The Political Economy of Trade and Growth

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Yang, H.-S. *The Political Economy of Trade and Growth: An Analytical Interpretation of Sir James Steuart's Inquiry*. Aldershot, England and Brookfield, Vermont, USA: Edward Elgar, 1994. ISBN 1 85898 093 3. Pp. x + 326.

This is a 'Ph.D. book' originally supervised by D. P. O'Brien, who together with T. W. Hutchison receives strong acknowledgement (pp. v, 3n.5). It is the first attempt at a comprehensive, book length interpretation of Steuart's political economy since Sen (1957).

The author enunciates a clear disposition towards a sound historical approach to interpretation of an old text; but at the same time proposes an 'analytical' approach, as the subtitle signals (pp. 3-4). By this is meant an application of the method of *'rational reconstruction'* (p.4), whereby modern methods of mathematical modelling are to be deployed upon Steuart's text. Yang does not actually provide an explicit and precise definition of rational reconstruction, though his intention is quite clear. I would offer the following: 'rational reconstruction' is the application of formal models designed to accurately capture the *intentions* or ideas of an earlier author or text, while going beyond the actual analytical or formal *execution* of the writer. It thereby is a method of interpretation which, at its best, may enable a clearer grasp of the logical coherence (or otherwise), and logical implications, of an earlier economic writer's system or ideas.

Nevertheless, the use of this method is a source of considerable contention among historians of economic thought. (The present reviewer knows this to be so, only too well - because he has engaged in a little rational reconstruction himself!) Furthermore, this approach must become particularly dangerous when, as is the case in Yang, the logical coherence of the text is *assumed:*

> One might ask whether Steuart's *Inquiry* was really written, from start to finish, coherently. If not, how can we interpret it in a consistent way? The answer to this question is that we merely assume that all its different parts and pieces are logically, more or less, coherent. Unless they are supposed to fit together, any attempt to interpret each of them would be prone to be at best piecemeal and fragmentary, or, at worst, serving one's own particular interest (p.4).

I have no doubt that many scholars and readers will be at least dismayed by this stance - and at worst, may find this alone sufficient reason to reject the entire interpretation out of hand. Yang's assumption here is all the more baffling because, despite his belief (expressed in the above quotation) that this supposition is *necessary* to his method, it is not: one may well use formal methods to clarify *contradictions* in an earlier text; e.g., systems which are overdetermined (see, for example, Aspromourgos, 1995). It should have been possible for Yang to present his interpretation in a manner which allowed Steuart's consistency (if it is there) to emerge as a conclusion. We shall have reason to return to this contentious matter below.

As to the structure of Yang's book, there are ten chapters. Following a brief introductory chapter, there are eight chapters of interpretation thematically organized, followed by a brief concluding chapter. Chapters Two to Five deal with the core of Steuart's 'real' theory (though it should be stressed that Steuart has no 'neutrality' doctrine), as enunciated in Books I and II of the *Inquiry*: the basic framework of the social economy Steuart theorizes (Ch. 2); distribution and value (Ch. 3); output, employment and population (Ch. 4); and growth and foreign trade (Ch. 5). Chapters six and seven examine Steuart's monetary analysis: money and interest (Ch. 6); and money, exchange rates and the balance of foreign payments (Ch. 7). Chapter Eight covers public finance, which certainly has 'real' and monetary dimensions. The penultimate chapter provides an account of Steuart's political and social philosophy. By way of an interesting and effective technique, Yang makes extensive use of appendices, mainly to compare Steuart and other economic writers, with respect to various themes. In this manner, the main text of each chapter can concentrate on the interpretation of Steuart - while appendices deal with the Cantillon, Quesnay models of circulation (Ch. 2); value in Petty, Cantillon, Quesnay, Steuart and Smith (Ch. 3); Steuart and Keynes (Ch. 4); and Steuart and Smith again (Ch. 5). Strangely, this treatment of Steuart in relation to his predecessors and contemporaries is not undertaken with regard to monetary analysis, so that the book is somewhat lopsided in this respect.

The remainder of this review will concentrate largely on the interpretation of Steuart's real theory since this is where the present reviewer's comparative advantage in making informed comment lies.

The chapter on distribution and value, together with its appendix, is comfortably the longest in the book - and the appendix is as long as the chapter proper. The critical interpretive problem here turns on three related issues: the role of demand in relation to the theory of value (and hence also, in relation to the theory of distribution); the determinacy of distribution in Steuart's system; and the theoretical status of profits in the *Inquiry*. Yang's central and striking conclusion in this context is that Steuart is not appropriately to be placed in the tradition of 'cost of production' or 'supply side' theorists of value - from Petty through Cantillon to Quesnay and Smith (Turgot is barely mentioned) - but rather, stands outside this framework, in so far as demand plays a qualitatively different and more systematic role in Steuart's treatment of value and distribution (pp. 36-37, 39, 55-56, 86-88). This conclusion is based upon an argument that in Steuart equilibrium prices are determined by reference to cost of production plus a profit margin per unit of output, with the latter being determined by 'demand and supply' conditions. Hence, it is claimed, in Steuart prices and distribution cannot be determined by technology and exogenous real wages, in the essential manner of Petty and Cantillon.

This startling conclusion - that Steuart has a demand and supply theory of equilibrium prices and therefore stands outside the classical tradition in this respect - does not seem to this reviewer to be the most plausible way of resolving the meaning of Steuart's text. Steuart stands firmly in the tradition of classical value theory from Petty to Ricardo: prices are determined by production conditions and real wages, but together with profit margins. The difficulty is that Steuart has no determinate theory of profits - and while the distinction between wages and profits is firmer than in Cantillon - no clear and emphatic functional distinction between wages and profits is constructed by Steuart, as Yang knows (pp. 35n.14, 49-50, 58-59; and with regard to tax incidence, 232n.8). The notion that a theory of demand-and-supply determined profit margins is to be found in Steuart is untenable. Vague references to 'moderate' or 'reasonable' profit margins do not a theory make (Steuart, 1767, pp 173-74, 195, 263, 395, 695). The notion that there are price-elastic commodity demand functions in Steuart is even more untenable (pp. 34n.12, 40n.21). On this issue his position is clear:

> It is impossible to lay down a distinct theory for the rise and fall of the prices of ... commodities... All that can be said with certainty, is, that competition on the part of the consumers will make them rise, and that competition on the part of the furnishers will make them fall. Now the competition among the furnishers may be reduced to

> theory; because it is fixed within determinate limits ... But the competition among consumers is fixed within no determinate limits: some demand to satisfy physical wants; others those of vanity and caprice (Steuart, 1805, vol. 3, pp. 15-16.)

In other words, a theory of supply price is possible; a theory of demand price is not. But if supply price can be theorized within determinate *limits*, Steuart's incapacity to provide a determinate account of profits means that his system remains indeterminate (*vide* Aspromourgos, 1996, Ch. 8). Alternatively, one may collapse profits (as profits *of labour* really, not capital) into wages, and the system may become determinate - but then essentially indistinguishable from that of Cantillon.

Of course, the interpretation of profits is inevitably linked with the interpretation of capital. On this matter Yang also makes too much of Steuart's achievement because Yang fails to draw a critical distinction in relation to this issue. Capital has (at least) two distinct meanings in English: produced means of production; and, 'advances' to the production process, with at least an *expectation* of a right to some share of the resulting net product, thereby subsequently returning profits. Now, the latter notion effectively entails the former; but the former does not entail the latter. This distinction is particularly important when one is considering economic writers of the seventeenth and eighteenth centuries - a period of transition towards capitalism. The mere recognition of produced means of production in the writings of Petty, Cantillon and Steuart says nothing whatsoever concerning their grasp of the latter notion of capital, and cannot be treated as evidence of such, as Yang does (pp. 45, 50, 73-77, 87-88).

It may be added that in relation to Steuart's treatment of rents, the reader is caused some confusion by Yang's language (pp. 56-59). The data from Steuart presented here refer to *shares* of rents in gross agricultural product but Yang describes these proportions as *rates* of land rents. They are certainly not rates in the usual sense - nor in the sense in which Yang himself uses that term in his formal model of Steuart's 'real values' (pp. 31-32). To get from Steuart's shares to rates of rents per units of land, one would need to know output/land ratios. Unequal shares of course are consistent with equality of rates (a property of Yang's model) - indeed a uniform rate of rents per unit of land, per uniform time period, *requires* unequal shares, if the value of gross product differs across different units of land.

The upshot of all this with respect to value and distribution is that Yang's rational reconstruction may be an internally consistent and determinate system - but this does not seem so true of Steuart. And as a matter of fact, Yang's model suffers from two conceptual problems (pp. 31-32; also 71-72). The first is rather minor. For the so-called 'land theory of value' to explain the relative prices of all commodities (ignoring profits), it is necessary for all commodities to directly or indirectly require some land input for their production. This imposes on the formal model restrictions which Yang has not made explicit. Stated briefly, there must be at least one basic commodity (in the sense of Sraffa, 1960, pp. 7-8), and at least one of those basics must require land input for its production. The most intuitive route to imposing this restriction is to assume that all commodities require labour input and that at least one subsistence consumption commodity requires land input.

The second conceptual problem is more significant and indeed, rather puzzling. In remarking upon his model, Yang comments:

> the singularity of [production] matrices might happen only incidentally [*sic*-accidentally?], in that the coefficient ... matrices are determined by ... methods of production ... and, therefore, the columns and rows ... can be linearly dependent on each other only by chance (p.31n.4).

In fact, the supposition that economically meaningful determinateness of the price system has any element of chance is quite ill conceived. The linear independence of the columns (rows) of the relevant square matrix is something which reasonably can be *assumed*, because it has a sensible economic meaning. This matrix is given by the nxn identity matrix minus a square matrix of the n commodity 'input' requirements per units of the n commodity outputs - with the special feature that the input requirements include the subsistence consumption of required labour inputs, as well as commodity inputs in the more usual sense. The supposition that this matrix possesses an inverse (and indeed, a positive determinant) is, in economic terms, equivalent to assuming that the technology in use, together with subsistence consumption requirements of labour, allow the economic system to produce a surplus of output over and above input (including subsistence labour consumption). Now Steuart obviously is theorizing an economy which produces a surplus - and even without the benefit of matrix algebra, he is as aware as we are that an economy which cannot produce a surplus cannot generate positive rents and/or other surplus incomes (with positive relative prices). A positive determinant therefore may be assumed.

Turning to output and employment, Yang presents another model designed to capture Steuart's intentions (pp. 98-100) - though this model is really little more than an accounting identity. The central theme here is that Steuart has a theory of output and employment in which an (element of) autonomous demand for luxuries is the ultimate determinant of outputs as a whole (pp. 100-05). (This is very Cantillonian.) Employment and population are simultaneously determined with outputs (of subsistence in particular), interdependently rather than with any clear unidirectional causation between outputs and population. The treatment of growth in Chapter Five is just a dynamic version of this story, with the difference that foreign trade becomes an additional source of autonomous demand (as does public expenditure in Ch.8: pp. 242-43) and Steuart's historico-relativistic method comes into play. (Yang's discussion of the balance of wealth and the balance of trade in this context is quite obscure: pp.140-47.)

With regard to all this, the following may be said. There is no question that in Steuart - as in Cantillon before him, though Steuart's analysis is richer and dynamic, where Cantillon's is quite static - there is a definite notion of an autonomous element of demand which regulates the course of outputs. It is also the case that in Steuart population and (subsistence) output are interdependent whereas in Cantillon the causation appears more clearly unidirectional, from subsistence to population. But once again, it not at all clear that Steuart gives determinate theoretical expression to this notion of (part of) demand as the autonomous element in the equilibration of outputs. (Nor, for that matter, does Yang's 'model'.) In particular, Steuart's discussions of luxury consumption as the autonomous and dynamic element in the determination of outputs never reveals a grasp that this, quite valid, autonomy must be constrained by income or resources (in particular, land utilization; cf. pp. 127, 132). Yang is here somewhat harsh on Keynes, when comparing the Principle of Effective Demand with Steuart's 'Effectual Demand' (pp. 117-26). In Keynes it is precisely the income dependent character of demand (the consumption function and multiplier mechanism) which provides what Steuart lacks - a determinate theory of output as a whole.

In Chapters Six and Seven on monetary analysis Yang's exercises in rational reconstruction reach heights of genuine absurdity. Here the reader is presented with an interpretation of Steuart on money, prices, interest and output which is formally identical to an IS-LM model (with an AD-AS model appended, and an open economy version in Ch. 7), which could be found in any intermediate undergraduate textbook - except that it has an equilibrium in general without full labour employment. The same model comes into play in the interpretation of public finance in Chapter Eight. To put the point mildly, the late John Hicks might be a little surprised to discover that the IS-LM model, which he thought *he'd* invented, was residing in Steuart's *Inquiry* all along - though on the other hand, given Hicks's latter day misgivings about the model, he might have been happy to pass ownership over to Steuart! This is the kind of exercise which *certainly* will give rational reconstruction a bad name. Without doubt Steuart here is being forced into an alien framework. Consider a minor example: in the open economy version, the model assumes the balance of foreign trade is identical to the current account balance, even though Steuart certainly takes account of international income transfers, as Yang concedes (p. 212n. 11). Why then make this assumption? The answer (not given by Yang) is - because that is what IS-LM models incorporating the absorption approach to the balance of payments routinely do! This kind of modelling is too 'convenient'. (The discussion of taxation and monetary circulation in Ch. 8, pp. 244-49 is also quite obscure.) More significantly, the IS-LM framework is premised upon an exogenous money supply, whereas Steuart clearly has a notion of money (or credit) endogeneity. Yang tries to accommodate this by incorporating a variable parameter in the money supply function - 'the state of credit' (pp. 187-92, 220n. 10, 221) - but justice is not being done to Steuart on this issue. This is all the more pity because Steuart on banking is particularly interesting (pp. 217-25). His opposition to Hume's Quantity Theory of Money and the notion of credit endogeneity strike some modern resonances in relation to Post Keynesian approaches to monetary analysis.

Finally, we come to Steuart's social philosophy, conception of the role of the state (the Statesman), and method. One has a strong suspicion that there is much more of great interest to be written on these subjects than is offered here. Chapter Nine has a fragmentary character and is a 'postscript' really. It is somewhat disappointing in what purports to be a comprehensive interpretation of Steuart, that the broader intellectual framework of his political economy - his socio-political philosophy and methodology - should be 'relegated', so to speak, to the end of the book. It would be truer to Steuart's system if this material were at the beginning rather than the end. (It is noteworthy that on the very first page of Ch. 2, Yang is obliged to refer forward to this penultimate chapter: p.9 n.1.) There is a research project here, waiting to be undertaken.

On the matter of Steuart's 'interventionism' - which stands in some contrast to the stance of Adam Smith (though not so much as might appear at first glance) - there may be much more which is relevant to the contemporary world, in the light of a decade of 'deregulation' in the (at least English-speaking) First World and post-socialist reconstruction in a large part of what was the Second World. The high water mark of the former is probably past; and with regard to the latter, it is not so surprising that there should be more enthusiasm for capitalism in just those places where it has hardly existed. But if Steuart has something to teach us about a more sensible, 'middle way', the notion of 'interventionism' itself will have to be placed under scrutiny. It hardly does justice to Steuart's stance - implying as it does, that the social economy is, as it were, a spontaneously and independently existent 'body' upon which government 'intrudes'. The relation between economy and polity - in Steuart and in fact - appears to be more complex, subterranean and subtle than that.

Notwithstanding my substantial criticisms and misgivings concerning this book, the author has a serious and scholarly intent - and there is much in it which is interesting and convincing. For example, the resolution of the relation between (subsistence) output, population, employment and unemployment in Steuart - in terms of unemployment as a structural problem of intersectoral proportions - is original and compelling (pp. 106-09, 125-26). Whatever the serious failures of the book, if they stimulate others also to enter into print on Steuart, then that is all for the good as well. This work is likely to become the point of departure for others to test alternative interpretations - if only because no more comprehensive treatment of Steuart (even if not comprehensive enough) is likely to be seen for some time. My own judgement is that when so tested, Yang will be obliged to retreat from a significant number of his conclusions.

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