

**QUADERNI di STORIA dell' ECONOMIA POLITICA
VOL. VI**

JAMES STEUART ON DISTRIBUTION

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Introduction

In order to present a consistent account of Steuart's theory of distribution it is necessary to distance ourselves from the modern functional approach to income distribution, and to think more in terms of institutional and sociological economic analysis. This is because Steuart presented an "old fashioned" theory of wealth and income distribution, based primarily on the distinction of classes and their role in the economy, and only secondarily on the specific and direct functional productive contributions made by factors of production.

The aim of this paper is to analyse Steuart's theory of distribution without giving special emphasis on his theories of value, prices and money. However, before proceeding with the specific analysis is presented a few introductory remarks on his theory of class stratification in society.

Steuart begins his analysis of the "modern" economy by specifying societal stratification in relation to the "economic spheres" of production and consumption. To begin with, he emphasized that there is a class stratification in society in relation to the different productive contributions (Zampolini, 1985, pp. 28-31). More specifically, he

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"generally" distinguished between farmers and free hands (1.43)¹, and went on to divide the free hands into two distinct classes, the "idle consumers" and the workers (1.58). On the other hand Steuart distinguishing the various classes of society according to the land ownership, and money value of non-land property held (1.56), pointed to the general common economic interests between different classes (Works, vol. V, p. 309), and he did recognize some circumstances under which a class (economic) conflict could arise (Works, vol. V, pp. 310; 314).

The above stratification of society is related by Steuart with different consumption patterns in relation to the "stage" of economy. He emphasized that there are two different types of consumption goods: necessities and luxuries (1.269-71). When the economy is functioning in the stage of "infant trade", that is, in the first and lowest stage of its economic progress the class of workers consume only "physical necessary" goods, while the class of "idle consumers" consume (higher quality) necessities and luxuries. However, these different kinds of consumption pattern, do not "ad infinitum" strictly correspond to the different classes of society, but, in a well developed and wealthy economy-before its stage of decay (Skinner, 1985, p. 14), the individuals would be enabled to consume a variety of necessary and luxury goods.

To summarize, Steuart identified, though in a not strict and absolute way, the different classes in society according to: whether its members were producers; the level of wealth; and the consumption patterns. Every class was playing its specific role in economy, either in production or in consumption. The "general" role of the class of idle consumers was to "give work" to labourers through its luxury

consumption (1.1.212; 1.268) - an argument put forward also by Mandeville (1714, pp. 69, 154), Montesquieu (1748, vol. II, p. 82), and Hume (On Refinement in the Arts, ed. 1970, p. 31). The classes of farmers and manufacturers organized production (1.90; 1. 92), while the merchant class distributed the surplus and adjusted the market

¹ All references cited as follows: volume, book, page, (e.g. 1.1.16), are to 1805 edition of Steuart's "Works". For Skinner's edition of "Principles" we cite volume and page only (e.g. 1.310).

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differences of demand and supply (1.150-1)². That of "industrious" men produced goods and services (1.137).

However, since «ambition prompts him [i/e/ individual] to support himself in his elevation» (1.270) Steuart recognized that there was some mobility between the lower and higher classes - though he regarded it as proper to «discourage the intermarriage of the persons of different classes» (1.73). Thus he emphasized - as did also Harris (1757-8, p. 54 ft) - the mobility of individuals between classes, particularly between the "middle" class of merchants and manufacturers and the class of idle consumers (1.313).

In the following pages bearing the above economic stratification of society in mind, we shall analyse the way in which Steuart developed his distribution theory. We will proceed as follows: In section I, the notions of wealth and income will be defined, and Steuart's attitude to the equality and/or inequality of wealth and income distribution will be described. In sections II, III, and IV we shall analyse how, according to Steuart, the market rate of rewards (i.e. wages, profit, rent) are determined and justified. However, these distributive shares do not "exhaust" the total production of the economy. The interest on money must also be paid from the "surplus". Thus, in section V, is presented Steuart's "monetary" theory of interest. Though this study is not specifically elaborated on Steuart's theory of money, we think the subject matter of this paper justifies the incorporation within it of Steuart's analysis of the reward for "money property".

In order to make Steuart's position in the subject in question to stand out more clearly, we include references to his immediate predecessors and contemporaries, both for analytic comparison where this is appropriate (e.g. early Smith and Turgot), and with regard to their influence on Steuart's analysis (e.g Petty, Locke, North, Law, Montesquieu, Hume, Cantillon, Rousseau, Harris)

²Steuart considered the "internal" trade as: 1) a saving time operation (1.151) - a function emphasized also by Harris (1757-8, pp. 21-2), and Turgot (1776, p. 156); 2)an adjusting market operation (1.158-9) - a function recognized also by Cantillon (1755, pp.11, 14-5),Hume (Of Intrest p.52) Harris (1757-8, p. 22) and Smith 1736, pp. 204, 233); and 3) a factor for increasing employment (1.121) - an argument mentioned also by Hume (Of Interest, ed. 1979, p. 53) and Harris (1757-8, p.23).

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I. Distributive Shares

Steuart's critique of the "metallist" tradition was mainly based on his opposition to the old mercantilistic (Houmanidis, 1972, pp. 64-7) identification of wealth with

money, viz: «coin is one article of our wealth, but never can be the measure of it» (2.371)³. Thus he emphasized the real and not money content of wealth - a view already developed by Petty ("Verbum Sapienti"; ed. Hull, p. 110, and "Quantulucumque concerning Philosophical works, vol. II. p. 46; Of Money ed. 1970, pp. 41, 45), Cantillon (1755, p. 3), Harris (1757-8, part I, pp. 9-10), Smith (1763, pp. 190-1), Turgot (1766, p. 174). Wealth, for Steuart, could be augmented only when there is a net surplus in the economy, which is equal «to the whole produce of the earth, and whole industry of the country, deducting the physical-necessary of all the industrious;» (2.678)⁴. This surplus obviously is represented by the difference between the total market value of commodities exchanged minus the minimum real cost of production - if the "common" labourer is rewarded by a rate of wage representing necessary consumption. This surplus is distributed to other classes of society (including non-common labourers) according to their production contribution and the reward of property.

Property reward is justified by Steuart under the "doctrine" of ownership. Steuart, following the principle of property rights as expressed by Locke (Taylor, 1965, p. 156; Mitchell, 1986, p. 303), emphasized that property rights, or rather, the income associated with them, because they enable the development and effective expression of "multiply wants" bring a "spur to industry". At the same time, the distribution of property is constantly changing (in favour of the industrious) through the working of the market economy, viz:

³ Steuart considered that the introduction and use of money in economy brings: a) an expansion of economic growth (1.44-5; 1.303) - this was a "maxim" already developed in 17th and 18th centuries mainly by Locke (Works, 1962, p. 7), Law (1705, pp. 5, 97-9), Montesquieu (1748, vol. III, p. 45); b) increases the effectiveness of tax system (1.303); and c) produces a more equal distribution of wealth (1.318). Steuart, to mention in passing, emphasized three functions of money: as unit of account (1.156; 2.409-10; Works, vol. 5, p. 5), as medium of exchange (2.412; Works, vol. 5, pp. 174-5), and as store of value (1.45; 2.543).

⁴ For Steuart, this surplus «is the only fund that ought to be taxed» (2.686).

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«When a spirit of industry prevails, the balance is always turning in favour of the industrious, and as it is a pretty general rule, that the rich are not the most laborious, so the balance is generally turning against the rich. This being the case, the more that industry prevails, the quicker will this revolution be brought on. By such revolutions, wealth becomes equably distributed; for by being equably distributed, I do not mean, that every individual comes to have an equal share, but an equal chance, I may say a certainty, of becoming rich in proportion to his industry. Riches which are acquired by succession, or any other gratuitous means, do not in the least contribute to circulation, the owner, as has been said, changes only his name» (2.II.156, my emphasis).

Thus, social stratification arises and is maintained by the exchange of the fruits of industry, but the individuals (or families) comprising each social class are constantly changing. Steuart is against the equal distribution of property for three particular reasons:

First, equal distribution decreases productivity (1.126-7). Steuart, is speaking of the inefficiency of self-supporting agriculture, comparing it with the higher productivity achieved by production for trade and by large scale operation (1.93, 95-6; 2.733-4)⁵.

Second, it destroys the "system of reward" in society (1.317). Third, it could reduce the "effectiveness" of demand as the prime force for development. This objection to equality, that it inhibits the multiplication of wants and thus reduces effective demand, bears both on the "aspiration effect"⁶ and on the more direct effect that demand has for encouraging industry - both factors crucial to economic development via their effects on men's work effort (1.48; 1.57 ft; 1.131; 2.316-7).

However, Steuart supported the principles «of an imaginary law of nature, which makes all mankind equal» (1.209), particularly equality before the law (2.720) - principles developed by Rousseau (1754, pp. 57-9; 1758, p. 125). Though against "absolute economic equality" between men, Steuart emphasized that society could achieve a

⁵Mandeville explicitly emphasizes that the existence of property increases the work effort of men (1714, p. 201).

⁶The positive relationship between the multiplicity of wants and the work effort had also stressed by Mandeville (1714, p. 200), Hume (Of Commerce, ed. 1970, pp. 10, 14) etc. See also Eagly, 1961.

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"perpetual substitution" of wealth between different individuals, only under a well developed market economic system (1.304, 318-9) in which is offered an "equally of chance" open to all men⁷.

He was of course well aware that in a capitalist system some maldistribution of wealth and income may be unavoidable, as for example because of hoarding (1.46, ft) or because of sudden price changes (1.183)⁸. Indeed, extreme inequality, may increase hoarding and cause a market disequilibrium between total production and consumption which can cause unemployment. He proposes the following two "policies" for the remedy of extreme inequality. The establishment by the statesman's intervention of upper and lower limits in prices and hence incomes (more in the following sections), and a proper use of tax system. With regard to the second "policy" Steuart proposed "a proportional", or expenditure tax, upon luxury consumption goods (2.712)⁹. Such a tax has two purposes, first «to advance...the public good, by throwing a part of the wealth of the rich into the hands of the industrious poor» (1.334) through public expenditure financed by the tax (2.726); and second, to diminish hoarding when the economic situation needs such remedy (2.725-6).

Steuart as we have mentioned considered that the total production is "exhausted" by distributing it in wages, profits, rents and interests. It is now time to analyse specifically the rewards of productive services and property, and to explain the way in which their rates are determined in the market.

II. Wages

Steuart uses the term "industry" instead of labour in his "Inquiry..." to characterize every productive service exercised voluntarily for reward in agriculture, manufacture and commerce (1. 146-7).

Despite his terminology he considered that labour in the modern sense is the most important factor in the production of all goods and services, «for no article of expense can be increased, without

⁷ The equality of economic chance open to all men conceived by J. Rawls (1972, pp. 60-7) as the second principle of justice.

⁸ An argument also put forward by Cantillon (1755, p. 165).

⁹ In favour of taxes upon luxury consumption was also Richardson (1744, pp. 149, 228), Hume (Of Taxes, ed. 1870, p. 85), and Rousseau (1758, pp. 152-3).

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increasing the work of those who supply it» (1.137). In extension, labour is the most crucial factor for the production of "surplus" - mostly agricultural (1.40) - and economic growth (2.438).

The notion of productivity (in its primitive form) was not unknown to Steuart, though he did not use it in his theory of distribution:

«the labour of mankind is not in proportion to their numbers, but to their industry. The produce therefore of agriculture must be estimated, not according to the quantity of fruits only, but also according to the labour employed to produce them»(1.127).

However, the productivity of labour in different employments must not be measured according to «which produces the greatest quantity of fruits absolutely taken», but according to «which produces the greatest quantity relatively taken» (1.128) [see also 1.II.170-6]. Moreover, the productivity of labour, for Steuart, is proportional to work effort which in turn depends on the multiplicity of material and/or "imaginary" wants of men (1.48-9; 1.89; 1.166)¹⁰.

The societal production function includes labour and land. Land is directly employed in the agricultural sector and indirectly through the production of necessaries in other sectors. Steuart was well aware of the problem of measurement of the productivity of each separate factor in production: «Since...it is impossible rightly to separate the effects of nature from those of art and industry» (1.128). Because of this he did not develop a productivity approach for a uni-causal underpinning of the analysis of distributive shares. Nevertheless, he clearly recognized that labour's value productivity determined the wage rate:

«That the rate of wages is not in proportion to the value of the work performed, relatively to the person who employs the workman, and not in proportion to the price of subsistence. This I take to be an universal principle, in all countries of industry...Let...subsistence be ever so cheap, the freeman will insist upon wages in proportion to the value of his work, when brought to the market» (1.400-1).

¹⁰Steuart recognized, but not emphasized that the increase of labour productivity produced also by the amount of capital invested (1.1.184; Works, vol. 5 p. 287).

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Thus the market demand (mainly) for labourer's products determines their prices which in turn determines the wage rate. Steuart then, though he had developed the necessary instruments and concepts for the development of a static "equilibrium" distribution theory, did not follow up such a development. Instead, he developed a dynamic theory of distribution with socioeconomic content; for example, he considered the wage rate to conform to that rate consistent with the "living standard"¹¹ as well as the dictates of the market. ;

Steuart analysed the limits in which the wage rate may fluctuate in exactly the same manner as he had considered possible fluctuations in the market price of

commodities in general. He considers that the demand for "common" labourer determines the money wage rate which in its lower level must at least correspond to the consumption of physical-necessaries (1.274; 2.341-2; 2.397-8). It seems that Steuart is here very close to Smith's notion of "natural price" of labour (Smith, 1763, p. 176). However, any wage rate higher than "bare subsistence" is justified by Steuart on the dictates of market and on some "elements" as for example «An extraordinary dexterity in any art...[and]...The difficulty of acquiring the dexterity requisite, resulting both from the time and expense of apprenticeship» (1.274-5). These qualitative characteristics of the "non-common" labourers were also recognized by other authors in the 18th century: For example, Cantillon (1755, pp. 19-23) mentions "the time lost in learning", "the cost and risk incurred", "Ingenuity and Industry", and "skill"; Harris similarly emphasized training time, risk, dexterity and skill as elements which regulate «the prices of labour and services of different sorts» (1757-8, p. 17); Smith considers the natural wage rate to include except of subsistence and «the expenses of education, and to compensate the risk of not living long enough, and of not succeeding in the business» (Smith, 1763, p. 176); and Turgot stressed that «more skilful, more energetic» labour (1766, p. 146), received differential wage rates. However, in the "modern" economy, the actual wage rate is determined by the interaction of demand for and supply of labour.

¹¹ The content of living standard have been determined variously. For example, Petty considers it having and historical basis (Roncaglia, 1985, p. 67); Cantillon determined it in relation to "custom" (Spengler, 1954, p. 292); while, Steuart (Skinner, 1986, p. 21) and Turgot (1766, pp. 122-3) in biological terms.

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Steuart explicitly pointed out that the money wage rate, like the price of every economic good, is determined by market forces, viz:

«I have laid it down as a principle, that it is the complicated operations of demand and competition, which determines the standard price of everything. If there be many labourers, and little demand, work will be cheap. If the increase of riches...have the effect of raising demand, work will increase in its value, because there competition is implied» (2.334).

He uses a Walrasian technique to depict the path toward the clearance of the labour market, as he had done for commodity markets (1.177). In general, he emphasized that disequilibrium between the demand for and supply of labour caused a change in the wage rate (1.190). However, he considered the wage rate to be flexible upwards, but inflexible downwards beyond a certain level (standard of subsistence). In the short run, if the demand for labour is greater to supply, then the wage rate increases (Works, vol. 5, pp. 289, 293). While, if the supply of labour is higher than demand the wage rate will decrease but not below the price of subsistence (Works, vol. 5, 295, 311). In the long run, when the demand for labour is higher than supply the so-called "iron law of wages" comes into play, and wages will return to the previous standard (2.695).

Though Steuart recognized the allocation mechanism of wage rate in different employments - «The allurements of gain, will soon engage every one to pursue that branch of industry which succeeds best in his hand» (1.90) - he did not elaborate specifically on this kind of analysis. Rather, he analysed the causes and effects of changes in the general wage level in different dynamic market situations, and it is this kind of analysis which we will follow.

He mostly concentrated his analysis on the demand function for labour, considering that the supply of labour is fixed in the short run, while in the long run it depends on the generative faculty of men (1.78), and their «self-love, or...desire of ease and happiness» (1.34). Both these factors may be related to per capita consumption of both "physical and political necessaries" (1.269-70). However, though Steuart recognized that the supply of labour is endogeneously determined *in* the system, the demand for labour is what determines the market wage rate, by extension the supply of labour.

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For Steuart, the demand for labour is a function of the demand for (mainly luxury) goods, and the rate of consumption (mainly of the class of idle consumers) (1.265, 268). The consumption rate, or effective demand, is in turn determined (mainly) by the rate of "surplus", together with the level of hoarding: «a desire in the rich of acquiring every thing with money that is demand, was shown to be the spur to industry in the poor It was said, that if riches did not inspire a taste for luxury, that is for the consumption of the labour of man, these riches would not circulate; and that they would then be adored rather as a god, than made subservient to the uses of men» (2.724), thus, «Consumption and the demand for work would diminish in proportion to the part of—income withheld» (2.649).

The surplus can only increase if labourers increase their work effort; and an increase in surplus will increase the demand for goods and hence labour. If in this case it is supposed that the supply of labour is fixed, or does not change immediately, then the real wage rate increases. The above arguments are based upon the following assumptions:

1) Labour is rewarded in relation to its productive contribution as estimated not by producers but by consumers (2.691; Works, vol. 5, p. 312), thus the labourer receives a part of the economy's surplus (1.318; 2.694).

2) There is a positive relationship between the wage rate and the work effort (1.44-50; 166; see also Eagly, 1961). Steuart did not strictly share the opinion of those writers who argued that "necessity produces industry", as did for example Mandeville (1714, p. 298), Gee (1729, p. 38), Richardson (1744, p. 201), Temple (1758, pp. 21, 25,33-5, 39-41) etc. Instead, he emphasized that there is a positive relationship between the wage rate and work effort, given that there is a multiplicity of wants, that is, given the non-saturation demand assumption. He held this opinion in common with North (1691, p. 14), Child (1699, ed. 1751, p. x), Defoe (1728, pp. 19-26), Hume (Of Commerce, ed. 1970, pp. 15-6), Smith (1763, pp. 160, 199), but Steuart differed from these authors in that he used this approach as a "modus operandi" of his system, and developed the following "policies" to encourage work effort and eliminate idleness: a) The statesman should sustain and encourage the "multiplicity of wants" of individuals, so as to increase work effort; particularly in the early stage

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of development and before the deterioration of country's balance of trade (1.118). b) He should encourage work effort by setting wages according to piece rates rather than time rates (1.169). c) The system of taxation should be regulated so as to increase work effort and decrease idleness. Specifically, Steuart emphasized that in the case where the positive relationship between wage rate and work effort does not hold because of consumption saturation, then through an expenditure of proportional tax the statesman could increase the work effort (2.691). d) The way in which economic

policy is exercised influences the work effort, that is, an arbitrary economic policy «falling unequally upon individuals of the same conditions...stops industrious people in the middle of their career» (1.212-3).

3) The rate of hoarding. Steuart stressed that hoarding may cause unemployment (1.245; 2.649), and some parallels may be drawn between his position and that of the "underconsumptionists" and Keynes. Thus, he introduced various measures and instruments of economic policy for the decrease if not the elimination of hoarding, and the restoration of effective demand to a full employment level. For example, one of his arguments for the introduction of paper money is that hoarding would be decreased (1.325)¹². Moreover, he regarded one justification for the existence of interest - of which more in section IV - to be that it eliminates hoarding (2.445). Also he emphasized the usefulness of public credit (2.642, 644), and taxation (2.671-2) in decreasing hoarding.

We should stress here that Steuart considered all the factors influencing wages discussed above to be inter-related, as are economic phenomena in general:

«<how naturally one alteration brings on another, as in a chain, insensibly altering the whole system of the sentiments and employment of the greatest part of the inhabitants» (Works, vol. 5, p. 284).

¹²Generally speaking, Steuart had emphasized that an increase of the quantity of money increases consumption, production and employment (1.45; 1.303; 2.356-7 - an argument put forward by Law(1705, pp. 99-102)' Harris (1757-8, pp. 59-60) and Wallace (1758, p. 4)

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We have mentioned above endogenous elements in the supply of labour, that is to say, Steuart pointed out that there are connections between the wage rate and the growth of the population and hence the labour force. But, such endogenous demographic influence may be weak or not excitant for long periods of time. Though Steuart recognized the "iron law" of wages, he stressed that during economic development the increase of the real wage rate will be consolidated into the intrinsic value of commodities because the labourers adopt a higher living standard, which perhaps does not cause an increase of population (1.192-3). In such a case, that is,

«when the rate of the market can afford them [i.e. labourers] great wages, relatively to the price of necessaries, such profits consolidate into the price of the manufacture...The statesman then must endeavour to create a competition among them, by introducing fresh and untainted hands into such branches» (2.684).

Thus, Steuart considered that just as commodity prices should be allowed to fluctuate between certain politically and economically desirable limits, so should the real wage rate. The lower limit is the price of necessary subsistence, and the upper that which does not produce deterioration in the country's balance of trade.

Though Steuart considered "positive" profit to be a special reward of "producers-workers" - because he analysed mostly the market function of small scale operations- he also hinted at a distinct (entrepreneurial contribution in the economy. Thus the next section looks at Steuart's views on different profit types.

III. Profit

The profit motive, or the «degree of eagerness...to their view of profit» (1.173) was considered by Steuart as the most powerful driving force of economy. The profit

motive increases competition between producers (1.174), increases production and brings about a more efficient spatial distribution of production (1.262). However these dynamic consequences of the profit motive take place in the main by increases in work effort rather than the reinvestment of profits. Steuart distinguishes between the following kinds of profits:

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<<positive relative and compound. Positive profit, implies no loss to any body; it results from an augmentation of labour, industry or ingenuity, and has the effect of swelling or augmenting the public good... Relative profit, is what implies a loss to somebody; it marks a vibration of the balance of wealth between parties, but implies no addition to the general stock.... The compound is easily understood; it is that species of profit....which is partly relative, and partly positive» (1.179- 80)¹³.

As it is obvious only positive profit is part of surplus while the relative profit shows the transmission of wealth from one man to another - a view which distinguishes Steuart from the "old" mercantilists. Therefore, we shall concentrate on Steuart's analysis of positive profit, how it arises and how its rate is determined.

Steuart considered positive profit as a special kind of wage (Meek, 1958, pp. 294-5). He did not properly distinguish between ordinary labour inputs, managerial inputs, and entrepreneurial activities because he specifically analysed an economy characterized by small scale enterprises in which the functions of owner, director, and labourer were concentrated in one person.

It is perhaps, remarkable that Steuart did not analyse, at least explicitly, any entrepreneurial role, nor distinguish net profit from other factor payments, as did Defoe (1728, pp. 35-6), Hume (Letters, vol. II. p. 94), Cantillon (1755, pp. 47-53) and Turgot (766, pp. 152, 157-8).

Having said that, we can find some entrepreneurial activities described by Steuart. First, Steuart recognizes that merchants are the connecting link between the different stages and sectors of production (1.146). The special activity of merchants is the reduction of the economy's transaction costs in searching for different goods at different places and different prices and adjusting supply according to the dictates of demand (1.150-1.156). Second, Steuart recognizes the role of entrepreneurs in innovation, and specifically of innovations in production through the introduction of labour saving "machines" (1.255-6).

¹³ Marx (Capital, ed. 1954, vol. H. p. 9; Theories of Surplus Value, ed. 1969, vol. I. p. 41) commented favourably on Steuart's distinction of the types of profit.

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However, he did not develop these observation to obtain a theory of profits and entrepreneurship. He only considered the above mentioned activities as justifying a rate or profit above the normal, or "moderate" (1.192) market rate, as determined by the dictates of the market and the general situation of the economy. Any short or long-run differences between any specific profit rate and the "normal" profit rate are explained as follows by Steuart:

1) Some speculative actions, particularly of merchants, are rewarded with a profit rate above the normal one (1.170-1).

2) There are "windfall" gains caused by sudden changes in the rate of demand (1.174).

3) There is a short-run rate of pure profit produced by innovations in production. "The first inventors", writes Steuart, «gain thereby a superiority which nothing but adopting the same invention can counter balance» (1. 256)¹⁴. Unfortunately, Steuart does not ask the crucial question of what determines the introduction of any such innovation. The closest he gets, which is not at all close, is in a solitary passage mentioning the actions of "scholars" which create and promote innovation (1.124).

4) The "old" enterprises have advantages over a new one, which bring them a higher rate of profit, such advantages include market experience (1.262) and good will (1.171).

Steuart was opposed to long-run extraordinary profits (and wages) because their consolidation into the real value of goods diffuses in the whole economy (2.II.221) and causes a downward prices inflexibility (3.III.11). This results in the deterioration of the balance of trade, through the diminution of the country's absolute advantage and the increase of unemployment (1.248-50). He singled out only one case where the statesman could permit the existence of extraordinary profits, «as an encouragement to some of the more elegant arts, which serve as an ornament to a country; which establish a reputation for taste and refinement in favour of a people, and thereby make strangers prefer articles of their production» (1.240).

¹⁴Steuart explicitly recognized the role of imitators in the decrease of profit rate (1.1.213; 1.171; 1.262).

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In all other cases there should be a policy, «of reducing consolidated profits, whether upon articles of exportation, or home consumption, [that is]...to increase the number of hands employed in supplying them;» (1.250).

Thus, it is clear that Steuart did not develop any distinct entrepreneurial theory nor did he emphasize the contribution of capital - at least in the way the physiocrats and the classicists did - as reasons for the emergence of profit. Of course, as we shall see in section V, he recognized interest as a part of surplus, but he explained it as a monetary phenomenon. Contrary to the classicists he regarded agricultural rent as the only residual element of distribution.

IV. Rent

Generally speaking, Steuart did not develop any theory of rent, but regarded it as the residual element of distribution, viz:

«all rents are in a pretty just proportion to the gross produce, after deducting three principal articles. First, The nourishment of the farmer, his family, and servants. Secondly, The necessary expenses of his family, for manufactures, and instruments for cultivating the ground. Thirdly, His reasonable profits, according to the custom of every country» (1.53).

Thus, he follows the treatment of rent as the residual element of distribution in the same way as did Petty (1662, ed. Hull, pp. 42-5), Montesquieu (1748, vol. II. p. 83), Cantillon (1755, p. 7), Turgot (1766, pp. 154,180) and of course the Physiocrats.

Steuart regarded the rent of land as a property income, and as a motive for the increasing of large scale cultivation (1.90; 126-7; 168). He considered the rent rate to be determined by the general demand for agricultural products (1.53-4; Works, vol. 5, p. 288), the position of land in relation to the market (1.65-6), and the fertility of land (Works, vol. 5, p. 288). Unfortunately Steuart did not develop his views on decreasing

returns in agriculture (1.48; 1.129-131; 1.197) in relation to the above two last determinants of differential rents as a basis for a specific theory of rent. However, the sum of wages, profits and rents does not exhaust the total income of economy and its produced surplus. One further share is

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paid out of the surplus, the interest on money which we are now going to analyse.

V. Interest

In this section we shall analyse Steuart's theory of interest by answering the following questions: 1) What kind of services are rewarded by interest, and how is interest introduced into the economy? 2) How is the market rate of interest determined? 3) What is the most efficient economic rate of interest? and 4) How can it be regulated?

The last distributive share from the surplus is the interest of money, which for Steuart is a pure monetary phenomenon (Sen, 1947, p. 29; 1957, p. 88; Wickers, 1959, p. 285; Skinner, 1967, p. 281). However, interest is a property reward which is received by the owner of money, for its use, «interest of money...comes in, to indemnify the giver of credit, for the use of his money» (2.468).

The definition of interest as a reward to the lender for the use of his money was well known in economic thought. For example, Petty (1662, p. 47; 1682, p. 446 ed Hull) considered that interest is a compensation to the lender for not using his money; Locke (Works, 1692, p. 36) justified it by the advantages drawn by the borrower through the use of money; Montesquieu (1748, vol. II, p. 67), Cantillon (1755, pp. 199-201), Turgot (1766, p. 160; 1770, pp. 152-4) repeated the last justification of interest.

Steuart considered further that interest is an instrument for the diminution of hoarding, as «no money is to be suffered to remain useless to the proprietor of it» (2.444) - Turgot was well aware of this consequence of interest (1770, p. 162). However, though some authors considered that the rate of interest is inversely related to the volume of hoarding [North (1691, pp. 5-6), Locke (Works, 1692, pp. 8, 12, 65)], it was Steuart who emphasized interest as a proper instrument for the elimination of hoarding and the increase of consumption and employment.

Steuart, employing the historical method, emphasized that interest on money arose in an economy through the expansion of trade, production

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and the establishment of money as a means of exchange and as a medium of store of value¹⁵(2.443-4; 2.461).

Therefore, interest as a phenomenon of the exchange or "modern" economy is used as an instrument for the circulation of property, namely by diminishing hoarding, and as an income to the proprietors of money by which they can increase their luxury consumption. Because of the diminution of hoarding and the increased consumption associated with income from interest (2.451):

«The loan.....upon interest, as society now stands composed, is established, not in favour of the lenders, but of the whole community» (2.448).

Steuart did not develop explicitly any classical theory of saving-investment in his argument that interest is an instrument for diminishing hoarding-probably because of

the absence of a pure capital theory in his analysis. But he insisted that, by the diminution of hoarding, the consumption (of consumable and/or investment goods) increases and so production and employment do. His argument is consistent with his basic view that demand is the driving force of the economy.

Steuart developed a loanable funds theory of the determination of the interest rate. He emphasized that interest is a price for a service offered, and, in common with other services, this price is determined through the market forces of demand and supply (2.454). Moreover, he used -as in the case of the short-run market process for the restoration of equilibrium (1.177) - the Walrasian mechanism for the establishment of the equilibrium rate of interest, namely, price changes clear the market. He supposes that there are two groups of persons in the market the lenders and the borrowers, and a fixed amount of money for lending.

«The borrowers desire to fix the interest as low as they can; the lenders seek, from a like principle of self interest, to carry the rate of it as high as they can. From this combination of interests arises a double competition, which fluctuates between the two parties. If more be demanded to be borrowed, than there is found to be lent, the competition will take place among the borrowers.

¹⁵ Steuart offered - as also did Turgot (1770, p. 155, 159-60) an historical reinspection in regard to "usury" and the prohibition of interest between "Jews" and Primitive ages of Christianity" (2.447).

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Such among them as have the most pressing occasion for money, will offer the highest interest, and will be preferred. If, on the contrary, the money to be lent exceed the demand of the borrowers, the competition will be upon the other side. Such of the lenders, as have the most pressing occasion to draw an interest for their money, will offer it at the lowest interest, and this offer will be accepted» (2.449).

This process for the establishment of the market rate of interest could be properly presented by the common diagram of demand and supply. However, this process was not something new in the literature, though we can say that Steuart had developed it in a more sophisticated and scientific way. Steuart's predecessors and contemporaries had developed various views in regard to the causes determining the rate of interest. For example some of them such as North (1691, pp. 4,8), Cantillon (1755, p. 199), and Turgot (1766, p. 165; 1770, p. 153) emphasized that the market rate of interest is determined by the demand and supply of loanable funds-the last two authors considered also the rate of interest must cover a risk-premium for the lender [Cantillon (1755, pp. 162-3, 203, 207, 211); Turgot (1766, pp. 160-1; 1770, pp. 150, 161)]. Others used the mechanism of demand and supply in relation to the total quantity of money existent in economy, this view was put forward by Locke (Works, 1692, pp. 9-10), Law (1705, p. 13, 67) and Montesquieu (1748, vol. II, pp. 67-8). Hume, on the other hand, related the rate of interest with the reward of capital invested and emphasized that its rate «was controlled by three important real forces the quantity of accumulated loanable funds, the demand for the use of them and the average rate of profits earned in business» (Of Interest ed. 1970, p. 123) [see also, *ibid.* p. 49, 54]. This path would be followed by Smith in his "Wealth of Nations". However, in his "Lectures" Smith developed mainly a demand and supply of loanable funds theory for the determination of the market rate of interest (1763 p. 220) [see also, Taylor, 1965, p. 87].

Steuart's originality in the subject in question lies not only in his consideration of

interest as a pure monetary phenomenon, but also in his analytical development of the process and the specific factors which determine the market rate of interest. More specifically, he analysed the demand and supply functions for loanable funds in terms of the following variables.

The demanders of loanable funds he divided into two classes:

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«the class of men who borrow in order to profit by the loan... [and the class of men]... who borrow in order to dissipate. The first class never can offer an interest which exceeds the proportion of their gains: the second class, finding nothing but want of credit to limit their expense, become a prey to usurers» (2.451).

Thus, there are, so far two variables in the demand function which influence the demand for loanable funds: the rate of profit (2.451), and the idle consumer's propensity to consume out of their property¹⁶ (1.243; 2. 452).

Moreover, Steuart recognized another variable which inversely influences the rate of demand for loanable funds, the price of land. When the price of land is high the rate of interest is low and vice versa (2.456). Because, when monied persons buy land they offer an amount of money to the landlords who then have no reason to ask for borrowing, that is, the demand for loanable funds is diminished, and so is the rate of interest (2.453; 2.456).

Therefore, in conclusion, the demand function for loans has three variables: 1) the rate of profit; 2) the propensity of proprietors to consume out their property; and 3) the demand for non money assets which influences it inversely¹⁷.

In regard to the supply function of loanable funds, Steuart developed a chain of arguments and comments [against the metallist substance of money and the bimetallism (2.356-7; 2.416, 431-2; Works, vol. 5, pp. 8, 178, 182)] in favour of the introduction and extension of paper-money (1.315-6). In addition he emphasized the expansion of credit and the banking system as means of increasing the quantity and

¹⁶Stueart was well aware that the propensity of the rich to consume (mainly luxury goods) was proportional to their income and wealth(1.234). [see also Vicker(1959, p.269); Skinner (1966, pp. Ixxii); Akhtar (1979, p.296)].

¹⁷Locke emphasized the following factors of money demand which influences the rate of intrest: 1) the frequency of payment (Works, 1961, pp. 24, 27, 73); 2) the volume of transactions (ibid. p.12); and 3) the rate of profit (ibid. pp.12, 14). These three factors influence proportionally the rate of demand for money, and in extension, the rate of intrest. On the other hand, he considered that the supply of money was determined by: the quality of species in economy, and the amount of outflow or inflow of precious metals in economy according to the situation of foreign trade (ibid. p.19).

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circulation of money in the economy and thus reducing the rate of interest (1.303; 1.330; 2.600; 2.642-4). On the other hand, he stated that the statesman through the regulation of the supply of paper money could influence the rate of interest (2.325; 2.453).

Steuart emphasized that the introduction of loans «upon interest, is a very good expedient to accelerate circulation [mainly of money], and to give birth to industry» (1.326 brackets added). But which rate of interest is the most advantageous "to give

birth to industry"? Steuart was a defender of a low market rate of interest (Sen, 1947, pp. 27-8; Skinner, 1967, p. 282; Akhtar, p. 1979, p. 292) not because of its effects on the price level, as for most mercantilists, but because of its! positive effect on demand, production and employment¹⁸. "I entirely agree", says Steuart, «with Sir Josiah Child, that low interest is the soul of trade; the most active principle for promoting industry, and the improvement of land;» (2.461), but «it is not the measure of [trade]» (2.469).

Steuart, as we have said, developed his arguments for an economy that functions through small-scale operations, where the producer is at one and the same time both capitalist and labourer. Thus, he insisted that interest is not a part of the cost of production (2.467-8). Therefore, Steuart turned against the old mercantilist view that the rate of interest -as an item of the cost of production and trade - plays a key role in the establishment of a positive balance of trade. For Steuart, a positive balance of trade comes about through «the dexterity alone of the workman...enabling him to undersell his competitors every where» (2.467).

How then did Steuart justify his argument for a low rate of interest?; The answer is derived from his theory of the influence of the quantity of money and its velocity - which he properly defined (1.323; 2.715; Works, vol. 5, 78) -on the level of production and employment. He did not emphasize the case on inflation considering - and probably he was here influenced by Law (1705, pp. 64, 99), and Wallace (1758, pp. 3-4, 11-2) - that an increase in the quantity of money and its

¹⁸ Locke (1692, pp. 65, 69) and J. Child (ed. 1699, pp. vi, 6) considered the low rate of interest to be an advantage to trade. On the other hand, Hume (Of Interest, ed. 1970, pp. 47, 54-5) and Turgot (1766, p. 173) emphasized that the rate of interest is the "barometer", or "thermometer" of the rate of profits and the abundance or scarcity of capital in an economy.

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velocity of circulation in the main increases demand (1.44-5; 1.303), and if supply responds (2.354; 2.376) then production and employment also increases (2.344). On the other hand, he insists on the deleterious effect hoarding has on effective demand. For Steuart, only increased "circulation of money" could eliminate hoarding, redistribute wealth and increase the work effort of individuals. Therefore, a low rate of interest will be a "symptom" of adequate available money in circulation, whilst a high rate of interest will be the result of "shortage" in money in circulation. In other words, Steuart considered that the low rate of interest, consequent upon an increase of money in circulation, eliminates hoarding and encourages the circulation of money. It is a fact that Steuart did not develop any saving-investment mechanism for the absorption of hoarding through the rate of interest as the classicists did, nor did he follow the common mercantilist line that interest is a cost of production the diminution of which would have a positive effect on the trade balance. He argued only that the low level of interest is a consequence of the available money supply, and is of advantage to the economy only because it eliminates hoarding, reinforces the circulation of money, and partly encourages (but does not much influence) foreign trade (1.316; 2.445; 2.461; 2.469).

After all, Steuart's attitude to direct state intervention on the market rate of interest¹⁹ has a modern sound. The statesman by regulating the paper-money supply could indirectly influence the market rate of interest, viz:

«a statesman has it in his power to increase or diminish the extent of credit and

paper money in circulation, by various expedients, which greatly influence the rate of interest» (2.462)²⁰.

However,

¹⁹Stueart was against the regulation of a low rate of interest by "statute" as Child proposed (2.457). However, arguments opposed to the regulation of the rate of the rate of interest by "statute" were also developed by North (1691, pp. 7-8), Locke (1692, 11-2) and Turgot (1770,p. 151).

²⁰The inverse relationship between the quantity of money and the rate of interest was also emphasized by other authors as for example Law (1705, p. 174; 1770, p. 160). While Cantillon has some suspicious for the generality of this argument (1755, pp. 213-5).

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«the operations of demand and competition work irresistible effects in determining the rate of interest in commercial states; the statesman who is about to make a regulation, must keep these principles constantly in his eyes» (2.455). Thus, «If, by prudent management, the conventional rate or interest, can...be brought below the legal, then there may be no harm in diminishing the latter by statute, not however quite so low as the conventional standard; but so as to leave a reasonable latitude for gentle fluctuations above it» (2.460)²¹.

As it is obvious from the above analysis, Steuart supported a monetary policy of "cheap money" in order to increase, or at least to! postpone the diminution of, the level of effective demand, production and employment. We must not forget, that one of the central purposes of his "Inquiry.." was to show how an underdeveloped economy could be advanced through the maintenance of full employment.

Thus, Steuart considered the rate of interest could be used as an instrument for the smooth functioning and expansion of the economy, rather than as a reward for some productive economic activity. However, we think that his analysis of interest as a monetary phenomenon, where its rate could be properly regulated by the statesman through the instrument of money supply, has a real modern content.

Conclusion

It is hoped that the previous analysis has shown Steuart to be a significant and original contributor to the "science" of economics, and that his comparative neglect by his successors is unjustified. His sociologically inclined analysis of income and wealth distribution, does not have the clarity of Ricardian and neoclassical analysis, but is more dynamic. Despite his neglect of the investment-saving mechanism, of the productive role of capital and of the specific characterization of entrepreneurial activities, his theory of distribution may be justified on real and institutional elements. He considered distributive shares to be

²¹A similar argument put forward also by Cantillon, viz: «If the Prince of Administrators of the State wish to regulate the current rate of interest by law, the regulation must be fixed on the basis of the current market rate in the highest class, or thereabout» (1755, p. 221).

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determined in a dynamic economy according to: biological necessary consumption;

market conditions of supply and demand for productive activities (he particularly emphasized the role of demand); and the general "situation" of the economy. In addition, he developed a "monetary" theory of interest based upon interest's three economic characteristics. First, interest performs the role eliminating hoarding and increasing consumption; second, interest is an instrument of economic policy; and third, interest is a reward of property.

The previous analysis shows Steuart's economics (in regard to distribution) to be basically dynamic and empirical in character, with institutional overtones. As such, it fits well with his theories of economic growth and international trade-subject matters which deserves an extensive analysis but which lie outside the scope of this paper.

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