INET Plenary Conference
October 21-23, 2017, Edinburgh Scotland

Reawakening: From the Origins of Economic Ideas to the Challenges of Our Time

Saturday Lunch Session: ***Adam Smith and the Scottish Enlightenment***

The road towards a decent society; lessons from classical political economy

(provisional draft, please ask for quotation)

Gianni Vaggi

University of Pavia

Introduction

"This essay is written in the classical tradition, making the classical assumption, and asking the classical question. The classics from Smith to Marx, all assumed, or argued, that an unlimited supply of labour was available at subsistence wages. They then enquired how production grows through time." (Lewis, 1954)

There are several themes on which classical political economy could enhance our approach to development.[i] The general thread is the relationship between the needs and desires of human beings and the economic mechanisms which either favour or hinder their achievements. It is a relationship between the *use value* dimension of goods and services and the conditions which regulate their *exchange value*.

A quick view at some episodes of history of economic ideas will help to better understand some of the issues and the challenges of our days. The presentation of the authors will follow a chronological order, each episode will be described in a very sketchy way, this paper does not aim at adding new knowledge on any specific author, but it tries to link to present day development issues.

Section 1 describes the 2015 Sustainable Development Goals by the United Nations; they represent the most updated list of the features of a decent society. Then we go back the seventeen century with the Mercantilist writers and their effort to build wealth and power through trade. In section 3 Petty and Quesnay introduce the role of people and nature in the formation of wealth: they emphasise the physical characteristics of commodities and the central role of agriculture, use values dominate the picture. Section 4 and 5 take us to the age of the Enlightenment and of the industrial revolution, where capital and technology assume a leading role in the search of prosperity. This period shows that social organization is much more complicated than the simplistic view of competitive markets plus self interested individuals. Markets can generate imbalances instead of correcting them and wealth and power could concentrate into few hands. Sections 6 and 7 describe the contributions of Malthus, Ricardo and Marx and introduce the problem of possible economic stagnation and crises; here the exchange value element begins to overcome the specific features of commodities, their use value. In section 8 we find again Mercantilism, but now in a modern fashion, when it also dresses the robes of international financial markets, wealth and power seem not even to need labour, means of production and natural resources. From the triumph of 'good use values' in the seventeen Sustainable Development Goals we end up in the realm of pure exchange value.

1. Well being and a decent society

On September 25 2015 the UN General Assembly has approved a resolution which sets the stage for development policies to 2030; the resolution is known as Agenda 2030 because it includes 17 Sustainable Development Goals, SDGs, which represent the main challenges to be achieved by 2030. The SDGs include 169 targets(see UN 2015). 241 indicators have been added in March 2016(see UN-ECOSOC 2016), by now they have become more than 300. The seventeen SDGs are grouped into five areas of critical importance: *People, Planet, Prosperity , Peace and Justice, Global Partnership.*

There are three dimensions of sustainability: *environmental, social and economic* and the development policies and programs should include *all three dimensions*.

Many goals deal with environmental sustainability, mainly in the area Planet. Other goals pick human development topics such as gender, education, health and they are part of the area People. Two goals, poverty and hunger, can be regarded as fundamental basic needs and they were already part of the 2000 Millenium Development Goals. Other goals are new and they have to do with the economic aspect of development.

The SDGs have been deeply influenced by the 2008 *Report by the Commission on the Measurement of Economic Performance and Social Progress* by Stiglitz, Sen and Fitoussi(see Stiglitz, Sen and Fitoussi 2008) which provides a wide ranging description of well being. There is no single measure of well being and seventeen goals describe what is now called a 'dashboard approach' to well being and to development. The SDGs include most of the elements that have emerged in development debates: from the basic needs, to human rights, to respect for nature and concern for the future of the planet. The overall aim is that of *dignity* for the present and future generations. Let me use the eighteenth century language, the SDGs are the most

comprehensive set of 'use values' that we have: a combination of commodities, services, social and economic relations that we regard as the building blocks of a *decent society*.
The SDGs indicate a pathway and they have a strong normative content; they aim at polices and appropriate behaviours by all economic, political and social stakeholders. But how? Are present market mechanisms and the powerful actors at harmony with these aim? Which are the main elements which can hinder the attainment of the goals? In the end: will the realm of the 'exchange value' support the fulfilment of those desirable goals? We will focus on three of them: Goal number 8 on *full and productive employment and decent work for all*; Goal number which asks for *a reduction of inequalities within and between countries*; Goal number 12 on *sustainable production and consumption systems*.
Going back to history of economic thought and to classical political economy in particular might give some clues.

2. The age of merchant capital. Trade and Power

Classical political economy and Smith want to challenge Mercantilist policies an approach to economic policy which had dominated almost three centuries of the economic history of Europe. The XVI century is the century of the Iberian peninsula: Spain and Portugal support the major discoveries and they are also the immediate beneficiaries of the flows of precious metals into Europe. Their wealth derives from the control over the territories of Latin America, as if they had enlarged their own countries and had discovered gold and silver mines in them. The following one is the century of Britain and of The Netherlands, two small European countries which had very little part in the discoveries of the sixteen century, the Dutch and British East India companies have been established in 1602 and 1601 respectively.
To the Mercantilist national wealth has to be measured by the stock of precious metals, gold and silver, in the coffers of the country. Precious metals are the typical form of a generalised purchasing power, both at home and abroad. Gold guarantees a command over goods and over people, with gold you can give employment to your subjects, you can establish ports and build ships(see Perrotta, 2014). In the end Mercantilists want to secure to the nation a larger control over material goods and over services: the merchants themselves but also the king and the people should benefit from that.
In 1621 Thomas Mun, a director of the British East India Company, publishes a little pamphlet by the title *A Discourse of Trade from England unto the East Indies*, the subtitle is much more explicit: *Answering to diverse Objections which are Usually Made against the Same*. Mun defends the Company and wants to convince the government that what is good for the Company

is also good for the nation as a whole: a prosperous foreign commerce is beneficial to all social groups.[ii]

Mercantilism describes the struggle between large powerful companies and these merchant companies search the support of the nation state.*The alliance between big merchants and the state is a typical feature of Mercantilism*.

Mun's most well known pamphlet is *England's Treasure by Forraign Trade,* supposedly published in 1623, which becomes the 'holy book' of mercantilist thought[iii]. Thomas Mun is the 'father' of the mature phase of Mercantilism, which is characterized by the 'balance of trade' system, according to which a surplus in the balance of trade is the source of national wealth. A country can grow richer only by exporting more than it imports, in a sort of export led growth model *ante litteram*. "....we must observe this rule; to sell more to strangers yearly than we consume of theirs in value."(Mun 1623?, p. 5). Of course not all countries can run a trade surplus at the same time; Mercantilism is a zero-sum-game.

Mun distinguishes *natural wealth* which consists of primary, mainly subsistence, goods from *artificial wealth* 'consists in our manufactures and industrious trading with forraign commodities' (Mun 1623: 7, see also : 71-3). It is more convenient for a country to produce and to sell artificial wealth because that generates more employment, in modern terminology we can say it includes more value added. The Mercantilists ask for the active management of trade in what they call a 'beggar thy neighbour' type of policy.[iv] Notice that wages have to be kept low, because sales are mainly foreign sales thus there is no role for domestic demand; workers should content themselves of having a job.

Mercantilism should not be easily dismissed; it is an important period in the history of Europe and from the seventeenth to the nineteenth century mercantilist policies are very effective in determining the economic successes of countries such as England and The Netherlands. Mercantilist thought contributes to the process of formation of the nation-states and to the building of economics as a science and Mercantilist views dominate the economic policy debates until mid seventeen century.

3. William Petty and Francois Quesnay. Surplus and Reproduction

3.1. Sir William Petty (1623-1687)

Petty is one of the founders of the Royal Society(1660), but Britain is characterized by four decades of civil wars, which include the beheading of Charles the First, the protectorate of Oliver Cromwell and the first or Commonwealth of England, Ireland and Scotland. The turbulences end with the so called Glorious Revolution of 1688 in which the Parliament acquires much stronger powers with respect to the Monarchy. In 1689 the Parliament issues the *Bill of Rights*. The second part of the seventeenth century features the first bourgeois revolution, but at the same time we have more than twenty years of Anglo-Dutch wars for the control of trade routes. England and the Netherlands are the most successful mercantile countries.

In his 1662 *Treatise of Taxes and Contributions* Petty brings to the fore the notion of a physical agricultural **surplus**. Thanks to the surplus of food it is possible to have a social division of labour, that is to say a separation of the different activities.

Petty's second contribution can also be found in the *Treatise*… where we read: "That Labour is the Father and active principle of Wealth, as Lands are the Mother"(Petty 1662, p. 68). **Land and labour** are the two original, non-produced, items in the production process. Petty recognizes the existence of means of production, capital goods, but capital goods are themselves the outcome of a production process, they are produced means of production, while land and labour are not the result of a productive activity. Recall the first two areas in which the seventeen SDGs are grouped: People and Planet, which sound as Petty's land and labour. Of course Planet(nature) and People have broader implications than land and labour, but it is an important way to remind us that production inputs are not all the same.

4.2 Francois Quesnay(1694-1774)

The story of the agricultural surplus as a necessary requisite for prosperity continues with the Physiocratic school in France. Quesnay is the master of the school and the main problems is that France is a backward country *vis à vis* England. Notwithstanding a larger population and a more fertile territory France is losing wars, colonies and power to England, including the contemporary 'seven years' war, 1756 – 1763. The Physiocrats main issue is how to explain this backwardness and how to remedy to it. To put it in another way: which are the causes of England's prosperity and of France's backwardness?

With his 1758 *Tableau Economique* Quesnay introduces a general model of the working of the economy which provides the background for his policy recommendations. Quesnay distinguishes three main economic magnitudes: the gross output, the inputs required in its production and the net output, *produit net*, the surplus. Quesnay introduces the distinction between **productive** and sterile or **unproductive** sectors. He describes an economy with two sectors, agriculture and manufacture, which he calls 'productive' and 'sterile' class respectively.[v]

According to Quesnay manufacture is sterile because it does not yield a physical surplus but it only transforms the inputs, raw materials and wage goods, required in its production without adding any new value: the gross output and the inputs have the same value.[vi]

However not all agricultural activities are productive. In the 1756 article *Farmers* Quesnay uses the metaphor of oxen and horses: corn can be produced with two different techniques. One technique employs oxen to pull the plough with the wooden spade, this is what Quesnay calls *small scale cultivation*, the other technique uses horses and the plough with an iron spade and it is called *large scale cultivation*. The second technique is superior to the first one because more land can be sown during the day and the iron spade goes deeper into the ground. Horses are used in England while in France corn is produced mainly with oxen, with few exception in the northern provinces, this implies a higher physical productivity in the cultivation of corn in England.

Large scale cultivation requires a larger amount of capital than the small scale one: horses are a type of fixed capital, the iron spade lasts longer than the wooden one. Technology is strictly dependent on the amount of physical capital available, a sort of embodied technical progress. Which are the constraints to the adoption of the best techniques of cultivation? The crucial issue is that horses are more expensive than oxen and the French cultivators are too poor to afford the fixed capital necessary to move towards large scale cultivation. It is not just a matter of different techniques of cultivation: *the two techniques correspond to two different social organizations of agriculture.* In France sharecropping prevails in which the cultivators share the harvest with the landlords. The French cultivators are poor and they have no incentives to invest. In England the tenant farmers pay a rent to the landlords, but then they have the entire output, hence they benefit from any improvement in agricultural productivity. England's capitalistic agriculture is more productive than French agriculture, where there are still many features of a feudal mode of production. Quesnay message implies that structural change and increasing agricultural productivity are not just a technical question but they require deep changes in the organization of cultivation.

In order to modernize French agriculture the Physiocrats suggest different policy measures: they ask for the abolition of all the different type of taxes which rest on the farmers and on the production of agriculture and which are typical of a feudal system. The loss of revenue for the Kingdom should be covered by a single tax on rent, which is the main component of the net product of agriculture. The general idea is to switch the tax burden away from productive activities and from basic consumption goods to net incomes and to value added in general. A theme which is still at the forefront in developing countries, particularly at a time in which there is a big need to mobilize domestic resources. Of course the landlords did not like the idea of their rents being taxed.

The second way to support French farmers consist in a new a trade policy, which liberalises the export of French grains and abolishes all duties on both domestic and foreign trade of grains. Quesnay is adamant that trade is not a source of value because it is an exchange of goods of equal values, thus no new wealth is created in commerce. He wants to eliminate the traditional exclusive privileges of French corn merchants who are the only ones entitled to buy corn from specific provinces and to sell it into the cities[vii]. The cultivators should be able to sell their products wherever they will receive the highest possible price including foreign markets. Quesnay's quest for free export of French corn is more similar to a model based on the export led growth than to a model of generalised of free trade.[viii]

Many development theorists focus on the primary sector and on food production in particular, the most famous being Lewis 1954, whose contribution emphasizes the low productivity of agriculture due to a surplus of labour (see Lewis 1954)[ix]. The idea that in an economy there are more and less important sectors is part of the Structuralist approach to development economics; structural change implies moving labour and resources from less to more productive sectors. The criteria to define some sectors as being the crucial one in the process of development can be quite different and can involve either the physical nature of commodities, the use value, or their value in exchange. Agriculture is important because it produces basic goods; some sectors are important components of exports; other sectors generate the higher value added; other sectors are the most innovative one and so on. Whatever the definition of productive/unproductive sectors the structural approach has large policy implications for developing countries, it definitely support a developmental role for the state and for industrial policies in particular.
The increase in agricultural productivity is one of the targets of Sustainable Development Goal number 2 which asks for the elimination of hunger by 2030. Is productivity growth in the staple food sector a necessary pre-requisite to economic growth and structural change?
With Petty and Quesnay the physical and material characteristics of commodities, their use values, play an essential role. At the same time Quesnay is worried by the low exchange value of French corn which prevents the cultivators from becoming wealthy and from carrying on investments in fixed capital and in the modern techniques of cultivation.

4. Enlightenment; checks and balances and comparative economic history

4.1. The separation of powers

The 28 years which go from 1748 to 1776 forge a new vision of the state and provide some of the ideas which help to overcome both Feudalism and Mercantilism.

In 1748 Montesquieu publishes his *The spirit of laws*, three years later we have the first volume of the *Encyclopédie* by Diderot and D'Alembert. The following year in Scotland David Hume publishes the *Political discourses*. Back in France in 1754 it appears the *Discourse on the Origin and Basis of Inequality Among Men* by Rousseau and in 1756 we have Francois Quesnay's first economic article. Smith is in France between 1763and 1766 and on his return to Scotland he begins to write his most famous book *An Inquiry into the Nature and Causes of The Wealth of Nations*, which appears in 1776.[x]

In his 1748 book Charles-Luis de Secondat Baron de Montesquieu (1689-1755) gives the first clear description the tripartite division (separation) of powers: the 'Legislature', the 'Executive' and the 'Judiciary, which will become a fundamental piece of the view of a modern state.[xi] With the separation of powers Montesquieu wants to avoid the concentration of power into the hands of few people, **checks and balances are necessary "in order to avoid that someone abuses of power"** (Montesquieu, 1748 vol. 1: 162-3). It is not just a new theory of the state and of good governance[xii] it is more than this, it is a matter of rights: without the separation of powers there is no freedom(see Montesquieu, 1748 vol. 1:164).

In this process of powers diversification trade can play a positive role; France is still dominated by the Feudal political, social and economic structure and trade can be a mean to avoid that the King and the landlords concentrate too much power in their hands. Montesquieu writes that "the natural consequence of trade is to bring peace"(*ibid*., vol. 2: 8). This leads Albert Hirschman to ascribe to Montesquieu the view of the *doux commerce,* sweet trade, as a formidable argument for capitalism in his early stages(see Hirschman, 1977: 60, see also Larrère 2014). However Smith himself will show that trade can also be quite sour and the same for finance, particularly when economic and financial power is highly concentrated and there are major imbalances among the different actors.

4.2 Comparative economic history

Many authors of the Enlightenment share the view that throughout history mankind has organized itself according to some specific historical types; it is the so called 'four stages theory'. Montesquieu, Turgot and Smith adopt it. Human societies evolve through four stages: hunting, pasturage or grazing, agriculture and the commercial stage. The stages differ because of the different way in which societies solve the problem of their survival and reproduction, which depends upon the prevailing *mode of subsistence*.[xiii]

In the early stages there is a very strong link between the specific characteristics of the products and the satisfaction of people's needs, the use values dominate the early stages, but in later

stages the exchange value takes on a dominant role in the organization of society and in the allocation of commodities.
In the first stage we have societies of hunters and gatherers and subsistence is secured by a direct link between people's needs and the nature which satisfies them, the amount and quality of available natural resources provides an indication of the ability of these societies to survive. The second stage is pasturage and livestock allows a more diversified diet and also it is a measure of the power of the tribe and of the people inside it. The nomadic tribes of central Asia describe this type of social organization. In the third stage, agriculture, subsistence and reproduction are closely linked to the quality of lands: irrigation and the use of farm animals become an essential component of productivity and of subsistence. The division of labour is now much more articulated: there is the King, but there are also the administrators, the clergy, the educators, the warriors who are in charge of defending the territory and of course the peasants who cultivate the land. In this stage we see the appearance of cities. Ancient Egypt and the kingdoms of Mesopotamia are a examples of these type of societies, but the Feudal kingdoms of Europe too can be representative of the third stage. The final stage is dominated by commercial relationships, this is the age of merchant capital in which commercial power is the main determinant of private and of national wealth. England and The Netherlands are the typical success stories; the small territory has not prevented them from becoming world powers during the seventeenth century.
The 'four stages theory' does not only to explain the evolution of the economic history of Europe along a temporal dimension, Montesquieu and Smithy also look at the geographical dimension: **different stages do co-exist during the same historical period**. This is also true of today; we still have human beings which live according to the gatherers and hunters model; societies in which livestock is the main indicator of wealth and of status; countries in which the control of natural resources is the major determinant of private wealth and of power.
It is worth noticing that the authors of the Enlightenment discuss another issue: the causes of the 'rise and fall of nations'. Once it has reached the commercial stage a country does not necessarily progress forever and ever; it can well fall behind, a theme which is taken up also by Smith.[xiv]

Two very different views of societies and of the pros and cons of the evolution throughout the different stages emerge in a famous debate which in opposes David Hume (1711-1776) to Jean-Jacques Rousseau(1712-1778). The former, a Scotsman who at the age of 28 has already published the famous *A treatise of human nature* (1739), follows Mandeville in his support of self-love as a leading determinant of human behaviour; Hume, much more than Smith, is the 'father' of self interest and of utility. He believes that progress requires the evolution of human societies through the stages while Rousseau thinks that this evolution and the origin of more and more structured forms of society is the real cause of inequalities among people, as we read in his 1754 *Discourse on the Origin and Basis of Inequality Among Men*. Self-interest and markets do not guarantee happiness and they corrupt the original good characteristics of human beings in the 'state of nature'. Each man is born free but the appropriation of natural resources by some men, that is to say private property, leads to inequalities. It is the debate on the 'noble savage' and on the pristine positive nature of mankind(see Meek 1976 and Winch 1996). Needless to say Hume won.[xv]

5. Adam Smith(1723-1790. The productivity of labour, value and distribution.

5.1. A new principle of wealth: labour productivity

Smith's 1776 *An Inquiry into the Nature and Causes of the Wealth of Nations* is an attack on Mercantilism (see Smith 1776, IV.iii.c.9) and it offers a new principle of wealth and of the causes of its increase. National wealth does not increase because of a surplus in foreign trade but it depends on the improvements in the productivity of labour, which in turns depends upon the division of labour. The title of Book I of the *Wealth of Nations* is: *Of the Cause of Improvement in the productive Powers of Labour, and of the Order according to which its Produce is naturally distributed among the different Ranks f the People*. The structure of Book I is quite clear about the way in which Smith organises his analysis. The first three chapters are dedicated to the new principle of wealth: the division of labour. Here we find how to increase the quantity of products available in a society, the material aspect of wealth. Notice that Smith does not take a 'supply side' approach, in which a growing output will always be automatically sold without any role for the demand side; the title of chapter 3 of Book I is *That the division of labour is limited by the Extent of the Market*. Market size facilitates specialization and positive externalities, thus more capital can be invested and even new products can be invented.[xvi]

Chapters 4 to 7 discuss the value of the commodities; the first two chapters are mainly concerned with the way of measuring the exchange value of commodities, while chapters 6 and 7 describes the determination of the prices of commodities and of their relative values, that is to say they tackle the issue of the determination of the exchange value. Chapter 4 is dedicated to money and it includes a reference to the separation between 'value in use' and 'value in exchange' with the famous example of water, a very useful good with zero or low price, and a diamond, a pretty useless good with a high price(see Smith 1776, I.iv.13).

In chapter 6 Smith says that the rules for the determination of prices are different in “the early and rude state of society” from those of a society in which there are “both the accumulation of stock(capital) and the appropriation of land” (see *ibid*. I.vi.1, see also I.vi.5 and I.vi.8). In the first case the labour theory of value applies; there is a sort of direct link between labour and the value of its product. In a commercial, capitalistic, economy this simple link is lost and the exchange value, Smith’s natural price, must account for wages, profits and rents(see *ibid.* I.vi.10 and I.vii.).

The final chapters, 8 to 11, explain how income is distributed among wages, profits, and rents, the three “different Ranks of the People”. These are the three classes of a commercial society, which play different functional roles in the organisation of economic activities. Chapters 8 to 11 discuss wages, profits and rent, the distribution of income.

Book I highlights three aspects of a commercial society, that is to say of the ‘fourth stage’: how to produce more commodities, use values; what are the causes which explain their exchange values; the way in which the use values are distributed.[xvii]

The title of Book II is *Of the Nature, Accumulation, and Employment of Stock* and its core is really growth theory: how the quantity of commodities can be increased. The road to prosperity does not depend on protectionist policies and on the control of foreign trade routes but on the accumulation of capital in the most productive activities. Smith uses the notions of **productive** and **unproductive labour**, but sometimes he mixes up two different definitions. On one side the criterion which defines productive labour is the ability to ‘add value’ to the other inputs as in Quesnay . “There is one sort of labour which adds to the value of the subject upon which it is bestowed: There is another which has no such effect.”(*ibid.* II.iii.1.).[xviii]

On the other side Smith seems to ascribe the quality of ‘productive’ to the labour which produces those specific commodities which can be accumulated and used in further production: wage goods and other means of production. Hence agriculture and manufacture are productive sectors. However in the fourth stage, the age of commercial society, agriculture loses the primacy it enjoys with the Physiocrats. Agriculture produces wage goods and the price of corn is one of the two circumstance which affect the nominal wages and the subsistence of workers, the other being the demand for labour(see *ibid.* I.viii.52)[xix]. Therefore improvements in the cultivation of soil are very important because they make food available to other social groups.[xx] However ‘the nature of agriculture, indeed, does not admit of so many subdivisions of labour…..as manufactures’(*ibid.* I.i.4); now manufacture takes the centre stage as the leading sector.

5.2. The spirit of monopoly and economic imbalances

Already in Book I Smith mentions the fact that economic growth does not necessarily progress forever and ever; the fourth stage does not imply that ”the annual produce of the land and labour of the society” (see *ibid.* Introduction.9) will always increase. A society can be in an “ advancing, stationary, or declining condition” (*ibid.* I.vii.1). The issue of the causes of the ‘rise and fall of nations' is quite clear to Smith and one cause of decline is the excessive power of the rich merchants and the master manufacturers.

In Book II chapter V entitled *Of the different employments of capital* Smith says that there is a natural order of investments: savings go first to agriculture, then towards manufacturing and domestic trade, lastly they are invested in foreign trade. A country does prosper if this sequence is not violated. Foreign trade is not the starting point of economic progress. That part of capital which is employed in the carrying trade, is altogether withdrawn from supporting the productive labour of that particular country(see Smith 1776, II.v.30). Unfortunately the ‘spirit of monopoly’ of the merchants and their influence on governments can overturn this natural order.

Investments are guided by profitability thus the rate of profit is a decisive magnitude to assess the condition of a country, but the ‘dealers’, the ‘market intermediaries’, try to narrow the competition and to increase their profits above their natural level(see *ibid.* I.xi.10). In the chapter on money in Book II Smith uses particularly harsh words against the ‘chimerical projectors’ who promise very high profits through credit and financial instruments, hence he is in favour of a legal upper boundary to the rate of interest’(see Kurz 2016: 632-33). The abuses of finance can lead to the disruption of the natural order of investments, and this is highly damaging for the country.

Book IV of the *Wealth of Nations* is a direct attack on Mercantilist views (see Smith 1776, IV.iii.c. 9):

‘nations have been taught that their interest consisted in beggaring all their neighbours. …….. Commerce, which ought naturally to be, among nations, as among individuals, a bond of union and friendship, [sweet trade] has become the most fertile source of discord and animosity[sour trade]’. These doctrines have dominated economic policies for two centuries, but this has been the outcome of the alliance between the merchants and the nation state: ‘The sneaking arts of underling tradesmen’ (*ibid.* IV.iii.c.8).

And a bit further we read: ‘But the mean rapacity, *the monopolizing spirit of merchants and manufacturers*, who neither are, *nor ought to be the rulers of mankind*, though it cannot perhaps be corrected, may very easily be prevented from disturbing the tranquillity of any body but themselves’(*ibid.* IV.iii.c.9, emphasis added).

The merchants and manufacturers try to convince the rulers and the public that what is good for them is good for the people of the country as a whole, precisely as Mun did one hundred and fifty years before. Is it an essay on persuasion, the "sophistry of merchants and manufacturers…… [to] persuade …. that the private interest of a part……… is the general interest of the whole" (Smith 1776, I.x.c.25).

Notice that Smith refers to the merchants but also to the manufacturers, it is not just a question of tradesmen, the problem lies in the spirit of monopoly which guides the behaviour of both categories and make them act in such a way has to exert more and more power. The association of these groups with the state is instrumental to generate policies which can increase their power and their wealth to the detriment of 'the tranquillity of any body' else and 'to the repose of Europe'. Smith opposes the alliance between big corporations and the state because it increases the differences among people: 'this alliance could perpetuate and even enlarge the differences between the different market players, *thus increasing imbalances instead of reducing them*'(*ibid*., book IV,iii.c.9-10, italics added).

5.3 The labouring poor

The **labour market** is a typical case in which there are large differences between the two parties can lead to increasing **imbalances**. When discussing wages Smith re-asserts the fact a commercial society can go through different states: it can either progress, or stagnate, or even decline.

" it is in the *progressive* state, while the society is advancing to the further acquisition, rather than when it has acquired its full complement of riches, that the condition of the labouring poor, of the great body of the people, seems to be the happiest and the most comfortable. It is hard in the *stationary*, and miserable in the *declining* state"(*ibid.*, I.viii.43, italics added).

Workers are much better when the economy is growing fast, rather than when income is already high, " the full complement of riches". Wages growth with the growth rate of the economy and income distribution worsen with the slowing down of economic growth. This reminds us of the debate about secular stagnation and of the worsening of income distribution within many high income countries.

Quite apart from the particular state of society the labour market can lead to an increase of the differences among people rather than to reduce them. Workmen and master manufacturers are in opposition in the determination of wages: "what are the common wages of labour depends every where upon the contract usually made between those two parties, whose interests are by no means the same. The workmen desire to get as much, the masters to give as little as possible...”(*ibid*., I.viii.11). However the two classes have very different economic powers and it is clear which of the two parties will win. The workers are poor and cannot resist without wages but a few days, while “a landlord, a farmer, a master manufacturer, or merchant, …….. could generally live a year or two upon the stocks which they have already acquired”(*ibid*., I.viii.12). Not only the masters are more wealthy but being “fewer in number, can combine much more easily; and the law, besides, authorises, or at least does not prohibit their combinations, while it prohibits those of the workmen. …”(*ibid*., I.viii.12). Smith does not attack trade unions, the real distortions of the labour market come from the masters’ side; in the labour market competition is hindered by the excessive differences in the economic powers between the two parties and the government does nothing to reduce these imbalances.

Moreover the associations of masters lack transparency: ‘masters are always and every where in a sort of tacit, but constant and uniform combination, not to raise the wages of labour ……. We seldom, indeed, hear of this combination, …….These are always conducted with the utmost silence and secrecy,…… *(ibid*., I.viii.13). In the end the violation of competition boils down to three main causes:

-masters are too much wealthier than workers;

-they are less in numbers which make it easy to join forces in order to support their interests;

-they are connected to political powers and can influence the rulers and the law makers.

Smith is not a supporter of the view that markets always produce efficient outcomes. Competition has to do with the number of players but much more about their different economic powers and there is a tendency of the most powerful players to reproduce and to enlarge their influence on the markets.

Smith often refers to the workers with the term ‘**labouring poor**’ (see for instance *ibid*. I.viii. 27, 30, 31). The term ‘labouring poor’ reminds us that since the eighties the share of wages in national income has shrunk in all high income economies. Full employment and decent work have been regarded as essential component of growth since the nineteen-seventies, they are also the essence of Goal 8 in the Sustainable Development Goals: ‘Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all’. The labour market alone will not overcome the large imbalances among the two parties.

5.4 The macro foundations of microeconomics

The above pictures looks at odd with the popular descriptions of Adam Smith and the view in which competitive markets plus rational agents guided by self-interest lead the society to prosperity.[xxi] The rational expectations revolution of the seventies has strengthened this picture. Economic agents follow the simple principle of non-tuism (see Wilson 1976: 81, 92), a parametric behaviour guided by price signals alone.

In 1967 Alec Mcafie with his *The individual in society* opens the door to the storiographic revision of Smith. The 1976 introduction to Smith's *The Theory of Moral Sentiments* by Mcafie and Raphael tackles the so called *Das Adam Smith Problem* and shows a much more complicated picture of the passions which lead the actions of human beings. A number of characters appear in Smith's work, man appears in many different variants: self-loving, altruistic, prudent, virtuous, impartial, benevolent, sympathetic, labouring poor, rich(of course), middling rank, prone to vanity. We have one man for each passion plus infinite combinations, far away from the stereotype of the *homo economicus*(see more on this point in Vaggi 2004).

In Smith man's behaviour is not based on simple individualism, there is a sort of social middle conformation(see Zanini 1993: 12) which gives to man's behaviour the social connotation of propriety. Smith's 'prudent man' is a intermediate social agent and there is a social, macro, determination of the moral conduct of the individual. No single all encompassing description of human behaviour is possible, whatever the natural predisposition of the individuals they become specific social characters. The general rules emerge through social experience, morality is a social phenomenon.

The process of socialization takes place through mutual experience. Experience plays a fundamental role in shaping human behaviour and man's view of justice and of morality 'The general maxims of morality are formed, like any other general maxims, from experience and induction'(Smith 1759: 319). The sympathetic interaction of the individuals produces social norms, the rules and conventions are the results of experience(see Samuels 1966: 185). As Vivienne Brown writes 'people through their productive activity create their social reality'(Brown 1992: 20). There is an interaction of economic organisation and of socially generated individual consciousness, a co-evolution of individuals and society (see Samuels 1966: 187).

'The selfish and original passions of human nature' are tamed by habit and experience and they are also guided by reason and by the authority of conscience and this leads the individuals to continuously change and adapt their position:

"habit and experience have taught us to do so easily and so readily, that we are scarce sensible that we do it; and it requires, in this case too, some degree of reflection and even of philosophy, to convince us, how little interest we should take in the greatest concerns of our neighbour, (….) if the sense of propriety and justice did not correct the otherwise natural inequality of our sentiments"(Smith 1759: 135-6, see also 159).

The microfoundation view assumes a very simplified character and this is the pillar upholding the entire structure. No need to talk of virtue or self-command, no need to identify instruments of communication ad socialization. In Smith's work there is a continuous interaction between man and society, between human passions, the historical conditions and institutions, which have a leading role in shaping the character of the individual in society. The behaviour of the individual slowly evolves depending on the existing social and institutional framework. Warren Samuels writes that for Smith society is a *market-plus-framework* and not the sum of competitive market and self-interested agents(see Samuels 1966).

5.5. Natural progress and developing countries

One of the implications of Robert Solow's growth model(see Solow 1956) is that in the steady state all countries should converge to the same income per capita. The lower capital intensity and the higher profit rates of low income countries *vis à vis* the rich ones, should generate a flow of savings towards the poorest countries. This is the type of 'trickle down' economic growth which should be very much favoured by free capital mobility in international markets.

For Smith international markets do not help to close the gap between rich and poor countries. Will all societies progress towards the commercial stage in a deterministic way? What about developing countries? Will they growth fast enough so as to catch up with high income countries?

In the *Early Draft of the Wealth of Nations* Smith writes: 'it is easier for a nation, in the same manner as for an individual, to raise itself from a moderate degree of wealth to the highest opulence, than to acquire this moderate degree of wealth'(Smith 1763: 579). Smith writes that poor countries face five major impediments(see *ibid*.). Let us see them with some comments referring to modern developmental issues.

- The extreme difficulty of beginning capital accumulation. Lack of domestic savings
- It took a long time to find things which now appear the simples inventions, economic growth can skip some technical innovations, mobile versus fixed-lines telephone, but quite often this is not the case.
- The nation is not always in a condition to imitate and copy the inventions and improvements of its more wealthy neighbours. In order to be effective technical transfer requires many favourable surrounding conditions which are not always there.
- The application of these [improvements] frequently requires an amount of capita which is not available in developing countries. Appropriate technology and capital accumulation should

go hand in hand and above should take into account the local economic and social conditions.

- the oppressive and injudicious governments to which mankind are almost always subject, but more especially in the rude beginnings of society. This is self explanatory, but we can say that economic growth and development require the appropriate social and political conditions.

Of course bad governments too play a negative role. The 'chiefs of an independent nation……. as soon as the idea of private property in land is introduced … seize much greater tracts of it to themselves….[and] are unwilling to divide the profites of this land with any freeman'(*ibid*.). In many developing countries economic power still depends on the control of natural resources. Societies can progress but not in a automatic way and the process could be quite painful. Smith recognises that both individual and human societies are strongly affected by powerful forces, such as self-interest and the search for profits, but he does not take a deterministic approach to the history of mankind. There is no automatic self-adjusting mechanism in the markets. The natural progress of opulence could be derailed by monopolistic forces and there is tendency towards a form oligopolistic competition both in international and domestic markets. Increasing returns to scale and the division of labour favour the business with the largest stock of capital. For Smith there is the tendency by the people who have more power and more wealth to increase their distance with the rest of the citizens. This tendency ought to be opposed, markets alone cannot preclude the most powerful social groups from trying to take advantage of their position. Remember that Goal 10 of the SDGs is about social inclusion and aims to 'reduce inequality within and among countries'. Laws and regulation should prevent growing imbalances and should help to rebalance economic powers. Smith seems to believe that this is possible, Marx will be much less confident.

6. Entering a new century. Population and trade

The last years of the of the eighteen century see the *Declaration of the Rights of Man and of the Citizen* (*Déclaration des droits de l'homme et du citoyen*) approved by France's National Constituent Assembly in August 1789 is a pillar in the story of human rights which moves on from the 1689 Bill of Rights in Britain to the 1948 *Universal Declaration of Human Rights* by the United Nations General Assembly. Article 1 of the 1789 Declaration reads "Men are born and remain *free* and *equal* in rights. Social distinctions can be founded only on the common good". The first article of the 1948 Declaration is quite similar: "All human beings are born *free* and *equal* in *dignity* and rights. They are endowed with reason and conscience and should act towards one another in a spirit of brotherhood."

In both texts the first sentence is almost identical, a sentence which evokes Rousseau's works and which recognizes three essential features of the rights of human beings: freedom, equality and dignity. *Development as freedom* is the title of Sen's 1999 famous book, Goal 10 of the SDGs asks for the reduction of *inequality,* and *The road to dignity*, is the title of a document by UN Secretary General of December in preparation of the 2015 UN Resolution which includes the Sustainable Development Goals.

6.1 Thomas Robert Malthus (1766-1834)

In 1798 Malthus writes *An Essay on the Principle of Population*. In the first pages we read: 'the power of population is indefinitely greater than the power in the earth to produce subsistence for man. Population when unchecked, increases in a geometrical ratio: Subsistence increases only in an arithmetical ratio'(Malthus 1798:13-14). Malthus' prediction has not come through, but after World War II population has increased from 2.5 billion in 1950 to 7 billion in 2000, the time of two generations and 25 years is also the unit of measure that Malthus adopts in his work to calculate the increases of both people and subsistence(see *ibid.:* 20, 22). In Malthus' analysis we can find the first two areas in which the seventeen SDGs are clustered: People and Planet. We have some specific use values, subsistence goods and human beings, People, are not just producers as in Petty, in Malthus they must be fed and land represents all those natural resources which are in the area Planet.

6.2 David Ricardo (1772-1823) and the profit rate

Could free trade overcome Malthus' gloomy prophecy about the lack of food?

In England the issue of foreign trade policies characterises the years following the Napoleonic wars and the Vienna Congress and gives rise to a famous debate in the history of economics, that on the Corn Laws, a bill concerning the imposition of duties on the imports of corn from Continental Europe. Malthus and Ricardo agree that economic policies have to to judged depending on their impact on the rate of profit which, following Smith, is regarded as the decisive magnitude for the increase of prosperity. According to Malthus a tariff on corn imports will favour the profitability of the entire economy; by raising the home price of corn a tariff supports landlords' rents which represent an essential component of the effective demand of British manufactures. Ricardo believes that a tariff on imported corn will compel to use less fertile lands, labour productivity in the production of wage goods will decrease thus reducing the profit rate. Malthus wins; tariffs are introduced with the Importation Act of 1815, which will be repealed in 1846.

Is the dispute only about trade? Ricardo's main concern is profitability not free trade.

In Malthus' and Ricardo's theories the reasons for a **declining profitability** and of the limitation to growth rest on two elements: **people** and **planet**. In Malthus population grows in excess of available subsistence; in Ricardo the best lands are scarce. Capital accumulation, new techniques of cultivation, the availability of new natural resources available, see the shale gas example, can delay the decline of the rat of profit, but they cannot remove the fundamental relationship between People and Planet.

The evolution of Ricardo's analysis is quite interesting. In his *Essay on Profits* of 1815 Ricardo assumes that wage goods are made up only of the products of agriculture, but in the 1817 *Principles* he abandons this restrictive assumption: wages now include also manufactures(see Sraffa 1951). Without the assumption that wages are composed only of agricultural products it is not possible to have a sector, agriculture, in which the gross output and the inputs are made up of the same commodity and hence where the surplus can be measured in physical terms: now output and inputs are heterogeneous set of commodities. In order to know the size of the net product a system of relative prices is needed and for that it is necessary to have a theory which explains the exchange value of commodities. The exchange value comes to the fore in the determination of the rate of profit(see Sraffa 1960).

Ricardo's 1817 *Principles* opens with a chapter on value(see Ricardo 1817: 11) where he searches for a unit of measure of relative prices which could allow to transform gross output and inputs into magnitudes expressed in terms of the same unit of measurement.[xxii] A similar approach is in Marx' *Capital* which opens with a long chapter on commodity in which we already find the contradiction between use and exchange values.

In Malthus and Ricardo the discussion of productive and unproductive labour is closely linked to the distinction between **value and riches**. Following Smith Ricardo says that riches have to do with 'necessaries, conveniences, and amusements of human life'....Value..... depends not abundance, but on the difficulty or facility of production'(Ricardo 1817: 273). Riches refer to the availability of commodities, while their exchange value is regulated by a different principle. Few pages later Ricardo gives the example of the privatization of water: 'water which had no price will now have a positive exchange value, not because of its scarcity but because of the monopoly'(*ibid.*: 276-277). This privatization increases the wealth of the proprietor of water the but not the riches of the country, on the contrary other workers they have to use part of their output to pay for water which before was free; ‘not only would there be a different distribution of riches, but an actual loss of wealth’(*ibid*.: 277). Again a situation in which the use value aspect of a good is overcome by its exchange value.

In the following decades of the nineteenth century a new idea will gradually impose itself: any type of good and service is equally ‘productive’ in so far as it has a positive price; an exchange value higher than zero bestows on goods and services the feature of being ‘productive’. This evolution is linked to the abandonment of a view of value as being determined by the techniques production of commodities in favour of an approach which sees in utility and in scarcity the foundation of value(see Vaggi and Groenewegen 2003:118,124).

7. Karl Marx(1818-1883) and the crises

7.1 The laws of motion of societies

The view that in the long-run the profit rate will decline is taken up by Karl Marx and it is part of his explanation of the repeated crises which will lead to the collapse of the capitalist mode of production.

As the authors of the Enlightenment one century before him Marx too wants to explain the evolution of human societies, a very ambitious topic. In his 1859 *Contribution to a Critique of Political Economy* he outlines a methodology which should help to disentangle the complexities of social systems and to identify the causes of their evolution.

Marx uses an articulated set of concepts from the ‘economic base’, or ‘structure’, which includes all the economic relationships among people, to the ‘superstructure’, with all other types of connections(see Marx 1859, Preface). Inside the ‘economic base’ there are the ‘modes of production’, with the ‘productive forces’: labour, natural resources, means of production and technology. The specific way in which the relationships of production are linked together is called ‘relationships of production’ and identifies a particular mode of production. Wage labour and private property of the means of production characterize the capitalist mode of production and capitalism is the society in which the capitalist mode of production is the dominant one.

Marx focuses on the different ways in which labour is are related to the other productive forces and in which degree people are free to decide what to produce in the sphere of production and how to obtain and use an income in the sphere of circulation. In the capitalistic mode of production workers are free in the sphere of circulation because the wage labour is the outcome of a private contract which from legal point of view the workers are not obliged to sign.

However labour is are restricted in production because workers have no say on what, how and how much to produce. Even in the sphere of circulation there is only an illusory form of freedom; workers are compelled to accept jobs at very low wages because they do not control the means of production.

Marx' special attention to the conditions of labour reminds us of SDG number 8 which asks for decent work and full employment. Marx' approach can help to remember two crucial points:

-first, people are at the centre of social change, indeed the positivity/negativity of social change should be evaluated with respect to people's concrete freedom and empowerment;

-second, people are influenced and even constrained by the social structures and relationships to which they belong.

7.2 The falling rate of profit and the crises

For Malthus and Ricardo the profit rate has a tendency to decrease because of the fast growing population and the scarcity of the most fertile lands, these facts lead to a decrease in the productivity of labour and to a growing cost in the production of wages goods. The relationship between People and Planet is at the forefront. For Marx the profit rate diminishes for reasons which are inbuilt into the social relationships which characterize the capitalistic mode of production.

The capital invested in each new productive cycle is made up of wages, *variable capital*, and of other means of production, *constant capital*(see Marx 1867, vol. I. 193-ff and 204-206).[xxiii]

The capitalists try to keep the profit rate as high as possible by increasing the length of the working day and by reducing the value of the wage basket. The length of working day cannot be extended to infinity and the labour content of wages can be reduced thanks to an increase of the productivity of labour in the sectors producing wage goods. However in order to reduce the labour embodied in wage basket it is necessary to employ techniques of production which require more raw materials and machinery, that is to say more constant capital(see *ibid.* vol. I. chapter XVI). Therefore the ratio between constant and variable, called 'organic composition of capital'(see *ibid*. vol. I:574; vol. III: 144), has a tendency to increase and this 'must necessarily lead to *a gradual fall of the general rate of profit'*(*ibid.* vol. III.: 212, Marx' italics). According to Marx the capitalists are 'forced' to introduce technological innovations in order to contain the decrease in profitability, but this is one of the contradictions which will lead to the collapse of capitalism. Of course workers' wages will be squeezed and the workers will not be able to buy more products.

In volume 2 of *Capital* Marx deals with the issue of crises and uses different schemes to illustrate how the circulation of money, of commodities and of capital could be disrupted, thus leading to crises. Capitalist production is characterised by different branches and spheres of production(see Marx 1867 vol. 3: 142, 155) which do produce different types of commodities, because of the different role they play in the reproduction process. In Marx' first 'reproduction schemes' the economy is made up of two sectors, or departments; department one produces means of production, constant capital, the other department produces consumption goods, variable capital(see Marx 1867, vol. II: 399).

It is interesting to notice that two sectors are defined by the physical characteristics of their products and by the role that these products play in the process of reproduction. Wage goods and means of production, variable and constant capital, are specific use values which can become inputs in the production processes. Specific use values and the technical characteristics of reproduction decide of the productive/unproductive role of the sectors, but the determination of the profit rate depends on the realm of the exchange value.

The capitalistic process of production gives rise to two main types of crises.

A first type of crisis has to do with the different rates of capital accumulation in the two major sectors of the economy, a position also adopted by the Russian economist Tugan-Baranowski at the end of the century (see Sweezy 1942 , Part I, chapters VIII-XII). However these crises do not imply the collapse of capitalism.

A second and more damaging type of crises is that of either under-consumption or of over-production for the whole economy. This point is also discussed in Part 2 of the *Theories of Surplus Value* (see Marx 1905 vol. II, chapter XVII). The substitution of machines to workers in the production process leads to the an excess supply of labour the 'industrial reserve army'(see Marx 1867 vol. I: 589). This squeezes wages but it also reduces the purchasing power of the workers and creates a potential lack of effective demand; 'it is a sheer tautology to say that crises are caused by the scarcity of effective consumption, or effective consumers'(*ibid*.: 414). Marx rejects Say's law (see Dobb 1973, p. 164). Hence there is a generalised crisis of overproduction: 'The Contradiction between the Impetuous Development of the Productive Powers and the Limitations of Consumption Leads to Over-production'(see Marx 1905 vol. II: 527).

In his 1913 *The Accumulation of Capital* Rosa Luxembourg stresses the under-consumption view of the crises, a tendency which prevents the full realisation of the surplus value, and ultimately will lead to the collapse of capitalism. This fall is the outcome of the **contradiction between the use and the exchange value in the capitalist mode of production**; commodities

which are highly needed cannot be sold at a profit because of the lack of effective demand even if the potential consumers, the 'labouring poor', are there.
In order to increase their profits and to escape the under-consumption and over-production type of crisis capitalists look for the support of the **nation states** and try to influence their policies. The interests of the capitalists are opposed to those of the workers, but the capitalists also compete against other capitalists, both inside the country and at the world-wide level and the state can be a useful ally in this fight. In the capitalistic system competition among capitalists is an inherent contradiction between capital accumulation on profitability (see Mandel 1987: 378). One century later Paul Baran and Paul Sweezy write *Monopoly Capital* and emphasise the tendency of the capitalistic process of accumulation to destroy competition and to generate large monopolistic capitalist groups(see Baran and Sweezy 1966).

8. On Financial Mercantilism and four 'paradoxes'

We started with Mercantilism; the previous section has shown the 'mercantilist practices' are still with us. This section will show that there are many similarities between the old days merchants and today financial intermediaries operate. Some curiosities emerge.

8.1 A savings glut?

Many explanations of the so called *secular stagnation* have to do with finance; in particular they focus on the relationship between savings and investment and the fact that due to an excess of savings the real interest rate needed to equate investments and savings at full employment level may be negative. [xxiv] Hence monetary policy becomes ineffective because due to low inflation and to low nominal rates there is a floor, the so called Zero Bound Level, ZBL, for nominal rates (see Baldwin and Teulings, 2014, p. 2.) which makes it impossible to reach negative rates. To put it in Keynesian terms it is as if the liquidity trap had become a permanent feature of the economy(see Krugman in Baldwin and Teulings, 2014, p.15).[xxv]
Let us highlight ***two paradoxes***.

Paradox 1, in Harrod's growth model a higher saving ratio, s, leads to a higher warranted growth rate. In the neoclassical version of the model, with S=I, a higher s implies a higher income per capita in the steady state, provided. Now it seems that savings are the cause of a growth slowdown. I believe that the problem is the lack of investments, not of course in East Asia where investment ratios are still high and of effective demand.

Paradox 2, the three countries/areas which are saving more are China, continental Europe and Japan, the one which saves less is the US(see Blanchard, Furceri and Pescatori 2014:104), however the economy is now growing faster in the US than in Europe and in Japan.
This suggests that the savings glut plus demography are not sufficient elements to explain secular stagnation; one has to look for a combination of both supply and demand side causes of the slowdown of growth rates in high income economies. There is a the need for huge investments in particular in infrastructures in both high income economies(see Caballero and Farhi 2014: 118-119).

8.2 Mercantilism today

Both stagnating economies and structural imbalances stimulate neo-mercantilist and protectionist policies; nations fiercely compete on international markets(see also UNCTAD 2014: 17-19).

> ***A first feature of Mercantilism;*** *I consider as neo-mercantilist all those polices which rely mainly on exports for the sale of the goods and services they produce and which restrain domestic demand.*

We must not confuse Mercantilism today with the lack of competition on international markets. During the last thirty years there have been very strong newcomers in international markets, the so called emerging economies, in particular in East Asia, and we can say that many sectors are now more competitive than they used to be during the fifties and sixties of the last century. This has very little to do with the idea of competition characterized by a multitude of independent producers and by the possibility of new producers to enter the market; this is a ***competition among giants***. In many sectors: from automotive, to finance, to capital equipment, to infrastructure procurement, to international finance there is a strong concentration of productive capacity, also through mergers and acquisition. At the world level these sectors are characterized by ***oligopolistic competition***.[xxvi]

> ***A second feature of Mercantilism*** *is the alliance between big corporations and the states and not only in East Asia. Big international companies may even turn the functions and powers of the states and of international institutions to their advantage.*

This type of alliances are quite similar to those opposed by Smith, these coalitions perpetuate and enlarge the gap between the different market players, thus increasing imbalances instead of reducing them.

On one point recent economic events seem to contradict *Mun's rule* according to which the current account balance determines the direction of capital flows. Moreover the movements of the exchange rates *are not* regulated by the imbalances in the current account and by the 'flow-specie' mechanism which had already been devised by David Hume(see Vaggi and Groenewegen 2003: 78-80). The evolution of the Euro-dollar exchange rate during the last eight years does not support this rule. Of course a negative current account does generate outflows in the financial account, however, the flows related to the current account balance are only a small part of the overall financial flows. And financial flows play a major role in foreign exchange markets, the exchange rates do not depend on trade flows but much more on financial flows unrelated to exports and imports.

Paradox 3. This leads us to the role of international finance and somehow paradoxically brings us back to an earlier phase of Mercantilism the so called *monetary balance system* (see Rubin 1929, pp. 26 and 43-46), prevailing in sixteenth century Europe. According to this view financial flows depended on the level of interest rates and on the reputation of the national currency: a strong currency resulting in net inflows. This is somehow similar to modern phenomena such as 'flight to quality' and the readiness to accept zero and even negative interest rates on assets denominated in a currency which is regarded as a very good store of value. This leads us to international finance.

8.3 International finance; the rule of exchange values

In the old days the merchant's gain derived from his ability to *buy cheap and selling dear* and the difference was his *profit upon alienation*. In order to achieve this gain the merchant had to move the goods in space and time. In international financial markets investors act like modern mercantilists, who gain on the difference between their buying and selling prices, *but there is no need either to go through production processes or to move goods across time and space*.

Space has become relevant only in so far as different financial markets have specialized in different types of products. The City of London is home to the largest foreign exchange market, Wall Street is very strong on bonds; different regulations and laws apply to similar products depending on the place of issuance.

Time is much more important because profitability depends upon the *time* of buying and of selling any type of financial product. In financial markets operations are typically quite fast, in the foreign exchange markets they last few days. agents are characterized by *short-termism*.[xxvii]

Even the bond markets can no longer be regarded as a place of long-term commitments. The fact that the contracts/obligations refer to 10 years bonds and are long-term does not imply that they are not sold and bought in a continuous way. The search for high yields in emerging markets does not imply that these capital inflows will stay till the maturity of the bond; the capital gain motive dominates the interest rate component.

In financial markets '*products'* are basically *forward contracts,* sort of *bets,* that is to say commitments to buy and to sell at some future time and at certain conditions. These are *immaterial products*, but they can make people and countries either richer or poorer. Using a Marxian terminology we could say that in financial markets the *appropriation of surplus value no longer needs to go through commodity production, but moves directly from money to more money M – M', with M' > M.*

Free movements of capitals should help to allocate capital in the most efficient way. Financial markets should bring savings where they are lacking and hence most needed and were they can also generate higher returns. This is the so called 'market efficiency hypothesis'. At the *macro* level international financial markets should increase the average world growth rate and should speed up the closing of the gap between low and high income economies; however there are serious doubts that more finance implies more growth(see for instance Arcand *et al* 2012). And "it is hard to ascertain or measure the real gains from financial openness and freely moving capital….trillions of dollars have crossed borders, and yet despite our best efforts and hundreds of studies, it has been extraordinarily difficult for economists to identify any benefits from these flows"(Rey 2015: 6).

Paradox 4. East-Asian economic growth is largely explained by a combination of export–led growth, industrial policies and huge accumulation of physical capital. Capital accumulation has largely relied on domestic savings with investment ratios in the order of 25-30 per cent of the GDP; China has reached 45 per cent in 2009-2010. These investments are largely based on self-financing by firms through reinvested profits. In the Japanese and Korean experience one could speak of a fundamental profit-investment nexus(see UNCTAD 1996) which has by passed international financial markets.[xxviii]

Financial markets can help to understand why 'quantitative easing' policies have failed to stimulate the real part of the economy. With interest rates close to zero monetary policy cannot affect the real economy. Nothing new under the sun, at least since Keynes' 'liquidity trap', but the possibility of using these additional liquidity into the financial sector further reduces the stimulus to channel it into the real economy and it increases the volatility of financial markets.[xxix]

A higher volatility amplifies the opportunities of speculating on the difference between the buying and the selling price of any financial product, which is at the core of financial mercantilism.[xxx]

Besides increased market volatility there is another more worrying feature of financial Mercantilism *the concentration of market power into the hands of few big players*. In Smith's times it was the British East India, in our days it could be the overwhelming power of big international investment banks. As in the case of transnational corporations this situation generates *large imbalances in negotiating power among the different market players*. It is thanks to this superior power that the 'modern merchants' can twist the markets to their own interests. There are at least three ways in which the largest investment banks can influence the markets:

- asymmetric access to information,
- lack of transparency in many financial products and contracts,
- some investment opportunities, usually the more remunerative ones, are available only to investors with large amount of funds.

9. Conclusions, value in use and value in exchange

The Sustainable Development Goals bring to the fore the use values of commodities and the crucial role of natural resources and of labour. Development is about concrete objects and specific useful items. It is not just a matter of goods and services but the approach to sustainability through three dimensions -environmental, social and economic- should involve production and consumption patterns as stated in Goal 12. However there is not much about how to achieve this sustainability and there is no discussion, at most some hints, of the possible conflicts between 'useful development objects' and the way in which they could be either favoured or hindered by economic forces. The classical political economy distinction between value in use and value in exchange can greatly help to improve the debate.

For the classical economists economic growth is the outcome of capital accumulation and of the increasing productivity of labour, but they are not naive supporters of a view of economic growth which will inevitably 'trickle down' to all social classes. Quesnay, Smith, Ricardo and later Marx do believe that there are dominant economic forces, but this fact does not remove the need to address issues such as justice, equity and fairness; growth is not enough, it does not eliminate the need to investigate other aspects of economic process, first of all the distribution of income, an issues which is coming back to the fore in recent years.

Financial mercantilism is a variation of the capitalist mode of production and through financial markets it tends to perpetuate and even to increase the gaps and the differences among the individual in society. One very famous catchphrase in Agenda 2030 is *leave no one behind* ; the search for a decent society requires the re-balancing of the diverging economic powers. These can be done with many policies both in rich and in poor countries: fiscal and industrial policies, employment programs, social protection systems and many more.

I close with a extreme example of the separation between use and exchange values in the age of Financial Mercantilism.

> *On July 2014 a 'vulture' fund Themis Capital and Des Moines won a case against the Democratic Republic of Congo which should now repay 18 million dollars of an original debt plus 70 million as interest(The Financial Times, 27th November, 2014). The debt had been contracted in the early 1980s by Mobutu, Themis Capital was not among the original creditors, it bought Congo's debt years later at huge discount on face value, but now debt must be repaid at full nominal value. Congo has an income per capita of 430 dollars, 71.3 per cent of the population is below the national poverty line and most of its people were not born when the debt was contracted.*

References

Backhouse R. E. and Boianovsky M. (2015). *Secular Stagnation: the History of a Macroeconomic Heresy*, Blanqui Lecture, European Society for the History of Economic Thought, Rome, 14 May.

Badhuri A. (1984) *The economics of backward agriculture*. London. The Macmillan Press Limited.

Baldwin R. and Teulings C. (2014), *Secular Stagnation: Facts, Causes, and Cures,* A Vox.org/CEPR eBook

Baran P. and Sweezy P. (1966). *Monopoly Capital.* New York: Monthly Review Press.

Blanchard O.J., Furceri D. And Pescatori A. (2014), *A prolonged period of low interest rates?*, in Baldwin R. and Teulings C. 2014.

Brown, M. (1992) *Adam Smith's Economics - Its Place in the Development of Economic Thought*, London, Routledge.

Caballero R.J. and Farhi E. (2014), *On the role of safe asset shortages in secular stagnation*, in Baldwin R. and Teulings C. 2014.

Dobb M.H. (1973). *Theories of value and distribution since Adam Smith*. Cambridge: Cambridge University Press.

Hirschman A.O. (1977). *The Passions And The Interests*. Princeton. Princeton University Press.

Kurz H.D. (2016). Adam Smith on markets, competition and violations of natural liberty. *Cambridge Journal of Economics*. 40: 615-638.

Larrère, C. (2014). Montesquieu et le doux commerce: un paradigme du libéralisme. *Cahiers d'histoire. Revue d'historie critique*, Vol. 123: 21-38.

Lewis, W.A. (1954) Economic Development with Unlimited Supplies of Labor. *The Manchester School of Economic and Social Studies*, 22:139-191.

Krugman P. (2014), *Four observations on secular stagnation,* in Baldwin R. and Teulings C. (2014).

Mallaby S. (2015), Short-sighted complaints about short-term capitalism, *The Financial Times* 5.8.2015.

Malthus, T.R. (1798). *An Essay on the Principle of Population as it affects the Future Improvement of Society, with Remarks on the Speculations of Mr. Godwin, Mr. Condorcet and other Writers*. London. J.Johnson. Reprinted in New York. Augustus M. Kelley, 1965.

Mandel E. (1987). Entry Marx K.H., in Eatwell J., Milgate M. and Newman P. editors, *The New Palgrave Dictionary of Economics*, vol. 3. London. The Macmillan Press Limited.

Marx K. (1859). *Contribution to the Critique of Political Economy*. London: Lawrence & Wishart, 1971.

Marx K. (1867). *Capital,* 3. Vols. London: Lawrence & Wishart, 1954, 1956, and 1959.

Marx K. (1905. *Theories of Surplus Value*. London: Lawrence & Wishart, in 3 Parts, Part 1 and Part 2 1969, Part 3 1972.

Macfie, A.L. (1967) *The Individual in Society - Papers on Adam Smith*, London: Allen and Unwin.

Meek, R.L. (1976). *Social Science and the Ignoble Savage*, Cambridge. Cambridge University Press.

Montesquieu, C.L. de Secondat (1748). *De l'esprit des lois*, 2 vols., Paris. Classique Garnier, 1949.

Mun T. (1623), *England's Treasure by Forraign Trade*, Thomas Clark, London, 1664, New York. Augustus M. Kelley Reprints.

Perrotta, C. (2014). Thomas Mun's England Treasure by Forraign Trade: the 17th Century Manifesto for Economic Development. *History of Economics Review*, n. 59: 93-106.

Raphael, D.D. and Macfie, A.L. (1976) *Introduction* to Smith (1759).

Ricardo D. (1815). *Essay on the Influence of a Low Price of Corn on the Profits of Stock* in Sraffa and Dobb 1951.

Ricardo D. (1817) *On the Principles of Political Economy and Taxatio*n in Sraffa and Dobb 1951.

Rey H. (2015), Interview in *Finance and Development* June, vol. 52 n.2, IMF, Washington D.C.

Rubin I.I.(1929), *A History of Economic Thought*, Ink Links, Ltd, London,1979, 1st Russian edition 1929.

Samuels, W.J. (1966) *The Classical Theory of Economic Policy*, Cleveland, World Publications.

Smith, A. (1763) *Early Draft of Part of the Wealth of Nations,* in *Lectures on Jurisprudence* , Meek R.L., Raphael D.D. and Stein P.G. editors, Oxford. Oxford University Press 1978.

Smith, A. (1776), *An Inquiry into the Nature and causes of the Wealth of Nations*, *WN*, edited by R.H. Campbell, A.S. Skinner and W.B. Todd, Oxford: Oxford University Press, 1976.

Smith (1759) *The Theory of Moral Sentiments*, *TMS*, edited by D.D. Raphael and A.L. Macfie, Oxford: Oxford University Press, 1976.

Solow, R. M. (1956). A Contribution to the Theory of Economic Growth, *Quarterly Journal of Economics*, 70: 65-94.

Solow R. (2011), in IMF, *Finance and Development*, June 2011.

Sraffa P and Dobb M.(1951). *The Works and Correspondence of David Ricardo*, edited by Piero Sraffa with the collaboration of Maurice Dobb, 11 vols., Cambridge. Cambridge University Press, 1951-73.

Sraffa P. (1951). *Introduction* to vol. 1 of Sraffa and Dobb (1951).

Sraffa P. (1960). *Production of Commodities by Means of Commodities*, Cambridge. Cambridge University Press.
Stathakis G. and Vaggi G. (2006) editors *Economic Development and Social Change-Historical roots and modern perspectives*. London and New York.Routledge,.
Stiglitz J., Sen, A. and Fitoussi J.P. (2008), *Report by the Commission on the Measurement of Economic Performance and Social Progress*, Paris, http://www.stiglitz-sen-fitoussi.fr/en/index.htm.
Sweezy, P. (1942). *The Theory of Capitalist Development*. New York: Monthly Review Press.
UN-SG (2014), *The road to dignity by 2030: ending poverty, transforming all lives and protecting the planet, Synthesis report of the Secretary-General on the post-2015 sustainable development agenda*, 4 December, New York.
UN (2015), *Transforming our world: the 2030 Agenda for Sustainable Development*, 25-27 September. New York.
UN –ECOSOC (2016), *Report of the Inter-Agency and expert Group on Sustainable Development Indicators.* UN Statistical Commission 47th session, 8-11 March.
Vaggi G. (1985). A Physiocratic Model of Relative Prices and Income Distribution, *The Economic Journal*, n.380, vol. 95, December.
Vaggi, G. (1996) 'Adam Smith and the Economic Policy of Laissez Faire', *History of Economic Ideas*, 1-2.
Vaggi G. and Groenewegen P.D. (2003). *A Concise History of Economic Thought – From Mercantilism to Monetarism*. Basingstoke. Palgrave Macmillan.
Vaggi G. (2004). The Social-Economic Man of Adam Smith-or the Macrofoundations of Microeconomics in History and Political Economy: *Essays in Honour of P.D. Groenewegen*, edited by Aspromourgos T., Kriesler P. and Lodewijks J. London, Routledge.
Wilson, T. (1976) 'Sympathy and Self-Interest', in *The Market and the State*, Oxford: Oxford University Press.
Winch D. (1996). *Riches and Poverty. An Intellectual History of Political Economy n Britain, 1750-1843*. Cambridge. Cambridge University Press.
Zanini, A. (1993) 'The individual and society. On the concept of "middle conformation in Adam Smith's Theory of Moral Sentiments', *History of Economic Ideas*, 2.

Endnotes

---

[i] Perhaps it is not by chance that some of the most careful development economists, most notably Hirschman and Sen, go back to the thinkers of Enlightenment in their works. Hirschman The Passions and the Interests, Political Arguments for Capitalism before its Triumph, 1977 Sen from On *Ethics and Economics* of 1987 till 2009 *The Idea of Justice*.

[ii] Mercantilist authors sometimes support different views, between 1621 and 1623 Edward Misselden and Gérard de Malynes debate on the role of trade and on the control of the exchange rate, see Perrotta 2014.

[iii] The first edition has been lost and we have the 1664 edition by his son John.

[iv] Mun believes that it could be convenient to send money abroad provided this in due time will generate more trade, including more imports which however will then be exported again(see Mun 1623, 15). Mun is also in favour of lowering the selling price, which seems to be a contradiction for a merchant, if this can increase the trade surplus.

[v] There is also a third class, the landowners (which include the King and the Church) who receive and spend their revenues.

[vi] Notwithstanding his admiration for Quesnay Smith will criticize the idea of the sterility of manufacture but he will also make use of the distinction between productive and unproductive sectors of the economy.

[vii] On the problem of prices in Physiocracy see Vaggi 1985.

[viii] Quesnay is not in favour of unlimited free trade, indeed he oppose the purchases of foreign manufactures.

[ix] See also Badhuri's 1984 for a description of agricultural backwardness in India.

[x] It is worth mentioning that between 1756 and 1763 Great Britain and France are fighting each other during the 'seven years' war.

[xi] Montesquieu tripartite division is an answer to the issue raised more than two centuries before by Niccolò Machiavelli and also discussed by Thomas Hobbes in 1651: how could a non-hierarchical society survive and may be even prosper without disintegrating? In the early eighteenth century Mandeville has his own answer.

[xii] Good governance is the topic of at least 7 targets and of 11 indicators of Goal number 16, the one about inclusive societies, peace and justice.

[xiii] For a detailed description of the four stages theory see Meek 1976.

[xiv] Edward Gibbons *The History of the Decline and Fall of the Roman Empire*, whose first volume appeared in 1776, will be considered a fundamental example of the attempt to understand the causes of decline of powerful nations.

[xv] Rousseau is also worth remembering for his 1762 book *Of the Social Contract, or Principles of Political Right*, in which he accepts Montesquieu's separation of powers but he tries to provide the foundations of a society in which the people has a major control on both the legislative and the executive power.

[xvi] More on this point in Stathakis G. and Vaggi G. (2006): 12-14.

[xvii] The material aspect of commodities, their use values are sometimes indicated by Smith with term riches(see Smith 1776, I.vii.1)

[xviii] Smith's definition reminds us of the modern definition of GDP according to the 'production approach' in which GDP is regarded as the sum of all added values. The big difference is that to Smith wages are part of the inputs while value added, which he calls revenue, is made up of profits and rents(see *ibid*. II.iii.4).

[xix] The issue of cheap food for the workers of manufacture will characterize English economic debates forty years later.

[xx] In a passage which strongly reminds of that of Petty Smith says that the differentiation of economic activities is possible when thanks to the improvements in the cultivation of land, the labour of half of the society becomes sufficient to provide food for the whole'(Smith 1776, I.xi.c).

[xxi] On the popular view of Smith see more in Vaggi 1996.

[xxii] A detailed description of the quest for a value theory in classical political economy is beyond the scope of this book, but see Sraffa 1951sections IV and V.

[xxiii] *c* can also include the amortization of fixed capital, machines, but we ignore this element here. Following Marx let us measure all magnitudes in terms of labour embodied, even if in volume 3 of *Capital* he relaxes this assumption and tries a different solution for the determination of relative process(see Marx 1867: 142-ff.).

[xxiv] On the various explanations for secular stagnation see Baldwin and Teulings, 2014. Backhouse and Boianovsky (2015) provide an history of the origin of the debate.

[xxv] Major explanations for the increase in savings are related to demographic reasons and to an increase in life expectancy combined with lower population growth rate, the so called "ageing society" (see Baldwin and Teulings, 2014: 11-12, 14).

[xxvi] Mercantilist policies do not necessarily imply state intervention. In many cases mercantilist authors asked the sovereign to refrain from regulating trade, for instance in the case of an old law prohibiting the export of money(see Mun 1623?: 34-36). These does not make them free traders; the real issue is that they were able to influence the state to adopt or not to adopt those policies and strategies which were more favourable to national merchants. The overall mercantilist period is more complicated than its traditional representations.

[xxvii] Short-termism is not just a feature of financial operators, but it seems to become a rather pervasive behaviour by corporate people and some people speak of short-term capitalism(see Mallaby 2015).

[xxviii] According to Solow it is "time to rethink the way the credit mechanism mediates between savers and investors and puts credit to productive use"(Solow 2011: 51).

[xxix] The capital requirements imposed on banks contribute to keep the money away from consumption and investments. However these requirements are necessary because the volatility of international financial markets affects the prices of public bonds, a fact which weakens the structure of banks' accounts and requires higher capital ratios. Thus more money is available but it cannot be used either for consumption or for investments precisely because of the size of international financial markets and the way in which they work.

[xxx] Gavin Jackson underlines the relationship between quantitative easing and in the intensity of volatility, "investors…must sell when prices fall and buy when prices rise, which adds to any market movement"(*Financial Times*, 15, October 2015).