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RESEARCH IN THE HISTORY OF ECONOMIC THOUGHT AND METHODOLOGY
VOLUME 26-C

DOCUMENTS ON AND FROM THE HISTORY OF ECONOMIC THOUGHT AND METHODOLOGY

WARREN J. SAMUELS
MARIANNE JOHNSON
KIRK JOHNSON
Editors

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EDITED BY

WARREN J. SAMUELS

8476 SW 10th Road, Gainesville, FL, USA

MARIANNE JOHNSON

*Department of Economics, University of Wisconsin-Oshkosh
Oshkosh, WI, USA*

KIRK JOHNSON

*Department of Economics, Goldey-Beacom College,
Wilmington, DE, USA*

JAI

United Kingdom – North America – Japan
India – Malaysia – China

JAI Press is an imprint of Emerald Group Publishing Limited
Howard House, Wagon Lane, Bingley BD16 1WA, UK

First edition 2008

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

ISBN: 978-1-84663-908-1
ISSN: 0743-4154 (Series)

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LIST OF CONTRIBUTORS

Kirk D. Johnson	Department of Economics, Goldey-Beacom College, Wilmington, DE, USA
Marianne Johnson	Department of Economics, University of Wisconsin-Oshkosh, Oshkosh, WI, USA
Mark Ladenson	230 Oxford road, East Lansing, MI 48823, USA
Warren J. Samuels	8476 SW 10th Road, Gainesville, FL 32607-7028, USA
Bernard Paris	1430 NW 94th Street, Gainesville, FL 32606, USA

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GLENN JOHNSON'S NOTES FROM FRANK H. KNIGHT'S COURSE IN THE HISTORY OF ECONOMIC THOUGHT, ECONOMICS 302, UNIVERSITY OF CHICAGO, WINTER 1947

Edited by Warren J. Samuels and Marianne Johnson

These are the second set of notes from a course taught by Frank Knight on the history of economic thought to be published in this archival series. The first set of notes was taken by F. Taylor Ostrander and was published in this series in volume 22-B (2004) (also relevant are Ostrander's notes from Knight's courses on Economics from Institutional Standpoint and on Current Tendencies (volume 23-B, 2005). Ostrander took the course in 1934. Glenn Johnson took the course in 1947. Brief biographies of Knight and Johnson may be found in volumes 22-B (2004) and 24-C (2006), respectively.

Published below are (1) the syllabus, or working bibliography, distributed by Knight in the course, dating from 1946; (2) the reading assignments in Smith and Ricardo and (3) in J. S. Mill; and (4) Glenn Johnson's notes from Knight's lectures.

COMMENTARY

Knight presents the two general orientations of the course in his first lecture. One identifies the purpose of the study of the history of economic thought. The second

Documents on and from the History of Economic Thought and Methodology
Research in the History of Economic Thought and Methodology, Volume 26-C, 1–62

ISSN: 0743-4154/doi:10.1016/S0743-4154(08)26048-7

relates to the construction of economic theory. These must be the concern of my rest two points.

(1) The purpose of the study of the history of economic thought is, Knight says, first, to understand the foundations of modern, neoclassical economics and, second, to teach the subject of economics. One could "go back ever further and could study views of other countries, and could study policy." The objective of teaching the history of economic thought, moreover, is not to study that history as a whole or as contributions to intellectual history but only that part of it which in retrospect seems to have been the source of neoclassical economics. "Take up the classics to learn economics out of these." That is the main task—to understand these foundations of modern economics. The past is important only insofar as it relates to the present, serving as the historical foundation for the presently hegemonic school. The past becomes what is taught based on and as an anticipation and reflection of the present. This is presentism, candidly stated; the history of economic thought is important only with regard to the present. Such an orientation can easily become cheerleading for both neoclassicism and for the market economy—somewhat more or less akin to how selective readings of Marx were performed likewise in the former Soviet Union. Those with such an orientation are likely to most resent the history of economic thought as a domain of critics of the hegemonic school.

(2) Knight says of the construction of economic theory, that modern economists "are all individualistic" but that "philosophically individualists are myths, individuals being bearers of culture. Spiritual qualities—minds—ideas, attitudes—tied up with folktales, literature—a process of social conditioning to get a 'social mind' not quite consistent with democracy." Indeed, he goes so far as to say that "When people are original they are only slightly so and probably wrong." Be that as it may, a main point seems to be that "Individual aspects [are] over-emphasized in our society. Individuals [are] made out of society by a modern process of differentiation since 15th century though some occurred in upper classes of others."

All of that, however, is prelude to his primary target. Although he understands that individuals are socialized and thereby a product of their society, seemingly adopting a methodologically collectivist position, he is actually laying the groundwork for the individual qua individual: "Modern economics takes individuals as given." Although the individual is socially conditioned so as to become social minds and the bearers of culture, "The 'economic man' is a real concept." The process of social conditioning is "not quite consistent with democracy"—by which he means both general individualism and methodological individualism in which the individual is taken as given and only the individual counts.

(3) The crux of the new system is a "presumption of material gains through exchange." Escape from the Middle Ages came through the transfer of power from church to state. The Protestant Reformation meant the nationalization of the churches and thereby the period of the nationalistic state, the period of

mercantilism. Eventually, however, from a belief that the state can do no wrong there emerges individualism, the belief that an individual's ends cannot be wrong, i.e., the liberal view of society. Among other things, individualism "implies freedom to get what you want." This new system has rested on "stable fixed patterns of social life through laws a great part of which dealt with trade and economics." The Enlightenment brought liberalization of religions, although the Counter-reformation limited liberalism. Indeed, Knight feels he can overdo the liberalization of religion. He points to the "intolerance of Semitic religion—Christianity, Judaism and Islam [are] the only religions claiming to be the one and only religion. Europe inherited this compulsion—people couldn't imagine that people could live together with different religions with peace and order. The result was the absolute state (church or civil), divine right of kings, absolute sovereign. State sovereign over people and king sovereign over state." Religions provide what the people demand:

> Great bulk of people have always had a religion—not necessarily their leaders. Man as much a romantic as economic. Believes in absolutes, in concepts, imagination a function of religion is to sanction organizations. Christianity has accepted every form of political organization. People need supernatural sanction except in the upper crust. Morality for certain group not dependent on religion, the opposite generally being true. Render unto Caesar that which is Caesar's in new testament—obey authorities not necessarily law.

When the new economic system of mutually beneficial exchange and maximum production comes about, the correct principle is not that of a "fundamental harmony of interest," it is unquestioned freedom of individual action. This is the proper subject of modern Political Economy. Moreover, "The whole argument is not about the mechanics [of the new economic system] but about social policy—whether it should be left to individual or turned over to political headquarters. <u>There is a danger of overemphasizing the mechanics</u>." Thus, "Laissez-faire based on the individuality of ends, the individual being the best judge of his ends." This course is a course in the history of the increasing technical sophistication of economics. But the core of economics is the social philosophy of individualism, so understood. This is why the individual is taken as a given.

(4) Contemporary economic theory assumes away anything that might interfere with reaching unique determinate optimal equilibrium solutions. Similarly, Knight rules out of analytical bounds or finesses any consideration that would interfere with his conception of the theory of economic policy of a market exchange economy. He does the latter in such a way as to treat the existing market economy almost as absolutist as earlier peoples treated theirs—as a relatively absolute absolute. What is more, Knight does not equivocate:

> Adam Smith's Wealth of Nations [Knight is recorded as saying] both an analysis and an instrument of propaganda. The objective is the public policy of keeping the government out of business—to remove the hangover of medievalism and mercantilism. Explanation and

justification are mixed and necessarily so. If a thing is explained it is inevitable under the conditions and if the conditions are justifiable the results are justified.

Prior to the point at which he makes these arguments, however, Knight presents an account of the origins of the market exchange economy and of the economic and, especially, the political systems which antedated the modern economy. That account includes stories not only of the State but of religion. It also includes a story of the market economy as an exchange economy which relies much less on the justificatory role of competition than does the later Chicago argument that markets are competitive by their very nature as markets. To use Knight's own language, his writing is a propaganda for economic freedom but a particular argument for a freedom particularly understood. This is pure Knight, Knight almost at the very top of his game (an analogy beloved by him). I say "almost" because his mind was to produce many more articles and a book or two that further developed his intellectual fortress. But we must pay some attention to his "propaganda" effort as the reader will find it in the lectures recorded by Glenn Johnson in his handwriting, especially the lines of reasoning he adopted, why he took those lines, and the shortcomings of his account for one who is sympathetic to a market economy but finds Knight's account deficient on *positive* grounds.

Among the positive grounds on which his account can be criticized are the existence of people those who define their self-interest in malignant grounds. Another involves the need for state action when individual interests conflict. But Knight has responses to those criticisms. Malignancy sounds too much like the strong term "evil" in religion and should be the domain of ordinary law. Conflicting individual interests can be compelled to reach solutions within markets, so that ordinary law is not too readily open to change of law. These Knightian responses can elicit their own rejoinders but his point is clear.

(5) His point is indeed pure Knight. He recognizes everything that institutionalists considers important but prefers the narrow foundations of neoclassicism. Other neoclassicists take the "given individual" of methodological individualism to define actual reality. Theirs is an impoverished version of Knight but one (weakly) nourished by him. For only a few lines later Knight himself defines reality in such limited terms.

Knight seriously accepts the general outline of institutionalist analysis. He grants that underlying individual economic behavior there is a system of social organization through markets. There is a body of law, the law required in order to have such an economic system and its social foundations; in short, there is social control, legal and non-legal. His principal concern is that too much attention is given to adjusting the details of legal and non-legal social control, the framework of the market. This is the case even though he agrees that the results of market organization are a function of both mutual interaction in existing markets and the underlying system of social control. He is therefore able to preach freedom while acknowledging the social control role of the framework of the free market. His concern that too much be made of power also derives from his fear of giving too much attention to adjusting the details of the framework. This general argument is supplemented, for example, by statements of concern lest changing the law increase uncertainty and make profitable investment less likely.

(6) The foregoing amounts to providing support for a business-dominated economy, polity and society. Furthermore, it supports the felt needs of a saving-investment elite and a government receptive to the business middle class. Knight opposes any consolidation of social interests antagonistic to business and to a business society. Government is to be receptive to the felt needs of business inasmuch as the business system is the regnant social order.

Need a market economy be a capitalist system? Need a market economy be capitalist dominated, need the business class have what Charles Lindblom calls a privileged position? That has been the key question in the Western polities for almost two centuries. When the middle class, the class of businessmen, pressured the landed aristocracy to share the powers of government in law making, and when they pressured government to protect the interests of business as it had earlier protected the interests of landowners, the middle class purported to speak on behalf of the masses as well as the class of businessmen. But when the middle class succeeded in both respects, it sought only, or primarily, its own interests, joining relatively soon thereafter with the landed property class to defend the interests of all the propertied against the efforts of the non-propertied to share in the control of government and to have their interests protected. This was the origin of movements called the Ricardian or Benthamite left, socialism, and the welfare state. The last century and three-quarters has seen ups and downs in the relations between propertied and non-propertied. Overall, however, two points can be made: first, business tends to dominate government, as business interests are more intense, more concentrated, and more able to finance lobbying, than consumer and worker interests; and, second, business has been increasingly, if unevenly, profitable and more able to produce goods as the decades passed along. The issue is no longer the status of the business system but how much it has been bent toward the more populous segments of society. Or so it seems some of the time. Many scholars vacillate between perceptions of increasingly pluralist democracy and of good old elitism.

(7) Knight makes clear a sophisticated version of the relation of neoclassical to institutional economics. Knight does not deny the role of institutions in the allocation of resources. He generally prefers, however, the practice of an a-institutional economics, i.e., a pure conceptual abstract a-institutional economics for two reasons: first, it permits clearer, more concise purely abstract theorizing; and, second, it minimizes the intrusion of, indeed distracts attention from, institutional variables that might engender tinkering with the economic system.

So while the predominant neoclassical view is that institutions do not matter, that is by no means entirely true of Knight. What is true of Knight are his desires (1) to facilitate a laissez-faire system of belief and (2) that the defense of neoclassical economic theory also serve as a basis for disregarding interventionist pleas and efforts. This is true of his general viewpoint and it also applies to his presumption against any line of reasoning on any topic otherwise amenable to reformism.

The foregoing accounts for his mixed view on and practice of institutionalism, as well as his generally critical posture toward mainstream institutionalism. Knight knew that institutions mattered; what he did not want to abet is changing the legal and non-legal framework in such a way that it replaced the solution to problems achieved through markets. Knight recognized and accepted the functioning of social control but in the name of freedom wanted to limit our perception, application and, especially, change of it. Likewise he recognized and accepted the market plus framework approach but want to limit our perception and application of the framework, again, especially change of the law. It has been the relatively rare institutionalist who could not be so disabled by his or her agreement that institutions matter that they could effectively counter his argument on its own terms in what is essentially a hermeneutic contest. To the argument that the choice is not between market and government but between one law-based market and another law-based market, Knight could reply that the problems engendered by changing the law in order to change markets are infinitely greater than the problems of any particular law-based market.

It is not only institutionalists who question the laissez-faire position as unproven or at best grounded on slender supports. Donald Walker summarizes Léon Walras' position thusly:

> … so long as economists are content purely and simply to proclaim laissez-faire, laissez-passer as a sacrosanct dogma, their attacks on the socialists are no better founded than the opinionated proclamations of the socialists themselves. (Walker, D. A. (2006). *Walrasian Economics* (p. 98). New York: Cambridge University Press)

(8) In the actual world of politics and economics, members of the business community and of the political community engage in actions of mutual support depending on what each side finds beneficial. It is unfortunate but likely inevitable that democracy has come to that pass. It is also unfortunate that conservatives tend to assign blame to politicians for this when it seems more appropriate to damn both groups. I have argued with Chicagoans—not with Knight, as I did not know him personally—as to why they blame politicians and not businesspeople for corruption and why they strongly tend to assign rights to polluters and not pollutees. They typically say that politicians are the corrupting influence, that power in the market is limited, and if businesspeople have too much power and/or abuse their power they should be condemned, and that they

were not aware of having any bias in rights' assignments. They would not deny that businesspeople out to capture government and put it to their own uses is not the same thing as government providing the legal foundations of a market economy. To many others, however, the distinction involves as much impossibility as distinguishing coherently between framework-filling activities of government and specific special-interest interventions. To this latter, the Knightian thinker responds that minimizing activist government readily engaged in changing the interests to which government gives its support, as part of the framework, would be sufficient to allow individuals room within which to pursue their own ends. The thinker influenced but not entirely convinced by Knight would in turn respond that there is no conclusive reason why first manipulators of government should be given privileged status—to which the Knight-Bruno Leoni-Hayek et al. conservatives would again rely on the argument of coercion defined in terms of legal change. To which, in a continuing debate, their opposite numbers would say, well, you have made our case for economics being ideology and not science.

Which brings me to some further points. Knight is akin to many Austrians (and others) in manifesting a particular tension: His positive analysis recognizes problems of power whereas his normative theory, his ideology, diminishes and obfuscates them. Power for Knight opens up avenues for legal change that his ideology, his normative case, for capitalism urges not be pursued. But his ideology becomes another absolutist religion, something Knight detested in regard to traditional ecclesiastical religion but not the civic religion and apologia of capitalism. This latter system of obfuscation would cloud human minds, prevent recognition of the manipulation of public opinion, the ubiquitous search to change the rules of the game, and the fact that pursuit of ostensibly individualist values was conducted on unequal terms. It was unequal in its distribution of power, hegemony over government, manipulative capacity, and control over contracts in a world of standardized contracts of adhesion legitimized as "free contract." The "freedom to choose" and pursue one's own ends and the presumption in favor of gains from trade were abstract and at least partly illusory for those without assets.

Knight's absolutes may have been only relatively absolute absolutes but they were absolute enough to draw attention to arguably the most sophisticated ideology = religion known to man. It is too bad that Knight did not respond to Pareto.

(9) In reading through Glenn Johnson's notes, one cannot escape the feeling that Knight has in mind a series of targets to criticize in order to defend his favored neoclassical position. One of his most elaborate statements is also one of his most concise:

> Smith practically has no distribution theory—subjective value people introduced this change around 1870. Smith has chapters on wages, profits, and rents. If Smith had broadened this further to include differences in incomes he would have been forced into distribution theory.

> Classical school—no theory of imputation. Marginal productivity theory is the modern theory of distribution. Ricardo's distribution theory was a sort of general scheme—not too clear. James Mill and McCulloch stated wrong theories so clearly they were obviously wrong yet still accepted—when not hypnotized by their own theories they thought correctly.

His procedure is to assert what he considers a defect and on that basis dismiss what he dislikes. His widespread practice is to establish the ontological and theoretical, and thereby the ideological basis of capital by attempting to reduce all factors of production to capital.

While the idea of theory choice is well known among and appreciated by economic methodologists, the study of the criteria of acceptance and rejection, the criteria which serve as seines and filtration systems, have not been much studied. I personally suspect that the leading criteria are (1) consonance with received hegemonic paradigm, (2) consonance with elements of the neoclassical research protocol which requires the production of unique determinate optimal equilibrium solutions, such as optimality, equilibrium, uniqueness, stability, and, inter alia, mathematization.

The discussion centering on whether capital is produced by labor has the effect—it is difficult for me to see that it is unmotivated—of decentering what Knight envisions as the classical emphasis on labor, the result of which is to elevate entrepreneurial-capitalist decision making. Now I, following Bob Eagly, think that it is possible, even sensible, to interpret classical economics as, or as including, a set of decisions with regard to the use of capital. The difference is the vehemence with which Knight is recorded denigrating any theory that has a significant role for labor (I too do not think much of the labor theory of value—nor, for that matter, any theory of value as an absolute and invariant basis of price—but in my lectures I acknowledged its place in the history of economic thought and did not attempt intellectual assassination as does Knight) (see Eagly, R. V. (1974). *The Structure of Classical Economic Theory*. New York: Oxford University Press; Samuels, W. J. (1998). On the labor theory of value as a theory of value. *Review of Political Economy*, *10*, 227–232).

Comments (1) and (2) are combined by Knight when he himself combines several lines of reasoning to both criticize and laud Smith.

> If both buyers and sellers know what they are going no gains or losses. Natural rate is what the factor will bring in an alternative use. Smith didn't recognize that alternative use determines the cost. Smith had the notion between cost and price. Resources are distributed so that they have the same value in all uses. If population must be curtailed some land will be transferred to other uses where its use will be more profitable than in its present use. When we say price = cost that is way of saying that resources tend to be so distributed between different uses that remuneration is the same in all uses. The natural price is then the price toward which market prices are constantly gravitating. Smith has a tolerably good picture of the tendency of the whole system to equilibrium. Natural rate is not an empirical rate. It is the sum of the natural costs both natural

> prices and costs being a consequence of the equilibrium. What is the natural rate of remuneration of homogeneous land, machinery and labor? What is the natural rate for any one of them. Smith doesn't have a concept of this imputation problem, i.e., the field of distribution—it came into economics with the subjective value school of the 1870s which revolutionized the theory of price, alternative cost theory one of the major consequences of the subjectivist value school. Cost of producing one produce is the sum of the prices which other entrepreneurs would pay for the use of the factors of production—not "pain" and not a "labor theory" of value.

Knight, almost always candid and colorful, is not above using language one would not expect in a graduate course by a distinguished professor with a worldwide reputation. The notes, however, record the following:

> Cost of capital is amortization not interest—vindicates labor theory of value if capital was produced by and represents embodied labor. <u>Is capital produced by labor?</u> Where did such a stupid idea occur?, asks Knight. Capital is produced by land, labor and capital, i.e., all factors of production, says Knight.

Discussing subsistence theories of wages, specifically that which argues that "<u>In the long run</u> wages tend to the minimum for subsistence" he is said to have used the same term in comments on a putative assumption of that theory:

> The capitalist has arbitrary power over labor—the horse feed theory of wages. Assumes that the employer is in the position to pay what he wants. Stupid crazy, says Knight.

The term "horse feed theory of wages" dismisses by comic slur and both it and "Stupid crazy" are tendentious and putatively blind in light of both many of the world's labor market systems and certain segments of all labor markets, even academic ones. Even if he intended to refer only to wages, he is silent on the matter, and does not grant the role of unilateral unchecked power "arbitrary" over hours, working conditions, and the legal status of people of different socioeconomic classes. Johnson would certainly have recorded Knight's having done so.

Knight does not exclude even the great utility theorist Menger from his vitriol. He is recorded as referring to "Menger's crazy conception of capital."

> Jim Buchanan has articulated Knight's attitudes toward individuals, saying, Well, … Frank Knight was a great admirer of Adam Smith. He had his heroes, and he had his *villains* in the history of thought. He did not like Marshall; didn't think much of Marshall; didn't think anything of Ricardo, etc.
>
> The key is to try to learn from, as Frank Knight used to say … their mistakes. We don't study them to learn from what they can tell us so much, but learn from the way they got confused and how they worked themselves out of it and so forth and so on. (Buchanan, J. M., Wakatabe, M., & Yoon, Y. J. (2006). Adam Smith, James Buchanan, and classical liberalism: An interview with James M. Buchanan. *The History of Economic Thought*, *48*(1), 129, 133).

If one has a singular notion of what counts, or ought to count, in the history of economic thought, and if one pretty much not only dismisses but denigrates all else, the result is a colorful account but also a very high priestly one as well.

Another way of characterizing Knight is to note that he was a one-man intellectual wrecking crew. He could take any proposition by any author and interpose a line of thinking that would render the initial proposition dubious. Knight may have had such skills from the beginning, arising from his youthful but serious debates over religion in general and casuistry in particular. His early attention, however, to capital theory evidently further honed his skills. The notes below are full of examples. A scholar not wedded to any one theory of capital might find that no one theory is exhaustive and that a sensible point from one theory might seem to torpedo an otherwise sensible point of another theory. One wonders how sensible is criticism predicated upon a general equilibrium view of the world, in which all quantities are simultaneously determined, and in which conventional causation seems irrelevant. The criticism is directed to a pre-general equilibrium view of the economy from a standpoint utterly unknown to pre-general equilibrium thinkers. In any event, even Knight's view of general equilibrium is incomplete; as noted early in these comments, certain things were so anathema to Knight, so inconsistent with what he wanted to accomplish with his economics, that, notwithstanding his recognition of their existence, he felt compelled to exclude them.

If Johnson's notes do not misreport Knight's lecture at one point, it is difficult to conjecture what Knight meant by the statement, "Political Economy 1817—a great representative of abstract theory—yet his theory was only an explanation of what was going on." Even if the lecture is misreported, it is difficult to discern what Knight meant.

It is also difficult to determine precisely what Knight meant by the recorded statement, "Conditions for validity of a labor theory of value."

Another type of difficulty arises when Knight faults another author for not adopting his, Knight's, formulation of the problem. For example, Knight is critical of Böhm-Bawerk's basic theory:

> No such thing as the length of a production process—the length is not determinate—you may go back to garden of Eden. If you don't count back efforts, production is then instantaneous; if you count back efforts the length of production is infinite.

Knight is not wrong (though one wonders about when his formulation would be relevant to the decision making of a farmer); it has to do with a different problem: Böhm-Bawerk is concerned with physical production periods. And surely the sunk-cost principle is also relevant. Shortly thereafter he says that "Capital is a stock not a flow." The overriding problem is that many terms or concepts in economics can have more than one meaning, depending on context—which makes the exclusivist assertion of one meaning to be correct misleading. Further thereafter Knight claims that "No distribution theory among classicals where distributive shares are regarded as prices of the factors —Smith more realistic but at expense of consistency. No theory of capital in Ricardo." This view is meaningful only if one adopts Knight's version of (modern) distribution theory rather than some version of the classical economics' theory. To aver "No distribution theory" is myopic and arrogant, but consistent with his initially stated objective. But his account is neither rational nor historical reconstruction.

Another example is his critique of Ricardo's theory of wages and profit, a critique that is marked by his utterly ignoring Ricardo's very different type of theory and invoking his neoclassical view (it could be any other view), that "the main thing is what the classics didn't do—that different kinds of factor cooperate and that product has to be divided—must be done by supply and demand in the market." Similarly with the recorded statement that there is "Nothing in Ricardo to explain proportions of land and/or capital between industry and agriculture." No notice is made of the putative fact that such a division was not a part of Ricardo's theory of distribution. Nor (as I recall) was it part of his theory as interpreted by Eagley—a model of decision about the deployment of capital—though it might have, even should have, been.

I am not acclaiming a relativism beyond criticism or critique. I am suggesting criticism that is careful and explicit, that provides both a meaningful account of the original material and the speaker's view in a sensible manner and which gives the author of the criticized material credit for having some sense. Such a prescription still permits Knight's initially stated objective (1), which is another matter.

Another type of example is lack of careful modeling, including failure to ground his case (assuming Johnson did not omit it). Consider the proposition, "Expectations determine investment not the interest rate." I have no special preference for any particular theory of the interest rate. But it seems to me that, taken literally, if expectations determine investment they thereby are one of the factors governing the interest rate, e.g., through portfolio rebalancing and its affect on the demand for and supply of liquidity.

Also consider this position: "Illegitimate to ask what is the effect of a change in a wage rate as the wage rate is not primary—we can ask the effect of the change that that changed the wage rate." Does not the change in wage rate affect employment? Is that not the pre-Keynesian solution to unemployment? Why is it "illegitimate" to ask?

It is not too much to say that in many of the foregoing respects the notes reveal neither realism nor rigor. What Knight set out to do, he did. Although what he could do with, or to, Smith's and Ricardo's economics sometimes boarded on the brilliant, it often seems contrived.

These notes, and the lectures on which they were based, are among the most fascinating of any set published thus far in the volumes of this annual—and its nearest contenders include the other sets of Knight's lectures. Yet Knight regularly affirms a line of reasoning as if it were true, whereas they are at best only hypotheses. He does not say, here is something to be explained, this is how Ricardo did it with one hypothesis, and why, and this is how I do it, with another hypothesis, and why [he does say, "a great representative of abstract theory—yet his theory was only an explanation of what was going on"]. He issues two kinds of statements, denials, including denigrations, of others' explanations and affirmations of his own explanation. Knight has considerable company in doing this, including the Ricardo of the "Ricardian vice." Apropos of which one may consult the line recorded much later in the notes: "Peoples' minds are corrupted more by theory than by economic interests" and wonder if it is self-referential. In general, Knight neglected to give effect to the fact that Ricardo had a very different view of the structure and processes of a market economy. Knight and Ricardo focused on different paradigms and, where the problem was more or less generic, they focused on different specifications of variables and their relations.

(10) Knight seems to have, and to make the best of, a simple-minded notion of the mathematics of mechanics, one which finds the mathematics of equilibrium at a maximum level aesthetically pleasing and ideologically useful. We read, "Free competition comparable to frictionless surface in mechanics." We also sense an economist who is selectively prone to read causation into equilibrium positions in which equilibrium per se is a function of the set of pertinent equilibrium equations, and attributions of importance (e.g., that marginal productivity determines wage rates) that are in fact only elements in the equations. We also read that

> <u>Causality is the difference (marginal prod[uct]) a factor makes</u>. The partial derivative is the effect of the cause the cause being the variation in the other factor. Differentiation is as old as economics though the older economists didn't know the term. The axioms of marginality are a priori—as permanent as the axioms of algebra.

This is not quite what the mathematics or the economics of marginal equivalences, maximization solutions, and so on are all about. This is casting luster, not serious ontological analysis.

(11) It is not always clear, if indeed possible to determine, when Knight intends to be dealing with the actual economy or with the pure abstract a-institutional conceptual economy. Rarely does Knight seem to proceed to further elucidation and development, such as would clarify where he is on that dichotomy and the full subject under discussion. It is uncertain how much of that fullness was excluded by Johnson in his note taking.

Knight is able to criticize earlier authors on the basis of one or the other element of a dual approach to the ontology of price: scarcity, on the one hand, and the pressure of alternative uses (opportunity costs), on the other. This is the basis of much of his criticism, for example, of Ricardian rent theory and the theory of economic rent. With regard to Senior's position on the labor theory of value, as another example, he is recorded as saying, "Senior didn't really see the point—it isn't the limitation of labor which makes it valuable—it is the competition of other uses." Also, it is in this latter connection that he argues that "No explanation means anything except in terms of general equilibrium."

An odd tension pervades the lectures: Smith and Ricardo are considered important to the main approach taken by Knight, i.e., how they prepared the way for neoclassicism; but they are criticized for not being neoclassicists, for not being Knight, for that is what Knight's criticisms amount to.

(12) Knight is very skilled and adroit in identifying connections between variables and the implications of equilibrium.

(13) Knight's particular standpoint, from which he interprets much of value and distribution theory, is the theory of capital. For example, he exhibits a continuing tendency to reduce labor and land to capital. "This whole idea of different kinds of productive services is far fetched as they are all in the long run the result of capital investment—no distribution theory in a single productive factor economy." "Knight says that he is a crank on capital theory. In general all productive factors are capital." On the other hand, whereas the mainstream interpretation of Ricardo on rent is that it is the return to a factor of production in permanent inelastic supply, Knight argues that "The logic of the theory of rent is that land is a specialized agent. In the long run alternative uses of resources determine prices except for specialized resources whose price is determined by the price of its product." Overall, though, Knight considered Ricardo's rent this "verbal hocus pocus."

(14) Knight seems to envision utility as a way of expressing common experiences, of reducing the results of experience to a common denominator, rather than as itself a causal factor. Yet the use of the utility concept in an explanatory analysis strongly tends to cloak it in causal significance, for example: "Back to Subjective Value—Utility theory as an explanation of value—a common denominator of comparison. Largely a question of complementarity. Utility notion is cardinal as well as ordinal makes no sense if it isn't. Have to have an index function—a mathematical curve. Has to be assumed or something."

(15) Knight's lectures are organized around topics on which he had his own more or less idiosyncratic ideas.

(16) The apparent tone and substance of Knight's lectures seem reminiscent of some students who do not know the material yet offer often awkward criticism thereof. For example: "Indifference curve is total utility curve turned upside down—money given up instead of received." Another example: "Marshall's partial equilibrium analysis—not adequate." Knight's legendary pessimism seems to have been transformed into a negativism, one that even overwhelms the

optimism that one might anticipate from his general story of how past theory led to the hegemonic modern theory with which he concurred.

(17) While Knight was very much aware of the tension within the highest levels of economic theory between realism and rigor, he typically seems to have marched to the drumbeat of pure abstract theory. Yet he was not above saying, "Ingenuity—refinement of theory beyond realism—a curse."

(18) In his brief discussion of English history as background for Ricardo, Knight seems happy to stress the military power that industrialization brought or enabled. In the terminology of Knight's sometime colleague, Jacob Viner, the Industrial Revolution brought both power and plenty. (Viner had left Chicago for Princeton in 1946—the year earlier—after 30 years on Chicago's faculty.)

The editing is comparable to that of most sets of student notes published in the volumes of this annual. Compared to other sets of notes, Johnson's tend to combine what would normally be two independent sentences—complicated by the omission of sundry words and punctuation marks. In order to avoid presumptuous introduction of unintended nuances, I have generally left the sentence structure as I found it.

(1)

ECONOMICS 302

HISTORY OF ECONOMIC THOUGHT, WINTER, 1946

Working Bibliography

General Character of Course: A very brief survey of economic thought prior to the "classical school," with chief attention devoted to the latter, especially to the price and distribution theory of Smith, Ricardo, Senior and Mill. Limited reference to Historical or Socialistic Schools. Matter outside the classical doctrine to be obtained chiefly from reading.

General Words ("Manuals")

Ferguson, J. M., Landmarks of Economic Thought.

Gray, A., The Development of Economic Doctrine. Two recent books very readable, and excellent within their scope. Gray has nothing on the historical schools. Neither is he adequate on the classical writers.

Roll, E., History of Economic Thought. Somewhat Marxist slant.

Haney, L. H., History of Economic Thought. The fullest book covering the field; table of contents gives a fairly good arrangement of authors into groups or tendencies.

Ingram, J. K., A History of Political Economy. Briefer than Haney, and usable.

Spann, O., History of Economics. Translated from the German. Valuable for its intense opposition to the viewpoint of the classical school, in favor of an organismic or universalistic standpoint.

Schumpeter, J., Epochen der Dogmen- und Methodengeschichte, contained in Grundriss der Sozialökonomik, Vol. I.

Oncken, A., Geschichte der National Okonomie (Down to Adam Smith).

Gide, C., and Rist, C., History of Economic Doctrines (in French, or Translated from the French). (Begins with the Physiocrats.) A competent but uninspired book. Emphasis on French work and on the socialistic schools.

Scott, W. A., The Development of Economics. Covers modern period, beginning with background of classical economics. Excellent summaries, notable omissions (especially Mathematical economists).

Whittaker, E., A History of Economic Ideas. The best book in the field in content but massive, confusing, and repetitious through organization on the topical principle. First half deals with institutional and intellectual history rather than analytical economic thought.

Heimann, E., History of Economic Doctrines. An Introduction to Economic Theory. Oxford University Press, 1945, pp. ix, 263 (245). More introduction than history.

Salin, E., Geschichte der Volkswirtschaftslehre. Covers the field briefly in an interpretive, historical-philosophical manner.

Encyclopedias; especially Palgrave, Dictionary of Political Economy. (Ed. H. Higgs 1926) and the Encyclopedia of the Social Sciences; on men and movements, and <u>especially, Bibliographies</u>.

See Bibliographical Notes in Haney (above) 3d Revised Edition, 1936, pp. 803–809.

<u>On the Whole Period before the Classical School</u>

Monroe, A. E., Early Economic Thought. Lengthy excerpts from some 20 important writers.

Oncken, A. See under General Works.

Sewall, H. R., The Theory of Value before Adam Smith, Publications of the American Economic Association, 1901.

Dunning, W. A., History of Political Theories, Ancient and Modern; also *ibid.* From Luther to Montesquieu.

(Pre-classical economic thought being essentially political thought.)

Greco-Roman Economics

Simey, M. E., article entitled "Economic Theory among the Greeks and Romans." Economic Review, 1900. Copies on reserve. Best short account.
Laistner, M. L. W., Greet Economics. Valuable introduction and excerpts.
Calhoun, G. M., Business Life of Ancient Athens. Introduction and text valuable for background.

Medieval

Ashley, W. J., English Economic History and Theory, Vol. I, Pt. 1, Chap. 3, and Vol. I, Pt. II, Chap. 6. Best general account.
O'Brien, G., An Essay on Medieval Economic Teaching. Highly important, especially because written from a Catholic point of view.
Tawney, R. H., Religion and the Rise of Capitalism. Chapter One, on The Medieval Background.

Mercantilism

Heckscher, E. F., Mercantilism, 2 Vols.
Horrocks, J. W., A Short History of Mercantilism.
Schmoller, G., The Mercantile System. Ashley Economic Classics. Invaluable also as a specimen of the German historical economics. In quite at desk, E11.
Ashley, W. J., The Tory Origin of Free Trade Policy, in the Quarterly Journal of Economics, Vol. 11. Also in Surveys Historical and Economics.
Johnson, E. A. J., The Predecessors of Adam Smith.
Mun, T., England's Treasure by Foreign Trade. Ashley Economic Classics.
Furniss, E. S., The Position of the Laborer in a System of Nationalism.
Viner, J., English Theories of Foreign Trade before Adam Smith, in Journal of Political Economy, Vol. 38, nos. 3 and 4. Reprinted in Studies in the Theory of International Trade, Harpers 1937.

Physiocrats

(Given very little attention in this course.)

Higgs, H., The Physiocrats.
Ware, N., article on "The Physiocrats" in American Economic Review, 1931.

Bloomfield, A. I., Foreign Trade Doctrines of the Physiocrats, American Economic Review, Vol. XXVII, no. 4, December 1938 (Reprint on Reserve).
Turgot, A. R. J., Formation and Distribution of Riches (Ashley Economic Classics).

Classical School

Whitaker, A. C., Labor Theories of Value in English Political Economy. Nearly essential, if obtainable (purchase).
Bowley, M., Nassau Senior and Classical Economics (purchase alternative to Whitaker). Better, but more difficult.
Cannan, E., Theories of Production and Distribution. Valuable, but laborious reading.
Cannan, E., Review of Economic Theory. Used selectively, more available than his other book.
Taussig, F. W., Wages and Capital (London School Reprint).
Knight, F. H., The Ricardian Theory of Production and Distribution. Reprint from the Canadian Journal of Economics and Political Science.
Cannan, E. (Ed.), Lectures of Adam Smith.
Smith, A., Wealth of Nations. Full text, Everyman's Library (2 Vols.) or Modern Library (Reprint of Cannan edition—1 Vol.) most available. Abridged edition edited by W. J. Ashley gives portions covered in the course conveniently in one small volume. Cannan edition (2 Vols.) the definitive edition, but expensive and bulky for class use.
Ricardo, D., Principles of Political Economy. Available in Everyman's Library (1 Vol.). Gonner edition best (London, G. Bell and Sons; Bohn's Libraries).
Senior, N. W., Outline of Political Economy. Reprinted 1938, Allen and Unwin.
Mill, J. S., Principles of Political Economy. Ashley (Ed.), Longmans, 1 Vol.

Subjective Value or Marginal Utility School

Smart, Wm., Introduction to the Theory of Value.
Jevons, W. S., Theory of Political Economy.
Wieser, F., Natural Value. Smart's prefaces to Böhm-Bawerk's two main volumes and to Wieser, Natural Value.

Böhm-Bawerk, Capital and Interest, and Positive Theory of Capital.
Weinberger, O., Die Grenznutzenschule.
Mises, L., Bemerkungen zum Grundproblem der subjektivistischen Sozialpolitik, Band 59, Heft 1.

Historical and Institutional and Socialistic Schools

See articles in Palgrave's Dictionary of Political Economy, and in the Encyclopedia of the Social Sciences.

(2)

Economics 302

Reading Assignments in Smith and Ricardo

General Note: These assignments correspond to the ground covered in the course, and specifically to its limitations. That is, they cover the topics of price and distribution theory. It should be understood that considerable injustice is done to all three of the authors if these sections are taken to represent their work as a whole.

Adam Smith

What is recommended is that the student should provide himself with the abridged edition of The Wealth of Nations edited by Professor Ashley. The selections listed roughly follow the Table of Contents of that work.

1. Book I, Chs. I–XI (the entire Book) except for the omission of Ch. XI, Parts II and III, down to the last two topics, namely, "Effects of the Progress of Improvement Upon the Real Price of Manufactures," and "Conclusion of the Chapter;" these two topics of Ch. XI, Part III, are included, along with all of Ch. XI, Part I.
2. Book II, Chs. I and III–V (i.e., the entire Book, except for Ch. III).
3. Book III, Ch. I only ("Of the Natural Progress of Opulence").
4. Book IV, Introduction and Chs. I, II, VIII, and IX.
5. Book V, Ch. I, Part III, Article 2 ("Of the Expenses of the Institutions for the Education of Youth"); and Ch. II, Part II ("Of Taxes") entire.

David Ricardo

Note: There is little order in Ricardo's own exposition; the chapter titles do not correspond at all closely with the contents.

1. Price Theory: Chs. I, XX, XXVI, IV, XXX, and IX.
2. Distribution Theory: (a) Rent: Chs. XI, XXIV, and XXXII; (b) Wages and Profits: Chs. V, VI, VIII, XV, XXI, and XXXI.
3. For further light on Ricardo's position as a whole: Ch. VII ("Foreign Trade") and Ch. XXVI ("On Gross and Net Revenue").

(3)

Suggested Readings in J. S. Mill's "Political Economy"

I. Ashley's Introduction in J. S. Mill's "Political Economy."

II. Value Theory: Book III, Chs. I–VI; also XIV ("Excess of Supply"); XV ("Measure of Value"); XVI ("Peculiar Cases"); XVII, XVIII ("International Trade").

III. Distribution Theory: Specifically the subject of Book II. It is probably better for the student to begin by obtaining an idea of Mill's conception of production and its organization from Book I, Chs. 1–VII inclusive. Especially Chs. III and V, Section 9. Then the chapters on distribution may be taken in the "Ricardian" order.

   1. Rent: Book II, Ch. XVI, cf. also Book I, Ch. XII.
   2. Wages and Profit: Book II, Chs. XI–XIV; XV. (Chs. XII and XIII may be skimmed.) In connection with Ch. XV ("Of Profits"), cf. also Book I, Chs. IV and V.
      Also Book III, Chs. XXIII ("The Rate of Interest") and XXVI ("Distribution as Affected by Exchange").
   3. For a view of the "institutionalist" side of Mill's thought, see especially Book II, Ch. IV ("Of Competition and Custom"); also Chs. I and II ("Of Property").

IV. Some reading should be done in Book IV, "Influence of the Progress of Society on Production and Distribution;" Chs. II ("Influence on Value and Prices") and IV ("Tendency of Profits to a Minimum") perhaps most important; note titles and section headings of others from Table of Contents.

V. Similarly for Book V, "On the Influence of Government." Most important, Chs. I ("Functions of Government in General") and XI ("Grounds and Limits of the Laissez Faire Principle").

(4)

GLENN JOHNSON'S NOTES FROM FRANK H. KNIGHT'S COURSE IN THE HISTORY OF ECONOMIC THOUGHT, ECONOMICS 302, UNIVERSITY OF CHICAGO, WINTER 1947

I. General Explanation
   A. Interest to use features of the history to teach the subject—similar in this respect to philosophy the study of which is ruminations of its own history.
   B. Take up the classics to learn economics out of these. Smith, Ricardo and Mill the three basic classicals. Perhaps Malthus and J. B. Say and Senior. Next great group the subjective value group—Austrian group—Böhm-Bawerk. Neoclassical school being a fusion of Austrian and classical groups—represented by Marshall and his synthesis. That is the main job—to understand these foundations of modern economics. Could go back ever further and could study views of other countries, and could study policy. Human and social life has aspects (interrelationships) creating insoluble problems. The "economic man" a real concept. The course includes (1) a survey of the evolution of economic theory and (2) the development of modern economics.

II. Great differences between early economic thought and later thought.

III. History "Knight" as democrats we are all individualistic—but philosophically individualists are myths, individuals being bearers of culture. Spiritual qualities—minds—ideas, attitudes—tied up with folktales, literature—a process of social conditioning to get a "social mind" not quite consistent with democracy.

IV. When people are original they are only slightly so and probably wrong.

V. Individual aspects over-emphasized in our society. Individuals made out of society by a modern process of differentiation since 15th century though some occurred in upper classes of others. Spann's view grew into totalitarianism philosophically.

VI. Modern economics takes individuals as given.

VII. Great difference between economic thought and later thought—before and after Smith, Hume and Cantillon being conversion writers. [The preceding follows an arrow pointing to it in the margin.]
   A. Prior to Smith—political nature of economics important—thus the study of economic thought prior to Smith is a study of politics and [incomplete; possibly judiciary].

B. Modern economics is individualistic, independent to satisfy his own wants with his own resources. Economic society consists of the interactions between such individuals, i.e., exchange with money. Exchange is impersonal, inhuman in theory—<u>ideal</u> excludes personal contacts. Maximum total satisfaction. The economic man neither nor loves, competes or cooperates—no personal feelings. The market secures cooperation without feeling—in free markets this is true in practice—little actual rivalry.

This idea began to originate in 18th century—the exchange system began to be conceived as a mechanism for effective cooperation.

Historical explanation versus judgment and action—modern economic development out of the discovery that there is a presumption of material gains through exchange. This concept may have been unconsciously attained. Consciously farseeing—future was conceived, and, it is now again a burning question. 18th–19th the century of individualism following mercantilism. Back of mercantilism, the Middle Ages with its society, custom sanction by religion in quite a primitive manner.

Individualistic (exchange) economy—money being exchanged not goods as in late Middle Ages with its handicraft economy. "Enterprise" economy with organized units under centralized authority of the entrepreneur, a person or group, the ordinary person or family selling services to the firm and buying products from it in a matter [manner ?] much different than in [from a] handicraft economy. All of this grew out of the recognition of "mutual gain through exchange." Middle Ages had to be transcended by (1) transferring of power from church to state through Protestant reformation in which churches were nationalized, the mercantilist period being the period of the nationalistic state. People accept, as an end, the attainment of the good things of life through power, power no longer being wrong. The state can do no wrong in my country right or wrong, replacing the attitude that the church can do no wrong. This was then individualized to the rational use of means to attain individual means: power over nature (<u>not other men</u>) being the means to get the ends, my own ends cannot be wrong with the liberal view of society, i.e., mutual gain through free exchange. Assumed that people know own ends—new supernatural good—the good is to get the person's own ends. Society is no longer an entity as under totalitarianism or Holism. Means and ends individualized. "Enterprise system" is the means of increasing the efficiency in attaining these individual ends.

Three stages of specialization:

A. Handicraft
B. Production of one product for exchange
C. Sale of service only.

Economy or efficiency strong with individualism which implies freedom to get what you want with as much means and as you can get [awkward]. Man no longer lives for future life. Can be stated as the direct road to hell or as a path of dropping mysticism toward enlightenment from obscurantism.

Stripping Roman imperialistic period without literature we go back to the Greeks. We have a four-fold system:

Primitive

A. Greek city-state economies
B. Middle ages
C. Mercantilism
D. 18–19 century individualism (exchange) market. "Enterprise" "Entrepreneur." Economy or efficiency.

Greek city-states not democratic, presupposed slavery, class distinction and suppression of women, suppression of most areas and classes. Slaves and certain classes were capital not people. Economic life of Greece—"The Business Life of Ancient Athens," by G. N. Calhoun [1926], will give you a feel of Athens superior to that from Plato, Aristotle, Xenophon and the orators, Demosthenes—Professor [Robert J.] Bonner's "Lawyers and Litigants in Ancient Athens" [1927]. We get stable fixed patterns of social life through laws a great part of which dealt with trade and economics. Popular courts or juries with debates, the defendants giving prepared speeches written by the orators. History of Economic thought gives only Plato, Aristotle, Xenophon being quite unrealistic. Greek word for economics meant household or estate management including both the villa and town house.

Oikos (estate) plus nomen (management) similar to southern plantation. See [Carl] Bücher, Industrial Evolution [1901], for discussion of Roman Latifundia. Bücher is dispirited and so is what Knight says, he says. Economic Thought of the Greek writers was primarily speculative—division of labor, interest taking, etc.—incidental probably put in as embellishment. Dr. [Arthur Eli] Monroe's book [Early Economic Thought, 1924] has sections. Max Weber describes the Greek city-state as a "companionship in arms" to aggrandize the state as a unit. Man lived, married and had his living in the state in contrast to U.S. concept of the state.

Plato, to a lesser degree Aristotle, an aristocrat above economic life—thus you don't have speculation based on fact. Except for Xenophon no intellectual curiosity as to economic facts of life. Knight is negative on value of studying the small very select Greek city-states. Knight emphasizes the difference between the Greek city-state and the modern organization through the relatively unrelated Roman period, Middle Ages, etc. Later Rome under domination of a near Stoic philosophy—Post-Platonism. Roman interest concrete—not abstract philosophy. Relations between Roman and Greek law—Roman law would fit trade; Greeks primitive law not fitted for the greater Grecian period.

Modern times, economic history, is the history of trade and commerce. Lujo Brentano, "Der wirtschaftende mensch in der Gerschichte" [1923]. Trade is as old as mankind—foreign trade older than domestic trade as in the Bible—the trader a cheater—social enemy. Primitively, exchange system not used domestically division of labor between different people with different resources being more important than domestic trade.

Organization of trade fascinating—"Primitive Trade" [1926], by Elizabeth Hoyt. "The Silent Trade," by Philip J. H. Grierson (1903).

Trade is a method of production, particularly foreign trade. If only product A trade for B we do so because this is a more efficient way of producing B. Did it originate through gifts? Herodotus on Silent Trade in Cunningham "Economic Aspects of Western Civilization" [William Cunningham, An Essay on Western Civilization in its Economic Aspects, 1898]. Silent trade examples throughout world to prevent people from fighting. Did it grow out of mutual grain robbery? More likely by gifts and hospitality, tribal trade described in "Argonauts of the Western Pacific" (1922) by Bronislaw Malinowski.

Society is a unit—the directive is to maintain the unit—prior to modern economics explain why trade, revival of interest taking—getting ahead of others—are therefore frowned on.

Weber felt that interest taking was prohibited because it would impoverish people making it impossible to defend the unit.

Two great legacies of Rome—the legal system and Christianity.

<u>April 18, 1947</u>

Brentano's changes in the economic unit—the application to smaller and smaller units of principles of economics. As time has passed, trade relations have come farther and farther into the relation of people through a process of <u>individualization</u>. <u>Freedom</u> was unintelligible to earlier ages not having experienced to [sic] process of ordering their own lives. <u>Free association</u> replaced stable stereotyped costumes controlled life with its unchangeable status. These three words almost represent a religion to us. Are we getting away from this—since World War I—we have a trend toward state control of individuals resulting from dependence on state. We have a choice in the proportions of these two concepts which we want—as one increases the other decreases. Political freedom associated with minimization of government functions—free association instead of stereotyping—each individual finding his own place in society.

I. Market is the most important form of free association everything by the mutual consent of those concerned. Free association also in religion—the struggle between church and state in opposition to economic interpretation of history. Knight thinks that religious freedom preceded economic freedom.
II. Catholic church—Middle Ages—more politics than religion. Break up allowed more individualization.
III. Outline:
    A. Classical antiquity
    B. Middle Ages
    C. Renaissance, 16th–18th century
    D. Enlightenment.

Dramatic romanticization of French Revolution underemphasizes the importance of English. Newton 1688 and Locke 1690 developed—form a watershed of modern thought middle of 17th century 1648 contemporary with the Treaty of Westphalia. The period of enlightenment starts here. Voltaire and Montesquieu in 18th century had drawn from England. The 18th century France was a center of European culture. Puritan Revolution 1649 in England their restoration and Revolution again in 1688. Modern democratic ideas were effectively launched at this time. Settlement of America—Massachusetts important.

Reformation in Germany and counter-reformation made less difference. Catholic churches were nationalized as well as protestant church. Nor object of protestation 16th century religion—Wickliffe in 14th century an exterminated heresy. As a result of reformation churches were nationalized—religious freedom not increased.

In the period of Enlightenment a real liberalization of religions occurred, 9/10 apathy, 1/10 brotherly love. Economic thought developed.

Counter-reformation put a quietus on liberalism.

IV. Pertinent thing—the intolerance of Semitic religion—Christianity, Judaism and Islam the only religions claiming to be the one and only religion. Europe inherited this compulsion—people couldn't imagine that people could live together with different religions with peace and order. The result was the absolute state (church or civil), divine right of kings, absolute sovereign. State sovereign over people and king sovereign over state.
V. Relation between religion and social organization. Great bulk of people have always had a religion—not necessarily their leaders. Man as much a romantic as economic. Believes in absolutes, in concepts, imagination a function of religion is to sanction organizations. Christianity has accepted every form of