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Commodities in Economics: Loving or Hating Complexity

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Abstract

A review of economic thought since the sixteenth century reveals two streams of economic discourse, dirigisme and laissez-faire. Starting with the mercantilists, dirigiste approaches to economics embrace the real-world complexity of commodities that often differ greatly in attributes that are growth- and rent-augmenting. Most importantly, this means that free trade is likely to be polarising: it concentrates growth- and rent-augmenting commodities in countries that already enjoy a head start in these commodities. Advanced countries, therefore, support laissez-faire, while lagging countries tend to support dirigisme. In order to rationalise their laissez-faire stance, advanced countries began developing a new economic discourse that strips commodities of their complexity. The foundations for this ideological reconstruction of economics were first laid by Adam Smith; this process eventually reached its climax with the neoclassical economists who stripped commodities down to one attribute: their capital intensity. In opposition to this laissez-faire economics, other writers, supportive of the interests of lagging countries, brought complexity back into their economic discourse; they argued that lagging countries had a fighting chance of catching up to advanced economies only by indigenising a growing array of growth- and rent-augmenting commodities.

Keywords: commodities, complexity, mercantilism, Physiocracy, classical, neoclassical

Introduction

> "Some tender money to me; some invite me;
> Some other give me thanks for kindnesses;
> Some offer me commodities to buy..." (Shakespeare)[1]

How have different schools of economic thought over the past five centuries dealt with the complexity of real-world goods and services that are exchanged on markets: commodities for short?[2]

Commodities in the real world are complex. They possess multiple attributes – in production, consumption and tradability – that often vary across different commodities and classes of commodities. It may be expected, therefore, that the behaviour of markets will differ depending on the attributes of commodities that are traded on them. Consequently, there have emerged within economics several specialties that study markets in particular classes of commodities, such as agricultural economics, labour economics, financial economics, real estate economics and transportation economics. However, these specialties will not concern us here.

[1] *Comedy of Errors*, IV. iii. 6.
[2] Commodities include all goods and services that are produced for sale and profit.

Instead, we will examine the manner in which various writers on the economy have, over the past half a millennium, incorporated commodities into their discourse when dealing with two overarching questions that are central to determining the government's policy stance on the economy. First, what are the conditions under which all markets, individually and simultaneously, attain unique and stable equilibria that also correspond to an efficient allocation of resources? Secondly, do the patterns of specialisation resulting from the free operation of markets affect an economy's growth rate, income distribution, state formation, military power, the aptitudes of its population, its legal institutions, and levels of civilisation more generally?

Although this paper sets itself tasks that appear too ambitious for an essay, they are in fact quite tractable once we recognise a fundamental dichotomy in much of the economic discourse since the 16th century. One set of economic theories embraces the real-world heterogeneity of commodities, while a second set of theories proceeds to homogenise them by stripping them of their real-world complexity. This dichotomy paves the way for exploring several questions of fundamental importance to understanding the economic thought, policies and history of the past five centuries. What are the economic, political, military and institutional consequences of these two divergent approaches to the economy? What are the imperatives that motivate them; and what are the writers and countries that support them? We explore these and other questions.

1. Commodities, Divergence and Dirigisme

> "*Owing to increasing returns in processing activities (in manufactures) success breeds further success and failure begets more failure*" (Kaldor, 1981, p. 331).

It may help to preface our discussion with an intuitive look at some implications of commodity attributes for growth and economic policies.[3]

Consider two polar situations. In the first case, all commodities are identical in their growth- and rent-augmenting effects (GREs), say, because they are characterised by constant returns to scale and the absence of external economies. In the event, the patterns of specialisation – determined under free trade – will have no consequences for growth. It is immaterial for a country's growth prospects whether it specialises in raw cotton or designer clothes. In fact, any attempts to change this specialisation – the result of market forces alone – will be counterproductive since this will cause efficiency losses that will both lower incomes and direct investments into the 'wrong' channels.

In the second case, consider economies that produce a range of goods with *rising* GREs: C1, C2, C3, C4, C5, C6.[4] The growth prospects are likely to be higher in Country A that specialises in C4, C5 and C6 compared to Country B that specialises in C1, C2 and C3. Further, growth and rising exports in Country A may deepen its existing comparative advantage in C4, C5 and C6, making it harder for Country B to catch up. It may even be the case that Country A – because of its richer endowment of knowledge, skills, and technology spillovers from existing industries – may succeed in producing C3 at lower cost than Country B. All this will tend to widen the development gap between countries A and B.

At this stage, what are Country B's chances of catching up to Country A? At some

[3] In the interests of simplicity, we exclude the variable effects of commodities on power, laws, institutions, attitudes, the sciences and the liberal arts.

[4] The GREs of a commodity depend on its economies of scale, external economies, use of skills (technical, managerial, marketing), opportunities for innovation and creativity, market power, and the demands it makes on physical and intellectual infrastructure.

point, as wages in the two countries diverge, declining relative wages in Country B may allow it to retain its comparative advantage in existing commodities, and possibly gain comparative advantage in C4. Alternatively, if Country B does not wish to wait forever to be rescued from growing divergence, it may begin to implement policies to reverse this divergence. Among other things, it may offer various combinations of time-sensitive production, export, research and educational subsidies to firms that venture into C4, and progressively extend these subsidies to C5 and C6; encourage skilled workers from country A to *emigrate* to country B; offer incentives to family-owned firms in Country A to relocate with their owners to Country B; engage in industrial espionage to transfer technology from Country A to Country B; encourage their own citizens to move to country A to acquire their more advanced skills and then lure them back with higher wages and/or appeals to patriotism.

Not to be naïve, these options may not be open to Country B. Even if it can muster the political will to move the economy upstream, this path may be blocked by more advanced countries. Almost certainly, Country A and others in the same camp will use their coercive and soft power – flowing from their wealth, diplomacy, control over global finance, media, and, ultimately a more powerful military – to block Country A's challenge to their comparative advantage in C4, C5 and C6. In the event, polarisation may become impossible to reverse.

2. Mercantilism

> "The power of industry is such that there is no silver mine or gold mine in New Spain and Peru that can be compared to it, and the duties on the commerce of Milan are worth more to the Catholic King than the mines of Zacatecas and Jalisco" (Botero, 1613[2012], p. 45).
>
> "[Manufacturing] is a mine more fruitful of gain, riches, and plenty, than those of Potosi" (Uztariz, 1724[1752][5]).

What do the writings of the mercantilists – starting in the late 16th century – reveal about their understanding of the nature of commodities?[6]

Influenced by classical Greece, the Renaissance writers recognised a fundamental distinction between Nature and Art and the relations between these two.[7] In the theories of Plato and Aristotle, the arts are classified under two criteria: the manner in which they imitate nature and their end uses. One set of arts cooperates with nature to "assist and perfect them;" examples of these are medicine, farming and education. A second set of arts, including architecture and carpentry, uses principles learned from nature to produce results not found in nature, such as houses and furniture. In addition, there are the arts that copy appearances of nature (the mimetic arts) and others that copy the principles of justice from nature (the speculative arts of philosophy and legislation) (Close, 1971, pp. 164, 170 and 174). Although this taxonomy contains the germs of a three-fold division of the economy into primary, secondary and tertiary sectors, the classical thinkers did not seem to be interested in the practical consequences of the arts for the economy or power.

[5] Quoted in Reinert and Reinert (2011, p. 8).
[6] Although we reject Adam Smith's characterisation of Mercantilism as a unified system of thought about the economy, we recognise significant similarities in the ideas and policies proposed by mercantilist writers. The contributors to Magnusson's (1993) edited volume on mercantilism also take this view.
[7] Nature consists of the four elemental forces – earth, air, water and fire – their powers of regeneration, and the principles that underlie change and motion in the cosmos. Art is human activity, man working with or upon nature to produce new configurations that meet human needs not directly fulfilled by Nature (Close, 1969, p. 467; and Close, 1971, pp. 163, 167).

In classical Greek thought, Art is inferior to Nature. The arts imitate nature for practical uses and entertainment, and work on material drawn from Nature; to the extent that they deviate from Nature, the arts of politics, ethics and law are 'unreal' or false (Close, 1971, p. 14). In the sixteenth century, however, some Western thinkers were already re-evaluating the significance of the arts under the influence of advances unfolding in the sciences, navigation, shipping, manufacturing and military technology. In 1605, Francis Bacon, in *The Advancement of Learning*, writes disapprovingly of the view that art is 'merely an assistant to nature, having the power to finish what nature has begun, to correct her when leaping into error…but by no means to change, transmute or fundamentally alter nature' (Margaret, 1986, pp. 8-9). More emphatically, he writes elsewhere that Art not only completes what nature begins, but also possesses the power to alter nature 'radically and shake it to its depths'. In the apt phrase of Sophie Weeks, 'infinite malleability is an essential feature' of matter. Already, some Renaissance thinkers were convinced that human ingenuity could endlessly shape and reshape the material it obtains via agriculture, forestry, fishery and mining (Weeks, 2007, p. 142).

Arguably, these insights into the powers of Art were inspired by growing contacts of the backward parts of Western Europe with the superior commerce, manufactures, shipping and military technology of the leading Italian cities, such as Venice, Milan and Florence. Well before the late sixteenth century, when this contrast between Art and Nature began to receive scholarly attention, practical men and statesmen in the backward parts of Europe understood that the Italian cities owed their wealth and power to their manufactures, commerce and shipping. The rise of the Hanseatic League – the alliance of traders from the ascendant centres of commerce in northern Germany – and, later, Holland, offered additional evidence of the power of commerce and manufactures to generate wealth.

Thus it is in backward England, starting in the late thirteenth century, that we observe the first tentative attempts at using the powers of the government in support of domestic traders and manufactures.[8] These interventions in support of British commerce began on a small scale with Edward I (1272-1307), who lowered the duty for English traders in the import trade; they were "significantly extended" by Edward III (1333-1360), and 'systematised' by Richard II (1377-1399) who sought to break the commercial monopoly of the Hanseatic League (Hunt, 2003, pp. 31-32). Although these policies were not always effective, Edward I, together with other mercantilist measures, expelled several foreign enterprises from England; Edward III encouraged the growth of an indigenous woollen industry by supporting immigration of Flemish weavers to Norfolk, banning the export of raw wool, and demanding that Englishmen wear cloth woven in England (Cunningham, 1889, pp. 201-2). He also introduced clock-making and linen-weaving to England by supporting the immigration of foreign artisans (Curtiss, 1912, p. 46). Moreover, the mercantilist legislation of Richard II was not 'merely haphazard'. Successive petitions to Parliament and the report of a Royal Commission on trade demonstrate that the merchants of the day were clear that 'they were laying the foundations of the famous mercantile system'. His successive parliaments adopted the three principal planks of later mercantilists: favouring natives and discriminating against foreigners, a policy favouring English shipping, and bullionist measures. Under pressure from English traders, Richard II ended the privileges enjoyed by Hanse traders in England and, at the same time, forced the League to admit the principle of reciprocity in its dealings with English merchants (Cunningham, 1889, p. 215; Palais, 1959, pp. 852-65).

It was clear to the earliest mercantilists that the Italian cities and the Dutch Republic owed their wealth and power not to Nature – they had few natural advantages other than their

[8] At this time, England specialised in the production and export of primary goods, foreign traders managed nearly all of its foreign trade and even some of its domestic trade, and Englishmen owned few ships.

location – but to the advanced state of their arts.[9] Implicitly, if not explicitly, the mercantilists placed all economic activities into three categories, anticipating the three-fold taxonomy of A. G. B. Fisher and Colin Clark, viz. primary, secondary and service sectors (Kenessey, 1987, p. 361). In *England's Treasure by Foreign Trade*, Thomas Mun (1664[1903], pp. 9, 98, 102-103) divides the economy into two sectors, Natural and Artificial. The Natural consists of the products of agriculture and the extractive sectors; they include, "Fleece wools, iron, lead, tynn, saffron, corn, victuals, hides and wax and other natural Endowments." In turn, the Artificial breaks down into "manufactures and industrious trading with forraign commodities…" We have here the distinction between manufactures and one class of services – shipping, insurance, buying, packaging, warehousing, selling, lending, and long-term investments associated with foreign trade – that the mercantilists valued greatly. Mun attributes Netherlands' prosperity to its foreign commerce and control of fisheries in the North Sea.

The mercantilist literature contains another taxonomy of economic activities based on the contributions they make to social wealth, where wealth consists of the use-value created by different activities (Perrotta, 2004, Ch. 9). Some writers classified the different occupations as productive or unproductive; others placed them under three headings, directly productive, indirectly productive, and unproductive. The distinction between productive and unproductive activities depended on three criteria: whether they produced physical goods or services, whether these goods were durable or perishable, and whether they served essential needs or were luxuries. Some services that supported the production of physical goods were seen as indirectly productive.

In order to augment domestic productive activity through international trade, the mercantilists examined the 'productive potential' of exports and imports, that is, their ability to serve as sites of productive activity (Perrotta, 2004, Ch. 10). Raw materials possess the greatest productive potential but this is exhausted as they undergo processing into finished goods. If the object of a country's trade policy is to expand domestic value-added in different lines of production, it should import goods that have the greatest productive potential, and export goods that have fully exhausted their productive potential. This would allow it to capture the greatest amount of value-adding productive activity in manufactures, transportation, shipping, storage, and commerce.

The mercantilists also ranked the contributions the different arts made to production, exports, employment, military power, people's aptitudes and the arts of civilization. Manufacturing was always superior to agriculture, and trade stood above manufacturing.[10] 'There is much more to be gained by *Manufacture* than *Husbandry*;' wrote William Petty (1691[1899], p. 256), and 'by *Merchandise* than *Manufacture*….' Since the early seventeenth century, writes Sophus Reinart, mercantilists have maintained that 'there was something *revolutionary* about the manufacturing process, and that one should specialize in competitively importing raw materials and exporting finished goods' (emphasis added) (Serra, 1613[2011], p.3). It is worth noting that the advantages of manufacturing – and policies in support of manufacturing – were already commonplace during the fourteenth century in the Italian, German, Flemish and Dutch city states. 'In the majority of cases,' writes Carlo Cipolla (1963, p. 413), 'there was a conscious effort to industrialise. At the beginning of the fourteenth century the conviction was widespread that industry spelled welfare. In a Tuscan statute of 1336,

[9] Writing in 1565, John Hales (1581), an English cleric and theologian, recognised that the prosperity of Venice was owing to her export of manufactures (Reinert, 2003, p. 3). Similarly, Thomas Mun (1664[1903], p. 13) wrote, in 1621 (published in 1664), about how foreign trade had been the 'chief means' of raising Venice, Genoa and Holland to prosperity. Geoffrey Cymcox, the editor and translator of Giovanni Botero (1613[2012], p. xxxiii), thus describes Botero's thinking on the greatness of cities: 'A city that is a center of manufacturing and is endowed with an industrious population will be great and prosperous, as the cities of Flanders and northern Italy amply demonstrate.'

[10] According to the mercantilists, Lars Herlitz (1993, pp. 92-93) writes, 'the labor of crafts and manufacturing was more productive, or at least capable of becoming more productive, than that of agriculture.'

statements may be read which might have been written by the most modern upholders of industrialisation in the twentieth century.'[11]

The superior dynamism of manufacturing stems from its inherently greater scope for product innovation, its ability to endlessly shape, reshape, combine and recombine the products of nature. In 1588, the Italian writer, Giovanni Botero (1613[2012], p. 43), wrote that manufacturing surpasses the primary sector in contributing value-added because 'the things made by skilled human hands are far more numerous and costly than those produced by nature, for nature furnishes the material and the subject, but human skill and cleverness impart to them their inexpressible variety of forms.' He then proceeds to offer several examples of how manufactures transform crude materials – wool, silk and marble – into 'manifold and varied' artificial objects (Keller, 2012, p. 7). Similarly, Thomas Mun (1664[1903], p. 17) writes, '…we know that our natural wares do not yield us so much profit [value-added] as our industry.' He also offers a list of the products that are shaped from one primary product, iron ore. After the ore is 'digged, tried, transported, bought, sold,' it is 'cast into Ordnance, Muskets, and many other instruments of war for offence and defence, wrought into Anchors, bolts, spikes, nayles and the like, for the use of Ships, Houses, Carts, Coaches, Ploughs, and other instruments for Tillage.'[12]

Several mercantilists were aware of increasing returns in manufacturing and commerce due to the greater scope they afforded to division of labour. William Petty offers examples of division of labour in textiles, ship-building, trade by sea, and watch-making; Henry Martyn points to division of labour in ship-building, textiles and watch-making; Ernst Ludwig Carl saw this principle at work in all the trades (Sun, 2012, pp. 40-46). However, Antonio Serra (1613, p. 121), an Italian writer of the early seventeenth century, offers the clearest statement of increasing returns in manufacturing. In manufacturing, he writes, 'it is possible to achieve a multiplication of products, and therefore of earnings. The same cannot be done with agricultural produce, which is not subject to multiplication. If a given piece of land is only large enough to sow a hundred *tomoli* of wheat, it is impossible to sow a hundred and fifty there. In manufacturing, by contrast, production can be multiplied not merely twofold but a hundredfold, and *at a proportionately lower cost*' (emphasis added). An Italian philosopher of the eighteenth century, Ferdinando Galiani, sums up Antonio Serra's insight in a few words: 'Manufactures increase with the number of arms you put in, while agriculture decreases' (Serra, 1613[2011], p. 5).

One of the earliest statements of the principle of cumulative causation may also be found in Serra (1613[2011], p. 127). Venice owes its prosperity, he writes, to 'a combination of two accidents, each of which lends force to the other.' The two accidents are the multiplicity of its manufactures and its extensive trade with other parts of Italy as well as with Asia and the rest of Europe. The number of people attracted to Venice by 'its extensive trade and its geographical location is increased still further by the number of businesses, and the number of businesses is increased by the extensive trade, which is itself increased by the number of people who come to the city.' This succinct statement of cumulative feedbacks between the 'number of businesses' and trade carries us beyond Adam Smith's (1776[1937], p. 17) statement that the 'division of labor is limited by the extent of the market.' It explicitly spells out connections that remain implicit in Adam Smith.

Manufacturing enjoys several additional advantages over agriculture, according to Serra (1613[2011], p. 121). Unlike agriculture, it is not hostage to the weather; its products are more storable and, hence, easier to export to distant places. Manufactures also 'yield much higher earnings than agricultural produce.' 'This can be seen,' he writes, 'especially in the

[11] Quoted in Issawi (1996, p. 239).

[12] In agriculture too, cross-breeding and culling are capable of producing new varieties of plants but, until quite recently, these processes were very slow compared to the fabrication of new products in the different branches of manufacturing.

production of woollens, especially the finer fabrics, in the production of linen, silk, weapons, paintings, sculptures, books, and all the medicinal drugs, *as well as an infinity of other things'* (emphasis added). The variety of products in manufacturing also insures it against shifts in demand: declining demand in some activities is likely to be offset by increases in others.

Some mercantilist writers have also examined the contrary effects which natural and artificial wealth produce on the character of a people and on civilisation in general. Thus Mun (1664[1903], pp. 98-99, 112) argues that since the wealth produced in agriculture is 'always ready and certain, so doth it make the people careless, proud, and given to all excesses…' Although England's rich soil produces plenty, it also 'makes us a people not only *vicious* and *excessive,* wasteful of the means we have, but also improvident and careless of much other wealth that shamelessly we lose [such as in fishing]…whilest in the mean time (through lewd idleness) great multitudes of our people cheat, roar, rob, hang, beg, cant, pine and perish…' On the other hand, manufactures and commerce 'enforceth Vigilancy, Literature, Arts and Policy'.

Mercantilists were motivated not only by wealth-creation for its own sake, but also by the forms of wealth they sought, and their wealth-creation policies also advanced the power of the state (Fontanel et al., 2008). We know that their quest for gold was no fetish: as generalised purchasing power, gold could pay for mercenaries, ships and other provisions of war, especially when these expenses were incurred overseas or wars had to be fought at short notice. 'In war,' writes Fernand Braudel (1992, p. 547) while discussing mercantilist policies in early modern Europe, 'gold or silver coins were as indispensable as bread'. The growth of manufacturing and commerce could enhance state power through three other channels. To the degree that they stimulated economic growth, they expanded the country's tax base and, therefore, the state's capacity to secure advantages for its own nationals through military power. A large and diverse manufacturing sector could supply most of the state's needs for arms, munitions, and clothing. Finally, a country's fleet of trading ships (already armed) could be easily diverted to fighting wars.

3. Physiocracy

'The earth is the mother of all our goods' (Quesnay, 1759[1970], p. 13).[13]

Although no country had pursued mercantilist policies longer or more assiduously than Britain, the first theoretical reaction to it was elaborated by a French school of economics, Physiocracy, that was influential in France over two brief periods, 1763-70 and 1774-76.

In opposition to the dirigisme of mercantilists that promoted manufactures and commerce, the Physiocrats supported laissez-faire and regarded agriculture as the only productive sector in the economy. In contrast to the mercantilist framework of complex commodities – with variable consequences for growth, state power, and civilisational arts – the Physiocrats took a streamlined view of the economy that consisted of two sectors, agriculture and non-agriculture, which differed in only one significant respect. Agriculture alone is 'productive' since it produces a surplus over and above the costs of labour and capital employed in this sector. Artisans and traders are 'sterile' since they merely reproduce what they consume.

Agriculture is to the economy, the Physiocrats claimed, as the heart is to the circulatory system. The surplus generated in agriculture is the return to land that only enters agricultural production. Hence, this surplus accrues to the landlords or proprietors. Artisans and traders are supported by a part of this surplus, viz. the food and raw materials they acquire from farmers in

[13] Quoted in Moore (2013, p. 677).

exchange for their manufactures and services. In other words, all the three classes of society – the farmers who rent land from its owners for cultivation, the artisans (including traders), and the proprietors – are supported by agriculture. Agriculture is the engine of the economy.

The twin policy pillars of the Physiocratic policy – a single tax on land and laissez-faire – flow directly from their characterisation of commodities.[14] The landlords paid the single land tax since they received all of the surplus produced in agriculture; as a 'sterile' class, any taxes imposed on artisans and traders would be transferred to the landlords. A single tax also had the merit of greatly simplifying the tax system and, therefore, reducing the cost of administering taxes. The Physiocrats also expected that laissez-faire would increase agricultural incomes. The removal of internal barriers to trade would create a single national market for agriculture: and this would increase agricultural production by concentrating production in regions with the lowest costs. At the same time, the rising price of corn under free trade would encourage farmers to utilise their lands more efficiently. Laissez-faire would also incentivise proprietors to increase investments in a variety of land improvements, and thereby increase the agricultural surplus.

The advocacy of laissez-faire by the Physiocrats may be seen as a pushback by the landowning elites against the mercantilist policies that had dominated France during the reign of Louis XIV.[15] According to Norman Ware (1931, p. 618), Physiocracy accommodated the 'special needs of a new landowning class…The problem of these new landowners was to rid themselves of the innumerable taxes of the *ancien regime* which fell of necessity upon the land and made profitable farming impossible. Thus the single fixed tax on the net product of the land and freedom of trade in grain were their basic economic reforms.' It was also part of a larger movement in the social and natural sciences which sought inspiration from the order and harmony in nature (Spiegel, 1983, p. 185).

The Physiocrats' redefinition of commodities offers an early and transparent example of how economic theory serves the interests of powerful classes. In order to privilege the new capitalist land-owners, they identified agriculture as the only sector that produces a surplus. They ignored the rent earned by manufacturing and commercial enterprises due to market power – conferred by innovations or increasing returns to scale – and their proximity to markets, raw materials, and waterways. Finally, if agriculture earns a surplus because of fixed land, this also subjects labour in this sector – as Ann-Robert-Jacques Turgot pointed out – to diminishing returns; while manufacturing and commerce are more likely to enjoy increasing returns to scale because of their greater scope for division of labour.

4. Classical Economics

> 'It is a very common clever device that when anyone has attained the summit of greatness, he *kicks away the ladder* by which he has climbed up, in order to deprive others of the means of climbing up after him. In this lies the secret of the cosmopolitical doctrine of Adam Smith...' (List, 1827[1909], pp. 295–6).

Although classical economists retained elements of complexity in their discussions of economic growth, they took the opposite approach when making the case for laissez-faire and free trade. Quite simply, their ideological quest was not compatible with complex commodities.

[14] The Physiocrats did not account for the presence of increasing returns to scale in manufacturing and commerce, or suggest that these activities generated external economies.
[15] Mark Blaug (1985, p. 24) writes, 'Physiocracy, as Adam Smith suggested, should be understood as a reaction to the mercantilist policies of Colbert during the reign of Louis XIV.'

Several of the leading classical economists embraced the distinction – common in mercantilist writings – between 'productive' and 'unproductive' activities. The former produced value that was fixed in tangible goods and hence could be stored; the latter produced intangible services that could not be stored or traded at a distance. This is not an empty distinction. Unproductive labour cannot be used to mobilise labour in the future: it does not fix itself in tangible goods. Hence, Adam Smith concludes correctly that the standard of living in any economy will depend on 'the proportion between the number of those who are employed in useful labour, and that of those who are not so employed' (Smith, 1776, pp. 314-15, lviii). Despite criticism from some quarters, Blaug (1985, p. 55) writes, 'Smith's distinction was retained by all the leading classical economists… and it was handed down in the end to Marx to become the basis of the present-day Soviet national income accounting.'

The classical economists also built their theories of the macro economy and income distribution on a structural distinction between agriculture and manufacturing. Production in agriculture used both labour and land; and since land was assumed fixed, this produced a tendency towards diminishing returns in agriculture.[16] On the other hand, production in manufacturing depends only on labour: hence, this sector is not subject to diminishing returns.[17] This division of the economy into two sectors with different production characteristics – together with a population that rises and falls as wages rise above or fall below the subsistence level – defines an economy that always returns to equilibrium at subsistence wages. As wages rise or fall in response to external shocks, the population adjusts to restore the economy to a new equilibrium at the subsistence wage (Clark, 2007, Chapter 1).

Adam Smith made much of another distinction between manufacturing and agriculture, the first supported a more extensive division of labour.[18] This distinction was vital to Adam Smith's theory of economic growth: since division of labour is the chief source of productivity gains in the economy.[19] Within manufacturing too, the division of labour differs from one branch to another. 'There are perhaps no manufactures,' writes Adam Smith (1776[1937], p. 243), 'in which the division of labor can be carried further, or in which the machinery employed admits of a greater variety of improvements, than those of which the materials are the coarser metals [iron and steel].' His description of the extensive division of labour in a pin factory nicely illustrates this.

This asymmetry between manufactures and primary production raised intractable problems for the classical theory of trade. Countries that enter world markets with advantages in manufacturing will deepen these advantages. Further, because of external economies produced by expanding manufactures, these countries will extend these advantages to other related lines of manufacturing even in the face of rising wages.[20] In the long run, therefore, free trade will concentrate manufactures in a few countries – conceivably in one country – while all other

[16] With the exception of Antonio Serra, mercantilist writers did not explicitly recognise diminishing returns in agriculture, but their emphasis on manufacturing, export of manufactures, and acquisition of colonies – as sources of raw materials and outlets for a growing population – appears to be based implicitly on the diminishing capacity of agriculture to support a growing population. The export of manufactures could feed a growing population by paying for imports of food and raw materials (Spengler, 1988, p. 6).

[17] The inclusion of capital in manufacturing did not affect this result. Since equipment used by workers still formed a small part of the costs of production, this could be readily expanded to equip each new worker in manufacturing. This ensured fixed returns to a labourer equipped with the tools of his trade.

[18] John Stuart Mill (1885, pp. 124, 557) makes the same point. 'The division of labor is also limited, in many cases,' he writes, 'by the nature of employment. Agriculture, for example, is not susceptible of so great a division of occupations as many branches of manufactures, because its different operations cannot possibly be simultaneous.' He adds that this asymmetry also exists between other extractive industries and manufacturing.

[19] Adam Smith opens chapter 1, Book One, of his classic with a succinct statement connecting productivity of labour to division of labour: 'The greatest improvements in the productive powers of labor, and the greater part of the skill, dexterity, and judgment, with which it is anywhere directed, or applied, seem to have been the effects of the division of labor.'

[20] This flows from two observations: (a) a positive feedback between increasing returns and size of markets, and (b) a stronger tendency towards increasing returns in manufactures than in primary production. For a fuller discussion of this issue, see Alam (2000, pp. 51-52).

countries specialise in primary goods. Adam Smith's dynamic theory of trade did not make a universal case for free trade. On the contrary, it made the case for lagging countries to protect their manufactures until they too could share in the dynamic gains from the expansion of manufactures.

Adam Smith's theoretical case for free trade faced another embarrassment: it was contradicted by historical evidence, indeed by the historical evidence presented by Adam Smith himself. If a country's economic prospects are best advanced by a policy of free trade, how are we to explain Britain's rise to economic eminence (Alam, 2000, pp. 52-53; Chang, 2003, pp. 19-24)? Adam Smith (1776, p. 393) pointedly acknowledges that since the mid-16th century, England had led Europe in its devotion to mercantilist policies. He writes that since 'the beginning of the reign of Elizabeth… the English legislature has been peculiarly attentive to the interests of commerce and manufactures, and in reality there is no country in Europe, Holland itself not excepted, of which the law is, upon the whole, more favourable to this sort of industry. Commerce and manufactures have *accordingly* been continuously advancing during all this period' (italics added). Elsewhere, he maintains that 'manufactures and commerce together, have given birth to the *principal improvements* in agriculture' (italics added) (Smith, 1776, p. 360). Instead of making the case *for* free trade, familiarity with Britain's rise to economic preeminence would persuade lagging countries to imitate her success by protecting their manufactures and commerce. In order to discourage the rest of the world from following her example, Britain needed a universal theory of free trade, one that argued that free trade was advantageous for *all* countries. In the early nineteenth century, two British economists, Robert Torrens and David Ricardo, answered this call.

David Ricardo steered away from the complexities that had frustrated Adam Smith's attempt at formulating a theory of universal free trade. In his famous numerical example, England and Portugal produce wine and cloth with constant unit labour costs (Blaug, 1985, p. 123).[21] In other words, chapter eight of his *Principles of Political Economy* proceeds by stripping commodities of all but one of their attributes, viz. their different labour costs. Labour is also immobile between countries. It did not matter that David Ricardo's theory of growth and distribution was built on diminishing returns to labour in agriculture, so that the unit labour cost of wine would rise with output. Wine and cloth – proxies for agriculture and manufacturing – now became nearly homogenous activities; they required only labour for their production under conditions of constant returns to scale. Commodities in the Ricardian world are completely defined by a single number: their fixed labour costs.

This redefinition of commodities – produced under conditions of constant labour costs – allowed Ricardo to exclude time from his framework. In addition, since labour could not move between countries, he could now examine a one-off impact of the *opening* of trade on the allocation of labour *within* each country. Under these conditions, later economists concluded that trade would produce complete specialisation in each country: it would also improve each country's welfare. Quite conveniently, then, through an extreme evisceration of commodities, David Ricardo had avoided dealing with all the big questions regarding the impact of trade on division of labour, technology, costs, tastes, income distribution, savings, capital formation, class conflicts, national sovereignty and population growth. On this daring disappearing act was founded perhaps the most venerable – but tautologically true – result in the entire canon of economics, viz., the theory of comparative advantage.

It should be noted that the assumption of constant costs had already been introduced into the theory of markets by Adam Smith. 'If we look carefully at Smith's examples of price determination,' wrote Blaug (1985, p. 41), 'we notice that he always assumes implicitly that the

[21] Most economists accept this reading of the numerical example David Ricardo (1817[1996], pp. 94-95) employs to develop his theory of trade. Among others, Roy Ruffin (2002) has contested this interpretation.

'natural price' of a commodity does not vary with its rate of output. In other words, he assumes that the industry in question produces under conditions of constant costs…; cost per unit remains constant regardless of the level of output.' Did Adam Smith begin the practice of *choosing* the assumptions to produce the *right* results?

5. **Neoclassical Economics**

> 'Too large a proportion of recent 'mathematical' economics are mere concoctions, as imprecise as the initial assumptions they rest on, which allow the author to lose sight of the complexities and interdependencies of the real world in a maze of pretentious and unhelpful symbols' (Keynes, 1936, pp. 272*)*

Initiated by the Physiocrats, the evisceration of commodities underpins Adam Smith's theory of natural prices and becomes explicit in David Ricardo's universal theory of free trade. It was finally carried to its logical conclusion in the 1950s with the formalisation of the competitive paradigm by Kenneth Arrow and Gerard Debreu (1954) and others.

In the late nineteenth century, the marginalists set the stage for the formalisation of the competitive paradigm by focusing on the purely allocative functions of markets. Thus, for Stanley Jevons, the task of economists was to determine – in the presence of a fixed labour force and given tastes and technology – 'the mode of employing their labor which will maximise the utility of the produce' (Blaug, 1985, p. 295). Once this static framing of the marginalists' enterprise was accepted, determining the conditions under which markets simultaneously attain a unique and stable equilibrium became the Holy Grail of neoclassical economics. Increasing returns activities were excluded since this would greatly complicate this quest.[22] Only the assumption of constant returns to scale offered the chance (though not the certainty) of ruling out multiple equilibria.[23] The imperative of constant returns to scale also led to the disappearance of land from the neoclassical account of production. The differences between any two goods could now be reduced to one dimension: the ratio in which they combined capital and labour. Capital was also taken to be fully malleable, so that machinery and buildings from a declining textile industry could be converted into blast furnaces for use in an expanding steel industry.

Constant returns to scale was a vital element of the competitive paradigm that was used to justify inequalities arising from non-property incomes. It was not too difficult to show that competitive firms eager to maximise profits paid wages equal to the marginal product of labour. Certainly, this result depended on the assumption – rarely satisfied – of perfectly smooth substitutability between labour and capital in production; but such difficulties have never stopped neoclassical economists from introducing clever assumptions as long as they produced the desired results. Phillip Wicksteed placed the marginal productivity theory of factor prices on a pedestal when he showed that under the assumption of constant returns to scale, payments to factors fully exhaust the total product. There could now be no turning away from constant returns to scale: it became an indispensable ingredient in the theoretical armour of neoclassical

[22] Some of these difficulties are stated succinctly by Geoffrey Heal (1998: abstract). 'Recognizing increasing returns,' he writes, 'affects the possibility of market equilibrium, can introduce sticky prices, causes economies to lock-in to inefficient technologies and introduce path-dependence, affects the possibility of continuing growth, produces problems for regulators, and changes our conception of the effects of international trade. All in all, increasing returns can change quite radically our view of how the economy operates.'

[23] Alam (2013) has shown that the market equilibrium described by the competitive paradigm is inconsistent with constant returns to scale.

economists.[24]

Two Swedish economists, Eli Hecksher (1919[1950]) and Bertil Ohlin (1933[1950]), used this framework to reformulate Ricardo's theory of comparative advantage. They would explain comparative advantage in terms of differences between countries in their factor endowments, although they had a more capacious understanding of factors of production than the neoclassical economists. In the early post-war years, Paul Samuelson (1948, 1949) incorporated the factor-endowment theory of trade into an explicitly neoclassical framework that only allowed for two factors of production, capital and labour; he also assumed that production technology was a public good that was equally available to all countries in the world. Within this formal neoclassical framework, free trade among countries produced an extraordinary result: it equalised wages and the return to capital across all countries no matter how far apart their wages and capital returns were before trade. This was the ultimate defence of free trade. It did not matter whether a country exported computer chips or potato chips; free trade would produce convergence of wages and returns to capital across all countries. Once stripped of all but one of their differences, commodities can be used to support magical results.

6. **Challenging Laissez-faire Economics**

Opposition to laissez-faire has come from lagging countries eager to develop indigenous capacity in manufactures, construction, finance, commerce, shipping, education and research and development.

In the interest of economy, much of our discussion will focus on the arguments of two writers, Alexander Hamilton (1791[1913]) and Friedrich List (1827[1909]), who advanced the protectionist cause in the United States.[25] Although List was a German national, he developed his protectionist ideas while he was in the United States from 1825 to 1830. The articles he published in support of protectionist policies – during his stay in the United States – were published as *Outlines of American Political Economy*. Hamilton and List argued that an economy that combines manufactures with agriculture would produce greater prosperity than one which specialises in agriculture. While they were interested in promoting a better utilisation of existing resources, their chief interest lay in emphasising the superior contributions that manufacturing makes to the development of a country's productive powers. In other words, while Smith and Ricardo had homogenised commodities, these writers took a leaf from the mercantilists and insisted on demonstrating the multifarious differences between manufacturing and agriculture.

Hamilton's (1791, pp. 11-17) *Report on Manufactures* built its case for protection primarily around the greater scope for division of labour in manufacturing. Adam Smith recognised three sources of productivity gains from division of labour, viz. improvements in skills, mechanisation, and savings in time; to this list, Hamilton added several more. The diverse talents of a population are more likely to find their best uses in manufacturing with the variety of demands it makes on knowledge, skills and aptitudes. For the same reason, manufacturing is more likely to offer jobs that match the capacities of women, children, and workers faced with a temporary slack in their regular work. With artificial lighting it allows work to be carried on at night; and, protected from the elements, it allows work to occur year-round. Manufacturing also benefits agriculture by creating more stable markets for its products and, as new manufactures

[24] For an excellent review of the place of constant returns to scale in the thinking of the leading classical and neoclassical economists, see John Hicks (1989).

[25] According to one source only six of the fifteen leading American economists during the half century from 1820 to 1870 threw their weight behind the promotion of manufactures (Fetter, 1943, p. 53). Although outnumbered, the protectionist writers carried the day.

are introduced, it creates demand for new agricultural products. On the whole, Hamilton's *Report* presents a more comprehensive account of the advantages of manufacturing than Adam Smith's *Wealth of Nations*.

List carries Hamilton's analysis of the advantage of manufacturing to a deeper level. He focuses his discussion on the 'productive powers' of an economy or its 'powers of producing wealth'. He breaks down a country's productive powers into three components: its natural, material and mental capital. Natural capital is the equivalent of 'land' in the writings of classical economists; material capital consists of machines, inventory and raw materials; and mental capital is a comprehensive category that includes human, scientific, cultural, social, institutional and political capital. It is mental capital that possesses the greatest potential to propel an economy forward on all fronts. List also emphasises the positive feedbacks that operate among the three forms of capital in different economic activities.[26]

In List's system, the superiority of manufacturing over agriculture and commerce derives from its greater ability to generate mental capital. The classical economists did not comprehend 'how greatly the nature of the agricultural productive power differs from the nature of the manufacturing productive power' (List, 1841, p. 148). List was determined to rectify this fundamental error in classical economics in a most exhaustive manner; he devotes nine of the seventeen theoretical chapters in his book to discussions of the powers of manufacturing to stimulate progressive changes in every department of society and economy. 'Manufactories and manufactures,' he writes, 'are the mothers *and children* of municipal liberty, of intelligence, of the arts and sciences, of internal and external commerce, of navigation and improvements in transport, of civilisation and political power. They are the chief means of liberating agriculture from its chains, and of elevating it to a commercial character and to a degree of art and science, by which the rents, farming profits, and wages are increased and greater value is given to landed property.' On the contrary, agriculture holds back a country's economic development. In a condition of 'merely agricultural industry, caprice and slavery, superstition and ignorance, want of means of culture, of trade, of transport, poverty and political weakness exist' (List, 1841, pp. 141-142).

In the 1930s, two economic historians unintentionally challenged the world-view of eviscerated commodities. David Ricardo had reduced differences between commodities to their labour coefficients; and neoclassical economists had narrowed this down to capital-labour ratios. A.G.B. Fisher and Colin Clark marshalled statistical data to present a very different view of economic activities. They divided the economy into three rather well-defined sectors – primary, secondary and tertiary – whose output and employment shares in the economy followed rather different trajectories in countries that had experienced sustained growth in per capita incomes. These different trajectories in the shares of the three sectors could be explained primarily by different income elasticities of demand and growth rates of labour productivity in the three sectors. Although these explanations contradicted the assumptions of homogenised commodities, the neoclassical economists did not notice.

Some two decades after Fisher and Clark explored the implications of the different attributes of primary, secondary and tertiary activities for long-term changes in the structure of an economy, the neoclassical economists extended their paradigm into the new territory of growth economics. In the 1950s, Robert Solow (1956) and Trevor Swan (1956) developed theories of growth for an economy that produced one commodity under conditions of constant returns to scale. Their neoclassical growth theory predicted convergence in the levels of per capita income across all countries. It did not matter that the economic history of the past century

[26] 'The augmentation,' writes List (1827[1909]): 228), 'of the national material capital is dependent on the augmentation of the national mental capital, and *vice versa*.' A similar reciprocity exists between 'material agricultural capital' and 'material manufacturing capital'; and 'material commercial capital acts everywhere as an intermediary, helping and compensating between both."

directly contradicted this prediction. This new growth theory engaged the attention of many of the leading economists for at least two decades.

Starting in the 1940s, the eviscerated commodities of neoclassical economics faced a new theoretical challenge from development economics, a new branch of economics called forth by the imperatives of promoting economic growth in the lagging countries of Asia, Africa, Latin America and Eastern Europe. Encouraged by the Keynesian rejection of neoclassical economics, several economists began building their analysis of economic development on a complex view of commodities and markets. The early pioneers of development economics – chief among them Paul Rosenstein-Rodan, Ragnar Nurkse, Tibor Scitovsky, Hans Singer, Raul Prebisch, W. Arthur Lewis, Albert Hirschman and P. C. Mahalanobis – preferred to examine the problems of development under conditions that better approximated the real world (Seers, 1984). Among other things, they observed significant differences across industries in their conditions of employment, the technologies they used, the demand conditions they faced, their ability to generate positive externalities, the rates at which they produce learning by doing, the pressures they create for savings and investments, the strength of their forward and backward linkages, the indivisibilities in their operation, the pressures they produce for worker discipline, etc. In comparing the growth-enhancing attributes of the manufactures and agriculture, these economists concluded that the manufactures possessed by far the greater potential for injecting dynamism into the moribund economies that had long been trapped in primary production with traditional technologies. In other words, they turned the world of neoclassical economics on its head: they were closer in their methods to the mercantilists and the protectionist economists of the nineteenth century.

Upon this more realistic conception of commodities, the development economists supported an interventionist role for governments in the backward economies of the post-War era. It is doubtful however if the newly formed governments in the former colonies waited for the approval of economists in implementing their interventionist programs in support of economic development. They could not sit on the sidelines in the face of rising demand in the newly independent countries for jobs, education, industrialisation, electricity, roads, dams, the loans for private investment in infant industries. For the most part, the development economists provided the rationale for what the governments in developing countries were already doing or would have done on their own.

Starting in the late 1970s, a few neoclassical economists – led by Paul Krugman (1979) and others – took upon themselves the task of explaining intra-industry trade flows that made up the bulk of trade between advanced countries (Jomo and Arnim, 2008). The explanation was fairly straightforward once they jettisoned the assumption of constant returns to scale. In a world of increasing returns to scale (IRS), a country's competitive advantage may arise from a variety of accidents. International trade then deepens these advantages. IRS also makes it unlikely that any country – even a big country – will develop competitive advantage in all the lines of a given branch of manufacturing. Throw into this picture product branding and diversity of tastes in a population and you have an explanation of intra-industry trade flows. Once these intuitive ideas were packaged in equations a 'new' trade theory was born. At last, mainstream economists had embraced some elements of the complexity of commodities that were part of the repertoire of mercantilists and their intellectual heirs. Strategic trade policies had now acquired a measure of theoretical respectability in academia. Strangely, however, the rise of the new trade theory was followed by the triumph of the neoliberal paradigm that was squarely rooted in neoclassical orthodoxy. The great powers were not about to jettison their interests just because some MIT economists had made mercantilism mathematically respectable.

7. **Concluding Remarks**

A review of economic discourse since the 16th century – primarily in Western Europe – reveals two opposite approaches to the study of economies, which may be described as dirigisme and laissez-faire. Setting them apart is the manner in which they incorporate commodities into their discourse.

The older dirigiste approach – dating back to the sixteenth century – embraces the complexity of real-world commodities, each endowed with properties that may generate widely divergent consequences for growth, market structures, state formation, and levels of civilisation. Stated succinctly, this approach arranges commodities in a hierarchy, based on their growth- and rent-augmenting effects (GREs). The GREs of commodities are likely to rise with increasing returns to scale, capital-intensity, skill intensity, research and development expenditures, technology and social spillovers, etc. Under laissez-faire, lagging countries are likely to be pushed into industries with *low* GREs, while advanced countries increase their share of industries with *high* GREs. Hence, the choice of dirigisme by lagging countries that seek to catch up to the leading economies.

Advanced in opposition to the dirigiste approach, the second approach seeks support for its laissez-faire stance by stripping commodities of all but one of their attributes, viz. their capital intensity in production. This approach was first elaborated by Adam Smith to rationalise the global interests of Britain, already the most advanced economy in the 1770s, by making the case for the superiority of free trade for *all* countries. Underpinned by a battery of assumptions about technology, tastes, rationality, information, transaction costs, property rights, and market structures, free markets bring about an 'efficient' allocation of resources. Since efficiency is the chief desideratum in this approach, and this is automatically achieved by markets, there remains nothing for governments to do. Only as an afterthought, since markets cannot produce them, governments are allowed to supply public goods.

A survey of economic thought and economic policy over the past half a millennium reveals some fairly stable patterns in most sovereign countries between their economics, economic policies and levels of development.[27] The leading economies, with the most advanced knowledge and technology infrastructures, promote – and impose when they can – free trade policies in the rest of the world, even as they continue to deviate from their own precepts when this is deemed necessary for economic or political reasons. On the other hand, sovereign lagging countries employ dirigiste policies in order to increase their global share of high-end industries (with high GREs), at least until such time as they become globally competitive.

Other patterns too are worth noting. On account of the strong synergies between high-end industries and military power, the two often grow together. Historically, the leading economies – in some cases, notwithstanding their small population – have deployed powerful militaries to establish their imperium over lagging economies through a variety of devices, including trading outposts, colonisation with or without colonial settlements, Open Door treaties, installing governments of their choice, overthrowing 'unfriendly' governments, lending programmes, military sales, the use of soft power, etc. The objective of this imperium is clear: capture for their own corporations the most valuable resources and markets in lagging countries.

This suggests two corollaries. In periods when the power of advanced countries has been ascendant – from the early 1800s into the 1940s and, again, starting in the 1980s – most

[27] These patterns are unlikely to be observed in countries that are sovereign but whose dominant classes draw their income and power from primary sectors (and primary exports), especially when the labouring population is considered racially inferior to the land-owning and urban elites.

lagging countries were forced into unequal economic relations with the advanced countries. On the other hand, when the imperium of the great capitalist powers has been in retreat – because their economies were hit by depressions, they were fighting among themselves, or they were challenged by the rise of communism – we observe the greatest spread of dirigiste policies across the lagging countries. Such a window opened up for about three decades after 1945, due to the decline of the three leading imperialist powers of the previous century, the rise of a new capitalist hegemon – the USA – and the challenge to global capitalism from the rise of Soviet Union.

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The Labour Theory of Property and Marginal Productivity Theory

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Abstract

After Marx, dissenting economics almost always used 'the labour theory' as a theory of *value*. This paper develops a modern treatment of the alternative labour theory *of property* that is essentially the property theoretic application of the juridical principle of responsibility: impute legal responsibility in accordance with who was in fact responsible. To understand descriptively how assets and liabilities are appropriated in normal production, a 'fundamental myth' needs to be cleared away, and then the market mechanism of appropriation can be understood. On the normative side, neoclassical theory represents marginal productivity theory as showing that (a metaphorical version of) the imputation principle is satisfied ('people get what they produce') in competitive enterprises. Since that shows the moral commitment of neoclassical economics to the imputation principle, the labour theory of property is presented here as the actual non-metaphorical application of the imputation principle to property appropriation. The property-theoretic analysis at the firm level shows how the neoclassical (and much heterodox) analysis in terms of 'distributive shares' wholly misframed the basic questions. Finally, the paper shows how the imputation principle (modernised labour theory of property) is systematically violated in the present wage labour system of renting persons. The paper can be seen as taking up the recent challenge posed by Donald Katzner for a dialogue between neoclassical and heterodox microeconomics.
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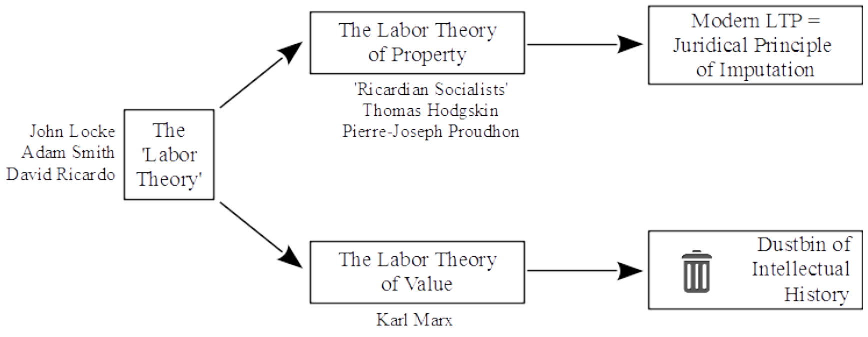
Keywords: labour theory of property, responsibility, imputation principle, appropriation, whole product, labour theory of value

1. Introduction: LTP, the Path Not Taken

In the pre-Marxian period, there was a group of heterodox political economists, including Thomas Hodgskin (1832) and Pierre-Joseph Proudhon (1840), who tried to develop the inchoate in-the-air ideas about the unique and normatively-relevant role of labour (as opposed to the other 'factors of production') into a labour theory of property (LTP) (Menger, 1899) rather than a labour theory of value. In the history of economic ideas, these early attempts to develop a labour theory of property were largely overshadowed by Karl Marx's monumental attempt to develop a labour theory of value – whose eventual failure (Ellerman, 1983, 1992, 2010a) has made it the favorite foil of orthodox economics.

Figure 1: Fork in the Road: How to Develop the 'Labour Theory'



This paper outlines a modern attempt (Ellerman, 1992, 2014) to go back to that fork in the road and take the other path (figure 1). This property-theoretic approach to the microeconomic (e.g., firm-level) questions, usually ill-posed as being only about theories of value and distribution, can also be seen a contributing to the dialogue proposed by Donald Katzner (2015) between neoclassical microeconomics and heterodox political economy.

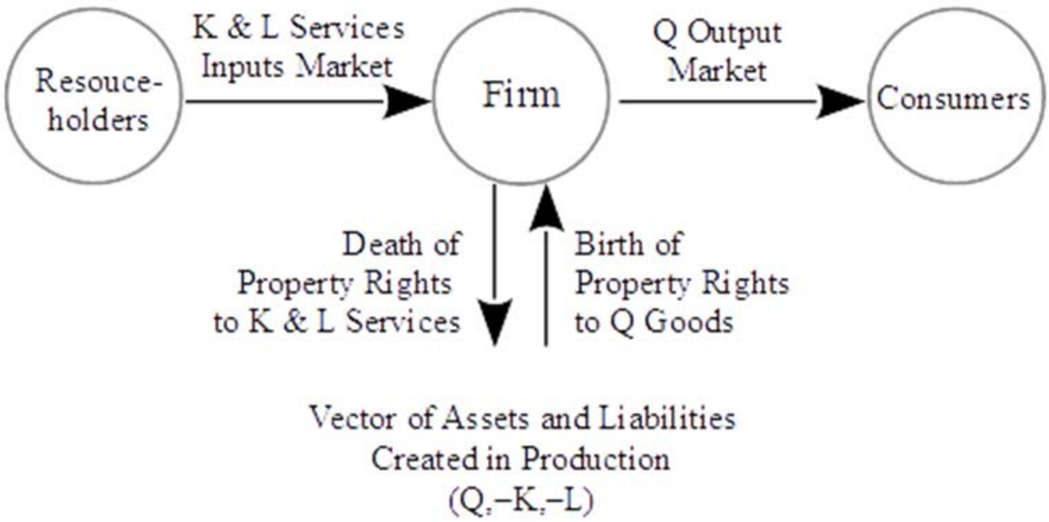
2. The Conventional Neglect of the Question of Appropriation

The labour theory of property is a normative theory, but there is also a descriptive theory of property as to how property rights are actually created and terminated in a private property market economy. Neoclassical microeconomics 'neglects' that descriptive theory in favour of focusing on the distributive shares metaphor that 'pictures' each party to production as getting a 'share' so the only question to be addressed is the value-theoretic question about the size of the 'shares.'

The flows of property rights should always be described in an algebraically symmetric manner reflecting both assets and liabilities. In a common stylised picture of production, the input services, say K and L, are used up and the outputs Q are produced. The assets Q are created so the property-theoretic question is: 'who is to own those assets?'. The services K and L (and other intermediate goods) are used up so the property-theoretic question is: 'who is to owe those liabilities?'.[1] Combining the questions: 'who is to legally appropriate the assets and liabilities (Q,$-K$, $-L$) created in production?' (figure 2).

[1] The termination of rights was an original meaning of 'expropriation'. 'This word [expropriation] primarily denotes a voluntary surrender of rights or claims; the act of divesting oneself of that which was previously claimed as one's own, or renouncing it. In this sense, it is the opposite of "appropriation". A meaning has been attached to the term, imported from foreign jurisprudence, which makes it synonymous with the exercise of the power of eminent domain, ...' (Black, 1968, p. 692, entry under 'Expropriation') Since 'expropriation' now has this acquired meaning, I will treat the 'expropriation (termination) of rights to the assets $+X$' as the 'appropriation of the liabilities $-X$.'

Figure 2: Assets and liabilities created in production



It is a remarkable fact – which itself calls for explanation – that the literature on the economics of property rights *does not even formulate the question* about the mechanism for the initiation and termination of property rights in these normal activities of production (or consumption for that matter).

One reason for the neglect is that discussions of property creation tend to be restricted to a rather mythical state of nature (e.g., Locke, 1690) or original position, or to the 'appropriation' of unclaimed or commonly owned natural goods (e.g., Cooter and Ulen, 2004) rather than the everyday matters of production and consumption of commodities where property rights are constantly created and terminated. On the negative side, the law and economics literature looks extensively at the assignment of liabilities in the legal trials that may follow the accidental destruction of property (Calabresi, 1970). But what is the mechanism for assigning the liabilities for the normal deliberate using-up or consumption of goods where legal trials are clearly not the mechanism for liability assignment?

3. The Fundamental Myth that Product Rights Are Part of Capital Rights

In the case of production (leaving aside consumption for the moment), there is a reason – albeit a mistaken one – for not formulating the question of the mechanism for the appropriation of the assets and liabilities produced in normal production. It is rather commonly thought that the product rights are 'attached to' or are 'part and parcel of' some pre-existing property right such as the ownership of a capital asset, a production set, or, simply, the 'firm'. This idea in various forms is so ubiquitous that it might be termed the *fundamental myth* about the current private property system.

To see the fallacy, one only has to consider the result of renting in the capital employed in production. The party who hired in the capital and paid for all the other used-up inputs would have the legally defensible first claim on the produced output, not the owner of the capital asset to whom the rent was being paid as one of the input costs. Since it is not a major intellectual feat to conceptually consider capital as being rented in, the persistence of the fundamental myth points to its ideological role on both the left and right.

The simplest version of this fundamental myth is the assumption that the bundle of rights that constitute ownership of an asset includes 'a right of ownership-over-the-asset's-products, or *jus fruendi*' (Montias, 1976, p. 116), the 'right of usufruct [which] entitles the holder to the "fruits" or "produce" derived from an asset' (Furubotn and Richter, 1998, p. 79), or simply 'the right to the products of the asset' (Putterman, 1996, p. 361). Aside from being vulnerable to the 'rent out the asset' argument given above, this idea of an 'asset's product' has an antique flavour prior to the understanding (e.g., marginal productivity theory) that the services of *many* assets may be employed in the production and there are no grounds of unique *physical* causality to present the product as the 'fruits' or 'produce' of just one asset (e.g., the land) or service.

Perhaps the most common example of the fundamental myth arises when a corporation uses a technologically-specified productive opportunity such as $Q = f(K,L)$ in our example. Then the question of 'who is to own Q and owe $-K$ and $-L$' is often answered by 'the corporation, or in terms of natural persons, the owners of the corporation.'

But this is confusion between owning a corporation and 'owning' the productive opportunity that a corporation may or may not undertake depending on its contracts. The line of reasoning is: 'a corporation is an owned asset [true] and a corporation owns its products [by definition] so there is no need for some mechanism to account for the ownership of the product [false]—it's all part of the ownership of the corporation [false].' It is only a tautology to say that a corporation owns 'its products'; the question is how did the products produced in a certain productive opportunity, perhaps using some of its assets, become 'its products'. For instance, must the Studebaker Corporation own the cars rolling off the end of the assembly line in the factory owned by Studebaker? Since Studebaker at one point leased its factory building to another automaker, the answer is 'no'. Those cars were owned by the other company which was making the lease payments and paying for all the other inputs in car production and which thus would have the defensible claim on the cars rolling off the end of the assembly line.

The simple fact is that the ownership of a corporation is the indirect ownership of the corporate assets (e.g., the Studebaker factory building) and the 'rent the capital' argument still applies to those assets (i.e., not to the corporation as a whole but to its assets). Whether or not the company owns the products produced using some of those assets depends on whether the company leases out those assets to some other party (who would then appropriate the product) or the company hires in a complementary set of inputs to undertake the production opportunity itself. The legal party who ends up appropriating (i.e., having the defensible claim on) the produced assets is the party, sometimes called the 'residual claimant,' who was the contractual nexus of hiring (or already owning) all the inputs used up in production (and thus who 'swallowed' those liabilities). Since that party undertaking production is determined by who was the nexus of the hiring contracts (who hires or already owns what or whom), the rights to the product are not part of some prior bundle of rights to a capital asset or to a corporation. Being a certain 'nexus of contracts' and thus the residual claimant in a technologically specified productive opportunity, like $Q = f(K,L)$, is not an owned property right. The grip of the fundamental myth in one form or another seems to account for the failure *to even formulate the question*, not to mention the mechanism, of the appropriation of the assets and liabilities that are created in normal production activities.

4. Origins of the Fundamental Myth

The intellectual space to ask the question of appropriation in production was opened up by the realization that product rights were not part of capital rights – the 'fundamental myth.' Whence the fundamental myth? The myth is not a point of contention between orthodox economics and its favourite foil, Marxian economics. Both agree that product rights are attached to the 'ownership of the means of production' but disagree about that ownership being private or public. Marx shares responsibility by having given his imprimatur but the idea goes back to older notions of land ownership. In feudal times, the governance of people living on land was taken as an attribute of the ownership of that land. The landlord was Lord of the land. As Otto von Gierke put it, 'Rulership and Ownership were blent' (1958, p. 88). Marx mistakenly carried over that idea to his analysis of capital in the system that he thus inappropriately named 'capitalism'. The command over the production process was taken as part of the bundle of capital ownership rights.

> 'It is not because he is a leader of industry that a man is a capitalist; on the contrary, he is a leader of industry because he is a capitalist. The leadership of industry is an attribute of capital, just as in feudal times the functions of general and judge were attributes of landed property' (Marx, 1867, p. 332).

Marx's use of the fundamental myth that governance and product rights were part of capital is one of many points of agreement between Marxism and much orthodox economics (Ellerman, 2010a).

In defence of Marx, by 'capital' he did not simply mean financial or physical capital goods; he meant those goods used by wage labour with private ownership of the means of production. Otherwise, 'capital' becomes just the 'means of labour'. In short,

Marx's capital* = Means of labour (capital) + contractual role of being the firm using wage labour.

If one wishes to use the word 'capital*' in that Marxian sense, then one gives up being able to talk about the '*ownership* of capital' since there is no 'ownership' of that extra *contractual* role. One can't have it both ways. But Marx continued to talk about 'capital' as being owned, a common fallacy of using the same word with different meanings at different places in an argument. Many versions of the fundamental myth take the same form of assuming that the capital owner has the contractual role of being the firm (i.e., capital*) and then taking all the property rights accruing to capital* as being part of the ownership of capital (*sans* asterisk *).

For instance, take the common notion of 'owning a factory'. There is the ownership of factory buildings (or ownership of corporations with such assets), but there is no 'ownership' of the going-concern aspect of *operating* a factory since that is a contractual role in a market economy. By using the same phrase 'owning a factory' to straddle both meanings, one could seem to have an 'argument' that the contractual role of operating a factory was 'owned'. For instance, when it is pointed out that operating an owned factory is a contractual role, not an extra owned property right, a typical orthodox response is: 'Yes, but it is that role which is called the 'ownership*' role.' After thus redefining factory-ownership* to *include* the contractual role of residual claimancy, the semantics shift back to conclude that 'the product rights are part of the ownership of the factory' (meaning the ownership of the factory building). Such loose patterns of thought in neoclassical and Marxian economics allow the fundamental myth to persist.

5. The 'Invisible Judge' Mechanism of Property Appropriation

Since Adam Smith, economic theory has worked to elucidate the invisible hand mechanism embodied in the price system that guides property rights towards an efficient allocation. However, the life-cycle of property rights includes not just transfers in the market but also the initiation and termination of the property rights.

The market also embodies an invisible hand mechanism that governs the initiation and termination of property rights – but this mechanism seems to have been truly invisible to both orthodox and heterodox economists due to the many forms of the fundamental myth that the product rights are already included in pre-existing capital rights.

There is a *visible*-hand mechanism of appropriation used when the legal system intervenes in the market. The prime example is a civil or criminal trial to assign the legal liability for property that has been destroyed. Such a trial also illustrates the underlying *juridical principle of imputation*: assign the *de jure* or legal responsibility to the person or persons who were actually de facto responsible for destroying the property.

The *invisible* hand mechanism for the legal assignment of initial and terminal rights comes into play when there is no explicit trial – when the visible hand of the legal authorities does not intervene and when it thus, in effect, renders the *laissez faire* judgment of 'let it be'. Using the Smithian metaphor, we might conceptualize 'non-action' on the part of the legal authorities as the ruling of the 'Invisible Judge' who always rules 'let it be.'

There are two types of contracts where the role of the Invisible Judge is particularly important, namely, the first and last transfer contracts in the life-cycle of a commodity.[2] When a newly produced commodity is first sold and the Invisible Judge lets it be, then the first property right was, in effect, assigned to the first seller. Conversely, when a purchased commodity is subsequently consumed, used up, or destroyed and the Invisible Judge lets it be, then the liability was, in effect, assigned to the last buyer. Thus we have the:

> **Market mechanism of appropriation:**
> The property rights (or liabilities) to newly produced (respectively, finally used-up) commodities are assigned by the Invisible Judge to the first seller (respectively, last buyer) of the commodities.

The application to normal consumption is straightforward. When a commodity is consumed and the Invisible Judge lets it be, then the liability for the using up or consumption of the commodity is imputed to the last buyer.

The most important and consequential application of the market mechanism of appropriation is to production activities. Abstractly considered, one legal party purchases (or already owns from past purchases or activities) all the 'inputs' to be used up in the production process. When those inputs are used up and new products or 'outputs' are produced, then the last buyer of the inputs is in a legally defensible position to be the first seller of the outputs unless the legal authorities intervene to overturn both sets of contracts. Hence when no such intervention takes places – as in normal production – then that one legal party in effect legally appropriates a bundle of both legal liabilities and ownership rights, the input liabilities and the output assets ($Q,–K,–L$) in our example.

The recognition of the market mechanism of appropriation shows that the market has an under-appreciated role in the property system. The market is not just for rearranging

[2] Our focus is on commodities, rivalrous and excludable private goods that are produced and consumed as a part of deliberate human activity – even though in the distant past there may have been endowments of unproduced goods.

existing property rights. In view of the widespread belief in some form of the fundamental myth, many supporters and critics of the current private property system have misplaced their focus. The pattern of appropriation is conceptually defined not by the ownership of property but by the pattern of contracts (although the ownership of property obviously plays an indirect role in the bargaining power to make contracts one way rather than another). When the legal system validates or invalidates certain contracts, the property system is also transformed.

We have so far only been concerned with clearing up myths and fallacies in *descriptive* property theory. But just as there is both a descriptive theory and a normative (efficiency) analysis of the price system, so there is also both a descriptive and normative theory of the underlying property system.

6. Normative Property Theory of Appropriation and Transfers

The fundamental theorem for the competitive *price* mechanism proves a correspondence between the descriptive notion of a competitive equilibrium and the normative notion of Pareto efficiency. The fundamental theorem for the Invisible Judge market mechanism of appropriation has the same logical form of a correspondence between a descriptive situation and a normative principle of appropriation.

The normative property theory presented here is the modern treatment of the labour theory of property that is 'modern' in the sense of being based on interpreting it as the property-theoretic application of the usual *juridical principle of imputation according to responsibility*:

> assign or impute de jure (or legal) responsibility in accordance with de facto (or factual) responsibility.[3]

Since this principle is used in the interventions of the visible hand of the law, i.e., legal trials, it is natural to see under what conditions the invisible hand mechanism of the property system follows the same principle.

7. The Imputation Principle in Marginal Productivity Theory

Neoclassical economics is already quite familiar with a certain version of the juridical imputation principle since it is routinely applied (or implied) in the interpretation of marginal productivity (MP) theory in competitive markets.[4] However, this attempted application of the imputation principle is based on a metaphor, a mistake, and a miracle. Since this mis-application of the imputation principle has such normative acceptance in neoclassical economics, probably the best way to present the labour theory of property (i.e., the property-theoretic application of the imputation principle) to neoclassicals is simply as the actual imputation principle without the metaphor, mistake, or miracle.

[3] '[This] is itself a principle about natural responsibility, and so, as a guide for adjudication, unites adjudication and private morality and permits the claim that a decision in a hard case, assigning responsibility to some party, simply recognizes that party's moral responsibility.' (Dworkin, 1985, p. 288) See also Perry (1997). This responsibility for the results of deliberate actions should not be confused with many other uses of the word such as one's 'responsibilities' in an organisational role.
[4] For instance, 'To each according to what he and the instruments he owns produces.' (Friedman, 1962, pp. 161-2)

7.1 The Metaphor: Treating Services of Things like the Actions of Persons

The first and foremost problem is the neglect of the difference between responsible human actions and the non-responsible (but causally efficacious) services of things. Both are treated simply as causally effective productive services.

> 'We have insisted that the word "produce" in the sense of the specific productivity theory of distribution, is used in precisely the same way as the word "cause" in scientific discourse in general' (Knight, 1965, p. 178).[5]

> 'For "'labor" we should now say "productive resources"' (Knight, 1956, p. 8).

There is an old literary metaphor (a version of the pathetic fallacy) where natural forces are pictured as being 'responsible' for certain consequences. Economists sometimes indulge these picturesque images as when an asset is imagined as producing a (marginal) product or when natural forces and human actions are coupled together as if both were de facto responsible.

> 'Goods are typically produced by the co-operation of various kinds of productive services, and the special problem of distribution, in modern terms, is that of the division of this joint product among the different kinds of co-operating productive services and agents' (Knight, 1956, p. 21).

'Together, the man and shovel can dig my cellar' and 'land and labor together produce the corn harvest' (Samuelson, 1976, pp. 536-537). However, since the demise of primitive animism the law has only recognized persons as being capable of being responsible. When orthodox economists are called in for jury duty on a trial of a person accused of committing a murder with a gun, they would not ask the judge why the gun is not on trial. They understand in their own non-professional lives, that even though the gun was causally efficacious (i.e., 'productive') in the commission of the act, the responsibility for the murder is imputed back through the gun to the person using those criminal means.

As the legally-trained Austrian economist, Friedrich von Wieser, put it:

> 'The judge ... who, in his narrowly-defined task, is only concerned with the *legal imputation*, confines himself to the discovery of the legally responsible factor, – that person, in fact, who is threatened with the legal punishment. On him will rightly be laid the whole burden of the consequences, although he could never by himself alone – without instruments and all the other conditions – have committed the crime. The imputation takes for granted physical causality...
>
> If it is the moral imputation that is in question, then certainly no one but the labourer could be named. Land and capital have no merit that they bring forth fruit; they are dead tools in the hand of man; and the man is responsible for the use he makes of them' (Wieser, 1889, pp. 76-79).

[5] Frank H. Knight was perhaps the most philosophically sophisticated defender of this 'imputation' interpretation of MP theory as well as a founder of the Chicago School of Economics.

The responsibility for the results of using tools or assets is imputed back through the things to the human users. For instance, a description without the pathetic fallacy would be that a man is responsible both for using up the services of a shovel and for thereby digging a cellar (note the positive and negative side of responsibility) – or that labour uses up the services of land in the production of the corn harvest.

There is a common pose that orthodox economists are judging the existing system according to some normative principles, but the causality seems to be the reverse. Normative principles are judged according to whether or not they align with the social role of orthodox economics in giving a 'scientific account' of the existing system. For instance, Wieser summarizes the essence of the labour theory of property (juridical imputation principle) critique of the employment system – 'Land and capital have no merit that they bring forth fruit; they are dead tools in the hand of man; and the man is responsible for the use he makes of them.' But that gives Wieser no second thoughts about the system of renting human beings; [6] it only shows that the moral or legal notions of imputation do not apply! The social role of economics requires a new notion of 'economic imputation' in accordance with another new notion of 'economic responsibility'.

> 'In the division of the return from production, we have to deal similarly... with an imputation,—save that it is from the economic, not the judicial point of view' (Wieser, 1889, p. 76).

By defining 'economic responsibility' in terms of the animistic version of marginal productivity, Wieser could finally draw the conclusion demanded by his calling: to show that the competitive employment system 'economically' imputes the product in accordance with 'economic' responsibility. Thus we arrive at one of the highpoints of neoclassical microeconomics: trying to justify a metaphorical 'division' of the product with a metaphorical notion of 'responsibility'. Needless to say, the actual juridical principle of imputation uses the usual moral and legal notion of imputation where 'no one but the labourer could be named' – not the metaphorical notion of 'economic responsibility'.

Friedrich von Wieser's American counterpart in providing this interpretation to MP theory was John Bates Clark, who was even more explicit in trying to co-opt the normative force of the imputation principle using the Lockean narrative of everyone getting what they have produced.

> 'At the point in the economic system where titles to property originate,—where labor and capital come into possession of the amounts that the state afterwards treats as their own,—the social procedure is true to the principle on which the right of property rests. So far as it is not obstructed, it assigns to every one what he has specifically produced' (Clark, 1899, p. v).

Clark is so sure that the competitive system of renting people satisfies the imputation principle that he spells out the alternative.

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[6] This may seem an unusual use of 'rent' but, 'hiring a car' in the U.K. and 'renting a car' in the U.S. are the same thing. As Paul Samuelson explains:

> 'One can even say that wages are the rentals paid for the use of a man's personal services for a day or a week or a year. This may seem a strange use of terms, but on second thought, one recognizes that every agreement to hire labor is really for some limited period of time. By outright purchase, you might avoid ever renting any kind of land. But in our society, labor is one of the few productive factors that cannot legally be bought outright. Labor can only be rented, and the wage rate is really a rental' (1976, p. 569).

> 'A plan of living that should force men to leave in their employer's hands anything that by right of creation is theirs, would be an institutional robbery—a legally established violation of the principle on which property is supposed to rest' (Clark, 1899, p. 9).

Although more circumspect in statement, Frank Knight is no less assured that the competitive system of renting people delivers both efficiency and justice – with 'justice' defined by the metaphorical version of the labour theory of property.

> 'The analysis [of market competition] shows how, under the conditions necessary for its existence, this organization achieves *efficiency* in the utilization of resources and *justice* in the distribution of the total product, efficiency being defined by the ends chosen by individuals and justice by the principle of equality in relations of reciprocity, giving each the product contributed to the total by its own performance ("what a man soweth that shall he also reap")' (Knight, 1956, p. 292).

7.2 The Mistake: No Division of the Product in terms of Property Rights

We have seen the metaphor used in interpreting causally efficacious services of things as if they were the responsible actions of persons. The simple 'mistake' involved in this interpretation of MP theory is that it does not deal with the actual distribution of property rights and liabilities in production at all. In a productive opportunity described by $Q = f(K,L)$, the initial ownership of the (positive) product Q is not divided between different legal parties such as the input-suppliers. It is all appropriated by one legal party, the same party who 'shoulders' or 'bears' all the input-liabilities $-K$ and $-L$. Thus one legal party appropriates both the positive and negative product, which we will call the *whole product*: [7]

$$(Q, -K, -L) = (Q, 0, 0) + (0, -K, -L).$$

Whole product = Positive product + Negative product.

The *basic question* about production is not about any hypothetical division of property rights to the product (or even about the MP pricing of inputs) but about: *who is to be that one legal party who appropriates the whole product*? The standard answers are: 'Capital' (i.e., the employer in the employment system), Labour (i.e., the people working in the productive opportunity who perform the responsible actions L to use up the inputs K to produce the product Q), or the State (i.e., in a socialist or communist system).[8] In order to address that question about the actual appropriation of the assets and liabilities created in production, one needs a theory of property, not a MP theory of the derived demand for inputs.

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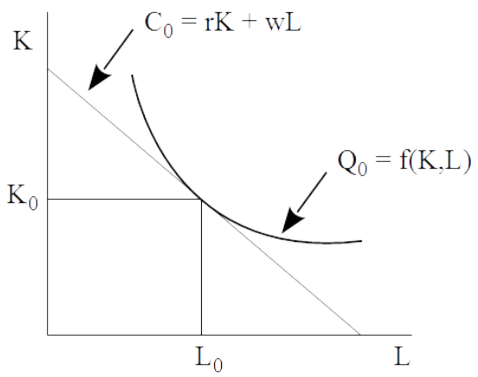
[7] I have used the 'whole product' phrase to recognise the labour theory of property tradition summarised by Carl Menger's jurisprudential brother, Anton Menger (1899).

[8] Much ink has been spilt in neoclassical economics on the near-tautology that the party who 'bears the risks' (i.e. appropriates the negative product) should also appropriate the positive product. Of course, *one* party appropriates the whole product (positive + negative product). The real question is: who is to be that one party?

7.3 The Miracle: Each Factor's Immaculate Production of its Marginal Product

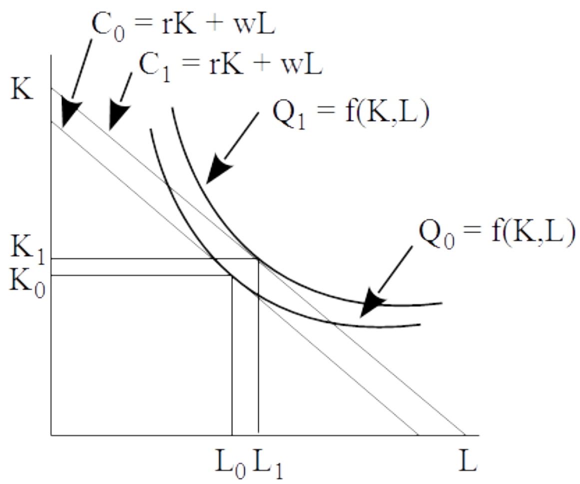
The whole picture of each unit of a factor producing its marginal product is not even remotely plausible in the first place, since production requires other inputs! Each (marginal) unit of the labour L cannot 'immaculately' produce its marginal product $\Delta Q/\Delta L$ of so-many widgets without using up some services of capital (and other intermediate goods summarized in K). This again raises the question of algebraic symmetry in the treatment of production. If neoclassical theory was to pay less attention to trying to co-opt the normative force of the imputation principle in MP theory, then it might follow its own assumption of cost-minimization. Given unit prices r for capital services and w for labour services, for each level of output Q_0 there is (under standard assumptions) a level of capital services $K_0 = K(Q_0)$ and a level of labour services $L_0 = L(Q_0)$ so that $Q_0 = f(K,L)$ is produced at minimum cost (figure 3).

Figure 3: Least cost amounts $K_0 = K(Q_0)$ and $L_0 = L(Q_0)$ needed to produce Q_0



If, say, labour L_0 is to be increased by one unit to $L_1 = L_0+1$, there is a minimum cost level of output Q_1 such that $L_1 = L(Q_1)$. Thus cost minimization requires that the other input, K in this case, also be increased to $K_1 = K(Q_1)$ so the extra output $\Delta Q = Q_1 - Q_0$ is not produced 'immaculately' or *ex nihilo* (figure 4).

Figure 4: Cost minimization implies no 'immaculate' marginal products



Thus we see that the actual (non-immaculate) marginal product of labour is a vector, not a scalar amount:

$$\text{Vector Marginal Product of Labour} = (\Delta Q, -\Delta K, 0)$$

where $\Delta K = K_1 - K_0$.[9] In a perfectly analogous way, one can define the vector marginal product of capital.

In retrospect, one might ask about the scalar marginal (immaculate) product of labour $MP_L = \partial f(K,L)/\partial L$. If a marginal increase in labour is combined with a slightly more labour-intensive production process, using the same amount of K, then the increase in output would be MP_L. But that would in general take the firm off the least-cost path for output expansion so it is only a hypothetical or notional change.

This raises the question of why doesn't neoclassical economics follow out its own assumptions using the vector marginal products taken along the least-cost expansion path instead of the notional (immaculate) marginal products off that path? The answer seems to be that only the immaculate marginal products give the 'distribution of the product' or 'distributive shares' picture (with the 'exhaustion of the product' under constant returns to scale) – which can then be combined with the pseudo-application of the imputation principle to show that the competitive employment system satisfies 'the ethical proposition that an individual deserves what is produced by the resources he owns' (Friedman, 1976, p. 199).

7.4 A Stunning Success of Neoclassical Economics

No amount of staring at partial derivatives $MP_L = \partial Q/\partial L$ or $MP_K = \partial Q/\partial K$ will reveal the relevant difference between the responsible actions of persons and the non-responsible services of things that is the basis for the actual imputation principle 'from the juridical point of view' where 'Land and capital have no merit that they bring forth fruit; they are dead tools in the hand of man; and the man is responsible for the use he makes of them.' It is rather remarkable how so much of the economics literature that 'criticises' MP theory (Appendix A in Thurow, 1975; Chapter 6 in Keen, 2011) misses that fundamental point (i.e., can't find the R-word, 'responsibility'), and even accepts that MP theory *in theory* reflects the imputation principle. Even some of the most sophisticated philosophers writing about justice seem to confuse the pseudo-application of the imputation principle in MP theory with the actual principle.

> 'Accepting the marginal productivity theory of distribution, each factor of production receives an income according to how much it adds to output (assuming private property in the means of production). In this sense, a worker is paid the full value of the results of his labor, no more and no less. Offhand this strikes us as fair. It appeals to a traditional idea of the natural right of property in the fruits of our labor. Therefore to some writers the precept of contribution has seemed satisfactory as a principle of justice' (Rawls, 1971, p. 308).

Then these various 'critiques' of MP theory focus on the difficulties in actually defining and measuring marginal productivity, on the non-competitive nature of markets, on the vagaries of

[9] Profit maximisation would then require that the value of the vector marginal product of labour be equal to the wage w. See Chapter 5: 'Are Marginal Products Created *ex Nihilo*?' (Ellerman, 1995) for the mathematical treatment.

supply and demand, and especially on the lack of justice in the given distribution of factor ownership (even including human talents).

> 'The marginal product of labor depends upon supply and demand. What an individual contributes by his work varies with the demand of firms for his skills, and this in turn varies with the demand for the products of firms. An individual's contribution is also affected by how many offer similar talents. There is no presumption, then, that following the precept of contribution leads to a just outcome unless the underlying market forces, and the availability of opportunities which they reflect, are appropriately regulated' (Rawls, 1971, p. 308).

It is a stunning success of the neoclassical 'science' of economics to get so many progressive and left-wing thinkers to accept the pseudo-imputation principle of MP theory as being correct in principle and then to only fuss about its empirical applicability and background conditions.

8. Analysis of the Employment Contract

The property theoretic question is *not* about the value-theoretic notion of 'distributive shares' since in fact the various input-suppliers do not appropriate shares in the *positive product* Q. There is also a dual metaphor about the output-demanders using up the inputs and thus having shares in the *negative product* $(0,–K,–L)$ as claims against them. The dual metaphor tells a 'story' about marginal cost pricing of outputs just as the usual 'story' leads to the marginal productivity costing of inputs. But these dual metaphors duel only with each other.

There is in fact no legal imputation of the positive product to the input suppliers (i.e., input suppliers do not in fact sell outputs) and no imputation of the negative product to the output demanders (i.e., customers do not in fact pay off input liabilities). Moving beyond the 'deep' metaphors of neoclassical value theory to the 'shallow' legal facts, the whole product (positive plus negative products) is in fact legally appropriated by *one legal party* (residual claimant), the party who stands between the input suppliers and output demanders, and who pays for all the inputs and sells all the outputs of production.

The simple legal fact that one legal party legally appropriates all the positive product (produced outputs) and legally bears all the negative product (input liabilities) is not really controversial – although neoclassical theory has learned to always redirect attention from that total asymmetry to the symmetrical 'picture' of the distributive shares metaphor. The property-theoretic analysis of production changes the focus of normative questions from the value-theoretic 'distributive shares' questions to the basic property-theoretic question of 'Who is to be the whole product appropriator?' or 'Who is to be the firm?', e.g., Capital, Labour, or the State.

Since *all* who work in a production opportunity ('Labour' including managers) are de facto responsible for using up the inputs K to produce the outputs Q, i.e., for producing *Labour's product* $(Q,–K,0)$,[10] but only legally appropriate $(0,0,L)$ in the employment system,

[10] The summation or integral of Labour's vector marginal product $(\Delta Q, -\Delta K, 0)$ from 0 to L gives the same result as Labour's product $(Q, -K, 0)$. One could, of course, do the same formal summation for the vector marginal product of capital, but it would be without the same significance since the services of things are not responsible.

Labour is *de facto* responsible for but does not appropriate the difference, which is the whole product: (Q, –K, 0) – (0, 0, L) = (Q, –K, –L) (see table 1).[11]

Table 1 Imputation Principle Violation under the Employment System

Labour *de facto* responsible for	(Q, –K, 0)	= Labour's product
Labour legally appropriates	(0, 0, L)	= labour commodity
Labour responsible for but does not appropriate	(Q, –K, 0) <u>– (0, 0, L)</u> = (Q, –K, –L)	= whole product.

The legal party who has the contractual role of being the last buyer of all the inputs consumed in production would 'swallow' the input liabilities –K and –L and thus would have the legally defensible claim on the outputs Q. In this manner, the employer would legally appropriate the whole product (Q, –K, –L). Since Labour was *de facto* responsible for the whole product, the responsibility principle was violated by the employer's appropriation of the whole product.

The *fundamental theorem of property theory* (Ellerman, 2014) gives the two descriptive conditions:[12]

- *no-externalities condition* (i.e., all property transfers between parties are covered by consent), and
- *no-breach condition* (i.e., all voluntary contracts to transfer property are fulfilled by the transfer of the property from the possession of the seller to the buyer),

under which the invisible hand mechanism of property appropriation satisfies the juridical principle of imputation (imputes legal responsibility in accordance with factual responsibility).

It is the no-breach condition that is violated by the employment contract. The basic fact that connects the contractual mechanism and the imputation mechanism is that *things* (as opposed to persons) can, in fact, be transferred from the factual possession and control of one party to another. Person A might rent a van (i.e., sell some of the van's services) to another person B. To fulfil the contract, the van would be factually transferred from A to B so that B can then use the van (i.e., use up the van services) independently of A and be solely de facto responsible for the results obtained by using up the services of the van. As per the fundamental theorem, the contractual mechanism functions correctly when legal title to those services stays coordinated with the factual possession and use of the services. Then the legal imputation of the Invisible Judge to B for using up the van's services according to the last-buyer contract will be in accordance with de facto responsibility of B for the use of those services.

But this mechanism breaks down when person A (an 'employee') tries to rent him- or herself (i.e., sells his or her own services) to person B (the 'employer'). There is no voluntary action to fulfil an employment contract so that the employer can 'employ' the employee and be solely *de facto* responsible for the 'employment' of those services. What actually happens

[11] This provides the modern reconstruction of the old slogan: 'Labour's claim to the whole product' put forward by the 'band' of classical labourists such as Thomas Hodgskin and William Thompson. For the history of that school, see Anton Menger (1899) and particularly the Introduction by Foxwell (1899) as well as Lowenthal (1911) and Stark (1943). Although the classical labourists would hardly expect some other party to pay the costs of production in a cooperative or labour-managed enterprise, they were not clear that the negative product (0, –K, –L) must always be included along with the positive product (Q,0,0) in making 'Labour's claim to the whole product' (Q, –K, –L).

[12] Historically, these are Hume's two conditions: '*transference by consent,* and *of the performance of promises'.* (Hume, 1739, Book III, Part II, Section VI, p. 526).

to 'fulfil' the employment contract is that the employee agrees to co-operate with the employer in a certain activity. But unlike the van case, there is no voluntary transfer of *de facto* responsibility. Both the employee and the working employer are jointly de facto responsible for the fruits of their joint activity. The employee's responsible agency is inherently inalienable (Ellerman, 2010b, 2015). Frank Knight (perhaps the most thorough defender of the current system of renting workers instead of owning them as property) thus has to represent the co-responsible co-operation of employer and employee as being like an employer employing a thing like a van or horse.

> 'It is characteristic of the enterprise organization that labor is directed by its employer, not its owner, in a way analogous to material equipment. Certainly there is in this respect no sharp difference between a free laborer and a horse, not to mention a slave, who would, of course, be property' (Knight, 1965, p. 126).[13]

When the legal authorities accept (NB: 'accept' in the *laissez faire* sense of taking no action) the *de facto* responsible co-operation of the employee as 'fulfilling' the labour contract for the sale of labour services from the employee to the employer, then the Invisible Judge mistakenly imputes all the legal responsibility to the employer for the using up of the 'input' labour services and for the other positive and negative fruits of their joint activity.

The legal authorities take no action to declare that the employees are 'non-responsible' or to declare that the employer is solely *de facto* responsible for the positive and negative product of the joint activity. And that is just the point; an Invisible Hand or *laissez-faire* mechanism works by non-action. The mis-imputation of the Invisible Judge is based simply on the legal authorities accepting the employees' co-responsible co-operation as 'fulfilling' the legal transfer so that there *seems* to be no breach to give grounds for intervention.

The employment contract is impossible to actually fulfil with the transfer of responsible actions from the seller (employee) to the buyer (employer). In what might be taken as a fraud on an institutional scale, 'an institutional robbery—a legally established violation of the principle on which property is supposed to rest' (Clark, 1899, p. 9) or as Proudhon put it simply 'property is theft', the responsible co-operation of the 'employees' is taken by the legal authorities as 'fulfilling' the labour contract which allows the employer to take the contractual position of the whole product appropriator. *That is the basic trick* in the employment system of renting human beings.

Since the contract for renting people is impossible to fulfil, it is invalid like the voluntary self-sale contract (to essentially take on the full-time role of a non-responsible instrument) which is already recognised as being invalid.[14]

Clearly this property-theoretic analysis of the employment contract has *nothing* – repeat *nothing* – to do with the size of the wage payment (which was never used in the analysis) so it is totally independent of the superficial exploitation theories of the neoclassical variety (paying less than the value of the marginal productivity of labour) or the Marxian

[13] There is, of course, no difficulty in the legal authorities recognising the *de facto* co-responsible co-operation of employer and employee when they commit a crime together rather than produce widgets together:

> 'All who participate in a crime with a guilty intent are liable to punishment. A master and servant who so participate in a crime are liable criminally, not because they are master and servant, but because they jointly carried out a criminal venture and are both criminous' (Batt, 1967, p. 612).

[14] 'Since slavery was abolished, human earning power is forbidden by law to be capitalized. A man is not even free to sell himself: he must *rent* himself at a wage' (Samuelson, 1976, p. 52 [his italics]).

variety (extracting more labour time than is embodied in the wages). The whole employment system of renting persons is a *property* system based on 'a legally established violation of the principle on which property is supposed to rest' that is established by virtue of the employment contract to rent human beings. It takes a property theory to criticise a property system, not a value theory which at best may show that 'wages are too damn low' – but which would thus not even be a critique of wage labour *per se*.

9. Workplace Democracy: the Alternative to the Employment System

If this neo-abolitionist proposal were accepted that the contract for the renting of human beings be recognised as invalid and be abolished, then production could only be organised on the basis of the people working in production (jointly) hiring or already owning the capital and other inputs they use in production.[15] The market mechanism of appropriation would *then* correctly impute the legal responsibility to the *de facto* responsible party. The conservative thinker, Lord Eustace Percy, singled out that *de facto* responsible party in 1944:

> 'Here is the most urgent challenge to political invention ever offered to the jurist and the statesman. The human association which in fact produces and distributes wealth, the association of workmen, managers, technicians and directors, is not an association recognised by the law. The association which the law does recognise – the association of shareholders, creditors and directors – is incapable of production and is not expected by the law to perform these functions. We have to give law to the real association, and to withdraw meaningless privilege from the imaginary one' (Percy, 1944, p. 38; quoted in: Goyder, 1961, p. 57).

The legal members of the firm as a legal party would then be the people working in the firm. After abolishing both the owning and renting of persons, private property would finally be founded on 'the principle on which property is supposed to rest'. Such a firm is a *democratic firm* and the private property market economy of such firms is an *economic democracy*.[16]

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[16] See, for example, Dahl (1985). The best examples today are probably the Mondragón industrial cooperatives in the Basque region of Spain (see Oakeshott, 1978; Ellerman, 1984; Whyte and Whyte, 1991).

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Power, Property, the Law, and the Corporation – a Commentary on David Ellerman's paper: 'The Labour Theory of Property and Marginal Productivity Theory'

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Keywords: labour theory of property, responsibility, imputation principle, appropriation, whole product, labour theory of value

The point of departure of David Ellerman's paper is that the role of labour in economics can be looked at in a fundamentally different way than has typically been the case. The paper's purpose is, therefore, oppositional. However, it cannot simply be dismissed. It is clearly articulated, well reasoned, and most importantly, thought provoking. It requires one to rethink how one conceives some basic issues in economics. As such, one does not need to be entirely convinced by the argument to consider it worthy of dissemination. At the same time, if one subscribes to the ethic of structured or critical pluralism one must also consider the pressure points of the argument (see Dow, 2004; Dobusch and Kapeller, 2012). Below, I briefly reconstruct Ellerman's core claims and provide some comment on that argument.

1. Ellerman's core claims

I first briefly enumerate as a consistent whole Ellerman's core claims for the Labour Theory of Property. The intent is to be concise without traducing the argument. There is, of course, always a potential that summarising an argument will become a barbarisation of it. I suggest then, that one read the following in conjunction with Ellerman's original paper.

1. Neither marginal productivity theory nor the Marxist labour theory of value actually explores the specific mechanism for the initiation and termination of property rights in the normal activity of production. 'Who is to own the asset' (the outputs) is simply intrinsic to the theory. This absence creates the need for an initial descriptive theory of property rights to clarify the mechanism.
2. The property right mechanism is not typically formal legal ascription via a trial. We tend rather to accept a 'fundamental myth'. That is, property rights (to the outputs) follow from a relation to the ownership of capital used, the organisation of production or the firm. The implication is that there is a transition from a bundle of rights, which constitute ownership of the means of production (as assets), to a right of ownership over its products.
3. However, there is a degree of camouflage created by loose and inconsistent use of terms (capital, ownership...). Production is a process. The firm etc. is a going concern with a contractual role in a market economy. This is *different* from any possible property right to the many and different constituents in the process. A problem arises because the two are conflated or elided. Confusion then facilitates the fundamental myth.

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4. An appropriation then follows. This can be visible in the form of legal intervention to assign rights or invisible in the form of the market mechanism. The market mechanism applies a form of 'let it be' judgement. Rights to outputs are assigned to the first seller and last buyer. Appropriation follows a pattern of contracts.
5. Having clarified the descriptive elements of 'who is to own the asset' (establishing that one needs a theory of property to understand the mechanism) one can then consider the normative issues by criticising the focus on distribution. Here, one follows the juridical principle that one assigns *de jure* (or legal) responsibility according to *de facto* responsibility. Only a person can be responsible. Land, capital etc. cannot fulfil the criteria. Concomitantly, it is recognised that a person cannot be sold. However, neoclassicals (J.B. Clark, Frank Knight) allow that one can rent the self and so rights to output follow to those to whom one has rented the self. From this point of view this is 'just' in so far as one receives a marginal product from labour (Milton Friedman etc.). However, there is still appropriation of the whole product by the firm.
6. Appropriation of the whole product reveals that the focus on marginal distribution misses the point. Since only humans can be 'responsible' then only labour can be *de facto* responsible for the whole product. An employer's appropriation is then a violation of assignation according to responsibility. Responsible agency is inherently inalienable. A contract to rent the human is thus invalid. The employee and employer are jointly responsible. As such the imputation of legal responsibility to the employer for the using up of inputs (including labour services) creating rights over the fruits of that activity is mistaken (there is an institutional robbery).

Ellerman then states:

> 'Clearly, this property-theoretic analysis of the employment contract has *nothing* - repeat *nothing* - to do with the size of the wage payment (which was never used in the analysis) so it is totally independent of the superficial exploitation theories of the neoclassical variety (paying less than the value of the marginal productivity of labour) or the Marxian variety (extracting more labour time than is embodied in the wages)… It takes a property theory to critique a property system' (Ellerman, 2016: pp. 33-34).

For Ellerman, the argument provides grounds for a substantive critique of the current organisation of the capitalist firm. If responsibility is 'joint' then assignation necessarily implies that there is a case for economic democracy.

Ellerman's argument has a clear line of reasoning. The argument opens up a quite different way of thinking about economic theory in the context of capitalism. Contesting received ideas is an important function in any discipline. But this applies also to any critique of the fundamentals of received ideas. As such, I now consider some of the pressure points on the argument. It should be noted that exploring pressure points does not lead (by entailment) to refutation. Highlighting the commitments, which seem necessary for an argument to function effectively, may work to enhance or reduce the persuasiveness of argument. One must also acknowledge that property theory has a long tradition and one cannot adequately represent the entirety of it in one paper. I focus here on Ellerman's specific argument as set out in this issue of *Economic Thought*. Highlighting its pressure points may simply be a means to refer one to further reading (see, for example, Ellerman's list of references).

2. Pressure points for Ellerman's case

Ellerman's argument states that a property theory is required in order to understand a property system. It states that conflations regarding terms such as 'capital' disguise the actual issues of ownership. Thereafter, it turns on the claim that only the human can be responsible, responsible agency is inherently inalienable and the contract to rent the human is invalid. Since responsibility is applied to production and to outputs then property is ultimately being appropriated through an institutional system. There is a clear line of reasoning here, but also a structuring process of that line of reasoning.

One way to approach the whole would be to suggest that the argument appears incomplete. One could argue that if one needs a theory of property then one also needs a theory of power. One could read Ellerman's position as: there are a set of conventions expressed through the market mechanism that appear to be rooted in law. The conventions are internally inconsistent and the law incoherent. The consequence of this inconsistency and incoherence is an appropriation. The assumption is then that consistency and coherence create the grounds for a different system in which the appropriation does not occur. However, one might equally argue that a full explanation of the appropriation would be one that also addressed why the inconsistency and incoherence arise. A theory of property cannot be simply analytic. Ellerman's argument in his paper in this issue of *Economic Thought* seems incomplete in these terms.

Legal systems are relatively comfortable with contradiction and ambiguity, despite the precision that is also built into the codification of statute and that is formally applied to case law. The law accepts inconsistency and ambiguity. It often rules in accordance with inconsistency and ambiguity and develops both. It does so because the law is itself referenced to wider political, social and economic concerns within which these inconsistencies and ambiguities serve some identified purpose. A system emerges and is reproduced; its relations are always also power relations. This does not render Ellerman's argument redundant, but there may be many reasons why revealing inconsistencies and incoherence may not lead to inferences that a system is unjustified. There is no entailment from clarity to refutation; this depends entirely on issues of justification and these can extend to how one reasons out ambiguity and inconsistency for broader purposes. At the same time, if theory is incorrectly posed (and so a source of obfuscation), it is important to identify how and in what ways and to contest this as an adequate account of the world. *Particular* normative force, however, does not follow directly from a *given* descriptive correction. One must address the reasons why a system reproduces inconsistency and incoherence and then contest the norms on which this is based. These are not reducible to the argument that x is myth or y is appropriation based on description z. For something to be wrong (rather than incorrect) there must also be deliberation regarding what is better, subject to commitments founded in some criteria that shape the judgements applied to a system (function, ethics, etc.) and the terms of any alternative. Note, this is not an endorsement of a fact-value Humean guillotine or some version of the positive-normative division in economics. It is rather the claim that the integration of fact and value reveals the systemic complexity and openness of human systems. What occurs, including what is chosen, is not grounded in atomism.

For example, the modern corporation is (as Ellerman is no doubt fully aware) deeply problematic as a legal entity (Haldane, 2015; Coffee 1981; Jansson et al 2016; Corporate Reform Collective, 2014). It creates its own nexus of ownership problems (who owns a corporation?):

> 'Ownership, like friendship, has many characteristics and if a relationship has enough of them we can describe it as ownership. If I own an object I can use it, or not use it, sell it, rent it, give it to others, throw it away and appeal to the police if a thief misappropriates it. And I must accept responsibility for its misuse and admit the right of my creditors to take a lien on it. But shares give their holders no right of possession and no right of use. If shareholders go to the company premises, they will more likely than not be turned away. They have no more right than other customers to the services of the business they "own". The company's actions are not their responsibility, and corporate assets cannot be used to satisfy their debts. Shareholders do not have the right to manage the company in which they hold an interest, and even their right to appoint the people who do is largely theoretical. They are entitled only to such part of the income as the directors declare as dividends, and have no right to the proceeds of the sale of corporate assets — except in the event of the liquidation of the entire company, in which case they will get what is left; not much, as a rule' (Kay, 2015).

Thereafter, and more relevantly in terms of matters of inconsistency, it has legal person status and so has some of the rights attributed to natural persons, including ownership of assets. As many have noted, a legal person without consciousness has the quasi-status of a natural person, without all of the inherent characteristics. At the same time, in different contexts for different purposes, and based on the reproduction and augmentation of power within relations (expressed in but not reducible to the law) it is sometimes treated as though it had those characteristics and sometimes as though it did not (see Lawson, 2015). So, a corporation can sue for defamation, which implies a consciousness that can suffer harm. However, in many jurisdictions a corporation cannot be prosecuted for manslaughter etc., since it lacks a material entity that can be incarcerated and lacks a mind to which intentionality can be ascribed. The law seeks to deal with these problems by iterating inconsistencies (quasi conscious for some purposes, not conscious for others). For example, the law may focus on significant natural persons who occupy key roles within the corporation and seek to apply responsibility to them on behalf of the corporation (so there may be a 'corporate manslaughter' law and it may impose a fine on the corporation, but the significant penalty intended as deterrent is likely to be imprisonment of an executive).[2]

However, at the same time, the law seeks to balance the whole by limiting the degree to which the corporation as a generalised legal entity within society can be destabilised by the mere existence of any given law, since this affects broader economic concerns (capital markets, credit markets, pension funds, employment etc.) and narrower economic interests (vested in the lobbying of corporations steered by their executives). In an objective sense, one can view the law *in toto* as odd and inconsistent; at the same time, one can consider it explicable in its inconsistencies and identify the tendencies that arise (including a relation to conventions which may themselves be ambiguous or fluid).

One such tendency in the modern world has been the gradual augmentation of corporate power (see Drutman, 2015; Bakan, 2005), and then income inequality based on corporate power (precisely the issue of labour shares and profit shares that Ellerman puts aside based on distribution but reintroduces implicitly regarding the issue of a share in terms

[2] See the UK Corporate Manslaughter and Corporate Homicide Act, 2007. The test applied in the UK is management failure (a breach in a management system akin to gross negligence). For the various issues in context see Wells, 2001: Chapters 4 and 6; for more adversarial critique see Tombs and Whyte, 2015.

of economic democracy and joint responsibility). One might then argue that a fuller explanation of the inconsistencies in order to create the fuller case for economic democracy via ownership is not easily divorced from distributional issues. Distribution is a source of power, which in turn is rooted in socio-economic relations and is manifested in influence. This, for example, is basic to Piketty and many others argument regarding the institutional problems of wealth and income inequality (see Pressman, 2016). The broader point is that power relations seem to be intrinsic to any adequate theory of property. This being so, one can also ask what would be the actual response to the labour theory of property if it was to become widely disseminated? What would be the response in law and then through conventions to widespread dissemination of the argument that property is appropriated via the market mechanism and based on a myth? This is a different issue from simply suggesting Ellerman is incorrect in identifying camouflage and inconsistency. It by no means leads to the argument that making a case for an alternative is meaningless or pointless. I am extremely sympathetic to the intent - addressing the organisation of modern capitalism. But the argument does seem to be incomplete (at least as it is posed here).

In some respects the argument faces the same basic problem as the Marxist transitional argument from extraction of surplus labour to the case for the alternative. Many are aware that work is exploitative in general and their work relations are exploitative in particular; it is not the lack of awareness that prevents the alternative. What is it? One cannot be sure - but recognition and change combine issues of how power relations configure and how individuals and collectives are implicated in any configuration of power (and to be clear power need not always and everywhere be considered a negative). It is not impossible that the convention of 'let it be' simply continues despite a greater recognition of the inconsistency. Again I by no means wish to suggest the point refutes Ellerman's case, but it does suggest incompleteness.

Concomitantly, consider the core claim that responsibility is inherently inalienable. In a certain sense this seems unequivocal. I can act in conjunction with another, I can follow directions, but another responsible person cannot occupy my mind – there is then a basic difference between 'control' as following direction and 'control' as offering up sentience. I am always and everywhere a centre of responsibility. The issue then becomes whether inconsistency can be justified, such that property can be assigned non-jointly. Can one willingly collude in an inconsistency (perhaps as a greater good or lesser evil argument). It strikes me that there are many different ways this could then be developed (including different ideas of legal imposition, force of convention, consent and so on, none of which need be neoclassical). The point, however, is that *justification* is not necessarily prevented by a specific variety of inconsistency (inferred from non-alienability). Justification is more complex than simply the problem of inconsistencies. Clarity may be a service in terms of theory construction, but there is no necessary shift from clarity to consequent in argumentation. It depends on the nature of argumentation, subject also to a social reality of complex context dilemmas and openness (what collectively emerges and is reproduced intentionally and unintentionally).

Clarity is, though, an important service in so far as clarity provokes an explicit focus on justification. Ellerman's way of posing the problem does require one to think carefully about this and so opens up an extremely interesting set of issues. For example, it leads one to consider how one reconciles matters of social construction with arguments of normative force for particular claims regarding the nature of situations. The inalienability of responsibility is not a legal argument, it is something that can be recognised in law (and argued about legally). It is, however, at root an argument concerning the nature of personhood, the nature of what it means to be human. It is an ontological claim. So one might also note that

Ellerman's case – in at least its normative dynamic – requires a clear ontological argument regarding the nature of personhood (and species-hood), and the possible consequences of personhood for socio-economic forms, including the case for economic democracy. Before there can be property rights one must consider properties of the human to which they can adhere. This, arguably, is a broader issue than alienability *per se*.

3. Final comment

In this commentary I have focused on Ellerman's paper in isolation from the general discourse from which it arises. I have also taken it on its own terms as a relatively consistent and credible argument. Ellerman's paper does, of course, have context, and that includes further work on property theory and critique of it. Proudhon (1840[1994]), for example, is clearly concerned with power and with natural rights and how they are justified. Proudhon argues that, once the real position of property is revealed, people will recognise that only equality is consistent with property (there is the force of necessity in argument). Marx (1847/92[1952]), meanwhile, was deeply critical of Proudhon's *Philosophy of Poverty* in *The Poverty of Philosophy,* where he explores the totality of social relations within socio-historic materially influenced phases as an issue of exchange. Neither Marx's nor Proudhon's work is structured as economics in the disciplinary form we recognise today (and which Ellerman is addressing as the audience for his paper in this issue of *Economic Thought*). Ellerman takes up the Marxist critique in greater detail elsewhere (see his bibliography). The arising question is whether either the work on which he draws, or the Marxist critique are complete in terms of the points I have made here. Ellerman may have some further comment on this.

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The Methodology of Polanyi's *Great Transformation*

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Abstract

Polanyi's book, *The Great Transformation,* provides an analysis of the emergence and significance of capitalist economic structures which differs radically from those currently universally taught in economic textbooks. This analysis is based on a methodological approach which is also radically different from existing methodologies for economics, and more generally social science. This methodology is used by Polanyi without explicit articulation. Our goal in this article is to articulate the methodology used in this book to bring out the several dimensions on which it differs from current approaches to social science. Among the key differences Polanyi provides substantial scope for human agency and capability to change the course of history. He also shows that the social, political and economic spheres of human existence are deeply interlinked and cannot be analysed in isolation, as current approaches assume.

Keywords: methodology, social science, capitalism, liberalism

JEL Codes: B31, B41

1. Introduction

Meier (2008) writes that 'A list of the most seminal works in political economy of the twentieth century would have to include Karl Polanyi's *The Great Transformation*'. Similarly, in his foreword to the re-publication of Polanyi (2001[1944]), Stiglitz testifies to the continuing importance and contemporary relevance of the book. Nonetheless, the methodology adopted by Polanyi in his analysis of The Great Transformation is radically different from current methodologies in Economics, both orthodox and heterodox. Our goal in this article is to explicitly articulate several components of this methodology by showing how Polanyi uses them. This goal is of great importance because the failure of economists to predict, understand, or remedy the East Asian Crisis, the Global Financial Crisis, the Greek Debt Crisis, constantly recurring economic crises in Latin America, and many other major economic problems stems from defective theories, based on defective methodologies. The ability to replicate Polanyi's analysis would add substantial depth to our understanding of contemporary events in the social, political and economic spheres. However, in order to do this, we need to have an understanding of the methodology used by Polanyi in constructing his ground-breaking analysis of capitalism.

A major obstacle to understanding Polanyi is a deeply-flawed epistemology which led to the creation of the 'social sciences' in the early twentieth century as a result of the ascendance of logical positivism. The idea that science is based solely on observables, and consists of quantitative and universal laws, was applied to the study of society, as in physics, in the hope that this would lead to deeper insights. The name 'social science' reflects this hope. In fact this project has been singularly unsuccessful for many reasons; see Zaman (2014) for a detailed exposition. Even though positivism had a 'spectacular crash', positivist ideas remain popular, and positivist methodological foundations for economics have not been revised.

One of the core ideas of positivism is that facts and logic are sufficient to arrive at the truth. Actually, theories are essential to link the facts and frame them within some ideological framework. Facts cannot be understood without an ideological/theoretical framework. Thus, theories are essential to understanding historical experience, and to formulating a suitable response to this experience. In turn, subjective elements are essential in framing theories. A defeat in battle may be interpreted as a temporary and reversible setback, or as an inevitable outcome. Human experience, and history, cannot be understood without theories. In turn, theories are generated by human beings in the process of organising historical facts into coherent frameworks. Thus theories cannot be understood outside the historical context which generated these theories. This reflexive relation between theories and historical experience is at the core of the analysis offered by Polanyi. This understanding is also violently in conflict with the idea of 'social science' as an attempt to find 'scientific' social theories, which are valid without reference to historical context. This point of view about theories used in 'social sciences' has several radical implications:

1. Historical materialism is rejected. Human beings actively participate in shaping history, because responses to historical experience are generated in light of theories created by human beings to understand these experiences. Although theories can reflect class interests, they can also cut across class interests, and human beings have substantial agency to choose among alternative theories.

2. The analysis of the emergence, evolution, and replacement of theories cannot be understood by studying the relation of these theories to the 'truth'. Rather, we must study the theories in their historical context, to understand how they functioned to protect and further interests of certain classes, and harm others.

3. The methodology of science, which requires separation of the observer and the observed, cannot be used in social sciences. Theories formulated by observers shape their understanding of their experience, and their responses to this experience, directly affecting history. Thus, understanding social phenomena requires simultaneous consideration of the observer and the observed.

A meta-theoretical analysis, like Polanyi's, is necessarily complex and multi-layered. We start with the basic layer of historical experience. At the second layer, we analyse how this experience impacted on contemporaries, and what theories were formulated to understand it. At the third layer, we look at how different groups respond to this experience differently, in light of their understanding based on these theories. At the fourth, we analyse how these theory-mediated responses affect the course of history. The meta-analyst must attempt to stand outside this stream. Many critiques of Polanyi are based on fundamental misunderstandings of what Polanyi was saying; for examples, see Mayhew (2000). Our re-construction of the methodology of Polanyi is also multi-layered, and multiple elements have to be considered together to be properly understood. It is important to state at the outset that our goal is to present the methodological approach used by Polanyi and not the main ideas of *The Great Transformation* – summaries from different perspectives are available in Mayhew (2000) and Zaman (2010).

In this article, we focus on several major methodological principles used by Polanyi, each of which is diametrically opposed to conventional methodology currently in use in economics. The first of this is to consider the central role of institutions as mediators of change. Institutions emerge to provide concrete means for achieving collective human objectives in the political sphere. A second principle is "methodological communitarianism," according to which only collective action creates social change – this is directly in conflict with the methodological individualism of conventional economics. A wide range of illustrations of conflicts and coalitions among groups, as well as impacts of external factors, is used by Polanyi to illustrate the impact of collective action on shaping history. A third principle is the strong interaction between the social, economic and political spheres which requires simultaneous consideration of all three. This means that current discipline boundaries, make it impossible to achieve insight into economic processes. A fourth principle is the reflexive relationship between theories and history. Changing historical circumstances generate theories designed to understand this change. In turn, theories affect history, since responses to change are mediated by theories. Finally, Polanyi argues that social change is initiated by external factors, but understanding the process of change requires considering responses to these external stimuli by various groups. These responses have to be considered simultaneously at the ideological level and at the institutional level. Each of these issues is discussed in detail in separate sections below.

2. An Institutional Perspective

Polanyi's (p. 3[1]) book opens with the following statements:

> 'Nineteenth century civilization rested on four institutions. The first was the balance-of-power […which prevented…] long and devastating war between the Great Powers. The second was the international gold standard… The third was the self-regulating market which produced an unheard-of material welfare. The fourth was the liberal state.'

This opening makes it clear that these institutions will play a central role in the analysis that follows. More explicitly, Polanyi (p. 4) states that 'Ours is not a historical work; what we are searching for is not a convincing sequence of outstanding events, but an explanation of their trend in terms of human institutions.' Thus, Polanyi follows in the tradition of Ibn-e-Khaldun[2], who was the first to search for underlying engines which drive history. This quote makes it clear that the goal of Polanyi is to explain broad historical trends in terms of underlying drivers of history, taken to be human institutions. As promised, the book traces the emergence, evolution and extinction of many different institutions, not just the four listed above – thus showing that the institutions are not exogenous invariants, to be used as a basis for explanations. In other words, Polanyi does not treat institutions as the final cause, in the Aristotelian sense. This leads to a puzzle: how can institutions play a central role in explaining history, when they are themselves born, shaped, evolve and die as a result of other forces? We provide an answer in the next section.

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[1] All quotes attributed to Polanyi are taken from his book *The Great Transformation: The Political and Economic Origins of Our Time*, (2001[1944]) unless otherwise stated.

[2] Ibn Khaldūn (1332–1406) was a (Tunisian) Arab Muslim historiographer and historian, regarded as among the founding fathers of modern sociology, historiography, demography and economics. He is best known for his book, the *Muqaddimah*. This book analyses historical change processes using the fundamental concept of 'asabiyyah', or social cohesion.

3. The Spirit of History

Hegel argued that the 'spirit of history' realises the principle of rational freedom in the world through the mechanism of human history. Thus history is shaped by larger forces which impel it in certain directions leading to the realisation of greater freedom and rationality. Polanyi also uses certain global forces and ideas to explain the progress of history, but these are concrete and explicable, rather than abstract and metaphysical. To illustrate, Polanyi considers the collapse of the Gold Standard as a turning point in history. At the same time, the event is considered as a manifestation of hidden social forces at work. For example, he writes that the collapse of the Gold Standard, and the accompanying collapse of the international system (political and economic) was caused by deeper social forces at work, which were not understood by contemporaries (Polanyi, p. 25). Similarly, the rise and fall of nations or groups may depend on whether or not their institutions are aligned with the underlying process of social change (Polanyi, p. 27). The underlying process is often hidden and misunderstood by contemporaries, as we will further clarify later.

Polanyi (p. 262) writes that 'Institutions are embodiments of human meaning and purpose.' Collective human will to achieve some goal can lead to the formation of institutions necessary to the achievement of that goal. If such institutions are not formed, than these purposes and goals remain ineffective. Polanyi (p. 8) writes that 'Interests, however, like intents, necessarily remain platonic unless they are translated into politics by the means of some social instrumentality.' Specifically, even if a vast majority of human beings collectively desire peace, this desire will remain unrealised unless an institution emerges to translate it into reality. This provides a resolution of the puzzle raised before. The spirit is a collective will – basically a goal which inspires and motivates a large community of people – and the institutions represent the embodiment of the will, which is the mechanism by which this will operates in the real world. As the metaphor of body and spirit suggests, the spirit cannot effect actions without an embodiment; at the same time the body is dead without a spirit, and cannot be understood in isolation, separately. This is how institutions are central to the story of Polanyi, without being the final cause of changes which take place. The capabilities and structure of the institutions shape and limit the ways in which any given goal of the spirit is materialised in the real world. This is why institutional analysis is necessary to understand history.

4. Methodological Communitarianism

The title of this section is a neologism, formulated to express the antithesis of methodological individualism. It rests on two premises:

1. An individual's behaviour and motivations cannot be understood outside of his community and his social and historical milieu. Our actions as individuals are strongly shaped by social norms which are prevalent in, and taught to members of, any given community.

2. History is shaped by groups; individuals are too small to affect the streams of history. Of course, individuals can create and inspire communities with a common vision, thereby influencing history.

In subsections below, we provide textual support to confirm Polanyi's use of these principles in his analysis.

4.1 Individual Behaviour is Shaped by Society

In support of the first premise of methodological communitarianism, we offer the following quote from Polanyi (p. 54):

> 'Broadly… all economic systems known to us up to the end of feudalism in Western Europe were organized either on the principles of reciprocity or redistribution, or householding, or some combination of the three. These principles were institutionalized with the help of a social organization which, inter alia, made use of the patterns of symmetry, centricity, and autarchy. In this framework, the orderly production and distribution of goods was secured through a great variety of individual motives disciplined by general principles of behavior. Among these motives gain was not prominent.'

There is substantial additional textual evidence that Polanyi thinks individual motives are shaped by larger social forces. Indeed, one of the central theses of Polanyi is that working for profits or money is not ordinarily a powerful motive within human beings, and the market economy must strengthen this motive in order to be able to function. Polanyi was misunderstood as saying that men in primitive societies were not motivated by self-interest. Some anthropologists and economists then attacked this idea by arguing that men everywhere are 'rational' – motivated by self-interest; see Mayhew (2000). In order to avoid a repetition of this error, we clarify Polanyi's position below.

First, Polanyi (p. 48) argues that humans are social beings, and that this is an invariant: 'For, if one conclusion stands out more clearly than another from the recent study of early societies it is the changelessness of man as a social being.' It is clear that Polanyi does not think that the nature of man varies, or has changed, due to the emergence of the market society in modern times – even though some passages from the text could be misinterpreted in this way. However the fundamental motivation of humans, which is invariant across societies, is to protect and enhance social standing (Polanyi, p. 48). Now the link between social standing and material goods can be redefined within different societies. In particular, the market society must strengthen this relationship, since it forms the basis for economic activity within such a society. However, all societies – other than market societies – protect themselves by promoting generosity as a marker of social standing: 'The premium set on generosity is so great when measured in terms of social prestige as to make any other behavior than that of utter self-forgetfulness simply not pay. Personal character has little to do with the matter. Man can be as good or evil, as social or asocial, jealous or generous, in respect to one set of values as in respect to another' (Polanyi, p. 49).

4.2 History Is Shaped by Groups

Once we view history as the history of society, which embeds within it political, economic and social relationships, it is almost tautological that history is shaped by actions of groups. Social change requires changes in networks of social relationships, emergence, destruction, or alterations in relationships between different classes inevitably requiring involvement of large numbers of people. As Polany (p. 159) writes: 'The essential role played by class interests in social change is in the nature of things… hence only when one can point to the group or groups that effected a change is it explained how that change has taken place.'

As an illustration of this principle, Polanyi (p. 162) shows how different classes advanced and impeded the spread of the market. The trading classes led the change, joined by a new class of entrepreneurs coming out of the remnants of older classes in a development which was consonant with the interests of the community as a whole. 'But if the rise of the industrialists, entrepreneurs, and capitalists was the result of their leading role in the expansionist movement, the defense of traditional society fell to the traditional landed classes and the nascent working class…'

This is the fundamental explanatory principle, used throughout the book by Polanyi. He analyses historical changes in terms of how they affected the interests of different groups, and also the institutions available to embody and translate these interests into practice.

Nonetheless, Polanyi explicitly mentions an important caveat. Even though actions of groups lead to historical change, these actions are not exogenous. These actions are often responses to external challenges: 'Yet the ultimate cause is set by external forces, and it is for the mechanism of the change only that society relies on internal forces. The "challenge" is to society as a whole; the "response" comes through groups, sections, and classes. Mere class interests cannot offer, therefore, a satisfactory explanation for any long-run social process' (Polanyi, p. 152). Again, this is similar to the idea of institutions as the embodiment of a spirit. Here the process of change is set into motion by external forces which act upon the society as a whole. However, the process is carried out by groups responding to these changes in different ways, sometimes in harmony and other times in conflict.

5. Beyond Class Struggle

While Marx took class struggle as the fundamental driving principle of history, Polanyi (p. 160) argues that 'mere class interests cannot offer a satisfactory explanation for any long-run social process.' Just as institutions are central to Polanyi's story, but they are not drivers of change, so class struggle is an important component of Polanyi's story without being the driver of long-run social change. To understand this correctly, it is essential to focus on the qualifier 'long-run'. In the short run, within a stable social structure, the dynamics of the change process may be driven by class struggle. However, in the long run, this is not the case. In one of his few clear articulations of methodology, Polanyi (p. 159) explains why this is so:

1. The process in question may decide about the existence of the class itself; that is, the process of social change may create or destroy classes.
2. The interests of given classes determine only the aims and purposes toward which those classes are striving, not the success or failure of such endeavours.
3. The chances of classes in a struggle will depend upon their ability to win support from outside their own membership, which again will depend upon their fulfilment of tasks set by interests wider than their own.
4. Challenges for society as a whole are created by external causes, such as a change in climate, in the yield of crops, a new foe, a new weapon used by an old foe, the emergence of new communal ends, or, for that matter, the discovery of new methods of achieving the traditional ends.

On the basis of these considerations, Polanyi (p. 159) writes that 'Thus, neither the birth nor the death of classes, neither their aims nor the degree to which they attain them; neither their co-operations nor their antagonisms can be understood apart from the situation of society as a whole.' It seems likely that Polanyi explicitly articulated his position in order to clearly differentiate it from the Marxist analysis which was then in vogue. We illustrate Polanyi's methodology by providing examples of these principles from the text.

5.1 Emergence of a Group Interest

The Gold Standard served to link economies and provided a vehicle for international trade. Paper currency with fractional backing can be used domestically within a nation, as it is backed by government writ. However, international trade requires more solid ground. Reliance on the theory of free trade led to substantial interdependence of economies, and the Gold Standard appeared to all to be the only guarantee of free trade. Polanyi (p. 19) writes about how this external circumstance created a new group interest:

> 'Budgets and armaments, foreign trade and raw material supplies, national independence and sovereignty were now the functions of currency and credit. By the fourth quarter of the nineteenth century, world commodity prices were the central reality in the lives of millions of Continental peasants; the repercussions of the London money market were daily noted by businessmen all over the world; and governments discussed plans for the future in light of the situation on the world capital markets. Only a madman would have doubted that the international economic system was the axis of the material existence of the race.'

This is an illustration of the first point, that external circumstances can create new classes and new class interests. In this particular case, with widespread trade in necessities like grains, sustaining foreign trade became a common interest cutting across classes, and their private interests. Even though maintaining the Gold Standard adversely impacted on certain classes and certain nations, the commitment to free trade (viewed as a necessity by all) overrode these narrow class interests, and even national interests. This again illustrates the need for going beyond class interests in historical analysis.

5.2 External Circumstances may Determine Outcomes

Polanyi documents across-the-board, universal agreement, on the necessity of the Gold Standard, for reasons already discussed. He goes on to write that:

> 'Indeed, the essentiality of the gold standard to the functioning of the international economic system of the time was the one and only tenet common to men of all nations and all classes, religious denominations, and social philosophies. It was the invisible reality to which the will to live could cling, when mankind braced itself to the task of restoring its crumbling existence.
>
> The effort, which failed, was the most comprehensive the world had ever seen. The stabilization of the all-but-destroyed currencies in Austria, Hungary, Bulgaria, Finland, Roumania, or Greece was not only an act of faith on the part of these small and weak countries, which literally starved themselves to reach the golden shores' (Polanyi p. 27).

Despite tremendous efforts made by diverse groups, often acting against narrow self-interest, the Gold Standard collapsed when the USA went off the standard in 1933. There is a detailed and complex explanation provided by Polanyi of inherent contradictions in the system which led to the failure of the Gold Standard. Flaws in the monetary system are not our concern here. Methodologically, what this illustrates is that the combined striving of all groups – which can also be called the spirit of the age – did not lead to the desired outcome. The outcome was determined by technical and economic external factors, which are taken as the final cause in Polanyi's analysis.

5.3 Acting Across Class Interests

The third point states that typically, no class has sufficient power to enforce its desired outcomes on all others. This leads to the necessity of building coalitions, and of acting in ways which serve broader interests, in order to achieve successful outcomes. Coalitions and compromises may require acting against narrowly defined class interests. This is illustrated in the discussion by Polanyi (p.5) of the 100 years of peace: 'The nineteenth century produced a phenomenon unheard of in the annals of Western civilization, namely, a hundred years' peace—1815-1914*.*'

After documenting what he means by this phrase, namely no major war between major European powers (accompanied by 'almost incessant series of open wars into the domains of outworn cultures or primitive peoples'), Polanyi (p. 6) proceeds to provide an explanation of it. He shows that the 100 years of peace, contrary to past experience of continuous wars between European powers, was produced by a new factor – the emergence of an acute peace interest. He documents that prior to this era, wars were a universally accepted part of statecraft. However, 'After 1815, the change is sudden and complete' (Polanyi, p. 7). Whereas in the late 18th century, Rousseau had condemned tradespeople for their lack of patriotism in preferring peace to liberty, leading thinkers of 19th-century Europe called patriots 'the new barbarians'. In creating this change in public sentiment, and in redefining the range of acceptable policies for state and church, the group benefitting most from peace played an important role. Initially, this was the group of feudals and dynasts whose trade interests were threatened by wars. Later, institutions of *haute finance* were created which preserved peace to protect their financial interests which spanned across countries. The crucial point, the focus of this section, is that these groups were small in numbers, and did not have enough power to enforce their will on numerous other groups and powers in existence. Nonetheless, they succeeded in achieving their goals by co-opting leading thinkers into creating a new common interest, and by persuading other classes with different interests to yielding to this common interest instead of pursuing narrow class interest. A wide variety of methods were used to achieve this newly created common interest over the course of Polanyi's (p. 6) century of peace:

> 'Yet every single one of these conflicts was localized, and numberless other occasions for violent change were either met by joint action or smothered into compromise by the Great Powers. Regardless of how the methods changed, the result was the same. While in the first part of the century constitutionalism was banned and the Holy Alliance suppressed freedom in the name of peace, during the other half—and again in the name of peace—constitutions were foisted upon turbulent despots by business-minded bankers. Thus under varying forms and ever-shifting ideologies—sometimes in the name of progress and liberty, sometimes by the authority of the throne and the altar,

> sometimes by grace of the stock exchange and the checkbook, sometimes by corruption and bribery, sometimes by moral argument and enlightened appeal, sometimes by the broadside and the bayonet—one and the same result was attained: peace was preserved.'

It was one of the interests of certain powerful groups – the feudals and the dynasts, and later *haute finance* – to preserve peace. They gained the most from a functioning international trading system. Prior to the emergence of a powerful faction interested in preserving peace, wars occurred almost constantly in Europe. This means that wars served the interest of several other powerful classes in European society. Nonetheless, the group interested in peace was able to utilise the institutional structures and co-opt other powerful social groups to achieve their desired goal, using a wide variety of mechanisms.

Similarly, the Gold Standard benefitted some groups, and harmed others. Nonetheless, the groups benefitting from the Gold Standard were able to persuade other powerful factions to abandon narrow class interest in favour of what was perceived to be a common social interest.

This idea of Polanyi has several consequences which are of great importance. Theories are developed in the heat of evolving circumstances, in order to further interests of dominant groups. For example, the theory of free trade and comparative advantage provided grounds to argue that Europe should open its markets to the products of the advanced economy of England. It is significant that this theory was developed in England after it had a 50-year lead in industrial production over Europe. Successful application of this theory would have reduced Europe to a raw material producing hinterland for British industrial products. The German economist Friedrich List developed the infant industry theory which supported the interests of the German merchant classes against those of the British. His theories served as a basis for the protectionist policies which allowed the European economies to develop without threat of competition from Britain; see Bairoch (1995) for a more complete description. The relations between economic theories and group interests are central to Polanyi's analysis. Current methodology which views theories as part of 'social science' fails to relate them to group interests, and hence misses an essential component of the meta-analysis required to understand the emergence and role of these theories. It is worth noting that Polanyi's analysis of the complex inter-relationships between theories and class interests is more sophisticated than the simple power/knowledge idea as exposited by Foucault.

A second consequence has to do with the necessity of looking deeper than observable manifestations, to arrive at real causes of change. The influence of logical positivism has been so great that many political scientists have disavowed the idea of looking deeper into the (unobservable) motivations, and content themselves with an analysis of the observable political processes. However, if a large number of different mechanisms utilised to achieve peace are all manifestations of a single underlying peace interest, it will be impossible to achieve a unifying understanding of the political process without analysing the motivations and capabilities of different groups within a given institutional structure.

5.4 External Causes Drive Social Change

This principle is illustrated in Polanyi's book by many different examples, of which we just select two.

Polanyi (p. 42) writes that the invention of machines which enable large-scale industrial production is central to understanding the market economy: 'We do not intend to assert that the machine caused that which happened, but we insist that once elaborate machines and plant were used for production in a commercial society, the idea of a self-regulating market was bound to take shape.' Thus the invention of heavy and expensive machinery for mass production was an external factor that was an important driver of the process of social change leading to the industrial revolution. Indeed, the 'great transformation' of the title, which transformed social, political and economic structures of European society, was triggered by this external change.

As another example, consider Polanyi's statement that 'The connection between rural poverty and the impact of world trade was anything but obvious' (Polanyi p. 93). Again the external factor of a large increase in world trade led to a process of social change, which created the phenomenon of pauperism in both rural and urban areas of England. Efforts by various classes to deal with this new social problem led to the generation of theories about poverty and changes in social structures and attitudes towards poverty. In other words, an external stimulus led to emergence of new classes, re-configuration of class interests, changes in economic structures, and other social change.

6. Interlinkage of Social, Political and Economic Spheres

Throughout his analysis, Polanyi demonstrates the close linkages between these three major spheres of human existence. In fact, he also discusses the connections with the geological sphere, Earth, which has become extremely important recently, in the context of climate change and environmental degradation. These linkages make it impossible to analyse them in isolation, contrary to the assumptions embodied in current disciplinary boundaries between the three. We provide a few examples of these linkages from the text.

Polanyi starts by arguing that while markets may have existed since time immemorial, they have not been the central mechanism for the production and distribution of goods in any society other than our current modern one. He argues that 'the control of the economic system by the market is of overwhelming consequence to the whole organization of society: it means no less than the running of society as an adjunct to the market. Instead of economy being embedded in social relations, social relations are embedded in the economic system… society must be shaped in such a manner as to allow that system to function according to its own laws. This is the meaning of the familiar assertion that a market economy can function only in a market society' (Polanyi p. 60). The 'great transformation' of Polanyi's title is the transformation of a traditional society into a market society which dramatically affected both the political and the social spheres. 'Machine production in a commercial society involves, in effect, no less a transformation than that of the natural and human substance of society into commodities. The conclusion, though weird, is inevitable; nothing less will serve the purpose: obviously, the dislocation caused by such devices must disjoint man's relationships and threaten his natural habitat with annihilation' (Polanyi p. 44). As Polanyi prognosticated, the disruption of natural, social relationships and the environmental catastrophe which beckons, are consequences of the spread of market-based values.

A second example, discussed in great detail by Polanyi, is the linkage between a stable, international trading system and peace. He writes that 'In the absence of stable exchanges and freedom of trade the governments of the various nations, as in the past, would regard peace as a minor interest, for which they would strive only as long as it did not interfere with any of their major interests. First among the statesmen of the time, Woodrow Wilson appears to have realized the interdependence of peace and trade, not only as a guarantee of trade, but also of peace' (Polanyi p. 23). He explains both World Wars as a consequence of disturbances in international trading systems.

The following passage by Polanyi also shows the strong relationships between the economic sphere and the political and social spheres:

> 'In the early thirties, change set in with abruptness. Its landmarks were the abandonment of the gold standard by Great Britain; the Five-Year Plans in Russia; the launching of the New Deal; the National Socialist Revolution in Germany; the collapse of the League in favor of autarchist empires. While at the end of the Great War nineteenth century ideals were paramount, and their influence dominated the following decade, by 1940 every vestige of the international system had disappeared and, apart from a few enclaves, the nations were living in an entirely new international setting. The root cause of the crisis, we submit, was the threatening collapse of the international economic system. It had only haltingly functioned since the turn of the century, and the Great War and the Treaties had wrecked it finally' (Polanyi p. 24).

The book is replete with examples of direct relationships between the economic, political and social spheres of human existence. The few examples listed above should suffice as a sample.

7. Theories and Learning from Historical Experience

Whereas the naïve view is that experience leads to knowledge, Kant[3] is more accurate: 'Experience without theory is blind, but theory without experience is mere intellectual play.' Experience is merely knowledge of a sequence of events, but learning from this experience requires an interpretation of this experience in light of theories about causality. This problem is obscured in conventional methodology because of the empiricist illusion that facts speak for themselves. By re-interpreting the causal relations, the same set of observed facts can be made to support many different theories. This difficulty is fundamental and cannot be overcome, since Hume correctly observed that causal relations cannot be deduced from observational data. Thus causal theories must be imposed upon experience in order to learn from it. If the causal theories are wrong, then experience can lead to ignorance and error, instead of leading to knowledge. Polanyi provides many examples of this type of problem in his book. For example, he writes that:

> 'A hundred years' peace had created an insurmountable wall of illusions which hid the facts. The writers of that period excelled in lack of realism. The nation-state was deemed a parochial prejudice by A. J. Toynbee, sovereignty a ridiculous illusion by Ludwig von Mises, war a mistaken calculation in business by Norman Angell. Awareness of the essential nature of the problems of politics sank to an unprecedented low point' (Polanyi p. 198).

An interesting example central to the theme of the book is the variety of theories coined to explain a sudden rise in pauperism in England in the early nineteenth century. Polanyi (p. 94-95) writes that:

[3] This is declared to be 'an old Kantian maxim' in *General Systems* Vol. 7-8 (1962) p. 11, by the Society of the Advancement of General Systems Theory, but may simply be a paraphrase or summation of Kantian ideas.

> '"Where do the poor come from?" was the question raised by a bevy of pamphlets which grew thicker with the advancing century… On one point there appears to have been general agreement, namely, on the great variety of causes that accounted for the fact of the increase. Amongst them were scarcity of grain; too high agricultural wages, causing high food prices; too low agricultural wages; too high urban wages; irregularity of urban employment; disappearance of the yeomanry; ineptitude of the urban worker for rural occupations; reluctance of the farmers to pay higher wages; the landlords' fear that rents would have to be reduced if higher wages were paid; failure of the workhouse to compete with machinery; want of domestic economy; incommodious habitations; bigoted diets; drug habits. Some writers blamed a new type of large sheep; others, horses which should be replaced by oxen; still others urged the keeping of fewer dogs. Some writers believed that the poor should eat less, or no, bread, while others thought that even feeding on the "best bread should not be charged against them." Tea impaired the health of many poor, it was thought, while "home-brewed beer" would restore it; those who felt most strongly on this score insisted that tea was no better than the cheapest dram. Forty years later Harriet Martineau still believed in preaching the advantages of dropping the tea habit for the sake of relieving pauperism.'

Polanyi offers the explanation that a new factor had entered the scene which contemporaries were not aware of. This was an erratic increase in foreign trade with an upward trend. This led to increasing employment in industries, but also unemployment when sudden drops in demand led to widespread layoffs. The point here is not to discuss right and wrong, but to note that theories are often designed to explain emergent and unusual situations. For example, Keynesian theory was designed to explain the Great Depression. It would not be at all surprising if contemporary explanations miss factors which may become clearer with hindsight, and with the perspective offered by time and more experience. Another example, which is part of the core arguments of the book, is the formulation of economic theories in response to the Speenhamland episode.[4] Polanyi argues that this effort to provide a guaranteed minimum wage to workers failed because the norms of social responsibility embodied in these laws were not compatible with the newly emerging market institutions. However, contemporary explanations were based on theories which did not take these into account.

> 'The complicated economics of Speenhamland transcended the comprehension of even the most expert observers of the time; but the conclusion appeared only the more compelling that aid-in-wages must be inherently vicious, since it miraculously injured even those who received it' Polanyi (p. 86).

[4] Polanyi (p 77) describes the Speenhamland incident as a central event in the formation of the market economy. The newly emerging market economy required a 'market for labour' – human lives freely available for sale and purchase in the open market. Speenhamland was the last attempt of the pre-market society to resist this horror. The Speenhamland laws of 1795 guaranteed the 'right-to-live' by ensuring that everyone would have a minimum wage, regardless of whether or not they were working. But this completely destroyed the incentive to work for the mass of labourers, an essential component of the market economy. The disastrous effect of this attempt to protect society on both the economy and on the labourers themselves created the social resolve necessary to throw the labourers to the wolves, withdrawing protection for the poor, and thus creating a labour market.

Polanyi proceeds to 'survey the consequences of the fact that the foundations of economic theory were laid down during the Speenhamland period*.'* He argues that 'First**,** the economic theory of the classical economists was essentially confused.*'* He provides examples and brief explanations of some of these confusions. Secondly, he argues that the economic system under observation of the classical economists was a mix of premarket and market economies, which was the source of the confusion. Thirdly*,* economists borrowed natural laws from biology and elsewhere to explain observed economic patterns. These theories had far-reaching consequences in terms of denying the viability of alternatives and suppressing the role of human agency in the economic system (Polanyi p. 130).

These examples suffice to show how Polanyi explains the emergence of theories as an attempt to understand complex emergent phenomena by contemporaries.

8. Theory-based Responses to External Stimuli Shape our Future

Polanyi (p.39) writes that 'we insist that once elaborate machines and plant were used for production in a commercial society, the idea of a self-regulating market was bound to take shape.' The large amount of production made possible by machines led to changes in social structures, and the emergence of theories which accommodated these production possibilities. In particular, Polanyi explains how the motive of subsistence must be replaced by the motive of gain to sustain large-scale production by machines. Similarly, large amounts of domestic and international trade led to an increasing importance of money. This, in turn, led to changes in social and economic theories adapted to the creation of the artificial commodity of money. Thus Polanyi illustrates how an external stimulus led to changes in social, political and economic structures of a society. Some of the action in the process of change is carried out by classes pursuing their interests. Generally speaking, classes do not have enough numbers or power to enforce their agendas, and must win cooperation of others to succeed. A variety of mechanisms can be used for this purpose, but one of the most important is the creation and propagation of theories which define a common interest, cutting across classes. Our goal in this section is to trace the emergence of such theories, and show how they have impacted on history.

Polanyi (p. 42) writes that 'The Industrial Revolution was merely the beginning of a revolution as extreme and radical as ever inflamed the minds of sectarians, but the new creed was utterly materialistic and believed that all human problems could be resolved given an unlimited amount of material commodities.' Whereas nearly all societies and religions have warned against the pursuit of wealth, the industrial revolution created the capability for production of vast amounts of wealth, and also generated ideologies which would justify this production as beneficial for all. For example, Keynes (1931) cited in Skidelsky (2001) argued that even though greed was a 'disgusting morbidity', it must nonetheless be allowed to prevail in society, since that would lead to the accumulation of wealth. This wealth would solve all social problems in the long run. Nelson (2001) has documented how this creed became widely believed among economists.

8.1 The Commodification of Human Lives

A perfect illustration of the methodological point under study is the Speenhamland episode, regarded by Polanyi (p. 87) as pivotal: 'study of Speenhamland is the study of the birth of nineteenth century civilization'. As Polanyi explains, the emergence of a market economy requires three artificial commodities – land, labour and money. Of the three, the most traumatic to natural human society is the commodification of labour – another name for human lives. Land and money had already emerged as commodities, but the social catastrophe created by Speenhamland Laws led to the emergence of the labour market, and the birth of the market economy. Our point of focus in this section is that these major events were mediated by theories which were based on a wrong analysis of the Speenhamland episode by contemporaries. These theories continue to guide policies to this day. We explain this in somewhat greater detail below.

Social conflicts and land appropriations via enclosures had led to the emergence of poverty on a large scale, a necessary first step for the emergence of a labour market. Polanyi (p. 41) writes that '[the process of social change created by trade and industrialization] wrought unprecedented havoc with the habitation of the common people… Writers of all views and parties… referred to social conditions under the Industrial Revolution as a veritable abyss of human degradation.' Repeal of the Settlement Act allowed the poor to move across counties, creating the pool of labour required by the increasing industrial production in support of increasing sea trade. However, this was countered by the Speenhamland laws, which guaranteed a minimal living wage to all – regardless of whether or not they worked. Polanyi (p. 82) writes that 'Speenhamland led to the ironical result that the financially implemented "right to live" eventually ruined the people whom it was ostensibly designed to succour.' Although it was not intended as such, the law was used to force all the poor to work, but the difference between the wage in industry and the minimal living wage was paid by the county. On the surface, this was a brilliant solution – industry would get a massive pool of labour at low cost, while everyone would get a living wage. This combination of the pre-capitalist norms of social responsibility proved to be incompatible with the demands of the emerging market economy. The provision of a living to the poor interfered with incentives to labour under miserable industrial conditions, and led to declining production, as well as de-humanisation of the poor. The complex economics of this situation were not understood by contemporaries, and were exceptional in any case, being a combination of pre-capitalist and emergent capitalist conditions. The attempt to understand the Speenhamland experience, so as to create change for the better, led to three important consequences.

8.1.1 Creation of Theories Justifying Indifference to Poverty

One consequence was the understanding that poverty was necessary to the functioning of society. Hunger was the only goad that could be counted upon to get labourers to produce, and without production, everyone would be worse off. Edmund Burke is quoted by Polanyi (p. 123): 'When we affect to pity as poor those who must labour or the world cannot exist, we are trifling with the condition of mankind.' Similarly Malthus (1809) argued that excessive procreation of the poor led to an increase in the numbers of the poor. Supporting them would only increase poverty by increasing their numbers. The only solution to poverty was to stop the poor from procreating, or even to allow them to die of plague and famine.

It was in the background of such theories, based on wrong lessons learned from Speenhamland, that the policies enacted in England were formulated. Relief was designed to be humiliating and degrading partly because the poor were responsible for their own poverty, and partly because providing extensive and comfortable relief would interfere with the production process. This came to be widely believed, and was responsible for the abolition of poor relief, as the following passage from Polanyi (p. 132) indicates:

> 'That the Poor Law must disappear was part of this certainty. "The principle of gravitation is not more certain than the tendency of such laws to change

> wealth and vigor into misery and weakness... until at last all classes should be infected with the plague of universal poverty," wrote Ricardo. He would have been, indeed, a moral coward who, knowing this, failed to find the strength to save mankind from itself by the cruel operation of the abolishment of poor relief. It was on this point that Townsend, Malthus and Ricardo, Bentham and Burke were at one.'

8.1.2 Natural Laws of Poverty

The Speenhamland laws created an obstacle to formation of the labour market necessary for capitalism. However they had a disastrous effect on the poor that these laws were meant to help. The reason for this failure, as identified by Polanyi, was the conflict and incompatibility between the mechanisms of a paternalistic and regulatory economy, and the emerging capitalist economy. However, contemporaries who analysed the experience came to the view that there were iron laws governing the economy, which operated outside the sphere of human free will.

> 'Essentially, economic society was founded on the grim realities of Nature; if man disobeyed the laws which ruled that society, the fell executioner would strangle the offspring of the improvident. The laws of a competitive society were put under the sanction of the jungle. The true significance of the tormenting problem of poverty now stood revealed: economic society was subjected to laws which were not human laws' (Polanyi p. 131).

Many authors have since realised that the economic realm is not subject to natural laws. Social, political and government interventions of all kinds, small and large, distort the operations of the free markets, and produce desired results of various kinds. In particular, there is no iron law dictating the existence of poverty. If thinking had not been conditioned by these misleading theories regarding the operations of the labour market, the era of plenty which followed would have been enough to eliminate poverty. As it happened, these theories, and the interests of the emerging capitalist class, provided the basis for the later action. These theories created the possibility of taking shocking and inhuman steps against the poor. Polanyi (p 86) writes that about the Poor Law Reform Act of 1834 that 'The scientific cruelty of that Act was shocking… Never perhaps in all modern history has a more ruthless act of social reform been perpetrated… Psychological torture was coolly advocated and smoothly put into practice by mild philanthropists.'

As evidenced by the quotes from Burke and Malthus, the enactment of these policies not only de-humanised the poor, but belief in these theories also de-humanised the rich. Understanding this impact of economics on the social sphere is essential to a correct understanding of anti-poverty policy to this day.

8.1.3 Extreme Faith in the Liberal Creed

The deliberate crushing of multitudes of lives of the poor as an essential offering to the emerging gods of capitalism required a strong faith in the liberal creed. Faint hearts would revolt at the magnitude of misery to be inflicted on the poor. As Polanyi (p. 141) writes 'Economic liberalism… evolved into a veritable faith in man's secular salvation through a self-regulating market. Such fanaticism was the result… the magnitude of the sufferings that were to be inflicted on innocent persons… The liberal creed assumed its evangelical fervor only in response to the needs of a fully deployed market economy.'

It is worth re-emphasising the complexity of the methodology in use by Polanyi. Emergent puzzling and urgent economic circumstances led to the formulation of theories and explanations. These theories posited iron laws necessitating poverty as essential for functioning of an economy, and also put the blame for poverty on the poor. Economic policy conducted in light of these policies affected society by weakening bonds of responsibility and compassion, which affected all social structures. There were also political consequences which are analysed elsewhere by Polanyi, demonstrating further the strong inter-linkages of these three spheres of human existence.

8.2 Commodification of Land

The idea that land, labour and capital are factors of production was introduced by Adam Smith and the classical economists, and continues to be a key element of economic theory today. One of the key insights of Polanyi is that labour, land and money are 'fictional' commodities. Mathematically, the familiar production function represents the idea that we can use these commodities as inputs into the production process for goods. However, labour and land represent human lives and their habitats, which cannot be treated as commodities for many reasons. Commodities are homogenous and can be produced at will. Each human life is infinitely precious, in the sense that no amount of wealth can reproduce it once destroyed. Similarly, each piece of land is unique, and converting it into a habitat for human lives requires patient work over time (Polanyi p. 193). If the production process damages human lives, or uses up natural resources or destroys the environment, flora and fauna, this cannot be undone – we cannot produce these 'commodities' at any cost. The market subordinates society – human lives and living places as well as social relations – to the demands of organising production. Polanyi (p 74) writes that 'the change from regulated to self-regulating markets at the end of the eighteenth century represented a complete transformation in the structure of society.'

In this section, we aim to show that institutional structures function with the help of theories created to justify them, and that this is one of the methodological concepts used by Polanyi in his analysis. This is expressed clearly in the following prescient passage from Polanyi (p. 76).

> 'Nevertheless, it is with the help of this fiction that the actual markets for labor, land, and money are organized; they are being actually bought and sold on the market. Now, in regard to labor, land, and money such a postulate cannot be upheld… (if land is treated as a commodity then)… Nature would be reduced to its elements, neighborhoods and landscapes defiled, rivers polluted, military safety jeopardized, the power to produce food and raw materials destroyed. Finally, the market administration of purchasing power would periodically liquidate business enterprise, for shortages and surfeits of money would prove as disastrous to business as floods and droughts in primitive society.'

It is the spread and dominance of market-friendly theories regarding natural resources and wealth which create the social possibility of chopping down unique wonders of the world for the production of timber, and the destruction of coral reefs to support production processes. These theories generate indifference to heart-breaking tragedies like millions of deaths from hunger and malnutrition, and the extinction of rare species. Conventional economic theory ignores the fact that we live on a finite planet with limited resources, and the biological resources have been produced by processes taking millennia, and cannot be reproduced. Emergent market structures generated theories equating land and labour to homogenous manufactured commodities, which has led us to the brink of an environmental catastrophe, without even sufficient recognition of the fact.

9. Dynamics of Social Change

The main theme of Polanyi's book is to describe the great transformation which took place in social, political and economic structures of society, as a result of the replacement of a paternalistic and regulatory economic system by a self-regulated market system. Understanding the methodology used by Polanyi to achieve his deep insights would be of great value in understanding social change today.

Polanyi's methodology offers a solution to the problem of historical specificity, discussed at book length by Hodgson (2002). If history is to be more than a chronological list of facts, we need to be able to deduce some generally-applicable laws from these facts. Yet it seems clear that there can be no significant economic laws which apply equally to the American Indians, Incas, colonial India, and today's Europe. Hodgson writes that an appropriate balance between historical specificity and the necessity for universal laws required for explanation remains an unresolved question. Economics today is based on the assumption that self-interested human behaviour is universal. However, there is strong empirical evidence that this is not true; see Karacuka and Zaman (2012) for a survey.

Instead of self-interest, Polanyi argues that humans act to maximise social standing. Social standing is defined in different ways in different societies, allowing for substantial variation in behaviour across time and place. The process of social change is triggered by external stimuli. For the great transformation under discussion, this was the invention of machines, which led to the development of industry. This external stimulus locates the discussion within the context of history, making it historically specific. The effects of this innovation, which led to the production of vast amounts of surplus goods, impacted in different ways on different groups. The process of social change, as traced by Polanyi, is built around three different components.

THEORIES: As external stimuli create social change, observers develop theories to analyse the reasons for these changes. Often the novelty of the changes and lack of historical perspective leads to development of theories which neglect crucial aspects. For instance the Speenhamland episode led the British economists to believe that poverty was an inevitable accompaniment of progress, and necessary for the proper functioning of the production process. Some theories become widely believed, and become part of the spirit of the age. Such theories are adhered to and acted upon by large segments of society, cutting across more narrowly defined class interests. For instance, the creed that all problems of mankind could be solved with material resources came to be widely believed. Polanyi provides many other examples of widespread beliefs which are generated by the process of social change, and also support emergent institutional structures created by the social changes. These theories provide an analysis of problems created by social change and prescribe potential solutions. These theories are translated into practice by two means.

CLASSES: Social classes, groups with aligned interests, act to achieve their goals. To the extent that the interests of certain classes are aligned with the spirit of the age, they can achieve power and also help to propagate theories which conform to their interests. In fact, classes can be created and destroyed by external events. The industrial revolution brought a new class of producers into existence, and also doomed the 'Squirearchy' – a powerful class of rural landlords. This is because the power of the latter class was based on land and the rural population, both of which became factors of production in the industries. Conflicting as well as aligned class interests create one of the dynamics for social change. But there are many other dynamics that must be taken into account. One that is stressed by Polanyi is the necessity for combined action, cutting across narrow class interests, to achieve change. Widely believed theories create universally appealing social goals, and allow for such coalitions.

INSTITUTIONS: At the social level, all change must be mediated through institutions, which provide concrete and operational mechanisms for the achievement of social goals. Institutions have different characteristics and capabilities, which must be taken into account to understand their effectiveness. For instance, the Gold Standard was an institution that permitted international trade. This was beneficial to the traders, as well as the rich and powerful. However, normally occurring trade imbalances would lead to fluctuations in general price levels. In a highly interlinked system, a fall in the price of exports could lead to bankruptcy for exporters, seriously disrupting the global trading system. Many methods were devised to resolve this problem, but the World War I created such huge imbalances that the Gold Standard could not be maintained by the leading countries. The collapse of the Gold Standard was an external shock which created its own dynamic for further social change. These changes are traced by Polanyi. The methodological point being made here is that although institutions can (and often do) serve certain class interests, their effectiveness and failure can depend on exogenous events as well as on technical issues relating to the environment (social, political, and economic) within which they operate.

10. Conclusions

It should be obvious from the discussion above that the methodology used by Polanyi is radically different from that currently in use, at least within economics, but also more generally within the social sciences. One of the key elements of that methodology is the interaction between the observer and the observed, which allows for human agency in shaping history. History is not subject to laws which propel it in certain directions. Rather, human attempts to understand historical experience are represented by theories. These theories shape responses to this experience, which then become part of history. Because theories are formulated to understand historical experience, they must be evaluated within the context of this experience.

If theories are not universal invariants, as is widely believed, then the current theory about Polanyi's methodology must also be evaluated within its historical context. This is easy to provide. After the global financial crisis of 2007-8, there has been widespread discontent with conventional economic theories, which did not provide any warning signs. The failure of economic theory was so obvious that a Congressional committee was formed to investigate it. In written testimony for this committee, the Nobel Laureate Robert Solow (2010) stated that 'A thoughtful person, faced with the thought that economic policy was being pursued on this basis [DSGE models], might reasonably wonder what planet he or she is on' (p. xx). Dramatic failures of conventional methods led to search for alternatives. This research is part of the effort being made on many different fronts by many different researchers and groups, to find satisfactory alternatives.

One of the key contributions of Polanyi is to demonstrate the close linkages between the political, social and economic spheres of human existence. This is exemplified by the main theme of his book, which is the transformation of social and political systems which resulted from economic changes produced by the Industrial Revolution. As another example, he argues that the global trading system based on gold created a powerful peace interest. Breakdown of the Gold Standard led to autarkic economies, which became a root cause of World War II. The methodological point here is that such causal chains cannot be contemplated within the framework of current disciplinary boundaries between politics and economics. For example, ignoring political, social, and environmental consequences leads to highly misleading evaluations of the costs and benefits of economic growth, as shown in Zaman (2014). Polanyi's methodology offers us new ways of looking at the world around us. Since it cuts across disciplinary boundaries, use of this methodology would offer substantial insights into contemporary social, economic and political dilemmas not available using conventional social science methodologies.

Some critics have faulted Polanyi for the wrong prediction that World War II was the end of an era, and some new economic system would have to be devised. In the aftermath of the war, Keynesian economics came to be nearly universally accepted. This provides a theoretical basis for supporting workers and the unemployed which is absent from classical economics. Keynesian theory created protection for society from the harms caused by the commodification of labour. This can be considered as a partial fulfilment of Polanyi's prediction.

Another virtue of Polanyi's methodology is that it offers solutions. Recent wars have cost trillions, sufficient resources to assure everyone on the planet of a comfortable living standard. Polanyi argues that the underlying spirit of the market economy is pursuit of wealth and luxury, which is not compatible with the goals of peace and freedom. He writes that 'We will have consciously to strive for them (peace and freedom) in the future if we are to possess them at all; they must become chosen aims of the societies towards which we are moving' (Polanyi p. 263). The right of an individual to a job should be at the top of the list of rights needed for ensuring freedom. If Polanyi's ideas about social change are correct, the first step should be creating global consensus – cutting across class interests – on the goals of peace and freedom. The second step should be the creation of institutions necessary to translate this spirit into effective action. On this account, heterodox economists should focus on the creation of consensus and effective institutions to bring about social change.

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A Commentary on Asad Zaman's paper: 'The Methodology of Polanyi's *Great Transformation*'

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Asad Zaman has set for himself the admirable but difficult job of articulating the methods used by Karl Polanyi in his well-known and well-regarded work, *The Great Transformation* (hereafter referred to as TGT). It is to his credit that he is partially successful in completing the task. Before I explain why I think that Zaman succeeds and why I think he does not, I need to spend a few paragraphs explaining why the task is important and why it is so difficult.

The task of articulating Polanyi's methods for gathering evidence and creating his argument in TGT is a difficult one for several reasons, the first of which is that Polanyi's writing style sometimes makes reading fun but hard. The late George Dalton, whose own work in economic anthropology was heavily influenced by Polanyi, described the prose style of TGT as that of 'a stiletto set in the end of a battering ram'. The combination of close analysis and rhetorical power that this description suggests can be persuasive but requires close reading and considerable background knowledge for the structure of Polanyi's argument to become clear. It is not, for most economists, an easy read.

What makes articulation of his method even more difficult is that Polanyi did not have a traditional academic background. His background as a member of an intellectual Hungarian family, a journalist in Vienna, and then his involvement in worker education in England where he sought refuge in the 1930s, prepared him to make a political statement rather than one that would be more traditionally academic. (See Block and Somers 2014 for the best available treatment of Polanyi's background and its influence on his work.)

What Polanyi was quite clear about when he wrote TGT was the inadequacy of then current economic analysis to explain the events that had wracked Europe during his young and middle years. He found neither Marxian analysis nor the narrowly neoclassical economic analysis of English and many other universities adequate to account for the social and political upheaval that had so altered his world. The amazing TGT was his effort to make sense of that upheaval, but in TGT Polanyi did not offer a fully developed theoretical approach that could be used in a variety of contexts to arrive at a better understanding of economic systems and their evolution. Most of TGT was about a specific time and place.

Polanyi's methods and his conclusions did not fit within either the Marxist or the Marshallian traditions that dominated Anglo-American economic thought in the middle of the 20^{th} century, but his work was compatible with that of the American Institutionalists who played a major role in U.S. economic thought during the interwar period. For modern readers who may not know much of the literature of the original American Institutionalism, this makes understanding the impact of TGT even more difficult. That Columbia University invited Polanyi to become a Visiting Professor and teach their General Economic History course, which was part of their graduate programme, is testament to the similarity of Polanyi's approach to that of the Institutional economists who had played such an important role at Columbia during the interwar years. (For more on this see Rutherford, 2011.) That he remained in association with Columbia after retirement as co-director of a Ford Foundation financed interdisciplinary project, is evidence of continued interest among colleagues and students at Columbia in sorting out the implications of TGT for further study of economic change and institutional evolution. It was after the publication of TGT, while he was at Columbia University (1947-1953) that he and his colleagues who produced the work published under the title *Trade and Markets in the Early Empires*, worked out more explicitly some of the theoretical implications of the analysis of TGT.

My point, a point that is also made by Block and Somers, is that TGT was written *before* and not after Polanyi had the opportunity or the context in which to fully explore the methodological underpinnings of TGT. Because his masterpiece was written at the beginning of his academic career, the task of articulating the methods used in its writing is made more difficult and especially so as Zaman limits his analysis to his chosen topic, Polanyi's method in TGT.

Finally, the difficulty of Zaman's chosen task is enhanced by the considerable remove of Polanyi's approach from that of most work undertaken by economists today. In a sense, of course, Polanyi was not a 'real' economist. He knew much but did not hold what would today be considered proper economic credentials and he made no effort whatsoever to provide the kind of 'literature review' that is today considered a necessary part of academic projects. This means that the analyst must bring considerable knowledge to a reading of TGT.

Having outlined the difficulties of the project that Zaman has undertaken, I turn now to the importance of his task. It is one thing to admire TGT for its trenchant analysis of the sources of the social, economic, and political turmoil of Polanyi's time. It is quite another to understand how similar studies of our own time should be undertaken. Indeed, I would suggest that one major cause of the failure of the kind of Institutional/Evolutionary/Historical tradition that led to Polanyi's warm welcome at Columbia is precisely the failure of that tradition to make clear what is required to be a Polanyian (or a Veblenian or a follower of W.C. Mitchell) in doing economic analysis.

To the extent that Zaman can lay bare the elements of Polanyi's approach so that those same elements can be used in analysis of other times and places, he will have made a major contribution to strengthening of an important part of the heterodox tradition in economics and to socioeconomic analysis in general.

Two key elements of Zaman's paper seem to me to be an excellent foundation for understanding TGT. The first is the role that groups of individuals play in shaping institutional (meaning politico/socio/economic) change. The second is that individuals acting together use 'theories' to guide understanding of the changes in which they are involved and to articulate both possible and desirable outcomes. Taken together, the process of reorganising political, social, and economic institutions, and the justifications used to effect that change, is what Polanyi means when he says that 'society' protects itself. Society becomes a reality for Polanyi because individuals band together to accomplish goals and because those goals emerge from the institutional nexus that organises and gives meaning to human actions and interactions. The evolution of socioeconomic and political systems is an interactive process in which individuals both shape and are shaped.

Zaman does a good job when he writes that 'Polanyi does not treat institutions as the final cause...' Zaman recognises that institutions play a central role for Polanyi in explaining history, but are themselves creations of the human processes that we call history. Zaman finds an answer to the puzzle of how institutions shape history but are also a consequence of history by use of the concept of 'collective human will.' This leads to his conclusion that

Polanyi's work rests on what Zaman calls 'methodological communitarianism,' an approach that is the antithesis of the methodological individualism that is the approach of much modern economic theorising.

Zaman explains how Polanyi's methodological communitarianism differs from Marx's analysis by saying that Marx's understanding of class struggle as the fundamental driving principle of history is a subset of Polanyi's analysis of change as the reaction of 'society as a whole' in response to external causes. He illustrates Polanyi's argument by writing that the new importance of international trade in the late 19th century had created 'new classes and new class interests,' in this case those who supported the Gold Standard as essential to flourishing international trade. He also uses the 100 years' peace to illustrate the importance of coalitions that cut across class boundaries, where class is understood as the classes of Marx and the other classical economists.

Zaman could offer a stronger illustration of Polanyi's use of methodological communitarianism by explicit use of Polanyi's critique of the economistic bias that underpins both the classical and neoclassical analyses of economic conflict and change. As Block and Somers put it

> '[Polanyi]... rejects the view that individuals are motivated solely by self-interest... [and] considers no mistake to be greater than to define classes as aggregates of economic interests. On the contrary, classes are social constructions; they represent collective responses to changes in the organization of society. In particular, Polanyi insists that reducing the working class to its economic situation and interests distorts the entire history of its political development' (p. 62).

Zaman's emphasis is on some of the magnets that drew new coalitions together during the 19th century and this is good, but further exploration of what Polanyi meant by 'economistic bias' would help the reader new to TGT to understand Polanyi's direct rejection of narrowly defined economic interests as the only thing that brings groups together.

To repeat myself: Zaman does a good job of identifying methodological communitarianism and the use of common understanding to shape responses to changed circumstances. But, there is much more to do to translate the brilliance of TGT into a well-understood set of methods that can be used to understand the transformations currently underway in our world and our economies. My suggestion to Zaman is that he considers the following in pushing his worthy project forward.

It does follow clearly from Zaman's well done identification of the key elements of Polanyi's method that what are often thought of as separate analytical domains must be combined because of the interrelatedness of social, political, and economic factors in the evolution of economic systems. Polanyi's method is of necessity interdisciplinary and this Zaman understands and rightly emphasises.

That said, what I find most puzzling about Zaman's essay is his statement that Polanyi's methodology in TGT is 'radically different from current methodologies in Economics, both orthodox *and heterodox*' (emphasis added) and in his grounding of this difference in a rejection by Polanyi of 'the deeply flawed epistemology' of early 20th century social science, namely logical positivism. As defined by Zaman positivism means that 'facts and logic are sufficient to arrive at the truth.' But, as Zaman notes, 'theories' are essential to link 'the facts' and to frame them. This is as true for observers as it is for participants in socioeconomic transformations.

While I absolutely agree with Zaman on this last point, I don't think that the social scientists in general in the early 20th century adopted the simplistic view of logical positivism that he alleges they did. It would require a very much longer essay to compare the evolution of Polanyi's own thinking and that of the American philosophical tradition of Pragmatism which contributed greatly to the kind of social science that Polanyi found so compatible at Columbia University. (For an eminently readable introduction to some of the leading practitioners of this school of thought see Rucker, 1969.) Zaman's insistence on the importance of theories leads him to the rather strong conclusion that because '[t]heories formulated by observers shape their understanding of their experience...' this means that the methodology of science, 'which requires separation of the observer and the observed' cannot be utilized in the study of society.

A long line of economists and other social scientists struggled with just this dilemma and those who did so most successfully owed, either directly or indirectly, their resolution of the issue to Charles Sanders Peirce's explanation of the role that abduction, as opposed to induction and deduction, play in providing the causal relationship between actions and observations. Daniel Bromley (2006, Chap. 6) provides an excellent treatment of the importance of abduction and Malcolm Rutherford's book on the American Institutionalist tradition in economics in the interwar years showed that it involved a combination of scientific method and always value-laden policy prescriptions. To support his position that the 'scientific method' cannot be utilised in the social sciences, Zaman needs to consider that substantial body of work and the considerable overlap of the Peirce-Veblen-Dewey-Mitchell et al. tradition with what Polanyi brought to Columbia in the late 1940s. Without doing so, Zaman cannot successfully support his conclusion that 'scientific method' cannot be utilised in the social sciences.

Further consideration of this issue would be particularly important for Zaman if he should, as I would recommend, go back to incorporate the material from chapter 4 of TGT into his articulation of Polanyi's method. In that chapter, Polanyi laid out a classificatory scheme for the ways in which different societies provision themselves. It is surprising to me that Zaman does not give greater emphasis to this Chapter and the role that it plays in allowing Polanyi to argue that the self-regulating market mechanism of 19th century utopian efforts and 20th and 21st century textbooks is a peculiar system indeed.

My understanding of the role of TGT in the history of modern economic thought is that Polanyi greatly enriched the Institutionalist tradition that he found at Columbia, with its emphasis on the importance of understanding history and evolutionary change, by adding his brilliant understanding of the need to simplify and abstract different systems of provisioning from their specific historical contexts. This required the social science descriptions of such systems that Polanyi relied upon and it allowed a kind of comparison of systems that seems pretty 'scientific' to me. Only through that method could the utopian self-regulating market system that was partially achieved in the 19th century, and the 20th century responses to its weakening of the non-economic bonds fundamental to society, be fully understood. It was precisely by relying upon the work of both social scientists and historians that Polanyi was able to offer the schematic rendering of such systems in Chapter 4 of TGT. And, it was that rendering that allowed him to present the stark contrast that the self-regulating market system of the 19th century offered.

What Polanyi also added to the multidisciplinary and institution based social analysis of his time was renewed emphasis on the evolution of ideologies as economies evolved and, with such evolution, the necessary evolution of the assumptions of those who used abductive reasoning in their studies of both evolving economics and ideologies. This is, as Zaman, says, a multilayered analysis and one that is greatly superior to the non-evolutionary and essentially non-historical approach that has come to dominate economics. Zaman is quite right to call this to our attention.

Block and Somers, in their fine and recent treatment of TGT, add another important conclusion. They argue that what makes TGT so distinctive is Polanyi's recognition of the ongoing importance of political power, where political power is understood as the legitimate exercise of collective human will. Zaman also recognises this point and his recognition would be given greater prominence were he to place greater emphasis on the evolutionary dynamic which is always there precisely because of political power.

By further articulation of the role of political power (or, more simply put, group power) in the evolutionary process, Zaman could also address more fully a not quite satisfactorily resolved issue in his essay. He emphasises that external forces produce change but that observation leads to the question of why the status quo is so constantly battered by recurring external forces. Why don't human populations settle into a kind of stasis? Actually, human populations did so exist for a very, very long time. Why has change become a constant in the modern world? A full explanation of evolution requires an explanation of novelty.

The Great Transformation is a book that is about a particular place, the North Atlantic trading community and specifically the English component of that community, in a particular time, the early 19th century to the middle of the 20th century. It is not a discourse on social science method. That said, Zaman does a good job of identifying some of the key elements: Polanyi's recognition that the individual should not be the focus of attention, the emphasis on the interrelatedness of what we otherwise identify as social, economic, and political, and the role that the understanding of context plays in the formation of policies to deal with new situations. I would not have expected Zaman or any one person to solve all of the issues that I have raised here and I raise them only to say that I hope that Zaman will continue his task of telling modern readers what it is that causes so many of us to go back time and again to reread *The Great Transformation* in search of better understanding of our world some three-quarters of a century after its publication.

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