

ЕКОНОМІЧНА
ІСТОРІЯ СВІТУ

(ECONOMIC HISTORY OF THE WORLD)

ХРЕСТОМАТІЯ

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1. JOHN LOCKE: A PHILOSOPHER DEDICATED TO ECONOMIC THOUGHT

I. German idealism only tangentially touched upon economic questions and therefore did not leave any deep traces in the economic sciences. Marx's turn from interpreting the world to changing it only constitutes the exception that confirms the rule. English philosophy, by contrast, was far from limiting itself to an interpretation of the world and thus contributed more than many other disciplines to the emergence of political economy. Apart from Locke, we may think of Berkeley, Hume, Bentham, and John Stuart Mill. And Smith and Jevons held chairs in philosophy. The creation of the liberal order required establishing not only the tasks and the limits of state activities regarding the economy, but also a theory of property that, though with its roots in ancient Roman law, was re-established in the course of the development of natural law.

Among the preeminent authors of the economic literature of the seventeenth century, Locke was the only one with a comprehensive classical, and in particular philosophical, education.¹ His father was a lawyer, and with the help of one of his clients the young Locke, at the age of fifteen, entered Westminster School, a prototype of the English public school system. There, he was taught to study the classical authors in Greek and Latin, for six days a week over a period of six years. When, at the age of twenty, he enrolled in Christ Church College in Oxford in 1652 with the help of a grant, this programme of study was continued: the ancient languages, rhetoric, grammar and logic, and philosophy, especially Aristotle, but also history, Hebrew, and theology. After his examination and his election as a tutor of Greek, he gave lectures on Aristotle, Cicero, and other ancient authors. He would later defend the study of Greek as the basis of the Western sciences, despite the fact that a turn towards the applied sciences was a hallmark of his times. Nor did Locke ignore the study of the more recent sciences. He engaged with medicine, made contact with the famous chemist Robert Boyle, and conducted experiments. He also tried his hand at medical treatments. One of his patients was Lord Ashley, the later Earl of Shaftesbury, whose protection Locke enjoyed. It was for Ashley, then Chancellor of the Exchequer, that Locke wrote the text



on the consequences of the lowering of interest, which we shall consider here. First written in 1668, it appeared in revised form in 1692.

During the first half of his life, little seems to have prepared Locke for the role of a great economist, if we leave aside that a strict discipline of thought helped him achieve a degree of stringency in argument that had rarely been reached before, and that his philosophy of natural law helped him in analysing the interests and rights of groups within society that were affected in very different ways by the state's fixing of a maximum interest rate.


However, Locke had not remained unperturbed by the turmoil of civil war, and he would soon take sides. Born in 1632, during the reign of Charles I, Locke attended Westminster School at the time the monarch was executed in 1649. Locke's father actually fought in the civil war. Cromwell's protectorate roughly coincided with Locke's time in Oxford. As a member of the diplomatic mission to Brandenburg in 1665, of the colonial administration, and of the Board of Trade, Locke would later play a role in the civil service and in politics.²

Locke's role in English politics as a radical, even as a conspirator, has been examined in minute detail. A book on the topic begins with the following dramatic passage:

The Secretary of State listened with intense interest as the man across from him confessed his involvement in a plot to assassinate the King and spoke of the activities of many others who planned to raise a general insurrection in England. Within hours of this confession, John Locke hastily departed from London, taking with him the unfinished manuscript of the Two Treatises of Government. Ahead lay six years of hiding and life as a political exile in Holland for the author of one of the classic works of Western political literature.

(Ashcraft 1986, p. 3)

The major themes of Locke's political philosophy are, indeed, immediately related to his experiences in life. The problems associated with an absolutism based on




the French model pursued by Charles II and the question of religious tolerance, which was not at all a taken-for-granted ideal for a religious person like Locke, take centre stage. The combinations of political radicalism and the battle against absolutism, of democratisation and Protestantism, of bourgeois and capitalist entrepreneurial spirit, of respect for the faith of others and openness for the new science, were not as obvious from the very beginning as they appear in hindsight after the victory of the revolution of 1688. Locke was caught in the whirlpool of his times, and it was some time before he found firm ground on which to stand.

After his return to England, Locke's theoretical *magnum opus*, the *Essay Concerning Human Understanding* (1690), the *Two Treatises of Government* (the conception of which dates back to the time before his exile and was drafted under threat to his life), the text to be discussed here, and *Some Thoughts Concerning Education* (1693), all appeared within the space of a few years. And even after the revolution, he still thought his theses risky enough to confess his authorship of the *Treatises* only in his will of 1704.

While the *Essay* earned Locke a reputation as one of Europe's great philosophers within a surprisingly short span of time, the *Second Treatise on Government* was seen as a manifesto of one of the radicals, containing arguments which defended the Parliament as the legislative body, 'the essence and union of the society' (Ashcraft 1986, p. 546), against the attacks from James II. Its publication after the victorious revolution made it possible to interpret it as a justification of dynastic change:

... to establish the Throne of our Great Restorer, Our present King William; to make good his Title, in the Consent of the People, which being the only one of all lawful Governments, he has more fully and clearly than any Prince in the Christendom: And to justifie to the World, the People of England, whose love of their Just and Natural Rights, with their Resolution to preserve them, saved the Nation when it was on the very brink of Slavery and Ruin.


(Locke 1964, p. 155)



Next to Locke the epistemologist and the political philosopher, Locke the economist appears almost invisible - so much so that major monographs on his work and life hardly consider our text worth mentioning. True, its external form is that of an economic pamphlet, written in a language, as Locke himself tells us, less carefully designed than that of his other works. There are repetitions and unresolved contradictions (or, at least, obscurities) which betray that the author served the purpose dictated by the moment of composition, not knowing that he was actually writing a classic text.

II. Locke had a comprehensive historical influence. He undermined absolutism by introducing the separation of powers, thus preparing the way for the American declaration of independence. It was said of Jefferson that he plagiarised Locke, of Rousseau that he moved 'within the space demarcated by the Treatises' (Specht 1989, p. 185). The combination of Locke's political philosophy, based on natural law, with the labour theory of value moved the latter beyond the confines of a political arithmetic where Petty had already established a place for it.

Petty, in his applied economic theory, had thought it useful to employ a thought experiment in which one man produces grain for a year, and another produces silver for a year. If these two men are at the same time capable of producing what is required for their subsistence, the product of their labour must have the same value. If the labour required for providing their subsistence takes up the same amount of time, it follows that the amount of grain and silver produced must have the same value because they also required the same amount of labour.³ (The example was chosen - if accidentally so, we don't know - in a way that made the calculation of interest irrelevant. Generally, such calculation forces you to leave a pure labour theory of value.) Thus, in Petty, recourse to labour value serves the purpose of calculating value and is an aspect of positive economics. By contrast, Locke's political philosophy modernises the Medieval and Roman legal tradition of using the work exerted on an object as a justification for the ownership of the changes thus effected. An object is the property of the producer to the extent that he independently produced it. If he only modified it, as in the case of a Roman sculptor who made a statue out of bronze, he is entitled to a




remuneration corresponding to the difference in price between the statue and the cost of the raw material, i.e. the bronze. It seems to be this normative idea which is given a new meaning by Locke when he takes an imagined state of nature as his point of departure. From there on, classical economics will combine the two perspectives of Petty and Locke.

Locke derives the right to private property from the right to self-preservation.⁴ In the state of nature, man acquires the fruit he collects, as well as the produce of the soil he cultivates through labour. Where he cultivates the soil, the soil itself becomes his property. However, there is a limit set to property rights, insofar as the labourer must not violate the ‘common Law of Nature’ and let the products of his labour go to waste. In particular, no one has a right to land which he only encloses without cultivating it (Locke 1964, §§ 37-8, pp. 312-14). Locke’s illustrations are not just taken from the Old Testament, but predominantly make reference to America, making his argument another example of the justification of the seizure of land by colonialists on the basis that they make better use of the land than the native inhabitants.

It is labour, and not only directly exerted labour but also indirect labour, which justifies property rights. The labour theory of value, however, is only considered under its qualitative aspect, so to speak. Labour establishes property, but there is no claim to the effect that relative prices should correspond to relative labour time. The latter corresponds to the quantitative aspect of the labour theory of value, which is introduced by Petty.

Locke’s position is expressed in the following passage:

An Acre of Land that bears here Twenty Bushels of Wheat, and another in America, which, with the same Husbandry, would do the like are . . . of the same natural, intrinsick Value. But yet the Benefit Mankind receives from the one, in a Year, is worth 5 l. and from the other possibly not worth a Penny, if all the Profit an Indian received from it were to be valued, and sold here . . . ‘Tis labour then which puts the greatest part of Value upon Land . . . : ‘tis to that we owe the greatest part of all its useful Products . . . For ‘tis not barely the Plough-man’s Pains, the Reaper’s and the



Thresher's Toil, and the Bakers Sweat, (that) is to be counted into the Bread we eat; the labour of those who broke the Oxen, who digged and wrought the Iron and Stones, who felled and framed the Timber employed about the Plough, Mill, Oven, or any other Utensils, which are a vast Number, requisite to this Corn, from its being seed to be sown to its being made Bread, must all be charged on the account of Labour . . . : Nature and the Earth furnished only the almost worthless Materials, as in themselves.

(Ibid., § 43, p. 316)


Locke hardly touches upon the typical problems of such a qualitative labour theory of value. How is the transfer of property, especially inheritance, to be regulated? And how does the property right to the products of an employee come about? Which limits to property rights result, if contractual work is permitted? Because Locke departs from a fictional state of nature but nevertheless illustrates it with historically specific examples, especially from America, he would also have to accept questions regarding other historical cases of dependent labour, such as slavery.

The introduction of money transcends the original limits of appropriation because money can be accumulated. The justification of the emerging inequality is given by pointing to the observably higher productivity of labour. The native inhabitants of America possess land in abundance:

. . . yet for want of improving it by labour, have not one hundreth part of the Conveniencies we enjoy: And a King of a large and fruitful Territory there feeds, lodges, and is clad worse, than a day Labourer in England.

(Ibid., § 41, p. 315)


If Locke had looked at changes in ownership from the perspective of exchange, this would have led him to move from the qualitative to the quantitative aspect of the labour theory of value.⁵ Someone exchanging a product that required little labour for another one that required a substantial amount of it owes part of his property to someone else's labour. The further path from Locke leads either to the theory of



exploitation or to a modification of the theory of ownership. In Ricardo, exchange value is modified by the rate of profit, and the gain is justified with the accumulation of capital. In Neoclassical Theory, further elementary factors play a role alongside labour. In his essays that are interested in solving problems of economic policy, Locke uses an explanation of relative prices based on supply and demand without giving a fully developed theory of it.

III. The polemic against a maximum interest rate set by the state as presented in *Some Considerations* is of significance beyond its immediate purpose, due to the theoretical discoveries which it contains. To begin with, Locke takes the old arguments for legislation against usury - the Scholastic tradition of protection, if you like - and turns them upside-down. The lowering of interest disadvantages needy creditors, such as widows and orphans, who live off income from interest, while being advantageous especially to financiers, because bankers are most likely to find ways around the limits set to interest (for instance, in the context of foreign exchange). Thus, the legislation aiming at raising the level of morality misses its aim, as it actually promotes dishonesty by disallowing what cannot be prohibited.

Next, Locke develops the notion of a natural rate of interest ('natural use') at which the supply of credit equals the demand for it.⁶ If this 'natural use' is close to the 'legal use', there is less need for banks to do their work.⁷ If the natural rate of interest exceeds the legal interest, different economic groups are affected in different ways. The careful differentiation between these groups is one of Locke's achievements. His assumption is that a high natural rate of interest results when debtors are asked to redeem their credit in times of unfavourable trading conditions or when there are only insufficient amounts of money in circulation. An artificial lowering of interest rates results in losses for creditors (those widows and orphans), yet does not bear any advantages for the trade of the Kingdom. The profit of the merchant debtor who borrows money, say, at 4 per cent, but has a profit rate of, say, 12 per cent, may increase; however, this advantage must be offset against the shortage of available



credit, which, in modern terms, leads to its rationing. As a consequence, trade is impeded and the country suffers because less export can be financed.


Locke is thinking along Mercantilist lines. The precious metal on which the circulation of money is based can be acquired only through a surplus in trade, and - in his view - it cannot be substituted with bills of exchange to any significant degree. Locke does not discuss the problem which arises from the fact that not all countries can achieve a surplus in trade at the same time. However, he is obviously right in emphasising that trade crucially depends on profit rates exceeding interest rates.

One of Locke's substantial contributions to economic theory is the way in which he supplements his quantitative reflections (the 'intrinsick value' of gold and silver depends solely on their 'quantity') with an analysis of the 'quickness of circulation'.⁸ In order to determine the 'proportion of money to trade', Locke, with a clearness that is striking to the modern reader, establishes the necessary volume of money needed by labourers, landholders, and merchants, based on the fact that labourers are paid weekly, tenants and landowners render their accounts quarterly, and merchants need to have around 5 per cent of their annual income available throughout the year. No less than . . . One Fiftieth part of the Labourers Wages, One Fourth part of the Landholders yearly Revenue, and one Twentieth part of the Brokers yearly Returns in ready Money . . . (Locke 1991, p. 240)' are needed in order to finance the country's trade.

Thus, the value of money is determined in terms of its purchasing power, which, in turn, is derived from its quantity and speed of circulation. Interest is not the price of money:

The fall therefore or rise of Interest, making immediately by its change neither more nor less Land, Money, or any sort of Commodity in England, than there was before, alters not at all the Value of Money, in reference to Commodities. Because the measure of that is only the Quantity . . . which are not immediately changed by the Change of Interest.

(Ibid., pp. 245-6)




Changes in the interest rate therefore only indirectly influence the price of money through their effect on the volume of trade. But if so, why is there such a thing as interest at all? ‘Money is [a] barren thing, and produces nothing, but by Compact transfers that Profit that was the Reward of one Man’s Labour into another Man’s Pocket’ (ibid., p. 250).

Thus, wholly in line with the theory of supply and demand, it is the uneven distribution of money, together with uneven investment opportunities, which gives rise to the phenomenon of interest. Locke’s theory of natural law, according to which property is based on labour, leads him close to the idea of exploitation, but in a somewhat ambiguous formulation he declares that if someone receives 6 per cent interest, ‘ . . . his Six per Cent, may seem to be the Fruit of another Man’s Labour, yet he shares not near so much of the profit of another Man’s labour, as he that lets Land to a Tenant’ (ibid., p. 251).

With this, Locke remains firmly within the old tradition of understanding any voluntarily entered credit relationship as analogous to tenancy relations. In the times of the Old Testament, someone who gave away a herd of animals on loan was entitled to lay claim to the offspring produced during the time of the loan. In that sense, the loan of a herd was analogous to the loan of arable land. In both cases, the creditor remained the owner of what was on loan and received a part of its yield. According to the modern understanding, by contrast, a credit agreement is an intertemporal exchange, in which the creditor gives away his money in exchange for a promise to receive another sum of money, one with a larger value.

Following an excursus on how to explain the price of land on the basis of the capitalisation of rent and the various influences of economic conditions, as well as the taxation of land prices, Locke returns to the question of the lowering of interest. If it occurs through market mechanisms, it is, of course, advantageous! One must not confuse the measure taken by the Dutch, who adapted their national debt to the lower interest rates on the market by way of a skilful conversion, with the legal fixation of a lower maximum interest rate.

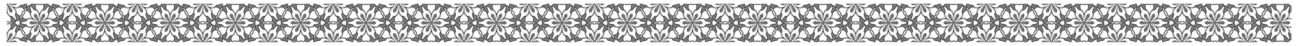


Finally, Locke comes to the crux of the matter and connects the analysis of economic interests with his theory of money. The politically powerful landowners want to lower the interest because they are indebted and hope that they will be able to increase the value of land. They conceive of the latter as determined by capitalised rent, i.e. interest (an idea which Locke meets with some doubt). However, their intervention upsets the whole working of the economy and, in particular, leads to a lowering of rents, with the result that the situation of especially the landowners worsens, rather than improves:

The usual struggle and contest, as I said before, in the decays of Wealth and Riches, is between the Landed Man and the Merchant, with whom I may here join the Monied Man. The Landed Man finds himself aggrieved, by the falling of his Rents, and the streightning of his Fortune; whilst the Monied Man keeps up his Gain, and the Merchant thrives and grows rich by Trade. These he thinks steal his Income into their Pockets, build their Fortunes upon his Ruin, and Ingross more of the Riches of the Nation than comes to their share. He therefore endeavours, by Laws, to keep up the value of Lands, which he suspects lessened by the others excess of Profit: But all in vain. The cause is mistaken, and the remedy too. 'Tis not the Merchants nor Monied Man's Gains that makes Land fall: But the want of Money and lessening of our Treasure wasted by extravagant Expences, and a mis-manag'd Trade, which the Land always first feels.

(Ibid., p. 291)

Thus, the pamphlet ultimately is a call to sort out the state finances and to create the right conditions for the flourishing of the private economy. This approach, like Locke's suggestions for a reform of the mint, appears liberal in spirit and makes one hesitate to call him a Mercantilist. Terence Hutchison pointed out that Locke the civil servant, more so than Locke the author, acted according to the principles of Mercantilism, for instance when he suggested to repress the Irish wool trade in favour of the English and in his projects aiming to reduce begging.⁹ At the end of the



day, this philosopher, who was as conciliatory in his writing as he was combative in his political actions, was altogether a child of his times: notwithstanding all theological speculation, he was a representative of the Enlightenment bourgeoisie and its faith in the fundamental rights of political freedom, religious tolerance, and private property.



2. HISTORICAL CONTEXT OF ADAM SMITH'S IDEAS

The capitalist mode of production, after it finally overcame the fetters of feudalism and the transitional period of mercantilism, reached its height and most clearly displayed its inherent socioeconomic features in the industrial


revolution, which occurred first in England and Scotland roughly in the last three decades of the eighteenth century and in the early nineteenth century. It spread to many parts of western Europe in the early nineteenth century.

Between 1700 and 1770, the foreign markets for English goods grew much faster than England's domestic markets. During the period 1700-50, output of domestic industries increased by 7 percent, while that of export industries increased by 76 percent. For the period 1750-70, the respective figures are 7 percent and 80 percent. This rapidly increasing foreign demand for English manufactures triggered the industrial revolution, which ultimately proved to be one of the most fundamental transformations of human life in history.

Eighteenth-century England had an economy with a well-developed market, in which the traditional anticapitalist market bias in attitudes and ideology had been greatly weakened. In England at this time, larger outputs of manufactured goods produced at lower prices meant ever-increasing profits. Thus, profit seeking, stimulated by increasing foreign demand, was the motive that accounted for the virtual explosion of technological innovations that occurred in the late eighteenth and early nineteenth centuries-and that radically transformed all England and eventually most of the world.

The textile industry was most important in the early industrial revolution. In 1700, the woolen industry had persuaded the government to ban the import of Indian-made "calicoes" (cotton) and thus had secured a protected home market for domestic producers. As outlined earlier, rising foreign demand spurred mechanization of the industry.


More specifically, an imbalance between the spinning and weaving processes led to many of the innovations. The spinning wheel was not as productive as the



handloom, especially after the 1730s, when the flying shuttle was invented and the weaving process was speeded up considerably. This imbalance was reversed by three later inventions : the spinning jenny, developed in 1769, with which one person could spin several threads simultaneously; the water frame, invented in 1775, which improved spinning by using rollers operating at different speeds ; and the mule, developed in the late 1770s, which com-bined features of the other two and permitted the application of steam power. These new inventions could be used most economically in factories located near sources of water power (and later steam power). Richard Arkwright, who claimed to be the inventor of the water frame, raised sufficient capital to put many factories into operation, each employing anywhere from 150 to 600 people. Others followed his example, and textile manufacturing in England was rapidly transformed from a cottage to a factory industry.

The iron industry was also very important in the early drive to mechanized factory production. In the early eighteenth century, England's iron industry was quite inconsequential. Charcoal was still used for smelting and had been since prehistoric times. By this time, however, the forests surrounding the iron mines were almost completely depleted. England was forced to import pig iron from its colonies, as well as from Sweden, Germany, and Spain. In 1709 Abraham Darby developed a process for making coke from coal for use in the smelting process. Despite the relative abundance of coal near the iron mines, it was not until the latter part of the eighteenth century (when military demands on the arms and munitions industries were very great) that the iron industry began using coke extensively. This increased demand led to the development of the puddling process, which eliminated the excess carbon left by coke. A whole series of innovations followed, including the rolling mill, the blast furnace, the steam hammer, and metal-turning latches. All these inventions led to a very rapid expansion of the iron and coal-mining industries, which permitted the widespread use of machines made of iron in a wide variety of industries.


Entrepreneurs in many other industries saw the possibilities for larger profits if they could increase output and lower costs. In this period there was a "veritable outburst of inventive activity" :



During the second half of the eighteenth century, interest in technical innovations became unusually intensive. For a hundred years prior to 1760, the number of patents issued during each decade had reached 102 only once, and had otherwise fluctuated between a low of 22 (1700-1709) and a high of 92 (1750-1759). During the following thirty-year period (1760-1789), the average number of patents issued increased from 205 in the 1760s to 294 in the 1770s and 477 in the 1780s.

Undoubtedly the most important of these innovations was the development of the steam engine. Industrial steam engines had been introduced in the early 1700s, but mechanical difficulties had limited their use to pumping water from mines. In 1769 James Watt designed an engine with such accurate specifications that the straight thrust of a piston could be translated into rotary motion. A Birmingham manufacturer named Boulton formed a partnership with Watt, and with Boulton's financial resources they were able to go into large-scale production of steam engines. By the turn of the century, steam was rapidly replacing water as the chief source of power in manufacturing. The development of steam power led to profound economic and social changes.

With this new great event, the invention of the steam engine, the final and most decisive stage of the industrial revolution opened. By liberating it from its last shackles, steam enabled the immense and rapid development of large-scale industry to take place. For the use of steam was not, like that of water, dependent on geographical position and local resources. Whenever coal could be bought at a reasonable price a steam engine could be erected. England had plenty of coal, and by the end of the eighteenth century it was already applied to many different uses, while a network of waterways, made on purpose, enabled it to be carried everywhere very cheaply: the whole country became a privileged land, suitable above all others for the growth of industry. Factories were now no longer bound to the valleys, where they had grown up in solitude by the side of rapid flowing streams. It became possible to bring them




nearer the markets where their raw materials were bought and their finished products sold, and nearer the centers of population where their labor was recruited. They sprang up near one another and thus, huddled together, gave rise to those huge black industrial cities which the steam engine surrounded with a perpetual cloud of smoke.

The growth in the major manufacturing cities was truly spectacular. For example, the population of Manchester rose from 17,000 in 1760 to 237,000 in 1831 and to 400,000 in 1851. Output of manufactured goods approximately doubled in the second half of the eighteenth century and grew even more rapidly in the early nineteenth century. By 1801, nearly 30 percent of the English workforce was employed in manufacturing and mining; by 1831, this figure had risen to over 40 percent. Thus, the industrial revolution transformed England into a country of large urban manufacturing centers, where the factory system was dominant. The result was a very rapid growth of productivity that vaulted England into the position of the greatest economic and political power of the nineteenth century.

The fact that Adam Smith wrote *The Wealth of Nations* in the period during which the industrial revolution was just getting under way attests both to the fact that many of the economic features that were to dominate the great industrial cities of the early nineteenth century were present in some form in some mid-eighteenth century English and Scottish cities (particularly Glasgow) and to the fact that Adam Smith was indeed a most perspicacious social scientist. A leading historian of this period has written, "Smith, looking at the economic organization of industry in his day, was apparently able to observe as something like a norm what many economic historians of today, looking back at the same period, have been able to observe only as an exception."³

By the mid-eighteenth century, in many commercial and industrial cities (including Glasgow), a significant amount of production took place in what have been called "manufactories." A manufactory was a center of production in which a capitalist owned the building, production equipment, and raw materials and hired wage laborers to do the work. It can be distinguished from the typical factory of the later stages of the



industrial revolution in that the laborers generally used the older handicraft techniques of production rather than mechanized, assembly-line techniques.

In the manufactories, the capitalist manufacturer could be seen as economically distinct from both the merchant and the wage laborer. Furthermore, by Smith's time the great productive potential of the capitalist organization of production was clearly seen in these manufactories. Smith was greatly impressed with the degree to which they had carried the division of labor and the resulting increases in labor productivity.

Within this context, Smith was the first important economist to distinguish clearly between profits that accrued to industrial capital and wages, rents, and profits on merchant capital. He was also the first to appreciate the significance of the fact that the three principal functional categories of income—profits, rents, and wages—corresponded to the three most important social classes in the capitalist system of his day—capitalists, landlords, and the "free" laborers who could not live unless they sold their labor power for a wage. He also developed a historical theory in which he attempted to explain the evolution of this form of class society and a sociological theory to explain the power relations among the three classes.



3. THE GREAT DEPRESSION


During the period just discussed, defenders of capitalism were very concerned over the example that Soviet industrialization gave to third-world capitalist countries. This concern was increased however, by the second major historical development mentioned above-the Great Depression of the 1930s.

During the first three decades of the twentieth century, the worldwide capitalist economy experienced several business cycles. The depression phases of these cycles, however, were relatively mild, and, in general, these were prosperous decades for most capitalist countries.

This era came to a halt in the 1930s, however. In the United States there were over 85,000 business failures between 1929 and 1932, as the American economy collapsed into a devastating depression. During those three years, more than 5,000 banks suspended operations ; stock values on the New York Exchange fell from \$87 billion to \$19 billion; 12 million workers lost their jobs, and fully one-fourth of the American population had no means of sustaining themselves; farm income fell by more than half; and manufacturing output decreased by nearly 50 percent.

The depression struck the United States first but quickly spread to the entire capitalist world. Real income fell from an index of 100 in the United States in 1929 to a low of 68 in 1931. Similar declines were experienced in the capitalist countries of Western Europe. Unemployment in Western Europe rose from just over 3 million to an unprecedentedly high figure of 15 million unemployed in 1932. In Germany, 43 percent of the labor force was without work in 1932. World trade declined precipitously and the entire capitalist world experienced a crisis of poverty, starvation, and general economic desperation.

The economic suffering of the period was worse than it had been during most wars and natural disasters, yet, natural resources were as plentiful as ever; the workforce was as numerous as ever and as desirous of productive employment; factories, shops, and other productive facilities were all as abundant as ever and stood ready for use; peoples needs and desires for commodities were certainly as numerous




and strong as ever. Yet, resources, factories, tools, and machines remained idle while unemployed workers lost their homes and could not feed themselves or their families.

Faith in the automaticity of the free market, capitalist economy plummeted. Millions turned to the right and advocated nazism or fascism or turned to the left and advocated socialism or communism. Laissez-faire capitalism had very few enthusiastic supporters. Nearly every economist and politician favored extensive government intervention into the market. This is reflected in the spectacular success of Keynes's *The General Theory of Employment, Interest, and Money* when it was published in 1936.

The capitalist economy was, however, rescued from this precarious state of affairs by World War II. Nearly every major capitalist economy experienced massive government intervention into the market system as the production of weapons, ammunition, and war-related materials increased sharply and continuously for several years. In the United States, for example, military-related expenditures were \$3.2 billion or 3.2 percent of GNP in 1940. In 1943, at the height of World War II, military spending was almost 40 percent of a much larger GNP. Profits rose to unprecedented heights and capitalists became aware of how rapidly massive military expenditures could end a depression and ensure large returns to their capital.


By the early 1950s, neoclassical economic theory was on the defensive. We have seen that neoclassical economic theory contained three basic ideological defenses of capitalism. The first was the invisible-hand argument that free market exchange harmonized all people's interests, created "rational prices," and resulted in an efficient allocation of resources. Theoretical work in welfare economics that formed the basis of the critique of welfare economics was done mostly in the 1930s and 1940s. This work had put the neoclassical ideologists on the defensive. The second ideological tenet was the neoclassical faith that the free market would automatically adjust to a full-employment equilibrium. The Great Depression of the 1930s and the work of Keynes had cast profound doubt on this proposition. The third ideological pillar was the belief that the distribution of income was determined by the marginal productivity of the different factors of production and that each individual received as income only



that value created, at the margin of production, by that individual's own factors. While this proposition did not receive its theoretical coup de grace until 1960 with the publication of Sraffa's *Production of Commodities by Means of Commodities*, the marginal productivity theory of distribution had never been convincing to critics of capitalism. In third-world capitalist countries, the abject poverty of the majority of people and its stark contrast with the opulence of the wealthy elite was so extreme that hardly anyone believed the theory to be applicable to these economies. The ideology was therefore in a state of intellectual disarray and capitalism (particularly in the third world, but in the industrial countries as well) was in danger of a severe crisis of legitimation.

The precursors of neoclassical theory-Say, Senior, and Bastiat-used each of these ideological doctrines to argue for a policy of extreme *laissez-faire*. These writers wanted the government to use its power only to protect the existing inequalities of power and wealth by enforcing the laws of contract and the laws of private property. Once these existing inequalities were coercively protected by the government, free market exchange was sufficient to perpetuate them. If workers had no way to exist except by selling their labor power in the market, and if a substantial pool of unemployed workers could be kept in a state of constant competition for the available jobs (as has almost always been the case under capitalism), then the free market would perpetuate the extreme wealth and power of the numerically tiny capitalist class. Under these basic conditions of capitalism, however, the free market was merely a financial slaughterhouse, where the rich increased their wealth by chopping up the poor.


Neoclassical economists have always adopted these three ideological defenses of capitalism. During the past century, however, neoclassical economics has split into two quite separate (and not infrequently hostile) traditions. This split has been the result of both the force of existing social, economic, and political circumstances and the persistent barrage of criticisms leveled at the neoclassical ideology. The split has existed since at least the 1870s. The social, political, and economic consequences of the Soviet industrialization, the Great Depression, the Cold War, and the anti-imperialist movement in the third world significantly exacerbated the split, however.



The problem was that while neoclassical economics continued to constitute the intellectual foundation for intellectually sophisticated ideologies of capitalism, most economists and politicians had lost faith in the free market, laissez-faire policy conclusion that is derived from the theory. This loss of faith can be seen most clearly in the rapid development during the 1940s and 1950s of two important trends in economic theory. The first was the nearly instantaneous and almost unanimous acceptance of Keynesian economics and the second was the birth and virtually explosive growth of a vast literature in the new field of "development" economics. Keynesian economics and the new development economics shared a general abandonment of faith in laissez-faire capitalism and both advocated policies that involved widespread and profound extensions of government into economic processes.

The neoclassical arguments for laissez-faire remained important throughout the entire period, however. They have always constituted the most elaborate, and seemingly scientific, ideological defense of capitalism. There is another important reason for the persistence of the neoclassical laissez-faire doctrine during the period in which confidence in free market capitalism was at a low ebb. Government intervention, in the United States economy, for example, has usually taken the forms of either various government regulatory agencies or the "military Keynesianism" of expenditures on space programs and on the military. These interventions affect the various capitalist enterprises very differently. Regulatory agencies have generally acted in a manner that protected and expanded the power of giant oligopolistic business firms, not infrequently at the expense of medium- and small-sized firms. The overwhelming bulk of the profits from space contracts and military contracts have gone to corporations that were among the largest and most powerful in the economy. Moreover, the profits reaped from the worldwide American economic empire have generally gone to the largest and most powerful of the multinational corporations .

For many thousands of medium- and small-sized capitalist firms, the expansion of government into the economy has steadily undermined their ability to compete with the corporate giants. They typically see themselves as reaping few, if any, of the benefits of government's expanding economic activities. To them, bigger government



means a deteriorating competitive position compared with the giant firms, mountains of "red tape," bureaucratic hassles, and ever increasing taxes. These medium and small firms are generally controlled by people who are ardent supporters of an ultra-conservative, laissez-faire political philosophy that advocates a decrease in the magnitude and extent of government's role in the economy. Giant corporations, however, are usually controlled by people who are more "re-alistic" and "liberal" in their economic and political philosophy. In the cant and jargon of American politics, advocacy of more government is usually associated with liberalism and advocacy of less government is usually as-sociated with conservatism. The economic base for both of these political tendencies, within both the Democratic and Republican parties, is primarily the business community.

Big corporations, with the backing of labor union bureaucrats, generally support liberals in both parties. Small businesses, with the backing of independent professional people and other middle-class elements, generally support the conservatives. In American politics, neither liberals nor conservatives ever question or criticize the institutional foundations of capitalism; that is, they are both profoundly conservative, but represent differing-and frequently hostile-groups within the capitalist class.

The common threads in the writings of all of the neoclassical economists, by virtue of which they can still be called a "neoclassical school" despite their differences are these: (1) they all defend, or simply take for granted, the capitalist system of private property and all of the fundamental institutions of capitalism; (2) their conception of economic behavior remains that of the isolated, egoistical, calculating utility maximizer, or Veblen's "homogeneous globule of desire of happiness"; and (3) they all defend some version of, or close substitute for, the three basic tenets of neoclassical ideology. Therefore, despite their differences, their general view of the individual and society continues to reflect the social perspective of the absentee rentier.




4. W. ARTHUR LEWIS AND THE ORIGINS OF DEVELOPMENT ECONOMICS

Before 1945, there was almost never a mention of "development economics." The standard view was that economic theory was universal and applied to all economies in all times and places. In less than ten years, economic development in what theorists of that period termed "backward" countries had become the most widely researched and written about field in academic economics.

In the late 1940s, there was a vast and powerful movement in the third-world countries of Asia, Africa, and Latin America. The movement combined nationalism with opposition to imperialism and colonialism. The charter of the United Nations proclaimed the goal of colonial emancipation. By 1950, India, Pakistan, Ceylon, Burma, the Philippines, Indonesia, Jordan, Syria, Lebanon, and Israel had all become nominally independent nations. During the 1950s, the trend continued with nominal independence given to or promised to Cambodia, Laos, Vietnam, Malaysia, Libya, Somaliland, Sudan, Morocco, Tunisia, Egypt, Ghana, Togoland, the Cameroons, and Guinea. While imperialism had not generally taken the form of outright colonialism in Latin America, the nationalistic tide of anti-imperialism was as strong there as it was in the former colonial empires of Asia and Africa.

The citizens of these third-world countries reacted against the racism and political and economic exploitation that they saw as responsible for the grueling poverty that prevailed in most of the countries. It became immediately obvious, however, that nominal and actual independence were not the same thing, that economic exploitation could take new forms, and that significant barriers were retarding if not preventing the desired independence and increase in living standards. Most politicians and economists living in third-world countries felt certain that simply relying on the free market would never improve their situation. The example of the rapid industrialization of the Soviet economy held a powerful attraction. It was the task of orthodox economics to suggest some formula for planned, forced industrialization that could give the hope of higher standards of living to third-world countries while




simultaneously making sure that these countries retained the necessary legal, economic, and governmental institutions that would assure safe, profitable investments in these countries for the large multinational corporations of the industrialized capitalist world.

W. Arthur Lewis provided the necessary theoretical framework for this task in a series of articles and books, the most famous being a 1954 article entitled "Economic Development with Unlimited Supplies of Labour" and a 1955 book entitled *Theory of Economic Growth*.¹ Lewis began with what was already common knowledge among historians and economists : industrialization requires a reorientation of an economy's production capacity. The economy must substitute the production of producer goods such as factories, machines, and tools, for consumer goods such as food, shelter, clothing, and other necessities. In other words, the economic surplus, over and above the necessary consumption goods, had to be increased by finding a large segment of society that could be forced to subsist on more meager provisions.

In England, in the classic case of capitalist industrialization, this deprivation was forced upon both the urban and rural working class in a pitiless onslaught of upper-class greed that has been amply chronicled by numerous historians. In the Soviet Union, by contrast, while working people definitely suffered during industrialization, nevertheless, much of the economic surplus that was necessary for industrialization was attained by expropriating the assets and enormous incomes of the capitalist and wealthy landowning classes.

In most third-world countries, the peasant and working classes were wretchedly poor because they were already creating a large economic surplus that was being divided by indigenous elites and foreign capitalists. The problem was that the foreign capitalists made most of their profits through their control of agriculture and resource extraction and appeared to show no interest in spending any of these profits in promoting industrialization in other sectors of these economies. The local elites were often "precapitalist" in their mentality, resembling feudal lords more than they did industrial capitalists. Thus, it appeared that the working classes were already subjected to the maximum possible exploitation and that the recipients of the resultant economic




surplus would never use it as a means of general industrialization. The great appeal that the Soviet model had in this period is certainly easy to understand.

Lewis changed the focus of the debate, however. Lewis argued that in industrialized capitalist countries with nearly full employment the neoclassical marginal productivity theory of distribution was correct and that the wages of workers reflected their marginal productivity. He argued that in third-world economies capitalism had not developed fully and that wages were not determined by marginal productivity. Wages were, he argued, determined by tradition: "In economies where the majority of the people are peasant farmers ... the minimum at which labor can be had [by capitalist employers] is now set by the average product of the farmer."² He believed, however, that "earnings in the subsistence sector set a floor to wages in the capitalist sector, but in practice wages have to be higher than this, and there is usually a gap of 30 percent or more between capitalist wages and subsistence earnings."³

The cause of poverty in third-world countries, in Lewis's view, was a shortage of capital. Because most workers worked in the subsistence sector, Lewis asserted that the marginal productivity of labor in these traditional economies was "negligible, zero, or even negative."⁴ Lewis got this result because he defined workers who were not working for capitalists as "unproductive." Committing the essential error of which Marx accused the classical economists, Lewis confused previously produced (or reproducible) means of production, which are used by all people in all times and places, with capital. Capital comes into being only with the capitalist mode of production and hence cannot be identical with all previously produced means of production. This is a confusion that affects almost all ideological defenders of capitalism. Lewis showed that he saw matters strictly from the point of view of the capitalist when he asserted that laborers not working for capitalists were unproductive:

The subsistence sector is ... that part of the economy not using reproducible capital. Output per head is lower in this sector than in the capitalist sector because it is not fructified by capital. ... As more capital becomes available more workers can be




drawn into the capitalist from the subsistence sector, and their output per head rises as they move from one sector to the other.

The problem, then, was simple. Third-world countries needed more savings to be invested in capital that would draw unproductive workers from the traditional sector, where they had "negligible, zero, or even negative" marginal productivity, into the capitalist sector, where their marginal productivity would be much higher and where they would increase the economy's output, and, eventually, increase everyone's economic welfare.

The basic problem in these countries was low savings. Increased capital, in a capitalist economy, comes from savings out of the profits of capitalists: the reason why savings are low in an underdeveloped economy relatively to national income is not that people are poor, but that capitalists' profits are low relatively to national income. As the capitalist sector expands, profits grow relatively, and an increasing proportion of national income is reinvested.

The problem was to promote what Marx had labeled "primitive accumulation"; that is, to expand the sector controlled by capital and reduce and eventually destroy the traditional economy. This became the central problem of development economics in the 1950s and 1960s. Nearly every orthodox "development economist" saw the problem in these terms, and, to combat the spread of socialism and communism, nearly every development economist advocated extensive government involvement-on the part of both third-world and first-world capitalist governments-as the only solution to the problem.

That this anticommunist concern dominated most development economics can be detected from a study of nearly any of the important texts of the period. It can, perhaps, be most clearly seen in the writings of Walt W. Rostow, whose *The Stages of Economic Growth: A Non-Communist Manifesto* was published in 1960 and was arguably the most influential book by a conventional development economist in the



1960s. Writing in 1983, Rostow recalled his commitment to combating communism. He had believed that "the struggle to deter and contain the thrust for expanded communist power would be long and that new concepts would be required to underpin U.S. foreign policy." He also forthrightly admitted, with a candor that is uncommon among conservative economists, that his intellectual attacks on communism were financed by the United States Central Intelligence Agency.

While development economics, like Keynesian economics, seemed to be an abandonment of neoclassical laissez-faire conservatism, most development economists argued that this situation would be temporary. Once these third-world economies fully attained a capitalist system, then the neoclassical theory would be applicable.




5. THE INSTITUTIONALIST ECONOMICS OF CLARENCE E. AYRES

Veblen's break with traditional economic theory had been sharp and extreme. He had rejected equilibrium analyses and he had rejected the neoclassical vision of a society filled with utility-maximizing exchangers. He had sought to understand the biological nature of human beings and had emphasized that this biological nature always rendered human beings interdependent social creatures. The social nature of human beings did not imply social relationships or social behavior that was biologically determined, however. People existed under a very wide variety of social conditions. And individual human beings were very malleable. This malleability permitted human beings to become conditioned and habituated to the radically different attitudes, values, and ac-tions that were required for the social behavior appropriate to, or consistent with, radically different social institutions.

As the neoclassical theory of utility-maximizing individuals became more and more esoteric, it also became much more difficult to master. It required a strong background in mathematics and years studying the esoteric analytical constructs of neoclassical economics to receive a doctorate in economics at most universities. For most graduate students of economics this left little or no time for the study of philosophy, anthropology, history, and sociology - the disciplines from which many of Veblen's ideas were drawn. Moreover, in many economics departments, the ideological domination of conservative neoclassical economists resulted in a situation in which the study of Veblen's writings became personally, politically, and ideologically "unwise" as did the study of Marx's writings. Evidence that a young economist took either Marx or Veblen seriously was often construed as evidence of intellectual incompetence. Consequently, the institutionalist and Marxist schools of economic theory have remained small-but they have also remained influential.

Clarence E. Ayres (1891-1972) received a Ph.D. in philosophy from the University of Chicago in 1917. Ayres was a "grand" systematic thinker in-terested in all facets of human existence. From the beginning, he showed as much interest in



economics as he did in philosophy. One year after receiving his Ph.D., he published a thought-provoking article entitled "The Function and Problems of Economic Theory."

1 In his first teaching position, at Amherst College, he was significantly influenced by Walton Hamilton, a brilliant young economist who coined the term institutionalism. Ayres had learned standard neoclassical economics as a student and was assigned to serve as a teaching assistant to Hamilton. Ayres has described the early impact that Hamilton had on his thinking:

As Professor Hamilton discoursed to Amherst freshman ... I began to wonder when he was going to get around to unfolding to these freshman such basic ideas as "marginal utility." Finally I mustered up my courage to ask him, and through the 44 years that have since elapsed I have never forgotten the gleam of amusement in his eyes as he replied, "I'd do so at once if only I understood them myself!" Like Henny Penny, I felt the heavens falling, for already I had conceived a tremendous admiration for the mental processes of this extraordinary young professor. Could it be that all the elaborate apparatus of marginal analysis was actually without meaning?

Ayres did indeed conclude that neoclassical theory was meaningless. He recognized that the concept of utility and the theory that in market capitalism utility-maximizing individuals automatically create an optimal situation were the intellectual heart of neoclassical economics. He also recognized the hollow, tautological nature of the foundations of this theory:

... the concept of utility is peculiarly open to criticism on the ground of tautology It is all very well to say that utility is the want-satisfying quality, whatever wants may be. But if we have no way of knowing, let alone measuring, wants, how can we know utility-let alone measure it? It is all very well to say that price is the measure of utility. But if we have no independent measure of utility (and we have none), that only means that we have equated price and utility by definition. Such being the case, nothing can be inferred from the correspondence.



Neoclassical economics was, in Ayres's view, merely folklore designed to preserve the status quo of social, political, and economic power.

In one of his earliest books, *Holier Than Thou*, Ayres's ideas showed the distinct influence of Veblen. He asked how seemingly intelligent people adopted ideas, attitudes, mores, and folkways that were based on superstition and that a more detached rational individual would find impossible to accept. The answer, he believed, could be seen in the functionality of these ideas, attitudes, mores, and folkways in sustaining the power of the wealthy, dominant social class.

Ayres's point of departure was a discussion of Veblen's account of the reasons for the rapid changes in clothing styles. Veblen had argued that the clothing of the rich had to set them distinctly apart from the poor. The motive of the clothing designers was merely to create sharp, stark differences in the clothing of the rich and the poor. The designers were rarely motivated by any genuinely aesthetic concerns or standards. The aesthetic ugliness of this year's styles would provoke a revolt that would lead to drastic changes next year, the year after that, and so on. As long as invidious distinction and not beauty was the motivating force, there would continue to be such revolts leading to perpetual changes in the styles of clothing for the rich.

Ayres, while obviously strongly influenced by and enormously respectful of Veblen, objected to this analysis on two grounds. First, he denied that there was any inherent or transcendent aesthetic standards by which the styles could be judged to be ugly. Second, he argued that the rate of change in the clothing styles of the rich depended entirely on the rate at which capitalists selling low-cost clothing to working people could imitate these styles and sell these cheaper imitations to poor people seeking to emulate the rich. This would reduce the distinction between the rich and the poor if the rich failed to make new and drastic changes in their styles.

Ayres went on to argue that not only were there no general standards of beauty but there were no general standards of moral rightness or goodness. People's attitudes on these matters were merely the accidents of the mores and folklore of their society.



Moreover, most people's attitudes toward truth or science were also simply superstitions.

But Ayres was not interested in being nihilistic or in promoting some form of extreme cultural relativism. There was still a question of whether there were understandable reasons for people's beliefs in cultural folklore and superstitions and also whether some beliefs had more truth value than others. Here the second great influence on Ayres becomes obvious-the philosophy of John Dewey.

Dewey had rejected the view, dominant in philosophy and the social sciences of his era, that ends and means are qualitatively different and can always be clearly distinguished. Ayres was influenced by Dewey's argument that means and ends are never entirely separable. Means are chosen, Dewey argued, because they promote some desired end. But if one investigates the reasons why the end in question is the object of desire, one nearly always finds that it is desired because it is seen as a means to some further end. Thus, if my end is getting to the grocery store, I have a number of means of conveyance from which to choose. These means of conveyance are "means" and yet they are valued as ends because I know that regularly I am going to need them to enable me to travel to the store (and elsewhere). Going to the store appears to be the end. It does not, however, have intrinsic value. Getting to the store is the means by which I can attain food. The attainment of the food then appears to be the end. But again this does not have intrinsic value. It is valued only as a means of satisfying my hunger. Dewey argued that if you examine most ends you find that they are desired because they serve as means toward other ends. Moreover, most means, for the same reasons, are also perceived as ends. Life, Dewey argued, is constituted by a continuum of causes and effects and means and ends. Any event is the effect of prior causes and the cause of subsequent consequences. No particular event can be called a cause only or an effect only but, rather, must be seen as both an effect and a cause. Similarly, things, circumstances, situations, and actions are almost never seen by people solely as ends or solely as means. If they are a means toward something valued, then they are valued. Similarly, the value of nearly every end derives from the fact that it serves as a means toward another end or ends.




Ayres adopted this view : "Day to day experience reveals no generic difference between 'ends' and 'means.' Every item of our experience is both an end and a means. There is no difference of 'substance' or 'essence' by which, in the continuum of day to day experience, 'means' and 'ends' can be distinguished."

Ayres followed Veblen in believing that most human actions and values fell into two dichotomous and antagonistic categories. At one extreme were superstitions, ceremonial values, and actions. These values and actions had as their social function the creation and preservation of hierarchical distinctions of social and economic status and were the foundations of all invidious distinctions based on social status. At the other end of the dichotomy were technological values and actions. These values and actions were instrumental in providing the means necessary to further what Ayres called the "general life process."

Ayres rejected absolutism and nihilistic relativism in both epistemology and ethics. He believed that, following Dewey, he had found a middle ground that preserved the advantages of both absolutism and relativism with the disadvantages of neither:

We know that social development is a continuous process, and it is in terms of this continuity that value and welfare can be quite objectively defined and understood . For not only is the social process a continuous one in the chronological sense; on the technological side it is a logical continuum, a time progression each item of which implies succeeding items by the same process by which each has been itself derived from preceding items in the series. It is this technological continuum which is the locus of truth and value.

Truth and value were derived from technological mastery of nature in furthering the "general life process." "When we judge a thing to be good or bad, or an action to be right or wrong, what we mean is that, in our opinion, the thing or act in question will or will not serve to advance the life process in so far as we can envision it."6 In his last major work, Ayres argued that "it is the dissociation of truth and value that




defines the moral crisis of the twentieth century. " When this dissociation occurred, truth was replaced by superstition. Most widely held superstitions were, he believed, the results of ceremonial values and actions that functioned to preserve hierarchical distinctions of social status. While the dichotomous nature of technological and ceremonial values persuades Ayres's writings, it is, perhaps, most succinctly stated and explained by a leading contemporary disciple of Ayres :

The value structure ... derives its social warrant from one of two systems of value formation. Values are either ceremonially warranted or instrumentally warranted . The essence of the institutional dichotomy is contained in this distinction between the two modes of social valuation existing within the society.

Ceremonial values are warranted by those mores and folkways that incorporate status hierarchies and invidious distinctions as to the relative "worth" of various individuals of classes in the community. They rationalize power relationships and patterns of authority embedded in the status quo.

Accordingly, patterns of behavior correlated by ceremonial values are observed to be those social practices that manifest their use of power and coercion in the conduct of human affairs: social practices that require invidious distinctions and status relationships to justify their existence. On the other hand, patterns of behavior correlated by instrumental values are manifest in those problem-solving activities upon which the life processes of the community depend."

The ideas of Veblen and Ayres have been developed, refined, and extended by a number of contemporary economists, including, but by no means limited to, Paul D. Bush, Thomas R. DeGregori, William M. Dugger, David Hamilton, F. Gregory Hayden, Louis Junker, Phillip Klein, Anne Mayhew, Walter C. Neale, Baldwin Ranson, Warren Samuels, Robert Solo, and Mark Tool. Bush and Junker developed an important extension of this basic institutionalist analysis with their concept of "ceremonial encapsulation." In Bush's words:




The dynamic force that brings about institutional adjustment is an expansion of the knowledge fund through the problem-solving processes of the community. According to the principle of ceremonial encapsulation, the new knowledge will be incorporated into the institutional structure only to the extent that it can be made ceremonially adequate; that is, only to the extent that its incorporation can be accomplished with-out upsetting the existing degree of ceremonial dominance embedded in the value structure of the community.

In other words, the ability of a given society to use new problem-solving knowledge is limited by the patterns of social, political, and economic domination that are exercised by the powerful and wealthy individuals of that society. And because the vested interests of the ruling elites come to be embodied in the dominant institutions of a society, millions of ordinary individuals who derive their livelihood from these institutions come to be defenders of these ceremonial values that preserve the status quo. Bush points to the example of the military-industrial complex in the United States:

The demilitarization of the American economy poses a grave threat not only to the vested interests of the giant corporations of the military-industrial complex, but also to the economic base of hundreds of communities, large and small, throughout the nation that have become heavily dependent on military contracts.

The economic waste that is inherent in ceremonial encapsulation of resources and technology by the military-industrial complex is also the source of secure income for millions of Americans as long as the Cold War ideology dominates the American Weltanschauung. The economic continuity of the lives of millions of Americans is encapsulated by the ceremonial nexus of anticommunist demonology, guaranteed profits of military contracts, and self-serving patriotism.

Similarly, F. Gregory Hayden has shown that giant enterprises in the chemical, farm machinery, and agribusiness industries have gained control of science and technology in their fields for the purpose of increasing their profits and industrial




control. The increases in profits have often come at the expense of land conservation and the preservation of vital social and ecological systems.

William M. Dugger has shown that in the United States today the large corporation is the central bastion of ceremonialism. It is the main institution that secures and preserves the social relations and individual behaviors necessary to maintain and perpetuate the American hierarchy of power, privilege, and invidious distinction. As a result, the large corporation tends to dominate all other institutions in American life. This corporate hegemony is maintained through four social mechanisms: subordination, contamination, emulation, and mystification. In Dugger's words:

Subordination ties all institutions together so that noncorporate institutions are used as means to corporate ends. Contamination puts corporate role motives into noncorporate roles. Emulation allows corporate leaders to gain acceptance, even respect, in noncorporate leadership roles. And mystification covers the corporate hegemony with a protective (magic) cloak.

Through these mechanisms, corporations are able to gain control of technology and to discard what they cannot use while subordinating the remaining aspects of technology to their own use. As a result, ceremonial encapsulation subordinates technological values to ceremonial values that perpetuate the structure of power and privilege.

In this process, propaganda and thought control are of crucial significance. In this regard, Dugger shows how colleges and universities are subordinated to corporate interests. The university's instrumentally warranted goals of free inquiry and the expansion of the intellectual horizons of faculty and students are generally subordinated to the teaching of ceremonially warranted conservative ideology, vocational training, and the promotion of research needed by specific industries. Thus, the social mission of the university is subordinated to the needs of industry to the detriment of the community.




The academic world is, in fact, a rigidly hierarchical system infused and pervaded by invidious distinctions-an ideal system for perpetuating the ceremonial propaganda of conservative ideology. At the top of the hierarchy are the elite Ivy League universities together with a few other elite private and state universities. These schools determine what ideas will be "respectable" within academia. They also train the professors who teach at the principal state universities and other private research universities. These latter schools train the professors who teach at the bottom of the hierarchy in state colleges and private teaching colleges.

At the top of the hierarchy, ideological purity is maintained. Conservative ideology is academically and intellectually pronounced as "scientific" while critical theory is ignored. One clearly sees this when one examines the profession of academic economics. The dissident schools of thought such as Institutionalism, post-Keynesianism, and Marxism go virtually untaught in the elite Ivy League universities. On the other hand, the majority of the most influential theorists and writers in the conservative neoclassical school teach at these elite universities. Institutionalists, post-Keynesians, and Marxists teach at the middle and lower levels of the hierarchy and hence are always struggling to maintain "respectability." Thus, as the academic hierarchy promotes the dominance of ceremonial values over instrumental values, it also promotes and defends the social, economic, and political hierarchies on which differential power and privilege rest, and on which the socially important invidious distinctions among individuals rest.

Finally, John Munkirs has shown that corporate dominance in the United States rests on what he calls the system of centralized private sector planning (CPSP). This system of economic planning is dominated by giant financial and industrial corporations. Munkirs argues that it is the function of conservative capitalist ideology to conceal this dominance. Munkirs writes:

Unfortunately, in America, the real choices that our technological knowledge make possible (choices between different production and distribution systems, for example, centralized versus decentralized) have been circumscribed by, or



encapsulated within, our capitalistic ideology and, in particular, by the values of self-interest, profit seeking, and laissez-faire. In brief, the particular type of centralized planning that exists in America today is due neither to technological determinism nor to conspiratorial machinations. Rather CPSP is a direct result of combining the values of self-interest, profit seeking, and laissez-faire with certain technological possibilities.

In this short account of the ideas of C.E. Ayres and several of his contemporary disciples, we have discussed only a few of the many facets of contemporary institutionalism. Institutional economists seek to understand much more than the simple workings of supply and demand in the market. They are interested in the evolution of the entire society. They examine the institutional foundations of economic, social, and political power and how this power is affected by, but also exerts powerful controls on, the market. As this brief account has shown, institutional economists see the economy as a part of a greater social valuation process that is far larger and far more important than the process of commodity pricing. Again, they depict two dichotomous social bases of valuation—the instrumental and the ceremonial. While human progress depends on the ascendance of instrumental values, the present economic order is characterized by a dominance of the ceremonial valuation process. Orthodox neoclassical economics will be of little help in this regard because most of its tenets have the social function of reinforcing the ceremonial values that underlay and protect the status quo with its emphasis on differential power and invidious distinction.

Institutionalists have also done a great deal of research in fields such as labor economics, industrial organization, law and economics, comparative economic systems, public choice, agricultural economics, and government regulation of business. As a contemporary school of economics, institutionalism remains alive and healthy.