological (and thus setting wages at their subsistence level at any time) it would still be different from the Walrasian system. If the division of labour (the technological coefficients) depend on the dynamic of wages then again we shall have a hierarchical system though the nature of parameters will not be different than that of the Walrasian system.

(b) The Concept of General Equilibrium in Classical Economics

The problem of the one-way causal relationship between, say, remuneration of labour, and values of commodities can take two different forms. One, it can be supposed, as it is usually done, that the problem of classical economics was not so much in trying to construct such a line of causation, as it was a failure in the attempt to bind them together. Consider, for instance, how Walras interpreted this problem in classical economics. "[A]ccording to the English School, we must have the prices of the productive services in order to determine the prices of the final products" (Elements,

p.421). But, argues Walras, this cannot be done as the prices of the productive services depend on the price of final goods. He describes Mill's system (by the way, completely false) as suggesting that the price of final goods, P , is the sum of its cost of production: $P = S + I$ where S stands for wages and I for interest rates. S , argues Walras, is pre-determined, thus, at least consistent with its being independent of the price P . I however, is described as the residual between the price and advances for labour. Hence, $I = P - S$. "It is clear now that the English economists are completely baffled by the problem of price determination"(p.425).

The question remains whether their failure according to Walras is in not succeeding to construct profits independent of prices or, in succeeding in constructing wages in such a way. As I have just indicated, there is a great difference between the two interpretations. If their failure was in not succeeding to divorce profit determination from prices, then it is believed that the Classicists perceived economics as a system of 'partial equilibria'. If, however, it is believed that they failed, technically, to achieve complete interdependence, (namely, they failed to connect wages with prices) then a 'general equilibrium' approach is attributed to them.

I believe that Walras criticised the classical school because he thought that they failed to see the general equilibrium nature of economics. That they have tried to divorce the problem of distribution from that of value. Some modern economists, like Hollander (1985,1987) and Morishima (1989) seem to believe that this was not the case. That the only reason why the classical economy has

not produced general equilibrium analysis is simply because of technical reasons. There is, however, a great difference between views like those of Hollander and those of Morishima. The former tends to argue not only that classical economics should be seen as a general equilibrium analysis, but that it should be seen as a 'neo-classical' one in the nature of its propositions (like, for instance, the subjective theory of prices and the role of demand). Morishima, on the other hand, does not seem to insist that classical economics offered 'neo-classical' propositions, rather, that 'general equilibrium' should be applied to it in order to extract from it, its own logically consistent propositions.

In any case, according to these views, the classical theory of value is a theory of 'cost of production' which, it is argued, is a general equilibrium theory. However, as I have argued above, this is not the same idea of general equilibrium as understood in the modern framework of analysis. Consider, for instance, an economy with n commodities which serve in the production of each other. Let A be the technology matrix where a_{ij} is the amount of commodity i used in the production of one unit of j . Let P be the vector (row) of prices while L is the vector of labour inputs. W will be the wages (in money) and r the rate of profits. We shall assume that the value and stock of money are constant throughout.

The idea of general equilibrium in terms of 'cost of production' theory of value means that prices are determined according to the following set of equations:

$$\begin{aligned}
 P_1 &= (1+r) [P_1 a_{11} + P_2 a_{21} + \dots + P_n a_{n1} + w\alpha_1] \\
 P_2 &= (1+r) [P_1 a_{12} + P_2 a_{22} + \dots + P_n a_{n2} + w\alpha_2] \\
 &\vdots \\
 (1) \quad &\dots\dots\dots \\
 &\vdots \\
 P_n &= (1+r) [P_1 a_{1n} + P_2 a_{2n} + \dots + P_n a_{nn} + w\alpha_n]
 \end{aligned}$$

Or in a matrix form:

$$P = (1+r)[PA + W\alpha].$$

If general equilibrium means complete inter-dependence, then the above system does not satisfy this condition. P is the price vector produced by this system of 'cost of production', r and W are the distribution variables. Surely, for all of them to be inter-dependent (or, in other words, to be determined simultaneously) there are not enough equations. To use Simon's terminology, this set is not self-contained. Thus, the idea of inter-dependence must be abandoned at once.

The 'traditional' solution to the problem is to fix one commodity as a numeraire; and to fix wages at the level of subsistence (i.e. $W = PS$ where S is the subsistence vector). Thus, we have two concepts of real wages. One in terms of the subsistence requirements of the labourers and the other, the purchasing power in terms of the numeraire. The former is pre-determined, the latter is being determined in the model.

The question is, does it mean that real wage is an endogenous variable? If subsistence is indeed a reflection of necessities, why does it matter at all what his wages are in terms of the numeraire. Suppose, for a moment, that the numeraire is taken from the bundle

of subsistence. The idea of a subsistence bundle is that one needs those levels of consumption from all the goods that comprise it. Hence, substitution is not possible. Thus, though the labourer may be able to buy more of the commodity he does not need any more, he will not do so because his earnings are sufficient only to pay for his subsistence.

Of course, this would be even more difficult to accept had the numeraire been taken from outside of the subsistence bundle. There are additional complexities that are introduced by this solution and I will deal, with them soon. At the moment, however, it is a solution in as much that it reduces the number of unknowns to the number of equations.

The problem now takes a new form. Equation (1) is now:

$$(2) P=(1+r)[PA+PS\alpha]$$

where S is a column vector and α is a row vector so that $S\alpha$ is a matrix. A typical component of $A+S\alpha$ is $a_{ij} + S_i a_j$ which is the amount of commodity i needed for the production of one unit of j plus the amount of i needed for the subsistence of the labour required for the production of j . We can now re-write (2) so that:

$$(3) P(1+r)^{-1}=P[A+S\alpha]$$

Thus we have a simple problem of finding the 'eigenvalue' and the 'eigenvector'. Following Perron-Frobenius we know that when a matrix is productive (i.e. $A \geq 0$ and for any $x > 0$, $Ax < x$) there is only one positive eigenvalue which corresponds to a positive eigenvector, and, that its value is always less than 1. Hence, as $(1+r)^{-1}$ is the

eigenvalue, then it means that $r > 0$.

The implication of it is that r , a distribution parameter, is secured as positive because of the productivity of the system, not because of prices. In fact, it is easy to show that r depends only on the technological coefficients. The eigenvalue of (3) is determined by:

$$(4) \det[(1+r)^{-1}I - (A+S\alpha)] = 0$$

Of course, prices too are determined by the technological coefficients alone. The question is whether or not we can call this inter-dependence. In my view this is not a case of inter-dependence. It is a case of one-way causality. Causality from the technological circumstances (which contain one distributional parameter) to prices and profits. Hence subsistence determines profits but not the other way around.

It must however be noted that I am ignoring here something which dominated Smith's analysis and, I believe, makes it a different case. This is the dependence of technology on distributional parameters; namely, the dependence of the division of labour on what the capitalists do with their profits and how it affects wages. But unlike Smith, in Mill though technological changes are considered, they are being considered independently of the development of economics (social institution). (In Chapter 3 book 4 Mill discusses the influence of progress and he considers various possibilities of combination between the development in the division of labour and different trends of other economic factors. He does not, however, consider the reciprocal influences that these trends might have).

Coming back to the problem of general equilibrium in a cost of production framework, some would argue that the only thing that matters is that we can establish an inverse relationship between wages and profits (from the theory of value). But this, I believe, can be quite misleading. It means that if we reduce profits we might raise wages, and this is not true. The only thing we may say here is that if we raise wages (subsistence level), profits will fall.

The inverse relationship between the rate of profits and wages appears to be an important proposition in terms of the moral implication of such an economic system. Presumably, this inverse relationship, given the uniqueness of the system's solution, provides us with some relationship between various prices and distributional parameters. Thus, by looking at a price we can learn from it something on the relationship between the rate of profits and the wages. A price, therefore, can be morally just according to what it proposes with respect to the values of the rate of profits and wages. However, as I will show immediately, even this inverse relationship is not at all a robust result as is usually assumed. In section 7 I will also show that even if it were, it would not be a meaningful relationship as what happens to actual shares of each social class in the total output is not determined.

If, however, we want to discuss wages not as a technological coefficient but rather as an endogenous variable, we shall have in spite of all the conceptual difficulties to refer to the concept of real wages in terms of the numeraire.

Let us study now the simple case of 2 commodities. Let commodity 1 be the numeraire so the problem we have is the following one:

$$(5) \quad \begin{aligned} 1 &= (1+r)[(a_{11}+S_1\alpha_1)+P(a_{21}+S_2\alpha_1)] \\ P &= (1+r)[(a_{12}+S_1\alpha_2)+P(a_{22}+S_2\alpha_2)] \end{aligned}$$

We can re-write it as:

$$(6) \quad \begin{aligned} F_1 &= [(a_{11}+S_1\alpha_1)+P(a_{21}+S_2\alpha_1)](1+r)-1=0 \\ F_2 &= [(a_{12}+S_1\alpha_2)+P(a_{22}+S_2\alpha_2)](1+r)-P=0 \end{aligned}$$

Where,

$$F_1(P, r, S_1, S_2) = F_1[P(S_1, S_2), r(S_1, S_2)] = 0$$

The partial derivative matrix will be:

$$\frac{\partial(F_1, F_2)}{\partial(P, r)} = \begin{array}{cc} \frac{\partial F_1}{\partial P} & \frac{\partial F_1}{\partial r} \\ \frac{\partial F_2}{\partial P} & \frac{\partial F_2}{\partial r} \end{array} = \begin{array}{cc} (a_{21}+S_2\alpha_1)(1+r) & a_{11}+S_1\alpha_1+P(a_{21}+S_2\alpha_1) \\ (a_{22}+S_2\alpha_2)(1+r)-1 & a_{12}+S_1\alpha_2+P(a_{22}+S_2\alpha_2) \end{array}$$

Let a_{ij} denote the components of $A+S\alpha$.

Now we can establish the inverse relationship between profits (r) and subsistence (say, S_1).

$$\begin{aligned} \frac{\partial r}{\partial S_1} &= - \frac{\hat{a}_{21}(1+r) \quad \alpha_1(1+r)}{\hat{a}_{22}(1+r)-1 \quad \hat{a}_{12}+P\hat{a}_{22}} \\ &= - \frac{\hat{a}_{21}(1+r)^2\alpha_2 - [\hat{a}_{22}(1+r)-1]\alpha_1(1+r)}{a_{11}(1+r)[a_{12}+Pa_{22}] - [a_{22}(1+r)-1](a_{11}+Pa_{21})} \end{aligned}$$

If $a_{22}(1+r)^{-1} < 0$ then the denominator as well as the numerator are positive so that the relationship between r and S_1 is negative. But there are some conditions when this is not the case.

It will be indeed difficult to argue that the denominator can be any thing but positive, but this is not the case with the numerator. If $a_{22}(1+r)-1 > 0$ the denominator must satisfy the following condition to be negative:

$$\hat{a}_{11}[\hat{a}_{22}(1+r)(P-1)+\hat{a}_{12}(1+r)+1] < \hat{a}_{21}P[(1+r)\hat{a}_{22}-1]$$

This is most unlikely as the right hand side is very small indeed. If P , which is a relative price, is around unity, the left hand side is clearly greater than the right hand side.

The numerator, on the other hand, must satisfy the following condition to remain positive (so that $\delta r / \delta S_1 < 0$):

$$(1+r)(\hat{a}_{21}\alpha_2 - \hat{a}_{22}\alpha_1) + \alpha_1 > 0$$

Which means

$$\frac{\alpha_2}{\alpha_1} > \frac{\hat{a}_{22}}{\hat{a}_{21}} \left[1 - \frac{1}{(1+r)\hat{a}_{22}} \right]$$

But as $1/(1+r)$ is always less than 1, $1/(1+r)\hat{a}_{22}$ is also less than 1 by assumption ($\hat{a}_{22}(1+r) > 1$). Thus, the expression in parentheses is close to 1. The question whether or not the numerator is positive depends on the relationship between the ratio of direct labour inputs and the ratio of circulating capital. There is nothing in the system to guarantee either results. The conclusion as if wages in terms of subsistence is inversely related to the rate of profits is conditional.

I admit that the above conditions are indeed stringent, but the problem of relationship between profits and wages cannot really be considered as technological. Indeed, if we wish to allow some sort

of endogeneity to wages, we shall have to treat it in terms of the numeraire. Wages are thus given as $W = S_1 + PS_2$. A change in real wages will be:

$$\frac{\partial W}{\partial S_1} = 1 + \frac{\partial P}{\partial S_1} S_2$$

Suppose that the r - S_1 relationship is indeed negative, we still have to see how a change in S_1 affects prices.

$$\begin{aligned} \frac{\partial P}{\partial S_1} &= - \frac{\alpha_1(1+r) \hat{a}_{11} + P\hat{a}_{21}}{a_{11}(1+r) \hat{a}_{12} + P\hat{a}_{22}} \\ &= - \frac{\alpha_1(1+r)[\hat{a}_{12} + P\hat{a}_{22}] - \alpha_2(1+r)[\hat{a}_{11} + P\hat{a}_{21}]}{a_{11}(1+r)[\hat{a}_{12} + P\hat{a}_{22}] - [a_{22}(1+r) - 1](\hat{a}_{11} + P\hat{a}_{21})} \end{aligned}$$

The denominator must be positive for the original r - S_1 relation to hold. The sign of the numerator depends on the sign of:

$$\alpha_1(\hat{a}_{12} + P\hat{a}_{22}) - \alpha_2(\hat{a}_{11} + P\hat{a}_{21})$$

And this depend on whether:

$$\frac{\alpha_1}{\alpha_2} > \frac{(\hat{a}_{11} + P\hat{a}_{21})}{(\hat{a}_{12} + P\hat{a}_{22})}$$

Hence, the effect of a change in subsistence on the price depend on the ratio between direct labour inputs. Now let us see what will happen to Wages in terms of the numeraire. If $\delta P/\delta S_1$ is negative, the answer will depend on the size of S_1 . Again, we have no definite answer as to the relationship between wages and profits.

Hence, if subsistence requirements rise, profits will fall but wages in term of the numeraire may fall as well. What can we say in such a situation on the moral significance of the rise in wages and fall

in profits. Surely, what seems to be missing is the effects of prices (or technology, to be more precise) on the distributional shares.

The meaning of all that is that the concept of general equilibrium that is often assigned to classical economics, does not really offer an insight into the question of the relationship between the theory of value and distribution. Either because in any case one distribution parameter determines the other as well as prices so that there is no causal relationship between prices and distribution. Or, because the relationship between the two distributional parameters in such a system is not well established. The truth is that given distributional parameters (r and S_1) may yield three different prices for three different types of technological circumstances (I will show it in section 7). But the system as presented above tells us very little about how distribution and prices are actually related.

One way of over-coming these problems is in the idea of the wage-fund doctrine. Given the time factor, wages are paid at the beginning of the period, profits are collected at the end of it. The wages for the next period are determined by the ratio between how much the capitalists decide to return to the system as circulating capital, and the number of labourers. Hence, it seems as if we have the following causal relations;

Profits---> Wages----->Profits---->

There are, however, two problems here. First, it seems that the theory of value is merely a by-product of this cycle. As wages are determined, they comprise part of the technological circumstances which, in turn, determine profits as well as prices. There is, however, no need on our part to look at prices at all as the determination of profits and wages does not depend on them.

The other problem is that the arrow from profits to wages depend on the decisions made by the capitalists how much to consume and how much to save. If anything, this is the place where the effects of a theory of value on distribution can present itself. However, in order to see how the decisions of the capitalists are being coordinated we must examine an aspect of the theory that seems to be missing entirely from the 'cost of production' approach. In the case of Mill as in the case of other classical economists there are surprisingly 'modern' descriptions of demand functions (see Forget 1989), nevertheless, a general interdependence between them is not established. Thus to argue that the 'cost of production' are the general equilibrium long-run prices to which all markets, analyzed in a partial equilibrium framework, will eventually converge is unacceptable. In Mill's case, I believe, it is the result of the partial equilibrium nature of analyzing social phenomena. Thus, cost of production are not necessarily the prices that will prevail, but they are a good reference point.

(c) The Moral Implications

Allow me now to say a few words on why the question of framework is relevant to the problem of moral significance.

To consider the difference between the general and partial equilibrium approaches, in terms of their proposed moral consequences, it would perhaps be useful to try and examine them in a wider context. Such, for instance, that may suggest something about possible methodological relationships between economic analysis and moral theory.

There are mainly two issues to be considered here. First, whether each framework of analysis is associated with a particular epistemology. And whether a particular epistemology implies particular moral considerations. Second, there is the question of whether or not the particular frameworks of analysis as such, with no reference to their epistemological origins, restrict in any way the moral analysis.

To the reader who is familiar with modern philosophy, the first question may seem a little bit puzzling. How can we relate the problem of discerning 'true' from 'false' to the question of distinguishing 'right' from 'wrong'. After all it was Bertrand Russell himself, the champion of 'analytical empiricism', who found the combination of science with ethics intellectually and morally objectionable. It is so, apparently, because 'analytical empiricism'

has changed the focus of philosophy. It has turned philosophical questions into 'syntactical' ones. Admitted by the way that doing it narrows significantly the scope of philosophy. (Carnap, for instance, was so taken by the 'linguistical' approach that he insisted that all problems of philosophy can be interpreted in the same way. It was Russell who had to convince him that this is a little bit far fetched).

In the framework of 'analytical empiricism' epistemology is reduced to the question of the meanings of words rather than the perceptions of 'ideas', 'concepts' etc. Thus indeed, to inquire about the meaning of 'x is y' is significantly different than investigating the meaning of 'x ought to be y'. The whole exercise where one tries to connect moral theory with economics (taken as a science in the sense of it being engaged in an inquiry into the 'is') through epistemology becomes thus, dubious.

But this was not the case in philosophy until the 20th century. Certainly by the time Smith, Mill and Walras wrote, philosophers used to deal with both questions from the same point of view. A rough retrospective view on the last couple of centuries will present us with mainly two competing schools in both of which ethical questions were no less a problem of knowledge than scientific investigation. Classical empiricism, founded by Lock, Hume and Berkeley on the one hand, and Rationalism, represented by Descartes, Leibnitz and Kant on the other.

According to 'Classical Empiricism' human knowledge was basically a

question of sensual experience. Consequently, knowing what it is that is good or bad is also a result of some sensual experience. Utilitarianism, therefore, is entirely in the tradition of classical empiricism. Of course, it does not mean that it is the only possible moral theory but nevertheless it is a good example of the psychological foundation of ethics in this tradition. In terms of scientific inquiries the question of what people consider to be good or bad is in itself a subject of a 'true' or 'false' investigation. Hence, ethics and science are subjects of similar sorts of inquiries.

Another feature of this trend of thought was that as far as method is concerned, it was primarily inductive reasoning that seemed to be consistent with the premise that human knowledge is based on sensual experience. The fact that Hume presented the world with the 'problem of induction' did not mean that a solution to the problem can be to resort to deductive reasoning.

The rationalistic school, on the other hand, adhered to the idea that human knowledge can only be a result of logical reasoning. Descartes went as far as suggesting that there is no real relationship between what is in the human mind and what it is that exists in the real world. Kant, on the other hand, made an effort to relate the two by searching for 'a-priori synthetic' statements. That is, statement about the real world that are derived from some pre-experience knowledge. In the same way as in classical empiricism the pursuit of the question what is was no different from the question how do we know our duties (which are the result of our perception of the right and the wrong). Thus, moral theory is on the one hand a study of

people but as it is founded on a-priori analysis it is an imperative at the same time. Not surprisingly, it was deductive reasoning that is consistent with this trend of thought. The question that will now have to follow is whether or not a particular epistemology implies something with respect to the framework of analysis.

As far as general equilibrium is concerned we have made a distinction between variables that are related through complete inter-dependence and those which are related but through a distinct causal relationship. For the empiricist, who bases his analysis on observation, interdependence is almost impossible to observe. Causal relations, on the other hand, are more easily detected. However, in view of Hume's problem of induction (and I do not examine modern solutions here) these causal relations cannot be extended to become a general theory. Hence, in principle, general theory should not have been a tool of classical empiricists. Nevertheless, as some of them thought that Hume's problem was solved, or, like Mill, thought that they have solved it themselves, the notion of general equilibrium is bound to be an extension of the causal relations which are observed.

According to Mill, induction is possible because the world is operating on rules. Thus, this assumption of rules allows us to extrapolate safely. However, as was said before, this is either explaining induction by induction or, even worse, basing induction on an a-priori principle. (To some extent it is amazing how similar this idea becomes to those of the great opponent of empiricism-Kant. He too thought that human knowledge is a-priori because the human

mind is itself part of nature. Therefore, as the mind is subject of nature, it is capable of understanding its laws.).

In the sense of general equilibrium being an extension of some observed causality, the lack of complete inter-dependence in the 'cost of production' approach is quite consistent with the way I believe a 'classical empiricist' would have described his general equilibrium. Even in the case of Adam Smith where I have applied a general equilibrium approach, the causal nature of it dominates the scene.

The difference in nature between the 'empirical' and 'rationalist' concepts of general equilibrium also has some direct moral implication. The lack of causal relationship in the 'rationalistic' view together with the complete interdependence of all economic variables will make it difficult to detect moral responsibilities within the system. Unlike a system where causality exists and where the conflicting sides can be more easily identified. In a world where we look separately at the buyers-sellers relationship of goods and services, moral judgement is bound to be focused on the advantages and disadvantages of each side to the trade. If, on the other hand, the buyer of a good is at the same time the seller of his services, it is presumed that his disadvantages in the one deal will be compensated by his advantages in the other. In other words, there is an important substitution between the supply of services, like labour, and the purchase of commodities. Consumption, in a person's utility, is a substitute for effort. Thus, the question cannot be whether in his particular relationship with his capitalist he feels

that he was properly treated. One must also consider the benefits he had as a buyer. Thus, the moral significance of prices in a system of complete interdependence will be different from the one where causal relations exist. The idea of, say, a just price is reduced in the former case as dependent on the final distribution that it supports rather than on the nature of the relationship between the buyer and the seller.

There is, obviously, much more that can be said on the subject. What we did say will serve to understand the complex system of classical economics as appeared in Mill. It will also help to discover the difference in the focus of normative analysis within the classical school and between it and, for instance, Walras.

PART IV

**MORAL PERSPECTIVES IN J.S. MILL'S THEORY OF
VALUE AND DISTRIBUTION**

1. INTRODUCTION

At the beginning of this work I have pointed out that one of the things which triggered this work was the absence of desert theories from contemporary discussions of economic justice. I have also argued that it seems to me to be the result of methodological development in economics. Some of these developments may indeed be due to the change in the subject matter. Some, however, may be entirely due to methodological questions of a more technical nature.

When we said that what seems to dominate contemporary notions of general equilibrium is the symmetry in the positions of all economic agents, we have implied that there was a change in the subject matter which affected the already known idea of interdependence. However, there is still an unresolved question here. Is it that the one time realization that economic agents have symmetrical positions that generated the change in methodology or was the change in methodology unrelated to any change in the subject matter.

In general it cannot be denied that some change in the subject matter of economics must have affected the way people perceived the world. However, I'm not entirely convinced that in the case of Walras it was that which invoked his idea of simultaneous equations (of a non-hierarchical nature). Rather, it was his perception of the world (his

'rationalist' foundations) that generated the change in method which, in turn, implied a different conception of the economic world.

I have tried to show (at the beginning) that such conception of the economic system may have important moral implication. One of them was the disappearance of desert theories although I am far from convinced that they have also disappeared from people's sense of justice. To show, therefore, that the disappearance of desert was not due merely to the discovery of interdependence but rather to a particular kind of interdependence I had to show that within the classical school interdependence coexisted with principles of desert.

This is by no mean an easy task as on the face of it there is some inherent contradiction between interdependence and principles of desert. If decisions and actions (and consequences) are inter-related then responsibilities which are essential for desert cannot be established. In the case of Adam Smith the principle of desert survived but in a very particular manner.

It survived because it was an essential part of his moral theory (the analysis of action) and not because he clearly observed its presence in economic analysis. His analysis of values in the partial equilibrium context reflected this idea very well. Whether labour was a general index for welfare or a particular index for effort does not really matters. What matters is Smith's belief that there should be proportionality between actions and outcome. If one labours so many hours it seemed an immediate conclusion that he should be able, in an action of exchange, to get something which stands in proportion

to his effort.

The general interdependence obviously created problems but we saw how the same idea can be transferred into the system through the distinction between the natural and the market price. The natural price, as it were, represented the situation where remuneration was according to effort ('what it really cost'). However, in the general equilibrium context Smith's expectation of what the natural price should represent had to be re-interpreted as those prices where growth is maximized. Although desert is not explicitly present in my interpretation of Smith's economics, the moral evaluation of the economic system was certainly driven by it.

However, I also argued that Smith's model is not typical of classical economics. It was based on the idea of general equilibrium in market prices which is then compared to the natural price specifications. In general, within some interpretations of classical economics general equilibrium only prevail in the natural prices (interpreted as 'cost of production' systems). From the moral point of view it is an important difference.

In a 'cost of production' setting we can only observe a very general relationship between two distribution parameters; wages and the rate of profit. From the moral point of view they are not very meaningful. As I will show later on, what happens to the total share of wages and profit is not always directly correlated with what happens to their rates. So as reflections of desert theories the inverse relationship between wage rate and the rate of profit is not very telling. Though

most classical economists were apprehensive about Rents because they did not reflect any effort, we cannot say how such principles of desert can be applied to the other classes which comprise the greater part of society.

To a great extent it is Mill who on the face of it, presents the greatest challenge to desert theories within the classical traditions. There are three reasons for that:

- (a) a utilitarian moral theory;
- (b) a partial equilibrium analysis of market prices;
- (c) a 'cost of production' theory of natural price.

Utilitarian moral theory is a teleological theory where the only principle is that of happiness maximization. Evidently there is no room in such a theory to any other principle and in particular, the principle of desert.

A partial equilibrium analysis means that there should have been some hope to desert principles because in a narrow setting the relationship between individuals are clearer. However, it seems that Mill's distinction between three instances of exchange (inelastic supply, constant returns to scale and diminishing returns to scale) have changed the focus of analysis. In some cases it is utility that matters, in others, only cost of production. We cannot hope to generalize from this a theory of desert. And as for (c) we already saw the problems of desert with 'cost of production' theories.

In spite of all that Mill seems to uphold the principle of desert. When one looks for Mill's writings on economic justice in the

'Principles' one will find them dominated by the theories of right. In particular, there were the principles of proportional remuneration and those which restrict the 'freedom' of the market in favour of individuals' progress (like education)¹. One may argue that the latter is not entirely inconsistent with Mill's idea of utilitarianism as there are inferior and superior kinds of pleasure. Advancing what Mill thought as superior pleasures is a dictate that follows from utility maximization and need not be ascribed to a theory of rights. The principle of proportional remuneration, on the other hand, is much more difficult to defend in this context. The task of this part, therefore, is to see whether we can reconcile these apparent contradictions and to examine what could be the meaning of proportional remuneration in Mill's system.

The solution to these problems is quite complicated and depends on a careful examination of Mill's methodology. According to it there is indeed no reason to believe that there is some particular kind of synchronization within economics as an organ of the social sciences. Moreover, the major role of ethology² implies that the use of an 'economic man' as a rational construction in deducing the working of the system is not very meaningful. The circumstances of the system serve as a feed back and affect the human character. Individual behaviour therefore, cannot be assumed but must be part of the system itself.

¹The freedom of market has nothing to do with the freedom that is advocated in *On Liberty*. See p.116.

²The study of character formation to which I will come back later on

Given Mill's objection to deduction as a mean for knowledge accumulation one must follow his solutions to the problem in order to understand his position with respect to economic analysis. He offers solutions (like the 'train of reasons') according to which the premises of the economic system will have to be the conclusions of an inference system based on induction. But as there is no possible way to learn by induction about social phenomena we are left with some 'tendency rules', on the one hand, and some deductions the premises of which are based on induction on the other.

Induction, it appears in Mill, is easier in the natural sciences. Therefore, the possible source of inductive base for social deduction should be those aspect of natural sciences that are closely associated with economics. As a matter of fact there is a branch of economics which Mill considers to be entirely in the domain of the natural sciences: the theory of production. According to Mill production is the application of human labour to matter. The rules which govern these relations can be learnt by induction and they will therefore have, a major role in our economic analysis.

The task in front of us is the following one: First, to establish the major aspects of Mill's methodology which are applicable to the social sciences. Secondly, we have to see how it is possible to reconcile his utilitarianism with ethical principles like the one about proportional remuneration. Thirdly, we will have to see what does his methodology imply with respect to his economic system. In particular we will have to investigate what is the relationship between market prices and cost of production prices. We shall also

ask how the fact that production relations are determined by natural laws (as opposed to social institutions) relate to the 'cost of production theory' and the natural price. Lastly, we shall have to engage ourselves in a kind of extrapolation in order to establish the significance of a principle of proportional remuneration in a 'cost of production' setting of general equilibrium.

On the whole I will argue that Mill's demand for an anchor in the natural sciences means that the theory of production and relations in production are the key elements in his theory. On the other hand, it will be shown that Mill considered economics as a part of the social science in an active way. Namely that although the general system of society is behaving harmoniously, each component of it need not have to be so. Therefore, the partial equilibrium approach to market prices is consistent with Mill's general view of society and science.

But at the same time, the theory of production provides us with some kind of an independently harmonious system. As all products are basically the result of applying labour to matter, we can use labour as a mean to compare commodities from the point of view of the natural science. Namely, this is not a labour theory of value but rather an 'empirical labour theory' which denotes the technological truth (learnt inductively) about relationship in production.

The labour relationship will obviously not determine prices. These, as was said before, are determined in a partial equilibrium setting. But there is an inherent interdependence between the various markets

as commodities are interdependent by nature (the theory of production or, the labour requirements relationship). This interdependence simply reflects the objective constraints of the system (there is a given number of labourers). Market prices, on the other hand, are being analyzed in a partial equilibrium framework because they reflect the general interdependence that captures the whole society. In other words, market prices are a result of social institutions, labour interdependence in production is a natural phenomenon. How do they relate to each other and what is the meaning of this relationship is what this whole exercise is all about.

In order to be able to relate the two we can use another idea of Mill and that is the idea of 'average' prices. Acknowledging that there is no exclusive economic interdependence between the market we can still try and relate them to one another by looking at averages. These averages form a system of 'cost of production' which may be thought of as Mill's idea of the natural price system.³

Now, if the theory of desert and Mill's own insistence on proportional remuneration, is to have any meaning then we must see how the 'cost of production' system that is generated by the social

³Some, like Hollander (1985), Forget (1989) and Bradly (1989), will argue that in the case of Mill it is clear that 'cost of production' are the Marshallian long-run prices. That is to say that though in the short run prices are being determined by the traditional analysis of intersecting demand and supply curves, in the long run prices will all converge to their cost of production. Naturally, it will take horizontal long-run supply curves in all markets to determine that prices are unaffected by the positions of the demand curves. This, I believe, is not a straight forward conclusion as Hollander would have liked to see it but nevertheless, under some assumptions it is possible to interpret Mill's system in a similar way. In general, though, such a view means to ignore Mill's discussion of averages and the distinction in framework between the natural and the social sciences.

circumstances relate to the one that is generated by nature and, obviously, reflects the true efforts.

The next section will deal with Mill's methodology. I will discuss there the epistemological foundations of Mill's work as well as their effects on method of investigation. I will look at the unique form of deduction that Mill uses and I will investigate its significance to the study of social phenomena. I will point out that it is because of this method of deduction (which is associated with the idea of a 'train of reasoning') that we shall not be able to consider the actual determination of prices in a general equilibrium form. Rather, we shall have to make do with a 'cost of production' framework which is an average that relates the actual state of prices to relationships in production. The role of ethology as the Baconian Axiomate-Media will also be discussed. I will then try to sum-up Mill's perception of the social sciences.

The third section deals with Mill's moral theory. I will argue there that Mill's moral theory was not Utilitarian in the 'classical' sense of the word. That some of his moral propositions, and in particular those relating to economics, cannot be explained within the framework of utilitarianism. In fact, they are surprisingly close to some of the moral propositions of the rationalist Walras. I will try to show that Mill's moral system can be explained as consistent when viewed from the point of view of his perception of the social sciences. I will also argue that the rules of justice, almost like in Smith and Hume, are the necessary conditions for moral responsibility and for achieving Happiness. Necessary though not sufficient.

The fourth section implements the previous ones into Mill's perception of the economic problem. I will suggest that economics, for Mill, is a discipline which combines natural and social science. This, I believe, is reflected in Mill's distinction between production and distribution. As such, it is possible to extract information about relationships in production in a far more reliable way than it is in the social sciences. These relationships which are independent (in Mill) of human institutions, can serve as a benchmark for any moral discussion of desert and remuneration.

I will show here that 'cost of production' is thought by Mill as an average (over time) of the actual prices in different markets. The actual determination of those prices is within a 'partial equilibrium' framework, but the average, implies Mill, is determined by the technological conditions of the economy. But not only on them, it also depends on the determination of one distributional parameter; wages. This, I maintain, creates a causal relationship between the one distributional parameter and the other. Fixing on the way the relative prices.

To that extent, Mill's proposition that distribution is not affected by prices is correct⁴. It is affected by it. Obviously, had there been a discussion of how prices may affect capitalists' savings (or the amount of circulating capital that they return to the system), the story would have been entirely different. Probably closer to Smith's economic model. Therefore, we can now treat relative prices as reflecting distributional considerations. Bearing in mind Mill's

⁴See chapter 26 in the 'Principles' pp.688-694.

moral proposition regarding proportional remuneration, we have a moral argument directed at prices rather than at distribution.

Section five deals with establishing the principle of proportional remuneration as Mill's concept of economic justice from the moral point of view. Section six is the major extrapolation and it applies the principle of proportional remuneration to Mill's theory of value. There I will show various interpretations of the idea of proportional remuneration. I will deal with it when we apply the principle to capitalists as well as workers, and when (and why) we apply it to workers alone.

I will also show that the 'cost of production' framework produces (under some circumstances) a robust factor price frontier. But this frontier is different from the neo-classical one as it does not reflect optimal conditions. Hence, under different technological conditions, the same wage-rate of profit ratio may be associated with different shares in output of labour and capitalists. Adding these considerations, we may find that when we consider proportional remuneration of capitalists, there is some sort of substitution, in terms of economic justice, between proportionality and distribution.

In the appendix to that section I introduce a simple form of a neo-classical model. I examine there the condition for prices to be proportional to effort. The conclusion I reach is that under complete inter-dependence there is no proportionality of prices to effort though utilities are maximized. Only if we break the inter-dependence into some sort of causality (like decisions on work

(production) precede exchange) we shall find that prices are proportional to effort. However, those equilibrium values will vary inversely to it as circumstances change.

2. A Note on Mill's Methodology

(a) Epistemological foundations

Before dealing with the question of method it is important to understand that Mill's epistemology is completely within the tradition of classical empiricism. "Truths are known to us in two ways: some are known directly, and of themselves; some through the medium of other truth. The former are the subject of intuition or consciousness; the latter, of inference."(Logic p.6). Any inference, he then argues, must be based on a premise that is known to be true. Otherwise, human knowledge will not be increased. Thus, the focus of acquiring knowledge is on the direct way; i.e. intuition or consciousness. The most powerful acquisition of knowledge is through consciousness."Whatever is known to us by consciousness, is known beyond possibility of question"(p.7). This knowledge, he argues, is acquired through our senses. Intuition, however, may become inference. Optical illusions, for instance, are such occasions. However, through experience we learn to understand that what it is that we believe we see is only an inference.

Thus, it is clear that as far as the epistemological foundations are concerned Smith and Mill seemed to have worked within the same tradition (like Lock and Hume). In turn, it implies that for both of them moral analysis will be strongly based on moral psychology; i.e. what it is that people believe to be morally good or bad. The question that will now follow is what method is appropriated to learn anything by inference.

(b) Induction vs. Deduction.

Many believe that Mill completely rejected the method of deduction and considered induction as the only possible inference by which the human knowledge may be increased. Blaug(1980), for instance, argued that Mill's Logic embodies "a deliberate disparagement of deductive logic (called ratiocination) as an intellectual sausage machine and a eulogy to the logic of induction as the only path to new knowledge."(Blaug, 1980. p69). Thus, when he comes to the social science and suggests that the only possible method here is the deductive one, one is tempted to interpret it as either saying that social sciences are not a science or, that deductive methods are legitimate tools of enhancing knowledge.

That Mill did not consider social sciences as less scientific is quite obvious. First, if they were not sciences, they should have been Art. As such, according to Mill, deduction would not be

applicable. "The error is therefore apparent, of those who would deduce the line of conduct proper to particular cases, from supposed universal practical maxims;"(p.946). Hence to argue that the fact that he attributed deduction to social studies means that it was less a science is wrong.

Moreover, Mill definitely considered the social discipline as first and foremost, scientific. "All phenomena" he wrote "of society are phenomena of human nature, generated by the action of outward circumstances upon masses of human being: and if, therefore, the phenomena of human thought, feeling, and action, are subject to fixed laws, the phenomena of society cannot but conform to fixed laws, the consequences of the preceding"(Logic, p877). So is it that he deliberately disparaged deductive logic? I think not.

There is little doubt that Mill was doubtful of deductive logic that is based on a-priori statements. In line with Sextus Empiricus' work from the third century, Mill argued that a-priori deductive logic suffers from 'petitio principii' (assuming what is required). Namely that the premises of the process of deduction are already based on the conclusion. For instance:

Major Premise	1 - All human beings are mortal
Minor Premise	1 - Socrates is a Human being
<hr/>	
Conclusion:	Socrates is mortal

Now, according to Mill, in this exhausted example the major premise was constructed upon the knowledge of the conclusion. Namely the

premise that 'all human are mortal' entails already the conclusion that Socrates is mortal. Thus, argues Mill, deductive knowledge is itself based on induction. Namely, only by observing many human beings, including Socrates we can reach the major premise. In other words, for the conclusion to be true in the above case, the premises must also be true. The only way to know that the major premise is true is by induction.

This, however, is not a simple matter. Any deductive process presupposes that in order to attribute a 'true-false' value to the conclusion, the 'true-false' value of the premises must have been well established. For an a-priori statement it is quite straight forward- the premise will be true by definition- but is it also true to the conclusion of an inductive process?. The answer to this question will lead us inevitably to a discussion of Hume's problem of induction and Mill's proposed solution to it.

In order not to digress any further, let me just point out that Hume's problem was that an induction that is based on numerous observation cannot be logically generalized beyond those particular incidents for which it accounts. Thus, the conclusion of an induction cannot gain a universal 'true-false' value that is needed for the premises of a deductive system. Mill's solution to the problem is based on the uniformity of nature. This, in turn, may either be a result of an induction which means that the solution to the problem of induction is based on itself. Or, even worse from Mill's point of view, that the uniformity of nature is an a-priori statement.

It is within this tension between the problem of induction and the rationalistic sense of its solution that one will have to consider the role of general equilibrium among the 'empiricist' economists. Even though 'analytical empiricism' seems to have found a solution which is somewhat similar (see, for instance, Whitehead) it is still within the framework of what is considered as 'analytical empiricism'. Mill's solution, on the other hand, is introducing some rationalistic features to his analysis.

So if deduction, according to Mill, suffers from the problem of 'petitio principii', it seems to be worthless for the purpose of acquiring new knowledge. However, this is not really the case.

Let us look at Mill's own example:

I	Major Premise 1 -All arsenic is poisonous
	Minor Premise 1 -This which is before us is Arsenic
	Conclusion -This which is before us is poisonous.

II	Major Premise 2 -All things which produce a precipitate of a certain colour are Arsenic
	Minor Premise 2 - This which is before us produces a precipitate of a certain colour
	Conclusion -This which is before us is Arsenic

Now the conclusion of I consists part of the induction process that generated major premise 1. But the minor premise 1 is based on the

conclusion of II. Namely, it is based on a different syllogism. Now, if we only had problem I then for all we know that thing which is in front of us precipitate a certain colour. Without conclusion II we could not have established conclusion I. Hence, argues Mill, it is clear that deduction, though in itself not a way to acquire knowledge, may become helpful when too many inductions are required. He called it a 'train of reasoning' (see Logic, Ch.4 pp-209-230). On the whole, Mill had not considered induction as the opposition to deduction, "The opposition" he wrote "is not between Deductive and Inductive, but between Deductive and Experimental" (Logic, p.219).

Clearly, therefore, one cannot argue that deduction as such was a logical anathema to Mill. He was, however, quite opposed to a-priori statements. This means that for any deduction to have any meaning at all it must be based on observation rather than on definitions. The premises of social sciences, consequently, must be the result of some observation. The question that will immediately follow is whether or not, induction is possible where no experiments are available. One thing, however, seems to be evident. That in Mill's methodology the realistic nature of the hypothesis plays a crucial role.

Deduction, thus, is a legitimate tool of acquiring knowledge when the circumstances are too complex to follow the rules of induction alone. It is, however, important to point out that not all deductions expand human knowledge. Abstract deductions, like for instance geometry, are not accepted by Mill as expanding the human knowledge. The fact that it is based on a-priori statements, i.e. statements that follows

definitions, empties it of any real contents.

Abstract deduction and induction are two competing methods of acquiring human knowledge. Both of these are engaged in establishing a single causation. Thus, in Mill's view and in the tradition of Lock and Hume, induction is the only path to the truth. But deductions which are not based on truly a-priori statements are valid to the process of acquiring knowledge. These are the 'concrete' and the 'inverse' deductions.

(c) Concrete Deduction and the idea of Inter-dependence.

The 'concrete' deduction is the method by which we may learn something about the more complex world. Namely, the world where an effect may be produced by a set of causes. "It infers the laws of each effect from the laws of causation on which the effect depends; not, however, from the laws merely of one cause, as in geometrical methods, but by considering all the causes which conjunctly influence the effect, and compounding their laws with one another"(Logic p.895).

So there seems to be two stages incorporated in the process of concrete deduction. First, one has to establish the causes of each effect. And secondly, to compound the causes of different effects

that prevail at any given one time. As for the social sciences Mill argues that the first step seems rather straight forward: "The actions and feelings of human beings in the social state, are, no doubt, entirely governed by psychological and ethological laws; whatever influence any cause exercised upon the social phenomena, it exercises through those laws" (Logic, p.896). The problem, however, arises at the second phase. "But when the question is that of compounding the aggregate result of many coexistent causes;...we attempt a task to proceed far in which surpasses the compass of human faculties"(ibid).

There are two different problems attached to the social science. First, the impossibility of experiments and second, the scope of inter-relations. The solution to the first problem is given by allowing some general introspections to serve as premises. Though they cannot be reached by proper induction, they nevertheless are not completely independent of a person's experience. The consequences of this reduced level of 'truth' in the premises is the reduction of conclusions to what Mill called 'tendencies'. In other words, the lack of universality of the premises only allows us to speculate on the directions of the conclusion. A deviation from that tendency is not necessarily an indication to the fallacy of the proposition.

The idea of tendency is also part of the solution to the second problem. The complexity of the social science and the difficulty in compounding all causes does not allow us to propose more than tendencies. However, there are two major propositions that Mill

states which may shed some more light on the investigation of such complex phenomena as the social one. First that the whole of the social body may be viewed as a single organism. That is, an organism that is comprised of many limbs (separated fields of inquiries) that live in 'consensus' with one another. Namely, society is fundamentally a harmonious collection of causes and effects. Like the physical nature even though such a conclusion about nature is the result of induction while here it is merely an a-priori assumption.

The second important idea is that the social phenomena is a simple sum of the individual phenomenon. Namely, if society is a harmonious organism which is comprised of simple sums of individual phenomenon then it should not be difficult to calculate the effects in one limb of that organism, on the others.

Now, the idea of the concrete deductive method implies that society should be investigated by separated branches. But at the same time, while each branch follows its own concrete deduction, on the whole the social investigation should be seen as a 'train of reasoning'. The conclusions of each concrete deduction serve as part of the premises' structure of another. Thus, creating that dependent and harmonic view of society.

All this leaves us with the following important conclusions. (A) Only natural sciences (the experimental) are open to induction. Thus, the Newtonian harmony of nature (or general equilibrium) is a valid logical generalization. In short, the natural world is a general

equilibrium system. (B) The social sciences are only open to deductions of particular sort; concrete deduction and the 'train of reasoning'. Each branch of the social science may be considered as a single or set of concrete deductions which are the collection of causes related to a well defined phenomenon. There is no inherent requirement for equilibrium within the system; there is however a general requirement for the general equilibrium between all fields of social investigation.

(d) The role and significance of Ethology.

According to Mill, the branch of the social study that dominates and balances the social organism is that of Ethology. "The actions and feelings of human beings in the social state, are, no doubt, entirely governed by psychological and ethological laws; whatever influence any cause exercised upon the social phenomena, it exercises through those laws" (Logic, p.896).

Before getting into more details, allow me to explain some additional methodological points. At least as far as deductive methods are concerned one must distinguish between universals and empirical laws. Empirical laws, according to Mill, are those observed uniformities

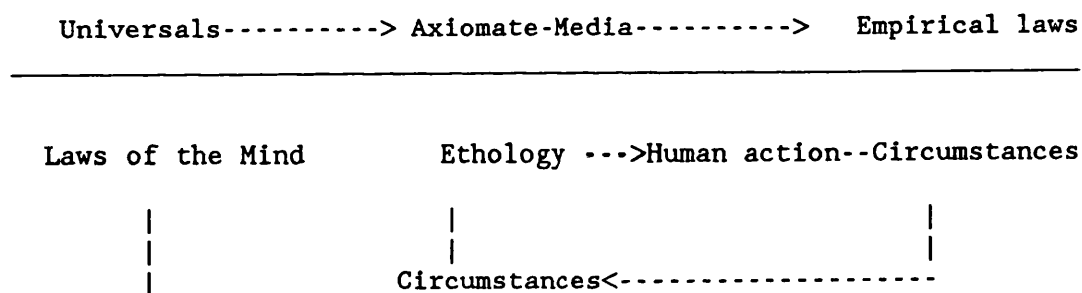
(either in succession or coexistence). However, they may not be generalized (as they have no experimental aspect) beyond the limits of our observation (see p.861). The reason for that is that they may be either part of a more complex rule of causation or, that they may be broken into simpler sequences of causation. At any rate "[t]he really scientific truths..are not these empirical laws, but the causal laws which explain them"(p.862).

"All ratiocination" wrote Mill, "start from a general proposition, principle, or assumption: a proposition in which a predicate is affirmed or denied of an entire class..."(pp.173-4). This thing which is attributed to an entire class is what Mill calls a universal. Note, however, that this does not mean that he adheres to a rationalistic approach. A universal can be the outcome of inductive reasoning. Past rationalists seemed to believe that universals were substances in themselves. Thus, once a property is attributed to this substance it must be attributed to all that belong to this universal (the dictum de omni principle).

As human actions are at the heart of the social phenomena, one should begin the investigation by looking at people's psychology. Psychology, according to Mill is the science of the elementary laws of the mind (p.869). But these laws of the mind (which is some form of epistemology) do not explain why people behave in a particular manner. This, it seems, depends on the encounter between the person's psychology and the circumstances. "Mankind " he argues, "have not one universal character, but there exist universal laws of the formation of character"(p.864).

Hence, ethology is the science of the formation of character. Its subject are the laws of the mind and given circumstances, its object are people's behaviour. "Ethology will serve for the ulterior sciences which determines the kind of character produced in conformity to those general laws [of the mind], by any set of circumstances, physical and moral"(p.869). It is, argues Mill, a form of a Baconian Axiomate-Media; a transition mechanism from the universals to the empirical laws. However, unlike Bacon, Mill believes that we can use deduction to move from the universals to the axiomate-media and from it to empirical laws.

Now we may depict Mill's system as follows:



Universals, in this particular case, are known by experience and induction. These laws of the mind should not be confused with psychology as we understand it or, indeed, as Smith or Hume saw it. "Psychology, according to Mill, studies the 'laws of the mind', that is, the laws according to which states of mind or consciousness follow, or are caused by one another."(Berger.p.10)

There are two General Laws of the mind:

1. Once a state of consciousness has occurred, it can be reproduced in the mind without the presence of the original cause. (Hume's assertion that 'every mental impression has its idea'. (Coll pap. p.852).

2. "These ideas..are excited by our impressions, or by other ideas, according to certain laws which are called Laws of Association"(Logic p. 852).

Given these laws of the mind, we can derive rules according to which we shall be able to assess how people will behave when confronted with any set of circumstances. "...the great problem of ethology is to deduce the requisite middle principles from the general laws of Psychology. The subject to be studied is, the origin and sources of all those qualities in human beings which are interesting to us....and the object is, to determine, from the general laws of the mind, combined with the general position of our species in the universe, what actual or possible combinations of circumstances are capable of producing or of preventing the production of those qualities"(pp.873-4)

This view of the social sciences has two major consequences. First, as the outcome of human actions affects circumstances it may cause a change in human behaviour. Thus, economic circumstances are not only susceptible to human nature, they also affect it. This, I believe, must have great implications on the way we perceive economics. We can no longer suppose that a one time economic man will remain unaffected by the social consequences of the economic

system. If so, the premises of our economic theory must change accordingly. It also means that a stationary economic state may not be so stationary in terms of its social consequences. That is, a system may be stationary in terms of the values of economic variables, but the apparatus that achieved them may change. For instance, the same set of economic variables may be either the result of a competitive system comprised of utility and profit maximizers or, say, an output maximizer central authority that is based on some co-operative arrangements. Indeed, in Mill's analysis of progress, he believes that the art of production will progress together with the co-operative nature of human being.

It is interesting to point here at some similarities to Smith. There, we saw that the efficiency of a competitive economic system may affect people's moral psychology. They will tend to confuse wealth with virtue as they wish to see wealth bestowed on virtuous people. Nevertheless, the significant difference is that in Smith's case these effects only change the quality of moral judgement but they do not change the fundamental psychology that governs people's behaviour. It certainly does not affect people's behaviour as far as economics is concerned. At best, it is affected by the same circumstances; i.e. the degree of interest a person has in the other's fortune.

The second consequences of Mill's ethology is, that the economic man must be affected by moral circumstances. Now in itself it is not a deviation from Mill's theory. Remember that we pointed out to the fact that society is a harmonised organism. The separated study of

each of its components help to understand its complexity of causation. As we may think of the sum of those separated studies as a 'train of reasoning' we know that each branch of studies includes in its premises the conclusions of another. Thus, the economic man must also reflect the results of people's moral views, or circumstances.

There is, however, another aspect to this theory which must have an impact on Mill's moral theory. It is the 'necessity of human actions'. Given the circumstances and the character's disposition we can foretell what his action will be "as we can predict any physical event" (Logic p.837).

Now Mill insists that this does not empty the concept of freedom as we can influence the circumstances. The power of self-formation (education) as he called it, is also the power of free-will. But as the power of self-formation depends on social circumstances it turns out as if the degree of moral responsibility is a function of the social state. Thus, we should not look for the impact of the 'necessity' paradigm on the analysis of how moral ideas are being produced (the utilitarian theory). Rather, we should ask ourselves how much of a free-choice those ideas reflect. In other words, how much freedom was generated by the social circumstances when particular ideas of morals were conceived.

In turn, all this will help to explain why it is that Mill had morally objected to the system of free enterprise even though he appeared to be a utilitarian. It will also help in understanding why

in such circumstances, it is remuneration that is based on objective measures that is the source of the real moral good.

Let me summarize this last section. We saw that it follows from Mill's view of methodology that deductive methods are only valid if their premises either directly result from experience, or that they are conclusions of another deductive process the premises of which were direct results of experience. We also saw that Mill's perception of the social science was that of a complete and harmonious organism. Nevertheless, too complex and not experimental to allow any inductive method to be applied. Thus, the harmony, or general equilibrium between all components of social life is not a generalized induction but merely a hypothesis.

The study of each branch of society is in itself a partial analysis of society. Thus, it has as inputs the conclusions of other sub-systems of social analysis. A change in any of them will change the circumstances of all of the others. Now, usually general equilibrium in economics only implies that for any given initial circumstances, a solution will be found. However, the circumstances that it is referred to are those of initial distributions as such with no reference at all to the behavioral parameters which also constitute part of the premises of the model. In Mill's concept of society those changeable circumstances will change not only the initial distribution but the rules of behaviour as well. Thus, changes throughout the system and sometimes with little direct relation to economics, will bring about a change in the whole mechanism of economic activity. Hence, general equilibrium may be

used as depicting a single point in time but not as a principle of economic systems.

In the following section I will examine the consequences of Mill's methodology on his moral and economic analysis. I will begin by investigating the applicability of utilitarianism, or any psychologically based moral theory, to economic analysis perceived in the above way. I will compare it with Smith's analysis. Then I will investigate Mill's economic theory from precisely the same point of view. I will deal with the question of framework, with concepts of remuneration and with the consequences of Mill's perception of the social science to economic questions as such.

3. The Problem with Mill's Moral Theory.

In view of the role of ethology in the social sciences and, in view of its inter-relation with the social circumstances, the question of what is morally good becomes rather complex. In particular, it becomes difficult to accept Mill as a classical utilitarian (as a consequentialist) when obviously some responsibility to the moral behaviour of human beings may lie in the social circumstances.

In terms of its implications to the normative discussion of his economic system, the question will be where precisely do the moral considerations of a utilitarian come in when we have a system of general equilibrium in terms of 'cost of production'.

In the case of Adam Smith a similar problem should have arisen. However, as I have interpreted differently his economic as well as moral theories, it appeared that when applied to economics, Smith's moral theory suggested a principle which was not very far from ideas

that were associated with the 'just price'; proportional remuneration. I will therefore advance my discussion of Mill with some comments on the interpretation of Smith's moral analysis of economics. In turn, it will also shed some light on whether or not there is some general moral proposition that one can associate with classical economics.

(a) Some Implications of Smith's Moral Theory

In analyzing Smith we emphasized the two aspects of his analysis. One, the practice of morality which is entirely psychological, the other, the theory, or ideal, of morality which is a logical extension of the actual way that people use to form a moral opinion. At both levels we observed that the key to moral approbation is in the proportionality of the intention to the outcome.

Suppose now (which is not entirely far fetched) that in order to accomplish a certain intent, some degree of proportionality will prevail between the intention and the effort. In other words, the more benevolent an outcome we intend, the more effort will have to go into it. Then proportionality of intention to the outcome also implies proportionality to effort. Hence, as Smith wished the distribution of wealth to follow the moral principles, we may say that he wished remuneration to be proportional to effort.

Nevertheless, as far as his economic system is concerned, it is clear that all are working for their self-interest. Thus for the system to become morally good it needed to be beneficent. The question was first of all who should enjoy and who should convey this beneficence. The answer depended on the social structure. As the produce belongs to the capitalists who, as it were, were remunerated by nature, the action of distribution is very clear. The capitalists act, the labourers are acted upon. Thus, beneficence will prevail only when labourers feel it. Hence, the condition for beneficence were a progressive economy with a low (minimal) rate of profit. It is, I maintain, a form of 'remunerative' justice. It is true that we do not distinguish between different works, but we do distinguish between labourers and capitalists. Namely, the remuneration of effort as opposed to remuneration for abstinence (to use Senior and Mill's observation). Smith obviously prefers the former to the latter.

I have gone through some effort to argue that Smith's moral theory cannot be interpreted as utilitarian. The fact that it is a form of pleasure that determines moral approbation is not enough to make it utilitarian. It is, nevertheless, a special kind of pleasure and indeed, it involves a rational process which cannot be considered as consistent with utilitarianism.

The reason I found it important to stress that point should be viewed in the larger context of this work. In my general introduction I have pointed out how in the past, due to the partial equilibrium approach, the key concept for economic justice was a 'just price'. More than

to reflect an opinion on the general distribution of wealth (which could not be contested due to acceptance of the social structure) it reflected the idea of fair play. This can be simply seen in the analysis of Thomas of Aquinas. In Aristotle, this fair play was associated with a hidden idea that a just price should reflect the effort in production. The fundamental thing, however, about just price theories was that the position of the competing sides were well known and well defined.

In Smith I have tried to show that general equilibrium does not necessarily take us away from the idea of proportional remuneration. It is, in Smith, rather simple as his price is defined in such a way that it incorporates the general distribution among the three classes of society. Moreover, even though the labourers do not participate in the actual trade for goods (or their demand is always balanced by their subsistence consisting part of the supply price), their wages depend on the coordination of wants of the capitalists. Thus, though not directly confronted, labourers and capitalists are the two sides of the equation.

Now as for Mill we shall have to consider whether his moral theory as such, given the methodological comments of the previous section, paves the way to a similar or different concept of economic justice.

(b) Questioning the Nature of Mill's Utilitarianism

For a long while it was accepted that Mill's moral theory (based mainly on Utilitarianism) is fundamentally a Benthamian version of utilitarianism. This, in turn, means the following propositions:

(a) The desire for pleasure is the only motive to people's actions.

(b) The pleasure from an action is expected to be derived from its result. (A complete consequentialistic approach).

(c) Pleasure is the only thing which has any moral value. (see a discussion of these points also in Berger pp.30-1).

As far as the morals of economics are concerned this view may have some serious implications. First, as it is inherently a teleological approach to ethics, justice and the moral good are dependent on one another. Namely, a just economic system is also a morally good one. Secondly, as it is an entirely consequentialistic moral theory, the idea of remuneration cannot be of great significance. If a distribution is 'Pareto-Optimal' like, using utility in the present sense, then it does not really matter whether the remuneration was proportional to anyone's effort as long as the outcome has generated the highest possible sum of utilities¹. In a more partial equilibrium sense it would mean that when a deal is struck the only

¹The fact that a Pareto equilibrium does not produce proportional remuneration can be seen in the appendix to chapter 6. It is important to emphasize that the effort I have in mind is the objective input (of labour) rather than the disutilities of it.

thing which matters is whether the two participants feel that they are happier now than they were before. Thus, a person who only had his labour to offer and he ends up with goods at his hand, must be happier than he would have been had he not traded at all. Even though he could have been happier had he been properly, in his view, remunerated.

This last addition of happiness will have to be measured against the loss of happiness of the person who hired him and now owns the total output. Moreover, if all utility functions were symmetrical, equality would be the distribution that generates the highest sum of utilities. Surely it cannot mean at the same time that remuneration followed a proportion-to-effort pattern.

However, there are many reasons to believe that this interpretation of Mill's moral theory is inadequate. To a large extent it is so admitted (see, for instance, Robson, 1968 and Ryan 1970) but, as Berger has noticed, "the orthodox interpretation continues to be widely promulgated" (Berger 1984, p.31). Let me now point out some of the reasons why such an interpretation is unacceptable.

First let me start with the assertion that the pursuit of pleasure is the only motive to human actions. The objection to it can be made at two levels; one, on the grounds of Mill's own direct observation about human nature, another, on the grounds of its inconsistency with his methodology.

As far as Mill's direct observations are concerned I would like to

mention two other motives which are related to one another. These are sympathy and social feelings. When Mill accounts for social advancement he argues that behind it is "the desire to be in unity with our fellow creatures"(Ut. CW. Vol10 p.231). He also wrote when discussing the Utility of Religion that "Through all departments of human affairs, regard for the sentiments of our fellow-creatures is in one shape or another, in nearly all characters, the pervading motive. And we ought to note that this motive is naturally strongest in the most sensitive nature, which are the most promising material for the formation of great virtues"(Utility of Religion, cw v.10 p.411).

Sympathy, acknowledged as part of human nature, may still be interpreted as consistent with the above formulation of utilitarianism. Namely, that people may be motivated to please others because it pleases them to see other happy. To some extent it seems similar to Smith and Hume's reading of sympathy. However, we must remember that in the case of Smith the pleasure of sympathy was a rather complex one. It could not be interpreted as merely enjoying the other's happiness (or misfortune for that matter), it also included as joy from realizing harmony of sentiments. Whether this latter joy is part of what is meant a person's own pleasure is doubtful. After all we do experience it also when we measure our 'sympathy' with another person's misery.

Coming back to our case it is rather clear that Mill did not believe sympathy to be a motive that reflects the pursuit of one's own pleasure. Commenting on his father's 'Analysis of the Phenomenon of

the Human Mind' he wrote "By the acts or other signs exhibited by another person, the idea of a pleasure.... or the idea of a pain..are recalled, sometimes with considerable intensity, but in association with the other person as feeling them, not with one's self as feeling them"(Analysis vol.2 p.218). Moreover, not only a person's action may be motivated by sympathy which, according to Mill, cannot be considered as his own pleasure, but the social way of life dominates a person's character. The requirement of social existence, which may be thought of as a form of fellow-feelings, conditions a person's character. "Any condition, therefore, which is essential to the state of society, becomes more and more an inseparable part of every person's conception of the state of things.."(Utilitarianism cw v.10 p.231).

The existence of sympathy and social feelings as motives which are independent of one's own pleasure is consistent with Mill's methodology. The affairs of mankind in their natural social setting are certainly the subject of the social sciences. We have already, in some details, explored Mill's view of the social sciences. From it, it became clear that though he found deductive method as the most appropriate, he rejected the use of what he called 'geometrical' or 'abstract' deduction.

It is mainly for two reasons; one, the general objection to deductions that are based on a-priori (in the real sense of the word, i.e. definitions) statements; the other, because geometry is the analysis of one force, not of conflicting forces like in mechanics or the social science.(see logic,p.888). He then goes on

to show that the 'Bentham school's' philosophy is an example of such a fallacy. Indeed, he refers there to the political theory that was constructed upon the single principle of human motive but, nevertheless, it is as valid to moral as it is to economic theory. The fundamental objection is that one cannot construct any aspect of social theory on the assumption that there is a single force which dominates the scene. Given Mill's own observations, the major premise of the Bentham school can only be justified on a-priori grounds. Namely, as Mill observes conflicting forces operating in the social arena, to argue that there is a single force behind it does not seem to be consistent with experience. That is, if we wish to set the pursuit of pleasure as the definition motives fine, but it will not lead us, according to Mill, to any increase in our knowledge. If, on the other hand, we wish to construct our premises on some observations than we cannot accept the Bentham's premise.

The key to the question of motivation should anyway be in the theory of ethology. A theory that is based on psychology or, the laws of the mind. There are two points to be made here. First, according to the laws of the mind ideas occur to us also via association. Secondly, according to ethology, human character (that generates human actions) is constantly reacting and adjusting to circumstances.

The fact the ideas can occur to us by association also means that the idea of pleasure may appear in our mind in connection with something that is only associated with pleasure but that does not have any such direct effect. When an action is associated with pleasure, argues Mill, we come to desire it on its own merit with no reference to the

original pleasure that was associated with it. Allow me now to quote at some length: "As we proceed in the formation of habits, and become accustomed to will a particular act or a particular course of conduct because it is pleasurable, we at last continue to will it without any reference to its being pleasurable. Although, from some changes in us or in our circumstances, we have ceased to find any pleasure in the action, or perhaps to anticipate any pleasure as the consequence of it, we still continue to desire the action, and consequently to do it....A habit of willing is commonly called a purpose; and among the causes of our volition, and of the actions that flow from them, must be reckoned not only likings and aversions, but also purposes. It is only when our purposes have become completely independent of the feelings of pain or pleasure from which they originally took their rise, that we are said to have a confirmed character."(Logic,pp.842- 3).

In other words, because it is the formation of character (ethology) that takes us from the universal laws of the mind to the observed empirical laws, human actions cannot be understood but as a combination of direct feelings and 'purposes', or habits which are derived from the laws of character formation. However, one must be careful not to associate those habits with the particular experience of the individual character. Some habits are acquired via other means like education and social circumstances. Hence, for a particular character, those habits may indeed be as remote as it can be from the original sense of pleasure that might have been associated with them.

This last argument on the affects of associations is also the reason

to reject Mill's adherence to the second proposition of 'classical utilitarianism'. To remind the reader this proposition read that it is the anticipation of pleasure as a result of an action that is its motive. Obviously, the association principle means that sometimes we shall continue to desire actions simply because they are associated with the idea of pleasure. Regardless of whether or not they keep producing this pleasure.

But there is another argument involved here, that of Mill's distinction between 'interest' and 'impulse'. To act because one expects pleasure as a result means to act out of 'interest'. Sometimes, however, we tend to act out of 'impulse'; meaning that the mere contemplation of our act prevents us from, or drives us to, doing it. Namely, sometimes, the idea of pleasure that is associated with a particular action may precede, rather than follow it. "The pain or pleasure which determines our conduct is as frequently one which precedes the moment of action as one which follows it"(Remarks On Bentham's Philosophy, cw.v.10 p.12). Of course, in terms of the 'laws of the mind' this idea too is connected to the principle of association. Nevertheless, it means that we do not always act because we desire the consequences of our action; sometimes, its mere contemplation is sufficient in order to invoke in us the feelings.

The third proposition, which is actually the conclusion of the first two, is that only pleasure has any value. This, naturally, is one of the most important questions in the context of a utilitarian moral theory. It implies that the only moral measure for anything would be

its pleasant or painful effects. Thus, in a social context, the concept of well-being (as happiness) becomes the sole measure for the moral evaluation of a social system. There is no other thing with an intrinsic moral value. Indeed, it is this idea that dominates contemporary normative discourse of economics as can be seen in 'welfare economics'. Not surprisingly, therefore, it is this idea which attracts the strongest criticism from those (like, for instance, Sen(1987)) who are unhappy with ethics-economics relationship.

However, at present I shall only deal with this question in as much as it concerns my analysis of Mill. It is, perhaps, interesting to note that in the case of Adam Smith, well-being perceived through wealth was by no means the 'true' measure for moral goodness. Nevertheless, Smith admits that in practice people do tend to associate virtue with wealth. But this does not mean that virtues themselves are defined in terms of 'well-being' or wealth. Namely, it is not well-being which constitute the morally good state of affairs. In the case of Mill, on the other hand, it is more difficult to dispose of this proposition. His modification of Utilitarianism does not really rule out the possibility that well-being is the only thing with an intrinsic value. Therefore, we shall have to see whether it is possible to attach Mill's modified utilitarianism to an alternative proposition.

First, however, I must point out why I suspect that Mill's moral theory cannot be interpreted as a consequentialistic theory of pleasure and pain. The most obvious reason is that Mill made it clear

that he believed that some actions are generated by the sense of pleasure that is associated with doing them rather than with their proposed consequences. In such a case it will become extremely difficult to judge actions where the pleasure of doing them is not well synchronized with their results. Another such reason is the idea of 'purpose'. If a person does an action because of habit and because sometime in the past it was associated with pleasure, what will be the moral judgement of it now, when it does not invoke the same sense of pleasure (or not at all) in the actor?

In the same line of argument one may wonder what is the meaning of virtue, or the pursuit of virtue, in Mill's moral theory. "[T]he true virtue of human beings" writes Mill in one place "is the fitness to live together as equal; claiming nothing for themselves but what they as freely concede to everyone else"(The Subjection of Women p.174). Does it mean that virtue is morally good because it promises pleasure to the person who acts by it? Moreover, virtue is an attribute of a character. A character, in Mill's theory, is only confirmed when he acquired some habits ('purpose'). Hence, as we saw before, the actions of that character are not related to any immediate sense of pleasure. So why is a virtue- virtuous?.

The answer to that, given by some (like Berger), is that virtue is morally good because it is part of the general conditions for the happiness of man. The key to this argument should be Mill's perception of happiness. I think that it will be agreed that by no means can one read Mill's theory as suggesting that mere sensual pleasure constitutes the idea of happiness. A good example for it

is Mill's distinction between 'higher' and 'lower' pleasures. In Utilitarianism he attacks the view as if by utility, or happiness, he refers to sensual pleasure as such. "Human beings" he writes "have faculties more elevated than the animal appetites, and when once made conscious of them, do not regard anything as happiness which does not include their gratification"(Utilitarianism cw.v.10.p.211). He then goes on to argue that even the Epicureans attached higher values to 'intellectual' pleasure than to 'sensual' pleasures. Nevertheless, he adds, some utilitarians believed that the difference between spiritual and corporal pleasures were only in terms of their consequences. Namely, the former had less real effects and when they did they were less harmful, or expensive, as were corporal pleasures. Thus, their 'better' value is not an intrinsic difference but merely an incidental one. Mill, however, insists that the 'intellectual' pleasures are INTRINSICALLY better pleasures than the corporal ones. The rule to measure the quality of 'higher' pleasure against the quantity of the 'lower' one, according to Mill, is to look at experience. People who are self-conscious and self-observing in a sufficient degree have always maintained that after experiencing both sorts of pleasure, they preferred the 'higher' one.

Naturally with such a large definition of pleasure the idea of pleasure, as we tend to understand it, as the sole thing with intrinsic value erodes. The desires for virtue, for money or power, though might have originated, by association, from some sort of pleasure, may indeed become an end in themselves. As such, and as they generate actions by habit (i.e. no expectation to pleasure),

it cannot be said that they are desired for the pleasure that they tend to produce. Such a desire, argues Mill "is not a different thing from the desire of happiness, any more than the love of music or the desire of health. They are included in happiness. They are some of the elements of which the desire of happiness is made up. Happiness is not an abstract idea, but a concrete whole; and these are some of its parts"(ibid. p.236).

From all that it appears as if Mill did not adhere to the idea that pleasure as such, in particular is its sensual significance, can be considered as the sole thing with intrinsic value. Under his definition of happiness, quite a wide range of things can be considered as having an intrinsic moral value. Like, for instance, equality even when we do not assume symmetrical utility functions. But I shall deal with it later on.

There is another reason why intrinsic value can be found in things other than pleasure. It is Mill's view of Freedom. Though I do not intend to go now into the extensive debate surrounding the problem of freedom, I would still like to use it as an example that may prove important to the understanding of Mill's concept of economic justice.

Following Mill's assertions in his Logic, between the laws of the mind and the actual expression of human nature in 'empirical laws', there is an intermediate phase- an axiomatic media- called ethology, or the science of character. The source, and eventually the

responsibility, to human actions cannot thus be found only in the origins of human understanding (the 'laws of the mind'). They must also be referred to the circumstances that, conjunctly with those laws, affect human characters and their subsequent actions.

This perception of human nature, as I have already discussed, is consistent with Mill's view of 'free-will'. Human will is only free in as much as they choose to alter the circumstances that effect their character. Accordingly, a person may have impulses and desires that are entirely created in him by the circumstances cannot be considered as having those things of his own. He thus "has no character, no more than a steam-engine has a character."(On Liberty. pp74-5). For a character to emerge, it must be the result of an interaction (almost dialectical) between those laws of the mind and the changing circumstances. "A person whose desires and impulses are his own- are the expression of his own nature, as it has been developed and modified by his own culture- is said to have a character."(ibid).

Thus, "Individuality is the same thing with development, and that it is only the cultivation of individuality which produces, or can produce, well-developed human beings....what more, or better, can be said of the condition of human affairs, [other] than that it brings human beings themselves nearer to the best thing they can be?"(ibid. p.79). Which means two things; one, that human nature needs freedom to become its best (even when its best means happiest), and secondly, that social circumstances are only measured in their effects on the development of human nature.

For people to have free-will at all, some social circumstances are required. Unless people are provided with those circumstances one may argue that as they don't have a free-will they are (a) not responsible and (b) not a subject of moral investigation. Hence, though one can always argue that a person's free-will, which is equivalent to saying a person's self-fulfilment, means a pursuit of happiness, the creation of conditions for it cannot be thought of as deriving from the value of happiness in its consequentialistic sense. Namely, the fact that society provides a person with the facilities to develop himself does not mean that he will indeed succeed in doing so. Thus, as we go along, and form habits interactively with social circumstances, those conditions earn a value of their own. "I regard utility" writes Mill, "as the ultimate appeal on all ethical questions, but it must be utility in the largest sense, grounded on the permanent interests of man as a progressive being"(On Liberty,p.224).

What Mill considered as progress is in itself an interesting subject to which I shall refer later on in relations to economic organization. One thing, however, is worth noting here; that Mill's view of 'civilization' was that of great cooperation. The ability to subordinate immediate personal advantages to the common interest is a necessary condition of 'civilization' as people become more and more dependent on one another.(Civilization,cw.v18.p.129). How it affects moral progress is a different matter. Of course, for Mill himself, the best of human nature is when they desire only those things which can be shared with others(Utilitarianism,cw.v.10 p.232). But Mill is quite aware of the fact that the effects of

actual social progress on human nature may vary. Extreme self-interest and uniformity are considered by him as quite possible, and sad, development.

Nevertheless, theoretically the progress of society, in conjunction with human nature, should according to Mill develop in a co-operative fashion. Namely, the 'tendency laws' are such that people will tend to see the common interest as an integral part of their happiness.

(c) The Question of Rules and A Note On Justice.

We saw thus that freedom has a value of its own which is independent of the immediate outcome in terms of pleasure. Moreover, as it is a condition for developing characters (and free-will), it is also a condition for human beings becoming moral creature. Obviously freedom is only one aspect of the whole set of conditions that determine the circumstances in conjunction with which the interaction of the 'laws of the mind' will create a morally accountable character. Education as well as economic conditions form a significant part of it.

But to create those conditions under which all persons will develop

themselves, independent of any direct effect (as we do not know a-priori whether all will really benefit from it), means that we are looking for rules of social organization; moral rules. Those, it seems, are not entirely consistent with 'classical utilitarianism'. If moral values of actions depend entirely on their consequences there is no room to determine a-priori rules of behaviour. Certainly not rules that may or may not yield greater happiness in the end. Thus, a theory of justice becomes difficult as it is a theory of rules.

We have spent quite a long while arguing that Mill's Utilitarianism cannot be considered as 'classical' in two major senses. One, that not all actions are motivated by an anticipation for their pleasant consequences. And second, which is not un-related, that there are some other things besides direct pleasure that have an intrinsic moral value. Surely it should not be too difficult to defend a theory of justice in such a framework.

Nevertheless, many find in Mill's defence of rules of justice in a utilitarian setting as a proof to the existence of the problem in his own theory. However, I think that it will be agreed that one must distinguish between the question whether Mill considered himself a utilitarian in the classical sense, and the question whether his theory is indeed a form of 'classical utilitarianism'. I believe that we have seen enough evidence in Mill's work to suggest that his utilitarianism is far from being 'classical'. It is enough to consider the fact that Mill assumed that there are conditions

preceding any moral argument - that people must have free-will, or character - in order to argue that some rules are needed. Whether these rules are 'moral rules' or 'ante-moral' rules does not alter the fact that unlike classical utilitarianism, some kinds of rules which either precedes, or direct, moral conduct are not inconsistent with his theory.

Despite all that, Mill tried to show that justice is consistent with consequentialistic utilitarianism. Probably because he was himself a utilitarian or, perhaps, out of respect to his father. His efforts, thus, would be concentrated on showing that rules of justice are consistent with the enhancement of utility. According to his definition, the concept of justice is comprised of two major aspects; a rule of conduct and a sentiment that sanctions that rule.

The instincts that are behind the 'sense of justice' are those of 'self-defence' and 'sympathy'. A person wishes to defend himself and those with whom he feels sympathy. As the sense of sympathy depends on the state of society and as it is assumed that as society progresses so does the circle of people with whom a person feels sympathy. The sense of 'self-defence' is then extended to society as a whole. These sentiments causes people to 'resent', 'repel' or 'retaliate' against "any conduct which threatens the security of society generally"(Ut.cw.10 p.248).

Now, all these desires are by no means moral unless they are "in the directions conformable to the general good" (ibid. p.249). Hence, the gratification of these desires in rules of conduct is utilitarian

only in Mill's extended form of happiness. Namely, that only if people are capable of internalizing the common interest that rules and justice become part of the moral theory. It also means that justice is something that depends on the development of human character. Namely, there are some conditions which allow (via ethology) the creation of a free-willed character who will be capable of understanding his role in society and the dependence of his own happiness on that of the others.

Consequently, as the emergence of such a character is the condition for moral responsibility, it is also not surprising that it is the condition for the emergence of justice and rules.

I do not wish to go into details regarding Mill's discussion of justice, I would only like to concentrate on two concepts which are of great significance to economic justice; the theory of rights and that of desert.

(i) A Note on the Theory of Rights.

"When we call anything a person's right, we mean that he has a valid claim on society to protect him in the possession of it....If he has what we consider a sufficient claim..to have something guaranteed to him by society, we say that he has a right to it."(Ibid, p.250). Why, he goes on, does society have to guarantee something to an

individual?, the answer is -the general utility. Now, as the development of one's individuality is a condition for his happiness (given that 'higher' pleasures are greater than 'lower' ones), it is in the interest of general utility to guarantee the conditions for one's self-fulfilment. Freedom, therefore, is such an example of a right. Of course, all other conditions (educational and economical) will also be considered as a person's right. The question that we shall have to deal with later on is whether it also guarantees the right for private property.

(ii) On Desert and Distribution

When Mill gives an account of what immediate associations people have with the concept of justice, or injustice he mentions five: (i) to deprive someone of what belongs to him by law. (ii) to give by law rights that should not have been given, (iii) to remunerate each person according to his deeds, (iv) a breach of promise and friendship, (v) anonymity (to this last one he also attaches the idea of equality).

From all these, he believes that (iii) is the strongest sense of justice. But not only in the common sense of punishment. Also in the sense of reward. When analyzing Smith we saw that the return of good

was part of the idea of moral good. It was not, however, an idea of justice. This, of course, is the result of the observation that in Smith the rules of justice are rules of social viability. In Mill, however, the rules of justice are those which ensure a morally good society. Hence, rewards can no more be considered as optional, a failure to respond to a good deed has two consequences. One, it causes immediate disappointment. However, as Mill's theory cannot be considered as classical utilitarianism this may not be the main reason to reward a good deed. The second reason, the more important one, in my view, is that it might discourage a benevolent behaviour in the future. Thus, affecting the general circumstances that, eventually, affect the character formation. In that sense, it is entirely consistent with Mill's theory of justice to demand that reward will be a duty rather than an optional action.

"He who accepts benefits, and denies a return when needed, inflicts a real hurt, by disappointing one of the most natural and reasonable expectations, and one which must at least tacitly have encouraged, otherwise the benefits would seldom have been conferred."(Ibid,p.256). It also entails, argues Mill, a breach of promise and friendships.

Thus reward is a duty no less than the punishment is a duty. The reason for that, as I have said, is, in my view, the difference in the meaning of justice in the context of the whole moral theory. Namely, if just actions must also satisfy the moral good it is clear that there is no reason to prefer the satisfaction of revenge over that from fulfilled expectations.

Let me summarize this section before we move on to analyze the effects of Mill's methodology and ethics on his conception of economic justice. There are two conclusions of Mill's methodology which affect his moral analysis. One is that any aspect of social sciences must be studied by the tools of 'concrete deductive method' (or 'inverse deductive method' when dealing with history). The other, that empirical laws of human behaviour (the observed pattern of it) are a result of a deduction process that transmits the universal laws of the mind by the means of an 'axiomatic methodology'.

The particular nature of deduction which Mill finds useful in the acquiring of human knowledge (train of reasoning) is the main reason why he rejects the 'Bentham's-school' view of human nature. There, he argues, the method that is being used is that of 'abstract deduction'. The 'abstract method' suffers from two main problems. First, it is usually based on 'abstract' universals and thus it suffers from all problems related to 'a-priori' based theory. Mainly, the 'petitio principii' problem that we have discussed earlier. Secondly, it assumes that a single causation exists. "Mechanics" writes Mill "would be a science very similar to geometry, if every motion resulted from one force alone, and not from a conflict of forces. In the geometrical theory of society, it seems to be supposed that this is really the case with the social phenomena; that each of them results always from only one force, one single property of human nature"(Logic p.888). And as Mill strongly believes that social phenomena reflect a compound of causation, the

geometrical method is out of the question. Even when instead of 'a-priori' premises we substitute for more or less 'observed' ones, like the motive of self-interest.

Consequently, Mill rejects the assumption that one can construct any social theory on a single property of human nature. It certainly rules out a proposition that the sole motive of human behaviour is the pursuit of pleasure and avoidance of pain. Thus, Mill's moral theory can be anything but 'classical utilitarianism'.

The other aspect of his methodology which dominates his moral theory is the role of ethology. As I have shown in the previous section, ethology means the theory of character formation. Now, as characters are created by the interaction of psychology (the laws of the mind) with the social circumstances, they cannot be supposed as only affecting social phenomena but also as affected by them.

Given Mill's definition of the 'free-will' which corresponds to his idea of 'individuality', one can set some conditions for the development of characters who would be, first of all, morally responsible. These conditions which are the same as those which allow each character to develop its own course, can be considered as Mill's theory of justice. It is the framework for the developing of a morally responsible society that can carry on developing and by doing so, to increase the happiness, widely defined, of its members. This happiness, it must be said, is not merely pleasure as it is a sense of self-fulfilment. Hence, the role and importance of education as a fundamental right in Mill's theory cannot be

overstated.

It is possible to say that Mill's theory of justice is somewhere between Smith (and Hume) and 'classical utilitarianism'. In his *Enquiries*, Hume wrote: "The happiness and propensity of mankind, arising from the social virtue of benevolence and its subdivisions, may be compared to a wall, built by many hands, which still rises by each stone that is heaped upon it, and receives increase proportional to the diligence and care of each workman. The same happiness, raised by the social virtue of justice and its sub-divisions, may be compared to the building of a vault, where each individual stone would of itself, fall to the ground; nor is the whole fabric supported but by the mutual assistance and combination of its corresponding parts"(p.305).

From the above we can only sense the difference between rules of justice and those of moral goodness. Smith and Mill, however, make a connection between them. The rules of justice are the conditions for constructing the wall. Without them moral good will not be achieved. In Smith it is because society will not subsist. In Mill it is because people will not be capable of pursuing the real happiness.

4. The Structure of Economics in view of Mill's Methodology.

So far we have discussed in a somewhat separated fashion three main issues. One concerning the general problem of framework in classical economics and in particular, the problem of relationship between distribution and exchange in a 'cost of production' version of general equilibrium. Secondly, we have discussed Mill's methodology and his perception of the social sciences. Thirdly, we have investigated the nature of Mill's moral theory and examined his modification of utilitarianism from the point of view of his particular perception of the social sciences.

Now is the time to combine the three for the purpose of an investigation into the moral nature of Mill's economics. We shall proceed from here in the following manner. First, I would like to present Mill's distinction between production and distribution in the context of his general view of the social sciences. Secondly, I will explore the implication of this distinction on Mill's theory of value. I will discuss here the role and meaning of the 'economic man' and the partial equilibrium nature of Mill's theory of prices.

I will then discuss Mill's notion of values, as distinct from prices, and examine the problem and meaning of attributing to him a 'cost of production' theory of value. Naturally, in this section a reference will be made to Mill's distinction between distribution and exchange.

Thirdly, I will discuss the moral implications of all that. I will examine Mill's moral propositions regarding distribution and in particular the principle of proportional remuneration. I will examine the circumstances where the principle is upheld. I will also examine its relationships with distributional parameters (shares in output) and wonder on whether it is possible to think of principles of justice which serve as substitutes to one another.

We shall also investigate whether any idea of a labour theory of value can serve as a moral benchmark decreeing thus the deviations from those values as deviations from the morally just system. In the appendix, I will examine whether binding together the demand side of the economy through a simplified model of subjective theory of value helps in anyway to bring the actual prices close to satisfying the principle of proportional remuneration.

(a) Production and Distribution- The Scope of Economics.

One of the major aspects of Mills' theory which has not, in my view, attracted any serious consideration is the particular structure of

his 'Principles'. A structure which reflects most significant propositions with regard to the relationship between the different aspects of economic investigation.

Mill's 'Principles' starts with a long and detailed discussion of Production. "The production of wealth; the extraction of the instruments of human subsistence and enjoyment from the materials of the globe...has its necessary conditions. Of these, some are physical, depending on the properties of matter, and on the amount of knowledge of those properties at the particular place and time. These Political economy...assumes;referring for the grounds, to physical science.."(Principles, p.21).

Production, therefore, has in it an aspect which is entirely within the domain of the natural sciences. Hence, it can be studied through induction (as causal relationships are easy to detect) and subsequently, be generalized. That aspect of production then, is the only thing in political economy about which we need not have any reservations: "The laws and conditions of the Production of wealth partake of the character of physical truths. There is nothing optional or arbitrary in them."(p.199).

Production, according to Mill is, in principle, the application of human labour, past and present, onto matter. At a given technology we know that a production of a particular commodity requires so much direct labour and so much capital. We also know how much labour is required for the production of that capital. In other words, we know precisely how much labour and matter it takes to create a commodity.

Therefore, at any one time we can relate all produced commodities (and Mill includes in it also those which need to be simply collected), by the amount of labour required for their production. In fact what we have is a dual system. On the one hand, we can take the coefficient matrix A (from section 2) as depicting the technological circumstances at any one time. It tells us how much of each commodity is required for the production of the others but we can not relate one commodity to another without reference to a concept which is in the sphere of social institutions; prices. On the other hand, we can translate it into labour inputs language. It will tell us how much labour, direct and indirect is embedded in each commodity. And this measure is entirely in the domain of physical sciences.

The point I am trying to make here is not that Mill adhered to a labour theory of value, rather that the scientific nature of the theory of production provides us with a system that relates all produced commodities through their technological requirements. As such, it is a system of general equilibrium the common denominator of which, (or the numeraire) is labour and, its most important feature is that it is independent of social institutions.

There are basically two approaches to this issue. One, which is popular with those who are searching for a labour theory of value, and which assumes that things have some sort of an intrinsic value. The other, which I shall use, is trying to be faithful to the empirical nature of Mill's views in general and in particular with

respect to the natural sciences.

Let there be an economy with n commodities. Let A is the coefficient matrix as in section 2, and $\alpha = (\alpha_1, \alpha_2, \dots, \alpha_n)$ is the vector of required direct labour for the production of each commodity.

Let $\Lambda = (\lambda_1, \lambda_2, \dots, \lambda_n)$ be the vector of labour 'values' of commodities. Following the approach as if things have an intrinsic value which we have to discover and which are, as a matter of fact, not observable, we shall have the following system:

$$\begin{aligned} \lambda_1 &= \lambda_1 a_{11} + \lambda_2 a_{21} + \dots + \lambda_n a_{n1} + \alpha_1 \\ \lambda_2 &= \lambda_1 a_{12} + \lambda_2 a_{22} + \dots + \lambda_n a_{n2} + \alpha_2 \\ &\vdots \\ &\vdots \\ &\vdots \\ \lambda_n &= \lambda_1 a_{1n} + \lambda_2 a_{2n} + \dots + \lambda_n a_{nn} + \alpha_n \end{aligned}$$

And in a matrix form:

$$\Lambda = \Lambda A + \alpha$$

Rearranging it we shall have:

$$\alpha = \Lambda(I - A)$$

Notice that it is a rationalistic approach as we assume a-priori that there is something called λ_1 (labour value) and by using the proposition that commodities participate in the production of each other, we can discover those values. Namely, only when we consider the system as a whole can we discover those values; as if they are completely inter-dependent.

An alternative approach which I believe is more in line with Mill's general views and in particular in the way he perceives production,

is where labour values are derived from our knowledge of technology. Namely, the labour value of things is the amount of direct labour required for their production plus a simple sum of the direct labour required for the production of their means of production. Hence, we shall have the following system:

$$\begin{aligned} \hat{\lambda}_1 &= \alpha_1 a_{11} + \alpha_2 a_{21} + \dots + \alpha_n a_{n1} + \alpha_1 \\ \hat{\lambda}_2 &= \alpha_1 a_{12} + \alpha_2 a_{22} + \dots + \alpha_n a_{n2} + \alpha_2 \\ &\vdots \\ \hat{\lambda}_n &= \alpha_1 a_{1n} + \alpha_2 a_{2n} + \dots + \alpha_n a_{nn} + \alpha_n \end{aligned}$$

In a matrix form:

$$\hat{\Lambda} = \alpha(A - I)$$

Rearranged:

$$\alpha = \hat{\Lambda}(I + A)^{-1}$$

Notice that here we do not need the full system in order to discover the labour value of any commodity; it is by induction that we learn on the labour values of different commodities. All values here are caused by the technological requirement of labour¹.

When we compare the two systems we shall find that the difference between them is precisely that in the latter values are explained in

¹What is meant by this is that in the previous method we could not have told the labour value of any commodity because the determination of that value was dependent on the labour values of the other commodities. We could therefore, determine labour values only simultaneously, like prices. In this alternative approach the labour value of each commodity is determined independently of the other. It is a simple sum of the labour required, directly and indirectly, for the production of each good. There is, here, nothing abstract about the labour values. This is what distinguish this approach from the one presented earlier where labour values are constructed as an alternative to prices. And it is this technological interpretation of labour values which makes it consistent with Mill's methodology.

the full by the direct labour requirements while in the former case there is an unexplained residual. In the former case $\Lambda = (I-A)^{-1}\alpha$ and in the latter $\Lambda = \alpha (I+A)$. We can write $(I-A)^{-1} = I+A+A^2+A^3+\dots$ so that the difference between the two is $A^2+A^3+A^4+\dots$. Though not a significant difference in volume, it is a difference in substance.

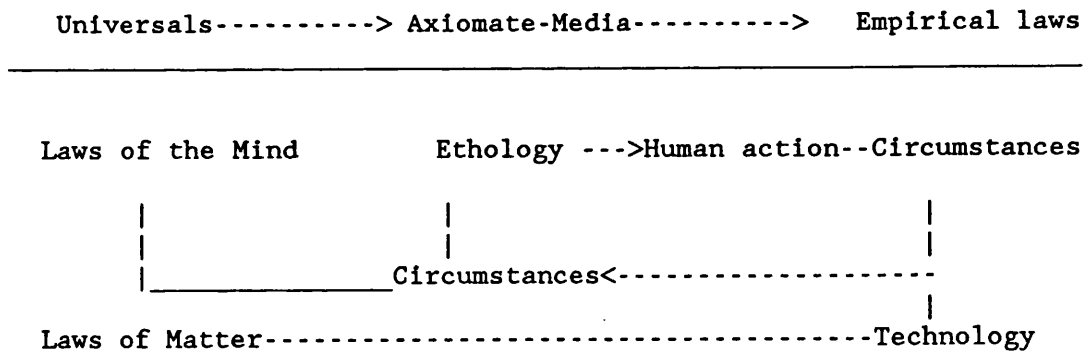
Thus, the theory of production offers a general equilibrium framework in the sense that we can now relate all commodities by their technological labour requirements.

Distribution and exchange, in Mill's theory, is a completely different story. Distribution of wealth, writes Mill, "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 whomever they please, and on whatever terms." (p.200).

There are two important features to Mill's characterization of distribution. First, its being entirely a social question and secondly, that it follows the act of production. The importance of the latter characteristic is in the nature of relationship between production and distribution. The former, however, is significant in terms of its implied methodology. While in the sphere of production, the natural sciences provided us with tools of induction through which we were able to construct a complete relationship between all commodities, the social sciences present us with difficulties in doing so. What it is that determine the circumstances of exchange of the different commodities cannot be so easily related. Modern

theory has dealt with the problem through some kind of an 'economic man's' behaviour. Mill too discusses the idea of the economic man however, in his case, I will show that it is not very meaningful to construct an isolated (from other social aspects) theory of economic interdependence. What will concern us in this complex structure is where precisely stands the theory of distribution between the completeness of the theory of production and the partial nature of the theory of exchange.

Economics, therefore, is quite unique in terms of Mill's perception of the social sciences. On the one hand, it is very much dependent on social institutions. But on the other hand it is a system which seems to have an objective and general anchor; the theory of production. Thus, Mill's picture of the social sciences must now be extended:



It now has some inputs coming in from the natural world. The question is, through which of the economic parameters does this input presents itself and, for what purpose. This is, I believe, quite a unique perception of economics. In the case of Adam Smith, for instance,

technology would not have been exogenous. There would have been an additional arrow from circumstances to technology.

So far we saw the meaning of the 'technological' input to the system. It relates all commodities to one another independently of any social institution. Now, allow me to discuss some of the difficulties that Mill saw in the social system. Difficulties in the sense of establishing a complete relationship between all commodities (general equilibrium).

(b) The Limits of Political Economy Within the Social Sciences.

There are two fundamentals to be considered when we come to discuss anything related to the social sciences. Its non-experimental nature and its portrayal as a harmonised organism. The first fundamental, the non-experimental nature, is a direct result of the complexity of social phenomena. The immediate consequence of this fundamental is that it does not allow a proper use of induction. Hence, the social sciences must be examined using the tool of deduction. In view of Mill's criticism of deduction, it must be qualified to particular sorts of deduction; mainly the 'concrete method of deduction'.

There are two main features to this method which make it possible to use deduction while avoiding the pit-falls of general deduction. One, that we shall avoid the property of 'geometry' where a single causation exists. Thus, 'concrete deduction' means to explain a single phenomenon by analyzing its various causes. The other feature

is that the 'a-priori' foundation of our deduction should, ideally, be part of a 'train of reasoning'; namely, it must be a conclusion of another deduction (when at least some of them have as premises conclusions of inductions which, it is presumed, are possible at some narrower aspect of the social investigation). Otherwise, deduction cannot be considered as a mean of increasing our knowledge about the world.

However, in view of the problems with which social sciences are confronted, Mill is willing to make some allowances. In particular, he seems willing to accept the 'a-priori' premise on a less strict platform than 'truth'. Namely, the 'a-priori' premise may indeed be a result of some introspection we make about human behaviour. This, however, should not be interpreted as accepting the idea that a premise can be a definition or, which is almost the same, that it does not matter how true (in a 'synthetic sense') it is. In other words, what it means is that Mill's 'a-priori' premises are not really 'a-priori' but merely a modified version of 'synthetic' like statements. Its 'true' value cannot be properly established (and therefore, probably, not falsifiable) but it matters a great deal whether or not we believe it to be a true description of the world.

The second fundamental of Mill's perception of social studies is the assumption that society as a whole is balanced and interrelated like an organism. "There is no social phenomenon which is not more or less influenced by every other part of the condition of the same society, and therefore, by every cause which is influencing any other of the contemporaneous social phenomena. There is, in short, what physiologists term a consensus, similar to that existing among the

various organs and functions of the physical frame of man and the more perfect animals"(Logic p.899). He then goes on to argue that this harmony of organs is unique to different bodies. Thus, a particular cause in one society, may spread differently in another as it encounters different circumstances of the various organs.

There are two conclusions to be drawn from it. One, that society as a whole may be considered harmonious, or, inter-dependent. Which, of course, means that from the point of view of modern interpretation society form a system of general equilibrium. Nevertheless, it also means that the individual organ (like, say, economics) cannot be in a self-sustained harmony. It depends on (and affects) all other aspects of society; its equilibrium properties can only be considered in relation to them, not as a complete interdependence within itself.

However, one may argue, general equilibrium within economics itself is possible when one uses the 'ceteris paribus' assumption. Namely, allowing for all economic variables to be related to other aspects of social studies but keeping these relations constant. But there are two major problems with this assertion.

First, a more general and not necessarily related to Mill, is the problem of sensitivity. That is, by freezing 'external' interdependence of economic variables we seem to imply that the 'internal' relations are the more stronger, or significant, ones. Indeed, if we appear to be able to decide what is exogenous and what is not we pretend to know something about the nature and strength

('elasticities' if one wishes) of relationship between all variables involved. Suppose we have three variables, A, B, C that we know are interrelated. Suppose too that A and B as well as B and C are strongly related. Surely to construct a theory about the inter-dependence of A and C leaving B 'ceteris paribus' is not the most meaningful line to pursue. Nevertheless, as we know the nature of relationship between all variables, we can thus choose to look at those we believe are more significantly inter-related. (For instance, to construct apparently independent theories on A and B and on B and C leaving C and A to be the exogenous variables respectively). The second objection to the 'closed' look at economics is based directly on Mill and is not entirely unrelated to the previous, general, objection. It is his own interpretation to 'ceteris paribus'.

According to his view, 'ceteris paribus' is used to indicate that there are other forces whom we do not know, and that may affect the propositions of our theories. But as our knowledge expands, we have to incorporate them into the theory. In other words, 'ceteris paribus' is in Mill's terminology to say that there are probably some other causes that are likely to affect our propositions. But as we do not know much about them, we shall simply reduce the level of our propositions to become mere 'tendencies laws'. Naturally, when we discover new causes we shall have to incorporate them. Once we have done so, we may indeed decide to conduct a partial analysis and choose those variables we wish to be endogenous and those we wish to be exogenous. Thus, choosing exogenous variables will be based entirely on the knowledge of their relations with the

endogenous ones. Hence, defining general equilibrium within the economic system will make sense if we believe all other social variables to have a less significant affect on economic variables than they appear to have on one another.

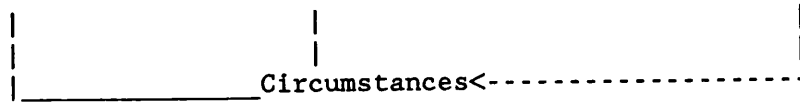
Another conclusion of the general interdependence of all aspects of social life is that one cannot hope to reach general conclusions but simply, rules of formation. "The deductive science of society" writes Mill "will not lay down a theorem, asserting in an universal manner the effect of any cause; but will rather teach us how to frame the proper theorem for the circumstances of any given case.....All general propositions [therefore]...are grounded on some supposititious set of circumstances supposing that no other were combined with them."(p.900).

On the face of it this last conclusion does not seem to be consistent with the 'concrete' method or, for that matter, with its association with the 'train of reasoning'. However, we must distinguish the deduction of 'laws of formation', to which the above conclusion applies, from the deduction of 'empirical laws' which must be concrete and adhere to the various circumstances of society. Bearing in mind Mill's general assertion that in the social science we deduce an 'axiomate media' in the form of ethology, which then transmits the universal 'laws of the mind' to 'empirical laws', we can see that there might be room for different methods of deductive reasoning.

Let me remind the reader of Mill's perception of the social sciences.

Universals-----> Axiomate-Media-----> Empirical laws

Laws of the Mind Ethology --->Human action--Circumstances



The universals, naturally, hold to any human being. The social circumstances and the 'empirical laws' of different societies varies according to the difference in people's character. Ethology, the axiomate media, does not offer us a proposition about the character of individuals, it only tells us how they will form a character under different circumstances. This is precisely that part of the analysis for which a deduction is required that is not 'concrete' but 'hypothetical' in the sense that it can be attributed to different circumstances. Here indeed, the premises of deduction cannot be part of any train of reasoning as ethology is not part of a greater system but in itself a complete system.

The next move, from ethology to 'empirical laws', involves much more the particular nature of the subject of investigation. As the social scene is a vast set of many phenomena and inter-relations, we cannot any more ignore the effects of one social aspect on the other. The 'concrete' method, which takes each phenomenon separately but tries to investigate the whole set of its causes, is applied here. Its premises obviously, will be the conclusions of other branches of social investigation. For instance, if we analyze the 'economic phenomenon' and we take as its premise people's motive, we obviously derive it from ethology- the science of character formation.

However, if the economic circumstances affect, say, educational circumstances, it will affect the characters of individuals through the 'laws of character formation' (ethology). Once this has happened, the economic motivations of those characters may change altogether. The premise of economic analysis, consequently, will have to change too.

In the same way, it was this line of argument that helped us through the complex of apparent contradictions in Mill's moral theory. The reasons why we cannot think of Mill as a utilitarian in the classical sense of the word is because he made allowances to the development of people's personality. In our terminology it means that he took into consideration the change of circumstances that changes a person's character and consequently, his disposition to pleasure and pain. Thus, the concept of happiness had to be extended and other things than direct pleasure could have had intrinsic moral values.

The meaning of all this is that in the social sciences it will be difficult to establish relationships between all variables (or markets) for two reasons. One, that it is not necessarily that what determines the circumstances of one market are related in the most significant way to economic variables. Some other aspects of social life may affect those circumstances much more. These influences may come from custom, moral views, social organizations etc.. The other reason is that even if we wished to construct those relations on the behaviour of individuals (all the rest 'ceteris paribus') then we shall have the problem that people's character are affected by the circumstances that their behaviour create. Thus, though something may

be true at one moment of time, human behaviour may change endogenously. This last point is also the reason why the idea of the 'economic man' is not very helpful and, indeed, it plays no role in Mill's discussion of economics.

(c) Ethology and the 'Economic Man'

Allow me to say a few words on Mill's direct reference to economics as appeared in his *Essays on Some Unsettled Questions of Political Economy* (1836) and were later referred to in his *Logic*. To begin with, Mill begins his justification for a separate analysis of economics by re-stating its actual dependence on the other aspects of the social sciences. Only then, when this is clear, he explains why it might be helpful to study economics separately. "Notwithstanding the universal consensus of the social phenomena, whereby nothing which takes place in any part of the operations of society is without its share of influence on every other part;....it is not less true that different species of social facts are in the main dependent, immediately and in the first resort, on different kind of causes" (*Logic*.p.900).

Political economy, argues Mill, is concerned with consequences of three features of human nature. The desire for wealth, the aversion to labour and the desire for present enjoyment. (*Essays*, p.137, cw, v.4

p321). To that extent, Mill is completely loyal to his Logic. The three principles, or forces, behind economic analysis ensure that it will not suffer the shortcoming of 'geometry' -the abstract method of deduction. Namely, it is not based on a single force but on contradicting forces which is a better description of the social scene.

Nevertheless, economics seems to suffer some of the deficiencies of the 'abstract method'. The reason for that is that its premises are not 'true' forces in the proper sense of the word. It is not that people in general do not have a desire for wealth, aversion to labour and a desire for present enjoyments. They don't have only these motives. The 'economic man', according to Mill, is a creature that is comprised of only these particular qualities. Thus, enabling us to examine the net effects that are produced by these net causes. "Not that any political economist" wrote Mill "was ever so absurd as to suppose that mankind are really thus constituted.."(Essays,p.138). In other words, it means that the 'economic man' is carved out from the output of ethology at a given point of time. That is to say, ethology- which is the rules of character formation- produced in conjunction with given circumstances a particular character. The 'economic man' then, is an abstraction of that particular character. Namely, the 'economic man' is not an a-priori premise in the proper sense of the word (i.e. it is not a definition). It is based on observation and on what circumstances have produced and to that extent, it is an approximation to a process of induction. Thus, the premises of economics must be embedded in reality. They therefore also depend on

the changing circumstances of mankind.

The assertion that the 'economic man' is not a 'real man' gave rise to arguments, such as in Blaug(1980), that the 'economic man' is a proper a-priori assertion. This, of course, seems as a contradiction to Mill's arguments in the Logic that one cannot increase human knowledge by a deduction that is based on a-priori premises. However, the fact that at the same time Mill argues that these premises of the economic man should be established through observation does not seem to be consistent with its a-priori nature. Indeed, the only way to settle this apparent contradiction is in the way I have suggested before. Namely, that the 'a-priori' nature of the economic man is entirely due to the fact that it is not the complete picture. Not because it is not true in itself.

Of course, if the process of analysis ends at deducing propositions from the abstraction of the 'economic man' one cannot really hope for a great scientific content to those propositions. Blaug (1980), for instance, interprets Mill's discussion in the Essay as saying that Mill's 'economic man' makes his Political economy essentially an 'abstract science' which is based on the 'a-priori' method. The hypothesis regarding human nature does not have to be grounded in fact (though he agrees that it must be grounded on some form of experience like observations or, introspection). Consequently, argues Blaug while quoting Mill, the propositions of economics are like those of geometry, true only in the abstract(pp.62-4).

But this is not the whole story. The study of human behaviour when

So the 'economic man' is itself subject to changes as a result of changes in the economic circumstances. But not only as a result of changes in economic conditions, also as result of changes in educational and moral circumstances. For instance, Mill seems to predict how the economic man will change with the progress of society. He will, according to Mill, become much more co-operative.

To sum up this last point, if we wished to relate all markets through some analysis of the behaviour of an 'economic man', we would have had to consider two other points. One, what are all the other inputs on his behaviour that we make exogenous; in particular, what degree of individuality the economic man reflects and what are the moral norms that influence him. Secondly, we shall have to analyze how do the circumstances of a particular economic state affect that character. Given all that, I believe that it would not be far from the truth to argue that Mill saw markets in a partial equilibrium light. Different markets may be related to different social parameters and the behaviour in them will not necessarily be affected by other markets (or prices) as by those social circumstances. To use the notion of the economic man for the purpose of analyzing the behaviour of individuals in one market is quite consistent with Mill's analysis (hence, perhaps, Mill's discussion of demand as a function of value (book 3 ch.2 section4 pp446-7)). But to extend the analysis so that all market will be related through the behaviour of the 'economic man' does not seem to me to be consistent with Mill's methodology and perception of the social sciences.

(d) The Implications of Mill's Methodology to his Theory of Value.

What Mill's conception of economics suggests is that there are two observable extremes. One, given by technology which relates all commodities to one another. The other, the actual prices that prevail in different markets and, which on the face of it, cannot be related to one another.

As I mentioned earlier there are different views concerning Mill's theory of value. His very 'modern' description of price determination using demand and supply has invoked two opposing views. One, that his theory of value is in the framework of partial equilibrium analysis (see Blaug 1985). The other, that what ever is his theory of value, we must interpret his work in terms of modern analysis (see Hollander 1985). Not surprisingly, this latter approach goes along with the idea that Mill's theory of value, and indeed the whole classical school's theory of value, is in the general equilibrium framework of analysis.

Obviously, those who interpret Mill's theory as a 'cost of production' theory of value in a general equilibrium setting would like to believe that they can use a 'cost of production' theory as all prices, in the long-run, converge to their 'cost of production'. Thus, they seem to end up with a somewhat Marshallian theory of value. (see Hollander 1985, Forget 1989). The line, therefore, between Ricardo and Marshall, seems to them as established.

However, how much of Ricardo there is in Mill is still an open question (see on this subject Schumpeter(1954), Stigler (1955), Viner (1958), Robbins (1970), Schwartz (1972), Blaug (1985), Hollander (1985),(1987), Forget (1989), Bradley (1989)). And even if it was, does the line between Ricardo and Marshall really imply that classical economics is a form of 'neo-classical' economics? How neo-classical is Marshall (see Mirowski 1973).

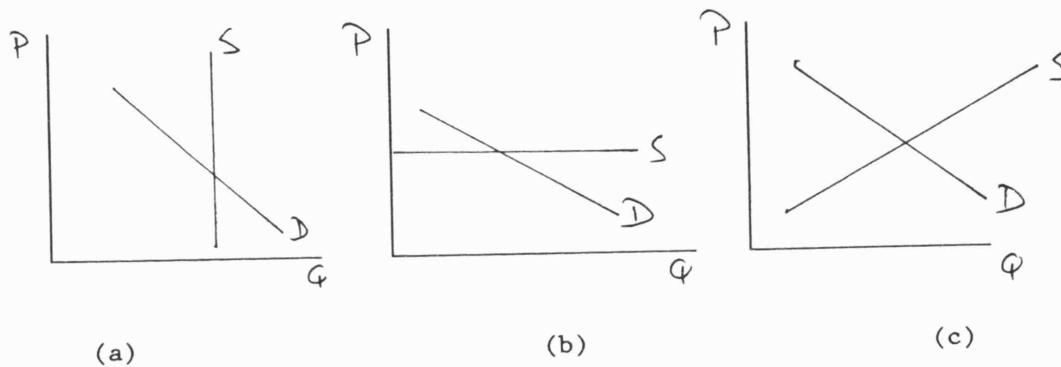
We saw already that a 'cost of production' theory does not really imply general equilibrium in the modern sense of the word (complete inter-dependence). We also saw that Mill's theory is basically open to many interpretations. However, the meaning of his distinction between what can be analyzed in a general equilibrium framework and what cannot is not a mere technical problem. It is a point of substance.

To begin with, it would be useful if we noted Mill's distinction between value and price. Value is the relative price while prices are in terms of money. All prices may rise but it is impossible for all values to go up. Namely, values are how commodities relate to one

another while prices, as a matter of fact, dominate that relation.

Naturally, if values relate all commodities to one another, it seems to resemble the idea that production provides us with a mean to relate all commodities to one another. But before that, we have to see how prices are being determined.

Mill argues that what determine prices are the following three circumstances of demand-supply relationship:



(a) depicts the market for commodities which are not produced and are given at a fixed level. Presumably, these are going to be luxury goods such as artistic works; the demand for them, probably, is the demand of the rich. Market (b), according to Mill, is the most common one. A market where the production of the commodity can be increased in a constant returns to scale fashion. Market (c) is the market for natural goods (like agriculture and mining) where we have increasing marginal costs as the quality (and quantity) of one of the factor of production (land) is diminishing (or fixed).

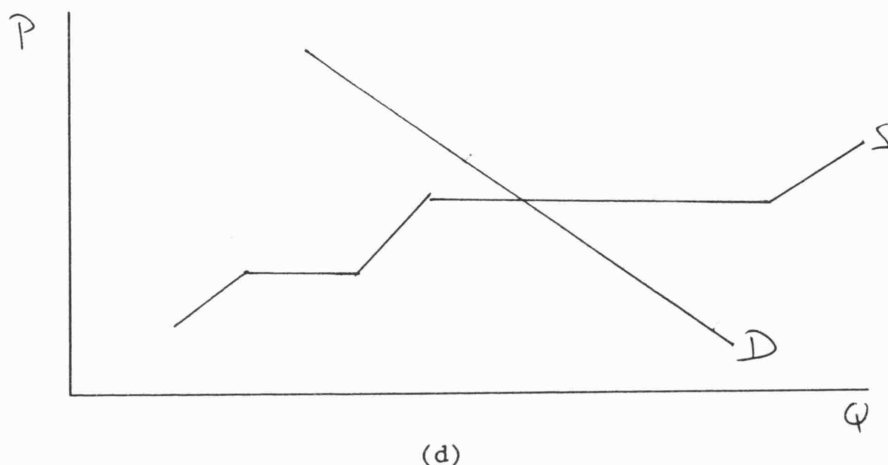
Naturally, Mill does not offer any theory whatsoever to related the different demand functions to one another. This is the 'partial equilibrium' aspect of his theory. Thus, to argue for a general equilibrium interpretation one will need two things; (i) to argue that all prices tend to their 'cost of production' and, (ii) that in spite of (c) we can relate the 'cost of production' of all commodities without any reference to demand.

As for the first, this seems to based on the 'classical' idea of 'natural' price. "As a general rule" writes Mill, "things tend to exchange for one another at such values as will enable each producer to be repaid the cost of production with the ordinary rate of profit"(Principles, p.452). However, it is important to note that according to Mill, cost of production, or the natural price, are taken as an average. A point around which prices oscillate though very seldom will really coincide with (p.453).

This last thing deterred many from accepting the 'cost of production' theory of value. Indeed, as I argued in Smith, the interpretation of 'cost of production' (or natural price) as the long-run equilibrium price is unacceptable. It is, in my view, a reference point through which we may establish some relation with the information supplied to us by technology about relationships in production. Thus, the meaning of the natural price, or the 'cost of production' is really more moral than practical in terms of the determination of prices.

In terms of the second problem, the rising marginal costs, there is

a possible solution. If (c) above really depicts agricultural commodities then it will not be a continuing rising marginal cost. Instead it will be as follows:



Namely, only after significant output from the given amount of land we shall have to resort to a less productive one. Even then, the productivity of land will not change with every small increase in its output. In such a case, for a given amount of population, variation in demand in (a) and (b) will not cause any change in the 'cost of production' system. If, however, the rising marginal productivity prevails in other raw materials, like mining, we have a more complex situation. While population will determine the cost of production in (d), shifts in demand in (b) will cause a rise in the demand for raw materials and in their cost of production. The case of (b) will not hold any more.

In any case, suppose that at one point of time we have the case of (a), (b) and (d). Until a further significant rise in population we may talk of 'cost of production' that relate all commodities to one

another. We have then the following system:

$$\begin{aligned}
 P_1 &= (1+r) [P_1 a_{11} + P_2 a_{21} + \dots + P_n a_{n1} + w\alpha_1] \\
 P_2 &= (1+r) [P_1 a_{12} + P_2 a_{22} + \dots + P_n a_{n2} + w\alpha_2] \\
 &\quad \vdots \\
 &\quad \vdots \\
 &\quad \vdots \\
 P_n &= (1+r) [P_1 a_{1n} + P_2 a_{2n} + \dots + P_n a_{nn} + w\alpha_n]
 \end{aligned}$$

And in a matrix form:

$$P = (1+r)[PA + w\alpha]$$

The principal component of cost of production, argues Mill, is labour. (Principles, p.457). "What the production of a thing costs to its producer, or its series of producers, is the labour expended in producing it."(ibid). The key in this statement is the reference to the 'series of producers'. Namely, we take capital as a produced good and if we go back long enough, we shall be left with the only agent of production, labour. The same idea appears also in Sraffa(1960.Ch.6) but allow me to give it a somewhat different interpretation.

Consider the 2x2 system where commodity 1 is the numeraire:

$$\begin{aligned}
 (1) \quad 1 &= (1+r)(a_{11} + Pa_{21} + \alpha_1 w) \\
 (2) \quad P &= (1+r)(a_{12} + Pa_{22} + \alpha_2 w)
 \end{aligned}$$

Now, applying (1) to its first argument:

$$a_{11}x_1 = (a_{11}^2 + Pa_{21}a_{11} + \alpha_1 a_{11}w)(1+r)$$

and (2) to its second argument:

$$Pa_{21} = (a_{12}a_{21} + Pa_{22}a_{21} + \alpha_2 a_{21}w)(1+r)$$

Returning them to the main equation (1) we shall get:

$$[(a_{11}^2 + Pa_{21}a_{11} + \alpha_1 a_{11}w)(1+r) + (a_{12}a_{21} + Pa_{22}a_{21} + \alpha_2 a_{21}w)(1+r) + \alpha_1 w](1+r) = 1$$

If we repeat the operation several times more we shall find that the expressions in the parenthesis approach zero so that the set of original equations will shrink to:

$$(3) \quad \alpha_1 w(1+r) = 1$$

$$(4) \quad \alpha_2 w(1+r) = P$$

Solving (3) for r:

$$r = \frac{1}{\alpha_1 w} - 1$$

Substituting in (4):

$$\alpha_2 w \left(1 + \frac{1}{\alpha_1 w} - 1\right) = \alpha_2 w \frac{1}{\alpha_1 w} = \frac{\alpha_2}{\alpha_1} = P$$

So the price ratio, the value, of 2 in terms of 1 is determined by the ratio between labour inputs in 2 and 1.

However, this is only in intellectual exercise. For this to be true we must assume that wages are the same throughout. Indeed, Mill is very clear to distinguish between cost of production reflecting labour as a quantity and labour as a cost (including wages). "[I]t would seem that the value of the product cannot be determined solely by the quantity of labour, but by the quantity together with the remuneration" (p.459).

But surely it is labour, according to Mill, that is the real agent of production. What is it, then, that causes prices (as cost of production) not to reflect the logical conclusion of the above

system? Let me for a moment return to the general form and write cost of production with wages as the numeraire:

$$\frac{P}{w} = q = (1+r)(qA + \alpha)$$

We can now rewrite it as:

$$q[\delta I - A] = \alpha \quad \text{where} \quad \delta = \frac{1}{(1+r)}$$

Recall that the information supplied by technology suggests that:

$$\alpha(I+A) = \Lambda$$

or:

$$\alpha = \Lambda(I+A)^{-1}$$

Hence,

$$\begin{aligned} q(\delta I - A) &= \Lambda(I+A)^{-1} \\ q &= \Lambda(I+A)^{-1}(\delta I - A)^{-1} \end{aligned}$$

And if we ignore the tail:

$$q = \Lambda(I+A)^{-1}(\delta I + A)$$

Now it is well established that prices are proportional to labour values only when the capital to labour ratio in all industries is the same. However, this is not the only case. Also when $r=0$, prices will be proportional to labour inputs. If $r=0$, $\delta=1$ then:

$$q = \Lambda$$

Which means that when profits are introduced, cost of production do not reflect any more the technological relations between commodities. But this is not to say that Mill disapproved of rewarding abstinence. It is not profits as such which distort the system, it is the uniform rate of profit. This, is entirely the

result of competition (which is a particular form of the social institution of exchange).

In fact, according to Mill, the only aspect of the rate of profit which will equal in all industries is the 'interest rate'. Other aspects, like risk, may come in a form of direct costs. However, in the system that we have used here, r represents the cost of risk as much as the interest rate (there is no other conceivable argument which can represent risk). Therefore, I would like to argue that in a system like the above it could be possible to have cost of production reflecting the labour inputs ratio.

So what we have so far is that 'cost of production' according to Mill, should reflect labour inputs but it is the arrangements of society that may cause them to deviate from their objective values. In other words, the only thing we can say about the 'cost of production' that they do not necessarily reflect the objective difficulty of attainment. Nevertheless, they do explain the deviation from them. What we shall have to do now is to investigate the moral implications of all that.

5. The Moral Significance of Mill's economic system

It was my reading of the 'Principles' that first aroused my suspicions regarding the utilitarian nature of Mill's moral theory. His discussion of distribution seems to be dominated by ethical principles which do not appear to be in complete accordance with the method of 'classical utilitarianism'. In fact, the mere use of 'principles', or rules, already suggests a departure from the mainstream thinking of this school.

Allow me just to repeat here what I mean by 'classical utilitarianism'. There are fundamentally two major aspects to it. One, the exclusiveness of 'happiness' (which must be sensually interpreted as all these theories are to be considered under the 'classical empiricism' heading). The other, its teleological nature as far as the theory of justice is concerned. Namely, principles of justice should be constructed in such a way that they will never overrule the principle of utility. That is, as the moral value of actions depend on their consequences, a principle, or rule, can only be applied to actions the result of which are known in advance and at a high degree of certainty.

In section 4 I have tried to show that Mill does not fall in this category because of his extended concept of 'happiness'. An extension that allows for a much wider conception of the moral good and for some other things to have moral value (like education) which are not be associated with any direct, or even indirect, utility. Nevertheless, his theory of justice is definitely teleological in the utilitarian tradition. The whole of his theory of justice (and duty) is completely dominated by his effort to show that rules as such are not contradictory to utilitarianism. That they can all be explained in terms of their contribution to the moral good. And that people follow duty from utilitarian reasons.

How successful Mill was in advocating his theory of justice and being consistent with 'classical utilitarianism' is a matter for a separate investigation. However, in the light of his methodological attack on Bentham and its immediate result- the extension of the concept of happiness- there is little to argue in favour of Mill's association with classical utilitarianism save, perhaps, his complex relationship with his father.

The best example, in my view, to the tension between Mill's theory and utilitarian principles can be found in his theory of economic justice. In Mill's discussion of distribution he seems to lay down principles of justice which appear to be more rationalist than empiricist in nature. For instance, I will show that in his discussion of both, private and communal, ownership of property the fundamental principles are based on some idea of a person's sovereignty on his self. That he has some kind of a right on his own

faculties. This, in turn, requires that communal ownership will be based on a voluntary transfer of this right to some agreed authority; while in the case of private property it is the foundation of the proposition that people have rights to the 'fruits of their labour'.

While there might be a utilitarian explanation for the last proposition, it is still difficult to explain the theory of right behind it, in terms of a utilitarian theory. Indeed, it is not surprising at all that Walras, the rationalist, holds an astonishing similar theory of right. In turn, it will be interesting to examine the difference between the manifestation of the similar moral principle in classical and neo-classical models. At present, however, I would like to concentrate on examining the precise meaning of this principle in Mill's moral theory as well as on its manifestation in his economic theory.

a. Initial Distribution and the Ideal of Private Property.

There is little doubt that Mill was quite unhappy with the social circumstances of his times. Nevertheless, even though he contemplated the 'communal' alternatives, he was willing to make allowances to the system of private property. Mainly on the grounds that it emerged from what Mill considered to be an initially wrong principle. A principle that can be historically explain but is not itself an

inherent feature of this kind of social institution.

This principle is the principle of 'first occupancy'. The reason that Mill gives for its becoming a principle of justice is that the judicial systems in the rude states of society were concerned with peace rather than with justice. As acquisition of property through violence was the main cause of disorder, it was necessary to establish 'first occupancy' as a principle of justice. Also, bearing in mind the nature of acquiring any sort of wealth in those days (by collection rather than production) it may also appear as a plausible principle.

Thus, argues Mill, the actual institution of private property stems from an initial distribution which is based on a principle of acquisition which is unacceptable. The morally upsetting state of private property, therefore, is not necessarily because of its inherent qualities, rather because of some historical distortions.

In order to consider the institutions of property properly, Mill suggests to think of a hypothetical situation where colonists occupy an uninhabited country; bringing nothing with them but what belonged to them in common. "[H]aving a clear field for the adoption of the institutions and polity which they judged most expedient; [they are] required, therefore, to choose whether they would conduct the work of production on the principle of individual property, or on some system of common ownership and collective agency."(Principles, p.201).

He then goes on and suggests a list of conditions that should accompany the establishment of private property in such a hypothetical situation. "Every full grown man or woman, we must suppose, would be secured in the unfettered use and disposal of his or her bodily and mental faculties; and the instruments of production, the land and tools, would be divided fairly among them, so that all might start, in respect to outward appliances, on equal term." (p.202).

The ideal of private property, therefore, is based on two principles; an initial distribution that will start all on equal terms and, the freedom to exploits one's faculties (i.e., the freedom of occupation).

The alternative, according to Mill, is to hold the instruments of production collectively. Hence, the direction of labour (the actual division of labour) as well as the distribution of produce will also be conducted publicly by an authority that we assume to be obeyed voluntarily. Thus, the two initial principles of communal systems are the collective ownership of means of production and, an agreed transfer of the freedom of occupation.

What is not very clear is what is the meaning of these conditions. At the beginning Mill said that in his hypothetical situation, the 'colonists' will choose the institution they find most expedient. He does not, however, deal with the question which institution they will choose, rather he suggests what they would do had they chosen a particular institution. As if the above principles have nothing to

do with a moral choice (which would have probably be reflected in the choice of institution), rather with the choice of its most efficient form. Thus, it can be said, the above conditions are not moral conditions but simply the principles that form the 'ideal' of the two concepts. They constitute, as such, the proper definitions of private and communal ownership.

If by the equal initial distribution and the freedom of occupation Mill means that this is the logical meaning of private property (in the abstract), they cannot be interpreted as principles of justice. To qualify as such, these principles must be explained in terms of Mill's moral theory (or utilitarianism as some would argue). Similarly, if communal ownership is characterized by a voluntarily transfer of all the means of production to an agreed authority, the volition side of it cannot be interpreted as a moral requirement.

However, it is difficult to maintain that these principles are not principles of justice even though they are being argued with no relation at all to any theory of morals. In the case of communal ownerships the first principle sounds like a definition; that is, all productive forces (including a person's own abilities) are in the hands of a central authority. Nothing is being said on what should be the aims or values of that authority. Nevertheless, the second (or hidden) principle, that the individual's productive forces should be voluntarily transferred, is not entirely a value free principle. It pre-supposes that individuals have a right to own their own faculties.

In the case of private ownership, however, the only things which fits the term definition is the idea that everyone is free to apply his faculties in any way he chooses. To argue that external means of production should be distributed equally, or in such a way that will bring all to an equal footing, can hardly be part of what defines 'private property'. In fact, even to argue that private property means that we own at least our own faculties, like in the previous case, is not a value free statement.

Therefore, it appears that these principles are moral principles after all. However, bearing in mind Mill's reputation as a utilitarian, these principles are quite surprising. They seem to be argued with no relation whatsoever to their consequences in utilitarian terms. As a matter of fact, they seem to be like a-priori rules of justice. Rules that are founded on the idea of individual's sovereignty of themselves. Quite a 'rationalistic' idea.

Now, we have already discussed the difficulty of any theory of rights in the 'classical utilitarian' framework. We saw, however, that in Mill's case there is room for such a theory. Mainly as 'free-will' in Mill's view is not something that people are being born with. How much of their behaviour is following customs and imitation and how much is a reflection of the person's individuality is a function of a person's education and social circumstances. Thus, some aspects of the theory of right actually precede any moral argument and as such, his theory is only semi-teleological. True, education is a key to a 'higher' level of happiness and as such the right of education

can be said to be embedded in the theory of the moral good (a teleological theory). However, as 'free-will' is a prerequisite for moral accountability, it may be argued that education is a principle of justice that is independent of the moral good. Providing someone with education and the proper social circumstances does not guarantee that he will be able to enhance his happiness. It merely provides the ability for him to become a moral being.

Nevertheless, one may still argue that all these principles are not moral principles on the grounds that the 'ideals' of private and communal ownership, are simply their most efficient forms. However, when we examine what efficiency may mean here, we shall find that it means the best method of bringing about the same moral principles. To see that it is enough to look at Mill's criteria for judging between the two kinds of social institutions. "We must also suppose two conditions realized, without which neither Communism nor any other laws or institutions could make the conditions of mankind other than degraded and miserable. One..is universal education; the other, a due limitation of the numbers of the community."(p.209). These two principles are later on reintroduced by Mill with slight difference. They become the following two; (a) guaranteed subsistence¹, and (b) the greatest amount of liberty and spontaneity².

There is little doubt that these two principles are principles of

¹Guaranteed subsistence is an extension of the principle restricting the numbers in a community.

²And this principle is the extension of the idea of education. In Mill, liberty and spontaneity are closely associated with education.

justice. The great amount of liberty and spontaneity is nothing else but Mill's idea of the greatest amount of happiness. Obviously, the first principle does not have a direct utilitarian sense but given Mill's belief that the second principle cannot hold unless the first one does, we can consider both of them as principles of justice.

b. Final Distribution and Proportional Remuneration.

Given the two principles of a just system of property, it is clear that one cannot stop at the initial distribution for the definition of a just economic system. After all, the distribution of subsistence as well as the material conditions for liberty and spontaneity depend on the mechanism that produces the final distribution.

Indeed, not only initial conditions constitute Mill's ideal of private property, also the principle of the produce distribution is an essential part of it. This too, seems to be based on some sort of individual's sovereignty principle. "Private property...is supposed to guarantee to individuals the fruits of their own labour and abstinence."(p.209). If we are willing to suppose that there is some correlation between efforts and 'fruits of labour' then we may say that this is a principle of proportional remuneration.

The fact that it is a principle of proportional remuneration and the

importance that Mill associates to this principle of distribution become clear from his analysis of the actual state of private property. It is the violation of this principle of proportional remuneration that is sufficient for Mill to reject the institution of private property whatever else can be said in its favour. Allow me to quote here at some length:

"If, therefore, the choice were to be made between Communism with all its chances, and the present [1852] state of society with all its suffering and injustices; if the institution of private property necessarily carried with it as a consequence, that the produce of labour should be apportioned as we now see it, almost in an inverse ratio to the labour -the largest portion to those who have never worked at all, the next largest to whose work is nominal, and so in a descending scale.....;if this or Communism were the alternative, all the difficulties, great or small, of Communism would be as dust in the balance."(Principles, p.208).

This principle, as an explicit principle, does not appear in so many words in Mill's own writings on morals and justice. However, I believe that it is a plausible interpretation of that principle according to which a person is entitled to the fruits of his labour. It is, perhaps, worth noting that in his Autobiography, Mill refers to this principle explicitly but not in the context of his own moral theory rather as an acknowledged principle of justice (Autobiography, p.239). (see also a discussion of it in Berger(1985) pp.166-8).

How much of a utilitarian principle it is questionable. Though Mill seems to have tried and construct this principle (the entitlement to the fruits of one's labour) on utilitarian grounds, it is on quite shaky foundations. The utilitarian aspect of this principle is the idea that positive remuneration serves people happiness in as much as punitive measures do. Thus, to return good for good is a principle of justice no less than the principle of punishing malevolence. However, doing good also depend on intentions. The creation of output through effort cannot be interpreted as doing good.

Thus, there is no reason to suppose why someone should be remunerated for pursuing his own happiness. Moreover, even if we could defend this proposition on utilitarian grounds, we would still be required to explain proportionality. If, however, we choose to consider the principle in a consequentialistic fashion then, maybe, we can make some utilitarian sense of it. Namely, actions are judged by their results, not intentions. The fact that an effort by an individual has generated wealth (that presumably served others as well), is sufficient in order to crown his action as a good deed. Thus, provided that we accept Mill's proposition that returning good (and by returning I mean proportional) is a utilitarian duty, then proportional remuneration may be justified in utilitarian terms.

However, as I have already said before, Mill's moral theory has departed far enough from classical utilitarianism for us to worry whether such a non-utilitarian principle can be interpreted as a moral principle. Surely, one can explain the principle of

proportional remuneration in terms of its contribution to the development of individuality. As individuality is a condition for self-fulfilment and a 'higher happiness', one must not do anything that will hinder its development. If a person applies his faculties (so carefully developed) to a particular task, and then, he would have been deprived of the fruits of his (past) and present efforts, he would most certainly be discouraged from developing his faculties any further.

Thus proportional remuneration is related to the conditions of creating morally responsible people who will then be able to achieve the highest degree of happiness. This means that this principle is not derived from the individual's sovereignty as such. We are entitled to proportional remuneration as a positive encouragement to the development of our faculties, not because we have an a-priori right to it. This point becomes clearer when we realize that in Mill's theory of communal ownership, the principle of proportional remuneration does not hold.

There are two reasons for that; first, in a communal system the responsibility for the development of people's individuality is on the authority. This agreed and accepted administrator is responsible to make sure that all members of society have the social and material circumstances to develop themselves. The other reason for that is the 'moral accountability' of the action that produces the output.

According to Mill, if division of labour is directed by a central

authority then there is no moral requirement for proportional remuneration. If a person does a particular job because he is the most fit to do it, there is no reason why society should enhance this person whom nature has already endowed. If, on the other hand, this person chose to do this particular job, he must be proportionally remunerated because it was his own choice to do it. He is morally responsible for his action. If he is directed to the action by a central authority, he can no longer be considered responsible for it. It was nature who endowed him in such a way that he would be chosen to do that particular job. Society is not bound to remunerate him for it beyond what it remunerates other people who do their suitable jobs.

So under the institution of individual property, a just economic system is a system where people are remunerated in proportion to their effort. Thus, self-development of all individuals is encouraged by the system. In a communal system, presumably, the advancement of all members of society will constitute the spirit of their covenant.

Hence, the principle of proportional remuneration in Mill's case can be interpreted as deriving from some other reason than an a-priori right to own one's self. Consequently, this principle is not independent of its general consequences. Namely, proportional remuneration should not be investigated independently of whether it improves or harms the general well-being. We shall, therefore, have to examine what is really meant by this principle and how it apply to Mill's economic system.

Bearing in mind that in Mill's theory of production there are fundamentally two agents, labour and nature, the principle of proportional remuneration seems to imply that all the produce belong to labour. However, one must distinguish between present and past work. Suppose at the first period of production all individuals work and the produce is distributed among them according to the principle of proportional remuneration. Now some of them consume it all and others save. If those who saved now choose not to work, they are still entitled to the remuneration of that part of past labour that they have now transferred to the new period. Thus, not only labourers own the produce but also those who by some legitimate mean, own some form of past labour.

Another reason why labour does not really have a claim on the whole of the output is that it is impossible to determine what part of the output is due to labour efforts and what is due to the forces of nature³. However as nature is not a social agent, no theory of entitlement is relevant here. Nevertheless, it means that though labour has a claim on the output it can share it with those who provide materials and by doing so, make a claim on behalf of natural forces.

³According to Mill there are only two requisites of production: labour and nature. It is between them that one cannot establish the relative contribution."It is impossible to decide that in any one thing nature does more than in any other. One cannot even say that labour does less. Less labour may be required; but if that labour which is required is absolutely indispensable, the result is just as much the product of labour, as of nature.....It is like attempting to decide...which of the factors, five and six, contribute most to the production of thirty"(Principles, p.26).

6. Proportional Remuneration and The Theory of Value and Distribution.

We saw that Mill's theory of value could, under some conditions, be viewed as a 'cost of production' theory of value. We also saw in section 2 that such a theory of value does not really correspond to the modern concept of general equilibrium as complete interdependence does not prevail. It is, therefore, a system where given one distributional parameter the other one is being determined by it together with the system of prices. Values as such, therefore, do not affect distribution (unless measured in term of the numeraire); they are however, affected by it. To that extent, we can argue that different structures of relative prices reflect different distribution circumstances. We shall find that this feature of the model is very important in the analysis of how proportional remuneration presents itself in an economic model.

The first question that we have to ask ourselves when coming to assess the moral significance of such a system is what does proportional remuneration mean in such a framework of analysis. The

first, more general, thing that comes to mind is that the distribution of output between the different classes of society should reflect their relative contributions to its production. However, this is too crude a definition as different products require different contributions from the various classes in their production process. Hence, perhaps a better definition would be where the purchasing power of wages in terms of the different commodities reflects the difference in the difficulty of attainment; the difference in labour inputs.

If labourers get their wages in term of the commodity they produce, they should be able to exchange it against another according to whether the effort (labour) to produce the other was greater or less to their own. Hence, they should be able to exchange one to one with a commodity with the same effort, more than one if the other commodity is easier to attain etc.. In other words, the price ratio between two commodities should reflect the ratio of direct labour inputs.

This, it must be noted, is not the same thing as having price ratio equal, or proportional, to labour values (which include indirect labour). If two commodities exchange one to one, it is possible that the direct labour in the first is lower than in the second, thus proportional remuneration from the labourer point of view requires that the price ratio will be less than 1. However, from the point of view of the capitalist, it means that the first commodity has more indirect labour than the second. Proportional remuneration, then, requires that the price ratio will be greater than 1 (only if we

assume that the capitalist's contribution, in terms of labour, is the indirect labour). To that extent, then, one may say that the labour theory of value takes into consideration both capitalist and worker.

Hence, deviation from the objective measure of labour inputs, reflects a deviation from the principle of proportional remuneration in favour of one side or another of those who are competing for remuneration. This, we know, does happen in a system of 'cost of production'. We shall therefore, have to examine the particular circumstances in which such deviation occur and, in whose favour it tends.

There is one qualification which I must advance to my analysis. The question of whether proportional remuneration is a concept which is applicable to capitalist. On the one hand, one can argue that the different capital inputs reflect different efforts in production on the part of the capitalists. On the other hand, for the capitalists, those differential aspects of the rate of profits are supposed to take care on the difference in risk and effort in the different industries. These, one may argue, do not present themselves through the difference in capital invested.

In any case, by having a uniform rate of profit we seem to have normalized those efforts. Proportional remuneration, in such a case, will only be applicable to labourers and will be reflected in the direct labour inputs. Nevertheless, as Mill did consider capitalists' contribution as remunerable, and as the only possible interpretation for their effort seems to be through indirect labour inputs, I will

refer in my analysis to both interpretation.

The actual deviation from the labour theory of value, as I have already argued, is mainly due to the introduction of a uniform rate of profit. I also argued that most writers, including Mill, argue that rates of profits will tend to uniformity however, they also give enough reasons to suppose that this will never come about. In fact, Mill argues quite clearly that only one aspect of what constitutes profits will tend to uniformity. This is the interest rate. Other components of profits like, the value of attendance or the compensation of risks, according to Mill, will never tend to uniformity (Principles, pp.411-12).

Nevertheless, Mill does argue that one can compile an average rate of profit at any one time. Hence, as the whole of the 'cost of production' framework is perceived as some sort of an average, to have a uniform rate of profit may be consistent with the general analysis. Therefore, the deviations from the labour theory of value, resulting from this uniform rate of profits, should not be perceived as an inherent feature of a system of 'cost of production'. Consequently, prices may be proportional to labour values even when the capital to labour ratio in all industries is not the same.

In any case, from the point of view of proportionality, labour values are some sort of an average between the capitalists' point of view and that of the labourers. If, however, we confine proportionality to direct labour inputs, then only if labour values are proportional to direct labour inputs will they be able to represent the idea of

proportionality.

At a given price ratio, proportionality would mean that labourers will be able to exchange the goods according to the direct labour inputs ratio. However, as we may suppose that there is an inverse relationship between direct and indirect labour inputs, the price ratio that satisfies proportional remuneration to labourers certainly does not satisfy the capitalists' expectations. In that case, however, the principles of justice may be satisfied if the capitalists were to be compensated in terms of their share in the total output.

a. Proportional Remuneration and Values.

The system of 'cost of production' in Mill's case is a meeting point between the natural and the social science in economics. On the one hand it is a system of 'average' prices constructed under given social institution. On the other, we have the technological labour values which depict the commodities technological relationships which are (in Mill) independent from social institutions. The analysis of what is economic justice will now be focused on comparing the system which is independent from social organizations (labour values) with a system which is dependent on them.

The immediate interpretation of proportional remuneration in terms of prices was discussed above. In short it is the following one: had individuals, (labourers as well as capitalists) received their remuneration in terms of the good they produce (or a numeraire),

they will be able to exchange it for another according to the relative effort involved in the production of each commodity. On the other hand, there is also the question of the relative share of each group in the total output as a measure of remuneration. The question is, of course, whether these two indicators point at the same direction.

When the rate of profit is set at zero then we know that prices equal their labour values. However, labour values include past labour as much as direct labour. Given the property rights and the fact that Mill believes in the right of capitalists to be remunerated, these labour values will not produce an exchange rate that fits the labourers point of view. Namely, relative prices (and labour values) will not represent the relative efforts on the part of labourers alone (i.e. the relative direct labour inputs). The rate of exchange that will correspond to the labour values is the one which is going to be somewhere between what proportional remuneration to labour implies and what it implies to capitalists (capital inputs ratios). Of course, if the capital to labour ratios are the same everywhere then the exchange rate suggested by the labour theory of value will correspond precisely to that of both labourers and capitalists. Therefore, the labour theory of value is a kind of a moral benchmark. It takes into consideration both capitalists and labourers as far as the proportional remuneration principle is concerned. When $r > 0$ prices deviate from their labour values and as wages are being depressed, the actual exchange rate reflects the capitalists' point of view alone. Hence, the deviation of prices from their labour values should be seen as a violation of the

principle of proportional remuneration.

When we consider shares in output the picture becomes a bit more complicated. The behaviour of total output (for a given number of labourers and changing wage (and profit) rates) and the shares of each group depends on technology. At one instance maximum output and highest share of labourers seem to be consistent with one another. It also means that prices will deviate in favour of the capitalists. Hence, given that the shares are working in favour of labourers, it might be said that the injustice generated by the price deviation is thus rectified. This, however, does not always hold. The idea, therefore, of economic justice is captured by two major components; the relative price and the relative share. Not always do they point at the same direction.

In any case, I do believe that through this extrapolation we can see how the concept of economic justice that is based on reward can generate mixed feelings about the moral value of competitive systems. As prices deviate from labour values it implies that there is some kind of initial injustice in the system which may explain many of Mill's critical statements about capitalist systems. On the other hand, as the behaviour of the share in total output may sometime rectify this situation, it may become a tolerable system.

Let me now be more precise on what we mean by proportional remuneration and its relation to values and distribution. Consider an economy of two sectors where only one of them (say 2) produces wage- good. Therefore, we have the following 'cost of production'

equations:

$$(1) \quad 1 = (1+r)[a_{11} + PS_2\alpha_1]$$

$$(2) \quad P = (1+r)[a_{12} + PS_2\alpha_2]$$

(1 is the numeraire hence $P = p_2/p_1$).

We can re-write (1) and (2) as:

$$F_1(P, r, S_2) = (1+r)[a_{11} + PS_2\alpha_1] - 1 = 0$$

$$F_2(P, r, S_2) = (1+r)[a_{12} + PS_2\alpha_2] - P = 0$$

where:

$$F_1(P, r, S_2) = F_1[P(S_2), r(S_2), S_2] = 0$$

The partial derivative matrix is:

$$\frac{\partial(F_1, F_2)}{\partial(P, r)} = \begin{array}{cc} \frac{\partial F_1}{\partial P} & \frac{\partial F_1}{\partial r} \\ \frac{\partial F_2}{\partial P} & \frac{\partial F_2}{\partial r} \end{array} = \begin{array}{cc} (1+r)S_2\alpha_1 & a_{11} + PS_2\alpha_1 \\ (1+r)S_2\alpha_2 - 1 & a_{12} + PS_2\alpha_2 \end{array}$$

S_2 now represents the wages in real terms. $W = PS$ is the wages in term of the numeraire. We can see that if P rises, the same level of wages can buy more of the other good. Proportional remuneration here means that a labourer should be able to buy more or less of the other good according to whether the effort in producing the other good is greater or smaller than the effort of producing the wage-good. (By effort on the part of labourer I mean the direct labour).

The relationship between S_2 (real wages in terms of the wage-good) and r are given as follows:

$$\frac{\partial r}{\partial S_2} = - \frac{\frac{\partial F_1}{\partial P} \frac{\partial F_1}{\partial S_2} \quad (1+r)S_2\alpha_1 \quad (1+r)P\alpha_1}{\frac{\partial F_2}{\partial P} \frac{\partial F_2}{\partial S_2} \quad (1+r)S_2\alpha_2-1 \quad (1+r)P\alpha_2} = - \frac{\frac{\partial F_1}{\partial P} \frac{\partial F_1}{\partial r} \quad (1+r)S_2\alpha_1 \quad a_{11}+PS_2\alpha_1}{\frac{\partial F_2}{\partial P} \frac{\partial F_2}{\partial r} \quad (1+r)S_2\alpha_2-1 \quad a_{12}+PS_2\alpha_2}$$

Where the denominator is:

$$(3) \quad S_2\alpha_1(1+r)[a_{12}+PS_2\alpha_2] - [S_2\alpha_2(1+r)-1](a_{11}+PS_2\alpha_1)$$

and the numerator:

$$(4) \quad S_2[\alpha_1(1+r)\alpha_2 - \alpha_2\alpha_1(1+r)] + \alpha_1 = \alpha_1 > 0$$

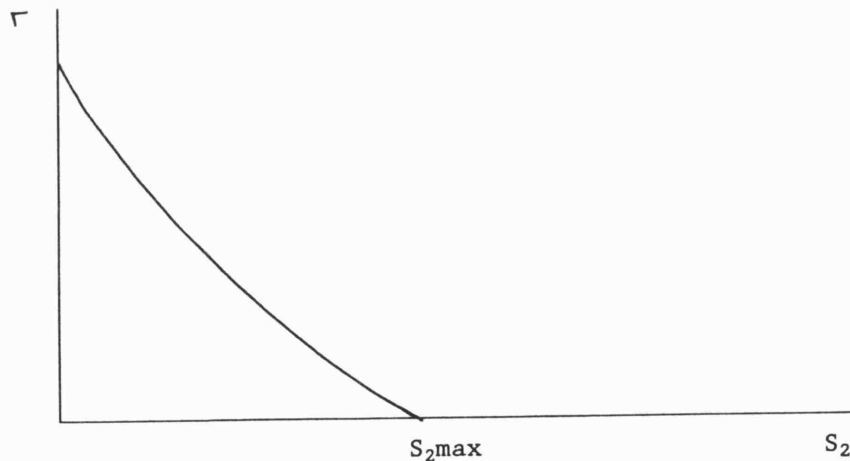
Rewriting (3):

$$(3)' \quad S_2(1+r)[\alpha_1 a_{12} - \alpha_2 a_{11}] + a_{11} + S_2\alpha_1 P > 0$$

We can see that it is highly unlikely that (3) will be negative.

Also, (4) is clearly positive. Hence, $\delta r / \delta S_2$ is surely negative¹.

Fig.1



¹In chapter 2 of part 3 I have questioned the nature of this relationship in a framework where all commodified were also wage-goods. There we saw that the reason for doubts was in the sign of the numerator. Here, by virtue of (4) this is no more a problem and the expected relationship between real wages and the rate of profit can safely be established.

At S_2 max, the rate of profits is zero and values reflect their labour values. In our case, when $r=0$, we shall have:

$$S_2 = \frac{\overset{(1)}{\downarrow} (1-a_{11})}{P\alpha_1} = \frac{\overset{(2)}{\downarrow} P-a_{12}}{P\alpha_2}$$

and

$$(5) \quad P = (1-a_{11}) \frac{\alpha_2 + a_{12}}{\alpha_1}$$

This price, P , when $r=0$, is equal to the ratio of labour values (see, section 4(a) above). But the ratio of labour values includes direct and indirect labour. Thus, we may say that (5) is how equality to labour values ratios is reflected in terms of direct labour alone. P stands in a known relation to the direct labour ratio. The higher it is, the higher will the relative price be.

Clearly, labour values ratio (λ_2/λ_1 where $\lambda_1 = \alpha_1 a_{11} + \alpha_2 a_{21} + \alpha_1$ and $\lambda_2 = \alpha_1 a_{12} + \alpha_2 a_{22} + \alpha_2$) which equals to P when $r=0$, will be the same as the ratio of direct labour inputs only when:

$$(5) \quad P = \frac{\overset{\downarrow}{\alpha_2}}{\alpha_1} \Rightarrow \frac{\alpha_2}{\alpha_1} = \frac{a_{12}}{a_{11}}$$

Namely when the ratio between the capital inputs in the two commodities equals the ratio of direct labour inputs. (It is also equivalent to the famous condition given by Ricardo that prices will be proportional to labour values if the capital to labour ratio in all industries was the same: $a_{12}/\alpha_2 = a_{11}/\alpha_1$).

The other end in fig.1 is when $S_2=0$. Then:

$$r = \frac{\overset{(1)}{\downarrow} (1-a_{11})}{a_{11}} = \frac{\overset{(2)}{\downarrow} (P-a_{12})}{a_{12}}$$

and

$$(6) \quad P = a_{12} \left[1 + \frac{1-a_{11}}{a_{11}} \right] = \frac{a_{12}}{a_{11}}$$

which, as could be expected, is completely independent of any direct labour consideration. At (6) the price is the equilibrium price when all the output remains in the hand of the capitalist. We can easily see that when this is the case, the price will reflect proportionality to effort only in terms of the capitalists' contribution. Namely, the price ratio at (6) gives the ratio of capital inputs between sectors 2 and 1.

At (5), on the other hand, we had the equilibrium price when all the output was paid as wages. Proportional remuneration would have required that prices will reflect only the difficulty in attainment from the labourers point of view (i.e. α_2/α_1). However, we can clearly see that this is not the case unless the capital to labour ratio (or the relative difficulty of attainment from both classes point of view a_{1j}/α_j) is the same in both sectors. Namely, it is possible that prices will be proportional to labour values but not to direct labour ratios. If proportional remuneration is a principle applicable to labour alone, we can argue then that competition and the subsequent uniform rate of profits are creating injustice.

If, on the other hand, when prices reflect labour values they also reflect direct labour ratios the price at both ends ($S_2=0$ and $r=0$)

will be precisely the same and will reflect the general relative difficulty of attainment:

$$P \stackrel{(5)}{\downarrow} = \frac{a_2}{a_1} \quad ; \quad P \stackrel{(6)}{\downarrow} = \frac{a_{12}}{a_{11}}$$

Hence

$$p^{(5)} = p^{(6)}$$

If this is the case, actual prices too are in general proportional to labour values. Hence, the labour theory of value means that throughout, prices will reflect a given relative difficulty of attainment which is consistent with the labourers' point of view. When, however, at (5) the price does not reflect the direct labour inputs ratio we may, under some conditions, attribute its deviation to the capitalists' proportional remuneration. Indeed, the price at (6) will be above the one at (5) only when the ratio of contributions among the capitalists is higher than that of labour inputs. This means that only when we do not consider labour will the price reflecting proportional remuneration adjust completely to the higher ratio of capitalists contributions. When only labour is considered, it will fall closer to the direct labour inputs ratio however, it will still remain above it. As only at (5), in such a case, the price ratio reflects the labour theory of value, the fact that prices do not fall to the level of the direct labour inputs ratio, means that labour theory of value is an average between the requirements of proportional remuneration of labourers and capitalists alike.

So far, however, we have only examined how prices relate to the

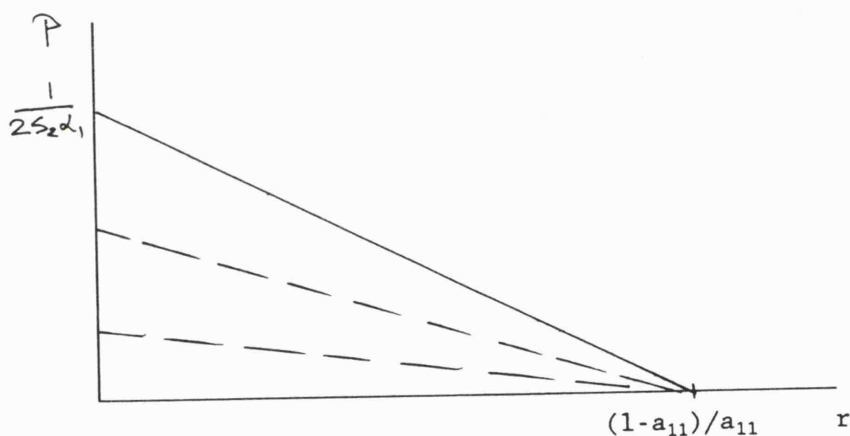
principle of proportional remuneration at both ends of the distributional parameters. What we shall have to do now is to examine the general relationship between equilibrium prices and distribution.

Let us look again at (1) and (2) separately. Equilibrium in (1) means that:

$$(7) \quad r = \frac{1 - a_{11} - PS_2\alpha_1}{a_{11} + PS_2\alpha_1}$$

We can thus draw the relationship between r and P which are consistent with equilibrium in industry 1:

fig. 2



We can also see that as S rises, the equilibrium curve shifts inwards and becomes flatter.

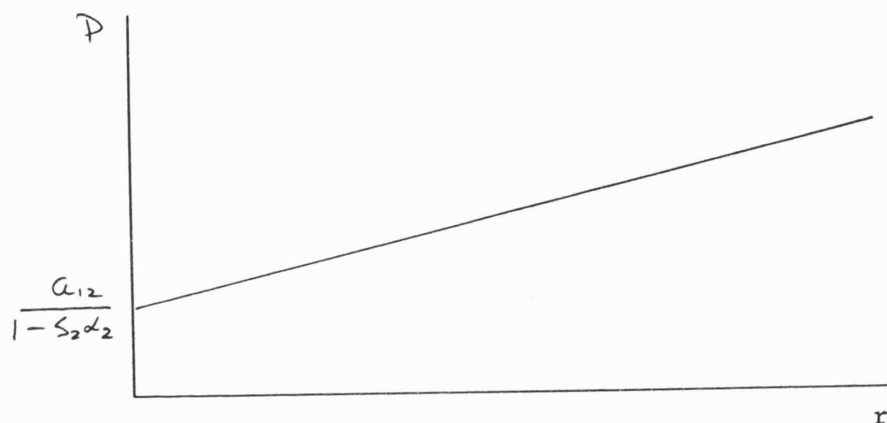
If we follow the same line with respect to industry 2 we shall find that (2) can be re-written as:

$$(8) \quad P = \frac{(1+r)a_{12}}{1 - (1+r)S_2\alpha_2}$$

From where we can see that r and P which are consistent with

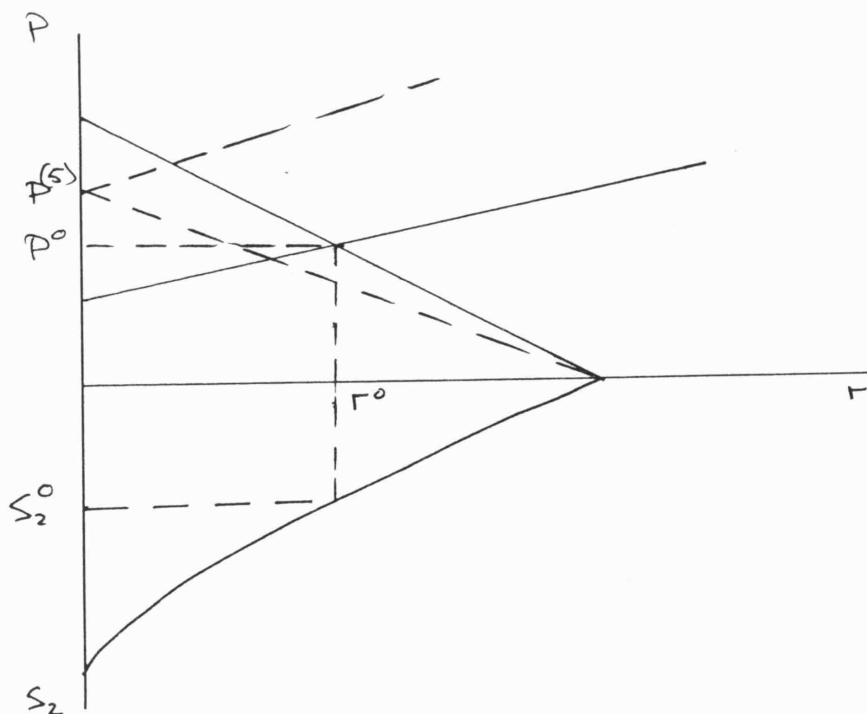
equilibrium in that market are directly related:

fig.3



Unlike the case in fig 2, here the equilibrium curve shifts upwards as S is rising. General equilibrium, therefore, will be achieved where these two curves intersect:

fig. 4.



Now, from fig. 1 we know that the equilibrium levels of r and S_2 are inversely related, thus, as S changes, the two equilibrium curves in fig 4 shift too so that new r and P now satisfy general equilibrium. If $r=0$, we know that the equilibrium price is given by (5). As r falls (and S_2 rises) the equilibrium price will rise or fall according to the relative shifts of the two equilibrium curves.

b. Equilibrium Prices and Distribution

Let us examine how equilibrium prices change as the distributional parameters change. In this framework it will be sufficient to examine one of them as the inverse relationship between r and S_2 has already been established. The effects of a change in S_2 on P are the following:

$$\frac{\partial P}{\partial S_2} = - \frac{P\alpha_1(1+r) \quad a_{11}+PS_2\alpha_1}{S_2\alpha_1(1+r) \quad a_{11}+PS_2\alpha_1} \frac{P\alpha_2(1+r) \quad a_{12}+PS_2\alpha_2}{S_2\alpha_2(1+r)-1 \quad a_{12}+PS_2\alpha_2}$$

Or,

$$- \frac{P\alpha_1(1+r)(a_{12}+PS_2\alpha_2) - P\alpha_2(1+r)(a_{11}+PS_2\alpha_1)}{S_2\alpha_1(1+r)(a_{12}+PS_2\alpha_2) - [S_2\alpha_2(1+r)-1](a_{11}+PS_2\alpha_1)}$$

where the denominator as before is positive. However, as for the numerator the story is different:

$$(9) \quad P(\alpha_1 a_{12} - \alpha_2 a_{11}) \begin{matrix} > 0 \\ < 0 \end{matrix}$$

Hence, the sign of (9), depends on whether $a_{12}/a_{11} < \alpha_2/\alpha_1$, or $a_{12}/a_{11} > \alpha_2/\alpha_1$. Which is precisely the same condition we had before for the price ratio (when $r=0$ and when it equals labour values ratio) to be above or below the direct labour inputs ratio. Thus, if the proportional remuneration from the capitalists point of view requires a higher P (namely, $a_{12}/a_{11} > \alpha_2/\alpha_1$) then (9) tells us that as the distributional parameters move from wages to profits, the price will reflect proportionality according to what fits the capitalists group ($\delta P/\delta S_2 < 0$).

From all that one can draw the following conclusions:

(a) Even when capitalists are excluded ($r=0$) and prices are proportional to labour values, labourers do not get the full proportional remuneration they can expect. Namely, the price ratio will not be equal to ratio of direct labour. It will be higher or lower according to whether the principle of proportional remuneration from the capitalists' point of view requires a higher or lower ratio. Only when prices are proportional to labour values do prices satisfy the principle of proportional remuneration when there are no profits in the system.

(b) As the rate of profits rises and the wages fall, equilibrium prices will preserve the principle of proportional remuneration according to rising importance of the group whose distributional parameter is rising.

(b) can now be interpreted as saying that when prices deviate from labour values and when r rises and S falls, the system moves from an

initial injustice to labourers (the prices at $r=0$ do not reflect direct labour inputs), to a greater one. If indeed, the rise in the rate of profits also means that total product and the share of profits in it have risen, then the path of equilibrium price will be consistent with justice in as much as the principle of proportionality accommodates those who have the largest share in the total output. It does not, however, suggest anything with respect to who should get what share and why.

c. Production, Relative Shares and Proportional Remuneration.

Let us now explore the production side of the model. We have the following three equations and I assume that the amount of labour is given:

$$(10) \quad Y_1(1-\delta) = Y_1 a_{11} + Y_2 a_{12}$$

$$(11) \quad Y_2(1-\delta) = Y_1 s_2 \alpha_1 + Y_2 s_2 \alpha_2$$

$$(12) \quad L = Y_1 \alpha_1 + Y_2 \alpha_2$$

Equations (10) and (11) can be considered as a separated problem which can be written, in a matrix form, as follows:

$$Y(1-\delta) = AY$$

This is a similar problem to the one we had in section 2 and in equations (1) and (2) above. We are looking for the eigenvalue and eigenvector of this system. Naturally, $(1-\delta)$ is the eigenvalue. As

the coefficient matrix here is the same as in problem (1)-(2), the eigenvalue of this system is the same as the one in (1)-(2). Thus:

$$(1-\delta) = \frac{1}{(1+r)} \quad ; \quad \delta = \frac{r}{1+r}$$

Hence, the rate of 'net-surplus' (δ) of the system corresponds in a direct way to the rate of profits. Thus, profits take upon them the meaning of growth in such types of models. However, it must not be confused for profits as the cause of growth; simply that when there is no growth, there are no profits.

Equation (12) helps us to find the levels of Y and Y rather than to deal with ratios. Hence, we can solve the system directly to get:

$$(13) \quad Y_1^* = L \left[\frac{1}{\alpha_1} - \frac{\alpha_2}{\alpha_1} \frac{S_2}{(1-\delta)} \right]$$

$$(14) \quad Y_2^* = L \frac{S_2}{(1-\delta)}$$

We can now define total output as:

$$(15) \quad TP = Y_1 + PY_2$$

Let us now examine how the total output and the share of labour in it change, in equilibrium, when there is a change in the equilibrium levels of the distributional parameters. First, the effects of a change in S_2 on Y_1 and Y_2 :

$$(16) \quad \frac{\partial Y_1}{\partial S_2} = \frac{L\alpha_2\alpha_1}{\alpha_1^2(1-\delta)^2} \left[\delta - 1 - \frac{\partial \delta}{\partial S_2} S_2 \right]$$

$$(17) \quad \frac{\partial Y_2}{\partial S_2} = \frac{L}{(1-\delta)^2} \left[1 - \delta + \frac{\partial \delta}{\partial S_2} S_2 \right]$$

And total product will change according to:

$$(18) \quad \frac{\partial TP}{\partial S_2} = \frac{\partial Y_1}{\partial S_2} + P \frac{\partial Y_2}{\partial S_2} + \frac{\partial P}{\partial S_2} Y_2$$

$$= (1 - \delta + \frac{\partial \delta}{\partial S_2} S_2) [\alpha_1^2 (P - \frac{\alpha_2}{\alpha_1})] + \frac{\partial P}{\partial S_2} L \frac{S_2}{(1 - \delta)}$$

There are only two circumstances when we can be sure about the outcome:

If $[1 - \delta + (\partial \delta / \partial S_2) S_2] < 0$ and $P > \alpha_2 / \alpha_1$ then it follows that $\partial P / \partial S_2 < 0$ and so $\partial TP / \partial S_2 < 0$.

If $[1 - \delta + (\partial \delta / \partial S_2) S_2] < 0$ and $P < \alpha_2 / \alpha_1$ then it follows that $\partial P / \partial S_2 > 0$ and so $\partial TP / \partial S_2 > 0$.

However, clearly the sign of $[1 - \delta + (\partial \delta / \partial S_2) S_2]$ depends on the level of S_2 . At very low levels of S_2 , the absolute value of $\partial \delta / \partial S_2$ is very high. Its negative sign should have made $[1 - \delta + (\partial \delta / \partial S_2) S_2]$ negative but as S_2 itself is very small, it become negligible altogether. As δ (which corresponds to the rate of profits) is at its highest equal to $(1 - a_{11})$; because $\delta = r / (1 + r)$ and r max is when it equals to $(1 - a_{11}) / a_{11}$ (see fig.2)) it makes $[1 - \delta + (\partial \delta / \partial S_2) S_2]$ a positive expression for low S_2 . Thus to investigate the changes in output as a result of changes in distributional parameters, we shall have to look at how the change in output changes.

If we write the second derivative of (18) we will get:

$$(19) \quad \frac{\partial^2 TP}{\partial S_2^2} = \frac{\partial^2 \delta}{\partial S_2^2} \left[\frac{L}{\alpha_1^2 (1 - \delta)^2} (\alpha_1^2 (P - \frac{\alpha_2}{\alpha_1})) \right]$$

$$+ \frac{\partial^2 P}{\partial S_2^2} L \frac{S_2}{(1 - \delta)} + \frac{\partial P}{\partial S_2} \frac{L}{(1 - \delta)} (1 - \delta + \frac{\partial \delta}{\partial S_2} S_2)$$

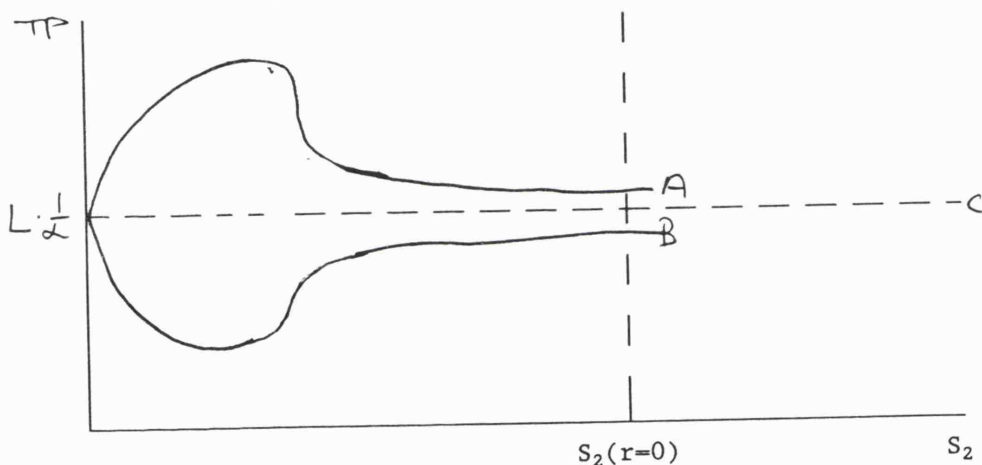
Not a very pleasant sight. Nevertheless if we assume for the sake of simplicity that $(\partial^2 \delta / \partial S_2^2) = (\partial^2 P / \partial S_2^2) = 0$ or very small indeed, the

sign of (19) will depend on:

$$(20) \quad \frac{\partial P}{\partial S_2} \frac{L}{(1-\delta)^2} (1-\delta + \frac{\partial \delta}{\partial S_2} S_2)$$

Clearly if $[1-\delta+(\partial\delta/\partial S_2)S_2]$ is negative and $(\partial P/\partial S_2)<0$, the sign of (20) [and (19)] is positive. The negative sign of (18) must change somewhere and the function has a minimum. In the same way the reverse will happen in the other case. We can therefore suppose that the total output functions, which depend on the technological coefficient (like prices and the rate of profit) will have the following form:

fig.5



We can easily see that the max/min occurs somewhere between $S_2=0$ and $r=0$ (maximum S_2 which is consistent with the system having a solution). When $S_2=0$, from (13) and (14) we can see the equilibrium values of Y_1 and Y_2 . Thus, according to (15), $TP=L(1/\alpha_1)$. When $r=0$, then we can calculate the equilibrium level of S_2 by using (5). This will be:

$$S_2^* = \frac{1-a_{11}}{(1-a_{11})\alpha_2 + a_{12}\alpha_1}$$

By inserting it to (13), (14) and by using the price equation (5) we will get:

$$TP = S_2^* L \left[P^* - \frac{\alpha_2}{\alpha_1} \right] + L \frac{1}{\alpha_1}$$

Clearly, whether or not TP when $r=0$ is greater or smaller (or equal) to TP when $S_2=0$ depends on whether or not $P > \alpha_2/\alpha_1$.

If $P > \alpha_2/\alpha_1$ then it is clear that $TP(r=0) > TP(S_2=0)$. It is also clear that for small S_2 the sign of $[1 - \delta + (\partial\delta/\partial S_2)S_2]$ is positive. Thus, as the sign of $\partial P/\partial S_2$ remains the same, (19) becomes negative for very small S_2 . From (18) we can see that for very small S_2 , the left hand side will be the more dominant, thus the sign of (18) becomes positive too. Therefore, we get a curve of the kind depicted in fig.5 and denoted A.

At first, TP rises with S_2 and then, when S_2 is high enough the sign of (19) and (18) changes so that TP changed altogether. It begins to fall and the slope, which is now negative will begin to rise. Whether or not the TP function gets its minimum before Max S_2 is not very important to us; what matters is that in any case the value of TP when S_2 is at its maximum is higher than when r is at its maximum.

In a similar way we can find curve B which depicts the conditions when $P < \alpha_2/\alpha_1$. Obviously, the highest level of TP would be when $S_2=0$. The third case is when $P = \alpha_2/\alpha_1$ which is the case depicted by line C. Here we can see that the level of output is not affected by the distributional parameters. Recall also that this is the case when

labour values reflect precisely the direct labour inputs ratio; prices, then, are always proportional to labour values and, in this case, they always reflect labourers' expectations with regard to proportional remuneration.

Naturally, looking at the distributional parameters is not sufficient for our purpose. We must also look at what happens to the relative shares. The share of labour is defined as:

$$\frac{W}{TP} = \frac{PS_2L}{(Y_1+PY_2)}$$

And the derivative with respect to S_2 :

$$\frac{\partial(W/TP)}{\partial S_2} = \frac{[\frac{\partial P}{\partial S_2}LS_2+PL]TP - (\frac{\partial TP}{\partial S_2})PS_2L}{TP^2}$$

which can now be written as:

$$(21) \quad \frac{\partial(W/TP)}{\partial S_2} = \frac{L}{TP^2} \left[\frac{\partial P}{\partial S_2} S_2 \left(1 - \frac{L^2 PS_2}{(1-\delta)}\right) + P \left[1 - S_2 L (1-\delta) + \frac{\partial \delta}{\partial S_2} S_2\right] \frac{L}{\alpha_1 (1-\delta)^2} \left(\alpha_1^2 \left(P - \frac{\alpha_2}{\alpha_1}\right)\right) \right]$$

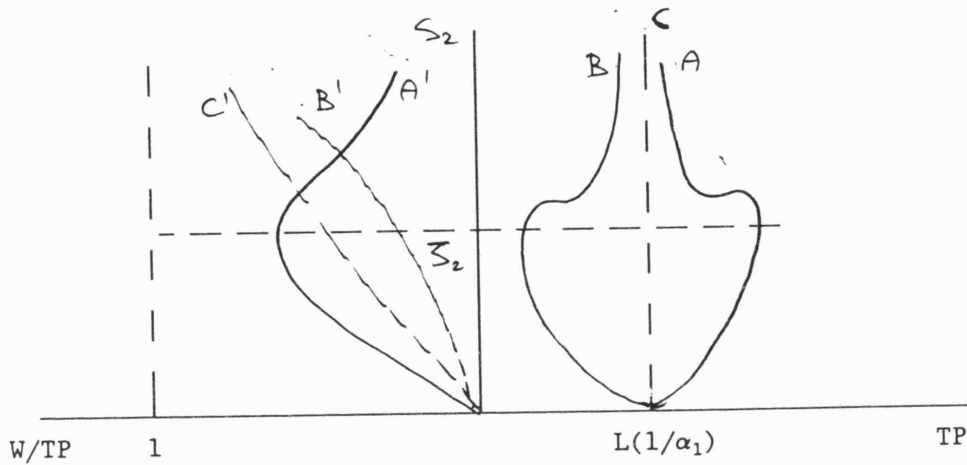
Again, only at two instances we can get a definite result:

- (a) if $[1-\delta+(\partial\delta/\partial S_2)S_2]<0$ and $P>\alpha_2/\alpha_1$ then $(\partial P/\partial S_2)<0$: hence, $(\partial TP/\partial S_2)<0$ and $[\partial(W/TP)/\partial S_2]>0$.
- (b) if $[1-\delta+(\partial\delta/\partial S_2)S_2]<0$ and $P<\alpha_2/\alpha_1$ then $(\partial P/\partial S_2)>0$: hence, $(\partial TP/\partial S_2)>0$ and $[\partial(W/TP)/\partial S_2]<0$.

When $[1-\delta+(\partial\delta/\partial S_2)S_2]$ is positive (at very low S_2) it is likely that the sign of (21) in (a) and (b) will be reversed. We could have examined (21) in more details in order to show it but I believe that it can be easily deduced without it. Figure 6 depicts what happens

to the relative shares with relation to what happens to total output:

fig. 6



We know very well what happens to the share of labour when S_2 is above S (this point will be the same in A and B whenever the distance of P from α_2/α_1 will be the same)². This is given by (a) and (b). We also know that at $S_2=0$, the share of labour will be zero. Given the continuous nature of (21) we can conclude that lines A' , B' and C' represent the share of labour in output which corresponds to the relevant circumstances. However, the importance of it is not very great. We can always say that subsistence requires that S will be large enough to exclude the case when [1-

²The value of S which maximizes (minimizes) output is derived from equation (18). It is, therefore:

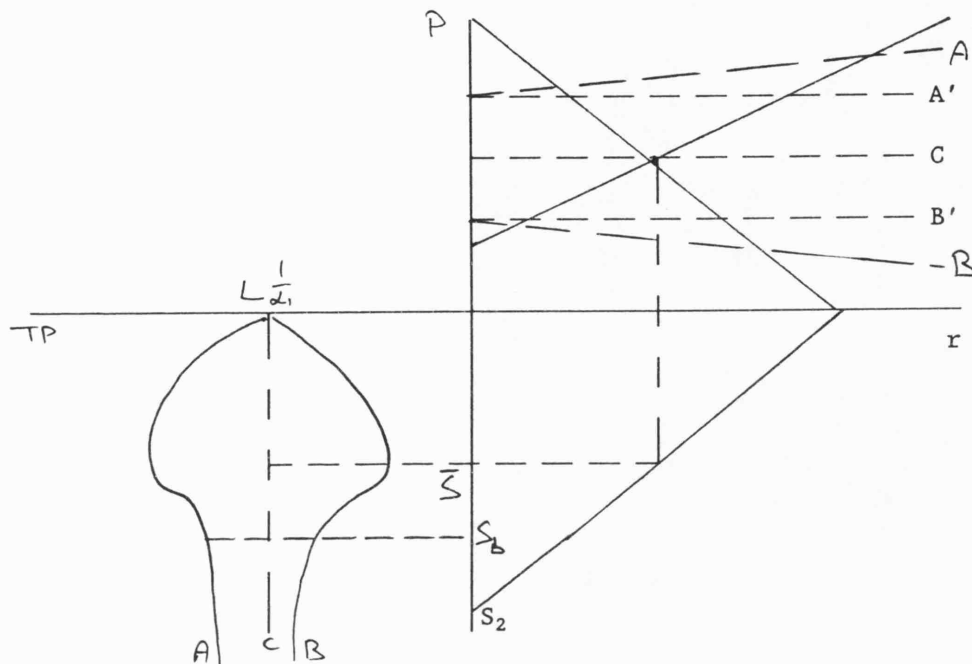
$$\bar{S}_2 = \frac{(\delta - 1) \alpha_2^2 (P - \frac{\alpha_2}{\alpha_1})}{\frac{\partial \delta}{\partial S_2} [\alpha_1^2 (P - \frac{\alpha_2}{\alpha_1})] + \frac{\partial P}{\partial S_2} L \frac{1}{(1 - \delta)}}$$

Clearly, if $P - \alpha_2/\alpha_1$ is the same (with different signs) the value of S will be the same. For particular technologies we may say without loss of generality that the value of S for both A and B is the same.

$\delta + (\partial\delta/\partial S_2)S_2$ is positive.

Figure 7 summarizes all these results:

Fig. 7



Let me first point out that lines A', B' and C in the (r, P) plane are our bench-mark. These are the price levels which are equal to labour values (measured when $r=0$). At C we have an additional feature; labour values (which include indirect labour, or capital in terms of labour) are equal to the ratio of direct labour inputs. As A' and B' deviate from C it is clear that from the point of view of proportional remuneration, A' and B' are some sort of an averaged between what the capitalists and the labourers would have expected. (The expectation for proportional remuneration by the capitalists will be satisfied at points e where prices are equal to the ratio of capital inputs.).

Now, if $P > \alpha_2/\alpha_1$ then maximum output will be achieved when $S_2 = S$. In this case, the share of labour in total output will be around its highest that could be achieved under the given technological condition and the social institution of competition. As S_2 is very low, the corresponding P (on line A) will not be so far from A' . Hence, prices will still be close to the average between capitalists and labourers expectation for proportional remuneration.

However, there is nothing in the system to guarantee that maximum output will be achieved. Moreover, if subsistence means having $S_2 > S$ (which is very likely as S is very small indeed) we can be certain that the economy will be somewhere along the line of falling share of labour. Here we will see that maximum output, taken as a measure for the general well being, requires to have wages at their subsistence level (S_b in fig,7). This means that prices will now be closer than before to A' . Hence proportional remuneration seems to tend towards what labourers might consider as a fair average between their expectations for remuneration and those of the capitalists. But not only that, the share of labour in output is now lower than what it could be. In fact, any rise in wages will mean that the share of labour (in term of the numeraire) as well as output itself will fall. It is so because prices will fall as wages rise.

Is it an idea of economic justice according to Mill? Well, to the extent that proportional remuneration is a necessary condition for economic justice, it is not. The fact that a larger share of the output is now in the hands of capitalists requires that the principle of proportionality should follow the ratio of their difficulty of

attainment (a_{12}/a_{11}). However, equilibrium price will move further from it the larger becomes the share of the capitalists.

On the other hand, one may argue that this is a balanced idea of justice. The share of profits has risen, so proportionality should compensate the other group rather than enhance the good fortune of the capitalists. Hence, the role of proportional remuneration is interpreted as the compensating factor for any given distribution.

In the case of $P < \alpha_2/\alpha_1$ (B in fig.7), then it is clear that to satisfy the general well-being we should have had $S_2=0$. However, given that subsistence (S_b) is a viability condition, this principle will be satisfied in the other end, where r approaches zero. In such a case, the share of labour is indeed very high while the price too gets closer to labourers' expectations for remuneration (B'). Hence, the balancing role of proportional remuneration seems to disappear altogether. Everything here seems to be working in favour of the labourers. However, we must qualify this statement. Even when prices are proportional to labour values, those do not reflect only the labourers' point of view; they are some average between the two groups. To that extent, moving along B and raising wages, is always consistent with the principle of proportional remuneration.

When, however, prices are proportional to labour values and they are equal to direct labour inputs, we have a somewhat different story. A rise in wages will not change output but will raise the share of wages on the expense of profits. Now, if proportional remuneration is only related to real effort, like direct labour, then path C is the path of economic justice. All deviations from it, which are

inevitable in such a system when not all industries have the same capital to labour ratio, expose the harming face of competition. The higher is the rate of profits, the greater is the deviation from the principle of proportional remuneration (in either path A or B). The labour theory of value is, in such a case, the key to what one considers to be the just economic system.

However, if proportional remuneration is interpreted in such a way so that capitalists, in the name of past labour, have a claim on the efforts that were needed in the production of a commodity, then the labour theory of value can no longer be the key to economic justice. If prices are proportional to labour inputs, the capitalists lose their share in output as wages rise, as well as the advantages of exchange.

To summarize, there are two ways to interpret proportional remuneration. One, as reflecting the real effort of production as denoted by the ratio of direct labour inputs. The other, as reflecting efforts of past and present labour; namely, that the ratio of capital investments reflects the difficulty of attainment from the point of view of the capitalist. However, as I mentioned earlier, this last interpretation is not very reasonable. Mill does acknowledge the right for remuneration on the part of abstinence. However, if we follow his analysis of profits, it seems that the only place where proportionality may come in on the part of the capitalist is when he takes risks. This, however, has very little to do with the amount of past labour, or capital, that is required in the production of anything. Consequently, I believe that Mill

meant proportionality to direct labour inputs when he discussed the idea of proportional remuneration. Indeed, it was only in reference to labour that he mentioned the subject at all.

Nevertheless, I have explored the meaning of both senses of proportional remuneration in Mill's system. Accordingly, if we accept the capitalist's right for proportional remuneration, we can see that the concept of economic justice becomes a complex one. On the one hand we have the inverse relationship between wages and the rate of profits (the question of the fair share). On the other, the question of the advantages in trade (proportionality of prices).

We have nothing in the theory to suggest anything about what should be the distribution of shares between labourers and capitalists; however, we can say something about the moral value of different distributions. If technology is such that we follow path A, then a rise in the rate of profits also means a rise in the share of labourers. Thus, to compensate capitalists for their falling share, prices approach the proportional remuneration value from their point of view ($P \rightarrow a_{12}/a_{11}$).

If technology is such that we follow path B, then the rise in the rate of profits means a fall in the share of labourers in the total output. However, instead of compensating labour for its falling share, prices approach yet again the proportional remuneration value from the point of view of the capitalists. They have now a larger share and the advantages of the market to go along with it.

If technology is such that we follow path C, then the rise in the rate of profits means a fall in the share of labourers in the total output. However, as prices are proportional to labour values, they are also proportional to direct inputs ratios and hence, labour is being compensated for its loss of share. However, in this case, if the rate of profits falls, the share of capitalists fall as well. Nevertheless, they are not being compensated by a price ratio which will reflect their presumed efforts.

If we do not accept the proposition that the capital inputs ratio between two goods reflect the different efforts of the capitalist, we will end up with only one just path; path C. Prices which are proportional to labour theory of value are those which are consistent with the principle of proportional remuneration.

As I said before, one of the draw-backs of such a system is that at least one distributional parameter (wages) is determined exogenously. As it affects both the other distributional parameter as well as prices, it seems that the whole question of economic justice depends on the choice of that parameter.

Indeed, on which path the economy will be is determined by coefficients which are truly objective. But on any of these paths, the determination of wages (S_2) will also determine the degree of proportionality of prices. Without going into details regarding the wage-fund doctrine, it is clear that in Mill the two classes were responsible for it. The capitalists in how much they decide to return to the system as circulating capital; the labourers, in how much they

decide to propagate.

The whole analysis that was carried out above assumed the question of setting the wages (and thus the rate of profits) as beyond the scope of economic justice. The question is what effects on prices would the assumption that the degree of capitalists' 'savings' is in itself a function of prices. How would that affect the setting of S and consequently, the proportionality of prices that would emerge as a result.

It is, however, not accidental that Mill neglected such consideration and left the whole analysis to be based on objective parameters. An introduction of subjective considerations would only be meaningful if it was not only related to economics. The fact that economics is part of a larger framework means, in Mill's case, that we cannot relate the determination of prices in one market to another. Therefore, the idea of 'cost of production' as an average is the only way to look at an economic system on its own. Economic justice, therefore, must be applied to this average.

For comparison purposes, I have introduced in the appendix to this chapter, a neo-classical model within which I examine the meaning of proportional remuneration. It will become evident that in a simultaneous equilibrium, the idea of proportionality does not prevail. In fact, equilibrium prices will change in an inverse relation to the ratio of proportional remunerations. If, however, we think of the system in a similar way to a cost of production system (where some variables are predetermined), we shall find that

prices are proportional to labour inputs but that they change inversely to them. Naturally, this will have to do with the meaning of equilibrium in such a system.

Appendix: Proportional Remuneration and Subjective theory of Prices.

Consider an economy with 2 kinds of individuals, 1 & 2, and where there are two commodities, x & y. Individual 1 produces only X and his production function is: aL_1 . He also owns a given quantity of Y at the beginning of the process denoted by Y_1 . Individual 2 produces Y according to a similar production function aL_2 , and he too, owns a given quantity of x at the beginning of the process denoted by X. I have deliberately chosen the same productivity factor for the two industries so that effort will be interpreted in terms of labour units (hours).

Each individual has the same utility function in x,y and L. This is given by:

$$U(X_i, Y_i, L_i) = X_i^\alpha Y_i^\beta L_i^\gamma$$

$$\alpha, \beta > 0 \quad \gamma < 0 \quad i=1,2$$

The utility maximizer individual of type 1 will have to solve the following problem:

$$\text{Max } U(X_1, Y_1, L_1) = X_1^\alpha Y_1^\beta L_1^\gamma$$

$$\text{S.T } \bar{Y}_1 = Y_1 + P(X_1 - aL_1)$$

The Lagrangian will be:

$$L(X_1, Y_1, L_1; \lambda) = X_1^\alpha Y_1^\beta L_1^\gamma + \lambda [\bar{Y}_1 - Y_1 - P(X_1 - aL_1)]$$

And the first order conditions are as follows:

$$(1) \quad \frac{\partial L}{\partial X_1} = \alpha X_1^{\alpha-1} Y_1^\beta L_1^\gamma - \lambda P = 0$$

$$(2) \quad \frac{\partial L}{\partial Y_1} = X_1^\alpha \beta Y_1^{\beta-1} L_1^\gamma - \lambda = 0$$

$$(3) \quad \frac{\partial L}{\partial L_1} = X_1^\alpha Y_1^\beta \gamma L_1^{\gamma-1} + \lambda P a = 0$$

$$(4) \quad \frac{\partial L}{\partial \lambda} = \bar{Y}_1 - Y_1 - P X_1 + P a L_1 = 0$$

Isolating λ from (2) and P from (1) and substituting to get the following demand function:

$$Y_1 = P X_1 \frac{\beta}{\alpha}$$

Substituting X_1 from (4) and we get 1's demand for Y as:

$$(5) \quad Y_1^d = \frac{\beta}{\alpha} (\bar{Y}_1 + P a L_1) \left[1 + \frac{\beta}{\alpha} \right]^{-1}$$

In a similar way we can calculate 1's optimal effort (labour). We shall get:

$$(6) \quad L_1 = -\gamma \frac{Y_1}{\beta P a}$$

2's problem is different in its budget constraint. Thus, 2's Lagrangian will be:

$$L(X_2, Y_2, L_2; \lambda) = X_2^\alpha Y_2^\beta L_2^\gamma + \lambda [\bar{K}_2 - Y_2 - P X_2 + a L_2]$$

And the first order conditions:

$$(7) \quad \frac{\partial L}{\partial X_2} = \alpha X_2^{\alpha-1} Y_2^\beta L_2^\gamma - \lambda P = 0$$

$$(8) \quad \frac{\partial L}{\partial Y_2} = X_2^\alpha \beta Y_2^{\beta-1} L_2^\gamma - \lambda = 0$$

$$(9) \quad \frac{\partial L}{\partial L_2} = X_2^\alpha Y_2^\beta \gamma L_2^{\gamma-1} + \lambda a = 0$$

$$(10) \quad \frac{\partial L}{\partial \lambda} = \bar{K} - Y_2 - P X_2 + a L_2 = 0$$

Following the same trail we shall find 2's demand for Y and supply of L

$$(11) \quad Y_1^d = \frac{\beta}{\alpha} [\bar{K} - a L_2] \left[1 + \frac{\beta}{\alpha}\right]^{-1}$$

Walrasian concept of equilibrium requires the clearance of all markets. In our case we can learn about those conditions by examining the equilibrium conditions of Y. In equilibrium:

$$Y_1^d + Y_2^d = \bar{Y} - a L_2$$

Substituting (5) and (11) and we get the equilibrium price to be:

$$(13) \quad P = \frac{\bar{Y}_1}{X_2} \left[\frac{1 + \frac{\gamma}{\alpha}}{1 + \frac{\gamma}{\beta}} \right]$$

If we assumed that both individuals were similar but in their aversion to labour, the equilibrium price would have become:

$$(14) \quad P = \bar{Y}_1 \left[1 - \frac{\beta}{\alpha} \left(1 + \frac{\beta}{\alpha} + \frac{\gamma_1}{\alpha}\right)^{-1} \right] \left[\left(1 + \frac{\beta}{\alpha} + \frac{\gamma_2}{\alpha}\right) \left(1 - \frac{\gamma_2}{\beta}\right)^{-1} \frac{\alpha}{\beta X_2} \right]$$

Now what does 'proportional remuneration' means. In such a model where each individual is the producer and labourer, remuneration is reflected in the terms of trade. Namely, how much can he get in return for the products of his efforts. The numeraire in our case is y. Thus, as P goes up, each unit of x is worth more y's. However,

as we can see from (13) and (14), the effort itself (which is denoted by L as the productivity is the same) is not present in those equations. The only effort (labour) related aspect of it is the aversion to work given by γ , which, naturally, is a taste parameter.

From (14) we can clearly see that the greater (in absolute values) is l 's aversion to labour, the worse are going to be his terms of trade. l , to remind you, produces x . The greater is his aversion to labour the lower will P become. Which means that a unit of y will cost more x 's (which he produces). From (6) we can also see the paradox that the more averse to labour l is, the more labour he will end up doing to maximize his utility. Thus, I think that one can conclude that proportional remuneration does not prevail in this model. The intuitive reason is that too many factors are involved. The decisions regarding labour and consumption are dominated by the same parameters- tastes- and the greater is one's dislike of labour, the more he has to work in order to compensate his disutility. But the more one works, the less favourable are his conditions in the market given the diminishing marginal utilities of his counterpart.

If, however, we reformulated the model as a two stage model, the story will be distinctly different. Suppose now that the work has already been done and that the two individuals appear in the market with what they originally had plus the direct fruits of their labour.

The problem for l becomes:

$$\begin{aligned} \text{Max } U(X_1, Y_1) &= X_1^\alpha Y_1^\beta \\ X_1, Y_1 \\ \text{S.T } \bar{Y}_1 + PaL_1 &= Y_1 + PX_1 \end{aligned}$$

With the following first order conditions:

$$\begin{aligned} \frac{\partial L}{\partial X_1} &= \alpha X_1^{\alpha-1} Y_1^\beta - \lambda P = 0 \\ \frac{\partial L}{\partial Y_1} &= X_1^\alpha \beta Y_1^{\beta-1} - \lambda = 0 \\ \frac{\partial L}{\partial \lambda} &= \bar{Y}_1 + PaL_1 - Y_1 - PX_1 = 0 \end{aligned}$$

From which the demand for y is being derived:

$$Y_1^d = \frac{\beta}{\alpha} [\bar{Y}_1 + PaL_1] \left[1 + \frac{\beta}{\alpha}\right]^{-1}$$

And for 2 the Lagrangian is:

$$L(X_2, Y_2; \lambda) = X_2^\alpha Y_2^\beta + \lambda [\bar{X}_2 + aL_2 - Y_2 - PX_2]$$

From the first order conditions we can derive the relevant demand:

$$Y_2^d = \frac{\beta}{\alpha} [\bar{X}_2 + aL_2] \left[1 + \frac{\beta}{\alpha}\right]^{-1}$$

Equilibrium then means:

$$P = \frac{\alpha(\bar{Y}_1 + aL_2)}{\beta(\bar{X}_2 + aL_1)}$$

Now we can clearly see that prices depend on effort. Indeed, if those individuals were completely dependent on their labour ($Y_1 = X_2 = 0$), then the price would have been:

$$P = \frac{\alpha L_2}{\beta L_1}$$

In other words, remuneration would have been proportional to effort. Nevertheless, they would have been inversely related to it. The more 1 works, the less favourable are his terms of trade (remuneration).

This too, is clearly due to the property of diminishing marginal utility.

Of course, some injustice to the model is done here. The decisions about work are not brought under optimizing behaviour, they are simply given. To complete the picture, I should have discussed a form of inter-temporal optimization but due to the already incredible diversion, I will have to leave it out for the present.

Conclusion

The reason I extended my analysis of the classical school beyond Adam Smith was that in terms of economic modelling I was not quite sure that he is a good representative of that school. In particular this is true considering my own interpretation of it. J. S. Mill, on the other hand, seems to be a much better representative. His partial equilibrium analysis of market prices and his 'cost-of-production'-general-equilibrium approach to natural prices appears to be much more in line with the various accepted interpretations of 'classical economics'. But this was not the only reason why I extended my analysis to include Mill (rather than, say, Ricardo). It was also Mill's standing as a Utilitarian moral theorist which attracted my attention.

Both his economic modelling and his utilitarianism were a source of worry to the status of desert within classical economics. In Adam Smith it was through his moral analysis of actions and the distinction he made between the role and motivations of the different classes that we were successful in using a theory of

desert as the adhesive of his theory¹. In the case of Mill it seems rather obvious that a utilitarian moral theory will not generate any kind of desert theory. His economic modelling too does not seem congenial to such a view. In the partial equilibrium setting it was his distinction between three instances of exchange² which made it impossible to generalize a desert theory.

The 'cost of production' general equilibrium approach to natural prices poses a particular problem. First there is the question what is meant by 'natural prices'. If these are only long-run prices as some would like to seem them then it would not be meaningful to apply to them any ethical considerations as they might not have any relation to the actual state of the economy. If, however, these natural prices are Mill's idea of 'average' prices then it is a different story altogether. Although the 'average' prices may never prevail as such they do reflect the general actual state of the system. They are an equivalent idea to the gravity centre by which Smith described his natural price. If we do follow this latter path we confront the problem of interpreting proportional remuneration within this system given that although there seems to be a simple relationship between wages and the rate of profit, it is not so simple when we consider the share each group has in the final output.

I have tried to show that one can use Mill's methodology to generate

¹ which obviously means that the theory of desert is an integral and important part of his theory.

²Inelastic supply, constant returns to scale and diminishing returns to scale: in some of them utility matters in others, cost of production.

an explanation that will reconcile his utilitarianism with his theory on Liberty. In turn, this also helps to explain his adherence to a principle of proportional remuneration when it comes to economic justice. I have shown that individuality is a pre-condition to morality and that rewarding expressions of it is detrimental to its development. In that respect, the social organization of private property seems to be more suitable when individuals have not yet developed enough and therefore, proportional remuneration is a basic principle of such an organization. For similar reasons Mill seems to imply that such considerations are not necessary under a communal ownership as individuals must already be well developed before entering such a system.

Applying Mill's methodology to economics meant that we had to make a distinction between the social science side of economics and the natural science side of it. The theory of production, according to Mill, is in the domain of natural science and can present us with technological relationship between all produced commodities. Measured in terms of labour we can generate a labour values system which is not the metaphysics of prices but rather the given technological relationship between commodities.

Given Mill's views on deduction and the nature of the social sciences, we cannot really construct a general equilibrium framework where the activities of all individuals are inter-related. The reason for that is Mill's undeveloped Ethology (the theory of character formation). Although society as a whole does entail such interrelationships, it does not prevail in the scene of economic

analysis. Individuals' character evolve continuously in relation to all those things which constitute the social existence. Therefore, when we analyze the determinants of a market price we must do it in a partial equilibrium setting. What affects the behaviour of individuals in one market is not only what they do or what happens in the other markets, but also those things which are not directly dependent on the market. Hence, within the framework of market prices we cannot really establish a clear economic causal relationship.

But if the story ended here this would have been an uninteresting one. Bearing in mind that deductions in Mill are tolerated only when some of the premises are inferred by induction, then it is in the natural science side of economics that we need to anchor our analysis of society. One reaction to such a need could have been to construct an 'economic man' on the bases of 'tendencies laws'. However, the problem with such a view is that it shuns completely ethology. The 'economic man' created by such 'tendencies laws' will be exogenous to the economic analysis and not an evolving character as was clearly Mill's view. But not only that, 'tendency laws' do help us a bit in our deduction but this is far from sufficient to make deductions meaningful in terms of knowledge accumulation. For that, we need a firmer support from the natural sciences.

What we have from the natural science by way of interrelationship is only the technological labour theory of value. How, then, can we associated a system of markets analyzed in a partial equilibrium framework with a general equilibrium system that is generated by the

natural sciences? The answer is very simply, through the interpretation of the natural price as the system of 'average prices'. As such, the 'natural price' of a commodity is an 'average' of the market prices depicted in the partial equilibrium framework. Now because production circumstances are given, it is only natural for all 'average' prices to converge to the 'cost of production' prices.

Now we have this 'cost of production' system which is a system of 'average' prices constructed under given social institution, on the one hand. On the other, we have the technological labour values which depict the commodities technological relationships which are (in Mill) independent from social institutions. The analysis of what is economic justice will now be focused on comparing the system which is independent from social organizations (labour values) with a system which is dependent on them.

The immediate interpretation of proportional remuneration in terms of prices is the following one: had individuals (labourers as well as capitalists) received their remuneration in terms of the good they produce (or a numeraire), they will be able to exchange it for another according to the relative effort involved in the production of each commodity. On the other hand, there is also the question of the relative share of each group in the total output as a measure of remuneration. The question is, of course, whether these two indicators point at the same direction.

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When the rate of profit is set at zero then we know that prices equal

their labour values. However, labour values include past labour as much as direct labour. Given the property rights and the fact that Mill believes in the right of capitalists to be remunerated, these labour values will not produce an exchange rate that fits the labourers point of view. Namely, relative prices (and labour values) will not represent the relative efforts on the part of labourers alone (i.e. the relative direct labour inputs). The rate of exchange that will correspond to the labour values is the one which is going to be somewhere between what proportional remuneration to labour implies and what it implies to capitalists (capital inputs ratios). Of course, if the capital to labour ratios are the same everywhere then the exchange rate suggested by the labour theory of value will correspond precisely to that of both labourers and capitalists. Therefore, the labour theory of value is a kind of a moral benchmark. It takes into consideration both capitalists and labourers as far as the proportional remuneration principle is concerned. When $r > 0$ prices deviate from their labour values and as wages are being depressed, the actual exchange rate reflects the capitalists' point of view alone. Hence, the deviation of prices from their labour values should be seen as a violation of the principle of proportional remuneration.

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When we consider shares in output the picture becomes a bit more complicated. The behaviour of total output (for a given number of labourers and changing wage (and profit) rates) and the shares of each group depends on technology. At one instance maximum output and highest share of labourers seem to be consistent with one another. It also means that prices will deviate in favour of the capitalists.

Hence, given that the shares are working in favour of labourers, it might be said that the injustice generated by the price deviation is thus rectified. This, however, does not always hold. The idea, therefore, of economic justice is captured by two major components; the relative price and the relative share. Not always do they point at the same direction.

(L)

In any case, I do believe that through this extrapolation we can see how the concept of economic justice that is based on reward can generate mixed feelings about the moral value of competitive systems. As prices deviate from labour values it implies that there is some kind of initial injustice in the system which may explain many of Mill's critical statements about capitalist systems. On the other hand, as the behaviour of the share in total output may sometime rectify this situation, it may become a tolerable system.

General Conclusion

In this work, which is part of a wider research programme, I have examined some of the effects that developments in economic theory might have had on concepts of economic justice that are associated with it. In particular, I have focused my attention on the concept of desert which seemed to have dominated human thought on economic justice since Aristotle and seemed to have disappeared almost entirely from present-day discussions of the subject.

One possible explanation to it is the emergence of Walrasian general equilibrium as a dominant feature of economic theory. In it, the idea of simultaneity erases all traces of causality between agents' activities and outcome. Thus the elusiveness of responsibilities becomes detrimental to any theory of desert. But whether or not the demise of desert theories should follow from such developments in economic analysis also depends on what precisely is meant by general equilibrium (and by the concept of desert).

It matters a great deal whether the idea of general equilibrium is how we perceive the real world or, a 'rationalistic' tool of analysis. While the Walrasian notion of general equilibrium seems close to the latter, the 'empiricist' tradition of liberal classical economics implies a tendency to the former. However, in view of such fundamental differences in the epistemological approach, the whole idea of general equilibrium gets different interpretations altogether.

Classical economics, as represented by Adam Smith and J.S. Mill is a good example of models of general equilibrium (or perhaps better said, of interdependence) where moral responsibility cannot be evaded. Indeed, in the ethical analysis of those models-- conducted by the same people who suggested them-- the role of desert was prominent. Contrary to the general belief that classical economists advocated natural liberty for its moral goodness as much as for its economic efficiency, analysis by desert reveals a serious moral inadequacy of natural liberty. This, in turn, may explain the discrepancy between the received view and the fact that the works

of classical economists are sometimes full with moral apprehensions about natural liberty.

Naturally, it was not only in the reconstruction of their economics where the room for desert was created. It was also through a difference in their interpretations of desert that we were able to argue that although interdependence is admitted, the idea of desert can still survive.

Now in the appendix to the last chapter I have shown that the Walrasian idea of general equilibrium cannot accommodate the most intuitive perception of desert. Because it is a simultaneous system the endogenous variables which interest us (labour and prices) are determined by the exogenous variables. However, when we investigate the relationship between these endogenous variables (or when we set one of them to be exogenous) the relationship between them contradicts the most intuitive perception of desert.

One might argue that the emergence of Walrasian general equilibrium correspond to a more fundamental change in the subject matter of economics. Class distinctions became less crucial and the role of individuals was extended to all aspects of economic activities. Hence, to think of interdependence in the Walrasian way is quite appealing. Nevertheless, for one there is a tremendous difference between assuming such general interdependence and the construction of a simultaneous system. Also, I'm not quite convinced of how true a description of the world it really is. But more than that, even if the grounds for the Walrasian idea were the change in the subject

matter of economic analysis it is still striking that he himself would adhere to a theory of desert.

But it is not only because of the structure of general equilibrium that we fail to apply to it an idea of desert. Some of the problem may lie with the rationality hypothesis. From the point of view of economic analysis all possible principles concerned with the internal composition of the range of decision making are compromisable. There is always an indifferent curve along which substitution is possible. Thus even if we resolve the issue of what precisely is meant by general equilibrium, we are still left with the problem of rationality. This, to a great extent, is a question of belief.

This work has only been a first step in my research programme. Its three main purposes were to show that (a) the application to economics of ethical concepts depends on the structure of economic analysis; (b) that the idea of general interdependence had different manifestations in economic analysis which, in turn, appeared to have been of some importance from the moral point of view; and (c), that moral apprehensions about natural liberty rather than its advocacy seem to be characteristic of the main classical economists.

The next step will be to investigate the meaning of the Walrasian notion of general equilibrium. It will require the analysis of his methodology, his ethics and in the end, his idea of economic justice. After that, the step to follow is an analysis of the question of relationship between the Walrasian model and the real world. In particular, it means the analysis of the role and meaning of the

Tatonnement process. Once this is finished we can embark on the most ambitious plan of discussing the relationship between modern economic analysis and ethics.

References

A Note On Mill's Works: I have mainly used Mill's Collected Works but I have used other sources for his 'Principles' and On Liberty. These are: PRINCIPLES OF POLITICAL ECONOMY (1848), Ed. W. Ashley (1909), rpt. Augustus M. Kelley Publishers, 1987. For On Liberty I also used: Mill, J.S., THREE ESSAYS, Oxford University Press, 1975. Apart from references to Logic I write (cw) when I refer to the Collected Works. Here is a list of Mill's Collected Works:

- Vol. 1. AUTOBIOGRAPHY AND LITERARY ESSAYS J.M. Robson and J. Stillinger (ed.) University of Toronto Press.
- Vols. 2-3. PRINCIPLES OF POLITICAL ECONOMY: WITH SOME OF THEIR APPLICATIONS TO SOCIAL PHILOSOPHY J.M. Robson (ed).
- Vols. 4-5 ESSAYS ON ECONOMICS AND SOCIETY J.M. Robson (ed).
- Vols. 7-8 A SYSTEM OF LOGIC: RATIOCINATIVE AND INDUCTIVE J.M. Robson (ed).
- Vols. 9. AN EXAMINATION OF SIR WILLIAM HAMILTON'S PHILOSOPHY AND THE PRINCIPLE OF PHILOSOPHICAL QUESTIONS DISCUSSED IN HIS WRITINGS J.M. Robson (ed).
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