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Directorate of Distance Education

B.A. (Economics)

V - Semester

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HISTORY OF ECONOMIC THOUGHT

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INTRODUCTION

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Economics describes and analyses the production, distribution and consumption of wealth. As a social science, economics comprises many schools of thought that discuss the wide variety of ways of conducting the aforesaid analyses. The most influential of these schools of thought in the 20th century included neoclassical economics, Marxian economics and Keynesian economics. However, the influence of economic schools of thought is not static, but rather, it is ever changing. Throughout history, a wide range of economic thinking has held sway. This is also true of India.

Throughout the history of human thought, India has produced important economic theorists. Manu, Shukra and Chanakya were the great economic thinkers of ancient India. Dadabhai Naoroji, Gopal Krishna Gokhale, R.C. Dutta, M.G. Ranade, M.N. Roy and M.K. Gandhi emerged as great economic thinkers during India's struggle for Independence. Contemporary Indian economic thinkers include Deen Dayal Upadhayay and Amartya Sen.

This book, *History of Economic Thought*, is divided into fourteen units that follow the self-instruction mode with each unit beginning with an Introduction to the unit, followed by an outline of the Objectives. The detailed content is then presented in a simple but structured manner interspersed with Check Your Progress Questions to test the student's understanding of the topic. A Summary along with a list of Key Words and a set of Self Assessment Questions and Exercises is also provided at the end of each unit for recapitulation.

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UNIT 1 INTRODUCTION TO ECONOMIC THOUGHT

Structure

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1.0 INTRODUCTION

The history of economic thought studies the origin of economic ideas and their interrelation in addition to tracing the contributions made by scholars and economists in terms of theories and economic concepts starting right from the ancient times to the present. In ancient Greece, scholars like Aristotle grappled with questions related to acquisition of wealth and whether property should be left in the hands of individuals. In the classical school of economic thought, several influential economists propounded theories that changed the course of economic studies. Adam Smith's *Wealth of Nations* was the very first book that talked extensively about economic matters. The central thesis of this book was that our individual need to fulfil self-interest leads to societal benefits which he terms as the 'invisible hand'.

In this unit, an analysis of the development and the approaches to economic thought has been undertaken.

1.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the meaning of economic thought
- Discuss the development, nature and approaches of economic thought
- Describe the significance of history of economic thought

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1.2 MEANING OF ECONOMIC THOUGHT

As human knowledge accumulates, it is analyzed and categorized into different sciences. Economic science is also a result of the same process and includes doctrines and generalizations which deal with economic phenomena of our life. Economic science, like other sciences, has had to undergo a process of evolution and is the result of innumerable contributions by various thinkers. In many cases, specific contributions went unnoticed for a period of time, while certain other contributions were recognized during the very life-time of their contributors. In some cases the views of these thinkers had a great impact upon that moulding of future patterns of economic thought. The role played by different thinkers in the process of its evolution has been uneven. Some thinkers appeared like luminous stars in the sky and dazzled everything in sight, while others appeared rather dim. However, even when the contributions by some thinkers were not very spectacular when they were made, every contribution has its own place and relevance in the development of economic science and in improving our comprehension of economic phenomena.

Ordinarily economic thought would be taken to cover the set of theories, doctrines, laws and generalizations, and analyses applied to the study and solution of economic phenomena and problems. It should be noted, however, the specific contents of economic thought have normally commanded an uneven prominence-some attracting more attention than the others; and the overall composition of economic thought is also subject to a continuous variation. Economic thought is not a given and fixed set of economic theories or tools and techniques of analysis. Economics is a dynamic science, a feature that it acquires on account of various reasons. This characteristic of it partly follows from the fact that it is a social science. It brings forth a body of generalizations which, as in other sciences, involve cause-effect relationships. But from amongst the set of causal forces at work, the relevant ones have to be sorted out for the problem at hand; and similarly on the side of effects a sifting process has to be undertaken. These tasks admit of a difference of judgement and opinion. Since human society is a complex phenomenon, a very large number of causes are likely to be at work in most cases and different investigators could very well differ as to the choice of the most 'relevant' causes at work. Also investigations could unearth those forces which were hitherto thought irrelevant or not of particular importance. Moreover, the identification of the causal forces at work does not imply that these causes would not change till their final outcome is encountered. Over time, the vary roles of specific forces are likely to undergo a change. The responses of economic units (individuals, firms, governments, etc.) would vary from one situation to the other in view of the prevailing moral, political, religious and social philosophy as also the institutional framework of the society.

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An economy is a dynamic phenomenon and therefore economic science is a dynamic one. With social change, new economic questions present themselves. And man's thinking is influenced by his social and physical environment. Economic thought develops along two lines. On the one hand, within the basic framework of a given economy and its institutional setup, there is always a scope for deeper and intensive investigation which provides a basis for further analysis and theorizing. On the other hand, the very dynamism of an economy provides a basis for further investigation. In a static and stagnant economy, there is not much scope for furthering the science of economics. But a changing economy poses newer challenges which economic thinkers have to meet. Normally, over time, a dynamic economy would increase in complexity and would thus demand new and better tools and techniques of analysis, as also a wider coverage of economic issues. A study of the history of economic thought, therefore, covers both these aspects of the development of economic science. The role and growth of each significant theory, the set of theories and policy prescriptions provided by each school and even the significant contributions by individual economists must be viewed in the context of the prevalent economic environment. At the same time, the study must take note of the way economic thought influenced the movement of economies and the resultant effects on economic science itself. In this connection, it may be pointed out that an important motivating force in the growth of economic science has been the concern of the economists with the overall enhancement of 'efficiency' of the economic system and economic welfare of the society as a whole or its particular sections.

The result is that economic science is always undergoing a change. Over successive time intervals, specific sets of economic ideas, theories, doctrines, tools and techniques acquire recognition and acceptance implying thereby that in different contexts we have different systems of economic thought. The study of the history of economic thought, therefore, automatically becomes a study of these various systems of economic thought. In the words of Haney, the study of economic thought 'may be defined as a critical account of the development of economic ideas, searching into their origins, interrelations, and manifestations.' As would be expected, to begin with most economic ideas and doctrines have been in a fluid form. However, with the passage of time, there has been a development in the concepts and tools and techniques of analysis. Old economic concepts acquired greater precision and new concepts were continuously introduced to cope with the emerging theoretical and practical problems. Along with the development of concepts there has also been a sharpening of the tools and techniques of analysis.

In this connection, we should keep in mind the distinction between economic ideas as such and economic science or economics proper. Economic ideas have been there since time immemorial, but it is only recently that they assumed the form of a system of thought which may be termed economic science or economics. References to economic questions are scattered almost everywhere in old literature.

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They are found in Plato, Aristotle, and others. Aristotle, for example, discusses currency, population and slavery. In India also, Kautalya is known for his discussion of various economic questions. But in all these cases we have only fragments of information and analysis. So long as we are not able to adequately generalize on these economic ideas and economic views with any great significance, we cannot claim the emergence of economic thought. In that sense, the time when these ideas started getting crystallized into economic thought is around the time of mercantilism. The birth of economic science might be said to have coincided with the rise of physiocracy, because it is in this system that for the first time we find a comprehensive economic theory. According to a widely held opinion, Adam Smith's book *An Inquiry into the Nature and Causes of the Wealth of Nations* (published in 1776) was the first systematic work of economic problems, while now modern critics have been more and more persuaded and rightly so, to attribute that priority to Richard Cantillon, author of *Essia sur la nature du commerce,* published in 1755. Economic thought is a body of economic ideas and generalizations which can be seen to 'belong' to each other. There are theoretical underpinnings of the economic investigations and policy prescriptions. There is a logical reasoning involved in the process of arriving at conclusions, and there is also an aspect of abstract theorizing. It is only at this stage of formation and cohesion that economic ideas collectively become economic thought. It is not of course necessary that the economic ideas in a system of economic thought must be conforming to each other or that they must belong to one main body; it is the overall thinking process which lends economic ideas the colour of mutual association and belonging and therefore brings forth the phenomenon of economic thought.

Individual economic ideas are almost always problem-oriented. There are generalizations about certain facts and problems and the desirable solutions thereof. Among various problems which man faces in his daily environment, there are economic problems also. Accordingly he has to try to solve them along with other problems. We find, therefore, that traces of economic ideas have always been there in the total thought system of mankind. There have been discussions of various economic problems and their possible solutions. For example, in the beginning there was a concentration of economic ideas on the economic problems connected with slavery, agriculture, usury, and to some extent with trade, commerce, etc. However, economic science as a science implies that the economic problems and their solutions must be viewed in a totality, and their interrelationships must be recognized. In economic science, there is a good deal of theorizing and generalization about the nature of economic problems; the typical response which different economic units (individuals, firms etc.) show to various stimuli are recognized and categorized and the types of feasible and actual solutions get listed. There is also a concern with the 'efficiency' of the economic system and the way in which it could improve its working. All this involves the use of numerous concepts and their definitions become progressively rigorous as time passes. The development of economic science is accompanied by the introduction of new tools and

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sharpening of the old ones. Not only this, in the development of a science abstract theorizing plays a prominent role and economics is no exception.

The place of abstraction in economics may also be noted via the distinction between inductive and deductive methods of analysis. In the inductive method, economic phenomena are investigated and data are gathered, interrelationships between different interacting forces are 'found out' and then corresponding inferences and generalizations are derived. This approach proceeds on empiricism and relies on 'correct' interpretation of the interrelations between economic forces. On the other hand, deductive method relies on abstraction. A set of causes is chosen as the one which is relevant to the problem in hand and the process of interaction between these forces is determined on the basis of set rules. So long as we have only economic ideas, there is hardly any generalization, or deductive analysis or abstraction. On the other hand, in economic science proper, there is a good deal of scope for generalizations, deductive analysis and abstraction. Actually, even empiricism or inductive analysis becomes acceptable only if it satisfies well-accepted rules of analysis and theorizing and when it uses acceptable techniques and tools.

History of economic thought, therefore, is not basically a history of economic ideas but that of economics proper, though for the sake of completeness a discussion of the origin of important ideas may be included. Such a history of economics may be attempted in numerous ways. One may, for example, take up important strands of economic thought and pursue their development over time. We may, for example, take up the development of the doctrine of laissez-fair, or that of economic welfare, or the theory of utility, etc. Another approach could be to pursue the study of economic thought in terms of 'schools', i.e., in terms of theories, inferences and policy prescriptions which formed broad harmonious sets in themselves, had a common set of premises, and which were put forth by identifiable groups of economists. Examples would be of the 'historical school', the 'Utopian socialists' and the 'marginalists'. Another approach could be to take up important personalities, i.e., economists who made great and significant contributions to the advancement of economic science or contributed in an important way to the investigation of economic phenomena and empirical problems. It is obvious that any one such approach would only serve particular purposes and may not be fully satisfactory from other points of view. It would therefore be preferable if a blended view of the development of economic science is taken in which due emphasis is accorded to the individual economists, to the schools and also to the development of important strands of economic thought.

Economic thought is closely related to economic environment. The growth of economic science can be traced along with the growing complexity of the world economies. Even in pure abstract theorizing, economics has its moorings in specific economic framework of a society. Economic theorizing may be in the context of a market economy, a centrally planned economy or an economy of some other

type. However, irrespective of the extent of economic theorizing, economic analysis does not lose its moorings of reality in the sense that it is always in the context of a certain economic framework-real or assumed. For example, a good deal of economic thought has developed in the context of a market economy and on the assumption of 'economic rationality' on the part of individual economic units, though economic science as a whole had its origin in the form of 'political economy'-or the study of the economic problems and their solutions which the society as a whole or its representative, the government, faced. The development of economic science is intimately related to the development of economic environment; and the two interact with each other. Economics assumes the framework of technology and resources available to the society as a whole as also the set of relationships with other economies. The appropriate identification, description and analysis of the responses of economic units is an important stage in the formulation of economic generalizations. Now the exact nature of responses depends upon the institutional framework of the society. As the institutionalists claim, there are two types of responses by individuals, the natural or instinctive responses and the acquired responses. The latter, when performed by a large number of individuals in a particular way assume the form of social customs and behaviour. This way the customs and behaviour get crystallized into institutions. Economic theorizing and investigation, therefore, have to be in the context of and within the framework of an economy. Through economic theorizing and investigation the efficiency of an economy in the context of its particular institutional framework is judged and remedial actions, if any, prescribed.

1.2.1 Lack of Agreement in Economic Thought

There are several reasons to believe that we should not expect a uniformity of conclusions and opinion amongst economists on issues of either theoretical or practical importance.

(a) Economics is a social science in which controlled experiments are next to impossible. Accordingly there is always a possibility of difference of opinion regarding the choice of relevant causal forces and the process of their interaction. In the same way, in abstract theorizing, the choice of the relevant factors and forces as also that of the limiting assumptions is important.

(b) There are chances that differences would exist with reference to the assessment of facts, especially when they are mixed with other ones. Determining the precise direction and strength of a particular force is a matter of investigation, judgement and opinion. Relevant phenomena are investigated and estimated with the help of available data and tools and techniques of analysis. All these things are subject to a modification. Data keep on changing; old data are replaced or supplemented by new ones. Similarly, there is a constant improvement in the tools and techniques of analysis.

(c) Economic analysis admits a wide variety of methods. As a result, even with given tools and objectives, the method of analysis may vary from one analyst to the other and yield non-identical results.

(d) Apart from these reasons, differences arise on account of the purpose for which an economic investigation is being undertaken. This is more so in the case of practical problems and their solutions. The cause-effect relationship between different forces would be assigned to suit a particular philosophy and purpose. Thus during the British colonial days, the Indian economists were generally motivated by nationalist feelings and objectives and they would look at the Indo-British economic relationship from the point of view of Indian interests, while the same issues would be considered by the British economists from a different angle.

(e) Another reason for the divergence of opinion arises on account of the materialistic and idealistic attitudes of the economists. Economists, in the ultimate analysis, are as much human beings and individuals as anyone else, and they are quite frequently swayed by the final conclusions which they would like to press forth.

Check Your Progress

1. In what context should the role and growth of each significant theory be viewed?
2. Where are references to economic questions found in old literature?
3. In what context has a good deal of economic thought developed?
4. What is the development of economic science intimately related to?

1.3 DEVELOPMENT

Let us now look at the causes which account for a tardy development of economic thought in its early phases.

We have noted earlier that human society is a complex phenomenon and is subject to a large number of interacting forces. To begin with, therefore, economic ideas were bound to be tied up with other ideas. Man's activities are related to his environment. Between environment and economic ideas, there is a close relationship. Environment motivates thinking, and thinking in economic matters brings forth explanations. Like most social disciplines, which have emerged over time, economic ideas were also problem-oriented to begin with. Pure abstraction came only later and even then the moorings of abstract analysis have always been in the realm of reality. Accordingly, the tendency to bring in non-economic factors in the study of economic problems slowed down the progress of economic science.

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It is not to be claimed that with the passage of time, economic aspects of our life have got delinked from non-economic aspects. The interdependence between the two is significantly strong even now and we should not expect economic science to become fully detached from the considerations of non-economic phenomena and social philosophy. As Taylor puts it, we cannot believe in the possibility "that economic science, or theoretical work in it, is or has been or can be so perfectly or absolutely scientific—objective, unbiased, neutral, and throughout secure as opposed to 'speculative'—as to make it possible to say, generally, that the great contributions which have been made to its development by great economists have been wholly uninfluenced by the political philosophies shared, and often partly created, by those economists in their other roles as more than that—human thinkers, in their human environments, about human life and affairs in general." What contributed to the development of economics as a separate science was the ever-growing importance of economic phenomena as such.

It should be noted that in the early stages of economic development, the share of economic problems in the totality of social life was a small one, both in absolute and in relative sense, and therefore, there was not much to study by way of pure economics. Early human civilization grew and prospered in warmer climates, near areas where nature was bountiful. There was not much of a difficulty in procuring the means of livelihood for the simple life which those people led. As a result, economic problems did not appear as pressing as they did in later times. 'Though economic phenomena existed in the relatively static life of primitive man, economic life was so limited, in the earliest ancient cultures, and so monotonous as virtually to preclude speculation in humdrum activities.' Before the advent of capitalism, economic organization was a simple one. Division of labour was not carried sufficiently far and therefore a good deal of production was meant for self-consumption. Exchange and marketing problems were simple and of limited importance. On this account, therefore, there was a dearth of the complex economic phenomena and the problems they create. For example, there was a lack of specific problems of public finance and the matters of fiscal policy. The economic relations between various individual economic units on the one hand and those between the economic units and the State on the other hand were quite simple and left insufficient scope for adjustment and manipulation. Accordingly, the volume and importance of early economic thinking could be of only a limited significance. 'Man cannot begin to theorize about the economic process as long as this is of so simple a character as to require no special explanation.'

Economic phenomena failed to command adequate attention till the emergence of capitalism. Those who had the time and resources to advance the study of economics, did not have enough of will and incentive to do so. Haney elaborates this point by saying that interest in certain economic problems is specifically conducive to the development of economics; but there were times when some of the interests most conducive to economic study were specifically

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deprecated. The climate of opinion and the regnant system of values did not favour growth. The degree of improvement in man's material lot that was considered desirable and to be expected was quite limited. The medieval theorist condemned as a sin precisely that effort to achieve a continuous and unlimited increase in material wealth which modern sciences applaud as a quality, and the vices of which he reserved his most merciless denunciations were the more refined and subtle of the economic virtues. 'He who has enough to satisfy his wants', wrote a Schoolman of the fourteenth century, 'and nevertheless ceaselessly labours to acquire riches, either in order to obtain a higher social position, that subsequently he may have enough to live without labour, or that his sons may become men of wealth and importance-all such are incited by a damnable avarice, sensuality, or pride.' Two and a half centuries later, in the midst of a revolution in the economic and spiritual environments, Luther in even more unmeasured language, was to say the same.

This lack of interest in a number of problems naturally hindered the growth of economics. The typical organization and philosophy were such that there was not much concern about the economic welfare of the society as a whole. In some cases, artisan and labour classes were even despised. The upper layers of social groups were assured of a substantial share of the national produce, and they showed little concern for the poverty of the masses. Accordingly there was a kind of indifference or even aversion to the study of economic phenomena. Instead greater attention was paid to fine arts, music and the like.

Till the close of Middle Ages, non-economic aspects of social life were accorded a great importance. The weightage assigned to material well-being in human life for the attainment of happiness was quite low. Instead a life which conformed to a code of moral values was considered preferable to the one which gave 'undue' weightage to material well-being. Materialistic gains at the cost of other aspects of a 'good' life were looked at with disfavour. This philosophy in which idealism played a predominant part prevailed in Western countries also till mercantilist philosophy shifted this composition in favour of materialism. At the same time, the Western economies started showing a kind of dynamism through which the totality of economic phenomena grew. More and more economic problems were faced, and attempts to solve the existing ones created yet additional problems. Of course, it is not contended that idealism has vanished now and materialistic outlook holds the ground, but there is certainly a sufficient concern with materialistic aspects of our social life. There is now an active interest in formulating the criteria for the efficient working of an economy and for studying its actual performance in their light. So while in the past, economics was only a problem-oriented study, now it also covers abstract theorizing and generalizations. The contributions made by different schools of economic thought, and the meaning, rationale, and logic of those contributions must be viewed in the context of the economic institutions and framework which these schools assume. At the same

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time, in numerous cases the actual theorizing and conclusions have been influenced by, the methods of the analysis and their underlying philosophy. Therefore, while studying the history of economic thought and judging the worth of various contributions this fact of interconnection between reality and theorizing must be kept in mind.

Haney points out that the belief in the omnipotence of the State also discounted the need to study economics. If the State could solve most of its own economic problems and those of the 'higher classes' through the use of its political power, there was hardly any need to emphasize the role of response to economic forces by individual economic units. The problems of State were viewed more as political problems. The same general point concerning indifference or aversion to economic phenomena might be made with regard to financial matters, though with some exceptions. Furthermore, as between nations also, the acquisition of wealth was considered more a matter of political power and conquest rather than that of economic relations.

Human beings have a natural fascination for distant and mysterious things as compared with things which they have to deal with daily. Economic phenomena, especially in the days of relative static and simple economic life, were slow in arousing interest. Because of their nearness and the general superficial familiarity, they were not singled out for special study. The things close by did not carry any mystery and fascination.

But with the passage of time, the forces restricting the development of economics have given way to those which favour it. The expanding economic activities of modern governments are playing an active role in the development of economic science. Their operations provide an important segment of the totality of economic phenomena on the one hand and have helped in the provision of necessary infrastructure for the growth of economic science on the other. It is now realized the world over that the budgetary and other activities of the government cannot be neutral in their effects on the economy. This is true not only of the centrally planned economies, or of mixed economies, but also of the market economies where the governments do not have any specific economic programme. Though it is therefore realized that the least the government should do is to ensure that its budgetary and other activities do not cause obstruction in the way of the society in achieving its goals, in practice, the governments are actively engaged in guiding and influencing their economies along 'proper lines.' For an efficient discharge of its duties, a government should be in possession of relevant data. Accordingly, these days governments have become an important source of all kinds of statistical information. There is also an increasing output of these data in published form. Along with the availability of data, there has been an expansion in the profession of economists also. Knowledge of economics is now more widely spread. It is a popular subject in the universities. There are also more and better computational and other research facilities and an increasing use of mathematical and other

techniques in assessing and investigating the role of different economic forces. Formulations of abstract theories and models have helped in the development of rigorous concepts. As a result of all these, the development of economic science is now at a much faster rate than ever before.

Check Your Progress

5. What kind of life was considered preferable around the close of the Middle Ages?
6. What do the operations of modern governments provide?

1.4 NATURE AND APPROACHES

A study of economic ideas from earliest times to the present day is the concern of the subject- 'History of Economic Thought'. A 'History of Economic Thought', as the title itself suggests, is a probe into the origin and growth of economic ideas. It is a historical account of the development of economic doctrines as also of their impact on economic institutions and activities. Thus the history of economic thought deals with the origin and development of economic ideas and their interrelations. Economic thought plays a pivotal role at least in the industrial environment of today.

There is a difference between 'History of Economic Thought' and 'History of Economics'. History of economic thought deals with the development of economic ideas. Economic ideas have been there ever since the birth of mankind. History of economics deals with the science of economics. The history of economics studies the origin and growth of commerce, manufacture, trade, banking, transportation and other economic phenomena and institutions. In short it is a study of the material or industrial development of the people in the past. Though these are separate branches but there is close relationship between them.

Social dynamics is principally a product of ideas of man and environment. The question whether it is environment which shapes ideas of man or vice versa has been a moot controversy and reminds one of the classical problem regarding whether the hen came first or the egg. But it is true that both ideas and environment interact with each other. The economic ideas of people at any time are coloured and conditioned by their environment. For example, the economic ideas of Plato and Aristotle were influenced by the institution of slavery, for slavery was a part of the Greek civilisation of the past. And the industrial revolution in England and the development of the urban areas and the wage system provided the basis for the socialist ideas of Karl Marx.

Professor Haney has defined the subject in the following words- "The subject the History of Economic Thought may be defined as a critical account of the

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development of economic ideas, searching into their origin, interrelations and manifestations."

According to Schumpeter, "The sum of total of all the opinions and desires concerning economic subjects, especially time and place float in the public mind."

According to Bell, "The History of Economic Thought is a study of the heritage left by writers on economic subjects,"

Thus, the history of economic thought-"Traces out the historical changes of attitudes, mentioning analytical performances in passing. Such history would need to display the close association that exists within the attitudes of the public mind in the sense defined; with the kind of problems that at any given time interest analysis and from general attitude of spirit in which they approach their problems."

The history of economic thought may be broadly classified into two parts - first part deals with the origin and development of economic ideas before the development of economics as a separate science and the second part deals with the economic ideas since the birth of political economy as a separate science.

Theoretical Approaches: There are different theoretical approaches adopted by scholars and philosophers from time to time in the study of the science of economics or in analysing economic phenomena. These approaches are as under-

(i) Chronological Approach: In the chronological approach, economic ideas are discussed in the order of time. Advantage of this approach is that it ensures continuity and enables the reader to fix the time at which the economic ideas have come into existence.

(ii) Conceptual Approach: In this approach, importance is given to the development of economic concepts and ideas. The believers of conceptual approach were not interested in the schools of thought which had popularised a given idea.

(iii) Philosophical Approach: This approach was first adopted by Plato, the Greek Philosopher. Afterwards it was adopted by early writers to discuss economic ideas. Aristotle, Quesnay, Adam Smith and above all Mark, all held definite philosophical views.

(iv) Classical Approach: Ricardo, Malthus and J.S. Mill were the economists of the classical school. The classical economists believed that the laws of economics are of universal application and that all economic laws could be formulated by a simple process of reasoning from one fundamental principle. The classical deductive approach has come in for a lot of criticism at the hand of the historical school.

(v) Historical Approach: The historical school had its origin in Germany. The historical approach lay emphasis on the inductive method. They believed that the laws of economics are not universal in nature. They are relatively conditioned by time, place and historical circumstances.

(vi) **The Neo-classical Approach:** The Neo-classical approach wants to improve the classical theories by suitably modifying them by taking into account the modern developments in the theory of economics. The Neo-classical approach is an attempt at the reconstruction of the classical theories. The economists of this approach believed that Induction and deduction are both necessary for the science, just as the right and left foot are needed for walking.

(vii) **Welfare Approach:** The welfare approach aims at providing a basis for adopting policies which are likely to maximise 'social welfare'. Welfare economics is concerned with the conditions which determine the total economic welfare of a community. The welfare approach emphasises on utility, demand and consumption.

(viii) **Institutional Approach:** The institutional approach is a twentieth century phenomenon. Veblen was the founder of this approach. The advocates of this approach assert that the "price system" should not be the central theme of economics. They attach importance to group behaviour which is constantly changing. They consider economic laws as relative. They believed that habits, customs and legal forms are the chief factors of governing human behaviour.

(ix) **Keynesian Approach:** A major development in modern economics is associated with the name of J.M. Keynes. Keynesian approach is termed as Keynesian Revolution. The core of the Keynesian approach is that it deals with the problems of the economy as a whole, and not only with those of the individual consumer. One of the greatest contributions of Keynes was to tie economic analysis to the great public problems of the day.

Significance of History of Economic Thought: The significance of the history of economic thought lies in the benefits that accrue from it. The study of the subject gives one an insight into the evolution of economic theory and the formulation of policies which controlled economic life, from the earliest time to present day. Thoughts of every age in the context of their surroundings have governed individual actions and policies and are therefore, important for us. The chief advantages of the study of history of economic thought have been very sell summed up by professor Haney as under-

1. The study of 'History of Economic Thought' reveals that there is a certain unity in thinking of man right from the earliest times to the present day. The economic thought and this unity connects us with ancient times. Thinking is the heritage of man. In every age, thoughts have been derived from the environmental influences. Apparently, they look new but the fact remains that there is a great continuity of ideas. It may be said that ideas belonging to an age are drawn from those of earlier ages and under the influence of different economic environment simply change in form and emphasis so as to face problems of the times.

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2. In spite of a tremendous improvement in the science of economics, even today the nature and scope of economics is under dispute. The study of economic thought assists us in tracing the origin and development of economics, and in understanding its nature, scope and relationship with other sciences. Economics, being a science, is dynamic and without studying ancient thought we cannot correctly assess the developments that have taken place in its nature and scope. So there is a great value in studying the history of economic thought.
3. The study of economic thought leads to a change in the outlook of the reader. He no more remains dogmatic. He starts examining and assessing critically the practical value of each idea and theory in the context of his own times and conditions. Thus it is clear that most of the economic ideas are relative. They are conditioned by time, place and circumstances. Many economic ideas of the past had their roots in institutional arrangements. Aristotle justified slavery because slavery was an accepted social fact of the Greek civilisation. Mercantilists' theories of foreign trade, physiocratic ideas about agriculture and Ricardian theory of rent are still studied.
4. The study of the history of economic thought reveals that there has never been an age in which ideas have not developed. The presumption that Middle Ages were dark ages leads one to think that no new ideas or philosophies were developed during this period. Of course there are some writers on the subject who deny continuity in the evolution of economic thought. They regard the Middle Ages as a complete break because the thinker of Middle Ages emphasised on the negative aspects of life. This however, is not totally true. For even during that period there was speculation on economic topics such as money, interest and the ideas of these thinkers were similar to those of Greek thinkers of the past.
5. A study of economic thought provides a broad basis for comparison of different ideas which proves to be of great value. It will enable a person to have a well-balanced and reasonable judgment. He is neither guided by his own fads nor does he lose courage and get confused by controversies. He cares more for the progress of the science.
6. By a study of economic thought, one may be able to take an objective point of view. He will realise that economics is quite different from economists and that the two are separate entities altogether. While economics is a science, economists are only human beings. The students will realise that economics is one thing and economists are another. They may find differences of opinion among individual economists. Discussion and controversies on the simplest point may confuse them, but later they realise that economics is a science, a systemised body of doctrines developed during the course of centuries, encircled by the view of different economists and gain confidence without caring for the personalities.

7. By the study of the History of economic thought, students will realise that old doctrines never die; they only fade away with a strange power of recuperation in an appropriate environment. For example, some ideas of Keynes, one the greatest of modern economists, may be traced back to socialist writers such as Sismondi and Proudhon and to Malthus.
8. By the study of History of economic thought, we come to know the persons responsible for formulation of the principles that constitute the framework of economics as at present taught. It will also help us to know at what period these principles were enunciated and what circumstances were accounted for their enunciation just at that period.
9. The study of 'History of Economic Thought' also reveals the differences in the points of view of various thinkers and shows how a particular point of view has been built, difference in opinion and points of view are bound to occur owing to the difference in the basic philosophy of life and the method adopted by each thinker in studying a problem. Thus students analyse these different philosophies that are accepted or rejected on their own merits. The study of the subject undoubtedly proves to be a great guiding and correcting factor. The significance of the study of the History of Economic Thought can therefore, hardly be over-emphasised. It is an essential tool of knowledge.

Check Your Progress

7. What does the history of economic thought deal with?
8. What does history of economics study?
9. Why were the economic ideas of Plato and Aristotle influenced by the institution of slavery?
10. What do the two parts of history of economic thought deal with?

1.5 SIGNIFICANCE OF THE HISTORY OF ECONOMIC THOUGHT

It is always helpful to have some knowledge of the history of thought of the subject one is interested in. Every science grows and evolves over time and during the process of its refinements and expansion, attracts numerous debate and controversies which not only relate to the subject matter of the discipline itself, but also to its application to the problems of actual life. As such a study of economic thought enables a student of economics to realize that the current fluidities in economic theories and inconclusiveness of various branches of thought are not something to be disturbed about; it is not indicative of a weakness of the science, but is a normal phenomenon with any science.

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The study of economic thought lends a perspective to the subject and enables the student to have a wider view of what he is studying. It enables him to realize that economics as a science is a comprehensive whole and that individual theories, tools and techniques have their meaning, importance and rationale only in the context of that overall totality. In the absence of a knowledge of the history of the economic thought, a student is apt to be misguided into believing that the theories he is studying are either final or have no relevance at all. This is more so because each theory is presented on the basis of certain assumptions and in the context of a given economic system with all the implied institutional factors. If a student gets a feeling of the finality of a theory, he may not feel free to use his analytical abilities for a deeper probe of the same.

Alternatively, he may be impressed by the abstraction of a theory and the unrealistic assumptions upon which it is based and might therefore come to the conclusion that every abstraction in economics is an equally useless exercise.

Secondly, a knowledge of economic thought enables a student to realize that economics is a dynamic science. On the one hand, economic science moves forth on account of the fact that new tools, techniques and concepts are being added to the armoury of the economists and on the other additional economic phenomena are being investigated and analysed. Moreover, the very dynamism of the world economies lends an element of dynamism to economics also. By studying economic thought a student is equipped to assign to current controversies and debates the place they deserve. He is not bogged down or disheartened by the heated controversies and differences of opinion. These things appear to him signs of life within the science of economics and he knows that these are indicators of continuous development and refinement.

Thirdly, a study of the history of economic thought brings home the fact that economic aspects are only a part of the totality of our life. Economics is only one of the social sciences. It does not explain the total behaviour of a society, nor does it provide a total solution to any problem. There is a need to study economic problems in the context of their overall social framework and the interdependence of economics with other social sciences should not be lost sight of. This realization also enables the student to appreciate the fact that similar problems would not yield similar solutions in the hands of different economists. Economists are also human beings living in a society, and the solutions which they offer must be conditioned by the totality of their existence and views. There would be subjective elements involved in the interpretation of economic phenomena and so they would propose different solutions according to their personal views. An economist with leftist views would advocate solutions which would be different from the ones advocated by an economist of rightist views. Some solutions would take note of the administrative and political difficulties in implementing the same, others would not. In this way the contribution to economic science made by any individual economist or a school of thought is to be appreciated only in the context of the underlying philosophy.

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Check Your Progress

11. What does the study of economic thought enable a student to do?
12. Which fact does the study of economic thought bring home?

1.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The role and growth of each significant theory, the set of theories and policy prescriptions provided by each school and even the significant contributions by individual economists must be viewed in the context of the prevalent economic environment.
2. References to economic questions are scattered almost everywhere in old literature. They are found in Plato, Aristotle, and others. Aristotle, for example, discusses currency, population and slavery.
3. A good deal of economic thought has developed in the context of a market economy and on the assumption of 'economic rationality' on the part of individual economic units.
4. The development of economic science is intimately related to the development of economic environment; and the two interact with each other.
5. Around the Middle Ages, a life which conformed to a code of moral values was considered preferable to the one which gave 'undue' weightage to material well-being.
6. The operations of modern governments provide an important segment of the totality of economic phenomena on the one hand and have helped in the provision of necessary infrastructure for the growth of economic science on the other.
7. The history of economic thought deals with the origin and development of economic ideas and their interrelations.
8. History of economics studies the origin and growth of commerce, manufacture, trade, banking, transportation and other economic phenomena and institutions.
9. The economic ideas of Plato and Aristotle were influenced by the institution of slavery, for slavery was a part of the Greek civilisation of the past.
10. The first part deals with the origin and development of economic ideas before the development of economics as a separate science and the second part deals with the economic ideas since the birth of political economy as a

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separate science.

11. The study of economic thought enables a student to realize that economics as a science is a comprehensive whole and that individual theories, tools and techniques have their meaning, importance and rationale only in the context of that overall totality.
12. A study of the history of economic thought brings home the fact that economic aspects are only a part of the totality of our life. Economics is only one of the social sciences.

1.7 SUMMARY

- Economic science, like other sciences, has had to undergo a process of evolution and is the result of innumerable contributions by various thinkers. In many cases, specific contributions went unnoticed for a period of time, while certain other contributions were recognized during the very life-time of their contributors.
- Economics is a dynamic science, a feature that it acquires on account of various reasons. This characteristic of it partly follows from the fact that it is a social science. It brings forth a body of generalizations which, as in other sciences, involve cause-effect relationships.
- The role and growth of each significant theory, the set of theories and policy prescriptions provided by each school and even the significant contributions by individual economists must be viewed in the context of the prevalent economic environment. At the same time, the study must take note of the way economic thought influenced the movement of economies and the resultant effects on economic science itself.
- Individual economic ideas are almost always problem-oriented. There are generalizations about certain facts and problems and the desirable solutions thereof. Among various problems which man faces in his daily environment, there are economic problems also.
- Economic thought is closely related to economic environment. The growth of economic science can be traced along with the growing complexity of the world economies. Even in pure abstract theorizing, economics has its moorings in specific economic framework of a society.
- Economic analysis admits a wide variety of methods. As a result, even with given tools and objectives, the method of analysis may vary from one analyst to the other and yield non-identical results.
- Before the advent of capitalism, economic organization was a simple one. Division of labour was not carried sufficiently far and therefore a good deal of production was meant for self-consumption. Exchange and marketing problems were simple and of limited importance.

- Till the close of Middle Ages, non-economic aspects of social life were accorded a great importance. The weightage assigned to material well-being in human life for the attainment of happiness was quite law.
- Human beings have a natural fascination for distant and mysterious things as compared with things which they have to deal with daily. Economic phenomena, especially in the days of relative static and simple economic life, were slow in arousing interest.
- There is a need to study economic problems in the context of their overall social framework and the interdependence of economics with other social sciences should not be lost sight of.

1.8 KEY WORDS

- **Physiocracy:** It is an economic theory developed by a group of 18th-century Age of Enlightenment French economists who believed that the wealth of nations derived solely from the value of "land agriculture" or "land development" and that agricultural products should be highly priced.
- **Marginalism:** It is a theory of economics that attempts to explain the discrepancy in the value of goods and services by reference to their secondary, or marginal, utility.
- **Mercantilism:** It is an economic policy that is designed to maximize the exports and minimize the imports for an economy. It promotes imperialism, colonialism, tariffs and subsidies on traded goods to achieve that goal.
- **Materialism:** It refers to a tendency to consider material possessions and physical comfort as more important than spiritual values.
- **Socialism:** It is a political and economic theory of social organization which advocates that the means of production, distribution, and exchange should be owned or regulated by the community as a whole.

1.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Along which two lines does economic thought develop?
2. How can the place of abstraction in economics be noted?
3. Write a short note on instinctive and acquired responses.
4. Why did economic problems not appear pressing in earlier times?

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5. How do the 'History of Economic Thought' and 'History of Economics' differ?
6. What did the medieval theorists condemn?
7. How is the study of economic thought helpful to a student?

Long-Answer Questions

1. Discuss the deductive and inductive methods of analysis.
2. Analyze the reasons responsible for lack of agreement in economic thought.
3. Explain why in the early stages of economic development, the share of economic problems in the totality of social life was a small one.
4. Examine any four approaches used for analysing economic data.
5. Discuss how the lack of interest in a number of problems naturally hindered the growth of economics.

1.10 FURTHER READINGS

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UNIT 2 MERCANTILISM

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Structure

2.0 Introduction
2.1 Objectives
2.2 Introduction and Forms
2.2.1 Main Characteristics
2.3 Thomas Mun
2.4 Answers to Check Your Progress Questions
2.5 Summary
2.6 Key Words
2.7 Self Assessment Questions and Exercises
2.8 Further Readings

2.0 INTRODUCTION

Mercantilism is an economic policy that aims to increase exports and reduce imports by a country in order to maximize gains thereby leading to an accumulation of wealth. It promotes a large scale production of goods and services by employing a large labour force at low wages. It lays emphasis on concepts like production, balance of trade, a large population to provide labour, interest rates etc. It developed as a means to increase wealth and hence the power of a nation to tackle with rival nations and gain an upper hand over them by the maintenance of armies and navies, both of which, required a huge amount of money.

2.1 OBJECTIVES

After going through this unit, you will be able to:

- Analyse the concept of mercantilism
- Discuss the main characteristics of mercantilism
- Describe the views of Thomas Mun on mercantilism

2.2 INTRODUCTION AND FORMS

Commercial activity in Europe started as early as the Crusades with the discovery of silk, spices and other rare commodities. Trade picked up in the second half of the middle ages with the rise of the 'spirit of discovery', the network of trade routes multiplied as new lands were discovered, sea routes to the east were discovered by the likes of Vasco da Gama. The 15th and 16th century saw great amassing of wealth, rise of capitalism, and new economic practices. There was a shift from the Mediterranean to the west Europe countries as the hub of commercial activity virtually

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ending the monopoly of the Turks on trade with the East. These nations were now competing against each other in the quest for wealth and to meet their goals, extracted all the wealth from their colonies. It was the Portuguese who established their supremacy in trade with the east following their building a settlement in Goa in 1510. This led to trade between Europe and China in the 16th century and later a Portuguese establishment in Macau, South China, in 1557. This was followed by Dutch and later Transatlantic trade of the English empire as well.

The commercial revolution spanning from the 16th to the 18th century was marked by expansion, increase in trading activity and the rise of mercantile culture. There was also a spurt in the banking sector and rise in investment apart from the manufacturing sector. Close at the heels of the commercial revolution came the industrial revolution in the middle of 18th century.

The following were the factors of the growth of commercial activities in Europe.

(i) Geopolitical Factors

The fall of Constantinople in 1453 necessitated the discovery of new trade routes as Turks controlled the Mediterranean region. The English altered their laws to the advantage of their navy so that their mercantile aspirations would not be hampered. A consequence of this was that the Hanseatic League that carried on trade in the northern region of Europe became dysfunctional. Spain remained a dominant force throughout this period because of its martial culture owing to the Reconquista and carried on its expansionist policies. However, competition grew between the European nations in their quest for wealth and greater power.

(ii) Monetary Factors

Trade grew as there was a greater need of precious metals with the introduction of silver currency. The Europeans faced a crunch of gold and silver as these were spent on trade with the East. With their ore mines also exhausted or containing metals too deep seated to be extracted the only available choice was furthering trade.

(iii) Technological Factors

The maritime inventions and scientific discoveries from the 16th to the 18th century helped the colonial expansion of European nations. The first atlas along with 53 other maps was published in a collection called Theatrum Orbis Terrarum in 1570. These were created by Abraham Ortelius and published by Gilles Coppens de Diest. By the end of 1572, Latin, French, Dutch and German editions of the atlas emerged and stayed in vogue till 1612. Experiments were carried on in ship building and skeleton based ship building, Galea and other tools for easy navigation emerged. Issac Newton's theories on motion published in the Principia helped sailors manoeuvre using their knowledge of the motion of moon. By 1670, the earth was measured in latitudes. There was now the quest to determine longitudes and the British Parliament even announced a prize for this purpose in 1714.

(iv) Sociological Factors

The development of mercantilism was the consequence of the amalgamation of cultural, religious, political and economic factors. In order to examine these causes, what may be highlighted is that in the start of the 16th century, Europe came across great religious and intellectual awakening because of Reformation and Protestantism.

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Erasmus and Martin Luther who started these two movements, respectively, gave a great stimulus to the concepts of individualism and private freedom. These movements went a long way in evolving the ideas of property and contract rights, which ultimately led to the growth of commerce and free exchange. Renaissance played an even more important role and stressed on the element of humanism. It challenged the medieval theologian idea that happiness in heaven should be preferred over worldly happiness; rather, it asserted that happiness on this earth was to be preferred over the promised pleasures of the other world.

In other words, it emphasized on the materialistic factor of human happiness. A large number of writers, artists and philosophers emphasized the economic basis of the society in their works, once the principles of humanism and individualism were accepted. They shook the foundations of the edifice of the church theology.

In the economic sphere, the decline of feudalism contributed to the growth of mercantilism. The feudal system was distinguished by economic self-sufficiency, agricultural production and absence of exchange economy. The agriculturists were needed to work free of charge on the fields of the lords for a stipulated period.

They were also required to work as soldiers for the lords during war times. As there were no organized industries and even commercial crops were not in much demand, these agriculturists worked for local self-sufficiency in food grains. In the absence of organized markets, the manufacture was undertaken mainly to meet the local requirements. This led to the development of an independent domestic economy. It was based on local self-sufficiency. Especially, there was no effective state organization. In the cities and towns, the guilds and municipalities tried to regulate the trade between the various localities. The surplus acquired by the manorial lords could be channelized only in trade, especially, overseas trade.

Mercantile activities first grew in the Scandinavian countries because of their powerful navy that could sail through the deep sea even across the Atlantic. Later, this efficiency came down to south-west Europe in Portugal and Spain, which had the added advantage of access to the Mediterranean Sea. England entered into the field in the 16th century.

Definition of Mercantilism

Mercantilism as an economic ideology started in Europe in the 18th century. It had its roots in the commercial revolution that had started in the 16th century. Its main aim was to increase a nation's wealth by government regulation of all of the nation's commercial interests.

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The commercial revolution was a phase of European economic extension, which lasted from more or less the 16th century until the early 18th century. The commercial revolution, along with other changes in the early modern period, had spectacular effects on the world.

No universal definition of mercantilism is completely satisfactory; however, it may be thought of as a compilation of policies made to keep the state affluent by economic regulation. These policies may or may not have been applied at the same time or place. Mercantilist ideas have developed over the centuries in reaction to the development of other theories of global political economy, namely liberalism and structuralism, and as the global political economy itself has altered. Mercantilism is an economic strategy where a nation tries to accumulate as much money as possible and by whatever means necessary. It was thought that the richer the nation, the more powerful it was. Mercantilism is an economic theory that states that the world only contained a fixed amount of wealth and that to increase a country's wealth, one country has to take some wealth from another through having a higher import/export ratio and through the actual conquest of new lands and resources. This was considered essentially fair as an effort to achieve economic unity and political control. The following concepts are also associated with mercantilism:

(a) Mercantilism refers to the supposed mercantilist period of European history (approximately 16th–early 18th century) when the contemporary idea of the 'nation state' was born.

(b) Economic gains by one nation state usually came at the expense of other nation states (as states fought for territory), thus leading to a zero-sum game. In a zero-sum game, for example, poker, what one party wins is equal to what the other loses.

(c) The mercantilist phase of history overlaps with the phase of 'classical imperialism', when war, conquest and colonial developments were frequent occurrences.

Mercantilism: Expansion and Rivalries

With the increase of commerce, conflicting individual trading interests came to the fore. Almost all of them looked for a strong central authority to look after them against their competitors. In the absence of a national government, this was not feasible and the relationship was definitely a weak link.

The growth of commerce and development of domestic economy gave rise to the issue of labour and distribution. However, possibly the most significant factor that stimulated the development of mercantilism was the materialization of the exchange economy.

This resulted in the development of international trade and encouraged large-scale production. For a fuller exploitation of the available economic resources, it was felt that the economic life should be regulated. The urge for new markets resulted in the discovery of new islands and countries and thus, the development of colonialism.

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In short, it can be said that mercantilism was motivated by factors like decline of feudalism, lack of state organization, rise of free labour classes, competition and development of exchange economy.

But, the greatest challenge came from industrial capitalism. The merchants carried on the business irrespective of national interest. When industrial capitalism came in England, for instance, English foreign trade was dominated by the East India Company, which was purchasing high quality cotton goods from India and selling them in England and her colonies. This harmed the interest of Lancashire cotton kills. From about the end of the 18th century, continuous pressure from the industrialist capitalist of England led to the curbing of the activities of the East India Company, and, finally, it closure. Industrial capitalism thus came to dominate the Western economy, and England was at its head.

Forms of Mercantilism

The mercantilist policies took many forms. Domestically, governments tried to encourage mercantilism through the following means:

- Offered capital to new industries
- Exempted new industries from guild rules and taxes
- Established monopolies over local and colonial markets
- Granted titles and pensions to successful producers

In the trade policy, the government assisted local industry by imposing tariffs, quotas and prohibitions on imports of goods that had competition with local manufacturers. Governments also forbade the export of tools and capital equipment and the mass departure of skilled labour that would permit foreign countries, and even the colonies of the home country, to compete in the manufacturing of manufactured goods. Simultaneously, diplomats encouraged foreign manufacturers to move to the diplomats' countries.

Shipping was particularly significant during the mercantile period. With the increase of colonies and the shipment of gold from the New World into Spain and Portugal, the control of the oceans was thought to be crucially important to national power. The governments of the era developed strong merchant marines since ships could be used for merchant or military purposes. In France, Jean-Baptiste Colbert, the minister of finance under Louis XIV from 1661 to 1683, increased port duties on foreign vessels entering French ports and offered bounties to French shipbuilders.

In England, the navigation laws of 1650 and 1651 forbade overseas vessels from engaging in coastal trade in the country and stressed that all commodities imported from the continent of Europe be transported on either an English vessel or a vessel registered in the country of origin of the commodities. In conclusion, all trade between England and its colonies had to be carried in either English or colonial vessels. The Staple Act of 1663 extended the Navigation Act by making it essential that all colonial exports to Europe be landed through an English port before being re-exported to Europe.

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France, England, and other powers had strong navigation policies. These policies were mainly directed against the Dutch, who controlled commercial marine movement in the 16th and 17th century. During the mercantilist era, it was frequently proposed, if not believed, that the principal advantage of foreign trade was the import of gold and silver. According to this viewpoint, the advantages to one nation were matched by expenditures to the other nations that exported gold and silver, and there were no overall gains from trade. For nations almost regularly on the verge of war, draining one another of precious gold and silver was thought to be approximately as desirable as the direct advantages of the trade.

Essence of Mercantilism

The essence of mercantilism was exchange of commodities for profit. It needed colonies as ready markets for buying and selling things at profit without competition. In the commercial period America was colonized by the Spaniards, the Portuguese, the British and the French.

2.2.1 Main Characteristics

It is not easy to state in which year or century Mercantilism came into existence and died out. According to L.H. Haney, the period of mercantilism was 16th to 18th century. Alexander Gray revealed, that Mercantilism came into existence at the end of fourteenth century or beginning of fifteenth century. Cannan has asserted that Mercantilism proper only appeared in the 17th century. In fact it was in the seventeenth century that maximum number of mercantilist writings appeared.

According to Newman, "The economic views which prevailed during the period falling roughly between the end of middle age and the beginning of the American Revolution have been named as the commercial or mercantile system by Adam Smith."

According to Haney. "Mercantilism comprises the economic views which prevailed among European statesmen from sixteenth to the latter part of the eighteenth century."

The economic ideas and policies which were followed by European statesmen from fifteenth century until the second half of the eighteenth century have been described as mercantilism. Like other systems of thought, it was a system comprising the views of many writers who were spread throughout Europe. It covered such a long period that variations and amendments, refinements and improvements in the views according to changing conditions of time and local circumstances were quite natural. The early mercantilists believed that the wealth of a nation consisted in the amount of bullion (gold and silver) possessed by it. So they suggested ways and means to increasing the stock of gold and silver in the country.

It may be stated that the growth of money economy and the rise of nations were the corner-stones of Mercantilism and it began to disappear with the industrial revolution and the growth of political freedom

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Different Names of Mercantilism-Mercantilism prevailed in many countries whose conditions were different and so the difference in the views of writers of one country and those of other countries was bound to occur. That's why Mercantilism has been known by different names in different countries.

A. It was known as metalism because of mercantilists' emphasis to increase the stock of gold, silver and valuable metals.

B. In France it was known as Colbertism, after the name of Colbert, the eminent Finance Minister of Louis XIV.

C. In Germany and Austria it was known as Kameralism. In the words of Haney' "Kameral's affairs concerned the economy of the prince and Kameralism was the art which maintained and administered the royal income."

D. The mercantilists thought that the wealth of the nation could be increased by trade and commerce. They gave importance to trade and commerce hence mercantilism is known as a commercial system.

E. The mercantilists were against free trade. They were in favour of balance trade. Some writers have called it Restrictive System, owing to the restrictions imposed on the commerce for securing favourable balance of trade.

For nearly three hundred years, mercantilism was a powerful force in England, Holland, France, Germany, Austria, Italy, Spain and in almost every other European nations.

Factors giving rise to Mercantilism- Many political, economic, social and religious factors were responsible for the rise of mercantilism.

Political Factors- Toward the close of the middle ages, nationalism became a strong force. Europe changed greatly due to reformation, renaissance, and inventions. As a result of these developments, there was a fundamental political change. It replaced feudalism with nationalism. It resulted in the emergence of strong nation states. Feudalism came to an end and the king became all powerful. In order to create strong and powerful states, the importance of economic unity was also recognised. The merchant was an important source of money and wealth. Hence the mercantilists tried to regulate the political and economic activities of the people.

Outside of the national boundaries, there was a problem of competition with other growing states. Each state wanted to preserve its independence and considered the other states as its rival. The strong feeling of nationalism was actually responsible for this situation. It was felt that a strong nation must have well equipped army and navy to defend itself and to protect its political interests in the outer world. It was found that the existence of armed forces implied having adequate financial resources, which in those days were equivalent to having adequate stocks of precious metals (gold and silver). The merchant has started their trade to other nations to acquiring gold and silver. Customs laws and navigation laws were used in this direction as the chief tools. In order to maintain the armed forces, the monarchy needed wealth, which could only be achieved through a favourable

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balance of trade. That's why almost all the thinkers of this age emphasised the importance of balance of trade.

Economic Factors- There were other factors, economic in character, which gave rise to mercantilism. Toward the end of the 15th century, remarkable changes were also taking place in the economic set-up of the society. Feudalism as a method of organising agricultural production was losing ground, due to modern changes in farming methods. Consequently income of feudal lords having been reduced, they had to resort to trade and manufacture. Trade proved to be of such vital importance that it shook the very foundation of socio-economic set up of the Middle Ages.

During the Middle Ages, money was scarce and emphasis was laid on self-sufficiency. The result was that there was little exchange. But from 16th century onwards, exchange economy became the rule. Markets developed and money was used in exchange. The sphere of exchange was widening as internal as well as foreign trade were fast developing. The fast growing exchange and trade necessitated the use of money which was made available in abundance in the form of gold and silver by the discovery of the new world. Inflation was the natural consequence. Rising prices hit the government and the labour classes hard. The need of the government grew to such an extent that the revenue obtained from the royal estates and prerogatives proved inadequate and therefore option had to be taken to increase taxation and undoubtedly the development of the industry and commerce provided fertile ground for it. Accompanied with the expansion of commerce & trade and increased supply of money, there started an era of cheap means of transport, improved agricultural methods and rise in population. Most of the mercantilist views were the outcome of these developments.

Religious Factors- During the Middle Ages, both economic and political life was dominated by religion and ethics. The Church was more powerful than the king. The king led a luxurious life. The reformation movement raised a voice against the supremacy of Roman Catholic Church and challenged the absolute authority of the Pope in religious and political matters. Protestantism gave more rational meaning to Christianity and pointed out the importance of money, economic efforts and thrift in man's life, as against Catholicism which preached total detachment of man from material things. In Europe, the king and the flourishing merchant class adopted the protestant religion, broke all the relations with the Roman Catholic Church and established their own churches.

The power of the Church declined and one of the monarch's rivals for political power was thus removed. The king had a feudal military service which used to fight in times of war. These lords were given land to maintain themselves. Similarly, the church was the biggest landed proprietor. The king used to derive revenue either from the feudal lords or from his own estates. Now the king started imposing taxes. He started maintaining a mercenary army. To the king, wealth acquired from international trade was more important than the wealth acquired from natural economy.

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Cultural Changes- Europe was undergoing sharp changes in terms of culture too. The renaissance gave a new light and learning to the people. According to the theological teachings of the Middle Ages, the miserable life on this earth was not to be considered source of worry, as it will be compensated by the pleasures in heaven. But under the impact of the reformation and the renaissance, people were made to realise that this life was more important than the life of the other world. These ideas were depicted in the literary and art works. Writers, artists and philosophers, all were trying to immortalise the new ideas. In 'Utopia', the book by Sir Thomas More, outlined an ideal state of society and threw a challenge to the existing pattern of society. As a consequence, money came to occupy a place of pride in human relations and materialism started gaining strength day by day.

Scientific and Technological Changes- In the field of science and technology, great advancements and inventions were made which helped in strengthening mercantilist philosophy and policies. The discovery of mariner's compass and invention of printing were of far reaching importance. Navigation had become easier and it led to the discovery of new continents. Columbus discovered America. A new sea route to India was established in 1948. The discoveries opened up the gates to a great variety of raw materials, a wide market and a wider field for regional specialisation. Consequently the cost of transportation had been reduced and scope of foreign trade was extended. The invention of printing press helped in the spread of new ideas and knowledge.

All the above factors provided an atmosphere for mercantilist views to flourish and gain strength every day. The mercantilists were practical men. They were interested in practical problems. Their main problem was the creation of a strong state. That is why it has been said by Schmoller that mercantilism is merely "state making" on the economic side. Mercantilism was not an end in itself. It was only an economic means for a political end, the end being creation of strong state. The mercantilists regarded wealth as a source of a nation's power. They saw in the wealth secret of nation's strength.

General outlines of Mercantilism- The fundamental aim of the mercantilist was to make his country strong. It was felt that a strong country must have well-equipped army and navy to defend itself and to protect its political interests in the outer world. It was found that maintaining armed forces implied having adequate financial resources, which in those days were equivalent to having adequate stocks of precious metals. The state power was the military power which in turn needed wealth. Only wealthy country could have and maintain strong forces and nation's unity is a pre-requisite for state's power. In general it is believed that mercantilism aimed at strong power, though as noted above, Schmoller believed it to be national unity. To Eric Roll, the mercantilist theory was nothing but the philosophical expression of the capital needs of the rising merchant class. They needed a strong state to protect them and they needed capital for trade which in those days consisted of gold and silver.

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Mercantilists regarded money and bullion as the sign of wealth. They believed that if country has mines, it can get gold and silver and it can accumulate those precious metals by imposing restrictions on export of gold. But if a country has no mines, it can get gold and silver only through trade. Trade must be conducted and regulated in such a way that gold and silver may come into the country. In order that a country may have more bullion, there must be a "favourable balance of trade." In other words, there should be an excess of exports over imports.

According to mercantilists, trade was the most important occupation. Industry and manufacture were ranked second in importance Agriculture was least important of all. Though agriculture might feed the population it brought no money in the form of gold and silver into the country. Therefore, they thought that it was not as important as trade and industry.

The economic doctrine of mercantilists was characterised by the following features. In their policies:

(i) Mercantilists gave importance only to nation advantages;

(ii) Mercantilists laid great emphasis on national policies for increasing stock of precious metals;

(iii) Their aim was maximum export and minimum imports;

(iv) They sought favourable balance of trade by direct promotion of export and restriction of imports;

(v) The ultimate aim was the creation of a strong and powerful state.

Economic Ideas of Mercantilism- Mercantilist writers have differences of opinion on many theories which generally describe as mercantilist theories. Mercantilism was rooted in practice. As a practical philosophy, it was products of the minds of statesmen, civil servants and business leaders of the day. According to Professor Scott, Mercantilism connotes a system of doctrines, but it will not be unfair to say that theorisation on economic matters was hardly the business, with which the mercantilist writers were concerned in the 15th and 16th centuries. In simple words, in the domain of thought, emphasis was shifted from political and religious to economic matters and for this, the credit should be given to earlier mercantilists alone. The earlier literature was scattered and fragmentary and it was only in the 17th century when mercantilist thought, was published in the form of books. To Eric Roll, the mercantilist theory was nothing but the philosophical expression of the capital needs of the rising merchant classes.

We shall now discuss in detail the views of the mercantilists. Their main views are clustered in the following concepts-

1. **The Role of Money-** Money was considered to be the most important source of strength to the nation. The mercantilists were of the view that money, usually in the form of precious metals or treasure, had played an important role in determining the economic well-being of a nation. Therefore, the mercantilists paid a lot of attention to the accumulation of precious metals. It was felt that an adequate supply of gold and silver in the form of bullion was

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essential to the safety of a nation. It has been said that mercantilists grossly confused money with wealth. But it is only fair to say that they regarded precious metals as a sign of wealth. According to Child, "That gold and silver should be taken as the measure and standard of riches was well founded**."**

Nearly all the mercantilists recognised precious metals as the most important form of wealth. They advocated storing of wealth in the form of precious metals because gold and silver were durable and they had high value per unit. According to William Patty, "The great and ultimate effect of trade is not wealth at large, but particularly abundance of silver, gold and jewels, which are not perishable nor so mutable as other commodities, but are wealth at all times and places, so as the raising of such, and the following of such trade, which does store the country with gold, silver and jewels etc., is profitable before others."

Mercantilists believed that there was a close relationship between production or employment and quality of money in circulation. They were aware of the existence of employed labour and natural resources in the country. So they believed that the increase in the supply of money would help in increasing production and export of manufactures. Hence their emphasis on the ways and means of increasing the stock of precious metals by maximising exports and minimising imports. In the words of Mun, "All nations who have no mines of their own are enriched with gold and silver (acquired by increasing export and decreasing imports)." Columbus declared in unequivocal terms, "Gold is a wonderful thing, whoever possesses it is master of everything he desires. With the gold one can get soul into paradise."

2. **Nationalism-** Nationalism was the pivot on which their main ideas were centered and they emphasised on the national strength and prosperity. Schmoller and Heckscher felt that the stress was on national economic unity, which naturally implied the enhancement of the power of the state. Every aspect of life was made subject to regulation by the ruler. The mercantilists believed that state intervention was necessary for the proper management of society's economic affairs.

   Military aggrandisement and the exploitation of new countries were the chief aims. Economically, the expansion of commerce and trade, and politically, success in wars were the natural goals which could not be achieved without a strong navy.

   Low wages and cheap food were considered essential for decreasing the cost of production and thus for enlarging the volume of exports. With the object of maximising exports and minimising imports, the government put heavy import duties to discourage imports of foreign goods and granted bounties and other tax concessions to encourage exports.

   In Mercantilism, the government allowed direct importation of foreign workers in order to establish new industries. It fixed prices and wages in order to encourage production. It passed navigation Acts to encourage

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shipping and the activities of the Navy. It offered various privileges to trading companies. It also helped in the establishment of colonies in order to secure raw materials as well as a market for the finished goods. As there was so much of economic activity and regulation by the state, mercantilism has been described as a policy of perpetual governmental activity.

3. **Balance of Trade-** Foreign trade was considered to be the only source of acquiring gold and silver. Thomas Mun was fully convinced that all those nations which did not possess their own mines could become rich after getting gold and silver from foreign countries through trade. He declared that the ordinary means to increase our wealth and treasure is by foreign trade. They advocated foreign trade as a tool for increasing a nation's wealth and treasure.

   The idea of balance of trade was the central doctrine in mercantilist thought. While talking of a favourable balance of trade, almost all of them did not signify whether they meant an overall favourable balance of trade, or a favourable balance with each country. Thomas Mun was the only exception who was very clear about it.

   The mercantilists believed that state intervention was necessary to promote favourable balance of trade. With the object of achieving a favourable balance of trade, the mercantilists followed a policy of discrimination, regulation and protection in the matters of trade. The mercantilists gave priority to commodities with a high labour requirement in their scheme of exports because there was an abundant supply of unskilled labour. The mercantilist's ideal seemed to be zero imports, and exports only in exchange for the precious metals. The export of raw materials was to be restricted; the imports, especially of luxurious items, were to be kept to the minimum. However, in practice, they believed in importing only if it was essential: if commodities could not be produced domestically or if their production would require the transfer of resources from export industries. According to Child, the trade which employed shipping must be encouraged more than others, "for besides the gain accruing by the goods, the freight, which is in such trades often more than the value of the goods is all profit to the nations." Sir Thomas Mun also held the same view. Although they did not mention it specifically, the mercantilists always referred to an overall balance of international payments.

4. **Population-** Mercantilists favoured a large and rapidly increasing population for making the nation militarily strong and for increasing its productive capacity. They believed that an increasing population meant both an increase in potential number of soldiers and sailors and an increase in the number of productive workers .They felt that cheap and abundant supply of labour force would help in keeping the cost of production low thus enabling the country to compete successfully with the world market. According to Davenant, "people are the real strength of a country".

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5. **Production-** The ideas of mercantilists on production were most primitive in their nature. The felt that the process of production was one which involves the application of human labour to resources. Consequently, they advocated an increase in both labour and resources of production. Mercantilists regarded agriculture as insignificant. They argued that agriculture did not contribute directly to the strength and prosperity of the nation like foreign trade. Mercantilists believed that foreign trade and commerce were the most productive professions and that agriculture was the least productive. Artisans occupied second place after the merchants. They believed that in the national interest, manufacturing industries were more closely associated with foreign commerce than with agriculture therefore it must receive maximum attention from the government. They also drew distinction between productive and unproductive labour. According to mercantilists, manufacturers, farmers and merchants belong to the productive category while professional persons such as doctors, lawyers, shopkeepers, stock brokers and clergymen were included in the unproductive category. Petty revealed that labour is the father and active principle of wealth as land is mother. Davenant considered labour as the most important factor and declared that "the wealth of all nations arises from the labour and industry of the people." Thus it is clear that land and labour were the only factors of production which were given importance by mercantilists.
6. **Rate of Interest-** Among the mercantilist writers, there were two main streams of thought on the subject of interest- one justifying the charging of interest while the other opposing it. Thomas Mun was the leader of those who were in favour of interest taking. In his view, money lending provided capital to poor merchants. The mercantilists advocated a low rate of interest on economic grounds. They believed that economic development could proceed effectively only if interest rate was low and rate of interest could be low only if the supply of money was adequate. Further, labour and other sources of production would be fully employed only if the money supply was adequate. So they argued that the accumulation of wealth would tend to lower the rate of interest and increase the availability of credit. Thomas Mun and his followers said that the rate of interest would be high or low depending upon industrial conditions of the country. Manley and Locke declared that the scarcity of money makes the rate of interest high while plenty of money makes it low. Most of the writers were against a high rate of interest. Davenant considered interest to be an unearned income. Further he told, "The users who are the true drones of a commonwealth living upon honey without of the labour, should be taxes."
7. **Wage and Rent-** The mercantilists were primarily preoccupied with the problem of production. They did not give much importance to the problems of distribution, especially those related to the payment of wage and rent. Petty said that the value of labour depended upon its product but as these

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ideas were not developed at all, they can only be treated as casual remarks. According to Cantilon, the value of labour equals that of material which is required for subsistence of labour. Thus, he gave the basis for the subsistence theory of wages.

8. **Taxation-** The mercantilists were in favour of the multiple tax system. Based on the basic principle, each should pay according to the benefits received from the state. Grotius and Pufendorf announced that man should be taxed in accordance with the benefits received in the form of protection. While Hobbes said that man should be taxed on expenditure incurred by him. Petty's views on taxation were most scientific. To use his words, "it is generally allowed by all that men should contribute to the public charge, but according to their share and interest that they have in public places, that is, according to their Estate and Riches." Some other mercantilists, who were directly employed by the state, also expressed their views on the subject. Generally the mercantilists favoured low custom excise duties, a tax on interest etc. Their chief canon of taxation was that of equality.
9. **Value-** Value was regarded as an intrinsic quality of commodity. It depends upon the utility of the commodity or it depends upon the satisfying power of human being. In the mercantilist literature, one comes across two types of value (1) intrinsic value (2) Extrinsic/ Market value. Intrinsic value depends on human needs and desires and the power of commodities to satisfy human wants and extrinsic value depends upon cost of production. Earlier writers regarded value as the intrinsic worth of commodity. They emphasised the subjective aspect called utility. The later writers regarded value as extrinsic, they called it artificial value or exchange value. Locke and Fortrey had drawn distinctions between natural value depending on cost and market value depending on demand and supply.

Decline of Mercantilism

Mercantilism declined in England and other parts of the world towards the end of eighteenth century. The following were the main reasons for the decline of mercantilism:

(i) Under the influence of the teachings of Adam Smith, the 'policy of plenty' began to replace the 'policy of power'.

(ii) The development of banking, both domestic and international, reduced the importance of bullion (gold and silver) and coins.

(iii) The expansion of market economy showed that real estates, factories and machinery were more important items of wealth than gold and silver.

(iv) The economic growth that took place during the Industrial Revolution made it possible for the society to rely on competitive forces and laissez faire and rather than promoting and regulating monopolies.

(v) The great progress made in science and technology taught people that a country could become richer not only by impoverishing its neighbours but

also by mastering the forces of Nature in a more efficient way. It was also found that the wealth of all nations could be increased simultaneously.

(vi) During the period of mercantilism, economic life was highly regulated. There were many regulations protecting the quality of goods. But these regulations which were once necessary ultimately became a barrier to progress so the regulations were withdrawn. But we should remember that the doctrines of mercantilism have not completely disappeared from the current scene. There are ideas and policies extant today that resemble the ideas of mercantilism.

Criticism of Mercantilism- Mercantilist theories and policies have been criticised by a host of writers. In fact, the decay of mercantilism began when some of the mercantilist writers who were more liberal in their views started decrying the policies adopted by Colbert in France and by the king of England. The storm of criticism against mercantilism was strong in France. The main causes of conflicts were (i) a miserable condition of agriculture, (ii) unfair taxes and (iii) a degenerated court. These causes led to violent protests against the policies of Colbert. William Petty, Locke and Dudley North were the main among these writers. William advocated freedom of trade; Locke put forward the advantages of individual liberty and challenged the basic assumptions of mercantilism. Dudley North stated that wealth did not consist of only gold and silver. He gave primary importance to domestic trade, agriculture and industry. He did not favour the granting of special privileges to any particular group of merchants. The decay of Mercantilism began around the end of 18th century when Adam Smith's book *The Wealth of Nations* was published.

It is claimed that mercantilism was not a scientific system of thought. The criticism against mercantilism and their policies were as under-

1. The Mercantilists are accused of a static approach in which the gain of one nation could be only at the loss of the other.
2. The mercantilists went wrong in supposing that a favourable balance of trade was the only source for bringing prosperity to the country.
3. They laid too much stress on gold and silver and neglected the importance of other commodities.
4. It is also claimed that the mercantilists were only resounding the aspirations of the rising merchant classes and the state power was advocated because it was both compatible with and essential for merchant power.
5. They overestimated the importance of commerce and underestimated the usefulness of agriculture and other branches of human industry.
6. Their ideas regarding 'value' and 'utility' were vague and abstruse.
7. Their ideas about capital and interest were imperfect.
8. They advocated lower wages because it was through lower wages that the cost of production could be kept low and exports could be made at high profits.

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9. The most misleading doctrine of mercantilism was the often repeated proposition that a country can get rich only at the expense of other countries.
10. They emphasised a large and dense population, abundance of money and foreign trade with a surplus balance.
11. The mercantilists regarded money and bullion as the sign of wealth. Adam Smith challenged the mercantilists. According to Smith, the wealth of nations can be increased by adopting the principle of "division of labour".

Mercantilist system has its own weakness. As an economic policy, it lacked universal application and as a body of doctrine, it could not provide proper guidance to the statesmen of the time. They confused the means and the end by over emphasising the importance of bullion as if it had such great magic power as to make it the only worthy end of national policy. They were in favour of increasing the total productivity of the nation; they regarded wealth and labour that produce it, as the ultimate goal of human existence.

While studying the ideas of mercantilism, one should therefore not overlook the circumstances and problems of their times. Like all other philosophies, mercantilism was essentially a product of its age. Mercantilists were under the circumstances, reasonably right in believing that money was needed for expanding commerce and trade. Being traders, they needed adequate funds for expanding trade and they emphasised on increasing the supply of money without caring much for inflation possibilities. Haney has remarked, "They are far from a mass of absurdities." Their emphasis on exports was mainly because of the fact that war was an everyday happening in that period and they considered self –sufficiency an urgent necessity for a country. To meet the requirement of the time, the balance of trade theory may be justified as a temporary measure, and not permanent national policy. Similarly their belief that the interests of the state and the individual were opposed to each other was necessarily moulded by their feeling that state should be absolute in all matters so that a country may gain in strength and compete with other countries without any obstructions created by individual interests. Thus mercantilism was a body of policies "designed by government, regulation of commerce and industry to secure a large net profit for the state as a profit in the shape of treasure."

Their loyalty to the state also flowed from trading interests and as commercial capitalism gradually gave place to industrial capitalism, theoretical argument and thinking shifted in favour of laissez-fair and free trade.

Mercantilists were not only practical administrators and traders, they also put forward such ideas which led to the development of various economic theories in modern times.

Important mercantilists- Mercantilists came from different walks of life. Thomas Mun was an English Merchant, J.B Colbert was a France Minister, Philipp Wilhelm Von Hornick was a Pamphleteer, Antonio Serra was an Italian. Antoine De Montchrestien was a manufacturer of hardware in France.

Check Your Progress

1. What was the commercial revolution spanning from the 16th to the 18th century marked by?
2. What was the development of mercantilism a consequence of?
3. List the means through which governments tried to encourage mercantilism.
4. What did the fast growing exchange and trade during the Middle Ages necessitate?
5. List two features of the economic doctrine of mercantilists.
6. Why did mercantilists favour a large and rapidly increasing population?
7. What do intrinsic and extrinsic value depend upon?

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2.3 THOMAS MUN

Sir Thomas Mun was an English merchant. He was born in England in 1571, he was the most prominent writers of his times and he served on the board of the East India Company. A merchant by profession, he was to a very great extent responsible for shaping the trade policies of England during his time. He has given systematic statement on mercantilists' principle in his book "England's Treasures by foreign trades". Thomas Mun was a prince among mercantilists. It has been rightly said by Alexander Grey that Mun has perhaps reached the closest to being the perfect mercantilist. He was an ardent advocate of the accumulation of treasure which would give the country enough strength to defend itself from foreign powers and also for averting a war. Further he said that accumulation of treasures could be possible only by reduction of imports and encouraging the exports. He suggested heavy import duties on the goods of domestic consumption and moderate duties on export goods.

In this book, he has clearly stated the theory of balance of trade. He stated the theory of balance of trade in the following words, "the ordinary means to increase our wealth and treasures is by foreign trades, wherein we must ever observe this rule: to sell more to strangers yearly than we consume of theirs values". Mun has suggested following methods by which a country would have favourable balance of trade-

1. He recommends the cultivation of waste lands. This step would help in reducing the imports of hemp, flax and tobacco.
2. He advised a frugal use of natural wealth so that more might be left for export.
3. He suggests that with regard to exports, "we must consider our neighbour's necessities." Not only that, promotion of exports requires that proper attention must be given to the price of commodities. If the goods are necessities and the foreign buyer cannot buy it from any

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other source, then they may be sold at a high price. As for other goods, it is better to sell as cheap as possible rather than close the market.

4. Mun suggests restraint on domestic consumption of foreign goods as it would also help in reducing in imports. Not only that, he advised people to refrain from unnecessary change of fashion.
5. Mun also suggests that, the value of a country's exports could be increased by confining them to her own ships. In other words, Mun was aware of the importance of the service, or invisible forms in the balance of trade. So he emphasised the earnings from shipping services. It must be noted that when Mun wrote his book, the Navigation Act of 1660, which restricted the use of foreign ships, had not been passed.
6. He said that the trade with distant countries should be considered more profitable than trade with nearer lands. Mun encouraged trade with far off countries.
7. He also suggests that England should be made a distributing centre so that it would help her to increase shipping, trade and the King's customs.
8. He also suggests that manufacturers of foreign material such as velvets and silk should be allowed to be exported free. This would provide employment and increase exports.
9. Mun also suggests that in certain cases they could allow the exports of money itself. His point of view is this: money begets trade. He argues that merely keeping the money in the country will not make a quick and ample trade.
10. Mun suggests that the fishing in the adjacent seas should be developed by the English people. In those days, fishing was the main industry of the Dutch. It was the "Golden mine" of the Dutch on which all their political and economic power was based.
11. In the last, he suggests that, "we must make efforts to make the most we can of our own."

Thomas Mun also suggested that England should engage in three cornered trade, that is, purchase goods from one foreign country and then sell them at profit to another. He also contributed to the theory of money and interest. In the opinion of Mun, money supply and trade and commerce go together. Mun did not favour the idea of accumulation of money to a limitless extent. He said that it would ultimately affect the balance of trade adversely. When large amounts of money are accumulated in the country, it results in an increase in prices and thus adversely affects the balance of trade. He also recognised the importance of taxation for the purpose of national defence.

Mun was in favour of industry and was against idleness and luxury. He praised the industrious Dutch and deplored the idleness of his countrymen who

spent most of their time in idleness and pleasure, smoking, drinking. Mun was also aware of the fact that money was only a means to an end and that it would not serve its purpose if enough goods and services were not available for buying. His question was, "what shall we do with our money?" .Thus, he was aware of the fact that money by itself was barren.

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Check Your Progress

8. List any two methods suggested by Mun through which a country would have favourable balance of trade.
9. What did Mun suggest with regard to manufacturers of foreign material?

2.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The commercial revolution spanning from the 16th to the 18th century was marked by expansion, increase in trading activity and the rise of mercantile culture.
2. The development of mercantilism was the consequence of the amalgamation of cultural, religious, political and economic factors.
3. Governments tried to encourage mercantilism through the following means:
   - Offered capital to new industries
   - Exempted new industries from guild rules and taxes
   - Established monopolies over local and colonial markets
   - Granted titles and pensions to successful producers
4. The fast growing exchange and trade necessitated the use of money which was made available in abundance in the form of gold and silver by the discovery of the new world.
5. The economic doctrine of mercantilists was characterised by the following features. In their policies-
   - Mercantilists gave importance only to nation advantages;
   - Mercantilists laid great emphasis on national policies for increasing stock of precious metals;
6. Mercantilists favoured a large and rapidly increasing population because they believed that an increasing population meant both an increase in potential number of soldiers and sailors and an increase in the number of productive workers.
7. Intrinsic value depends on human needs and desires and the power of commodities to satisfy human wants and extrinsic value depends upon cost of production.

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8. Mun has suggested following methods by which a country would have favourable balance of trade-
   (i) He recommends the cultivation of waste lands. This step would help in reducing the imports of hemp, flax and tobacco.
   (ii) He advised a frugal use of natural wealth so that more might be left for export.
9. He also suggests that manufacturers of foreign material such as velvets and silk should be allowed to be exported free. This would provide employment and increase exports.

2.5 SUMMARY

- The commercial revolution spanning from the 16th to the 18th century was marked by expansion, increase in trading activity and the rise of mercantile culture. There was also a spurt in the banking sector and rise in investment apart from the manufacturing sector.
- The development of mercantilism was the consequence of the amalgamation of cultural, religious, political and economic factors. In order to examine these causes, what may be highlighted is that at the start of the 16th century, Europe came across great religious and intellectual awakening because of Reformation and Protestantism.
- Mercantile activities first grew in the Scandinavian countries because of their powerful navy that could sail through the deep sea even across the Atlantic.
- Mercantilism is an economic strategy where a nation tries to accumulate as much money as possible and by whatever means necessary. It was thought that the richer the nation, the more powerful it was.
- Shipping was particularly significant during the mercantile period. With the increase of colonies and the shipment of gold from the New World into Spain and Portugal, the control of the oceans was thought to be crucially important to national power.
- The mercantilists thought that the wealth of the nation could be increased by trade and commerce. They gave importance to trade and commerce hence mercantilism is known as a commercial system.
- The fast growing exchange and trade necessitated the use of money which was made available in abundance in the form of gold and silver by the discovery of the new world. Inflation was the natural consequence. Rising prices hit the government and the labour classes hard.
- In the field of science and technology, great advancements and inventions were made which helped in strengthening mercantilist philosophy and policies. The discovery of mariner's compass and invention of printing were of far reaching importance.

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- The mercantilists paid a lot of attention to the accumulation of precious metals. It was felt that an adequate supply of gold and silver in the form of bullion was essential to the safety of a nation.
- In Mercantilism, the government allowed direct importation of foreign workers in order to establish new industries. It fixed prices and wages in order to encourage production. It passed navigation Acts to encourage shipping and the activities of the Navy.
- Among the mercantilist writers, there were two main streams of thought on the subject of interest- one justifying the charging of interest while the other opposing it. Thomas Mun was the leader of those who were in favour of interest taking. In his view, money lending provided capital to poor merchants. The mercantilists advocated a low rate of interest on economic grounds.
- Mercantilist system has its own weakness. As an economic policy, it lacked universal application and as a body of doctrine, it could not provide proper guidance to the statesmen of the time. They confused the means and the end by over emphasising the importance of bullion as if it had such great magic power as to make it the only worthy end of national policy.
- Mun suggests that with regard to exports, "we must consider our neighbour's necessities." Not only that, promotion of exports requires that proper attention must be given to the price of commodities.
- Mun was in favour of industry and was against idleness and luxury. He praised the industrious Dutch and deplored the idleness of his countrymen who spent most of their time in idleness and pleasure, smoking, drinking.

2.6 KEY WORDS

- **Humanism:** It is a philosophical stance that emphasizes the value and agency of human beings, individually and collectively.
- **Renaissance:** It refers to the revival of European art and literature under the influence of classical models in the 14th–16th centuries.
- **Structuralism:** It is a general theory of culture and methodology that implies that elements of human culture must be understood by way of their relationship to a broader system.
- **Reformation:** It was a major movement within Western Christianity in 16th-century Europe that posed a religious and political challenge to the Catholic Church and in particular to papal authority, arising from what were perceived to be errors, abuses, and discrepancies by the Catholic Church.
- **Feudalism:** It was a way of structuring society, in Medieval Europe between the 9th and 15th centuries, around relationships that were derived from the holding of land in exchange for service or labor.

- **Colbertism:** It is an economic and political doctrine of the 17th century, created by Jean-Baptiste Colbert, the Controller-General of Finances under Louis XIV of France. Which is sometimes seen as its synonym.

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2.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. List the concepts associated with mercantilism.
2. Write a short note on the challenge posed by industrial capitalism to mercantilism.
3. How were cultural factors responsible for the rise of mercantilism?
4. List any four reasons for the decline of mercantilism.
5. Why did mercantilists regard agriculture as insignificant?
6. Why did Mun not favour the idea of accumulation of money to a limitless extent?

Long-Answer Questions

1. Discuss any two factors of the growth of commercial activities in Europe.
2. Analyze the expansion of mercantilism and the related rivalries.
3. Describe the different names by which mercantilism was known in different countries.
4. Discuss the concept of balance of trade in mercantilism
5. Explain the reasons for the criticism of mercantilism.

2.8 FURTHER READINGS

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UNIT 3 PHYSIOCRACY

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Structure

3.0 Introduction
3.1 Objectives
3.2 Evolution of Physiocracy
3.2.1 Main Ideas and Theoretical Concepts of Physiocrats
3.3 Natural Order
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3.5 The Circulation of Wealth and Social Classes: Tableau Economique
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3.0 INTRODUCTION

Physiocracy is the collective name of those economic principles and policies which developed in France during the 18th century. The term physiocracy means 'Rule of Nature'. Economic thinkers who contributed to the growth and development of physiocracy have been designated as physiocrats. In other words, the physiocrats were a group of writers who developed a body of economic theory in France in the eighteenth century. Their publication covered the period from 1756 to 1778. Physiocrats have been regarded as ancestors of the 'French Revolution.' Physiocrats developed the doctrine that agriculture was the sole source of all wealth, the only productive occupation. Though the physiocrats wrote only for a relatively short period, their ideas had a profound influence on the economic thought. That is why they are regarded as the founders of the science of political economy. Physiocracy may be defined as a reaction against Mercantilism and its concepts.

3.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the evolution, main ideas and theoretical concepts of physiocracy
- Discuss the concepts of natural order, Tableau Economique, primacy of agriculture and taxation in physiocracy
- Describe the other important concepts, criticism and decay of physiocracy

3.2 EVOLUTION OF PHYSIOCRACY

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Physiocracy had its root in the then existing economic conditions of France which were mainly the result of mercantilist policy. There were many economic, political and social factors responsible for its origin. We enumerate these factors in brief in the following paragraphs-

1. Physiocracy was basically a revolt of the French against mercantilism. At that time, the condition of agriculture was miserable. There was need for an economic theory to prove that the pursuit of mercantilist policies was harmful to the progress and wealth of the nation. And the physiocrats provided the theoretical basis to attack mercantilism. The main objective of physiocrats was to recognise the French economy by means of tax reform and by promoting a system of efficient and large scale farming.
2. The policy followed during the supremacy of Louis XV and Louis XVI under the blind influence of the maxim 'I am state', led to steep deterioration of economic and social conditions in France. Corruption and degeneration of the court life was at its height. The king was interested in leading a luxurious life with its accompaniments of pomp, extravagance and debauchery. The finances of French Government were in bad shape. The unnecessary wars and the luxurious life at court made the government bankrupt and the government started borrowing loans under unfavourable conditions. Heavy taxes were imposed to replenish the treasury. Loans and taxes were two main sources of revenue of the state. The income from other sources was very meagre. Under the heavy weight of taxes, the trading communities had also suffered a great deal. Recurring and continuing wars added fuel to the fire. In 17th century, all these conditions provided ample reasons to the thinkers especially to Boisguilbert and Vauban who gave ideas which were quite new and which showed a ray of hope to people of France. Physiocracy was the direct outcome of the miserable conditions in France.
3. The tax system of France had seen the worst system of taxation in her economic history during the reigns of Louis XV and Louis XVI. The direct tax system was prevalent in those days in France. Taxes were regressive in character. The religious class and the nobles, who owned nearly two thirds of land, were exempted from paying taxes on their agricultural lands while the farmers had to pay heavy taxes. Since the clergymen and nobles were exempted from the tax, the burden fell upon peasants and artisans.
4. The worst of all taxes was a tax which was levied on salt. According to law, every person above the age of seven was required to purchase at least 7lbs of inferior quality salt yearly. This salt could be used only for eating purposes. Any person who used it for any other purpose was to pay heavy fine. At that time, taxes were imposed several times from the manufacturing stage

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to its final disposal to the consumers. These taxes increased the price of commodities. Again farmers were required to pay the charges for the use of roads and bridges. The tax collections were highly atrocious in their attitude towards peasants. The tortured life led by farmers gave further impetus to the physiocrat policies and doctrines.

5. The French peasants were exploited by the nobles and other wealthy classes by a number of methods. The landowners took a large share of the produce. The Government levied heavy taxes. The cultivators had to pay certain other duties which narrowed down the market for their produce. The markets for agricultural commodities were restricted because mercantilist policies were in favour of manufactured goods.
6. Mercantilist policies had outlived their importance. In England, agriculture was being revolutionised with the introduction of large scale farming and scientific techniques of production. So in France too attention was diverted to the strengthening of agriculture. Cantillon emphasised the importance of domestic trade and regarded landowners as the only independent producers. This led people in France to realise that trade and manufactures had been given too much importance at the cost of agriculture. These trends in the thinking of the people further shook the roots of mercantilism and enhanced the importance of agriculture.
7. Many subjective forces were also responsible for the change in the mercantilist policies. People would have started criticising these policies even during the reign of Louis XIV. Political Theorists started speculating more rational and simple laws which would be based upon principles of justice. The political and moral philosophers of those times underlined the importance of the individual in their discussion. They emphasised that man must be at the centre of philosophy and politics. The natural science made a great headway and a tendency to apply their methods of economic and social problem developed. The influence of England and English Thought, which was almost unknown to the people in France during the reign of Louis XIV were felt in later years to the extent that many books written by English authors were translated in French. Physiocracy was thus a cumulative result of all these factors.

3.2.1 Main Ideas and Theoretical Concepts of Physiocrats

In the publication of *Philosophie Rurale* by Quesnay and Mirabeau, the doctrines of the Physiocratic school were expounded in an elaborate manner. Dupont's *Physiocratie* published in 1767 and Turgot's *Reflexions* published in 1769 were the most influential and important. It was in these writings that the physiocrats enunciated and developed their doctrines. In its theoretical aspect, physiocracy contained the following ideas- the concept of natural order, concept of net product (primacy of agriculture) and the circulation of wealth (social classes and Tableau Economique).

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Check Your Progress

1. What was the main objective of physiocrats in France?
2. Why were the markets for agricultural commodities restricted?
3. Which ideas did physiocracy contain in its theoretical aspect?

3.3 NATURAL ORDER

The doctrine of the *law of nature* was first propounded by the Greek and Roman moralists and jurists. According to this doctrine, man was a living being, a member of universal human society, who was impelled by the impulse of self-preservation and produced those things which are provided by nature such as land, tree, forests etc. and which were necessary for physical existence. According to Roman jurists, man is free and equal in the natural stage. John Locke said "by the law of nature mankind are one community and make up one society."

The concept of natural order which was developed by physiocrats was quite different from that of the Greek and Roman jurists and philosophers of the past and physiocrats were not familiar with the modern revolutionary ideas. In fact, physiocracy has been described as 'the science of the natural order.' According to the physiocrats, the natural order is an ideal order given by God. Natural order was quite different from the positive order made by man. In other words, the society which was governed by the laws of nature was an ideal society and the society which was governed by positive laws made by government was an imperfect society. The natural order was quite evident to the intelligent people. The moral and religious philosophy of physiocrats was reflected in their concept of natural order. They believed in God. And they considered that the natural order is the work of God. According to Quesnay, "Natural order is merely the physical constitution which God himself has given the universe." They considered that only the natural order will increase happiness of mankind.

According to physiocrats, the human society was governed by two kinds of laws- natural laws and positive laws. Natural laws were those laws which guaranteed natural rights to man and were governed by human society in those days when there was no state or legislature. On the other hand, positive laws were the creation of man and they were obligatory simply because a penalty was attached to them. The positive laws were therefore strictly subordinate to the natural laws.

The term natural stands in contrast to a social order which might be the creation of man himself. However, the natural order is not equivalent to the state of nature. It includes the elements of a civil life. "Property, security and liberty constitutes the whole of the social order." The physiocrats were not against the progress of civilisation. They believed in the interdependence of all classes and of their final dependence upon nature.

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The natural order implied that only under conditions of freedom, man can enjoy the maximum happiness and derive maximum advantage in economic matters. It followed there should be minimum interference of government in economic affairs. It must confine itself to such things as protecting life and property. In other words they advocated laissez faire. According to physiocrats, the aim of all economic effort should be to secure the greatest amount of pleasure with the least possible outlay. When everyone does this, the natural order will be better assured instead of being endangered.

The interest of individual is best served in a free system and the interest of individual and the community were the same. The physiocrats believed that the individual interests were identical with the interests of the society and every man could be trusted to find out for himself the best way of attaining maximum advantage.

The physiocrats were opposed to almost all forms of government restrictions. They advocated laissez faire. It means freedom of business enterprise at home and free trade abroad. According to this doctrine, the only function of government is to protect life, liberty and property. So there will not be much work for government. Laissez faire does not mean that nothing will be done. There will be a lot of scope for individual effort. The only thing is that the functions of government will be reduced to the minimum. *In short, the natural order was the best and the most advantageous order for the physiocrats.*

Check Your Progress

4. What did the natural order imply?
5. What should be the aim of all economic effort according to the physiocrats?

3.4 PRIMACY OF AGRICULTURE

Mercantilists advocated that the source of wealth lay in foreign trade and that it consisted of precious metals. According to physiocrats, land occupied a predominant position as an agent of production. They thought that agriculture was supreme among all occupations. To them, the origin of all wealth lay in agriculture and this wealth consisted of real produce. According to physiocrats, agriculture produced much more than what was required to satisfy their needs. Whatever was produced in excess of the produce, required for the sustenance of the farmers, was used for meeting the needs of the persons engaged in commerce, industry and other professions. They introduced the idea of surplus resulting from the reward of nature which they called net product. In agriculture alone, the wealth produced was greater than wealth consumed. To them, commerce and industry are the branches of agriculture. Le Tronsne said, "labour applied anywhere except to land is absolutely sterile for man is not a creator."

Though the physiocrats described that industry, trade and professions were sterile, they never said that they were useless. By sterility they meant the incapacity

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to produce a surplus. In other words, industry was unproductive in the sense that it produced no extra wealth. Sterile class, to them, consisted of those who drew their incomes second hand or who exchanged or transferred value without the creation of any surplus. They simply reproduced the value consumed in the form of raw material and subsistence for workers. Consequently commerce, industry and foreign trade were sterile or unproductive.

They believed that the fruits of earth were given by God while the products of the arts were wrought by man who is powerless to create. In agriculture, nature cooperated with man and helped in the creation of a surplus, the net product. The physiocrats divided the society into three classes, namely, the proprietors, - to whom the land belongs and to whom the net product is paid; productive class, the farmers who cultivate the soil; and thirdly sterile or unproductive class. There is still another class, i.e. the wage earners who do not get a place in the physiocratic classification.

According to the physiocrats, the entire nation depends upon the farmer's capacity to invest a large capital and produce a large net product. The lower the capacity of the cultivators to invest capital, the smaller will be the size of net product, and the smaller the size of the net product, the greater will be the suffering of the nation. They advocated a light tax on agriculture. They also desired that the government should avoid such measurements which adversely affect the investment in agriculture.

It is clear from the above discussion that only labour engaged in agriculture operations is productive and the labour engaged in all other occupations is unproductive.

3.5 THE CIRCULATION OF WEALTH AND SOCIAL CLASSES: TABLEAU ECONOMIQUE

The physiocrats advanced their theory of circulation of wealth in society which is based upon the concept of net product. They were the first to attempt and analyse in a systematic way, the circulation of wealth in economy. The credit of putting the whole idea in a systematic and coherent form goes to Quesnay. Quesnay has studied Harvey's theory of blood circulation and extended this biological idea to the field of economics. By attempting an analysis' of this phenomenon, a synthesis of production and distribution was attained. This laid the foundations for a number of future fields of study in economies. The ideas regarding the circulation flow of wealth have been given by Quesnay in 1758 in the form of table called the Tableau Economique. The Tableau Economique is a graphical representation of the way in which the circulation of wealth takes place.

In the words of Mirabeau, "There have been, since the world began, three great inventions which have principally given stability to political societies, independent of many other inventions which have enriched and adorned them. The first is the invention of writing, which alone gives human nature the power of

transmitting without alteration, its laws, its contracts, its annals and its discoveries. The second is the invention of money, which binds together all the relations between civilized societies. The third is the economical table, the result of other two, which completes them both by perfecting their object; the great discovery of our age but of which our prosperity will reap the benefit." The circulation of wealth, represented by Quesnay, has been compared with the revolution which has been caused in biology by the discovery of the circulation of the blood.

Social Classes

To illustrate the economic table, Quesnay has divided the society into the following three classes-

- **The Productive class-** Productive class consists of the cultivators of soil. They extract wealth from the soil and pay rent to the landlords who pay the expenses of cultivation or make annual advances to cultivators for seeds, subsistence of farmers and their families, maintenance of livestock and implements
- **The Proprietary class**-The class of proprietors includes the owners of the land (landlords), the king, his councillors, the nobility and clergy.
- **The Sterile class**- This class consisted all those engaged in non-agricultural occupations. Merchants, artisans, craftsman, manufacturers, shopkeepers, domestic servants and other professionals formed this class.

Of the above three classes, farmers belong to the productive class because soil is the only source of wealth. After classifying the society into the above three classes, Quesnay traced the circulation of wealth (income) among the three classes of society in the following manner:

The general idea conveyed by the table is that the proprietors of the land contribute to production by expenses on improvement of land and by advances to maintain the cultivators. The cultivators, in turn, are able to procure surplus over and above all these expenses. This is the net product which goes to the landowners by way of rent. Out of these receipts, the landowners may and should make fresh annual advances to the cultivators which will enable them to produce a similar net product next year also. It is obvious that if the landowners fail to return these annual advances, agricultural production will fail and there will be reduction in the rent income also. The landowners divide their rent income by spending it on industrial goods and agricultural products (for food). The industry similarly divides its expenditure on food and raw material from agriculture and upon expenditure within the industrial sector. Agriculture sector provides food to the landowners and raw material to the industry and obtains finished industrial goods from industry. In this way, year after year, the circular flow is maintained. We can explain this flow of wealth with the help of the following example:

All wealth is produced by the productive class (the farmers). Let us suppose the value of the total produce in any year is equal to 10 million francs. Of this, the

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agricultural class (farmers) require four million francs for their maintenance. These 4 million francs do not circulate. The remaining produce of worth 6 million francs is distributed in the following manner:

Since the productive class requires manufactures, it buys them from the sterile class for 2 million francs. The remaining 4 million francs pass into the hands of landowners and the government in the form of rent and taxes. The proprietary class lives on these 4 million. It spends 2 million on food and other 2 million on manufacture. According to the physiocrats, the sterile class produced nothing but still received 4 million francs (two million from productive class and two million from proprietary class). The sterile class uses the four million francs for buying necessaries of life and the raw materials of industries from the productive class. Thus, the 4 million francs which come into the hand of the sterile class return to their starting point, the agriculturists. Thus the original 10 million francs replaced in the hand of the productive class. The cycle is complete. And the process goes on indefinitely. Thus, agriculture forms the basis of social life. And it is clear that the prosperity of the entire nation depends upon agriculture whose prosperity should be promoted under the following conditions:

- Freedom of cultivation means that agriculture should be free from all sorts of impositions.
- Uninterrupted and unrestricted circulation of commodities, agricultural as well as manufactured throughout the nation.
- Freedom of foreign trade.

Quesnay's Economic Table is regarded as a pioneering attempt at 'National Income Analysis' and 'mathematical economics'. Leontief, who has developed the famous input-output analysis, has adopted the same principle of Quesnay's economic table. It may be interesting to note here that Karl Marx was the only first rank economist of the 19th century who recognised the merit of Quesnay as an economist. In fact in a general way, Quesnay's net product is similar to that of Marx's surplus value. Schumpeter has made this point clearly in the following words, "Exactly as Quesnay let land alone be productive of surplus value so Marx let labour alone is productive of surplus value."

Check Your Progress

6. What is the Tableau Economique?
7. Who does the class of proprietors include?
8. What is the general idea conveyed by the Tableau Economique?

3.6 TAXATION

The physiocratic theory of taxation is bound up with the theory of the net product. According to them, national income was shared by the producer, the proprietors

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and the artisans. But the sovereign is the fourth sharer of the national income. They believed that only the output of land provided a surplus. So they argued that taxes should be paid from the net product, for it was surplus. And they said that landed proprietors must bear the burden of taxation because the product goes to them. They said that one-third of the net product was to be paid by the proprietors in the form of taxes.

Taxes were required for meeting the expenses of the state. The physiocrats argued that taxes must be paid liberally to the sovereign. They recognised that the sovereign was a co-proprietor of land not only because of the age old tradition but also due to the fact that the state really contributed to the advances made by the proprietors in originally preparing the land for the cultivation , in maintaining and improving its fertility. It does this through the construction and maintenance of roads, bridges, canals and other public works essential to the prosperity of agriculture. Thus the landed proprietors and the king belonged to the class of landowners with similar rights and duties and share in the revenue.

The physiocrats advocated a single tax on the net product from the land. While anticipating all possible objections which could be levelled against a single tax on land, they tried to provide an explanation for each one of them. Regarding the objection that to make one single class to bear the burden of taxation was not just, and the burden of tax should be equally distributed among all classes, they said that statesman's ideal was not equal taxation, but the complete abolition of all taxation, which could only be achieved by taxing the net product. The greatest advantage of a single tax on land as suggested by the physiocrats was that it was not arbitrary. It was regulated by a natural form.

These ideas of physiocrats had a great hand in the French Revolution. The distrust of indirect taxes is the direct result of their system. Their theory of taxation is regarded as excellent demonstration of the superiority of directs taxation over indirect taxation. The most interesting thing in the entire discussion was that they wanted the state to adjust its needs according to its revenue.

3.7 OTHER IMPORTANT CONCEPTS OF PHYSIOCRACY

Now we will discuss some other important concepts of physiocracy.

1. **Functions of the state**- In the 'natural order' of physiocrats, the functions of the state would be reduced to the minimum. There would be very little legislation. From their writings, it can very well be inferred that they wished to reduce legislation to the barest minimum-abolition of useless laws and promulgation of laws which were essential for the preservation of the natural order. According to Quesnay, "Government should be centralised in a single person, who however should be guided by the laws of nature. They wanted every law to be an expression of that Divine wisdom which rules the universe,

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and therefore the state was to be the 'law giver' not the 'law maker'. Thus they wanted to see the maximum authority with minimum legislative activity. According to Thomas Aquinas, "All those things that behave according to nature are best, for in everything nature operates for what is best. Now every natural government is performed by one only." He further said that as government by one ruler is best, so is government by a tyrant the worst. They said that the chief of the state should be protective sovereign and not a tyrant. They believed that the government run by many persons leads to discord and commotion. They were not in a favour of democratic government. Similarly, they did not support a parliamentary form of government. "Their ideal was neither democratic self-government… nor parliamentary regimes both were detested." And a government of third type of traders, artisans, manufacturers and merchants also did not suit them. The best form of the government which they advocated was single authority, vested with sovereign powers, but acting in conformity with the laws of nature and deriving the positive laws from these natural laws.

The physiocrats were in favour of a national assembly but without any legislative power. The national assembly would be just a council of state whose main concern would be to look after the public works and to apportion the burden of taxation. According to physiocrats, the main function of the state was to do all that was necessary for the preservation of the natural order and to protect the private property. The second important function of the state was that of imparting instruction and educating public opinion. The third and most important function of the state was construction and maintenance of public works.

2. **Trade-** Physiocrats regarded that all kind of exchange was unproductive. According to them, exchange implied only a transfer of commodity which was equal to value. Thus, it is not a means of increasing wealth for one gives as much as other receives but it is a means of satisfying wants. Accordingly, industry and commerce were considered unproductive. The mercantilists thought that foreign trade is the only means of increasing the wealth of nation. But the physiocrats thought that foreign trade produced no real wealth. To them foreign trade was also held unproductive. But the physiocrats were not entirely against foreign trade, they said that a country should exchange with other countries those goods which it cannot produce and those are in excess of its own consumption.

   The physiocrats attacked mercantilism which aimed at a favourable balance of trade. But they favoured free trade. They believed that laissez faire would lead to the disappearance of commerce altogether. The freedom of trade, which they advocated, was quite in conformity with their concept of the natural order. The natural order implied that each one would have the freedom of buying and selling wherever and whenever he chose. Free trade implied the total abolition of all those measures which the mercantilists had

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suggested and which aimed at restricting the exports of commodities to foreign countries and checking the free exchange of commodities. Their concept of free trade led to the theory of free trade enunciated by Walras. The physiocrats believed that free competition with foreign merchants alone could secure the best possible price, and only the highest price would enable them to increase their stock of wealth and to maintain their population by agriculture. So the physiocrats must be regarded as the founders of free trade. Their concept of free trade was a reaction to the policy of restricted trade as practised and advocated by the mercantilists.

3. **Interest-** The physiocrats allowed interest on the loans which were taken for agricultural purposes, because such loans were productive. They were not in favour to allow any freedom to the money lenders. They wanted the rate of interest to be fixed by the government.
4. **Population-** On the subject of population, the physiocrats said that the multiplication of men was a natural corollary to the natural order. Some physiocrats were optimistic and favoured the enlargement of population. But some of them were afraid of over-population. Riviere said that -"As it is in the physical order that men thus united in society multiply promptly, by a natural and necessary parallel to that multiplication they are reduced to lack the means of subsistence if they do not, at the same time, multiply those means of cultivation"
5. **Value-** Condillac was the only physiocrat who regarded value as the foundation of the science of economics. He emphasised that value was based upon utility. According to him, "value is not an attribute of matter, but it represents our sense of its usefulness, and this utility is relative to our need. It increases or decreases according to expansion and contraction of our needs. Thus Condillac has laid the foundation of the phychological theory of value. He was also aware of the fact that value increases with scarcity and reduces with abundance.
6. **Wage-** The views of Condillac were far more advanced regarding wages as compared to other physiocrats. The physiocrats believed in the Iron Law of Wages. For instance, Turgot said that the wage of workers is only equal to what is necessary for his subsistence. Condillac did not refer to an 'Iron Law of wage' But according to Condillac, "wage represent the share of the product which is due to the workers as co-partners." He believed that wares were determined by the force of demand and supply.

Criticism and Decay of Physiocracy

Physiocracy was basically a revolt of the French against mercantilism. Physiocrats had their own weaknesses.

- Their views on interest, value and wages was not clear.
- Physiocrats recognised absolute royal authority as the best form of government and advocated the total exclusion of the three classes of society-

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nobility, merchants and manufacturers, peasantry and the labouring population –from participation in political matters; while on the other hand they were ardent advocated individual liberty.

- They were wrong in considering agriculture alone as the productive occupation because commerce and industry are equally important and productive as agriculture.
- They regarded manufacture and exchange as unproductive although they are created from utility, which is one form of production.
- The physiocrats did not have a correct notion of production. According to modern economists, production meant the creation of utilities. But physiocrats did not understand this simple truth. According to them, creation of new commodities is production.
- They believed in individual freedom. They did not want restriction of any type in the life of individuals.
- They made important contributions to the theory of taxation. They advocated direct taxes rather than indirect taxes which affected the poorer people of the French society of their time badly.
- The physiocrats advocated complete freedom of trade and industry. But absolute freedom of trade and industry are not advisable. If we follow the laissez –faire doctrine, there will be little scope for social action.
- The aim of physiocrats was to develop agriculture. They regarded land as the only source of wealth. For them land alone yielded a surplus. It followed that the land owner alone should bear the burden of taxation.
- They extolled unrestricted competition in all commercial dealing and exchanges, and at the same time they refused liberty to money lending and advocated governmental regulation of the rate of interest.
- They regarded commerce as necessary and beneficial and, at the same time, as a financial burden upon the people.
- The weakest point of the physiocratic system was its theory of distribution. According to them, rent is free gift of nature. But Ricardo has pointed out that rent arises not because nature is generous but because it is niggardly.

The Italian writer Galiani attacked the idea of natural order while Condillac refused the idea that manufactures are sterile. There were many influences that worked against it. Their views on monarchy and despotism were not popular. There principles did not appeal to many a thinking people. The commercial and manufacturing classes were their vehement critics.

Contributions of Physiocrats

The physiocrats have made theoretical and practical contributions in the economic theory. The following are contributions to economic theory made by the physiocrats-

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- The idea that every social phenomenon is subject to law and that the object of scientific study is to discover such law.
- Economic development was a major concern of the physiocrats. They realised the importance of agriculture in securing a surplus for capital formation. Therefore, they emphasised the need for transferring traditional agriculture into the large scale agriculture based upon technologically advanced methods.
- The idea that personal interest, if left to itself, will discover what is most advantageous for it, and that what is best for the individual is also best for everybody. But this liberal doctrine had many advocates before the physiocrats.
- The concept of free competition, resulting in the establishment of 'bon prix', which is the most advantageous price for both parties, and implies the extinction of all usurious profits.
- The physiocrats had realised the interdependence of different classes in the economy. Quesnay described the circulation of wealth among different classes which have been a model for the modern input-output analysis of Leontief and general equilibrium analysis of Walras.
- An imperfect but searching analysis of production, and of the various division of capital. An excellent classification of incomes and of the laws of their distribution.
- The physiocrats were the first who analysed capita and realised the importance of capital formation in economic development.
- A number of arguments which have long since become classic in favour of landed property.
  - Ø The freedom of labour,
  - Ø Free trade within a country and an impassionate appeal for the freedom of foreign trade;
  - Ø Limitation of the functions of the State;
  - Ø A first-class demonstration of the superiority of direct taxation over indirect.
- They put economics on a scientific basis by applying scientific methods and by separating it from other sciences, notably jurisprudence;
- Their emphasis on the surplus or net product was notable, especially in connection with the later development of the rent concept;
- They argued for capital formation through reduced consumption by the wealthy.
- They made important contributions to the theory of taxation;

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- Their thought shows much progress towards a true social point of view, in that they saw, at least in an abstract way, the interdependence of individuals, and centered attention on producing and circulating the necessities of life;
- Their emphasis on land was influential, for weal or woe, in bringing about the later threefold classification of the factors of production.

Table 3.1 *Difference between Mercantilism and Physiocracy*

	Mercantilism	Physiocracy
1	Mercantilists regarded money and bullion as the sign of wealth. They believed that Gold, silver and valuable metals are the source of prosperity and power	Physiocrats believed that natural resources and production power are real wealth.
2	According to Mercantilists, trade is the most productive occupation. They wanted expansion of foreign trade. They aimed at maximising exports and minimising imports.	According to Physiocrats, agriculture is the most productive occupation. The physiocrats regarded foreign trade as evil. They wanted to reduce foreign trade.
3	The mercantilists thought that foreign trade is the only means of increasing the wealth of a nation. According to them, only raw materials should be imported and finished commodities should be exported.	But the physiocrats thought that foreign trade produced no real wealth. Physiocrats said that a country should exchange with other countries those goods which it cannot produce and those that are in excess of its own consumption.
4	The mercantilists were in favour of balance of trade. Therefore, they suggested that import should be lesser than exports.	To physiocrats, foreign trade was unproductive. They said that the balance of trade in not always possible.
5	The mercantilists believed in regulation of trade and industry.	The physiocrats advocated freedom of trade and industry. They did not want any type of state intervention in foreign trade.
6	According to mercantilists, agriculture is unproductive and only trade is productive.	Physiocrats believed that agriculture is productive and trade and commerce are sterile.
7	The mercantilists were in favour in multi tax system.	The physiocrats advocated a single tax on the net product from the land.
8	The mercantilists allowed interest on capital .	The physiocrats allowed interest on the loans which were taken for agricultural purposes, because such loans were productive.

Despite the criticism, physiocrats occupy an important place in the history of economic thought. In spite of their short span of existence, their overall influence was far reaching. In the words of Alexander Gray, "Even an admirer of Smith may have no scruples in finding in the physiocratic group the real beginnings of modern economics." in the field of taxation by advocating a single tax on land, they laid bare principles of shifting and incidence of taxation. Schumpeter said " it was however the physiocrats who made the great branch through which lay all further progress in the field of analysis by the discovery and intellectual formulation of the circular flow of economic life"

Check Your Progress

9. What did free trade imply for the physiocrats?
10. Why should physiocrats be regarded as the founders of free trade?
11. What did the physiocrats advocate regarding the political participation of the three social classes?
12. What was weakest point of the physiocratic system?

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3.8 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The main objective of physiocrats was to recognise the French economy by means of tax reform and by promoting a system of efficient and large scale farming.
2. The markets for agricultural commodities were restricted because mercantilist policies were in favour of manufactured goods.
3. In its theoretical aspect, physiocracy contained the following ideas- the concept of natural order, concept of net product (primacy of agriculture) and the circulation of wealth (social classes and Tableau Economique).
4. The natural order implied that only under conditions of freedom, man can enjoy the maximum happiness and derive maximum advantage in economic matters.
5. According to physiocrats, the aim of all economic effort should be to secure the greatest amount of pleasure with the least possible outlay.
6. The Tableau Economique is a graphical representation of the way in which the circulation of wealth takes place.
7. The class of proprietors includes the owners of the land (landlords), the king, his councillors, the nobility and clergy.
8. The general idea conveyed by the table is that the proprietors of the land contribute to production by expenses on improvement of land and by advances to maintain the cultivators.
9. Free trade implied the total abolition of all those measures which the mercantilists had suggested and which aimed at restricting the exports of commodities to foreign countries and checking the free exchange of commodities.
10. The physiocrats believed that free competition with foreign merchants alone could secure the best possible price, and only the highest price would enable them to increase their stock of wealth and to maintain their population by agriculture. So the physiocrats must be regarded as the founders of free trade.

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11. The physiocrats advocated the total exclusion of the three classes of society-nobility, merchants and manufacturers, peasantry and the labouring population –from participation in political matters; while on the other hand they were ardent advocated individual liberty.
12. The weakest point of the physiocratic system was its theory of distribution.

3.9 SUMMARY

- Physiocracy had its root in the then existing economic conditions of France which were mainly the result of mercantilist policy. There were many economic, political and social factors responsible for its origin.
- The policy followed during the supremacy of Louis XV and Louis XVI under the blind influence of the maxim 'I am state', led to steep deterioration of economic and social conditions in France. Corruption and degeneration of the court life was at its height.
- Mercantilist policies had outlived their importance. In England, agriculture was being revolutionised with the introduction of large scale farming and scientific techniques of production. So in France too attention was diverted to the strengthening of agriculture.
- In the publication of *Philosophie Rurale* by Quesnay and Mirabeau, the doctrines of the school were expounded in the system in an elaborate manner. Dupont's *Physiocratie* published in 1767 and Turgot's *Reflexions* published in 1769 were the most influential and important.
- According to the physiocrats, the natural order is an ideal order given by God. Natural order was quite different from the positive order made by man. In other words, the society which was governed by the laws of nature was an ideal society and the society which was governed by positive laws made by government was an imperfect society.
- The physiocrats were opposed to almost all forms of government restrictions. They advocated laissez faire. It means freedom of business enterprise at home and free trade abroad. According to this doctrine, the only function of government is to protect life, liberty and property.
- According to physiocrats, land occupied a predominant position as an agent of production. They thought that agriculture was supreme among all occupations. To them, the origin of all wealth lay in agriculture and this wealth consisted of real produce.
- The ideas regarding the circulation flow of wealth have been given by Quesnay in 1758 in the form of table called the Tableau Economique. The Tableau Economique is a graphical representation of the way in which the circulation of wealth takes place.

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- The general idea conveyed by the table is that the proprietors of the land contribute to production by expenses on improvement of land and by advances to maintain the cultivators. The cultivators, in turn, are able to procure surplus over and above all these expenses.
- The physiocratic theory of taxation is bound up with the theory of the net product. According to them, national income was shared by the producer, the proprietors and the artisans. But the sovereign is the fourth sharer of the national income.
- In the 'natural order' of physiocrats, the functions of the state would be reduced to the minimum. There would be very little legislation.
- The physiocrats were in favour of a national assembly but without any legislative power. The national assembly would be just a council of state whose main concern would be to look after the public works and to apportion the burden of taxation.
- The physiocrats allowed interest on the loans which were taken for agricultural purposes, because such loans were productive. They were not in favour to allow any freedom to the money lenders.
- The physiocrats believed in the Iron Law of Wages. For instance, Turgot said that the wage of workers is only equal to what is necessary for his subsistence.
- The physiocrats advocated complete freedom of trade and industry. But absolute freedom of trade and industry are not advisable. If we follow the laissez –faire doctrine, there will be little scope for social action.
- The physiocrats had realised the interdependence of different classes in the economy. Quesnay described the circulation of wealth among different classes which have been a model for the modern input-output analysis of Leontief and general equilibrium analysis of Walras.

3.10 KEY WORDS

- **Physiocracy:** It is an economic theory developed by a group of 18th-century Age of Enlightenment French economists who believed that the wealth of nations derived solely from the value of "land agriculture" or "land development" and that agricultural products should be highly priced.
- **Mathematical Economics:** It is a model of economics that utilizes math principles and methods to create economic theories and to investigate economic quandaries.
- **Laissez faire:** It is an economic system in which transactions between private groups of people are free from or almost free from any form of economic interventionism such as regulation and subsidies.
- **Natural Order:** It encompasses the natural relations of beings to one another in the absence of law, which natural law attempts to reinforce.

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- **Despotism:** It is a form of government in which a single entity rules with absolute power.
- **Monarchy:** It is a form of government in which a person, the monarch, is head of state for life or until abdication.

3.11 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the French tax system during the seventeenth century.
2. What did the doctrine of the *law of nature* state?
3. In which three classes did physiocrats divide society?
4. Under what conditions should the prosperity of agriculture be promoted?
5. What were the three important functions of the State, according to physiocrats?

Long-Answer Questions

1. Discuss the reasons for steep deterioration of economic and social conditions in France during the reign of Louis XV and XVI.
2. Analyze the concept of the natural order.
3. Elaborate upon the primacy of agriculture in physiocracy.
4. Discuss the three classes of society as given by Quesnay.
5. Explain the views of Condillac on 'value' and 'wages'.
6. Describe the differences between mercantilism and physiocracy.

3.12 FURTHER READINGS

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UNIT 4 CLASSICAL SCHOOL-I

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Structure

4.0 Introduction
4.1 Objectives
4.2 Adam Smith
4.3 T.R. Malthus
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4.0 INTRODUCTION

The Classical school of economic thought flourished sometime around the late eighteenth century with Britain as the centre. Its main thinkers and contributors are Alfred Marshall, J.B. Say, Adam Smith, David Ricardo, John Stuart Mill and Malthus. These eminent thinkers basically advocated that the market systems were primarily self-regulating systems and that freedom of the market was essential with minimum intervention by the state. They came up with important theories regarding markets, exchange and the creation of wealth in societies that culminated in the developments of the discipline of economics. In this unit, an analysis of the theories formulated by the aforementioned economists has been undertaken.

4.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss Adam Smith's significant theories and contributions to the field of economics
- Examine Malthus' Theory of Population and Market Gluts
- Describe Ricardo' theory of value and distribution in addition to Mill's theory on Utilitarianism and J. B. Say's Law of Markets

4.2 ADAM SMITH

Adam Smith is the founder of the classical school. He has been described as the "father of political economy". His work "*Wealth of Nations*" is generally regarded

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as the starting point of classical school. Thomas Robert Malthus, David Ricardo, J.S. Mill and J.B. Say are the leading economists of the classical school.

Adam Smith was born in Kircaldy, Scotland on 5th June, 1723. He studied at Glasgow University under Hutcheson from 1737 to 1740. And from 1740 to 1746, he continued his study at Oxford University. For three years he delivered free lectures on English and political economy at the University of Edinburgh. In 1751, he became Professor of Logic and then of Moral Philosophy at Glasgow University. After teaching for more than a decade, he became a private tutor to the Duke of Buccleuch. He travelled for two years on the continent. During the 10 months he spent in Paris, he came into contact with thinkers and statesmen of the status of Quesnay, Dupont and Turgot. In 1778, Smith was appointed as commissioner of customs in Edinburgh and remained on this post until his death in 1790.

In 1751, Adam Smith was appointed on the chair of Moral Philosophy. In 1759, Smith published his *Theory of Moral Sentiments*. In 1776, he published his *Wealth of Nations* (*An Inquiry into the Nature and Causes of the Wealth of Nations*). Adam Smith's *Wealth of Nations* was a challenge to mercantilism. Smith was the first economist to deal with economic problems in a systematic manner.

Adam Smith, first of all, emphasises the importance of labour as the source of wealth of a nation. According to him, the wealth of a nation can be increased by adopting the principle of 'division of labour' and division of labour is limited by the size of the market. The size of the market depends upon the volume of international trade. Division of labour necessitates exchange. This leads on to a discussion of the means of exchange and value. After discussing the problem of value and price in his book, Adam Smith discusses the problem of wage, profit and rent. In the last section of his book, he discusses the problem of public finance.

Influences that Shaped Smith's Thought-There are many influences that had an impact on Smith's economic-cum-philosophical thought. We may summarise these influences as –

I. **Mercantilism and Physiocracy**- According to Haney, Adam Smith built upon the work of his predecessors. He stated, "Adam Smith was acquainted with the writing of mercantilists, and the physiocrats; and he stood upon their shoulders,"

- **Mercantilism**- Smith's *Wealth of Nations* is a ringing challenge to mercantilism. Smith's theories evolve as a criticism of mercantilists' basic theories i.e. wealth as treasure, foreign trade and favourable balance.
- **Physiocrats**- The impact of the physiocratic economic doctrine on Smith is not so easy to establish. Much can be said for and against the physiocratic influence on Smith. It is pointed out that the physiocratic thought did shape Smith's views. During the 10 months he spent in Paris, he came in contact with thinkers and statesmen of the status of Quesnay, Dupont and Turgot. Smith had frequent meetings with Turgot, and had discussions on economic questions because at that time Turgot was preparing his *Reflexions*, which

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was published only three years later. Smith was certainly acquainted with the writings of the physiocratic thoughts and with many of its leaders. In fact, Smith had many views which were similar to those of the physiocrats. Smith's thoughts run parallel to those of the physiocrats as regards natural laws, beneficent providence, laissez-faire, self-interest and problem of surplus. These fundamental conceptions formed the ground work of the political economy of smith and the physiocrats. In conclusion it can be said that physiocracy in general was not much different from Smith's views. It is because physiocrats and Smith worked in essential similar political and economic climate.

II. **The Founder of Political Economy**- The founders of political economy include all those thinkers- mainly English and French- who prepared the ground for all classical systems. Adam Smith is acknowledged as the founder of classical political economy-classical economics. Thus we have to distinguish between the founder of political economy-Petty and classical economists Smith, Ricardo and others.

In the theory of money, Smith stands grateful to Hume, Locke and Stuart. Smith's historical interests were inspired by Stuart. Smith took over the problems of public finance and some of the solutions from Petty and Stuart. Cantillon's Essay is most systematic statement of economic principles before the appearance of the *Wealth of Nations.* Petty had stated the central problem of value. Petty, Stuart and Cantillon, in particular, may be regarded as Smith's predecessors. The effects of physiocrats on the development of economic thought were very similar to those of English economists. Eric Roll states, "The two contributors are united a single system in Adam Smith."

III. **Smith's Immediate Predecessors**- Hutcheson, Hume, Tucker and Ferguson were the chief predecessors of Smith. Smith's emphasis on self-interest and the related tendencies in his thought stimulated by the spirit of Mandeville's well known *Fable of the Bees*. Smith states that ordinarily the "natural" action of private self-interest leads to the most perfect organisation of social and economic relations and to the greatest welfare of all. Mandeville also clearly expressed the concept of division of labour. And he was perhaps the first to employ the word "divided" and "division" in relation to division of labour.

Francis Hutcheson was one of Smith's teachers at Glasgow University and had a deeper influence on Smith. Smith may well have got from Hutcheson some purely economic ideas i.e. ideas on division of labour, value, money and taxation. Hutcheson distinguished utility from value, stating that natural basis of all value or price is some of sort of use. According to him, wealth is differentiated from utility by labour. When labour is added to utility, we get value. Hutcheson was an ardent advocate of religious, political and economic liberty. To him may be traced Smith's theory of morals, sentiments, and ideas on the subject of values, interest and money. Adam Smith derived his faith in the natural order from Hutcheson.

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Josiah Tucker was another writer who influenced Smith. Tucker wrote several essays on subjects relating to commerce and taxation. He also emphasised the significance of labour. Tucker believed in a large population and suggested a tax on celibacy. He held that self-interest, if given free play, would be beneficent for the society. It may, thus, be inferred that Smith drew freely upon his views for his *Wealth of Nations*. Ferguson, a contemporary and friend of Smith, might have also influenced Smith on the subject of taxation. His maxims of taxation were not the same, but they must have influenced Smith's canon of taxation.

IV. **Environmental influence**: The last quarter of the eighteenth century, in particular, is full of events that mark the beginning of a new era in economic and political organisation. These events include the beginning of the Industrial Revolution which meant expansion of industrial capitalism, partnership between the leaders of industry and the scientists, the struggle for independence and the American Declaration of Independence that weakened the old colonial system.

In the field of politics, the ideas of liberalism were gaining ground in England long before the French Revolution. Economic theory had also acquired a new content and new method, much earlier than Adam Smith appeared on the scene. In fact, the fifty years around the end of the eighteenth century marked great social changes – new form of production, of social relations, of government and of social thought making spectacular progress. Thus, the environmental forces came to play a significance role and all this influenced the smith's thought.

V. **The Role of Travels and clubs-**At the age of fourteen, Smith went to Glasgow, where the philosopher Hutcheson deeply affected him. At Glasgow, Smith discussed the effects of bounty on the exports of corn, talking to merchants and convincing many of the advantages of free trade. Smith then went to Oxford on scholarship and he studied classics there. In about 1764, he travelled to Switzerland and France, where he had a chance to meet Quesnay and Turgot. Discussion with Turgot on economic topics influenced both (Smith and Turgot).

The clubs and associations had their influence on Smith. Smith joined the club at Glasgow and Edinburgh. It was common for intellectuals to meet at clubs in the eighteenth century to discuss fine art and trade. The questions of economic importance were generally discussed at the clubs.

Smith's Economic Ideas

Smith's thought is mainly embodied in his creation *Wealth of Nations.* The basics of his economic thoughts are summarised thus:

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Significance of labour- According to mercantilists, the main source of wealth was trade. For the physiocrats, land (the bounty of nature) holds the central place. According to them, it was only land that was productive. The mercantilists like Petty considered labour as the father and active principle of wealth while land was considered the mother.

In the starting of his book, Smith accepted the importance of labour and said that labour is the source of whole wealth. This thought of Smith is the basis of *Wealth of Nations*. The First paragraph of the *Wealth of Nations* is starts with "The annual labour of every nation is the fund which originally supplies it with all the necessaries and conveniences of life which it annually consumes and which consists either in the immediate produce of that labour, or in what is purchased with that produce from other nations." He did not undermine the importance of the role played by nature in production. He simply meant that while physical environment is unchangeable, labour is variable, and that the wealth of nations varies with the variation in the labour factor. Smith regarded the labour as the exclusive force upon which the wealth of nation depends.

Smith makes labour the cause and also the measure of value. Smith lays emphasis on labour as "productive labour'. According to Smith, productivity included any addition to exchange value i.e. productivity of labour was the value which it added to the materials on which it worked. There is an important point to be noted here. All exchange value was not considered. The exchange value in relation to vendible commodities was considered. The unskilled servants, public officials and professional men were taken to be unproductive.

Division of labour- Smith is not the originator of the idea of division of labour- the traces of it have been found from the Greeks. The emphasis which Smith laid on the labour factor was mainly a reaction against the physiocratic doctrine. According to Smith, "the greatest improvement in the productive powers of labour, and the greater part of the skill, dexterity and judgement with which it is anywhere directed or applied, seems to have the effects of the division of labour." Under the head of division of labour, Smith dealt with the different aspects of the separation of different trades and employment.

Division of labour refers to the specialisation of labour in different industries or different processes within the same industry. Adam Smith has illustrated division of labour with the help of pin-making industry. "one man draws out the wire; another straightens it; a third cuts it; a fourth points it; a fifth grinds it at the top of receiving the head; to make the head requires two or three distinct functions; to put it on a peculiar business;. . .and the important business of making a pin is in this manner divided into about 18 distinct operations." if one man performed all the above operations, that is if there was no division of labour, man could not make more than twenty pins. But on the other hand, if division of labour was practised, the average production of each man was 4800 pins. This process of division enables each man to produce at least 240 times as many pin as he would if he worked alone.

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The division of labour is an expression of man's constant need for the co-operation and help of his fellows. He says that "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest." Society is bound together by mutual exchanges which are motivated by self-interest and which are based on division of labour. This tendency of mutually satisfying each other's want is common to all men.

Smith was well aware of the limitation of the scope and extension of labour. According to him, the division of labour is necessarily limited by the nature of occupation, the extent of market and the quality of capital available. He made well known assertion that division of labour is limited by the extent of market- the larger the market (exchange), the greater the division of labour. A larger market means greater demand. If there is wide demand for a good, it will be produced on a large scale and there will be a lot of scope for the application of division of labour. In those industries which produce goods for international market, there will be great scope for division of labour. Self-sufficiency (no exchange) and division of labour do not go together. The application of division of labour depends upon the nature of goods. For example, the scope for division of labour is not as great in agriculture as in the case of manufacturing industry.

Smith believed that division of labour increased productivity. Division of labour has the following advantages-

- Division of labour will increase the output per worker.
- By doing the same kind of work constantly, the worker gets a great skill in his particular line. Practice makes a man perfect.
- A man can work continuously on a single operation. He need not spend time in changing tools or passing from one process to another. Thus it saves time since one does not have to change his job frequently and
- Division of labour prepares the way for introduction of machinery. It will result in the invention of great number of machines which facilitate labour. In other words, division of labour is the mother of invention.

Division of labour simplifies work and it is possible to make use of machines for each process. Smith was not unaware of some disadvantages of division of labour. For instance, extreme division of labour would result in monotony of work. By doing the same work again and again, man would not find pleasure in his work. He would be bored with the same job.

Money- After disposing of the subject of division of labour in the first three chapters, Smith takes up the subject of money. He attacked mercantilists because they over-emphasised the role of money in an economy. According to Smith, "a nation's true wealth consists not only in its gold and silver but in its land, houses and consumable goods of all different kinds." Money is a medium of exchange which is essential to trade and commerce. It did away with the inconveniences of barter- it facilitates exchange and without it large scale commerce would not be possible. It was, therefore, an important factor contributing to the extension of division of labour.

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Money only serves as an instrument for the circulation of wealth and for the measurement of value. Money does not add to the revenue of society but it is a great wheel of circulation. It facilitates the circulation of goods. Although the gold and silver coins that circulate in an economy form a valuable part of the capital of the country, they are dead stock and produce nothing. Smith linked money to a highway over which the goods (produce) of a town is carried, but which itself does not produce a blade of grass.

Value- According to Smith, there are two kinds of value: (1) value- in -use (2) value- in- exchange. Value-in-use expresses the utility of some particular object, in modern analysis, the capacity of a thing to satisfy wants. Value in exchange is the power of purchasing other goods. Smith points out the things which have the greatest value-in-use e.g. air and water have generally little or no value of exchange. And like this diamond has little value-in-use but it has great value-in-exchange.

The determination of value (value-in-exchange) has been one of the central problems in economics. Smith believed that labour was the real source of value. According to him, the value of the things depended on the amount of labour expended upon its production. In other words "The value of any commodity, therefore to the person who possesses it, and who means not to use or consume it himself, but to exchange it for other commodities, is equal to the quality of labour which it enables him to purchase or command. Labour, therefore is the real measure of exchangeable value of all commodities." Adam Smith emphasised that "Labour is the real measurement of the exchange value of all commodities." This is the famous labour theory of value.

Smith said that in an early crude state of the society, when the process of accumulation of capital had not started and the land was not appropriated by anyone, labour was both the determinant as well as the measure of value. But since the time of accumulation of capital started, and the system of proprietorship of land began, element of profit and rent came to be included into price and thus according to Smith, in all prices there is an element of rent and wage.

We must also note that Smith made a distinction between natural price and market price. When the price just covers the ordinary rate of interest, wages and profits expended in preparing and marketing the commodity, it sells at the natural price. In simple words, natural price is that price which covers natural rates of interest, wages and rent. Thus, the concept of natural price is essentially "the cost of production" theory of value. Opposed to the natural price is the market price, which is determined by the forces of demand and supply through the competition among the buyers and sellers. The market price may be below or above natural price.

Wage- According to Smith, wage is determined by the bargaining power of employers and wage earners. Employers, being limited in number, can easily organise themselves to form associations whereas the organisation of labour is not possible. The employers consistently try not to raise wages of labour above the actual rate. Hence, wages depend on the bargaining strength of both the parties. Since bargaining strength is on

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the side of employers, the labour gets only as much wage as will be sufficient to support him and his family. This is the subsistence level. According to Smith, *"Masters cannot reduce wages below a subsistence rate."* He observed that the market level might be higher than the subsistence level whenever the society was progressing and the funds for employment were expanding more rapidly than the population. Since this fund is dependent on the national wealth, the wage of labours will only increase with the increase in national wealth. In the stationary state, wages may be low. Thus, Adam Smith has taken into account both demand for labour and supply of labour in the determination of wages. We find in it the trace of the wages-fund theory and the Malthusian theory of the Population.

Adam Smith has also analysed the problem of wage differences. He has given the following reasons for differences in money wage-

- Agreeableness of the employment
- The cost of learning skill
- The constancy of employment
- The trust reposed in the workmen
- The probability of success.

Smith has a soft corner for labour. He said that no society could flourish if its labouring classes were poor and miserable. Thus labour class must be tolerably well-fed, clothed and lodged. Smith recognises the role of labour, land and capital in production.

Profit- Like wages, profit also depends upon the increasing and decreasing state of wealth in a country. Under the condition of competition, an increase in capital will lead to a decline in the rate of profit and vice versa. Adam Smith made certain exceptions to the statement that wage and profits moved in the opposite directions, since wages rise with an increase in the capital stock and fall with a decrease in capital stock. The capital stock determined the wages and demand for labour. In a developing society, (in new colonies) both wage and profit may be higher and in the stationary state, both wages and profit may be low. Profits vary from day to day on account of changes of price and fortune. Thus the average rate of profit is not easy to determine. But profits closely follow interest on money. Smith tried to prove that profit is equivalent to the total return on capital and interest is a constituent element in profit.

Interest- Smith discusses profit and interest together. A part of profit is paid as interest to the capitalist. Interest arises when the capitalist does not himself employ his capital, but lends it. Interest is the price paid by the borrower to the capitalists. According to Smith, "Interest is the compensation which the borrower pays to the lender, for the profits which he has an opportunity of making by the use of the money." Interest is treated as a part of profit. The borrower pays interest if he makes profit. He believed that interest would vary with profit.

Smith said, "Minimum interest must be something over and above what is sufficient to compensate the occasional losses to which lending is ordinarily exposed."

Rent –Rent is a payment for the natural produce of land. It is a price paid for the use of land. Smith said, Rent was a mere extortion. This rent is the highest price a tenant cay pay to the landowner. Land varies with fertility and situation. If land is far away from the market, much more labour is required by the tenant. Thus the surplus (rent) left over for the landowner is diminished. Differences in fertility generate differences in rents. Superior fertility means higher rent.

Smith's ideas on rent are not clear-cut. Smith was inconsistent while discussing the relation between rent and price. Smith states that the amount of rent depends upon price and price depends on rent- a contradiction.

Capital-Smith had realised the importance of the role of capital in the economic development of a nation. He treated capital as an important source of national wealth. Besides division of labour and money, capital plays a great role in production. He was aware of the fact that capital accumulation is essential for the industrial development of a nation. Smith holds the view that the accumulation of "stock" (capital) depends upon the extent of the application of division of labour which is necessarily limited by the extent of market, the density of population and the machinery of commerce. The division of labour is itself governed by the amount of capital accumulated. The accumulation does not only determine the amount of industry but also its efficiency. In the opinion of Adam Smith, "the portion of the income that was saved was immediately employed as a capital." In other words, an act of saving at once becomes an act of investment. In this way, saving is equal to investment. Smith did not pay much attention to the problem of hoarding.

Smith has classified capital in three portions which sets the labour in motion.

- The first portion is that portion of the stock of an individual of a society which yields revenue, as contrasted with that portion of the stock which is used for immediate consumption.
- The second portion of capital is the fixed capital. It affords a revenue or profit without circulating or changing masters, e.g. buildings, machines, improvement of land, instruments of trade which facilitate and save labour.
- The third portion is the circulating capital which affords a revenue or profit only by circulating or changing hands, e.g. money, stock for provision, raw material, partly manufactured goods and finished products

According to him, fixed capital is derived from the circulating capital, which is itself derived from 'lands, mines and fisheries.' All these types of capital set labour in motion which operates upon natural resources and produces food and raw products for industry.

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The analysis of Smith reveals a distinction between the gross and net revenue of the society. The gross revenue of all the inhabitants of a great country, he says, "comprehend the whole annual produce of their land and labour; net revenue which remains to them after deducting the expenses on maintaining first, their fixed and secondly, their circulating capital or without encroaching upon their capital, they can place in their stock reserved for immediate consumption or spend upon their subsistence, conveniences and amusement." Capital of the nation may be employed in four different ways-

- In procuring the rude produce annually required for the use and consumption of the society.
- In manufacturing and preparing that rude produce for immediate use and consumption
- Transporting either the rude or manufactured produce from one place where they are abound to those where they are wanted.
- In dividing in particular portion of either into such small parcels as constitute the occasional demands of those who want them.

Smith believed that investment in agriculture is the most productive form of capital investment because in agriculture "nature labour along with man." Industry, manufactures and domestic and foreign trade come next. The capital invested in agriculture not only sets in motion a great quantity of productive labour but also add a much greater quantity of annual produce to the real wealth of the country.

Free Trade- Smith advocated free trade. Free trade means that trade as among countries is not subject to restrictions. Smith was opposed to the mercantilist theory of balance of trade. Smith did not accept the mercantilist view that foreign trade is advantageous because it acquires gold and silver. According to him, gold and silver, just like other commodities and in the natural course of trade, will come to any country as other commodities do. Therefore, he does not agree that the export of gold and silver should be restricted. According to him, the only advantage from foreign trade is that it carries out surplus commodities and brings in commodities which are in demand. He treated foreign trade as domestic trade and considers it as much responsible for extending division of labour.

He believed that foreign trade would promote greater division of labour. Smith conceived the economic world as a great natural community created by division of labour. Smith believed in the natural organisation of the economic order under the influence of personal interest. He believed that the interest of individuals coincided with the interest of the society. He argues that every individual knows his interest best and is more competent to realise his interest and better understands the direction of his own action than the government. He illustrated the idea of the harmony of interest with this example-*"It is not from the benevolence of the butcher, the brewer or the baker, that we expect our dinner, but from their regard to their own interest."* He was a great advocate of laissez faire –non-

intervention by government in business. According to him, governments are wasteful, corrupt and incompetent. So he advocated minimum role for the government.

Role of Government – Smith advocated minimum role for the state in economic affairs. He considered non-intervention by government in economic matters as a wise policy. In his view, governments are always and without any exception, the greatest spendthrifts in the society. According to Smith, state could perform only the following three major functions-

- To protect society from foreign attacks
- To establish the administration of justice within the country
- To erect and maintain the public works and institutions that private entrepreneurs cannot undertake privately.

It is to be noted that non-intervention for Smith was a general principle and not an absolute rule. He justified legal control over interest rates, compulsory elementary education, state administration of post offices, and control over the issue of paper money by bankers. Though he advocated free trade, he favoured two kinds of protectionist tariffs-

- Those tariffs that protect a domestic industry essential to the defence of the country. He says, '*Defence*' is more important than opulence.
- Those that equalise the tax burden on a particular domestic industry by imposing a tariff on imports of that good.

Smith also suggested that if free trade is to be introduced in a country after a long period of protectionism, it should be done gradually in order to avoid unemployment.

Canon of taxation

Canon means a standard by which a thing is judged; it means a criterion. Therefore, canons of taxation are the criteria of taxation. According to Smith, the revenue of the sovereign is derived from two sources- (1) Funds, land and capital of the state and (2) taxes . Adam Smith has laid down four canons of taxation:

1. **Canon of Equity**- It can also be called the canon of ability. Smith stated it as: "The subject of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities, that is, in proportion to the revenue which they respectively enjoy under the protection of state."
2. **Canon of certainty**- Tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, manner of payment, quantity to be paid ought all to be clear to every person. The government and the tax payer should have knowledge about how and when and what taxes are to be levied. It is good for government because it provides a sort of correct estimate about prospective income. The certainty about taxes is good for taxpayers because he knows where he stands.

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3. **Canon of Convenience** –The manner and the time of tax payment should be convenient to the taxpayer. The idea is that the taxpayer should be psychologically and financially prepared for the onslaught of the tax. Smith stated, *"Every tax ought to be levied at the time or in manner in which it is mostly likely to be convenient for the contributor to pay it."*
4. **Canon of Economy**- This canon states that the cost of the tax collection should be the minimum possible. The revenue from a tax should be much more than the cost of its collection. Smith stated, *"Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state."* Taxation is an act of production. Therefore, both production and taxation imply the practice of economy. Every producer would try to produce at the lowest cost. In the matter of taxation also there is need to practise economy. This is a modern version of the canon of economy.

Critical Estimate of Adam Smith's Contribution to Economic thought – In spite of his important contributions, Adam Smith could not escape criticism. Among the criticism raised against Smith, the following are the most important:-

1. We find that Adam Smith did not give anything new to the development of economic thought as the concept of division of labour is as old as Plato and Xenophon.
2. He appears to be quite confused in his analysis of value
3. Smith's argument relating to wage led to no definite conclusions in so far as a tenable theory of wages is concerned. He has given many ideas but without any strong conviction.
4. Smith's approach is essentially materialistic. His concept of wealth is extremely narrow. He does not regard wealth as a means to the higher ends of life.
5. Smith was dominated by self-love, self-interest, and shrewd choices of a scotch trader. Thus, Smith's Individual is really an unreal one.
6. His economics appears to be a mixture of individual and social points of view, although on the whole, he has adopted the individual point of view. This is two-fold criticism. (i) It is impossible to build a consistent theory of economic value on a mixed basis which shifts back and forth because wealth and expenses, as seen by the individual businessman and welfare and human costs as seen by the social scientists differ; (ii) for the most part, Smith proceeds from the entrepreneur point of view. He warns the clashes of interest but for a solution he relies chiefly on the self-interest businessmen. He mentions real cost but without explanation, he shifts for contractual payments for wages and rent and develops no theory of profit. Capital remains the fund of the capitalistic employer.
7. Smith's theory of distribution is sketchy and incomplete.

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8. The philosophical basis of Smith's theory is not relevant to modern time. It is in the context of "natural order"- laissez fair, self-interest invisible hand that Smith's theory of development is supposed to operate. In developing countries, the state has come to dominate the development process. These countries, in particular, do not swear by natural order and what it embodies.
9. Smith point out that as the economy moves towards the stationary state, the sequence of development is first agriculture then manufactures and finally commerce. For Smith, this sequence is according to the natural course of things. This sequence of development of different sectors is illogical in modern economic planning, all the sectors must go hand in hand.
10. Smith does not discuss rate of interest separately- It is included in profit as the modern economic theory gives importance to rate of interest. The rate of interest is a constituent of cost, and interest earnings are a part of national income.

Notwithstanding the above criticism, we should note that Smith gave Political Economy a definition and made it a distinct science. He was the founder and father of political economy. And "he brought labour and capital into prominence, along with the land factor emphasised by the physciocrats.

Adam Smith was the first development economist who realised the importance of capital accumulation in economic development. Adam Smith's labour theory of value was the foundation for Mark's theory of surplus value, which the latter used as a weapon to attack capitalism.

The *Wealth of Nations* was written during that period of his life, when he was most active and busy with the study of the subject. *Wealth of Nations* was a remarkable book and without it, the development of economic thought in the years that followed could not have been possible. It must be said that Smith was responsible for chalking out the outline of economic inquiry, for determining its scope, and arranging the chief problems in the field of production, value and distribution. Besides this achievement of Smith's book, the more important were its socio-philosophical implications. He was the first to give a systematic statement on the harmony of social interests and also for introducing a utilitarian tradition in economic science.

Check Your Progress

1. How can the wealth of a nation be increased, according to Adam Smith?
2. In what way do Smith's thoughts run parallel to those of the physiocrats?
3. What does the "natural" action of private self-interest lead to?
4. What were the main sources of wealth for the mercantilists and physiocrats?
5. List two advantages of division of labour.
6. What role did Smith advocate for the state in economic affairs?

4.3 T.R. MALTHUS

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Thomus Robert Malthus was born in 1766. He came from a very respectable family. He was the youngest son of the family. He received excellent education. After studying philosophy and theology at Cambridge, he graduated with honours in 1788 and was soon made fellow at Jesus College. In 1805, he was appointed as the professor of History and political economy in the college founded by East India Company in England. He remained on this post until his death in 1834. Malthus is famous for his theory of Population. But another significant contribution of Malthus to economic analysis is theory of market gluts where he discusses the problem relating to the inadequacy of aggregate demand.

The main works of Malthus:

- *An Essay of on the Principle of Population*
- *The Principle of Political Economy*

Chief Influences on Malthus: Thoughts of Malthus were mainly moulded by the condition of England.

(i) England had seen agricultural prosperity during the first half of the eighteenth century but at the end of the century, agriculture was in the grip of a serious crisis. It appeared as if the population had increased to such an extent that the land fell short for their requirements.

(ii) Industrial revolution had bought in its trail unemployment, poverty, disease, riots etc. Partly as the result of these evils, various socialistic schemes were springing up especially in France.

(iii) The English poor law was also defective both in terms of subsistence and administration. It had therefore become necessary to investigate into the problem of population growth and Malthus did this work successfully. Prior to Malthus, it was generally believed that a rapidly increasing population necessarily led to prosperity and that the wealthiest and strongest countries were often the most populous. In Malthus's own times, the government as well as the employers favoured a dense population for recruitment to the armies and the factories.

Malthusian Theory of Population: As we know Mercantilists and Mirabeau had always regarded a large population as advantageous. They never entertained any fear of overpopulation because they thought that population will automatically be controlled by the means of subsistence. Malthus did not agree with this. A discussion on the subject between father and son led to the publication of the first edition of the *An Essay on the Principle of Population* in 1798 anonymously. The Malthusian theory of population is a well-known theory about the growth of population. The first edition of the essay attracted the widest attention. The idea put forward by him in the essay has come to be known as the Malthusian law

(theory) of population. The Malthusian theory of population discusses the relationship between population and supply of food. In simple words, all that the theory states is that population increases at a faster rate than food supply. Malthusian theory of population is based on the following two fundamental assumptions-

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- Food is necessary for the existence of man
- Passion between the sexes is necessary and will remain nearly in its present state.

On the basis of the above two assumptions, Malthus stated that *"the power of population is indefinitely greater than the power in the earth to produce subsistence for men."* Population, when unchecked, increases in a geometric ratio (i.e. at the rate of 2,4,8,16…) while the supply of food increases only in an arithmetic ratio (i.e. at the rate of 2,4,6,8, 10 etc.) Malthus believed that the population of the country, when unchecked, would double itself in every twenty five years. But food supply will not increase as fast as population on account of the influence of the law of diminishing returns on land. He further said that if population will increase at a fast rate, there will not be enough food for all. Because the population outgrows food supply. The growth of population has to be checked. This can be done by the application of some checks by nature or by man himself or by both.

The successive edition appeared in a revised form. The second edition of the essay was published in 1803. In this edition, Malthus altered his arguments to a great extent and the discussion appeared to be more mature. In the first edition, he stated only two checks on population but in the second edition, he introduced a third check i.e. moral restraint. It may be interesting to note that Malthus did not mention a tendency to diminishing returns in agriculture until second edition of the essay. His main point was that the pressure of population on food supply was ever present. In the second and subsequent editions, Malthus made his statements more carefully and with great caution. He summarised his doctrine into three propositions-

(i) Population is necessarily limited by the means of subsistence.

(ii) Population invariably increases more than the means of subsistence unless prevented by some powerful and obvious check and

(iii) The checks which repress the superior power of population and keep its effects on a level with the means of subsistence are resolvable into more restraint, vice and misery.

In the first edition Malthus has spoken of two kinds of checks on population growth-

(i) Preventive Checks- Those checks which are applied by men for checking population growth are called preventive checks. Preventive checks are major checks to control birth rate. Malthus suggested that those who cannot afford the upbringing of children should either postpone marriage or never marry. Malthus disapproved of vice as a preventive check. These include prostitution and birth control, both of which reduced the birth rate.

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(ii) Positive Checks- War, famine, starvation and diseases are the positive checks on population. They increase the death rate. If population is not checked by the preventive methods, then it will be checked by natural phenomenon such as famine, starvation and death. Thus, Malthus presents a dark and pessimistic picture about the future of mankind.

In the second edition of the essay, Malthus added a new check called 'Moral Restraint'. By moral restraint, Malthus simply meant the postponement of marriage. He did not approve of the birth control methods preached by neo-Malthus'. By 'check' Malthus might have even meant the means of establishing and adjustment between the population and the means of subsistence. The Malthusian theory of population was popular for nearly a century. It formed the basis of action for many governments.

Malthus considers the poor to be entirely responsible for their poverty and misery. Poverty and misery are the natural punishments for the poor class because they have failed to restrict their numbers. It follows from the above view that the government should not provide relief to the poor by means of "Poor Laws". If aid is given to the poor then more children would survive and provoke the problem of hunger and misery. So Malthus suggested the gradual abolition of "Poor Laws". The ideas of Malthus were incorporated in the Poor Law Amendment of 1834. The new poor law abolished all relief for able-bodied people outside work houses.

Criticism: The Malthus doctrine has been criticised on many points. The following are the main points of criticism:-

1. According to Malthus, population in a geometric progression. He has tried to prove that population doubles itself every 25 years. Even though there is no historical proof for this. Population does not grow in the manner suggested by Malthus. His ratios have been proved wrong by history.
2. His doctrine has been criticised on the point that the means of subsistence increase in arithmetical progression. The Malthusian theory is based on the law of diminishing returns. He has overlooked the possibilities of scientific improvement in agriculture for example, Agrarian Revolution took place in England along with the industrial revolution that brought about a huge increase in the production of agricultural products and food supply.
3. It is true that in many countries population has increased at a rapid rate. But food supply has also increased and people have not died of hunger in those countries. In fact, the standard of living today is much higher than it was a century ago.
4. Malthus has overemphasised the relationship between population and food supply. The problem of population as a whole is then not one of size, but of efficient production and equitable distribution, i.e. it is not a problem of numbers alone but of wealth.

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5. This is an age of International Trade and Commerce. If a country does not grow enough food grains itself, it can import food grains from other countries.
6. Malthus' doctrine has been further attacked in respect of positive checks. According to him, when population outgrows the means of subsistence, excessive population must die of starvation. He has tried to prove how insufficient nourishment leads to hunger and deaths due to epidemics, infanticide etc. He has named these as positive checks. But the truth is that insufficiency of food is due to incapacity of production and due to excessive population.
7. Positive and Preventive checks are heterogeneous in nature and some of them have no relation to subsistence. Take the case of war or disease as positive checks. If the population is swept off by war, it cannot be treated as a check because it does not involve a relation between food and population.
8. In civilised societies, people try to maintain an equilibrium between population and subsistence by reducing their birth rate through the application of preventive checks. But crowding in cities is not always due to limited subsistence. Malthus admitted that some customs and religious practices have operated as checks on population growth and they had no relation to food supply.
9. Malthus has also overlooked the importance of standard of living in checking population. Haney stated, "Putting the idea of checks and rate of increase together and easily falling into two positive statements, the limitations and abstraction are forgotten. He knew what had happened: he saw what was happening but was influenced by surroundings his vision as to what was to happen unduly obscured."
10. It has further been pointed out that Malthus failed to distinguish between the desire for offspring and the desire for sexual gratification.
11. Malthus thought that any addition to population is undesirable but "Every mouth brings with it a pair of hands". Since man is the source of labour, large numbers may sometimes mean greater wealth, strength and power.

Despite these criticisms it would be fair to say that the Malthusian theory of population, if seen in its entirety, is still intact. He should be given credit for laying bare the fact that excessive population was a danger to society.

Though the Malthusian theory of population does not apply to most of the western countries which are highly industrialised, it applies to most underdeveloped countries like India and China which are dominated by agriculture. In the poor countries of the world, overpopulation is a real danger. That is why many countries of the world today have adopted birth control measures and other family planning programmes.

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Other Economic Views of Malthus: Although Malthus is chiefly known for his theory of population, his views on rent, market glut, overpopulation and value are of great significance. We discuss, in brief, Malthusian Views on these topics in the following paragraphs:

Rent: Malthus did not enunciate a specific theory of rent. Despite this, no account of his contribution to the development of economic thought can be complete without reference to his views on rent. The views of Malthus on rent are found in *An Inquiry into the Nature and Progress of Rent*. Malthus defended the Corn Laws and emphatically stated that the reason for high prices of food were population growth and progress. The growth of population leads to scarcity of food, for the production of which, good land has become scarce. Consequently, price of the produce raised from the already cultivated land rises due to an increase in the rate of rent. Adam Smith and J.B. Say regarded rent as a monopoly return; they stated that monopoly was the sole cause of rise in price. Adam Smith described landlords as Monopolists who loved to reap what they had not sown. In this regard, he was in complete disagreement with Ricardo. According to Malthus, rate of rent increased because of the following factors:-

(i) There was shortage of fertile land.

(ii) This necessitated the cultivation of lands of low fertility.

(iii) The produce in each case is sold at natural price. The price of produce in each progressive country would be equal to the cost of production on land of the poorest quality actually in use.

Naturally, land with higher fertility will get rent. Thus, Malthus more or less anticipated the Ricardian theory of Rent.

Value: The contribution of Malthus to the theory of value is negligible. In fact, he did not develop the theory of value. He was somewhat confused about it. At one point he criticised Adam Smith's theory of value and at another point in his earlier writings, he used Smith's definition of value, that is, he describes value as the power to command other goods, including labour. He also stated that the amount of labour that is necessary for the production of commodities determines their value. But he later developed a cost of production theory which includes profit. In simple words, Malthus defined value as the amount of (Stored and current) labour plus profit.

Market Gluts or Over-Production:- The Malthusian theory of Gluts is one of the less known but more important contributions of Malthus to economic theory. In his theory of market gluts he discusses the problems relating to inadequacy of aggregate demand which later proved to be the foundation stone of Keynesian economics. Ever since the 1930s, aggregate demand has become a central problem in economics and Malthus is regarded as the forerunner of modern thought. In his analysis of effective demand, Malthus differed from Ricardo and other classical writers. According to the classical economists, a supply creates its own demand

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and, demand its own supply. This theory was particularly stated by J.B. Say. The idea expressed by Say was further developed by Ricardo and other writers which implied that in the long run adjustment takes place between demand and supply and therefore, there is no possibility of over production. There may be over-production and under-production in the short run, but generally over production in the long run was hardly possible. The view can be elaborated further. In their opinion, if the supply of any commodity is more than its demand, it will be balanced by another's demand being in excess of supply. Consequently, market gluts are impossible and the accumulation of capital at a rate greater than investment opportunities may not be possible.

Malthus was interested in the volume of output day by day in real world. In the opinion of Malthus, the level of output at any time depended upon effective demand. According to him, effective demand is that demand at which the cost plus the profit for the businessmen covered and the production is determined by this demand. In other words, production depended on the existence of effective demand is, demand which enabled the producer to cover cost plus profit.

Malthus argued in favour of unproductive consumption in order to maintain and increase effective demand. "It is absolutely necessary that a country with great powers of production should possess a body of unproductive consumers." Since the wages of workers are so low they cannot demand many goods. The capitalists, if they want can consume the excess of products. But the capitalists are more interested in saving and accumulation of capital. Their actual habits and mode of living do not give them enough opportunities for unproductive spending on sufficient scale.

Adam Smith and Ricardo were in favour of saving and capital accumulation without limit, Malthus argued against it because rapid accumulation of capital would result in the reduction of unproductive consumption and this in turn would check the progress of wealth. Malthus was not against saving as such. He suggested that a proper balance must be maintained between saving and consumption. In the class of unproductive consumers, Malthus included landlord, soldiers, Judges, lawyers, menial servant, physicians, surgeons and clergymen.

Malthus used the concept of effective demand to show that the economic system was not self-adjusting. Unless a large body of unproductive consumers was maintained, there would be periodic over-production, gluts in the market and stagnation. Thus for the first time in the history of English economic thought, Malthus has pointed out the possibility of crises in the form of trade cycle because of the inherent defects of the capitalist system. Many modern writers regarded Malthus as a forerunner of many under-consumption theories. Thus, Malthus had some insight into one of the most important problems of the modern economy, the maintenance of the level of aggregate demand.

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The contribution of Malthus to Economic thought

Malthus holds a unique place in the history of economic thought. The contribution of Malthus in economic thought is as under-

1. He was the first economist to throw light on the dangers of excessive population
2. Malthusian theory of population has introduced a dynamic factor into economics. Before Malthus, most of the economic analysis was based on the assumption of "other things being equal" but Malthusian theory of population made it an unrealistic assumption for population was always changing.
3. Malthus was the first economist to devote an entire book to the study of the principle of population. Malthusian theory of population has become a starting point for all modern studies of the problem. He has been rightly described as the "founder of modern demography".
4. Malthus collected a lot of historical and statistical data to illustrate his theory. He used his knowledge of mathematics and desired to prove the strength of his argument, justifies his claims for being included among the founders of historical economics.
5. His entire analysis of the causes of over-production and the principle of effective demand shows that he possessed a keener insight into these subjects than others, especially Ricardo. His views were more akin, in this respect, to modern thinking.
6. Malthus is the forerunner of many under-consumption theories of trade cycle.
7. In his essay he provides a clue to understand the problems of social reform in their true perspective, especially those relating to wages, poor law etc.

The importance of his essay is all the more enhanced by the fact that it provided the basis to Darwin's 'Law of the Survival of the Fittest'. As Darwin himself acknowledged that his theory was merely the doctrine of Malthus applied with manifold force to the whole animal kingdom, we can conclude with the memorable remarks of Lord Keynes that "If only Malthus, instead of Ricardo had been the parent stem from which the nineteenth century economics proceeded, what a much wiser and richer place the world would be today."

Check Your Progress

7. List the assumptions on which the Malthusian theory of population is based.
8. Why did Malthus suggest the gradual abolition of "poor laws"?
9. To which countries does the Malthusian theory of population apply?
10. List the factors responsible for the rise in rent.
11. Why did Malthus use the concept of effective demand?

4.4 DAVID RICARDO

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In the classical school of economics, Ricardo is considered one of the greatest theorists. Adam Smith is known as the founder of the classical school and David Ricardo is the last representative of the classical school of economics. Ricardo has a very significant place in the history of Economic thought.

Ricardo was born in 1772 in a Jewish family in England. He was the third of the seventeen children. His father was a stock broker in bills of exchange and public securities. In 1786, he entered his father's business. David Ricardo was the founder of the Political Economy Club, which was established in 1921. He died in 1823 at the age of fifty-one. Ricardo is known for his *Principle of Political Economy,* published in 1810 but he had written a number of pamphlets and essays too.

David Ricardo's main works:-

- *Principles of Political Economy* was published in 1810.
- His first pamphlet *The high price of Bullion: A proof of depreciation of Bank Notes* was published in 1800,
- *An Essay on the Influence of a Low Price of Corn on the profits of Stock* was published in 1815.
- *Proposal for an Economical and Secure Currency* was published in 1816.
- First edition of *On the Principle of Political Economy and Taxation* appeared in 1817.
- The second edition of *On the Principle of Political Economy and Taxation* was published in 1819.
- *On Protection to Agriculture* was written in 1822.
- *Plan for the Establishment of National Bank,* his last work, was published in 1823 after his death.

Ricardo and Malthus were both pessimist thinkers in the history of economic thought. It is notable that the institutional environment of Adam Smith was different from that of Malthus and Ricardo. During the period of Ricardo, industrial revolution had gained strength with all its attendants' evils. Developments in exploration, progress in colonisation and improvement in the means of transportation had created additional opportunities for investment. Industrial revolution had given way to the factory system in which workers were considered just like other inputs. There was rise in the price of grain due to depreciation of money and increased urban population. To meet the needs of the increasing urban population, inferior lands were brought under cultivation and land rents were increasing. Thus, the economy of the day could be described as the capitalistic economy due to the large employment of capital.

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The Principle of Political Economy and Taxation

Adam Smith had addressed the question of ascertaining the nature and causes of the wealth of Nations. He wanted to analyse the origin and growth of a nation's wealth in aggregate. Ricardo believed that political economy was an enquiry into the law which determined the division of the produce of industry among the classes who contribute to its formation. Ricardo was mainly concerned with the study of the problems of distribution and their solutions. In the preface of his book, *On the Principles of Political Economy and Taxation*, Ricardo said, that "To determine the laws which regulate this distribution, is the major problem in Political Economy." According to him, the produce of the earth is the return of the united application of labour, machinery and capital. This produce should be divided among the land, the owner of the stock of capital necessary for its cultivation and labour by whose industry it is cultivated. He named these shares respectively as rent to land, profit to capital and wages to labour. He declared that the determination of the laws which regulate their proportion is the major problem in political economy. Ricardo has shifted the emphasis from investigating the nature and causes of wealth (manufacture/production) to its distribution. According to Eric Roll, "The main achievement of Ricardo is to be found in the theory of value and distribution".

Value: Ricardian theory of value is basically a labour theory of value. Ricardo was not concerned with absolute values but with relative value. He says that although the employment of capital does not affect relative value, the difference in the proportion of fixed and circulating capital in different industries affects relative value. Ricardo has recognised two forms of value like Adam Smith, (i) Value-in-Use (ii) Value-in –Exchange. He says that "utility is not the measure of exchangeable value although absolutely essential to it." He points out that for a commodity to have a value of exchange, it must have utility. According to Ricardo, the value of commodity depends upon two things. (i) scarcity, and (ii) labour cost (quantity of labour required to obtain them). Ricardo assumed that there are some commodities, the value of which is determined by scarcity alone. Quantity of these commodities cannot be increased by labour and therefore their value cannot be lowered by an increase in supply. Rare pictures and statues, scarce books and coins belong to this category. In fact, he considered such commodities so limited in number that he has not given any consideration to them. For the valuation, he has considered the commodities of the second group. He therefore, holds that all such reproducible commodities are exchanged for each other in proportion to the amount of factor inputs (labour) required to obtain them. Ricardo was aware that labour was not of uniform quality and that different types of labour were paid at a different rate in the market. According to Ricardo, the value of labour is the only factor which causes variation in the ratio of goods exchanged for each other. Adam Smith applied labour theory of value to early stage of society. In the early stage, the value of these commodities depends almost exclusively on the comparative quantity of labour expanded on each. Ricardo said that the relative labour inputs not only

determined relative values in a primitive society, but also in a modern society having land and capital as factors of production in addition to labour. In fact he believed that labour was the foundation of value in all stages of society.

He divided the value into two parts- (i) natural value and (ii) market value. Ricardo has made distinction between Natural Price and Market Price. By natural value he means the point around which market value fluctuates and ultimately tends to equalise with it. The natural value is the long-term tendency. He has not been able to give an accurate and clear definition of natural value. Market value is actual short-term manifestation. Market value may deviate from the natural value because of temporary fluctuations of demand and supply. According to him, the deviation of market value is not permanent, it is only accidental. If Market Price rises above the normal (value) price, profit will rise and more capital will be used to produce the commodity. On the other hand, if market value falls below the normal price (value), profit will fall and capital will not be used to produce or less capital will be used to produce the commodity. Thus the supply would be reduced tending to bring the market value in accord with natural value. In other words, in the short-run, price depends on demand and supply and in the long–run, price of commodities depends upon the production cost. And the relative cost of production of two commodities is proportional to the respective amount of labour necessary to produce those commodities. The labour theory of value or the cost of production theory of value has been criticised on the following grounds:

(i) There is difficulty in measuring labour cost of production. Of course, Adam Smith used time as the measuring rod but all of the labour is not equally efficient, some are more efficient than others. The less skilled may take longer than the skilled over a particular piece of work and so put more labour into it.

(ii) Labour may be misdirected. Misdirected labour does not count as labour. So in order to get over the problem, Marx defined the amount of labour required as "Socially necessary labour".

(iii) Influence of demand is not considered in the labour theory of value which is the main weakness of the value theory.

In fact, the labour theory of value became a powerful means in the hands of Karl Marx to disclose that there was exploitation of labour in a capitalist economy. Marx found that the value of commodity depended on the amount of labour required for its production.

The theory of value, as put forward by Ricardo, produced many opponents. Torrens Hallander, Bailey and Malthus were chief among them. In all three editions of his book, he is found making desperate efforts for arriving at a definite conclusion. He even introduced the time element in his theory of value at the suggestion of McCulloch but he could not improve upon it. In fact he was not satisfied with his own analysis.

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The Theory of Distribution:-Ricardo considered distribution as the problem for political economy to analyse. His chief contribution lies in furthering the investigation of distribution problem and in his effort to correlate the theory of distribution with the theory of value, he was the first to make a scientific attempt to analyse the problem of distribution. He devotes his main attention to factoral distribution and frame laws which determine the share of different factors (share of wage, profit and rent) which contribute to the national income in a comprehensive manner.

His greatest significance lies in the fact that his theory of distribution turned out to be the focal point of future development in economic theory. He has summed up the scheme of distribution in the following words, "Profit depends on high price or low wages, wages on the price of necessaries, and price of necessaries chiefly on the price of food." The exchange value of food is determined by its cost of production in terms of labour at the margin of land utilisation. In the long run, wages tend to equal the exchange value of food and rates of exchange are equalised by competition. The remainder of the marginal product goes as profit, the rate of which, is also equalised by competition. It is in the more productive lands that rent arises.

Theory of Rent:

At the time when Ricardo formulated his theory of rent, rent was an important subject in England. Ricardo's whole theory of distribution is very closely bound with land as a factor of production and rent is the income which goes to it. In his doctrine of rent, Ricardo has made use chiefly of the law of diminishing returns in agriculture. Rent can be divided into two phases, (i) Cultivation of Lands of Inferior Quality or Extensive Cultivation, (ii) Low Diminishing Return and Intensive Cultivation.

According to Ricardo, " rent is that portion of produce of the earth which is paid to the landlord for the use of original and indestructible power of the soil." He has not included any payment received by the landlord for the capital invested in or on his land i.e. on building, drain, hedges, fence, fertiliser etc. in this category. The main reason why Ricardo used the term rent in such a restricted manner is that he stated that land is not unlimited, it is available in limited quantity and is non-uniform in quality. Due to an increase in population, land which is less advantageously situated or is of an inferior quality is called into cultivation and rent is however, paid for the use of it. When land of an inferior degree of fertility has been brought under cultivation, rent immediately commences on that of the first quality land and the amount of that rent will depend upon the difference in the quality of these two portions of land.

Ricardo explained his theory of land with the help of a hypothetical example of colonisation. Suppose some people go to a new country and settle down there. They will cultivate all the best lands available at the first time of the first settlement so no rent will be paid for the use of land. Suppose another batch of people go and settle down in this new country after some time. Naturally the demand for

agricultural produce will increase, so the second degree lands will have to be cultivated in order to meet the needs of the growing population. As population goes on increasing, less fertile land will come into cultivation and it is at this point that rent will be paid on the most fertile land. The amount of rent will be determined by the difference in the quality of the two lands. The land that is just able to meet its expenses of production is known as a non-rent or marginal land. Rent is thus the fertility differential of two lands. In other words, Rent indicates the differential advantage of superior land over the marginal land.

As to the question of how rent arises in intensive cultivation, Ricardo held that the difference between the return from two levels of investment of labour and capital will be rent. He has explained this in the following words:

If there is land No. 2, No. 3, No. 4 or No. 5 or the inferior lands are cultivated, capital can be employed more productively in those lands which are already under cultivation. If we double the quantity of capital, we will find that by doubling the original capital employed on No. 1, the produce will not be doubled, it will not increase by 100 quintal and it may be increased by 70 quintal and by employing same capital on land No. 2, we can obtain more than land no. 1. The quantity which we obtained from land no 2 will not exceed the quantity that we obtained from land No.1. In such a case, capital will be preferably employed on the old land and will equally create rent, for rent is always the difference between the produce obtained by the employment of two equal quantities of capital and labour.

It has been stated that rent arises due to a difference in the fertility levels of land. Besides fertility, rent may also arise on account of situational advantage. Some lands enjoy situational advantage. For example, if land is nearer to the market place the produce of that land reaches the market easily so there will be no transport cost. Thus, the producer save transport cost in such a case. Even if all lands are equally fertile, lands possessing situational advantage command some superiority over other lands. Thus rent arises on account of differences in fertility and in situation.

While discussing the relationship between rent and price, Ricardo has stated that rent does not enter price. According to him, rent is determined by price. Rent is high because the price (of corn) is high. Price is high not because rent is high. Ricardo has come to the conclusion that rent does not enter price because according to him, there are some no-rent lands. But still their produce has a price on the market and rent does not enter price here because of the marginal lands do not get any rent at all.

Criticism of Ricardian Doctrine of Rent

Ricardian theory of Rent has been criticised on various scores-

1. Some critics have objection against the order of cultivation described by him. According to him, the most fertile land and most favourably situated lands will be cultivated first. This assertion gives an impression that fertility

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is the only factor which gives rise to rent but this impression is obviously wrong because Ricardo himself said at more places than one that if all lands were equally fertile, there would be no rent.

2. According to Ricardo, the best lands are cultivated first but there is no historical proof of this. Best lands are not always cultivated first.
3. It is assumed that rent is a payment for the use of the *original and indestructible power of the soil*. But it is difficult to decide which powers of the land are original and which are the result of human action. Fertility of land can be improved by adopting better farming methods and appropriate techniques of production.
4. Ricardo stated that rent is determined by price and that it does not enter price. It has been attacked by many economists.
5. Arthur Young and H.C. Carey have tried to demolish the Ricardian doctrine by saying that owing to the progress of science even the worst lands have been turned into the most fertile ones.
6. Ricardian theory is based on perfect competition. But in the real world imperfect competition is the rule.
7. Ricardo in his theory does not assume rent land. In reality no such land exists, though there may be a marginal land which just covers the cost of producing output.
8. Ricardo over-emphasised the role of diminishing returns. This law will hold good only if other factors including the level of technology are kept constant. But historically improvements in agriculture have resulted in increasing returns per unit labour in the most advanced country.

Wages: After explaining the rent and the share of landlord in the national income, Ricardo proceeds to discuss the determination of wages. Wages are the price of labour. Like all other commodities, labour has its natural price (subsistence wage) and market price. According to him, "the natural price of labour is that price which is necessary to enable the labourers, one with another, to subsist and to perpetuate their race, without either increase or decline." Thus the natural price of labour depends on the price of food, necessaries and conveniences of life required by the labour and his family. If the price of food and necessities rise, wages will rise and when the price of food and necessities fall, wages will fall.

The market price of labour is that price which is really paid for it from the natural operation of the proportion of the supply to the demand. The market rate of wages is determined by the forces of demand and supply. If there is an abundant supply of labour, market price of labour will be low and if there is scarcity of labour, market price of labour will rise.

Ricardo stated that demand for labour is determined by the amount of capital. He said that the demand for labour will increase in proportion to increase in capital;

in proportion to the work to be done will be the demand for those who do it but we must note that market price will fluctuate around the natural price.

Ricardo believed that in the long run, both natural and market price of labour and because of the increase in the cost of producing food for increasing population money wages would tend to rise. Improvements in agriculture and import of food grain would lower the cost of living only temporarily. But ultimate money wages will rise in order to meet the increasing cost of food grains.

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Ricardo's idea is that in the long run, the wages of workers will enable them to live only at a subsistence level of wages. When the market price of labour rises above the natural price, there will be expansion in the families of the workers. As population increases, wages will come down to their natural price and when the market price of labour is below the natural price, poverty and misery will reduce the working population and wage rates will rise. Thus in the long run workers will receive wages at minimum subsistence level**.**

Profits: Ricardo has not given a clear-cut theory of profit. He has treated profit and interest as one thing. Ricardo has not given a complete discussion of the sources from which profit arise and has not analysed the various components of profit. According to him, "profit consists of interest and entrepreneur's gain." He treats profit as the residual income received by the entrepreneurs. Ricardo firmly believed that wages increased at the expenses of profit. In brief, the doctrine can be stated in his own words that profits depend on high and low wages. In other words, whenever there was an increase in wages profit would fall and vice versa. Thus according to Ricardo, wages and profits are diametrically opposed to each other. Ricardo believed that in the long run money wages would rise and the rate of profit will tend to fall.

It may be interesting to note here that though Ricardo believed that "the interest of the landlord is always opposed to that of the consumer and manufacturer." and the interests of workers and employers are always opposed, he never advocated state intervention to reduce the conflicts of interest. Ricardo believed that profits must be sufficient to afford an adequate compensation for their trouble and risk, and hence he admits that there must definitely be minimum limit to profits.

Money: Ricardo was a practical man. He was concerned about the urgent currency problem of his day. Ricardo wrote on currency problems at a time when the Bank of England introduce inconvertible paper standard and the market price of gold was increasing. Ricardo tried to explain why the market price of gold was rising and suggested that price of gold and other commodities are rising due to printing of Bank Notes or increasing quantity of money in the market. He proposed that the Bank of England should reduce the quantity of Notes in circulation so long as the price of bullion does not come down to its normal level. Ricardo however, did not believe in the complete withdrawal of paper currency.

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In short, he advocated gold bullion standard in which only the Bank Notes would be in circulation which would be convertible into gold bars in larger amounts at a fixed rate. So much was the truth in his arguments that the Bullion Committee accepted his suggestions.

Ricardo advocated that Bank of England should restore the gold standard. He believed the gold standard by acting as a check on the over-issue of currency would curb inflation. He also advocated economy in the use of gold and silver. To eliminate the cost of coinage and to economise gold, Ricardo suggested a sort of gold bullion standard. Ricardo's currency reform was adopted by parliament in 1819 and gold standard was introduced in 1921. Gold Standard remained the dominant monetary standard in Britain and many other countries for over a century, except during the major war periods and great financial crisis.

International Trade: In the matter of international trade, Ricardo was the true follower of Adam Smith but as an advocate of free trade, he appeared to be more resolute than Adam Smith or the physiocrats.

The chief contribution to the science so far as the theory of international trade is concerned "was his discovery of the laws governing the movement of money from one place (country) to another, and the admirable demonstration which he has given us of this remarkable ebb and flow". He explained the working of laws as follows: If a country has an adverse balance of trade, excessive money will be exported and the scarcity of money will be experienced in the country. The scarcity of money will lead to an increase in its value and price will fall, low price will stimulate exports and ultimately the money that was sent abroad will come back. Consequently price will rise, exports will be curtailed and imports will increase, thus leading to exports of money. The cycle will go on. Ricardo thus held the under that automatic operation of the economic forces, the balance of trade will itself come to position of equilibrium. It may be pointed out that this position of equilibrium may not establish so quickly as Ricardo thought. It may take some time before price may rise or fall under the influence of quantity of money. But under the system of foreign exchange, it is necessary to wait until the price responds to the changes in the quantity of money and hence his point appears to be correct. Accordingly money either seldom leaves a country or if it leaves at all, it is only for a short period. He therefore insisted that precious metal for international trade were mere lubricants that neither leave nor stay in any country permanently.

The theory of comparative cost is the major contribution of Ricardo to the theory of foreign trade. Adam Smith advocated free trade competition in foreign trade and his theory of trade was based on difference in absolute cost. But Ricardo developed the theory of comparative cost. According to Ricardo, "Trade might be taken place of the advantages of both trading countries, even when one of them was more efficient in the production of both commodities exchanged. The theory of comparative cost may be stated as follows: Under competitive conditions a country tends to specialise in those commodities in the production of which it has greatest comparative advantage. (Silverman)

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In the recent times, Benham has stated the law as follows: "The principle of comparative cost or comparative advantage points out that two countries will gain by specialisation and trade, provided that each has a comparative advantage of lower comparative cost in the commodities it exports."

Ricardo advocated that an efficient country should export those goods whose comparative cost is the lowest and it should import those goods whose comparative cost is the highest. He advocated free trade policy. Ricardo believed that under a system of perfectly free commerce, the pursuit of individual advantage is admirably connected with the universal good of the whole.

Ricardian theory of comparative cost is based on two fundamental assumptions-

- Ricardo assumed that labour and capital did not flow between countries.
- He assumed the law of constant costs rather than increasing costs as output extended.

The theory of comparative cost given by Ricardo has been criticised on the ground that it is based on the labour theory of value. Not only that, the theory is based on the assumption of full-employment.

Ricardo provided the foundation stones of socialism. The Ricardian theory of value is the starting point of modern socialism. Marx developed his theory of surplus value only on the basis of the labour theory of value. There are different opinions regarding the contribution of Ricardo to economic thought. According to Gide and Rist, "Next to Smith, Ricardo is the greatest name in the economics. Ricardo is the supreme example of abstract reasoning. He will be remembered as the master of deduction in economics. In the opinion of Haney, "One of Ricardo's greatest services lay in the fact that, more than any predecessor; he separated economics from other branches of knowledge, and from ethics and from government in particular. With Ricardo political Economy became Economics." According to Eric Roll, "The main achievement of Ricardo is to be found in the theory of value and distribution. Ricardo succeeded even more than Smith in isolating the chief categories of the economic system. He left to his successors many unsolved problems, but he also indicated ways in which they might be solved.

Check Your Progress

12. What did Ricardo believe regarding the political economy?
13. What does Ricardo mean by natural value?
14. State the two phases of rent.
15. What did Ricardo propose for the Bank of England?
16. What did Ricardo advocate regarding imports and exports by a country?

4.5 J.S. MILL AND HIS THEORY ON UTILITARIANISM

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John Stuart Mill was a 19th century philosopher, political economist and civil servant.

Mill's essay *On Liberty* (1859) gave a new dimension to utilitarianism and is one of the classical defences of freedom in the English language. Mill is a transitional thinker who essayed his ideas at a time when the English political society was in a state of flux, of transition from laissez faire to collectivist legislation. Beginning with a negative view of liberty, he comes closer to a positive one when he recommends 'state regulation in the overall interests of society. He starts with a definition of liberty as 'being left to oneself'. 'All restraint qua restraint is an evil'. He assumed the existence of two different spheres of human action: those which concern himself (self- regarding) and those which concern others (other- regarding). He claims complete freedom of conduct for the individual in all matters not affecting the community. The only part of the conduct of anyone, for which he is amenable to society, is that which concerns others. Community has a right to coerce the individual if his conduct is prejudicial to its welfare. Critics have said that Mill divides the indivisible. Every action of the individual has in its very nature some social consequences. Mill as 'the prophet of an empty liberty and an abstract individual. He had no clear philosophy rights, through which alone the conception of liberty attains a concrete meaning; he had no clear idea of that social whole in whose realization the false anti-thesis of state and individual disappears.

Mill was painfully aware of the anomaly of a 'tyranny of the majority' tyranny of the prevailing opinion and feeling in modern democracies. He had a peculiar horror of the mob mind, of the tyranny of the crowd. To offset this, he made an eloquent plea for freedom of thought, discussion and toleration of opinion. He was a champion of individual or personal liberty. His primary purpose was to protect the individual even his eccentricities and oddities against the attacks of society. He contends that social and 'political progress depends largely on the originality and energy of the individual and his free choice. Of course, he recognized the utility of some modest form of state regulation in the interest of the common good and came closer to socialistic ideas.

Mill declares that pleasures be at variance not only in quantity but also in quality. He drew a distinction between superior and inferior pleasures. Mill did not talk about with Bentham that pleasure was the only grounds and purpose for individual's events. He held that individual happiness did not give him utmost happiness; on the other hand it was the group happiness, which gave highest gladness and joy to the individual. Thus, he thought that happiness comes from outer surface and not from surrounded by. This was in absolute dissimilarity to Bentham's view that enjoyment comes from inside. Mill greatly tapering down the bay between self- interest and general contentment. He held that the utilitarian

standard is not the manager own maximum gladness, but the maximum amount of pleasure altogether.

Bentham was of the opinion that individual happiness was the only decisive factor for all human actions. Mill initiated the idea of good life as more than a life dedicated to happiness. He positioned the ethical ends above the human being contentment and thus attempted to endorse righteous life. He also distorted the state into an ethical end.

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Mill also differed from Bentham in justifying private property. The justification of private property came from the English utilitarians. Its great exponent Jeremy Bentham maintained that right to property was a major condition of achieving the greatest happiness. He advocated equal distribution of property in order to strike a balance between security and equality. Mill defended private property as essential for the welfare of the people. He wrote: 'The institution of property when limited to its essential elements , consists in the recognition, in each person, of a right to the exclusive disposal of what he or she have produced by their own exertions, or received either by gift or by fair agreement , without force or fraud; from those who produced it. The foundation of the whole is the right of producers to what they themselves have produced.

Mill in his work on utilitarianism modified the views of Bentham for the betterment of the society. He recommended numerous rudiments which were opposed to the hedonist doctrine of Bentham. It was with the austerity of Bentham's morals and synchronized utilitarianism with common sense that Mill made utilitarianism extra human and less consistent.

Mill's ideas of liberty also are at variance from Bentham's concept of liberty. Whereas Bentham did not connect any significance to the liberty because it did not in any method add to the maximum happiness of the maximum number of people. He was fond of more in giving importance to safety than freedom. Mill, on the other hand measured liberty is necessary for the accomplishment of the standard of utility and declared that minority rights could be secluded only when all take pleasure in liberty.

Both Mill and Bentham differed in justifying public and private interests. Bentham tried to set up identity between public and personal interests through the concept of super-added pleasures and pains. Mill considered these as outer authorization and therefore wanted to find this association on the basis of some interior sanctions and emotions of conscience. He therefore said that that the happiness and soreness concepts when restricted to oneself alone were outer, but when these related to 'others' these were interior and as such has bearing on sense of right and wrong.

From different diverse perspectives Mill obtained a dissimilar stand. Thus, he situated for public voting as against secret voting developed by' Bentham. He preferred extraordinary treatment of women, while Bentham did not think something

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of the kind. Mill was more anxious with the abolition of imperfection in the obtainable legal system. Mill was more troubled with the social and economic harms facing the society. Both justified democracy but for dissimilar reasons. While Bentham recommended and suggested it because of character of man, Mill justified because of the situation of man. Bentham talked about unicameral legislature while Mill went for bicameral system. Mill was a great winner of the individual liberty and stood for limiting government meddling in the life of the individual.

Check Your Progress

17. State the two spheres of action as assumed by Mill.
18. What did Mill write in defence of private property?

4.6 J.B. SAY

Jean Baptiste Say was born in Lyons on January 5, 1767. He was a French economist. He can be called the founder of the French Classical School. He is considered an exponent of Adam Smith's ideas on the continent. Say put Smith's ideas to a proper scrutiny and modification wherever necessary. In 1831, he joined the **Collège** de **France** as Professor of Political Economy. Just after 14 years of the publication of the Wealth of Nations, in 1803 his book Traite d' Economic Politique (Treatise on Political Economy) was published. He did not merely repeat the ideas of Smith but carefully reviewed them. He developed some of them and emphasised others. His book became quite popular and was used as a textbook in a number of American colleges. His book was translated in many languages. In this book, he has logically arranged and explained the ideas of Smith. He died in 1832.

Main Works of Say:

- *A Treatise on Political Economy* was published in 1803
- *Catechism of Political Economy* was published in 1817
- *A Complete Course on Practical Political Economy* was published in 1828-29

To J.B. Say, ideas about the nature and the scope of political economy were quite clear. He says that political economy was primarily a study of wealth. According to him, Political Economy studied and discovered the laws which govern wealth. The study of economics is classified by him into the three main parts: (i) Production (ii) Distribution (iii) Consumption of wealth. Ricardo adopted deductive method throughout his analysis but Say was in favour of the inductive method. He argued that methods similar to those used in natural sciences might be followed in political economy. According to J.B. Say, Political Economy was a purely theoretical and descriptive science. The law of political economy had a universal validity. To

him, an economist had no normative role to play. He stated that "the duty of economists is to observe, to analyse and to describe but not to give advice". Further he believed that the laws of economics were of universal application.

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Productive and unproductive labour: The physiocrats believed that amongst the agents of production only land is productive in the sense that only agriculture is the productive occupation. Even under the influence of physiocrats, Adam Smith attributed special productivity to agriculture but Say refuted the idea. He believed that "Nature is forced to work along with man" not only in agriculture but everywhere. While Smith gives priority to agriculture, Say gives top priority to manufacture. To Say, production is not the creation of matter, but creation of utilities. According to him, labour will either provide some service or would impart utility to some matter.

According to Smith, service of doctors, Judges, lawyers and actors, the producers of manufactured articles are unproductive labour. Say found fault with Smith for including only material things as wealth of economics. Say considered even services such as advice of a doctor as "product". The doctor gives advice only after taking fees for consultation. Its production consisted in saying it and its consumption in hearing it; accordingly any labour which is directed towards the creation of utility is productive, whether it results in a service or modification of matter. To Say, if produce of the labour is meant to be sold in the market in exchange for something else, it is a productive labour. The idea that economic activity consists of the production of material as well as immaterial goods has been put humorously by Robbins in the following words- "We do not say the production of potatoes is economic activity and the production of philosophy is not."

Say's Market Law: Say is widely known for his 'law of markets'. His theory of market was considered a great contribution.

During the days of J.B. Say, some businessmen and even economists thought that general over-production and unemployment were common occurrences. Say tried to disapprove this belief by his law of markets. Say's market law states that supply creates its own demand. Say stated that "it is production which creates market for goods." In other words, whatever is produced represents the demand for another product. Additional supply is additional demand. Thus products are always exchanged against other products. When a product is produced, it offers a market for other products, from the moment it is created. On the basis of the above reasoning, Say said that there is no possibility of excess supply of a product so that there cannot be any general over-production. It implied that there will not be any mass unemployment and an economy will always be at a full employment equilibrium.

Say admits that there is no possibility of general over-production. There will be no such thing as deficiency of 'aggregate demand'. Thus, Say's Law of Markets denies the possibility of general over-production. Say's law is basically a long run

tendency. Say's theory of market was considered a great contribution for a very long time.

Implications of Say's Law of Markets:

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i. As 'supply creates its own demand,' there will be no general over-production. It implies that there can be no general unemployment.

ii. According to this law, it will be profitable to have wide markets for they will increase the demand for goods and raise their prices.

iii. Everyone should be interested in the prosperity of everyone else. 'It is foolish to divide the nation into producers and consumers; everyone is both.'

iv. The law of Markets has been used in support of Free Trade doctrine. When we buy something from foreigners, we will be selling something to them simultaneously and thus a market will be created for them.

v. Say was interested in the development of industry.

vi. Say's Law became the basis for the laissez-faire policy of the government. As supply creates its own demand, it implies that there is automatic adjustment of the economy. So there is no need for State interference in economic matters.

Criticism:

J.B. Say holds an important place in the history of economic thought. Say's 'Law of Markets' was accepted as the true explanation of working of the economic system by most of the economists of the classical school. Malthus was the only classical economist who opposed Say's Law that "supply creates its own demand." He argued that demand might be deficient and cause unemployment.

Further we can show that Say's law of market is unrealistic from the following argument. Say stated that supply will create its own demand on the assumption that the incomes that are earned by people in the process of production are completely consumed. But we know that when there is an increase in income the entire income will not be consumed, a portion of it will be saved. Due to this, there may be deficiency of demand and supply will not create its own demand.

Haney stated that, "he was no Smith or Ricardo; he was no mere populariser ...the theory of political economy would have been different without J.B. Say."

Check Your Progress

19. How has Say classified the study of economics?
20. List two implications of Say's Law of Markets.

4.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

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1. According to Smith, the wealth of a nation can be increased by adopting the principle of 'division of labour' and division of labour is limited by the size of the market.
2. Smith's thoughts run parallel to those of the physiocrats as regards natural laws, beneficent providence, laissez-faire, self-interest and problem of surplus.
3. Smith states that ordinarily the "natural" action of private self-interest leads to the most perfect organisation of social and economic relations and to the greatest welfare of all.
4. According to mercantilists, the main source of wealth was trade. For the physiocrats, land (the bounty of nature) holds the central place. According to them, it was only land that was productive.
5. Division of labour has the following advantages-
   - Division of labour will increase the output per worker.
   - By doing the same kind of work constantly, the worker gets a great skill in his particular line. Practice makes a man perfect.
6. Smith advocated minimum role for the state in economic affairs. He considered non-intervention by government in economic matters as a wise policy. In his view, government are always and without any exception, the greatest spendthrift in the society.
7. Malthusian theory of population is based on the following two fundamental assumptions-
   - Food is necessary for the existence of man
   - Passion between the sexes is natural and will remain nearly in its present state.
8. If aid is given to the poor, then more children would survive and provoke the problem of hunger and misery. So Malthus suggested the gradual abolition of "Poor Laws".
9. The Malthusian theory of population applies to most of the underdeveloped countries like India and China which are dominated by agriculture.
10. According to Malthus, rent arose because of the following factors:
    - There was shortage of fertile land.
    - This necessitated the cultivation of lands of inferior fertility.

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- The produce in each case sold at natural price. The price of produce in each progressive country would be just equal to the cost of production on land of the poorest quality actually in use.

11. Malthus used the concept of effective demand to show that the economic system was not self-adjusting.
12. Ricardo believed that political economy was an enquiry into the law which determined the division of the produce of industry among the classes who contribute to its formation.
13. By natural value Ricardo means that point around which market value fluctuates and ultimately tends to equalise with it. The natural value is the long-term tendency.
14. Rent can be divided into two phases: (i) Cultivation of Lands of Inferior Quality or Extensive Cultivation, (ii) Low Diminishing Return and Intensive Cultivation.
15. Ricardo proposed that the Bank of England should reduce the quantity of Notes in circulation so long as the price of bullion does not come down to its normal level.
16. Ricardo advocated that an efficient country should export those goods whose comparative cost is the lowest and it should import those goods whose comparative cost is the highest.
17. Mill assumed the existence of two different spheres of human action: those which concern himself (self- regarding) and those which concern others (other- regarding).
18. Mill wrote: 'The institution of property when limited to its essential elements , consists in the recognition, in each person, of a right to the exclusive disposal of what he or she has produced by their own exertions, or received either by gift or by fair agreement , without force or fraud; from those who produced it.
19. The study of economics is classified by Say into the three main parts: (i) Production (ii) Distribution (iii) Consumption of wealth.
20. The implications of Say's Law of Markets are:
    - As 'supply creates its own demand,' there will be no general over-production. It implies that there can be no general unemployment.
    - According to this law, it will be profitable to have wide markets for they will increase the demand for goods and raise their prices.

4.8 SUMMARY

NOTES

- Adam Smith, first of all, emphasises the importance of labour as the source of wealth of a nation. According to him, the wealth of a nation can be increased by adopting the principle of 'division of labour' and division of labour is limited by the size of the market.
- In the theory of money, Smith stands grateful to Hume, Locke and Stuart. Smith's historical interests were inspired by Stuart. Smith took over the problems of public finance and some of the solutions from Petty and Stuart.
- Smith lays emphasis on labour as "productive labour'. According to Smith, productivity included any addition to exchange value i.e. productivity of labour was the value which it added to the materials on which it worked.
- According to Smith, there are two kinds of value: (1) value- in -use (2) value- in- exchange. Value-in-use expresses the utility of some particular object, in modern analysis, the capacity of a thing to satisfy wants. Value in exchange is the power of purchasing other goods.
- Like wages, profit also depends upon the increasing and decreasing state of wealth in a country. Under the condition of competition, an increase in capital will lead to a decline in the rate of profit and vice versa.
- Smith advocated free trade. Free trade means that trade as among countries is not subject to restrictions. Smith was opposed to the mercantilist theory of balance of trade. Smith did not accept the mercantilist view that foreign trade is advantageous because it acquires gold and silver.
- Smith's argument relating to wage led to no definite conclusions in so far as a tenable theory of wages is concerned. He has given many ideas but without any strong conviction.
- The Malthusian theory of population discusses the relationship between population and supply of food. In simple words, all that the theory states is that population increases at a faster rate than food supply.
- Malthus considers the poor to be entirely responsible for their poverty and misery. Poverty and misery are the natural punishments for the poor class because they have failed to restrict their numbers. It follows from the above view that the government should not provide relief to the poor by means of "Poor Laws".
- Malthus defended the Corn Laws and emphatically stated that the cause of high prices of food was the population growth and progress. The growth of population heads to the scarcity of food for the production of which good land become scarce.

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- Malthus used the concept of effective demand to show that the economic system was not self-adjusting. Unless a large body of unproductive consumers was maintained, there would be periodic over-production, gluts in the market and stagnation.
- Ricardo was not concerned with absolute values but with relative value. He says that although the employment of capital does not affect relative value, the difference in the proportion of fixed and circulating capital in different industries affects relative value.
- Ricardo's idea is that in the long run, the wages of workers will enable them to live only at a subsistence level of wages. When the market price of labour rises above the natural price, there will be expansion in the families of the workers.
- The theory of comparative cost is the major contribution of Ricardo to the theory of foreign trade. Adam Smith advocated free trade competition in foreign trade and his theory of trade was based on difference in absolute cost. But Ricardo developed the theory of comparative cost.
- The primary purpose of Mill was to protect the individual even his eccentricities and oddities against the attacks of society. He contends that social and 'political progress depends largely on the originality and energy of the individual and his free choice.
- Mill in his work on utilitarianism modified the views of Bentham for the betterment of the society. He recommended numerous rudiments which were opposed to the hedonist doctrine of Bentham.
- According to J.B. Say, Political Economy studied and discovered the laws which govern wealth. The study of economics is classified by him into the three main parts: (i) Production (ii) Distribution (iii) Consumption of wealth.
- Say's market law states that supply creates its own demand. Say stated that "it is production which creates market for goods." In other words, whatever is produced represents the demand for another product.
- The law of Markets has been used in support of Free Trade doctrine. When we buy something from foreigners, we will be selling something to them simultaneously and thus a market will be created for them.

4.9 KEY WORDS

- **Classical Economics:** It refers to the school of thought of economics that originated in the late 18th and early 19th centuries, especially in Britain. It focused on economic growth and economic freedom, advocating laissez-faire ideas and belief in free competition.

- **Canons of taxation:** These refer to the administrative aspects of a tax. They relate to the rate, amount, method of levy and collection of a tax.
- **Natural Price:** It is the (intrinsic) value of a commodity with respect to the costs of production, as distinguished from the fluctuating market value.
- **Market Price:** It refers to the amount of money for what an asset can be sold in a market. The market price of a commodity is closely linked with the demand and supply factors of the commodity.
- **Protectionism:** It is the economic policy of restricting imports from other countries through methods such as tariffs on imported goods, import quotas, and a variety of other government regulations.
- **Political economy:** It is a social science that studies production, trade, and their relationship with the law and the government. It is the study of how economic theories affect different socio-economic systems such as socialism.
- **Socialism:** It is a political and economic theory of social organization which advocates that the means of production, distribution, and exchange should be owned or regulated by the community as a whole.

4.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Which ideas did Smith get from Hutcheson?
2. List the events that marked the beginning of a new era in economic and political organization.
3. What does 'division of labour' refer to?
4. What is the division of labour marked by?
5. Write a short note on value-in-use and value-in-exchange.
6. List the ways in which capital of the nation may be employed.
7. State the three propositions of Malthus' theory of population.
8. List any three of Ricardo's main works.
9. Why did Ricardo use the term rent in a restricted manner?
10. How do Mill and Bentham's ideas differ?

Long-Answer Questions

1. Discuss any two influences that shaped Smith's thoughts.
2. Analyze Smith's concept of 'division of labour'.

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3. Describe the three portion of capital that set the labour in motion.
4. Explain why Smith was opposed to the mercantilist theory of balance of trade.
5. Examine the four canons of taxation.
6. Discuss Malthus' concept of market glut.
7. Elaborate upon the criticism of the Ricardian theory of rent.
8. Explain Mill's theory on utilitarianism.

4.11 FURTHER READINGS

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UNIT 5 CLASSICAL SCHOOL-II

NOTES

Structure

5.0 Introduction
5.1 Objectives
5.2 Alfred Marshall
5.3 J.A. Schumpeter
5.4 Pigou
5.5 Answers to Check Your Progress Questions
5.6 Summary
5.7 Key Words
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5.9 Further Readings

5.0 INTRODUCTION

In the previous unit, you studied about the classical school of economics, its main thinkers and the important concepts formulated by them. The discussion is continued in the present unit with an overview of the contributions made by three eminent economists namely Alfred Marshall, Joseph Schumpeter and Arthur Cecil Pigou.

5.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand Alfred Marshall's theories and laws of economics
- Discuss Schumpeter's methods of study and innovation theory
- Describe Pigou's economics of welfare, hypothesis and liquidity trap among other important concepts

5.2 ALFRED MARSHALL

Alfred Marshall was one of the greatest economists of his generation. He was the founder of the neoclassical school and was the first economist to rename political economy as economics. He is the one who gave value to the study of human wants and expenditure. His *Principles of Economics* is a masterly description and a modern adaptation of old ideas. He was the founder of the "Cambridge" school of Neoclassicism and author of most winning book, *Principles of Economics* (1890).

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Early years

Alfred Marshall was born at Clapham in London in 1842, and belonged to a humble background. His father was William Marshall, who worked as a clerk at the Bank of England. Alfred Marshall was educated at Merchant Taylors, a non-residential private school, and obtained distinction in school, as his records indicate a strong ability and skill for mathematics. With the financial support of his uncle, Marshall joined St. John's College at Cambridge University in 1862, to pursue Mathematics. He ended up achieving the second highest score in Cambridge's mathematics exam in 1865. After a short period as a substitute teacher in Bristol, Marshall was elected as an associate of St John's at the end of 1865. Marshall spent some years as a tutor, and was finally selected as lecturer in moral sciences at St. John's in 1868. His intellectual comfort shifted during this period. He moved from mathematics and grew fascinated in moral beliefs and ethics, then metaphysics, and finally altercated towards economics.

Marshall claims that he had come up with the neoclassical theory of value on his own, before reading Jevons' 1871 book. The latter is carefully dated, as Marshall reassessed Jevons' thesis for the Academy in 1872. Due to this reason, most historians have dismissed Marshall's claim as an overstated possession.

In 1875, Alfred Marshall went on a tour of the United States of America, financed by a small inheritance left by his uncle. He got engaged to Mary Paley in 1876, and they got married in 1877. According to Cambridge rules and regulations in place, marriage meant both had to resign from their positions at the university. Then the couple shifted to Bristol, where Marshall secured the positions of Foundation Principal and Professor of Political Economy at the recently-created Bristol University College in 1876. Due to his administrative obligation, Alfred allocated Mary to take over the work for the economics class. This finally helped to construct, *Economics of Industry* in 1879, a book written together by Alfred and Mary. That same year, Marshall had two of his small tracts, *Pure Theory of Foreign Trade* and *Pure Theory of Domestic Values*, privately printed for distribution among economists. These are the first of Marshall's works to contain diagrams - the famous Marshallian "offer curves" are introduced in the first, and demand-and-supply diagrams and the theory of consumer's rent, introduced in the second.

Overwork and ill-health provoked Marshall to resign from Bristol in 1880. The couple then stayed for a short period in continental Europe, to help Marshall recover. It was here that Marshall began writing the *Principles of Economics*, in 1882, which later become his most famous work. The Marshalls returned to England and taught at Bristol for a year again. In 1883, Alfred Marshall was hurriedly appointed to replace the late Alfred Toynbee at Balliol College, Oxford. He remained at Oxford for two years.

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He was elected as Professor of Political Economy at Cambridge University in 1885 on the death of Henry Fawcett. From this position, Marshall supervised Cambridge economics for the next two decades. Marshall helped design Balliol House, where they moved in 1886.

Marshall gave indication to parliamentary commissions for Depression of Trade in 1886, Gold and Silver in 1887, Aged Poor in 1893, Local Finance in 1897 and Indian Currency in 1899. He was the member of the Labour Commission and wrote an important message of economic policy and trade in 1908.

The Principles

Alfred Marshall's *Principles of Economics* was published in July, 1890. It was the first book published in Britain with a "net book agreement" - that is, the publisher Macmillan compelled booksellers to agree not to discount book price at retail. Marshall was bothered about the poorer students who would not be able to buy the book without discount. But Macmillan declared that without the agreement, the publishers' price would be much higher. In the end, it was agreed that *Principles of Economics* will be sold at a fixed price of 12s 6d.

The title page contained his famous saying, that "Nature does not make jumps" and Marshall visualized this to be simply the theoretical part that it would be tagged along by other volumes applying the theory to specific topics - foreign trade, money and banking, business cycles, growth, taxation, regulation, trade unions etc. The Principles was divided into six books.

Definition of Economics

According to Marshall, economics and political economy are both a study of normal dealing of life. It is on the one side a study of assets and on the other important side, a part of the study of man. It deals with the financial aspects of man and not social, political or religious aspect of his life. It describes their regular business of life, which consists of earning and spending money for the fulfilment of their necessities of life such as food, clothing and shelter. According to him, wealth is only a means to well-being. Hence he has given chief importance to man and secondary to wealth.

Method

As far as the method of study of economics is concerned, he considered induction and deduction both as useful characteristics of economics and according to him, both complement each other. Both induction and deduction are essential for scientific thought, as the left and right foot are both needed for walking.

Marshall was the great paraphraser of the method of partial equilibrium. The forces manipulating an economic activity are abundant and it is very challenging to examine all of them to reach at a complete description of the phenomenon.

Consequently, the best process is to keep other forces constant, and study the forces inducing the phenomenon. Thus all the other forces are reduced to inaction by the phrase "other things being equal".

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Wants and Satisfaction:

Marshall evaluates the features of wants and distinguished between necessities, comforts and luxuries. He believed that expenditure as the starting and end of all the economic activities and so he talks about spending first and production afterwards.

Utility and Demand: - A rational consumer wishes to maximize satisfaction from his consumption. The amount of satisfaction is closely connected to the amount of the goods consumed by the consumer.

Marshall has given equal importance to marginal utility with subjective real cost in theory of value. Marshall stated that supply and demand both determine the value. Demand is measured by marginal utility, whereas supply is measured by real cost. Marshall equated supply and demand to two blades of a pair of scissors. As per Marshall, the price of a commodity is not determined by supply alone or demand alone but by both demand and supply curve.

Marshall's Theory of Value and Time Element

Marshall's theory of value lays emphasis on both supply and demand as forces prevailing value, which is recognized as the Dual theory of value. It is necessary to note down that the hypothesis highlights the role of edge. Price is measured by the services of supply and demand at the edge. It is trivial efficacy and trivial price of manufacture that manage the cost.

Marshall classified value into four kinds

(i) Market place value,

(ii) Short term value,

(iii) Long term value

(iv) Secular value.

The market price of a product may be defined as the cost decision at a particular episode. In the case of market value, the contribution is fixed and price depends primarily on demand.

Law of Diminishing Marginal utility

Demand is based on the law of retreating marginal utility. Marshall confirmed the law thus, "the added benefit which a person obtains from a given boost of the supply of a thing, weaken with every raise in the stock that he already has".

Demand refers to the demand of a commodity at an exact price, other things being the same. The individual demand curve can be directly taken from the

rule of diminishing marginal utility. Assuming the marginal utility of money to be constant as the satisfaction from the additional units of a commodity diminishes, the price offered to additional units will fall. Hence the demand curve slopes downwards.

These individual demand curves can be summed up together to develop market demand curve. The market demand curve symbolizes the sum total of order of all the customers for a product at different prices. On the beginning of retreating utility, Marshall has developed the rule of replacement.

Up to now customer actions have been scrutinized with reference to only one commodity. In reality, the consumer has to select between more than one commodities. A balanced consumer will pay out his money in such a way that his total pleasure is utmost. They will go on replacing one product for another till they get optimum satisfaction.

Elasticity of Demand

Marshall introduced the concept of the "elasticity of demand" to economics. According to him, the elasticity of demand in a Market is great or small as the amount demanded increased more or less for a given fall in price and reduces much or little for a given rise in price. He explains how elasticity differs along the demand curve –declaring it as inelastic at very high and very low prices, and quite elastic at mediator prices. He also explains the comparative inelasticity of essential goods.

He illustrates five degrees of elasticity—perfectly elastic, unitary elastic, greater elastic, less elastic and inelastic. He explained that the demand for luxurious goods was highly elastic, for comforts elastic and for necessities, it is inelastic.

Formula to measure Elasticity of Demand:

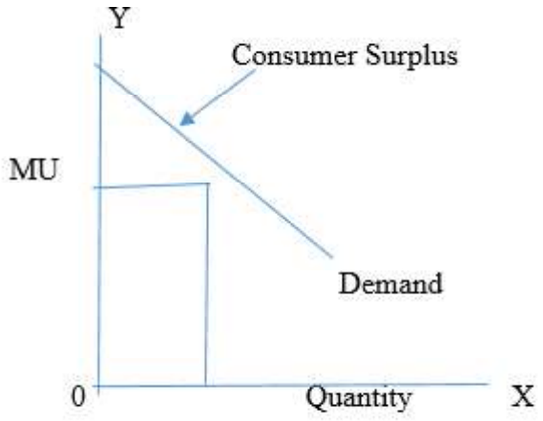
$$\text{Elasticity of demand} = \frac{\text{Percentage change in the quantity demanded}}{\text{Percentage change in price}}$$

Marshall was the first to define price elasticity of demand. Marshall gave three types of price elasticity—unit, greater than unit and less than unit elasticity. He also listed the factors affecting price elasticity of demand naming price level, nature of commodities, and various uses of commodities, substitute goods, time, taste and preference.

Consumer Surplus

Marshall introduced the term consumer surplus to economic literature in 1879 "consumers' surplus", or as he also called "Consumers' Rent" he defines the excess of the price which a customer would be willing to pay rather than go without the thing, over that which he actually does pay is the measure of this surplus satisfaction and can be called consumer surplus. Thus the concept of consumer surplus has become the basis of welfare economics.

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Representative firm

His second version of the Principles came out in June 1891, with the rescheduling some chapters. Among the major changes in the second edition is the introduction of the "representative firm". It go through more changes, passing through eight editions overall.

As defined by Marshall, a 'Representative firm' has the following characteristics:

1. A representative firm will be an average firm. It has a fair amount of internal and external economics
2. It is neither declining nor increasing.
3. Its management is neither very efficient nor inefficient.
4. It is neither old nor new.
5. It is neither earning super normal profits nor incurring losses.
6. There can be more than one such firm.

The Principles was not written as a course book or a book on classroom instruction. Marshall brought out his *Fundamentals of Economics of Industry* in 1892 which was basically a simplified description of the Principles, for young students and the wider public. But it was the Principles that become the major dissertation and brought English Neoclassicism to universities all over the world.

Factors of Production

According to Marshall, land and labour are the two leading factors of production. Capital is the subordinate factor of production. Entrepreneur is just a variety of labour. Consequently, land and labour are the major factors of production. Man being active, is the central force behind all activities relating to production and consumption, but nature plays a substantial role as he is shaped by his surroundings and environment.

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Division of Labour

Marshall held that enlarged demand for produce and extension of the market lead to division of labour. Division of labour and development of machinery went on collectively. Technology offers numerous rewards viz., avoids repetitiveness and mitigates the strain of muscles.

In order to achieve optimum saving in production, each individual should be persistently employed so that the proficiency and capacity may be used in a most excellent way. In short, Marshall identified the significance and the reward of division of labour.

Law of Returns

Alfred Marshall has explained that, "A raise in assets and labour functional in the farming of land causes in general a less than proportionate raise in the amount of manufacture raised, unless it happens to agree with a development in the art of cultivation."

Marshall said that cultivation was subject to the law of diminishing proceeds in the long run and the business division was subject to the law of growing returns. As per Marshall, "the division which natural world plays in manufacturing shows an inclination to diminishing returns, the part which man plays shows a tendency to growing return".

Marshall acknowledged the Law of Increasing Returns hence "A raise of labour and wealth go ahead usually to better organization which raise the effectiveness of the work of labour and principal." In manufacturing, a raise in unit of labour and capital would reflect more than proportion raise in manufacture.

Marshall explained the Law of Constant Returns in the following way: "If the actions of the laws of rising and diminishing profits are balanced, we have the law of constant return and an enlarged manufacture is achieved by labour and gives up increased just in section".

From the Laws of Returns, he arrived at a certain policy ending. He indicated that according to the law of increasing returns, industry would yield more economically. But he stated that the difficulty was that it would become a tool of power politics and it might not be put to appropriate use.

Later years

At Cambridge University, Marshall amplified the importance of economics in the Moral Sciences Tripos and the History Tripos, and later pressed Cambridge to create the separate "Economics and Political Sciences" Tripos. This new tripos was permitted by the university in 1903, and started in 1905.

Marshall took retirement in 1908. Against everyone's expectations, Marshall suggested Arthur Cecil Pigou as his successor as Professor of Political Economy

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at Cambridge rather than Herbert Foxwell. After retirement, Marshall set about completing his long-planned companion volume of the philosophy, applying the basic theory to definite areas. But due to his illness and other interruptions, progress was slow. His first companion volume, Industry and Trade, came into view in 1919 and the second, Money, Credit and Commerce, in 1923. But by this time, Marshall had already prepared a methodical layout of action and it is assumed that the latter volume was in fact paved by Mary Paley and the third volume, on economic progress, never went further than a rough sketch. Marshall died on July 13, 1924.

Check Your Progress

1. Name the first book published in Britain with a "net book agreement".
2. What does economics describe?
3. State the five degrees of elasticity illustrated by Marshall.
4. What should an individual do to achieve optimum saving in production?

5.3 J.A. SCHUMPETER

Schumpeter was born in 1883 in Moravia in the Austrian province. He received the degree of Doctor of law in 1906 from the University of Vienna. In his initial years he practiced law but later he decided to specialise in Economics. He studied Economics from professors Weiser, Philippovich and Bohm-Bawerk. During the seminars, he came into contact with Mises Bauer, Semary and Hilferding. He started teaching in 1909 at the University of Czernoitz, Graz (Austria), Bonn (Germany), Columbia and Harvard. He was famous for his achievements. He was the president of Econometric Society from 1937 to 1941 and of the American Economic Association in 1949.

He worked as minister of finance in the Austrian government, the president of a private bank, and a professor, before being compelled to leave his home country, due to the rise of the Nazis.

In 1932, he moved to the United States to teach at Harvard. Fifteen years later, in 1947, he became the first immigrant to be elected president of the American Economic Association. Born in Austria to parents who owned a textile factory, Schumpeter was very familiar with business when he took admission in the University of Vienna to study economics and law. He was one of the talented students of Friedrich von Weiser and Eugen von Bohm-Bawerk, published the book *Theory of Economic Development* at the early age of twenty-eight. In 1911, he got professorship in economics at the University of Graz. He was also minister of finance in 1919. With the rise of Hitler, Schumpeter left Europe and the University of Bonn, where he was a professor from 1925 until 1932, and moved

to the United States. In that same year he joined at Harvard, where he stayed till his retirement in 1949. He became president of the American Economic Association in 1948. He died in the year 1950.

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Influences

Schumpeter was influenced by Walras' general equilibrium analysis and the analysis of capitalist process of Fisher and Clark. And at the same time Weiser and Bohm-Bawerk influenced him in his idea relating to marginal productivity, order of goods, and opportunity costs etc.

He was a Marxist. But the scrutiny that led Schumpeter to his conclusion was totally different from that of Karl Marx. Marx believed that capitalism would be destroyed by its opponents whom entrepreneurship had allegedly exploited, and he enjoyed the view. But Schumpeter believed that capitalism would be shattered by its successes, that it would generate a large scholarly class that made its living by attacking the very bourgeois system of private possessions and freedom so it is necessary for the intellectual class's survival. Unlike Marx, Schumpeter did not enjoy the demolition of capitalism.

Capitalism, Socialism, and Democracy are much more than projections of capitalism's future. It is also a spotless protection of capitalism. Undeniably, Schumpeter was among the first to place a clear concept of entrepreneurship. He distinguished inventions from the entrepreneur's innovations.

Schumpeter was a great figure in the history of economic thought. His work in the History *of Economic Analysis,* completed by his third wife, Elizabeth Boody, and published after his death in 1954 is quite remarkable. In this book, Schumpeter made some notorious comments about other economists, arguing that Adam Smith was imitative, Alfred Marshall was puzzled, and Leon Walras was the greatest economist of all time.

Joseph Alois Schumpeter was an economist who was regarded as one of greatest intellectuals of the 20th century. He is best known for his theories on business cycles and capitalist development and for bringing in the thought of free enterprises.

Schumpeter's Contribution

- *The theory of Economic Development* (1912)
- *Business Cycles*-Two volumes (1939)
- *Capitalism, Socialism and Democracy* (1942)
- *Ten Great Economists* (1951)
- *Essays* (1951)
- *Imperialism and Social Classes* (1951)

- *History of Economic Analysis* (1954)
- *Economic Doctrine and Method* (1957)

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Methods of Study

As per Schumpeter's view, both inductive and deductive methods are compulsory for the study of economic science. Deductive methods are effective in price theory and inductive method was appropriate for the study of organisation of economics. Historical method was the most important for him. He has accepted mathematics as an essential means in the science of economics.

Over his many years in public life, Schumpeter developed informal contentions with the other great intellectuals of the west, including John Maynard Keynes, Irving Fisher, Ludwig von Mises and Friedrich Hayek. His work initially was outshined by some of his contemporaries.

Renowned Principles

Schumpeter is recognized for his 1942 book *Capitalism, Socialism, and Democracy* as well as for the theory of dynamic economic growth known as creative destruction. He is also attributed with the first German and English references to methodological individualism in economics.

Creative Destruction

Schumpeter made many contributions to economic science and political theory, but by far his most enduring legacy came from a six-page chapter in *Capitalism, Socialism, and Democracy* entitled "The Process of Creative Destruction."

Schumpeter invented the term 'creative destruction' to define how the old is being persistently swapped by the new. Schumpeter offered a new, distinctive vision into how economies grow, explaining that economic growth is not steady and passive but rather jerky and sometimes unpleasant."

The same process of industrial mutation—if I may use that biological term—that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of creative destruction is the essential fact about capitalism," he said.

Role of Entrepreneur

According to him, in any economic development, an entrepreneur plays a significant part. Schumpeter is believed to be the first scholar to acquaint the world with the theory of entrepreneurship. He derived the German word *Unternehmergeist,* meaning entrepreneur-spirit, adding that these entities organised the economy because they are liable for carrying innovation and technological transformation.

Schumpeter's arguments abruptly diverged from the prevailing practice. He highlighted the fact that markets do not passively tend toward equilibrium until profit margins are wiped out. Instead, entrepreneurial innovation and

experimentation constantly destroy the old and introduce new equilibrium, making possible higher standards of living.

In many respects, Schumpeter saw capitalism as a method of evolution within the social and economic hierarchy. The entrepreneur becomes the revolutionary, upsetting the established order to create dynamic change.

The praise for innovations and explosion of economic activity belonged to entrepreneur and in a world full of hazard and uncertainty; only excellent entrepreneurs will be successful by introducing innovative ideas. Hence an entrepreneur played a significant role in determining the rate of economic growth of any country and in their absence there will be hurdles in the growth rate.

Schumpeter's Innovation Theory

He has developed innovation theory of trade cycle which is based on his ideas that include the invention of new product, opportunity of a new market, reorganisation of an industry and progress of new methods of production.

As he assumes that these innovations can decrease the cost of production and may alter the demand curve. Hence innovations may bring about changes in economic conditions.

But his theory has been criticised on many accounts. His full employment theory is an unrealistic assumption as no country in this world has achieved full employment and innovations are usually financed by the promoters and not by banks.

Capitalism and socialism

Schumpeter agreed with Marx that capitalism planted the seeds of its own destruction, due to inner disagreement. The economic and social foundations of capitalism fell down on account of the destruction of the industrial structure and the decay of the entrepreneurial function. The sophisticated unemployed groups were not in favour of the capitalist class, and labours also organised themselves to fight against capital and the intellectuals supplied the leadership. All these factors led to the gradual decay of capitalism and supported the movement towards socialism.

As an economist, Schumpeter occupies an exceptional position. He founded no school and hardly had any follower. He was a class by himself. He possessed mastery over all branches of economics. He was autonomous in his ideas and style. Despite the originality of ideas and expression, his writings suffer from uncertainty and lack of consistency. "The result of complication, diversity and universality of his mind was that he could not fully incorporate his ideas", and that is why he could not gain the place which was held by his colleagues, especially Keynes.

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Check Your Progress

Check Your Progress

5. Name the notable economists by whom Schumpeter was influenced.
6. What is Schumpeter best known for?
7. Who invented the term 'creative destruction'?

5.4 PIGOU

Arthur Cecil Pigou was a British economist (1877-1959) and a disciple of Alfred Marshall. He prospered as a professor of Economics at the University of Cambridge. After Marshall he become the leading Neo-classical economist. He is the founder of "welfare economics". Being part of the Cambridge school, Pigou used common tools derived from neoclassical economics, such as marginalism, amongst others.

He remains an underappreciated contributor to the discipline of economics. Its most prominent years began from around the 1800s over to the work of John Maynard Keynes. Pigou's influence on the field is even superior to his own research. Pigou broke new ground in the regulation of welfare economics, for in his books *Wealth and Welfare* (1912) and *The Economics of Welfare* (1920), he used measures of national income and its allocation in order to understand how wealth and welfare are interrelated. He is also remembered for making a distinction between different degrees of price discrimination. His most durable contribution being the conceptualization of a corrective tax, immensely referred to as a Pigovian tax.

He was the son of an army officer and was educated at Harrow and King's College, Cambridge. He started off with reading history but later went on to study economics under Alfred Marshall as part of the Moral Science Tripos, rapidly becoming a prized scholar. Through Marshall's efforts, Pigou began lecturing himself in economics in 1901, became a member of King's in 1902 and won the popular Adam Smith Prize in 1903.

Pigou was considered one of the best students of Alfred Marshall. When Marshall retired as a professor of political economy in 1908, he was named as Marshall's substitute. Pigou was responsible for disseminating many of Marshall's ideas and thereby presented the leading hypothetical basis for what came to be known as the Cambridge school of economics.

Pigou applied his economic investigation to a number of other problems, including tariff policy, unemployment, and public finance. He also served on the Royal Commission on Income Tax (1919–20).

Economics of Welfare

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Pigou provided the first organized hypothetical basis of welfare economics and unified the normative problems with the progressive ones. He delivered a foundation for state interference at places here reserved and social net product deviated but his policy proposals were all value based as his study was more normative than theoretical. Though it was the first clear analysis of welfare economics, was criticized on many grounds.

Welfare is reflected in a person's mental condition or awareness which are made up of his satisfactions or utilities. The basis of welfare, therefore, is essentially the level to which an individual's basic needs are met.

Social welfare is deliberated as the core of the welfare of all the people in a society. Subsequently overall welfare is a very broad, complex and an unfeasible idea. Pigou set the limits of the assortment of his study to economic welfare. According to him, economic welfare is by no means a directory of aggregate welfare as several other components, like the excellence of work, one's surroundings, human relations, prestige, accommodation, and public safety are far away from economic welfare.

Pigou, therefore, described economic welfare as "that part of social (general) welfare that can be brought directly or indirectly into relation with the measuring rod of money." Thus economic welfare, in the Pigovian sagacity, comprises the aspiration of utility resulting from the usage of negotiable goods and services.

Pigovian Welfare Conditions

Pigou reflected that economic welfare and national revenue as basically synchronized. It is on this basis that he arranges two situations for maximization of welfare. The first incident states that welfare is upsurged when national income rises. An upsurge in the national income signifies an escalation in welfare. Pigou argued that in maximum cases the national income would upturn even though the disutility of work also rises.

Second, for welfare maximization, the sharing of the national income is similarly essential. If national income rests steady, flowing of income from the opulent to the deprived would ensure welfare. According to Pigou, such allocations mean a minor amount to the prosperous than to the deprived, as a consequence the financial situation of the former is improved. This welfare circumstance is based on the double Pigovian postulates of 'equal capacity for satisfaction and retreating marginal utility of income.'

He argued that different people obtain the same pleasure out of the same real income and that "people now rich are different in kind from the people now poor having in their original nature greater capability for enjoyment." With income subject to moving back to marginal utility, and transfers of income from the rich to the poor will boost social welfare by satisfying the more passionate wants of the

latter at the expense of the less intense wants of the former. Thus it is equal economic opportunity that maximizes welfare.

Dual Criterion

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To find up gradation in social welfare, Pigou implements a dual criterion:

First, a rise in the national revenue 'brought about either by increasing some goods without diminishing others or by relocating factors to activities in which their social value is higher,' is regarded a development in welfare without dropping the share of the poor.

Secondly, any restructuring of the economy which adds to the share of the poor without sinking the national income is also considered a development in social welfare.

Assumptions of Pigovian Conditions

(1) Each person tries to maximize on his contentment from his expenses on different goods and services.

(2) Satisfactions are comparable interpersonally.

(3) The law of diminishing marginal utility of income applies. It means that the marginal utility of income decreases as income rises. As a consequence, the growth in utility of a surplus volume of income to a deprived man is superior to the cost of utility to an opulent man from the similar extent of revenue.

(4) There is equivalent capability for satisfaction. It follows that different people gain the same satisfaction out of the same real income. Given this theory, it is possible to satisfy the Pigovian circumstances of maximum social welfare on the basis of his double measure.

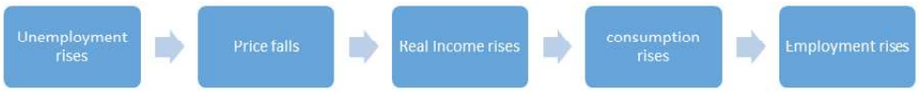
Pigou effect

Pigou was generally critical of Keynesian macroeconomics and developed the thought of the Pigou effect on real money stability. He advocated that the economy would be more self-stabilizing than Keynes projected. The term was named after Arthur Cecil Pigou by Don Patinkin in 1948.

Actually wealth was defined by Arthur Cecil Pigou as the summing up of the money supply and government bonds divided by the price level. He argued that Keynes' *General Theory* was lacking in not specifying a link from "real balances" to current consumption and that the totalling of such a "wealth effect" would make the economy more "self-correcting" to drops in aggregate demand than Keynes' forecast. As the result is received from changes to the "Real Balance", this evaluation of Keynesianism is also called the **Real Balance effect**.

As the universal price falls, the real money stability with the households and firms improves, which is equivalent to rise in their real wealth. This causes their expenditure and asset spending to rise, which leads to a rise in the collective

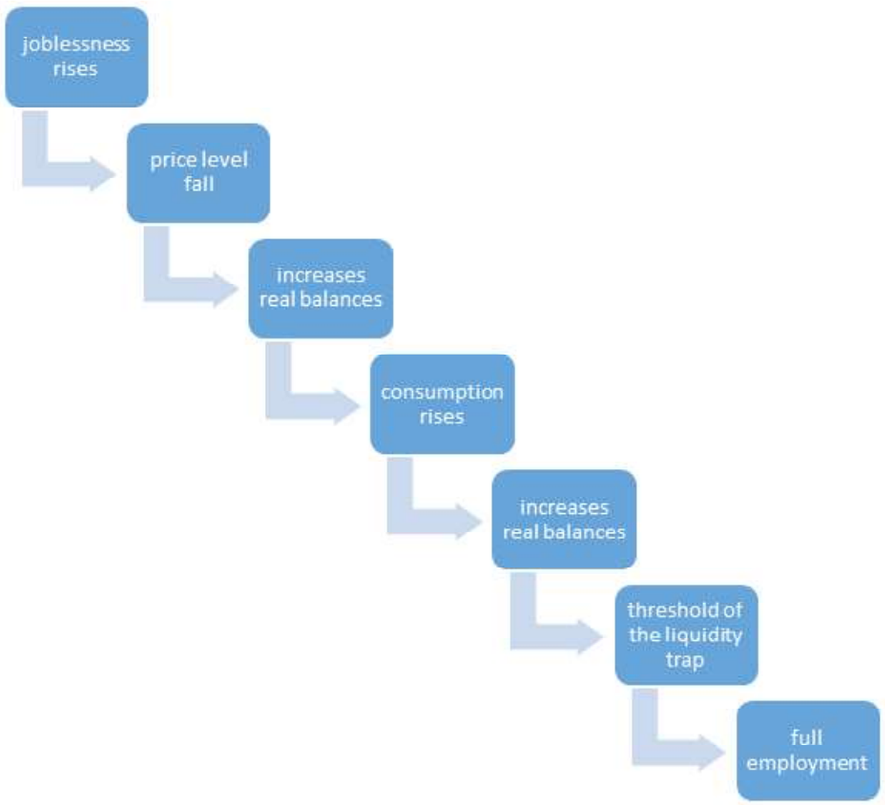
demand and thereby to an increase in actual income. Therefore, a drop in the price set off a rise in the actual income. This is explained by the cycle given below:



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Pigou's hypothesis and the liquidity trap

An economy in a liquidity trap cannot use monetary incentive to increase output because there is little relation between personal income and money demand. John Hicks considered that this might be another cause for steadily high unemployment. However, the Pigou effect creates a method for the economy to break away from the trap:



Pigou accomplished that equilibrium with employment below the full employment rate could only occur if prices and income were sticky.

Pigovian tax

The notion of externalities is established by A.C. Pigou. He contended that the government should intervene to correct them by taxing undertakings that harm the entire economy and finance activities that help the society as a whole.

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A Pigovian tax is an administration price on any activity that generates socially negative externalities. An externality is an action that forms an injurious effect on others in a society but not basically on the individual who indulges in that activity.

For example, pollution is an externality. Motorists of non-compliant automobiles don't suffer rightly from their smoke, but everybody behind them does. Their drain also upsurges pollution in the community.

The government induces Pigovian taxes on non-compliant vehicles to levy a greater fee on the drivers to pay off for the suffering they cause. The revenue from the tax is often used to improve the external cost. Preferably, a Pigovian tax will cost the manufacturer the same amount of harm that it causes others.

The main dispute against Pigovian tax is that externalities are hard to calculate. The distortive effects of an imperfectly set tax, especially added with the administrative costs of implementation, outweigh any potential benefit. But with the costs of pollution and climate change so large and extensive, the wrong increase in the cost of pollution is almost certainly better than none at all.

Later Years

He was a great climber who loved mountains and climbing, and also introduced climbing to his many friends, such as Wilfrid Noyce and others. An illness affecting his heart developed in the early 1930s, however, and this affected his vigour, curtailing his climbing and leaving him with phases of weakness for the rest of his life. Pigou gave up his position as professor in 1943, but remained an associate of King's College till his death. In his later years he gradually became more of a recluse, coming occasionally from his rooms to give lectures or to take a walk.

Pigou never married. He had good friendships, particularly in his later years. He had a penchant for complaining about politicians.

Check Your Progress

8. What is Pigou's most durable contribution?
9. What does economic welfare, in the Pigovian sagacity, comprise?
10. State any two assumptions of the Pigovian conditions.
11. Why can't an economy in a liquidity trap use monetary incentive?

5.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Alfred Marshall's *Principles of Economics* was published in July, 1890. It was the first book published in Britain with a "net book agreement".

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2. Economics describes the regular business of life, which consists of earning and spending money for the fulfilment of their necessities of life such as food, clothing and shelter.
3. Marshall illustrates five degrees of elasticity—perfectly elastic, unitary elastic, greater elastic, less elastic and inelastic.
4. In order to achieve optimum saving in production, each individual should be persistently employed so that the proficiency and capacity may be used in a most excellent way.
5. Schumpeter was influenced by Walras' general equilibrium analysis and the analysis of capitalist process of Fisher and Clark. And at the same time Weiser and Bohm-Bawerk influenced him in his idea relating to marginal productivity, order of goods, and opportunity costs etc.
6. Schumpeter is best known for his theories on business cycles and capitalist development and for bringing in the thought of free enterprises.
7. Schumpeter invented the term 'creative destruction' to define how the old is being persistently swapped by the new.
8. Pigou's most durable contribution is the conceptualization of a corrective tax, immensely referred to as a Pigovian tax.
9. Economic welfare, in the Pigovian sagacity, comprises the aspiration of utility resulting from the usage of negotiable goods and services.
10. The assumptions of Pigovian conditions are:
    - Each person tries to maximize on his contentment from his expenses on different goods and services.
    - Satisfactions are comparable interpersonally.
11. An economy in a liquidity trap cannot use monetary incentive to increase output because there is little relation between personal income and money demand.

5.6 SUMMARY

- Marshall claims that he had come up with the neoclassical theory of value on his own, before reading Jevons' 1871 book. The latter is carefully dated, as Marshall reassessed Jevons' thesis for the Academy in 1872.
- Marshall gave indication to parliamentary commissions for Depression of Trade in 1886, Gold and Silver in 1887, Aged Poor in 1893, Local Finance in 1897 and Indian Currency in 1899.
- According to Marshall, economics and political economy are both a study of normal dealing of life. It is on the one side a study of assets and on the other important side, a part of the study of man.

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- Marshall was the great paraphraser of the method of partial equilibrium. The forces manipulating an economic activity are abundant and it is very challenging to examine all of them to reach at a complete description of the phenomenon.
- Marshall's theory of value lays emphasis on both supply and demand as forces prevailing value, which is recognized as the Dual theory of value. It is necessary to note down that the hypothesis highlights the role of edge.
- Marshall introduced the concept of the "elasticity of demand" to economics. According to him, the elasticity of demand in a Market is great or small as the amount demanded increased more or less for a given fall in price and reduces much or little for a given rise in price.
- According to Marshall, land and labour are the two leading factors of production. Capital is the subordinate factor of production. Entrepreneur is just a variety of labour. Consequently, land and labour are the major factors of production.
- Schumpeter was influenced by Walras' general equilibrium analysis and the analysis of capitalist process of Fisher and Clark.
- As per Schumpeter's view, both inductive and deductive methods are compulsory for the study of economic science. Deductive methods are effective in price theory and inductive method was appropriate for the study of organisation of economics.
- Schumpeter derived the German word *Unternehmergeist,* meaning entrepreneur-spirit, adding that these entities organised the economy because they are liable for carrying innovation and technological transformation.
- Schumpeter agreed with Marx that capitalism planted the seeds of its own destruction, due to inner disagreement. The economic and social foundations of capitalism fell down on account of the destruction of the industrial structure and the decay of the entrepreneurial function.
- Pigou applied his economic investigation to a number of other problems, including tariff policy, unemployment, and public finance.
- Social welfare is deliberated as the core of the welfare of all the people in a society. Subsequently overall welfare is a very broad, complex and an unfeasible idea.
- Pigou was generally critical of Keynesian macroeconomics and developed the thought of the Pigou effect on real money stability. He advocated that the economy would be more self-stabilizing than Keynes projected.
- The notion of externalities is established by A.C. Pigou.ÿþ He contended that the government should intervene to correct them by taxing undertakings

that harm the entire economy and finance activities that help the society as a whole.

- The main dispute against Pigovian tax is that externalities are hard to calculate.

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5.7 KEY WORDS

- **Neoclassical Economics:** It is an approach to economics focusing on the determination of goods, outputs, and income distributions in markets through supply and demand.
- **Capitalism:** It is an economic and political system in which a country's trade and industry are controlled by private owners for profit, rather than by the state.
- **Elasticity:** It is the measurement of the percentage change of one economic variable in response to a change in another. An elastic variable is one which responds more than proportionally to changes in other variables.
- **Representative Firm:** It is a model firm not necessarily in existence which as an abstract construction is used to illustrate the operations of a market as a whole.
- **Welfare Economics:** It is the study of how the allocation of resources and goods affects social welfare.

5.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. List any two characteristics of a representative firm.
2. How did Marshall explain the Law of Constant Returns?
3. Write a short note on Schumpeter's arguments about market equilibrium.
4. List the two Pigovian welfare conditions.
5. What is a Pigovian tax?

Long-Answer Questions

1. Discuss Marshall's Law of Diminishing Marginal Utility.
2. Elaborate upon Marshall's Law of Returns.
3. Explain Pigou's economics of welfare.

5.9 FURTHER READINGS

NOTES

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UNIT 6 SOCIALISM

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Structure

6.0 Introduction
6.1 Objectives
6.2 Socialism: Meaning, Scope and Role
6.3 Karl Marx
6.3.1 Theory of Economic Development
6.4 Answers to Check Your Progress Questions
6.5 Summary
6.6 Key Words
6.7 Self Assessment Questions and Exercises
6.8 Further Readings

6.0 INTRODUCTION

Socialism is a philosophy characterised by collective ownership of property by the society. It believes in the idea that whatever the people produce is a social product and they are entitled to a share in it. Moreover, it can be used to meet the requirements of the society as a whole. Socialism stands in complete contrast to the capitalist ideology which perpetuates exploitation of the working class poor by assigning control of property in the hands of the powerful few while depriving the poor of even the basic necessities. This unit provides an overview of the meaning and scope of socialism.

6.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss the meaning, scope and role of socialism
- Describe the ideology of Karl Marx and his theory on economic development

6.2 SOCIALISM: MEANING, SCOPE AND ROLE

Socialism refers to any economic or political theory that states that property and natural resources should be owned and managed by the community rather than by individuals.

The term "socialism" has been functional to diverse economic and political systems all through history, which includes utopianism, anarchism, Soviet communism and social democracy. These systems differ far and wide in their formation but they share disagreement to an unhindered market economy, and the faith that

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public possession of the means of manufacture will lead to a better sharing of wealth and a more democratic society.

Socialism is a social, political and economic system in which every person in the community has an equal share of ownership. An ownership of this type is granted through a democratic system of supremacy. Socialism has also been established through a cooperative system in which each member of the society owns a share of communal resources.

Communal good can also be interpreted to mean taking care of people who can't add to social development such as children, caretakers, and the elderly.

The term socialism refers to any system in which the production and distribution of goods and services is the common responsibility of a group of people. Socialism is based upon economic and political theories that promote collectivism. In a state of socialism, there is no privately owned property.

Socialism was developed by Karl Marx in the period between capitalism and communism. In socialism, goods are made and distributed by workers, so the money belongs to the workers rather than private owners. For example, a bakery pays all the staff the same amount of money based on the profitability of the business. This can be considered as a socialist economy in a corporation.

Socialism exists within some countries as in the entire economic system or within factions such as in corporations, healthcare and public education.

Socialism depends on the efforts of each individual of the society. Members of the society pool together to activate factors of production, and profits are shared equally by all members. Its vital gain is that all members work equally, and individuals who can't contribute are benefited as well. Since the government controls the functions entirely, misapplication is possible.

Types of Socialism

There are different forms of socialism around the world, and they all differ when it comes to thoughts on how best to transform capitalism into a socialistic structure. In addition, the different types of socialism highlight the various aspects of social democracy. Following are some types of socialistic systems:

1. Democratic socialism

Democratic socialism is a political philosophy that supports and promotes political democracy. In this system, factors of production are under the administration of an elected management. Major services like housing, drinking water, electricity are provided by government, while free market mechanism is used to provide consumer goods.

2. Revolutionary socialism

The principle of revolutionary socialism is that socialism can be brought only by the defeat of the existing political and social structure. Socialistic system can't

come into view if capitalism is in active role. Revolutionaries rely on the belief that the pathway to a purely socialistic structure necessitates a lot of struggle. In such a system, the factors of production are retained and run by workers through a well-built federal structure.

3. Libertarian socialism

Libertarian socialism is anti –capitalist and works on the theory that people are always rational, self-regulating, and self-directed. If capitalism is taken away, people naturally turn to a socialistic system because it is able to meet their needs.

4. Market socialism

Market socialism is an economic system, where the production process is under the control of common workers. The workers make a decision regarding how resources should be distributed. The workers sell off what is in excess or give it out to members of the society, who then distribute resources based on a free market system.

5. Green socialism

Green socialism is also known as Eco-socialism, which is concerned with shielding of natural wealth and relates to both Ecology and communism. Large cooperatives in a green socialistic society are preserved and run by the public. In addition, green socialism encourages the expansion and usage of public transportation, as well as the meting out and sale of locally grown foodstuff. The production process is focused on ensuring that every individual of the community has adequate access to necessary goods. Moreover, the public is assured to get viable pay.

Gains of Socialism

1. Absence of exploitation

A socialistic structure ensures that no worker is ill-used. A socialistic system believes that each individual is assured to access necessities, even those that are already subsidized. Consequently, the system helps to curtail poverty levels in society. Furthermore, each person has the same right to access health care and other essential social aspects, such as education.

2. Elimination of discrimination

Socialism condemns discrimination and argues that every person has the right to do whatever they like. If there are jobs that should be done and there is no one to perform them, a higher reward is provided. Natural resources are protected for future generations.

Drawbacks of Socialism

1. Dependency on cooperative membership

The major drawback of socialism is its dependence on cooperative sharing to get things done. Additionally, competitive people in the community are viewed in an

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adverse light. The society expects collaboration and not competitiveness. According to the socialistic system, competitive individuals lean towards causing social turbulence for personal advantage.

2. Absence of competitiveness and innovation

Socialistic systems do not reward innovative ventures or competitiveness. Subsequently, a socialistic structure does not give boost to entrepreneurial ventures.

Difference between Socialism and Capitalism

Capitalism is based on forces of free market and the socialistic structure is based on their coherent foundation. Moreover, they also differ because of their implicit or stated goals, as well as the ownership structure, and the production process.

Structurally, a free market structure and socialism can be differentiated on the basis of rights to property as well as control of the production process. Under a capitalistic economic system, enterprises and private individuals control the means of production, together with all the profits. In a socialistic pattern, government has complete control over the resources which are used in the production process. Private property is overlooked, but where it subsists, it is in the form of consumer goods.

While capitalism is reliant on the choices of individuals who stimulate economic activities, a socialistic system controls the economic activities by forces of demand and supply.

Origin

Socialism emerged as a political ideology and as a reaction to the growing capitalist system. It presented an option to classical liberation which intended at improving the condition of the working class and creating a more democratic society. In its prominence on community ownership of the means of production, socialism contrasted piercingly with capitalism (private enterprises), which is based on a free market system and private ownership.

The roots of socialism go back to the ancient Greek era, when a logician Plato depicted a type of cooperative society in his dialog, *Republic* (360 B.C.). In 16th-century England, Thomas More drew Platonic ideals for his *Utopia*. According to this book, Thomas More depicted a fantasy island where money no longer played important role and all people lived and worked communally.

During the late 18th century, the industrial revolution brought about drastic changes as the invention of steam engine brought variations in both economic and social sector. The invention first affected the Great Britain followed by rest of the world. Factory owners became wealthy whereas labourers gained no profit and continued to live in increasing poverty. The labourers were compelled to work for more hours in unhealthy conditions.

Utopian Socialism

Utopian socialism can be described as a political as well as social idea of the mid-19th century based on the principles advocated by Robert Owen, a communist.

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A sketch was made for a new city with the intention to create a new utopian community in Indiana, based on the ideology advocated by Robert Owen.

The city was intended to give "intellectual and moral reward to every human being."

Socialists like Henri de Saint-Simon, Robert Owen and Charles Fourier presented their own models for social organization based on teamwork rather than rivalry. On the other hand, Saint-Simon argued for an arrangement where the state controls manufacture and allocation for the advantage of all the members of a society, both Fourier from France and Owen from Britain, proposed a system based on small cooperative, not a centralized state.

Owen was the owner of the textile mills in Lanark, Scotland. He moved to the United States in 1825 to instigate an experimental society in New Harmony, Indiana. His cooperative was based on the philosophy of self-reliance, collaboration and community possession. The experiment fell flat, and Owen had to face major financial losses. There were a number of small cooperatives and agricultural communities were working across the United States inspired by Fourier's theories. One of these lasted till the 1930s at Red Bank, New Jersey.

Influence of Karl Marx

Among modern thinkers, Karl Marx is certainly the most influential philosopher of socialism. According to him, Owen and Fourier's visions are dreamy and unrealistic hence he termed them as "Utopian". For Marx, society was made up of two classes: The first were the bourgeoisie who owned the means of production and used that money power to take advantage of the labour class and the second were the proletariats or the working class that lived in abject poverty.

Marx and his collaborator Friedrich Engels in "*The Communist Manifesto*" argued that true "scientific socialism" could be established only after a revolutionary class struggle, with the workforce emerging on top.

Marx died in 1883. Even after his death, his ideas influenced socialist thought to a great extent. His ideas were taken and used by various political parties such as the German Social Democratic Party and leaders like Vladimir Lenin and Mao Zedong.

Marx highlighted the clash between capitalists and the labour that came to dominate most communist thought, but other brands of socialism continued to grow. For example, Christian socialism or collective societies which formed around Christian religious ideology. According to anarchism, both private enterprises and governments are harmful and unnecessary. Social democratic system can be improved and achieved through gradual political improvement rather than revolt.

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Socialism in the 20th Century

In the first half of the 20th century—mainly after the Russian Revolution in 1917, the Soviet Union came to represent social democracy and emerged as the two most dominant communist movements throughout the world.

By the closing stage of the 1920s, Lenin's revolution had given stimulus to the foundation of the Communist Party of the Soviet Union.

Soviet Union and other communists joined services with other socialist movements in resisting fascism. After World War II, this coalition dissolved as the Soviet Union established socialist regimes across Eastern Europe.

In the late 1980s, with the downfall of the Soviet Union in 1991, socialism, as a worldwide political force, was greatly diminished. Only China, Cuba, North Korea, Laos and Vietnam remained communist states.

In the 20th century, socialist democratic parties won hold in many European countries by pursuing more centrist beliefs. Their ideas called for a gradual recreation of public reforms such as education and healthcare through the processes of elected government within a largely commercial system.

Socialism in the United States

Socialism began in the United States with the utopian communities in the early 19th century. The Socialist Party of America was established in 1901and reached its peak of support in 1912, when Eugene V. Debs won 6 percent of the vote in that year's presidential election. The Socialist Party never enjoyed the same accomplishment as in Europe but social improvements like Security and Medicare became a well-accepted part of American society.

Some open-minded politicians in the United States have embraced a variation on social democracy called democratic socialism. This calls for following socialist activities such as single-payer health care, free college tuition and higher taxes on the wealthy.

Socialist movement in the United States was relatively weak in comparison with Canada and Europe. There is a wide range of interpretations and definitions of socialism, and the lack of a common understanding of what socialism is or how it looks in practice reflects its complex evolution. Still socialist parties and their ideas continue to influence policy in nations across the world.

Check Your Progress

1. What does socialism depend on?
2. What is the major drawback of socialism?
3. How did socialism diminish as a political force?
4. What did Marx and Engels state about "scientific socialism"?

6.3 KARL MARX

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Karl Heinrich Marx was born on the 5th May, 1818 in Trier.1 He was a German philosopher, sociologist, historian, political economist, political, theorist and revolutionary socialist who developed the socio-political theory of Marxism. His ideas have since played a significant role in both the development of social science and also in the socialist political movement. He published various books during his lifetime with the most notable being *The Communist Manifesto* (1848) and *Capital* (1867–1894), many of which were co-written with his friend, the fellow German revolutionary socialist Friedrich Engels.

Born into a wealthy middle class family in Trier, Prussia, Marx went on to study at both the University of Bonn and the University of Berlin, where he became interested in the philosophical ideas of the Young Hegelians. Following the completion of his studies, he became a journalist in Cologne, writing for a radical newspaper, the *Rheinische Zeitung*, where he began to use Hegelian concepts of dialectical materialism to influence his ideas on socialism. Moving to Paris in 1843, he began writing for other radical newspapers, the *Deutsch-Französische Jahrbücher* and *Vorwärts!* as well as writing a series of books, several of which were co-written with Engels. Exiled to Brussels in Belgium in 1845, he became a leading figure of the Communist League, before moving back to Cologne, where he founded his own newspaper, the *Neue Rheinische Zeitung*.

Exiled once more, in 1849 he travelled to London where, living in poverty, he proceeded to continue writing and formulating his theories about the nature of society and how he believed it could be improved, as well as campaigning for socialism and becoming a significant figure in the International Workingmen's Association.

Marx's theories about society, economics and politics, which are collectively known as Marxism, hold that all society progresses through class struggle. He was heavily critical of the current form of society, capitalism, which he called the 'dictatorship of the bourgeoisie', believing it to be run by the wealthy middle and upper classes purely for their own benefit, and predicted that, like previous socioeconomic systems, it would inevitably produce internal tensions which would lead to its self-destruction and replacement by a new system, socialism. Under socialism, he argued that society would be governed by the working class in what he called the 'dictatorship of the proletariat', the 'workers state' or 'workers' democracy'. He believed that socialism would, in its turn, eventually be replaced by a stateless, classless society called pure communism. Along with believing in the inevitability of socialism and communism, Marx actively fought for the former's implementation, arguing that both social theorists and underprivileged people should carry out organised revolutionary action to topple capitalism and bring about socio-economic change.

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While Marx remained a relatively obscure figure in his own lifetime, his ideas and the ideology of Marxism began to exert a major influence on socialist movements shortly after his death. Revolutionary socialist governments following Marxist concepts took power in a variety of countries in the 20th century, leading to the formation of such socialist states as the Soviet Union in 1922 and the People's Republic of China in 1949, whilst various theoretical variants, such as Leninism, Trotskyism and Maoism, were developed. Marx is typically cited, with Émile Durkheim and Max Weber, as one of the three principal architects of modern social.

6.3.1 Theory of Economic Development

Marxian theory of development is based on the premise of the nature of production function, technological progress and the way the process of capital accumulation takes place. All these together influence the wage rate determination and accumulation of profit in the economy thereby consequent upon the dynamic behaviour of the economy.

In his *Das Kapital* (1867), Marx maintains that the production of goods takes place under the control of a capitalist and on his behalf, does not alter the general character of that production. According to him, labour is a process in which both man and nature participate. He argues that the labour power gives value to a commodity produced. However, the unearned income of the labour is retained by the capitalist as profit. Karl Marx terms this as the exploitation of labour. This injustice caused to the labour class can be eliminated only when the factors of production are transferred from the capitalist to the working class.

According to Marx, technology inevitably replaces labour and machines help the capitalist to earn greater profits. Thus, technological advancement results in increase in unemployment and furthering accumulation of capital. But this will also result in the reduction of investment opportunities and rate of profit. Therefore, the ruling capitalist class becomes an imperialist class. Under capitalism, income inequalities will grow. Growth would be unbalanced and business cycles would be more violent due to increase in unemployment, poverty and under consumption among the masses. The working class will revolt against the capitalist class thereby resulting into an end of capitalism and rise of communism.

The theory of development is based on certain assumptions such as the capital accumulation, technological progress and the production function.

Materialistic interpretation of history

According to Karl Marx, the foundation and evolutionary cause of all social life is materialism. Historical development is determined and influenced by the economic condition and non-economic forces have very little influence on these events. The mode of production determines the general character of social and political process of life and the class structure is related to the relations of production which is characterized by the following:

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- Division of labour in a society, skills possessed by the labour in the social content with respect to degree of freedom
- Knowledge about the availability of resources in the economy
- Technological progress

According to Marx the entire history of human kind is divided into four different social systems.

- Primitive communism
- Slave age
- Feudalism
- Capitalism

During the age of primitive communism, the factors of production belong to the community which also enjoys control over the resources. Individuals utilize the resources as per their needs. But in the other stages, the control of resources is restricted to a smaller class. This class also controls the society. The society gets divided into two classes, viz., the dominant class and the depressed class. Such a kind of division of society also creates tensions and conflicts. Hence, the control of resources results into a change in the structure of the society. But the basic structure relates to production, exchange and distribution. This also influences the shape of life. Friedrich Engels mentions that the ultimate cause of social change and political revolution is sought in the mode of production and exchange.

Surplus value

According to Karl Marx, labour is the only source of value of a community. The factors of demand and supply determine the value of a commodity only in the short run but in the long run the amount of labour used in the production of a commodity determines this value.

Karl Marx divides the society in two classes, viz., the working class and the capitalist class. The capitalist class owns the resources and purchases labour services from the working class and the working class sells its labour to the capitalists. The commodity produced by the labour is sold at a price in the commodity market and the labour is paid some wages for producing the commodity. The difference between the price by the commodity and the wages paid to the labour is the surplus value which is retained by the capitalist. According to Marx, capitalists are interested in producing those goods and services that generate more surplus value for them rather than socially useful commodities. Thus capitalism believes in the exploitation of labour which is nothing but the surplus value generated by the workers. The surplus value generated by the labour during the process of production is used by the capitalist class for reinvestment which furthers the process of production under capitalism.

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The capitalist tries to increase the surplus value which leads to the capitalist development. Hence, it is the surplus values generated by the labour class which has a great role to play in the development of a society.

Process of production

According to Karl Marx, it is the process of production in an economy that determines the evolution of society. Under capitalism, the value of a commodity consists of three elements. These are the **constant capital**, **variable capital** and **surplus value**. The constant capital represents machinery and material and remains constant during the process of production. Labour power represents the variable capital and changes with production. Finally, the surplus value is the value added to the production which according to Marx is equal to the profit. This occurs because the worker is not paid wages equal to the amount of value added during the process of production, but only subsistence wages.

If we suppose that the following is the production function:

$Q = f(K, N, L, T, Z)$

where Q is the amount of output

K is the capital stock

N is the amount of land

L is the amount of labour

T is the technical knowledge and technical interaction representing relations of production Z is the entire socio-cultural and institutional set-up of the society Accordingly,

$Q = (\alpha + \alpha) L + yK + nN$

where, a L is the variable capital (v)

b L is the surplus value (Sv)

and (yK + nN) is constant capital (c).

Since, yK and nN are not separate amount

Thus,

$$Q = (\alpha + \beta) L + yK$$

where yK is K + N

The coefficients of production (α, β and y) are responsive to the changes in the relations of production and thus are not fixed over a period of time. In the Marxian theory, changes in the techniques of production is not autonomous. As Marx puts it, the additional capital termed in the course of accumulation serve mainly as vehicles for the accumulation of new inventions and discoveries, or of industrial improvements in general. An increase in the amount of gross investment is shown by the rate of change of the relations of production. Any change in technology displaces labour, that is c/v rises over a period of time due to increase

in gross investment. This is known as the organic composition of labour change in the stock of variable capital determines the demand for labour. Gross investment also determines the labour capital ratio.

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The supply of labour is exogenous and increases with an increase in population. Because technology displaces labour, with change in technology, unemployment will increase and create a 'reserve army of labour'. This reserved army of labour facilitates movement of capital between the new and traditional production activities. It also influences the bargaining power of labour and thereby the amount of money wages. This results in exploitation of labour. Hence, with growth of capitalism, there is a progressive deterioration in the conditions of the labour class. According to Marx, 'with the progress of industry, the modern labour sinks deeper and deeper below the conditions of existence of his own class, becomes a pauper and pauperism develops more rapidly than population and wealth.'

Capital accumulation

The rate of capital accumulation is an important determining factor of economic growth in the Marxian theory. Marx argues that the quantity of accumulated capital is determined by the surplus value generated during the process of production. This is due to the fact that the wages received by the workers are spent for consumption. There is reinvestment in the society so as to maintain the stock of capital. Thus, 'all the circumstances that determine the mass of surplus value operate to determine the magnitude of accumulation.'

Another factor contributing to the accumulation of capital is the productivity of labour. As productivity of labour rises, the surplus value generated by labour increases and therefore results into accumulation of capital. The capitalist forms the elite class in the society as he is the owner of the capital. Higher the amount of capital owned by a capital, higher is the position power and prestige in the society. As Marx puts it, 'to accumulate is to conquer the world of social wealth, to increase the mass of human being exploited by him, and thus to extent both the direct and indirect sway of the capitalist.' The capitalist who has more advanced and efficient technology is also the one who is able to generate larger amounts of surplus and therefore is able to accumulate larger amount of capital.

After accumulating large amounts of capital, the capitalist spends on luxury and conspicuous consumption, may be due to necessities of business show off that may add to prestige. This kind of expenditure grows with the growth of accumulated capital. The motive behind this kind of lavish and wasteful expenditure is also to accumulate more capital.

The tendency to accumulate capital is normal and an important feature of the working of capitalism. This results in the emergence and expansion of huge enterprises that gain importance in the economy. This stimulates the concentration of capital in a capitalist society and gradually results into the emergence of monopoly

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power. Gradually, this results into monopoly capitalism and imperialism. But at the same time, the process of socialization of production is promoted, i.e., a large group of workers begin to work together. This provides material condition for transition to socialism.

One important aspect of capital accumulation under capitalism that Marx mentions is the cyclical nature of accumulation. There are cyclical crises from one period to another resulting into another kind of crisis. At times, there is a situation of overproduction or underconsumption or there may be an underutilization of the capacity resulting in underproduction. There are phases of depression, recession, recovery and boom through which the economy passes. When capitalism exhausts its progress there is a collapse of the system and is replaced by a superior form, i.e., socialism as a result of high level of unemployment, poverty and growing inequalities.

Critical evaluation

The Marxian theory of economic development has been criticized on several grounds. Some of these have been discussed as under:

- Marx argues that there is a tendency for the profit to fall as the organic composition of capital rises. But Paul Sweezy argues that as organic composition of capital rises, labour productivity increases. But this should have the effect of creating an industrial reserve army of labour which results into lowering of wages which in turn raises the rate of surplus value. Since both the composition of capital and the rate of surplus value are variable, the rate of profit would be indeterminate, though falling rate of profit is a basic feature of capitalism.
- The Marxian theory has also been criticized on the ground that at best it can be a synthesis of the historical evolution of the society during the process of economic growth but cannot be a theory of economic growth.
- Marxian theory has been criticized in respect to the wages and poverty among the working class. He argues that under industrial capitalism wages tend towards subsistence level. However, the evidences are that in the industrial societies, wages have had the tendency of upward movement.
- Another important criticism of the Marxian theory pertains to his assumption about the collapse of the capitalist system being replaced by socialism. Though revolutions have taken place in some countries such as Russia and China it is not simple to carry through a socialist transformation in the industrially advanced countries as the employment and wage levels are high. Ernest Mandel has also argued that there has been a straight line progressive evolution in the world starting from the first stages of fruit gathering and ending with the most advanced capitalist or socialist industry.
- The recent experiences with former USSR, China and the East European countries have shown that the social ownership of the factors of production

and production decisions have resulted into growing inefficiencies in the economy and the collapse of the system. There have been government failures resulting into collapse of economies.

Despite these criticisms the Marxian theory is relevant from the point of view of the historical evolution of a capitalist society.

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Check Your Progress

5. How does technological advancement results in increase in unemployment?
6. Which elements does the value of a commodity consist?
7. What does the capitalist spend on after accumulating large amounts of capital?

6.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Socialism depends on the efforts of each individual of the society. Members of the society pool together to activate factors of production, and profits are shared equally by all members.
2. The major drawback of socialism is its dependence on cooperative sharing to get things done.
3. In the late 1980s, with the downfall of the Soviet Union in 1991, socialism, as a worldwide political force, was greatly diminished.
4. Marx and his collaborator Friedrich Engels in "*The Communist Manifesto*" argued that true "scientific socialism" could be established only after a revolutionary class struggle, with the workforce emerging on top.
5. According to Marx, technology inevitably replaces labour and machines help the capitalist to earn greater profits. Thus, technological advancement results in increase in unemployment and furthering accumulation of capital.
6. Under capitalism, the value of a commodity consists of three elements. These are the constant capital, variable capital and surplus value.
7. After accumulating large amounts of capital, the capitalist spends on luxury and conspicuous consumption, may be due to necessities of business show off that may add to prestige.

6.5 SUMMARY

- Socialism is a social, political and economic system in which every person in the community has an equal share of ownership. An ownership of this type is granted through a democratic system of supremacy.

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- Socialism depends on the efforts of each individual of the society. Members of the society pool together to activate factors of production, and profits are shared equally by all members.
- The principle of revolutionary socialism is that socialism can be brought only by the defeat of the existing political and social structure. Socialistic system can't come into view if capitalism is in active role.
- A socialistic structure ensures that no worker is ill-used. A socialistic system believes that each individual is assured to access necessities, even those that are already subsidized.
- Socialistic systems do not reward innovative ventures or competitiveness. Subsequently, a socialistic structure does not give boost to entrepreneurial ventures.
- Utopian socialism can be described as a political as well as social idea of the mid-19th century based on the principles advocated by Robert Owen, a communist.
- Owen was the owner of the textile mills in Lanark, Scotland. He moved to the United States in 1825 to instigate an experimental society in New Harmony, Indiana. His cooperative was based on the philosophy of self-reliance, collaboration and community possession.
- In the late 1980s, with the downfall of the Soviet Union in 1991, socialism, as a worldwide political force, was greatly diminished. Only China, Cuba, North Korea, Laos and Vietnam remained communist states.
- Socialism began in the United States with the utopian communities in the early 19th century. The Socialist Party of America was established in 1901and reached its peak of support in 1912, when Eugene V. Debs won 6 percent of the vote in that year's presidential election.
- Marx's theories about society, economics and politics, which are collectively known as Marxism, hold that all society progresses through class struggle.
- Marxian theory of development is based on the premise of the nature of production function, technological progress and the way the process of capital accumulation takes place.
- According to Karl Marx, the foundation and evolutionary cause of all social life is materialism. Historical development is determined and influenced by the economic condition and non-economic forces have very little influence on these events.
- Karl Marx divides the society in two classes, viz., the working class and the capitalist class. The capitalist class owns the resources and purchases labour services from the working class and the working class sells its labour to the capitalists.

- The rate of capital accumulation is an important determining factor of economic growth in the Marxian theory. Marx argues that the quantity of accumulated capital is determined by the surplus value generated during the process of production.
- The Marxian theory has also been criticized on the ground that at best it can be a synthesis of the historical evolution of the society during the process of economic growth but cannot be a theory of economic growth.

6.6 KEY WORDS

- **Anarchism:** It is a political philosophy and movement that is sceptical of authority and rejects all involuntary, coercive forms of hierarchy.
- **Communism:** It is a theory or system of social organization in which all property is owned by the community and each person contributes and receives according to their ability and needs.
- **Collectivism:** It is a value that is characterized by emphasis on cohesiveness among individuals and prioritization of the group over the self.
- **Scientific Socialism:** It refers to a method for understanding and predicting social, economic and material phenomena by examining their historical trends through the use of the scientific method in order to derive probable outcomes and probable future developments.

6.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Define democratic socialism.
2. Write a short note on the differences between socialism and capitalism.
3. How are the relations of production characterised?
4. What have the recent experiences with former USSR, China and the East European countries shown?

Long-Answer Questions

1. Analyze any three types of socialism.
2. Discuss the gains and drawbacks of socialism.
3. Elaborate upon the concept of surplus value

6.8 FURTHER READINGS

NOTES

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UNIT 7 SCHOOLS OF SOCIALISM-I

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Structure

7.0 Introduction
7.1 Objectives
7.2 Different Schools of Socialism
  7.2.1 Utopian Socialism
  7.2.2 Christian Socialism
7.3 Answers to Check Your Progress Questions
7.4 Summary
7.5 Key Words
7.6 Self Assessment Questions and Exercises
7.7 Further Readings

7.0 INTRODUCTION

As discussed in the previous units, socialism is a populist economic and political framework centred on the ownership of the means of production by the public (also known as collective or common ownership). Such means include the equipment, tools, and factories used to manufacture items that are meant to meet human needs directly. Communism and socialism are umbrella words that refer to two left-wing economic schools of thought; both reject capitalism, although the 'Communist Manifesto', a pamphlet by Karl Marx and Friedrich Engels in 1848, precedes socialism by a few decades. There are different schools of thoughts of socialism. In this units, we will discuss different schools of socialism namely, utopian and Christian.

7.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the different schools of thoughts of socialism
- Discuss the utopian school of socialism
- Describe the Christian school of socialism

7.2 DIFFERENT SCHOOLS OF SOCIALISM

There are several types of socialism and no single definition captures all of them, but the common feature shared by its different forms is social ownership. Forms of socialism involve a number of economic and social systems marked by social ownership and democratic control of companies' means of production and

organisational self-management, as well as socialism-related political theories and movements. Let's discuss two of the significant schools of socialism.

7.2.1 Utopian Socialism

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When in the latter half of the 19th century, the revolutionary dogmas of Marx and his school had become most conspicuous in the social movement, the earlier systems became known, by way of distinction, such as Utopian socialism. Under this term were included the doctrines and projects of Robert Owen. The name was in some sense justified by the ideal societies that were advocated and put to all practical tests by these thinkers and their followers. But while Plato and Thomas Moore and Tommaso Campanella had constructed their fanciful commonwealths with no expectation of their being realized, the 19th century Utopians were profoundly convinced that their several systems were destined in no distant future to effect an entire transformation of social life. In the governmental reforms that were so much at issue in their time, these philosophers had little or no interest. According to them, the political would disappear with the social evils when society should be reorganized on the proper principles. These utopian socialists believed that all the schools found in history evidence that the normal course of mankind in progress toward its goal had been checked and deflected by ignorance and error concerning the principles of collective life—a correct understanding of those principles would bring naturally the resumption of progress.

All agreed that an important, if not the most important, source of the ills that afflicted mankind was poverty and its consequences. All agreed that the 'prevalence of poverty was due largely, if not exclusively, to the exaggerated recognition of self-interest as the 'mainspring of human action, and that the existing system of industry and commerce, based upon this principle and operating by unrestricted competition, must unendingly increase the misery of the race. All scored the injustice of unearned wealth as vehemently as they lamented the sufferings of undeserved poverty'. All denounced the existing capitalistic system. Robert Owen, however, found capital indispensable, subject to the regulations imposed by his system. Owen maintained that when his simple rational laws for the creation of what is good for men should prevail, there would be no 'useless private property'; but St. Simonians announced as the most important means to the realization of social justice that the right to unearned property, so far as it depended on inheritance, must be abolished. The error that has led men astray, so the Utopians, all argued, has been the assumption that nature designed the individual rather than the group to be the basis of social existence. Society is not a deliberately created service of previously isolated men for the promotion of their several selfish interests; it springs from the feeling not from the reason of mankind. Sympathy the 'sense of alikeness—brings men inevitably together' and 'benevolence—willing the good of all—is the natural principle of association'. 'These basic factors have been almost wholly

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lost sight of in the theory and practice of social life. Rivalry, competition, strife and war,' (The unit of this new order is to be a community of with the endless exploitation of the weaker by the stronger have become the accepted methods for determining the relations of individuals and of peoples to one another. The internal affairs of the community are to be directed to one another. To change all this and restore the reign of nature's peace and order to humanity, is the proclaimed purposes of all the Utopians).

The projects of the various schools for the achievement of this end had some things in common, but were; for the most part widely divergent from one another. Owen and the Owenites chiefly devoted themselves to the improvement of conditions in the industrial world. Philanthropic devices for the benefit of the labourers were managed by precept and by example upon the obdurate British factory owners, and the legislation that was at last secured, against the bitter opposition of the laissez-faire economists, received hearty support from the Owenites. The most characteristic feature of their work, however, was the establishment among the working classes of cooperative societies for the supply of their needs. This form of voluntary association for the production and exchange of commodities, attained great prominence and wide vogue in the 1820s and the 1830s. Cooperation was hailed as the much-desired expedient for escaping the evils of the strife between capital and labour. The success of this device confirmed Owen in his belief that he had solved the problem of society in general, and he set forth with fanatical fervour his scheme of a reorganized world.

The unit of this new order is to be a community of families numbering from 500 to 3000 persons, living on a tract of land large enough to support the members. The internal affairs of the community are to be directed by a council consisting of all the members from thirty to forty years of age; relations with other communities are in the charge of a like council of the members from forty to sixty years. Unions of these primary communities will be constituted under similar councils for larger areas. All the councils are to act in conformity to the code that Owen formulates, the basis of which is the fundamental law of nature that the individual's character is not formed by himself, but is the result of the circumstances and education to which he has been subjected. The chief prescriptions of the code are those that insure the 'same general routine of education, domestic teaching and employment' to all children of both sexes, who are put from birth under the care of the community. Members who, despite their education, fail to act rationally are to be removed to the hospitals for physical, mental or moral invalids, where their cure is to be affected by the mildest possible treatment. If any directing council contravenes the fundamental laws of human nature it will be supplanted by a new one consisting of the members of the community between twenty and thirty or over sixty years of age. It is not explained how this substitution is to be effected, and there is nowhere

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in the scheme, save in the clause referring to the hospitals, any suggestion of coercive government. What is to become of the existing political systems of the world is not discussed, but the thought is not obscure that they will fade, imperceptibly away in the light of the new order.

Robert Owen's project for escape from the evils of civilization took shape in that form of communal life which became famous as the phalange. His primary concern was with agricultural rather than industrial production, with the household rather than the factory. The true principles of association he worked out in an elaborate system wherein much acute and suggestive reflection was made useless by incoherent presentation and pedantic terminology. The outstanding feature of his social philosophy was the doctrine of what he has called passionate attraction. According to this doctrine, the passions or feelings of men, rather than their reason, must be considered the basis of every kind of association, and particularly of that cooperative union through which the primary needs of physical life are satisfied. Naturally 'all men dislike the incessant, monotonous labour that produces' the necessities of life. Naturally every man finds 'relative if not absolute pleasure in some species of labour or in some alternation in species of labour'. Ignorance or disregard of these basic facts accounts for the evils of social life whether in ancient or in modern times. Slavery, serfdom and the wages system, with the governmental institutions that accompany and sustain them, are but different forms of the distortion that results from the effort of certain classes, by deliberate liberate association, 'to put all the repellent labour of social life upon others and retain the agreeable for themselves alone.

Robert Owen said that the way out is to transform the social organization in the light of the principles that Owen has discovered. Labour must be made attractive, and therefore productive beyond all comparison with earlier ages. Every variety of taste, talent and other endowment must be recognized and utilized in the proportion that science shows to be requisite for the harmony of the whole and the happiness of the individual members. The typical association for this end is a group of five hundred families, fifteen to eighteen hundred persons, voluntarily united in a community which Owen called, true socialism. It should include capitalists, labourers and persons of talent, each contributing as he is able to the productiveness and agreeableness of the community's life.

Through the organization and specialization of the functions essential to the industries, occupations suited to every taste would be available with the result that every member would labour with the zest of pleasure. 'Passional attraction' rather than competitive greed for gain would rule the community life. No wages should appear in the system. Every species of necessary labour must be performed by the members, participation of all in the generally repulsive kinds being stimulated in various in genius ways. Every member of the community must be a shareholder,

whose part in the profits shall be determined in accordance with a scale that assigns a fixed proportion to capital, to labour and to talent. But every member must be guaranteed a minimum return sufficient to free him from anxiety for himself or his family, and every member must possess the right to labour in such occupations as are adapted to his preference and his capacity.

In the words of Robert Owen, with the establishment of such a system of social organization Owen believes that poverty will disappear, true liberty will be assured to every individual, the real natural rights of man will be recognized, happiness and order will be universal, and consequently government, so far at least as its coercive activities are concerned—armies, scaffolds, prisons, courts of justice—will have no longer any cause for existence. There never appears in Owens writings the slightest suggestion of revolutionary violence. His conviction is unfaltering that the great truths he has revealed will make their way by their own virtue.

7.2.2 Christian Socialism

Christian Socialism was a new belief of Christianity, which can also be termed as modern Christianity. It was a movement which was started in the mid-19th Century. This movement emphasises on the application of social principles of Christianity to modern industrial life. Christian Socialism can also be termed as Laissez Faire Individualism. It means the demand of all Christian activists on behalf of all other individuals of society—impoverished or wealthy, for the development of social programmes in all the political and economic activities. Therefore, Christian socialism can be referred to as any movement that attempts to amalgamate the basic objectives of socialism with religious and ethical beliefs of Christianity.

Role of Henri de Saint-Simon in Christian Socialism

Henri de Saint-Simon was a French Businessmen who is known for his contribution in the sociology. He was born in an impoverished aristocratic French family on October 17, 1760 in Paris, France. His school education was very irregular and at the age of seventeen he got admitted to the military. He was the part of the army troop sent to help the American Colonies to participate in their war of independence. He also posted as a captain of the artillery at Yorktown in 1781. At the time of French revolution, he visited France where he bought up a new land with the help of friend. He was active in the French revolution and got imprisoned in the Palais de Luxembourg during reign of terror and became enormously rich because of the depreciation of revolutionary currency. He proceeded to live a life of grandeur. Within several years he had brought himself close to bankruptcy. He turned to the study of science, attending courses at the École Polytechnique and entertaining distinguished scientists.

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In his first published work, *Lettres d'un habitant de Genève à ses contemporains* ('Letters of an Inhabitant of Geneva to His Contemporaries', 1803), Saint-Simon proposed that scientists should take the place of priests in the social order. By 1808, he was insolvent and was living mainly on the kindness of friends in the last 17 years of his life. Among his many later publications were *De la réorganisation de la société européenne* ('On the Reorganization of European Society', 1814) and *L'industrie* ('Industry', 1816–18, in collaboration with Auguste Comte). In 1823, in a fit of despondency, Saint-Simon attempted to kill himself with a pistol but succeeded only in putting out one eye.

Henri de Saint-Simon presented 'New Christianity' with special concern for the poor. His followers used to believe that the basis of social development would be a spirit of association or connection with religion as the controlling power that would gradually replace the prevailing essence of egotism and antagonism in society. They were of belief that the inheritance rights must be ended due to which the capital available in economy is in the hands of the prospective capitalists and can be used at the time of disposal of society.

Christian Socialism in Britain

In Britain, Christian Socialism was first used by some British men like Frederick Denison Maurice, novelist Charles Kingsley, John M. Ludlow and many others. They all started a movement that took shape in England immediately after the failure of Chartist agitation of 1848. The main motive for the movement was to arrange support for 'the Kingdom of Christ', 'its true authority over the realms of industry and trade' and 'for socialism its true character as the great Christian revolution of the 19th century'.

Contribution of John M. Ludlow

John M. Ludlow, bought up and educated in France, was inspired by the writings of Philippe-Joseph-Benjamin Buchez (one of the disciple of Saint Simon) and the emergence of cooperative societies in France, and thus enlisted the churchmen to promote the application of Christian principles in industrial organisation. The followers of Ludlow strongly criticized socially conservative Christianity and laissez-faire attitudes within the industrial sector. The benefit of the movement started by Ludlow is that cooperation has substituted competition. With this motto the Ludlow's followers joined various cooperativist movement and helped many small cooperative societies financially, which favoured co-partnership and profit sharing in industry. They were responsible for establishing the Council for Promoting Working Men's Association and the Working Men's College in London in 1854. A lot of members kept working for cooperativism. In the 1880s and 1890s, number of Christian Societies Organizations were formed in England.

Movement in France and Germany

In the latter 19th century, movements like that of Ludlow took shape among the French Protestants. In 1888, The Protestant Association for the Practical Study of Social Questions was established which stood in opposition with bourgeois Protestantism and rejected a strict egalitarian socialism. While in Germany, in the late 19th century, the movement for Christian social action became associated with violent anti-Semitic agitation.

Movement in United States

The movement for Christian Socialism in United States was led by Henry James Sr., who was the father of novelist Henry James and philosopher William James. He argued the similarity in the objectives of socialism and Christianity in 1849. In 1889, the society of Christian Socialists was organized. The rise of the Social Gospel Movement was observed in the early years of 20th century, which was the result of Christian Socialism that emphasized the social aspect of salvation.

Check Your Progress

1. What was the primary concern in Robert Owen's theories?
2. What would be the consequences of establishing utopian socialism according to Robert Owen?
3. What do you mean by Christian Socialism?
4. Who was the inspiration of John M. Ludlow?
5. When was The Protestant Association for the Practical Study of Social Questions established?

7.3 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. In Robert Owen's writings, the primary concern was with agricultural rather than industrial production, with the household rather than the factory.
2. In the words of Robert Owen, with the establishment of utopian system of social organization Owen believes that poverty will disappear, true liberty will be assured to every individual, the real natural rights of man will be recognized, happiness and order will be universal, and consequently government, so far at least as its coercive activities are concerned—armies, scaffolds, prisons, courts of justice—will have no longer any cause for existence.

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3. Christian Socialism means the demand of all Christian activists on behalf of all other individuals of society—impoverished or wealthy, for the development of social programmes in all the political and economic activities. Therefore, Christian socialism can be referred to as any movement that attempts to amalgamate the basic objectives of socialism with religious and ethical beliefs of Christianity.
4. John M. Ludlow was inspired by the writings of Philippe-Joseph-Benjamin Buchez, one of the disciple of Saint Simon.
5. In 1888, The Protestant Association for the Practical Study of Social Questions was established which stood in opposition with bourgeois Protestantism and rejected a strict egalitarian socialism.

7.4 SUMMARY

- There are several types of socialism and no single definition captures all of them, but the common feature shared by its different forms is social ownership.
- When in the latter half of the 19th century, the revolutionary dogmas of Marx and his school had become most conspicuous in the social movement, the earlier systems became known, by way of distinction, such as Utopian socialism.
- Utopian socialism is a concept that is used to describe the initial currents of modern socialist thought. It differs from the later socialist thought as it is based on idealism instead of materialism.
- The Utopian socialist Robert Owen's most prominent contribution to socialist thought was the belief that the social behaviour of human beings is not rigid or complete and that human beings have the liberty to settle themselves into any kind of society that they liked.
- Robert Owen's project for escape from the evils of civilization took shape in that form of communal life which became famous as the phalange. His primary concern was with agricultural rather than industrial production, with the household rather than the factory.
- Through the organization and specialization of the functions essential to the industries, occupations suited to every taste would be available with the result that every member would labour with the zest of pleasure.
- There never appears in Owens writings the slightest suggestion of revolutionary violence. His conviction is unfaltering that the great truths he has revealed will make their way by their own virtue.

- Christian Socialism was a new belief of Christianity, which can also be termed as modern Christianity. It was a movement which was started in the mid-19th Century.
- Henri de Saint-Simon was a French Businessmen who is known for his contribution in the sociology. He was born in an impoverished aristocratic French family on October 17, 1760 in Paris, France.
- In Britain, Christian Socialism was first used by some British men like Frederick Denison Maurice, novelist Charles Kingsley, John M. Ludlow and many others.
- John M. Ludlow enlisted the churchmen to promote the application of Christian principles in industrial organisation.
- The movement for Christian Socialism in United States was led by Henry James Sr., who was the father of novelist Henry James and philosopher William James.

7.5 KEY WORDS

- **Laissez-Faire:** It is an economic system in which transactions between private groups of people are free from or almost free from any form of economic interventionism such as regulation and subsidies.
- **Anti-Semitic:** It means feeling or showing hostility toward or discrimination against Jews as a cultural, racial, or ethnic group.

7.6 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. How did utopian socialism emerge?
2. Write a short note on the contribution of John M. Ludlow when it comes to Christian Socialism.

Long-Answer Questions

1. Discuss the characteristics of utopian socialism.
2. Explain the role of Henri de Saint-Simon in Christian Socialism.

7.7 FURTHER READINGS

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UNIT 8 SCHOOLS OF SOCIALISM-II

NOTES

Structure

8.0 Introduction
8.1 Objectives
8.2 Fabian
  8.2.1 Rejection of Marxian Theory of Class Struggle
8.3 Guild Socialism
  8.3.1 Main Tenets of Guild Socialism
8.4 Syndicalism
8.5 Answers to Check Your Progress Questions
8.6 Summary
8.7 Key Words
8.8 Self Assessment Questions and Exercises
8.9 Further Readings

8.0 INTRODUCTION

As discussed in previous unit, socialism is an economic and political philosophy that is concerned with greater distribution equity and that seeks solutions that require greater collaboration and social solutions. The idea of state control of the means of production is frequently correlated with socialism. The goal is to run business in the interest of society rather than in the interest of a few property owners. There are several forms of socialism; we have already discussed Utopian and Christian forms of socialism in the previous unit. In this unit, we will discuss Fabian, syndicalism, and guild socialism in detail.

8.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the Fabian form of socialism
- Discuss the emergence of syndicalism
- Describe the significance of guild socialism

8.2 FABIAN

Fabianism is an English version of evolutionary socialism, which was conceived in agreement with the new conditions and developments that came over England at the end of the 19th century. This English version of socialism is essentially pragmatic in outlook, flexible in approach and democratic method. It is the brain child of a group of British intellectuals and differs sharply from Marxism in that it believes in attaining socialism by slow, peaceful and flexible methods. E.M. Burns thus writes:

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Perhaps the most important variety of contemporary socialism which does not trace the paternity of its doctrines to Marx is Fabian socialism. The principal sources of Fabian socialism were British and American. They included the writings of Henry George, David Ricardo, and John Stuart Mill. The most dominant idea derived from these sources was the premise that most forms of unearned wealth are created by society.

Fabianism originated in England in the last quarter of the 19th century. Increasing democratization in the political sphere and the growth of collectivist legislation in the economic sphere provided a congenial atmosphere for the evolution of a new brand of socialism suited to the needs, temperament and traditions of the English people.

Between the years 1865 and 1885 Great Britain had entered on a period of change. The British constitution was turned into a democracy. A democratic state which was prepared to take upon itself social reform duties, a working class with economic influence and power, a nation with a growing social conscience, could not be treated from the stand point of revolution and class struggle. The fundamental socialist concepts required a new basis and new methods more in harmony with new conditions.

In the early eighties several socialist movements got underway in England. Several organizations, active in the propagation of socialist ideas were formed of which the Social Democratic Federation, the Socialist League, the Independent Labour Party, and the Fabian Society were more prominent. The Fabian Society saw the light of the day on 4 January, 1884: 'a group of intellectuals who envisaged the emergence of a socialist society in England. The society was named after Roman general Fabius who, while fighting Hannibal adopted the policy of 'wait, and hit hard at the right moment'. Its prominent members included Sidney Webb, G.B. Shaw, Graham Wall as, Sidney Olivier, A. Besant, H. Bland, W. Clark and E. R. Pease, etc. They were highly educated men and women, widely read in economics, politics and ethics. Thus the Fabian Society could boast of having on its rolls distinguished scholars, administrators and statesmen. The Fabians were primarily influenced by J. S. Mill, Henry George, and Karl Marx.

Henry George was considered as an American Social reformer. His contribution to the study of Fabianism is very much significant. George is well known for his book *Progress and Poverty* (1879). His far-reaching contribution to the study of Ricardian theory of rent is commendable. He played a very pivotal role in the field of British socialism. George's seminal ideas influenced the thought of Marx and Engels. Sydney Oliver, George Bernard Shaw, Sidney Web, H. G. Wells also have played a very significant role under the ideas of Henry George. Particularly the Fabians were attracted in terms of poverty and disparity of incomes. To him, poverty is an evil concept and was found from parochial loyalties, economic stagnation and political breakdown. Poverty can be prevented with the help of state action and intervention. The Fabian Society was established in 4 January, 1884.

8.2.1 Rejection of Marxian Theory of Class Struggle

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Henry George rejected Marxian theory of class struggle and revolutionary method and he was influenced by his concern for social justice and a society free from all forms of exploitation. Henry had developed socialist leanings in the later part of his life. He wrote that 'The social problem of the future we considered to be, how to unite the greatest individual liberty of action with a common ownership in the raw materials of the globe, and an equal participation of all in the benefits of combined labour'. Henry George, the American philosopher, who wrote *Progress and Poverty* in 1879, lectured in England in 1881 and greatly influenced the English socialist thinkers. According to Lancaster, George influenced the Fabians in two ways.

- Firstly, George's glowing picture of a society without want fired their enthusiasm for getting rid of unearned wealth.
- Secondly, George's hint led them to find, quite readily, differential values other than economic rent — in profits, salaries, and dividends, all of which were unearned to precisely the same degree as the rent appropriated by landlords.

Henry George was fully engaged and was committed to intensive and extensive studies and research. In 1906, the he started the Fabian Summer School to have lectures and discussions on politics and economics. The Fabian Research Department was instituted in 1912 to study the various socio-economic problems created by industrial capitalism. Henry said that 'The object of the Fabians have been to spread the socialist doctrine as they understand it, throughout the educated middle class and to persuade the national and local governments of Great Britain to put the doctrine gradually into practical operation.'

Major Tenets of Henry George

The major tenets of Henry George include:

- **Emancipation of land and industrial capital:** Henry George stated that the Fabian Society had democratic socialists as its members. The basis of Fabianism was hammered out in 1887 and was restated in 1919 with slight modifications. Henry George wanted to reorganize the society by the emancipation of land and industrial capital from individual ownership, and the vesting of them in the community for the general benefit. The society accordingly works for the extinction of private property in land the prevention of appropriation of rent by individuals. The society further, works for the transfer to the community of the administration of such industrial capital as can be conveniently managed socially. Such transfer was deemed imperative as industrial capital had become a monopoly in the hands of a class of proprietors on whom the majority depended for a livelihood. Labour should be duly rewarded. The idle class living on the labour of others could be eliminated when rent and interest are not allowed to go into their pockets,

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but are made the rewards of labour. 'For the attainment of these ends the Henry George looks to the spread of socialist opinions and the social and political changes consequent thereon, dissemination of knowledge as to the relation between the individual and society in the economic, ethical, and political aspects'.

- **Democratic state:** Unlike syndicalists and guild socialists, Henry George was confident of the fairness and effectiveness of action by the State — the democratic state. He looked upon the democratic state as the 'representative, and trustee of the people', 'their guardian, their man of business, their manager, their secretary, even their stockholder'. He suggested the following measures to make the state 'trustworthy': (a) Broadening the suffrage; (b) Securing a better trained civil service, and (c) Equalizing educational opportunities. The state, according to them, was the state civil service and it was the bounden duty of the civil service to act efficiently and in a manner responsive to public wishes.
- **Gradual reforms along ordinary parliamentary lines:** George rejected the Marxian theory of class struggle and the method of revolution and expressed firm faith in achieving a socialist society through gradual reforms along ordinary parliamentary lines. Fabian socialists advocated peaceful and tempered social changes. Land, industry and financial institutions are to pass from private ownership to the state by peaceful, gradual methods. While Marxism is revolutionary, Fabianism is evolutionary. Instead of the Marxian theory that the history of all hither to existing societies is the history of class struggle, Henry George maintained that history demonstrates the 'irresistible progress of democracy' and 'almost continuous progress of socialism'.
- **Transition from capitalism to socialism:** Henry George regards the transition from capitalism to socialism as a gradual process. He looks forward to the socialization of industry by peaceful economic and political agencies already at hand. Fabians see in the middle class a group that can be utilized in developing the technique of administration on behalf of the new social order. They also feel that an important step in the attainment of socialism is the rise of the social conscience of the community in favour of the socialist ideal.
- **Economic basis of Fabianism:** Henry George, also analyzing the economic basis of Fabianism, rejected the labour theory of value of both the classical economists and Marx and maintained that the community as a whole, and not labour alone, creates value. The aim of socialism, as Henry conceived it, is to obtain for all members of society the values which society creates, and this aim is to be achieved by gradually transferring land and industrial capital to the community, while making the state more fully representative of the community. Thus, its aim is to transfer ownership, not to the workers as a class, but to society, for general benefit. Socialism maintained that

democracy and socialism are complementary to each other, because both are based on the ideas of equality and justice. Through democratic processes, the socio-economic, cultural and political system of the society would gradually change paving the way for socialism. Socialism should be brought gradually, not through the short-circuiting path of revolutionary method. The Fabian strategy is one of permeation, 'Resolved to permeate all classes it has not preached class antagonism. Resolved gradually to permeate it has not been revolutionary, it has relied on the slow growth of opinion.' Henry George favours decentralization of power and greater municipalisation. He writes that, 'A democratic state cannot be a social democratic state unless it has in every centre of the population a local governing body as thoroughly democratic in constitution as the Central parliament'. Under the aegis of the state local self-bodies should be allowed greater opportunities to work.

- **Theory of land and rent:** Henry George opposed the revolutionary theory of Marxism. He holds that social reforms and socialist permeation of existing political institutions can bring about the expected development of socialism. He paid little attention to trade unionism and other labour movements. He recognized the major tenet of Marxian philosophy which was the abolition of private property. George questioned why there was chronic poverty in spite of advancement of technology. He himself gave the answer, stating that with the advance of technology, population grows. With the growth of the population, land grows in value. The growing share of the output and development of market economy is siphoned off by the owners of land and natural resources. In this context, many English economists had criticized the philosophy and ideas of Henry George. T.E. Cliff Leslie and Alfred Marshall has vehemently criticized his basic ideas on economy. George Bernard Shaw attempted to adopt Henry George's view of land rent and is considered as a huge and mounting subtraction from the income of workers. George said that a tax is levied upon the production of a thing that must constantly be produced by human labour. This labour will make supply more difficult, raise prices, and the man who pays the tax is constantly able to push the tax upon the consumer. Land has no role to constantly supply in order to meet the demand. Its price is always a monopoly value and the tax falls upon the land value which does not fall upon all land but only upon valuable land and that its proportion to its value.

8.3 GUILD SOCIALISM

In its origins, guild socialism was a purely English theory. It was set forth by English intellectuals in the first and second decades of the twentieth century. It is a socialist system and movement aiming at industrial self-government and functional democracy. It is the intellectual child of English Fabianism and French Syndicalism. It is 'a kind of anaemic version of French syndicalism'. Some describe it as a half-

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way between syndicalism and collectivism. It does not agree with syndicalism in wanting to abolish the state by direct action; nor does it want the state to control all of industry, as does the collectivism. But like the syndicalists, the guild socialists were the most ardent advocates of workers' control in industry. Unlike collectivists (State socialists) they advocate withdrawal of state control from the economic sphere. Guild socialists aim at the achievement of socialism with the guild as its foundation. They want to extend the democratic principle to any and every form of social action and in especial, to industrial and economic full as much as to political affairs. The object of guild socialism is to make work more interesting and the whole economic structure of society more democratic. The fundamental demand of guild socialism is that the whole structure of society should be made democratic.

It was not until 1909 that the guild-socialist theory assumed a more practical form. The Trade Unions played a prominent part in the great labour unrest during the years 1909-12. Writers like AR. Orage and S.G. Hobson put forward the proposal in the columns of the *New Age* that the guild idea should be adapted to modern conditions on the basis of the existing Trade Union Organization. They made vigorous attacks upon modern capitalism, criticized also the centralized collectivism of contemporary socialism, and gradually reshaped the original Orage-Penty proposals, for a restoration of medieval guilds, into an elaborate scheme for national guilds, properly adjusted to modern political and economic conditions. Their articles were later published in the book, *National Guilds, An Enquiry into the Wage System and the Way out*. Penty, Orage and Hobson were members of the Fabian Society and the Independent Labour Party, until they became disillusioned with these organizations, upholding centralized political socialism.

8.3.1 Main Tenets of Guild Socialism

Guild socialism offers an indictment of present society, based on industrialism. They protest against the contemporary capitalist method of exploitation in which the surplus value is pocketed by the capitalist. In return for the minimum wage, the workers surrender all control over the organization of production. They advocate the abolition of the present system which produces slave mentality in the workers. They argue wages, profits, rents, and interest should be apportioned upon a fundamentally different principle. They criticize the acquisitive nature of the mode economic system which separates ownership from service to munity. Right to property exists for its owner's sake, unrelated to any full social function. They protest against the dehumanizing consequences of the machine system. They attempt to devise a system that develop workers not merely skill but also pride in their work. Again, they criticize the contemporary political democracy based on the principle of territorial representation.

The goals of the National Guilds League are the abolition of the Wage-system, and the establishment by the workers Self-Government in industry, through a democratic system of Nation-Guilds, working in conjunction with other democratic functional organizations in the community. The general principles on which this statement of aims is founded may be reduced to the following three:

- The principle of Functional Democracy
- The principle that industry should be administered by the common action of workers both of hand and brain who carry on the industry
- The principle that power and responsibility in society should be related and proportional to the importance of the functions which individuals perform in the service of the community.

They advocate the setting up of guilds or cooperative associations in the economic sphere. Each industry and each technical and cultural service would be managed and controlled by guild which is defined by Drage as 'a self-governing association of mutually dependent people organized for-the responsible discharge of a particular function of society'. The guild is a Trade Union modified in two ways: it will be inclusive of all workers in an industry the unskilled workers as well as the clerical, technical and managerial workers - and its chief function would be not to protect the interests of its members, nor merely to secure better conditions of work, but to carry on and control the industry. While trade union is organized for militant purposes in a hostile society, the Guild will be organized for peaceful purposes in a friendly society. With regard to prices of commodities, where the interests of the consumers are involved, the Consumers' Councils in collaboration with the guilds will make the decisions.

State can exercise power only in a limited field such as defence, justice, education, taxation and international relations. In general the National Guilds League adopts a hostile attitude to the state. There is a tendency to relegate the State to the role of an association of consumers, represented on a number of bodies elected on a national basis for the purpose of negotiating with the big producing Guilds, but according to Hobson, the state continues to be the representative of the community at large. He ascribes a superior position to the state. As supreme authority the state should settle disputes between guilds in the capacity of a court of final appeal; when the guild congress proves unable to settle them.

They believe in the evolutionary methods of achieving socialism. The present trade unions will be the guilds of tomorrow and become instruments of transformation. The present trade unions have to perfect and strengthen themselves and pursue the method of 'encroaching control' which is 'wresting bit by bit from the hands of the possessing classes the economic power, by a steady transference of functions and rights from their nominees to representatives of the working class'. In this respect they differ from syndicalists who advocate direct action and general strike.

8.4 SYNDICALISM

Syndicalism is a form of revolutionary socialism which is essentially a French school of thought of the French labour movement. It is both a body of social doctrine or theory of social organization, and a plan of action. Syndicalism, loosely defined,

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holds that the workers alone must control the conditions under which they work and live; the social changes they need can be achieved only by their own efforts, by direct action in their own associations, and through means suited to their peculiar needs. Syndicalism places positive emphasis on the trade and industrial union movement as the basis of the new industrial structure and on the producer rather than the consumer.

The exponents of syndicalism were both the active leaders of the trade Union movement and a group of brilliant intellectuals. While activists like Fernard Pelloutier, Emile Pouget and others formulated the main tenets of syndicalism, Georges Sorel, Hubert Lagardelle and Édouard Berth with their intellectual brilliance provided its philosophical foundation. Sorel, the philosopher par excellence of syndicalism, attempted to work out a synthesis between the proletarianism of Marx, the anti-political associationism of Proudhon and the intuitionism of Bergson. Socialism, according to Sorel, required organization of the proletariat and not of the economic system. He was in favour of establishing an industrial self-government of the working class. According to syndicalism, workers should organize a general strike and paralyze the state. From the French revolutionary tradition, syndicalists acquired their methods of violence and their emphasis on the role of militant elite in the process of social transformation. Syndicalists called themselves a 'new school' of socialism. This variety of socialism is marked by certain distinct features and tenets.

Syndicalism is uncompromisingly opposed to the State and looks upon it as a bourgeois and middle class institution. Irrespective of its form, the state is an instrument of capitalist exploitation. All states are instruments of class rule. The territorial, military state reflects the ideals of property-owners and serves their interests. Workers cannot emancipate themselves unless they destroy the power of the state. Reforms and concessions conceded by the state are mere palliatives. The state, the syndicalists argued, is theoretically wrong because it embodies an impossible ideal of social unity. Society is essentially pluralistic, and no political constitution can make it otherwise.

Syndicalists not only dislike the middle-class state but also distrust middle-class socialism which is a product of clever middle-class intellectuals out of touch with the needs of the working class. Syndicalism claims to be the only school of socialism which is the product of the workers them- selves. It keeps alive among workers an intense class consciousness and forbids any rapprochement between the workers and the bourgeois. It is distrustful of the-middle class leadership and its primary objective is to put the workers in power. Since the workers as producers create value, they should be the controllers of society.

Syndicalists are deadly opponents of wars which they consider as the outcome of the conflicting interests of the capitalists. The workers must keep out of wars and unnecessary bloodshed and bend their energy for their own upliftment. The police and the defence forces uphold the interests of the ruling capitalist class by breaking strikes of workers and by fighting wars with other nations. The

oppressed working class have no country of their own; they have no need for patriotism as such national spirit is as assiduously created by the ruling class to mollify proletarian radicalism.

Syndicalism is a form of revolutionary socialism. Syndicalists are distrustful of political methods as a means of achieving their desired society. They do not believe in peaceful, constitutional methods. They advocate violent and revolutionary methods which they would call 'direct action'. Strike, sabotage and boycott are their chief forms for achieving direct action. Syndicalists differ from Marxists in believing that the time is not far off when the working class would rise in revolt against the capitalist class. Marx, they believe, was unduly optimistic in prophesying that capitalists would fight the workers and thereby bring about own destruction.

What the capitalists would do is to make comprises and bargains for their survival. In these circumstances the workers must carryon perpetual offence against the employers through strikes, sabotage, destruction of machinery, boycott, label, spoiling work through 'go-slow' methods. Syndicalists are ardent believers in direct action. It is the only means of educating the workers and preparing them for the final struggle. The general strike is the chief weapon.

The general strike is the final and mighty weapon which would paralyse the state and make the workers the masters of society. The general strike is not necessarily a striker of all workers. What is required is a strike on the part of a sufficient proportion of the workers in key industries to secure the paralysis of the capitalist system. Syndicalists rely on a conscious, militant minority who would inspire and provide leadership to the otherwise passive majority. The syndicalists' stress on elitism is akin to Lenin's. In Sorel's language, the general strike is to be a 'myth' to the workers. A myth being an idea which fills men with ardour and belief in a better future.

Sabotage is a policy of injuring an employer's property or enterprise through sluggish, bungling, wasteful, or positively damaging acts: done either while the worker remains on the job or in connection with strikes. It may take the non-violent form of slow work for long hours, poor work for low pay, revealing the secrets of the employer etc. The boycott of goods produced by non-union labour and the placing of the Union label produced by syndicates themselves are some of the other methods advocated by the syndicalists. All of this is in preparation for the general strike which may fail today, but 'today's failure is a preparation for tomorrow's success'.

The syndicalist plan of action is direct, vigorous, and well defined, but the structure of society which it seeks to achieve is extremely vague and nebulous. Syndicalism is primarily a creed of opposition; its thrust is negative. As Coker aptly put it, syndicalism offered a policy primarily of revolution, not of administration. Under syndicalism, the syndicate is to be the basis of industrial organisation. Syndicalists picture the future society as a free and flexible federation of autonomous and distributive associations based on collective ownership and carrying on the activities in accordance with the needs of the community. Workers assume control

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of production and private capital is to be replaced by collective capital. Thus syndicalists share the collectivist concept of property, the communistic principle of distribution according to needs and the anarchist goal of statelessness. All means of production, distribution and exchange will belong to the community and should be controlled and managed by the syndicates of workers. National services like highways, railways and post offices are to be placed in the hands of the National Federation of Workers. Prisons and Courts are to be abolished, and punishment is to take the form of social boycott.

Check Your Progress

1. Name some of the prominent socialist organizations of early eighties in England.
2. What do you mean by guild socialism?
3. What are the goals of the National Guilds League?
4. Who formulated the main tenets of syndicalism?

8.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. In the early eighties several socialist movements got underway in England. Several organizations, active in the propagation of socialist ideas were formed of which the Social Democratic Federation, the Socialist League, the Independent Labour Party, and the Fabian Society were more prominent.
2. Guild socialism is a socialist system and movement aiming at industrial self-government and functional democracy. It is the intellectual child of English Fabianism and French Syndicalism.
3. The goals of the National Guilds League are the abolition of the Wage-system, and the establishment by the workers Self-Government in industry, through a democratic system of Nation-Guilds, working in conjunction with other democratic functional organizations in the community.
4. Activists like Fernard Pelloutier, Emile Pouget and others formulated the main tenets of syndicalism.

8.6 SUMMARY

- Fabianism is an English version of evolutionary socialism, which was conceived in agreement with the new conditions and developments that came over England at the end of the 19th century.
- Fabianism is essentially pragmatic in outlook, flexible in approach and has a democratic method.

- Henry George was fully engaged and was committed to intensive and extensive studies and research. In 1906, the he started the Fabian Summer School to have lectures and discussions on politics and economics.
- Guild socialism is a socialist system and movement aiming at industrial self-government and functional democracy.
- It was not until 1909 that the guild-socialist theory assumed a more practical form. The Trade Unions played a prominent part in the great labour unrest during the years 1909-12.
- Guild socialism offers an indictment of present society, based on industrialism. They protest against the contemporary capitalist method of exploitation in which the surplus value is pocketed by the capitalist.
- Syndicalism, loosely defined, holds that the workers alone must control the conditions under which they work and live; the social changes they need can be achieved only by their own efforts, by direct action in their own associations, and through means suited to their peculiar needs.
- Syndicalism is a form of revolutionary socialism. Syndicalists are distrustful of political methods as a means of achieving their desired society. They do not believe in peaceful, constitutional methods.
- The syndicalist plan of action is direct, vigorous, and well defined, but the structure of society which it seeks to achieve is extremely vague and nebulous. Syndicalism is primarily a creed of opposition; its thrust is negative.

8.7 KEY WORDS

- **Associationism:** It is a theory in philosophy or psychology which regards the simple association or co-occurrence of ideas or sensations as the primary basis of meaning, thought, or learning.
- **Marxism:** According to Marxism, there are two main classes of people: The bourgeoisie controls the capital and means of production, and the proletariat provide the labour. Karl Marx and Friedrich Engels say that for most of history, there has been a struggle between those two classes. This struggle is known as class struggle.

8.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What do you mean by Fabianism? How did it originate?
2. Briefly explain the major tenets of guild socialism.

Long-Answer Questions

1. Describe the major tenets of Henry George.
2. Explain the emergence of syndicalism.

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8.9 FURTHER READINGS

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UNIT 9 INSTITUTIONAL ECONOMICS-I

NOTES

Structure

9.0 Introduction
9.1 Objectives
9.2 Gunnar Myrdal
9.2.1 Myrdal's Model of Circular and Cumulative Causation
9.3 Thorstein Veblen
9.4 Answers to Check Your Progress Questions
9.5 Summary
9.6 Key Words
9.7 Self Assessment Questions and Exercises
9.8 Further Readings

9.0 INTRODUCTION

Institutional economics focuses on understanding the role of the evolutionary process in influencing economic behaviour and the role of institutions. Its original emphasis lay in the instinct-oriented dichotomy of Thorstein Veblen between technology on one side and society's 'ceremonial' sphere on the other. Its name and core elements date back to Walton H. Hamilton's 1919 American Economic Review article. Institutional economics highlights a wider analysis of institutions and economies as a result of the dynamic relationship between these different institutions (e.g. individuals, firms, states, social norms). There are various thinkers who have given their perspective on the topic. In this unit, we will discuss the thoughts of Gunnar Myrdal and Thorstein Veblen.

9.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the concept of institutional economics
- Discuss the thoughts of Gunnar Myrdal
- Describe the philosophy of Thorstein Veblen

9.2 GUNNAR MYRDAL

Karl Gunnar Myrdal, born on 6th December 1898, was a Swedish economist and sociologist. In 1974, he received the Nobel Memorial Prize in Economic Sciences with Friedrich Hayek for 'their pioneering work in the theory of money

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and economic fluctuations and for their penetrating analysis of the interdependence of economic, social and institutional phenomena'. As an economist, Myrdal made early contributions to price theory, incorporating the role of uncertainty and expectations on prices.

Myrdal resists the approach of development poles because social system and economic processes do not expand towards stability but, on the contrary, factors have a propensity to cumulate to positive or negative cycles. In laissez faire conditions in developing countries, there is a predisposition towards a negative accumulation. In theory, Myrdal's conjecture is a contradiction of the mono-causal explanation of problems of developing countries by economic factors only. Relatively, in a broad way, all social relations have to be incorporated. At the national level (diverse stages of development between regions) as well as international level (trade between industrialized and developing countries) differences are inclined to boost because of the increase effects in the more developed areas and contemporary or modern sectors and backwash effects in backward areas (traditional sectors). The track of processes depends on the preliminary condition and the factors causing the change. In the developing countries, augmented regional dualism frequently is an outcome of circular causation.

Circular and Cumulative Causation (CCC) has been a significant principle of political economy over the years. The origin of the concept goes back to Thorstein Veblen (1857-1929) who utilized this in his test of the progression of institutions. In another study, Gunnar Myrdal (1898-1987) examined the conditions of African Americans and Asian underdevelopment throughout the lens of Circular and Cumulative Causation (CCC).

9.2.1 Myrdal's Model of Circular and Cumulative Causation

Circular Cumulative Causation is a theory developed by Swedish economist Gunnar Myrdal in 1956. This approach is multi-causal where the centre variables and their associations are demarcated. The suggestion following it is that a change in one structure of an institution will lead to consecutive changes in other institutions. These changes are spherical in a way where they prolong in a cycle, several times in a harmful way, there is no end and they continue this in every round. The change doesn't happen all at once but minutely because that would lead to confusion. Gunnar Myrdal borrowed the theory from Knut Wicksell and developed it with Nicholas Kaldor while working jointly at the United Nations Economic Commission for Europe. Myrdal concentrated on the societal provisioning characteristic of development, while Kaldor was focussed on the demand-supply relationship with the manufacturing sector.

Dynamics

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Myrdal mentioned the characteristics that are pertinent to the expansion process of an economy such as availability of natural resources, past traditions of production activity, national consistency, religious ideologies, economic, social, and political leadership. Myrdal stated that the instant effect of closing down certain lines of production in a community is a reduction in employment, income and demand. Throughout the analysis of the multiplier, Myrdal noticed that other sectors of the economy are also affected by the closure of these lines of production. Afterwards he stated that the slimming down of the markets in that area tends to have a disheartening consequence on new investments, which in turn reasons additional decline of income and demand and, if nothing takes place to alter the tendency, there is a movement of enterprises and workers towards other areas. Amongst the additional results of these events, smaller quantity of local taxes are composed at a time when additional social services is necessary and a vicious descending cumulative cycle has started and a drift towards a subordinate level of development will be more non-breakable.

A status of non-equilibrium is shaped, or as Myrdal writes in his own words about this as:

> The notion of stable equilibrium is normally a false analogy to choose when constructing a theory to explain the changes in a social system. What is wrong with the stable equilibrium assumption as applied to social reality is the very idea that a social process follows a direction – though it might move towards it in a circuitous way – towards a position which in some sense or other can be described as a state of equilibrium between forces. Behind this idea is another and still more basic assumption, namely that a change will regularly call forth a reaction in the system in the form of changes which on the whole go in the opposite direction to the first change. The idea I want to expound in this book is that, on the contrary, in the normal case there is no such a tendency towards automatic self-stabilization in the social system. The system is by itself not moving towards any sort of balance between forces, but is constantly on the move away from such a situation. In the normal case a change does not call forth countervailing changes but, instead, supporting changes, which move the system in the same direction as the first change but much further. Because of such circular causation as a social process tends to become cumulative and often gather speed at an accelerating rate.'

Myrdal wrote in his *Economic Theory and Underdeveloped Regions* that 'The disagreement progresses on a broad and methodological plane on the logic that the theory is conferred as a multipart of broad structures of thought' in order to seize the social facts as they systematize themselves into a blueprint when viewed under a bird's-eye viewpoint into this general vision, the specific characteristic.

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Added to this, Myrdal developed the Circular Cumulative Causation (CCC) concept and was of the opinion that it makes diverse assumptions from that of unwavering stability on what can be considered mainly significant forces directing the development of social processes. These strengths characterize the dynamics of these processes in two assorted ways. Hitherto, the provision of data or other information regarding sole economies was further than the scope of his work. He stated that in the regular case there is no such a propensity towards regular self-stabilization in the social system. The system itself is not moving towards any sort of equilibrium between forces, but is continuously on the budge away from such a condition. In his succeeding writings, Myrdal mainly referred to 'approach', defining it as something containing theories. By this term, Myrdal meant a compilation of devices, like 'the concepts, models and theories we use, and the way in which we select and arrange observations and present the results of our research'.

Check Your Progress

1. Why does Myrdal resist the approach of development poles?
2. Name the characteristics that are pertinent to the expansion process of an economy as mentioned by Myrdal.

9.3 THORSTEIN VEBLEN

The full name of Thorstein Veblen was Thorstein Bunde Veblen. He was born on July 30, 1857 in Manitowoc County, Wisconsin, U.S. He died on August 3rd, 1929 near Menlo Park, California. Thorstein was an American economist and social scientist. Thorstein's approach was evolutionary and active tactics to the learning of institutional economics. His one of the famous work in the field of institutional economics was *The Theory of the Leisure Class* (1899). After this theory, he earned recognition in literary circles. While analyzing the life of a wealthy person, he invented two theories 'conspicuous consumption' and 'pecuniary emulation' that are still widely used. Veblen was Norwegian. He didn't know English. He went to school, where he started learning English, but he spoke it with a Norwegian accent. He completed his graduation from Carleton College in Northfield, Minnesota within three years. He proved himself to be a bright scholar. He further went to study philosophy at Johns Hopkins and Yale universities, and was awarded Ph.D. from Yale in 1884.

When he was not able to find a suitable teaching job, he returned to his father's house in Minnesota, where he consumed his time in reading further developments in institutional economics. He got married to Ellen Rolfe in 1888, who belonged to a well-off and powerful family. He entered Cornell University in

1891 as an alumna fresher student. There, he enthralled J. Laurence Laughlin so greatly that, when Laughlin was questioned to head the economics department at the new University of Chicago in 1892, he took Veblen with him as an associate in economics. At the age of 39, in the year 1896, he became a teacher. Ellen Rolfe took divorce from him and in 1914 he married to Anne Fessenden Bradley, a divorcee whom he was knowing from many years. Anne had two daughters which were brought up by Anne and Veblen according to Veblen's practical ideas as spoken in The Theory of the Leisure Class.

Literary Works and Career development of Veblen

The literary works of Thorstein include:

- He wrote his first book titled, *The Theory of the Leisure Class*, which was published in 1899. It explains the crux of most of his thoughts. Veblen wanted to apply Darwin's evolutionism to the research of contemporary economic life of a person. According to him, the industrial system needed men to become diligent, efficient and cooperative, however, those who were the top leaders of the business world were only worried about making money and exhibiting their wealth; their viewpoint was survivalist, a residue of savage past. Veblen examined the 'modern survival of prowess' in the amusements, fashions, sports, religion, and aesthetic tastes of the ruling class. The book gained the attention of and began to be read as a satire rather than as science, earning Veblen a reputation of being a social critic.
- In 1904, he published *The Theory of Business Enterprise*, in which he expanded on his evolutionary theme of the incompatibility between the modern industrial process and the irrational means of business and finance.
- In 1914, he published his work, *The Instinct of Workmanship and the State of the Industrial Arts*, where he explained his idea of business enterprise being in conflict with the human tendency for useful effort; too much of humankind's energy was wasted through inefficient institutions.
- His work, *An Inquiry into the Nature of Peace and the Terms of Its Perpetuation* (1917), made Veblen acquired an international following. He maintained that modern wars were caused mainly by the competitive demands of national business interests and that an enduring peace could be had only at the expense of 'the rights of ownership, and of the price system in which these rights take effect'.
- Later in 1918, he joined the editorial staff of *The Dial*, a literary and political magazine in New York, for which he wrote a series of articles published in a book form as *The Vested Interests and the State of the Industrial*

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Arts (1919). Another series of articles in The Dial was later published in the book, *The Engineers and the Price System* (1921). These articles developed Veblen ideas for reform of the economic system. According to him, engineers, who had the knowledge to run industry, should take over its direction because they would manage it for efficiency instead of profit. This theme was central to the brief Depression-era movement known as 'technocracy'.

- His last book, *Absentee Ownership and Business Enterprise in Recent Times: The Case of America* (1923), was an ill-written and repetitious examination of corporate finance, in which he stressed again the contradiction between the industrial arts and business enterprise.
- Among economists, Veblen had both admirers and critics, but more of the latter. The scholarly analysis of modern industrial society owes much more to Veblen's German contemporary Max Weber, whose ideas are more complex than Veblen's. Even his closest disciples found his anthropological and historical approach too vague, though they admired him for his original ideas.

Institutional socialism

With his critique of traditional static economic theory, Thorstein Veblen established the groundwork for the view of institutional economics. Just as he was an economist, Veblen was also a sociologist who opposed his contemporaries, who regarded the economy as an independent, stable, and static body. Veblen disagreed with his colleagues, as he firmly believed that social structures were significantly ingrained in the economy. Rather than distinguishing economics from the social sciences, Veblen considered the relationships between the economy and social and cultural phenomena. The study of institutional economics usually considered economic institutions to be the larger mechanism of cultural development. While economic institutionalism has never been converted into a major school of economic thinking, it has encouraged economists to examine economic problems from a social and cultural perspective. It also encouraged economists to view the economy as an object of bounded rationale that is evolving.

Concept of Conspicuous Consumption

Conspicuous consumption is an economic concept that defines and explains the consumer's habit of using products of a higher quality or quantity than could be considered practical. In his book, *The Theory of the Leisure Class*, the American economist and sociologist, Thorstein Veblen, coined this term (1899). By considering the motivation to drive a luxury car rather than an economy car, the idea of conspicuous consumption can be demonstrated. Any kind of vehicle (or car in this case) offers transportation to a destination, but the use of a luxury car often draws attention to the driver's apparent wealth.

The advantage of conspicuous consumption can be found within the notion that consumers derive 'utility' from the consumption of commodities, postulated by economists. Two distinct characteristics of products were defined by Veblen as providing utility. In other words, the first is what he called the 'serviceability' of the good that is, the good gets the job done (e.g., luxury and economy cars are equally able to get to a given destination). The other characteristic of a good is that it is 'honourable'. Driving a luxury car illustrates that the consumer can afford to drive a vehicle that can be admired by others. This appreciation comes not solely from the ability of the car to get the job done, but from the obvious proof of wealth it offers. The car is therefore an external display of the position of one in society.

A consequence of the twofold features of commodities are that such conspicuous consumption is wasteful. He was not using the term, 'wasteful' in a negative sense, but as a technical term signifying that producing luxury commodities require extra assets than the making of a non-luxury commodity.

The essence of Veblen's study of modern society was the fact that, on the one hand, there is tremendous technical capacity for the manufacturing of products and, on the other hand, business enterprise restricts the quantity produced to what can be profitably sold. The role of advertising, in Veblen's opinion, is to establish a desire among consumers for products whose use shows status and prestige. The gulf between customers' expectations and technology's productive potential is minimised by ads. For this reason, Veblen regarded ads as waste, but waste that is inherent in a modern economy focused on the concepts of business profit-making. The awareness that all products have elements of serviceability and waste is an important point in Veblen's research. For instance, the fact that you drive a car means that you are rich enough not to have to take public transport, but a luxury car also has a higher status in society because it indicates that you do not have to take public transport or drive an economy car.

Check Your Progress

3. What was the title of Thorstein Veblen's first book?
4. How did Veblen differ from his colleagues on economic theory?

9.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Myrdal resists the approach of development poles because social system and economic processes do not expand towards stability but, on the contrary, factors have a propensity to cumulate to positive or negative cycles.

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2. Myrdal mentioned the characteristics that are pertinent to the expansion process of an economy such as availability of natural resources, past traditions of production activity, national consistency, religious ideologies, economic, social, and political leadership.
3. Thorstein Veblen's first book was *The Theory of the Leisure Class*, which was published in 1899.
4. With his critique of traditional static economic theory, Thorstein Veblen established the groundwork for the view of institutional economics. He opposed his contemporaries, who regarded the economy as an independent, stable, and static body. Veblen disagreed with his colleagues, as he firmly believed that social structures were significantly ingrained in the economy.

9.5 SUMMARY

- Institutional economics focuses on understanding the role of the evolutionary process in influencing economic behaviour and the role of institutions.
- Karl Gunnar Myrdal, born on 6th December 1898, was a Swedish economist and sociologist.
- Myrdal resists the approach of development poles because social system and economic processes do not expand towards stability but, on the contrary, factors have a propensity to cumulate to positive or negative cycles.
- Circular and cumulative causation (CCC) has been a significant principle of political economy over the years. The origin of the concept goes back to Thorstein Veblen (1857-1929) who utilized this in his test of the progression of institutions.
- Circular Cumulative Causation is a theory developed by Swedish economist Gunnar Myrdal in 1956. This approach is multi-causal where the centre variables and their associations are demarcated.
- The full name of Thorstein Veblen was Thorstein Bunde Veblen. He was born on July 30, 1857 in Manitowoc County, Wisconsin, U.S. He died on August 3rd, 1929 near Menlo Park, California.
- His work, *An Inquiry into the Nature of Peace and the Terms of Its Perpetuation* (1917), made Veblen acquired an international following.
- Rather than distinguishing economics from the social sciences, Veblen considered the relationships between the economy and social and cultural phenomena.

- Conspicuous consumption is an economic concept that defines and explains the consumer's habit of using products of a higher quality or quantity than could be considered practical.
- The essence of Veblen's study of modern society was the fact that, on the one hand, there is tremendous technical capacity for the manufacturing of products and, on the other hand, business enterprise restricts the quantity produced to what can be profitably sold.

9.6 KEY WORDS

- **Price Theory:** It is an economic theory that states that the price for any specific good or service is based on the relationship between its supply and demand.
- **Pecuniary Emulation:** It is an effort to equal or surpass another in status associated with wealth.

9.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the early life of Gunnar Myrdal.
2. Briefly explain the literary works of Thorstein Veblen.

Long-Answer Questions

1. Describe the dynamics of Myrdal's model of Circular and Cumulative Causation.
2. Describe the concept of conspicuous consumption in detail.

9.8 FURTHER READINGS

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UNIT 10 INSTITUTIONAL ECONOMICS-II

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Structure

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10.0 INTRODUCTION

Romesh Dutt and Wesley Clair Mitchell are two of the most eminent economists. Dutt and Mitchell's contribution to the study of economy is immense with their theories on land revenue and the self-generation theory respectively. They represent more ideas when it comes to the field of institutional economics. Their theories, in fact, has expanded the purview of institutional economics. In this unit, we will discuss the life and theories of Romesh Dutt and Wesley Clair Mitchell in the context of institutional economics.

10.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the contributions of Romesh Dutt and Wesley Clair Mitchell in the context of institutional economics
- Discuss the life of Romesh Dutt and Wesley Clair Mitchell
- Describe the economic ideas of Romesh Dutt and Wesley Clair Mitchell

10.2 ROMESH DUTT

Romesh Chunder Dutt was an Indian Civil Servant born on 13th August 1848 in an eminent Bengali Kayastha family. He was also known as economic historian, writer and translator of holy books, *Ramayana* and *Mahabharata*. His family

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was well-known for their literary and academic achievements. He was a son of Thakamani Dutta and Isam Chunder Dutt, the Deputy Collector in Bengal. He studied in various Bengali District schools, and later at Hare School, Calcutta. After his father's early demise in an accident, he was took care of by his uncle, Shoshee Chunder Dutt, a talented writer, who became his custodian in 1861. He was influenced by his uncle, who used to sit with him and discuss pieces from the works of the English poets. The well-known poet of Bengal in nineteenth century, Toru Dutt, was his relative. He went on to take admission in the University of Calcutta, Presidency College in 1864. He passed examination in 1866, ranked second in order of merit and won a scholarship. After completing his education he went to England for further study with his two friends without taking permission from his family.

He passed the examination of 'ICS' and worked at various administrative posts. At that time, the only Indian to qualify for the Indian Civil Service was Satyendra Nath Tagore. He intended to follow the path of Tagore. He joined Indian Civil Service in 1869 and in 1899, he was elected as the president of the Indian National Congress. Later, he was also appointed as a lecturer of Indian History at the University of London. After returning to India he worked on various administrative posts and was appointed commissioner of the burden division in the year 1894. After completing successful 26 years of government service he took retirement from the ICS post and plunged into writing.

10.2.1 Criticism of British Economic Policy

In his writings, Romesh Dutt criticized British government for their failure to improve the economic conditions of India. During the colonial times, India was a non-industrialized country, but due to British economic policy, the handicraft production came down sharply. However, industrial production was not increased to support the current economic condition. Hence, the Indian economy was forced to depend on farming.

The Peasantry of Bengal was his first book written on the economic problem of farmers in 1875. The ideas developed in this book were further expanded in his *Indian Famines, Their Causes and Prevention*, published in 1901. In this book, he talked about the over-assessment of land revenue and petitioned the government for the extension of the Permanent Settlement to the Ryotwari areas and also for a permanent fixation of rents payable by the ryots to the mediators. His essential contribution to the field came in the form of *The Economic History of India under Early British Rule: From the Rise of the British Power in 1757, to the Accession of Queen Victoria in 1837* and *The Economic History of India in the Victorian Age*. The theory on land revenue was included in his famous *Open Letters to Lord Curzon on Famines and Land Assessments in India* to which Lord Curzon's Government gave an official reply in the form of Resolution of 1902. Later, he started speaking in the support of the member of the London Indian society or the East Indian Association contesting for the House of Commons.

He also worked as the London correspondent for a Calcutta (Kolkata) based journal, *The Indian Mirror*.

According to him, India was not getting any benefits from British colonialism. For instance, trains, which were introduced by British, were used to transport goods made in British factories, thus, killing the traditional transportation services of India. As per his view Indian economy was not underdeveloped, but its progress was blocked by British. He did not agree with the Marxist belief that British colonialism was progressive.

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10.2.2 Economic Ideas

His economic thoughts can be found in his two important books. *The Economic History of India under Early British Rule: From the Rise of the British Power in 1757, to the Accession of Queen Victoria in 1837* and *Indian Famines, Their Causes and Prevention.* His first book deals with the economic colonization, while the second one deals with the condition of agriculture and reason and cure of famines in India. According to him there is a close relationship between political and economic situations. The main reason for Indian poverty were:

- Low productivity.
- Tax system.
- Breakdown of cottage industries

The cause of low productivity was adverse climate, soil infertility, traditional agricultural techniques, population, lack of education, low agricultural price, land tax system, and overall agrarian structure. Agrarian structure of the country was a great obstacle for economic development and welfare of the country. The Indians were paying 40 percent more tax than the tax payers of Great Britain. Thus, in many ways the sources of national income were reduced and the Indian Industries gradually declined. Hence, the poverty of India was due to self-centred and unsound financial plan of British.

R. C. Dutt suggested many measures to get rid of poverty from India. He designed a complete overhaul of the economic structure of the Indian society. The major suggestions were:-

- Restoration of cottage industries to remove underemployment.
- Conservation of irrigation amenities to reduce reliance on monsoon
- Interest rate should be lowered on public debt.
- Reduction in government expenditure.
- Decrease of purchase stores in England.

Dutt recommended a plan of improvement in the land revenue system.

- Land agreement should not exceed more than 30 years.
- The cess on land tax should not go beyond 6 percent.

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- The areas, where the permanent settlement had not been introduced, the profits collected by landlords on the behalf of the state, should not go above 15 percent of the produce.
- Those area where the land revenue was collected as per the state directions should not exceed 20 percent.

He also suggested the removal of excise duties on the Indian mill industries, decrease on the rate of interest on public money owing, creation of sinking fund, sharing of civil and military expenses by Britain. Larger employment of Indians in civil services, prohibitions of railway constructions with the state loan, etc.

As a civil servant and as an open-minded political leader of the liberal school, Dutt was an epitome of the new generation of cultured Indians. Romesh Dutt was all that the rising Indian intelligentsia aspired to be and was regarded as one of the builders of modern India. He combined history, politics and economics to display the impact of British rule in India and the reason of India's poverty. He not only analyzed the cause, but also recommended remedies. His experience as an administrator helped him in assessment of economic conditions of India. Thus, he secured an important place in the economic political history of India. R. C. Dutta expired on 30th November 1909.

Check Your Progress

1. What was the first book of Romesh Chunder Dutt?
2. In which work Dutt presented his theory on land revenue?
3. Name the reasons for Indian poverty as claimed by Dutt.

10.3 WESLEY CLAIR MITCHELL

Wesley C. Mitchell was one of the greatest figures of the institutional school. He is recognized for his pain taking studies of 'green backs' and 'business cycles'. He was born in rural Illinois on August 5th, 1874 and was the eldest son of a Civil War veteran. Though he came from a poor family, he manages to receive university education. Wesley Clair Mitchell took admission at University of Chicago in 1896, at first to study classics, but later on gravitated towards Economics. At Chicago, Mitchell came under the influence of Thorstein Veblen and John Dewey and received his Ph.D. in 1899 under J. Laurence Laughlin and Adolph C. Miller on financial matter. After serving the Columbia University for few years, he occupied many important positions. He was also a visiting professor at the University of Oxford, California and Cornell for his outstanding contributions to the science of economics; he received honorary degree from the Harvard, Columbia, Paris, Princeton, California and Pennsylvania universities. Some of Mitchell's outstanding works include:

- *A History of the Greenbacks* (1903)
- *Gold, Prices, and Wages under the Greenback Standard* (1908)

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- *Business Cycles, The Problem and its Setting* (1913)
- 'Human Behavior and Economics: A Survey of Recent Literature' (1929)
- *The Backward Art of Spending Money* (1937)
- *Measuring Business Cycles* (1946)

Mitchell was a founder of the National Bureau of Economic Research (NBER) in 1920 and was its first director of research. After taking responsibility of the NBER's founding study on income redistribution, Mitchell directed the NBER towards quantitative studies of the U.S. business cycles for which that organization has become famous.

He was responsible for building Columbia into one of the most notable fortress of the American Institutionalist School during the inter-war period. His students, carried on much of Mitchell's work in the post-war period. Although Mitchell followed the institutionalists in which he has nothing to do with agent-based theory, his work was full of hypothetical insights about society and the economy. He died on October 29th, 1948.

10.3.1 Economic Ideas of Wesley Clair Mitchell

Mitchell's economic ideas included:

- Method of Study
- Institutional Approach
- Theory of Economic Guidance
- Economic Welfare and Planning
- Business Cycle.

Method of study

Mitchell gave importance to quantitative analysis in economic study. Through this quantitative method, he was able to give a methodical account of recurring fluctuations. He was not interested in the old methodological argument that existed between historical and classical schools. He expanded the range of economics beyond the constraints of equilibrium.

Institutional approach

As per Mitchell each human being has a gut feeling which is different from person to person. The conduct of an individual that results from inherited capacities is an irrational form of behaviour. According to Mitchell, these associations—arts, writing, speech and religion provide a standard behaviour, habits of feeling, acting and thinking that are accepted by the community and finally implanted in a social institution. Social organizations are powerful manager to direct human behaviour. They are the picture of past achievements of human mental prowess. They form the foundation for the balanced behaviour of a person. Mitchell suggested America did not need to look inside the individual and evaluate the pleasant and unpleasant

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characteristics. In its place, he asked to look outside the individual that is, towards the habits which had been gradually moulded by the society.

Mitchell analyzes the foundation and growth of institutions and traditions and supplemented them with wealth, banking and labour problems. In his later studies, he highlighted the physical aspect of economic activities. According to him, the traditional economic theory was imperfect because it lacked an institutional approach. Mitchell was sure that the institutional approach would help develop economics into a science of human behaviour and in turn, economics would become influential in bringing about social change. He felt that the use of money would widen the scale of economic theory.

Theory of economic guidance

Mitchell, in his hypothesis of economic guidance, puts forward the thought that the beginning of corporate enterprise estranged ownership and management. As a result, power was concentrated in the hands of a few directors and management. Those who control the dealings of a corporation do it for their own interests. When he wrote about this theory in 1913, he found that the government cannot be held responsible for this.

Economic welfare and planning

Mitchell thought that if economics became a science of human behaviour, it would focus more on human welfare than resources. So, he recommended that in economics two things namely, determinants of welfare and the means to be employed to increase it, should be examined. For Mitchell, welfare did not simply mean overflowing supply of goods, but also a suitable working life, full of interesting activities. The principle of welfare should be developed in such a way so as to be beneficial for many lines of works by quantitative methods. He considered economic planning the most important and difficult task. He believed that planning by business alone would not succeed. He made it clear through lectures and talks, that planning was essential for an orderly economy but piecemeal planning was faulty because it overlooked the fact that the economic and social processes were interconnected. He was of the observation that the work of the national planners was for the fulfilment of what the majority desired.

Business cycle

Mitchell's greatest work was his study of business cycles in his book, *Measuring Business Cycles*. In his work, he composed huge statistical data and with the help of that he carried out a deep study of the individual cycles, group of cycles, and parts of the cycle. He made use of the frequency curves. Further, he made a proportional study of the different trends of changes in the prices during the period of the cycle. The study is an assessment of the existing theories, followed by a review of general economic association and a detailed statistical analysis of various economic factors like prices, interest rate, etc. According to Mitchell, the study of trade cycles is not considered as a branch of economic theory. However, the

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study of trade cycles was more essential and productive for gaining knowledge about the working of modern economic system. He recognized business cycles to the inequity between production and distribution. When imbalances occur, it results in superfluity in the market. Men and machines are unemployed. Business cycles return because there is no proper business planning. Business fluctuations are provoked by factors such as expansion of markets, domination, migration of people, etc.

As per the self-generation theory given by Mitchell, each stage of a trade cycle would automatically generate the other. According to him, the business crises were one feature of a recurrent cycle. A crisis was probably be followed by depression, depression by recovery, recovery by prosperity, prosperity by crisis, and so on. Certain factors like internal political conditions, changes in the monetary and banking systems, war, peace, new industrial methods, international relations, etc. were responsible for the slackening or quickening the phases of trade cycle. He indicated that different trades were affected by the trade cycle in diverse ways. Mitchell confirmed that during the restoration period, there would be an increase in the price level, high business prospects, and increased level of manufacturing and demand for goods, with hike in the level of employment. Business optimism, increased investment, and heavy orders for machinery lead to additional increase in the price level. Later on due to the operation of two factors namely, continuous increase in the functioning cost and stress on the money and investment markets, a crisis or recession occurs.

According to him, the present economic order which is characterized by high funds investment, middlemen, elasticity of credit, and lack of adjustment, was responsible for trade cycles. Mitchell's treatment of trade cycles is more detailed, practical, and genuine, since it is based on statistical and historical proofs. Although studies in different aspects of the problem had been made by other economist, it was only Mitchell who provided an analysis of all the phases of trade cycles on the basis of statistical data. Regardless of several merits, the theory is not without its criticism. It has been criticized by modern writers on several counts. Firstly, it simply takes other issues behind. Furthermore, it treats cyclical fluctuations as the movements of a machine. In the view of Homan, it is a static theory in which economic institutions are a relatively stable factor not highly variable.

10.3.2 Critical Estimate of Mitchell's Economic Ideas

Mitchell, who made a complex study of business cycles, was certainly the leading advocate of institutionalism. His *Measuring Business Cycles* is a masterwork in economic literature. Mitchell's use of the statistical methods and quantitative analysis has made economists more practical in their studies. According to him, inductive method should be practiced in the study of economic problems. Since collection of facts is more scrupulous, exhausting and time consuming, he had earned even more admiration from American economists. He had realized that the modern economic life was quite complex and its problems could not be handled effectively

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with the help of conventional analysis. He, therefore, begged to incorporate study of all connected institutions such as history, statistics, sociology, etc. Mitchell had strong deep understanding and believed that advances in economics and other social sciences can and will help to reduce flaw of the economic system such as repetition of depressions and joblessness, disparity of opportunity, concentration of power, and material uncertainty.

Check Your Progress

4. When and where was Wesley C. Mitchell born?
5. What is the self-generation theory?
6. Why has Mitchell's economic theory been criticized?

10.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. *The Peasantry of Bengal* was Romesh Chunder Dutt's first book written on the economic problems of farmers in 1875.
2. Dutt presented his theory on land revenue in his famous *Open Letters to Lord Curzon on Famines and Land Assessments in India*.
3. The reasons for Indian poverty as claimed by Dutt were:
   (a) Low productivity
   (b) Tax system
   (c) Breakdown of cottage industries
4. Wesley C. Mitchell was born in rural Illinois on August 5th, 1874.
5. As per the self-generation theory given by Mitchell, each stage of a trade cycle would automatically generate the other. According to him, the business crises were one feature of a recurrent cycle. A crisis was probably be followed by depression, depression by recovery, recovery by prosperity, prosperity by crisis, and so on.
6. Mitchell's economic theory has been criticized by modern writers on several counts. Firstly, it simply takes other issues behind. Furthermore, it treats cyclical fluctuations as the movements of a machine. In the view of Homan, it is a static theory in which economic institutions are a relatively stable factor not highly variable.

10.5 SUMMARY

- Romesh Chunder Dutt was an Indian Civil Servant born on 13th August 1848 in an eminent Bengali Kayastha family. He was also known as economic historian, writer and translator of holy books, Ramayana and Mahabharata.

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- Romesh Dutt was influenced by his uncle, who used to sit with him and discuss pieces from the works of the English poets.
- In his writings, Romesh Dutt criticized British government for their failure to improve the economic conditions of India.
- The cause of low productivity was adverse climate, soil infertility, traditional agricultural techniques, population, lack of education, low agricultural price, land tax system, and overall agrarian structure.
- R. C. Dutt suggested many measures to get rid of poverty from India. He designed a complete overhaul of the economic structure of the Indian society.
- As a civil servant and as an open-minded political leader of the liberal school, Dutt was an epitome of the new generation of cultured Indians.
- Wesley C. Mitchell was one of the greatest figures of the institutional school. He is recognized for his pain taking studies of 'green backs' and 'business cycles'.
- After taking responsibility of the NBER's founding study on income redistribution, Mitchell directed the NBER towards quantitative studies of the U.S. business cycles for which that organization has become famous.
- Mitchell analyzes the foundation and growth of institutions and traditions and supplemented them with wealth, banking and labour problems. In his later studies, he highlighted the physical aspect of economic activities.
- Mitchell thought that if economics became a science of human behaviour, it would focus more on human welfare than resources. So, he recommended that in economics two things namely, determinants of welfare and the means to be employed to increase it, should be examined.
- Although studies in different aspects of the problem had been made by other economist, it was only Mitchell who provided an analysis of all the phases of trade cycles on the basis of statistical data.

10.6 KEY WORDS

- **Permanent Settlement:** Also known as the Permanent Settlement of Bengal, it was an agreement between the East India Company and Bengali landlords to fix revenues to be raised from land that had far-reaching consequences for both agricultural methods and productivity in the entire British Empire and the political realities of the Indian countryside.
- **Ryots:** It refers to Indian peasants or tenant farmers.
- **Sinking Fund:** It is a fund containing money set aside or saved to pay off a debt or bond. A company that issues debt will need to pay that debt off in the future, and the sinking fund helps to soften the hardship of a large outlay of revenue.

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10.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the early life of Romesh Dutt.
2. Why did Romesh Dutt criticize British economic policy in India?

Long-Answer Questions

1. Describe the contributions of Romesh Dutt to the study of economics.
2. Discuss the economic ideas of Wesley Clair Mitchell.

10.8 FURTHER READINGS

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UNIT 11 JOHN MAURICE CLARK AND JOHN KENNETH GALBRAITH

Structure

11.0 Introduction
11.1 Objectives
11.2 Economic Ideas of John Maurice Clark
11.3 Economic Ideas of John Kenneth Galbraith
  11.3.1 Economic Ideas of John R. Commons
  11.3.2 Economic Ideas of Wesley C. Mitchell
11.4 Answers to Check Your Progress Questions
11.5 Summary
11.6 Key Words
11.7 Self Assessment Questions and Exercises
11.8 Further Readings

11.0 INTRODUCTION

In the previous unit, you learnt about the ideas of the American economist Wesley Clair Mitchell and the Indian economic historian Romesh Chunder Dutt. In this unit, we will discuss the ideas of John Maurice Clark and John Kenneth Galbraith.

John Maurice Clark was a twentieth century American economist whose work combined the rigor of traditional economic analysis with an "institutionalist" attitude. His ideas in many ways anticipated those of John Maynard Keynes. John Kenneth Galbraith was an American economist and public intellectual who was known as a proponent of public spending and a defender of American capitalism.

11.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss the economic ideas of John Maurice Clark
- Explain the concepts of the accelerator principle and workable competition
- Describe the economic ideas of John Kenneth Galbraith

11.2 ECONOMIC IDEAS OF JOHN MAURICE CLARK

John Maurice Clark was born on November 30, 1884 in Northampton, Mass., U.S. He died on June 27, 1963 in Westport Conn. He was an economist in

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America whose work on trusts brought him universal fame and whose ideas projected the ideas of John Maynard Keynes. Clark completed his graduation from Amherst College in 1905 and was awarded a Ph.D. from Columbia University in 1910.

In his career, Clark was posted at quite a lot of institutions, including at the University of Chicago (1915–26); he returned to Columbia in 1926 and retired in 1953. Clark's father was also an American economist named John Bates Clark. Clark collaborated with his father in 1912 to review an earlier work of Clark senior entitled *The Control of Trusts*.

As an economist, Clark's name has been mainly linked with industrial economics and competition. He is possibly best known for his concept of workable competition, as developed in his work *Competition as a Dynamic Process* (1961). The book discusses the elasticity of the economic system, the restrictions to power in market, and the importance of possible competition; these ideas were also stressed in his father's writings. Clark argued that perfect competition cannot be attained theoretically; this idea became accepted by antitrust scholars all over the world.

In 1923, Clark established his theory of the acceleration principle under the Economics of Overhead Costs which focused on the concept that investment demand can vary harshly if consumer demand fluctuations exhaust current output size. His following study of differences in demand of consumer as a basis of deviations in aggregate demand elevated some of the concerns later cured by Keynes. An across-the-board theorist, Clark also studied the economic costs of war, public works, and the labour market.

Acceleration Principle by John Maurice Clark

The accelerator principle, as advanced by J.M. Clark, refers to the accelerated effect on investment of a small change in the demand for or output (sales) of consumption goods. The principle elucidates that the need of rise in national income mostly results in large investment outlay and the reason behind the amount of outlay reviewing hinges not on the total level of commerce activity, but on whether that level is increasing or decreasing. Thus, a change in national income or output results in a change in investment. However, a small change in national income or output leads to an accelerated change in investment.

The acceleration principle is based on three main assumptions. These are as follows:

(i) Investment has both autonomous and induced components.

(ii) Investment is subject not on the total level of output or demand, but on the amount of rise in NNP or in total demand. If the rate of increase is growing, investment outlay will rise; if the frequency of income is constant, investment will be constant; if the rate of growth declines, investment will decrease.

(iii) The acceleration principle also highlights the instability of investment as compared with other mechanisms of cumulative demand. It suggests that

any change in percentage of aggregate demand may effect in considerable higher changes in percentages of spending of investment.

The accelerator principle of investment is that investment depends upon the growth of output and implies that investment will be unstable. Investment will fall simply because output grows at a slower rate. For investment to remain stable, output growth must be constant rate.

Concept of Workable Competition

The situation of workable competition was proposed by Clark to represent a situation where in a specific industry monopolistic power exists, but there is enough competition which protects consumers from being abused due to the existing monopoly. This is a 'workable' alterative to the theory of perfect competition. For example, we can say that the Indian telecom industry is in a state of workable competition as monopolistic power exists with a few big companies, however, there is enough competition between these companies to protect consumer interest.

In the situation of workable competition, the following conditions arise:

(i) In the long term, selling price on normal should be equivalent to or not pointedly above normal costs of production, so that profits do not noticeably surpass a normal interest return on investment. Prices should be responsive to basic reductions in costs.

(ii) In so far as normal costs of production are affected by the measures or volumes of plants and firms, the preponderance of industry output should be from plants and firms of the most efficient scale or with closely comparable technical efficiency.

(iii) The industry should not have chronic excess capacity, that is, significant plant capacity which is persistently unused even in periods of high general economic activity.

(iv) The industry's sales-promotion costs should not be substantially greater than what is needed to keep buyers informed of the availability, characteristics, and prices of products.

(v) The industry should be adequately progressive in introducing more economical production techniques and improved products, thereby balancing the costs of progress with the gains.

The first three of these aspects are easy to assess than the others, certain simplifications are likely relating to the workability of different market structures:

- Unregulated single-firm monopolies tend to generate unworkable market performance, mainly in the form of output restriction, prices well above costs, and consequent excess profits. They have undesirable effects on the uses to which resources are put and on income distribution.
- Oligopolies with high seller concentration and also very high barriers to entry tend towards unworkable performance, like that of single-firm

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monopoly. In general, however, they do not show significant degrees of technical inefficiency resulting from inefficient plant scales or excess capacity.

- Oligopolies with fairly high seller concentration but only moderate barriers to entry are also prone to unworkable performance of the sort just mentioned, but not to as high a degree.
- Oligopolies with only reasonable seller absorption and moderate-to-low blocks for entry have a habit of inclining towards workable performance both in price-cost relations and in technical efficiency, excluding that certain of them may have repeated long-lasting additional volume due to intermittent over entry by competing firms.
- Industries of atomistic structure have a habit of bending normally toward workable performance except they agonise from critical competition as described above.

Concept of Public Works

A public utility is an organization that delivers certain types of services to the public, including public transportation, sanitation, electricity, water, and similar services. In many countries such businesses are owned and operated by the state, however, in the United States they are mostly owned by private businesses and are operated under close governmental regulation. In India, an example of a public utility would be the Indian Railways.

The classic explanation for the need to regulate public utilities is that they are enterprises in which the technology of production, transmission, and distribution almost inevitably leads to complete or partial monopoly, that is, they are natural monopolies. The monopolistic tendency arises from economies of scale in the particular industry, from the large capital costs typical of such enterprises, from the inelasticity of demand among consumers of the service, from considerations of the excess capacity necessary to meet demand peaks, and other considerations. It is often also the case that the existence of competing parallel systems of local telephones or natural gas, for example, would be inordinately expensive, wasteful, and inconvenient. Given the tendency to monopoly and the potential therefore of monopolistic pricing practices, public regulation has for more than a century been applied to certain classes of business.

In practice, regulation aims to ensure that the utility serves all who apply for and are willing and able to pay for its services, that it operates in a safe and adequate manner, that it serves all customers on equal terms, and that its rates are just and reasonable. In the United States, all states have regulatory commissions, and the American Federal Government has several, including the Interstate Commerce Commission, the Civil Aeronautics Board, the Federal Power Commission, the Federal Communications Commission, and the Securities and Exchange Commission.

11.3 ECONOMIC IDEAS OF JOHN KENNETH GALBRAITH

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John Kenneth Galbraith was born on October 15, 1908 at Iona Station in Ontario, Canada. He died on April 29, 2006 at Cambridge in Massachusetts, U.S. He was a Canadian-born economist in America and public servant recognised for his support of public expenditure and for the literary quality of his writing on public affairs. Galbraith graduated from University of Toronto's Ontario Agricultural College in 1931 and completed his Ph.D. from the University of California, Berkeley in 1934. Galbraith became a U.S. citizen in 1937. He worked at Harvard and Princeton Universities until 1942.

During the Second World War, and the post-war period, Galbraith was posted in a variety of government posts and served as editor of *Fortune* magazine from 1943 to 1948 before recommencing his academic career at Harvard in 1948. He was a well-known a politically active liberal academician with an aptitude for interacting with the reading public. Galbraith became a key advisor to President John F. Kennedy and was appointed as Ambassador to India from 1961 to 1963, after which he resumed his career at Harvard; Galbraith became professor emeritus in 1975. He also continued his involvement in public affairs, and in 1967–68 he was national chairman of the Americans for Democratic Action.

Galbraith's major works included *American Capitalism: The Concept of Countervailing Power* (1951), in which he questioned the competitive ideal in industrial organizations. In his popular critique of the wealth gap, *The Affluent Society* (1958), Galbraith faulted the "conventional wisdom" of American economic policies and called for less spending on consumer goods and more spending on government programs. In *The New Industrial State* (1967) Galbraith envisioned a growing similarity between "managerial" capitalism and socialism and called for intellectual and political changes to stem what he saw as a decline of competitiveness in the American economy. Among his many other works were *The Great Crash, 1929* (1955), *The Liberal Hour* (1960), *Ambassador's Journal* (1969), *A Life in Our Times: Memoirs* (1981), *The Anatomy of Power* (1983), *Economics in Perspective: A Critical History* (1987), and *The Culture of Contentment* (1992). Galbraith for his services to the public was awarded the American Presidential Medal of Freedom twice, in 1946 and again in the year 2000.

Galbraith's *American Capitalism*

In *American Capitalism: The Concept of Countervailing Power*, published in 1952, John Kenneth Galbraith determined that the economy of America was managed by a trio of big business organizations, big labour, and an activist government. He defined the actions of the industry groups and unions as countervailing power. He compared this system with the era preceding the Great Depression, when big businesses had comparatively free restraint over the economy.

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Galbraith's *The New Industrial State*

Galbraith lengthened his examination of the role of power in monetary life, arguing that very few businesses in the United States is suitable for the model of perfect competition. The 'conventional wisdom' in economic thought represents economic life as a conventional competitive market that is governed due to the choices of independent consumers. The production control process runs from consumers of merchandises to the establishments that manufacture those merchandises. This process is overturned and industries start exercising control over consumers by advertising and related salesmanship activities.

The overturned process relates only to the industrial system, that is, the manufacturing core of the economy in which each industry contains only a few very powerful companies. It does not apply to the market system in the Galbraithian dual economy. In Galbraith's view, the main function of market relations in this industrial system is, not to limit the control of the corporate leaders, but to help as a tool for the application of their power. Furthermore, the power of these companies ranges into commercial culture and politics, letting them exercise substantial effect upon popular social attitudes and value judgments. That this power is exercised in the short sighted interest of expanding commodity production and the status of the few is both inconsistent with democracy and a barrier to achieving the quality of life that the new industrial state with its affluence could provide.

11.3.1 Economic Ideas of John R. Commons

John Roger Commons was born on October 13, 1862 at Hollandsburg in Ohio, U.S and died on May 11, 1945 at Fort Lauderdale in Florida. He was economist of America who turned into the leading authority on U.S. labour in the first half of the 20th century. He did his studies at Oberlin College and at Johns Hopkins University and taught at the University of Wisconsin from 1904 to 1932. Some famous works of his include *A Documentary History of American Industrial Society*, 10 volume in 1910–11, and *History of Labour in the United States*, 4 volume in 1918–35. Commons' theory of the growth of the American labour movement in relations of fluctuations in the market structure was largely accepted. After the First World War, Commons widened his name with the publication of *Legal Foundations of Capitalism* in 1924 and *Institutional Economics* in 1934. He was the author of many changes in legislation in the American state of Wisconsin that made the state an example for other states. Some of the legislation included lawful rights for labour unions, compulsory unemployment insurance, compulsory workers' compensation, and government regulation of utilities. He also made notable contributions to the federal government in the areas of civil service, public utilities, and unemployment insurance and contributed to the design of the Social Security Act of 1935, the U.S. government's first comprehensive program to fund old-age benefits through payroll taxes.

11.3.2 Economic Ideas of Wesley C. Mitchell

We've already studied about Wesley Mitchell in the previous unit. Let us briefly recapitulate his life and career once again.

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Wesley Clair Mitchell was born on August 5, 1874 in Rushville, Ill., U.S. and died on October 29, 1948 in New York, N.Y. Mitchell was an American economist recognised for being the world's leading expert on business cycles. Mitchell completed his education from the University of Chicago, where he started following the thoughts of Thorstein Veblen and John Dewey on Institutional Economics. In his career, Mitchell taught at various universities, including the University of Chicago from 1900 to 1902, the University of California from 1902 to 1912, Columbia University from 1913 to 1919 and again from 1922 to 1944, and the New School for Social Research, New York City from 1919 to 1921. In spite of his wide-ranging career of teaching, Mitchell was mainly dedicated to his interest of economics research.

In 1920, Mitchell helped to organize the National Bureau of Economic Research and was its director of research until 1945. He served as the chief of the price section of the War Industries Board during the First World War, as chairman of President Herbert Hoover's Research Committee on Social Trends, and as a member of the National Planning Board (1933) and of the National Resources Board (1934–35). Under Mitchell's leadership, the Social Science Research Council, of which he was chairman (1927–30), and the Bureau of Educational Experiments, greatly influenced the development of quantitative studies of economic behaviour in the United States and abroad.

Among his publications are *Business Cycles* (1913), *Business Cycles: The Problem and Its Setting* (1927), *The Backward Art of Spending Money* (1937), and *Measuring Business Cycles* (1946), co-written with A.F. Burns.

Check Your Progress

1. What is Clark best known for?
2. What is the accelerator principle?
3. What did Galbraith question in his work *American Capitalism: The Concept of Countervailing Power*?
4. List some famous works of John Roger Commons.

11.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. John Maurice Clark is possibly best known for his concept of workable competition, as developed in his work *Competition as a Dynamic Process*.

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2. The accelerator principle, as advanced by J.M. Clark, refers to the accelerated effect on investment of a small change in the demand for or output (sales) of consumption goods.
3. In *American Capitalism: The Concept of Countervailing Power*, Galbraith questioned the competitive ideal in industrial organizations.
4. Some famous works of John Roger Commons *include A Documentary History of American Industrial Society*, 10 volume in 1910–11, and *History of Labour in the United States*, 4 volume in 1918–35.

11.5 SUMMARY

- John Maurice Clark was born on November 30, 1884 in Northampton, Mass., U.S. He died on June 27, 1963 in Westport Conn. He was an economist in America whose work on trusts brought him universal fame and whose ideas projected the ideas of John Maynard Keynes.
- As an economist, Clark's name has been mainly linked with industrial economics and competition. He is possibly best known for his concept of workable competition, as developed in his work *Competition as a Dynamic Process* (1961).
- In 1923, Clark established his theory of the acceleration principle under the Economics of Overhead Costs which focused on the concept that investment demand can vary harshly if consumer demand fluctuations exhaust current output size.
- The accelerator principle, as advanced by J.M. Clark, refers to the accelerated effect on investment of a small change in the demand for or output (sales) of consumption goods.
- The situation of workable competition was proposed by Clark to represent a situation where in a specific industry monopolistic power exists, but there is enough competition which protects consumers from being abused due to the existing monopoly. This is a 'workable' alterative to the theory of perfect competition
- Public utility, is an organization that delivers certain types of services to the public, including public transportation, sanitation, electricity, water, and similar services.
- The classic explanation for the need to regulate public utilities is that they are enterprises in which the technology of production, transmission, and distribution almost inevitably leads to complete or partial monopoly, that is, they are natural monopolies.

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- John Kenneth Galbraith was born on October 15, 1908 at Iona Station in Ontario, Canada. He died on April 29, 2006 at Cambridge in Massachusetts, U.S.
- Galbraith's major works included American Capitalism: The Concept of Countervailing Power (1951), in which he questioned the competitive ideal in industrial organizations.
- In *American Capitalism: The Concept of Countervailing Power*, published in 1952, John Kenneth Galbraith determined that the economy of America was managed by a trio of big business organizations, big labour, and an activist government.
- Galbraith lengthened his examination of the role of power in economic life, arguing that very few businesses in the United States is suitable for the model of perfect competition.
- John Roger Commons was born on October 13, 1862 at Hollandsburg in Ohio, U.S and died on May 11, 1945 at Fort Lauderdale in Florida.
- Commons was the author of many changes in legislation in the American state of Wisconsin that made the state an example for other states. Some of the legislation included lawful rights for labour unions, compulsory unemployment insurance, compulsory workers' compensation, and government regulation of utilities.
- Wesley Clair Mitchell was born on August 5, 1874 in Rushville, Ill., U.S. and died on October 29, 1948 in New York, N.Y. Mitchell was an American economist recognised for being the world's leading expert on business cycles.
- In 1920, Mitchell helped to organize the National Bureau of Economic Research and was its director of research until 1945.
- Among Mitchell's publications are *Business Cycles* (1913), *Business Cycles: The Problem and Its Setting* (1927), *The Backward Art of Spending Money* (1937), and *Measuring Business Cycles* (1946), co-written with A.F. Burns.

11.6 KEY WORDS

- **Oligopolies:** These are market structures with a small number of firms, none of which can keep the others from having significant influence.
- **Monopolies:** These are market structures characterized by a single seller, selling a unique product in the market.
- **Public utility:** It is an organization that maintains the infrastructure for a public service.
- **Regulation:** It refers to rules made by a government or other authority in order to control the way something is done.

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11.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. List the assumptions of the acceleration principle.
2. Discuss the arguments made by Galbraith's in *The New Industrial State*.
3. Write a short note on the economic thoughts of Wesley C. Mitchell.

Long-Answer Questions

1. Discuss the economic ideas of John Kenneth Galbraith.
2. Explain the concept of workable competition.
3. Examine the economic ideas of John Maurice Clark.

11.8 FURTHER READINGS

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UNIT 12 INDIAN ECONOMIC THOUGHT I

Structure

12.0 Introduction
12.1 Objectives
12.2 Thiruvalluvar
  12.2.1 Economic Thoughts
12.3 Gopal Krishna Gokale
  12.3.1 Economic Ideas
  12.3.2 Agricultural Ideas
  12.3.3 Foundations of Indigenous Capitalism
12.4 Dadabhai Naoroji
  12.4.1 Drain Theory
  12.4.2 Criticisms
  12.4.3 Long-Run Relevance
12.5 Mahadev Govind Ranade
  12.5.1 Agrarian Policy
  12.5.2 Railway Investment
  12.5.3 Methodology of Economics
12.6 Answers to Check Your Progress Questions
12.7 Summary
12.8 Key Words
12.9 Self Assessment Questions and Exercises
12.10 Further Readings

12.0 INTRODUCTION

In the previous units, we studied the ideas of various economists on institutional economics. In this unit, we will study the economic thought of Indian thinkers. The Grand Old Man of India, Dadabhai Naoroji, was an early Indian political and social leader who became one of the founding members of the Indian National Congress. In terms of economic theory, he is best known for his drain of wealth theory which critiqued British rule in India. Likewise Gopal Krishna Gokhale was one of the founding social and political leaders during the Indian Independence Movement. His economic ideas, along with Thiruvalluvar and Mahadev Govind Ranade are also discussed in the unit.

12.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the economic thoughts of Indian thinkers
- Discuss the economic ideas of Thiruvalluvar and Gopal Krishna Gokhale
- Describe the economic theories of Dadabhai Naoroji and Mahadev Govind Ranade

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12.2 THIRUVALLUVAR

Thiruvalluvar, was a well-known Tamil poet and philosopher, also known as Valluvar. His birth place and date is still unknown, but his parents' names were Bhagavan and Aadhi. There is not much known about his family background, religion or birth place. Uncertainty still persist, it is believed that he lived in the town of Mylapore (present-day Chennai). It is believed that he may belong to either Jainism or Hinduism because during his times Hinduism, Jainism and Buddhism were the only three religions, which flourished in the Indian sub-continent. He is known for his work, *Tirukkural*, which is a collection of couplets on morals, social and economic matters, and love. This book is considered as a brilliant and widely appreciated work of the Tamil literature. No reliable information is accessible about Valluvar, the intellectual of Tamil literature. His life and background are variously inferred from his works and by different biographers. The assumption about Valluvar's life is mainly inferred from his work, *Tirukkural*. According to Zvelebil, Valluvar was perhaps a learned Jain with diverse leanings and close association with the early works of Tamil classical period and some knowledge of the Sanskrit legal and educational manuscript.

All major Indian religions, as well as Christian missionaries of the 19th century, have claimed him as inspired from their tradition. He has inspired many researchers down the ages by his ethical, social, political, economic, religious, philosophical, and spiritual spheres. He has been respected for his literary works, which are considered as classics of Tamil culture. In the 19th and early 20th century, European writers and missionaries variously dated the Valluvar to exist between 400 and 1000 CE. According to Blackburn, the 'current scholarly consensus' dates the text and the author to around 500 CE. In 1935, the Tamil Nadu government officially documented 31 BCE as the year of Valluvar. As recommended by Maraimalai Adigal, the Valluvar Year was added to the calendar. Thus, the Valluvar year is calculated by adding 31 to any year of the Common age.

Valluvar's teachings intimate both the cultural values and textual values in the 13th to 14th Century Tamil Nadu. Valluvar's text can be interpreted and exercised in other ways. Regardless of scholars signifying that Valluvar is either a Jain or a Hindu, almost every religious group in India, as well as Christianity, has claimed the work and its author as one of their own. However, these claims are not supported academically and are constantly disproved by scholars. For example, the Christian claims have cropped up only after the regal missionaries came to India, so they have been ignored. Valluvar is worshiped as a deity and saint by various communities throughout the Southern province of India. Several communities, together with those in Mylapore and Tiruchuli, worship Valluvar as the 64th Nayanmar of the Saivite tradition. There are many temples totally devoted to Valluvar from corner to corner of Southern part of the country. The most eminent temples are in Mylapore, Chennai built in the early 16th century. The government of Tamil Nadu celebrates the 15th of January as Thiruvalluvar Day in the poet's

respect as part of the Pongal celebrations. Thiruvalluvar Day was first celebrated on the 17th and 18th of May 1935. Valluvar's works have also influenced the South Indian classical music and popular culture. Carnatic musicians and composers such as Mayuram Viswanatha Sastri and M. M. Dandapani Desikar have tuned select couplets in the 19th and 20th centuries.

Even though researchers vary over the assessment of the era of *Tirukkural*, it is normally believed that it belonged to the Sangam Age in Tamil Nadu, which is dated around 3rd Century A.D. His work is regarded as realistic idealism. *Tirukkural* contains three important parts *Aram* (virtue), *Porul* (wealth), *Inbam* (love), which are necessary for ultimate salvation or *vitu*, which follow *Dharma* (religion), *Artha* (polity), *Kama* (love), and *moksha* (salvation) respectively—which are the four foundations of Hinduism. The book was divided into: (i) Arathuppal (ii) Porutpal and (iii) Kamathuppal.

Tirukkural is structured into 133 chapters, each containing 10 couplets (or kurals), for a total of 1,330 couplets. The 133 chapters are grouped into three parts or books:

- **Part I–Aram:** Dealing with virtues independent of the surroundings (Chapters 1 to 38)
- **Part II-Porul:** Chapter dealing with Polity (Artha), in other words, virtues with respect to the surroundings (Chapters 39 to 108).
- **Part III-Inbam:** The chapter deals with Kama or virtues related to conjugal human love (chapters 109 to 133)

The *Tirukkural* text has been converted into numerous Indian and global languages. It was translated into Latin by Constanzo Beschi in 1730, which helped make the work known to European scholars. *Tirukkural* is one of the most respected contributions to the Tamil literature. Valluvar is honoured and well-regarded in the Tamil culture as is revealed by his work, which has been called by nine diverse names: *Tirukkural* (the sacred kural), *Uttaravedam* (the ultimate Veda), *Thiruvalluvar* (eponymous with the author), *Poyyamoli* (the false less word), *Vayuraivalttu* (truthful praise), *Teyvanul* (the divine book), *Potumarai* (the common Veda), *Muppal* (the three-fold path), and *Tamilmarai* (the Tamil Veda). Valluvar was a realistic thinker. He did not mix spiritualism with earthly things. The political philosophy of Thiruvalluvar is applicable across times even today. *Porutpal* consists of 7 parts, further it has 70 verses/couplets. They include politics-25, ministry-10, defence-2, wealth-1, army-2, friendship-17, and citizens-13 respectively.

12.2.1 Economic Thoughts

Valluvar's economic thoughts are found in his never-ending contribution, *Tirukkural*, a book of principles. Valluvar's top seven economic ideas are: factors of production, agriculture, public finance, poverty and begging, wealth, ethics, and welfare state.

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- **Factors of production:** Thiruvalluvar has made many passing references about the factors of production viz., Land, Labour, Capital, Organisation, Time, Technology, etc. For example, he had said: 'Unfailing harvest, competent body of men, group of men whose wealth knows no diminution, are the components of an economy', (Kural 61). According to him, performing the work at the proper time, with appropriate technology is a key to conquer the world. He has also insisted on the need for saving. As profit cannot be made without capital.
- **Agriculture:** Valluvar considered agriculture to be the most fundamental economic activity. According to him, the agriculturists were the real 'intellectuals' and 'capitalists'—the important ingredients of an economy.
- **Public finance:** Valluvar has elaborated on public finance under the captions public revenue, financial administration, and public expenditure. He mentioned these as:
  - o Creation of wealth
  - o Collection of revenue
  - o Management of revenue
  - o Public expenditure

  Valluvar didn't support taxing the public. The three main sources of revenue are: (1) Wealth that comes by itself; (2) Customs duties; (3) Tributes paid by the defeated kings, i.e., 'reparation'. In case of public expenditure, Valluvar endorsed a balanced approach towards budget, with focus on defence, social service, and public works. Valluvar was also against taking external support. According to him a country should be self-sufficient, otherwise it cannot be considered as independent country.
- **Poverty and begging:** As per his views, poverty is the main reason for all the suffering. He considered begging as the greatest curse of society.
- **Wealth:** According to him, wealth is only means not an end. He supported gaining wealth by noble and honourable means. He opposed hoarding wealth and described it as profitless richness. He considered production to be the real wealth and labour as the greatest resource.
- **Ethics:** His entire teachings were based on morals. He was against illegal methods of achieving the objectives. He regarded drinking, gambling, and prostitution as the evils that did harm to the socio-economic life of a society.
- **Welfare state:** He advocated for welfare state, where there will be no poverty, illiteracy, and disease. The features of such a welfare state are:
  - o No disease
  - o Abundant wealth
  - o Good crops

- o Happiness
- o Security for the people

However, according to Valluvar, the most important feature of a peaceful state is 'wherein there are no several parties, where there are no internal dissensions; where there are no internal enemies'.

Check Your Progress

1. Which year is regarded as year of Valluvar?
2. Mention the diverse names *Tirukkural?*
3. What is the significance of 15th January in Tamil Nadu?

12.3 GOPAL KRISHNA GOKALE

Gopal Krishna Gokhale was born on 9 May 1866 at Katulk in Ratnagiri. The economic condition of the family was so bad that on his father's death, he could continue his studies only because his elder brother sacrificed his own education. He obtained his B.A. degree in 1884 and joined the Law College in Bombay, but could not complete the course. Gokhale was greatly influenced by the ideas of M.G. Ranade, whom he regarded as his master in political and public life; Dadabhai Naoroji, who was his hero; and famous Bombay lawyer, Pherozeshah Mehta. Immediately after his graduation, Gokhale joined the Deccan Education Society, Poona (Pune), as a Life Member. When the Fergusson College was opened in 1885, he was called upon to lecture there. He retired in 1902 specifically to devote himself to public life. In 1889, he became a member of the Indian National Congress. In 1890, he was elected Honorary Secretary of the Sarvajanik Sabha, Poona, of which Ranade was the most influential member. In 1893, he became the Secretary of the Bombay Provincial Conference. In 1895, he became Joint Secretary of the Indian National Congress along with B. G. Tilak.

12.3.1 Economic Ideas

As noted earlier, Gokhale's economic and social ideas constitute a part of his political thinking. He was not an economist in the strict sense of the term. Neither was he a social thinker with deep sociological insight. However, as a leader of the Congress and as a member of the legislature, Gokhale had to ponder over many socio-economic issues of the time which, in turn, gave birth to his economic and social ideas. These ideas reflected his way of thinking which considerably influenced the process of social change of his time.

As far as his economic ideas are concerned Gokhale owes much to M. G. Ranade and Professor List, a German economist. Both Ranade and List differed from the classical economists such as Adam Smith and Ricardo. Ranade argued that 'Political Economy being a Hypothetical Science, its propositions are not

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based upon axiomatic truths like those of Euclid and do not absolutely and universally hold good, like the latter, true in all times.' Therefore, if a particular economic policy was suited to England it was not necessarily valid for India as well. It was on this ground that Ranade opposed the policy of free trade in India as advocated by the classical English economists. Ranade noticed that in Germany it was because of state initiative that the country was able to transform itself into a first rate modern power, and hence he pleaded that the state should take initiative in accelerating the process of industrialisation. Like Professor List, Ranade thought that the trade policy of the country is integrated with its general economic policy and therefore he felt that 'the government should guarantee or subsidise private efforts till private enterprise could support itself...should advance loans to private capitalist at low interest and help them in the choice of places and the selection of the form of investment.'

According to Ranade, the grave problem before India was that of poverty and it could not be removed until the process of industrialisation set in. The policy of free trade and open competition, as followed by the British administrators, were not conducive to the growth of industrialisation in India and hence Ranade advocated state intervention in the economic life of the country. Moreover, there was no point in having a surplus budget while the budget of the common man failed to balance itself. During a period of budgetary surplus, Gokhale recommended that the state adopt the following measures:

- A reduction in state demand on land by 25 to 30 per cent
- The creation of a fund of millions of sterling to rescue the Indian agriculturists from the load of debt
- The activation of co-operative credit societies through establishing agricultural banks on Egyptian model
- The promotion of industrial and technical education and the sanctioning of the increased expenditure for this purpose
- Free and compulsory primary education
- Improvement of the finances of the local bodies

In 1905, Gokhale founded the Servants of India Society with the object of training men to devote themselves to the service of India as national missionaries and to promote by all constitutional means the national interests of the Indian people. In 1908, Gokhale founded the Ranade Institute of Economics. Gokhale was a front rank Reformer; he deprecated the caste-system and untouchability, pleaded for the emancipation of women and championed the cause of female education. In Gokhale's opinion, the introduction of Western education in India, with its liberalising influence, was a great blessing to the people. He was a firm believer in the theory that mass education was a prerequisite to national political consciousness. He advocated that primary education should be free in all schools throughout India at once. As for Gokhale's ideas on nationalism and the conduct of the nationalist movement, he sought greater autonomy for Indians who would

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cooperate with the Government in reforms and obtain through constitutional means and by persuasion and advance over the reforms granted until, finally, India became a self-governing Dominion within the British Commonwealth of Nations. While appreciating the benefits of British rule in general, he never failed to criticize unjust policies and high-handed actions of the Government.

In his opinion, the economic results of British rule in India were absolutely disastrous, resulting in frightful poverty. According to him, the greatest need of the hour in India was industrial education. In agriculture, he pleaded that old methods should be changed as much as possible. There was a crying need to introduce agricultural science and improved agricultural implements. Regarding the textile industry, Gokhale acknowledged that the handloom was doing good work and had some future before it, yet the main work would have to be done by machinery. He made extensive use of the public platform for communicating his ideas on social, economic and political reform. Some of his memorable speeches were made in the Imperial Legislative Council, especially on the Annual Budgets from 1902 to 1908. Gokhale paid frequent visit to England His first visit (1897) was in connection with the Welby Commission. His evidence was noted for his analysis of the leading facts in the history of Indian Finance, his examination of the constitution and expenditure of the Indian Army and his emphasis on the subordination of the interests of the taxpayers to those of the European services and the exclusion of Indians from the higher branches of public service.



Fig 12.1 *G.K. Gokhale*

Source: http://en.wikipedia.org/wiki/File:GKGokhale.jpg

Among the early figures in the Indian National Congress Gokhale's position was very high. He was feared by the Government and respected by the people. In politics he belonged to the moderate group opposed to the extremist school led by Tilak. He, however, placed equal emphasis on social reform as on political progress. For nearly three decades Gokhale dedicated his rare qualities to the exclusive service of his country and his people in a way which few could lay claim to.

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12.3.2 Agricultural Ideas

Gokhale was of the opinion that it was of no use to have surplus budget when the budget of the common man failed to balance itself. If there was to be a surplus budget the surplus must be devoted to the work of promoting development functions of the state. Gokhale was also aware of the state of the agricultural life in India. He saw that the agricultural industry in India was in a serious depression and the crop yield per acre was low. In such circumstances, he resented the increase in the land revenue demanded by the state. He made it clear that he regarded land revenue and the indirect taxes as together placing an unbearable burden on the poor. He wanted the state to give importance to irrigation and scientific agriculture as measures for agricultural prosperity. He disapproved the excise duty on cotton textiles which in his opinion was imposed to counter balance the duties on imports. Gokhale thought that such a duty further burdened the poor.

Following the German economist Professor List's ideas, Gokhale pleaded protection for the new industries in India on the ground that she was an industrially backward country. Gokhale observed:

> ...he (List) says that when a country is industrially backward...comes into vortex of universal competition-competition with countries which use steam and machinery... in their production-the first effect is to sweep of local industries and the country is thrust back on agriculture for some time. But then, he says, comes in the duty of the state. When such a situation is reached, the state should step forward and by a judicious system of protection it should foster such industries are capable of being fostered so that the country may once again enter on its industrial path with the aid of the latest appliances and ultimately stand successfully the competition of the whole world. India should follow this advice of List.

In short, Gokhale stood for the industrial development, advocated state initiative to further the process of industrialisation, demanded protection for infant industries, and thus paved the way for capitalist development.

12.3.3 Foundations of Indigenous Capitalism

Gokhale did not stop at merely criticizing the fiscal policy of the British government but also advocated the cause of Swadeshi. However, he did not identify Swadeshi with boycott. For Gokhale, the Swadeshi movement was both a patriotic and an economic movement. So far as its patriotic aspect concerned it meant devotion to motherland but the movement on its mate. It ensured a ready consumption of such articles as were produced in the country and furnished a perpetual stimulus to production by knowing up the demand for indigenous things. To Gokhale, the question of production was a question of capital, enterprise and skill and whoever could help in one of those fields could be called a worker in the Swadeshi cause. Gokhale did not mind even to seek governmental cooperation for the cause of the Swadeshi movement. Through the Swadeshi movement, Gokhale sought to lay the foundations of indigenous capitalism.

In the sphere of social reforms, Gokhale sided with Ranade. Like Ranade, Gokhale also believed that social reforms must go along with political reforms. As early as in 1890, Ranade had advocated certain reforms, namely:

- Not more than a year's income should be expended on the marriage ceremonies of son or daughter.
- The boys should not be married before the ages sixteen, eighteen or twenty and the girls before the ages of ten, twelve and fourteen.
- Polygamy should be prohibited.
- No one should marry after the age of sixty.
- Efforts should be made to promote female education.

By and large, Ranade believed that all these reforms should be introduced gradually, and the state might be utilized to bring about social change through legislative procedure whenever it was absolutely necessary. But on an average, Ranade believed, that 'popular initiation' rather than 'imposed laws' would be helpful in reforming the society. However, it must be noted here that Ranade was not totally against the state-intervening to promote social reforms as Tilak was. Gokhale followed Ranade in this respect. He was of the opinion that the state must help the progressive elements in the society. He thus supported the motion on the Civil Marriage Bill. With the support of an influential and enlightened minority Gokhale wanted the state to proceed with measures of social change. Gokhale pleaded for state-intervention to regulate the social and economic life of the country. Thus, the role that he envisaged for the state was very different from the role assigned to the state by classical liberalism.

Check Your Progress

4. Which policy of the classical English economists was opposed by M.G. Ranade?
5. Why did Gokhale found the Servants of India Society?

12.4 DADABHAI NAOROJI

In terms of economic theory, Dadabhai Naoroji is best known for the concept of the drain theory. During the last two decades of the 19th century and the first decade of the 20th century, the drain theory came to be seen as the symbol of Indian economic nationalism. Its basic message, namely that the financial mechanism, by which British rule in India was maintained, led to a transfer of wealth and income from India to Britain, imposing a 'bleeding drain' on the Indian economy, was not confined to scholarly writing. It was stated in speeches at public meetings, presidential addresses of the Indian National Congress and editorials of leading daily newspapers, notably the *Amrita Bazar Patrika*. For nationalistic Indians, it became an article of faith, and for some, it still is.

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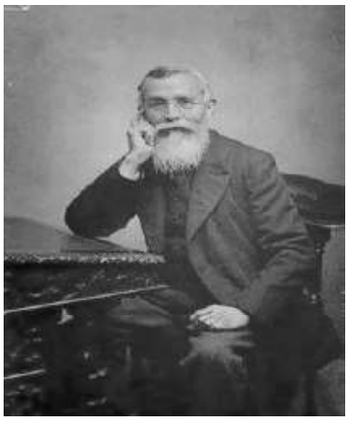


Fig 12.2 *Dadabhai Naoroji*

Source: http://en.wikipedia.org/wiki/File:Dadabhai_Naoroji,_1892.jpg

12.4.1 Drain Theory

The drain theory was first developed by Dadabhai Naoroji in a series of speeches and writings subsequently published in 1901, in a volume entitled *Poverty and un-British Rule in India*. Marginal contributions to the theory were also made by R.C. Dutt, G.S. Iyer, G.K. Gokhale and P.C. Ray. Posterity, not without reason, has tended to look on the drain theory as the brainchild of Naoroji.

Naoroji himself makes no great claim to originality. On the contrary, he purports to regard the concept of economic drain as well-established, attributing it to a number of British writers to whom he amply acknowledges his debt. These include Sir John Shore, who said in his minute to the Fifth Report of the Eastern Indian Company in 1787 that the company's trade produced no equivalent returns to India; Mr Frederick John Shore, a Bengal civilian, who said in 1837 that India had been drained of a large proportion of the wealth she once possessed; and Mr Saville Marriot, a Commissioner of Revenue in the Deccan, who stated in 1837 that most of the evils of 'our' in rule in India arose directly from, or might be traced to, the heavy tribute which the country paid to England. These concepts, namely trade with no equivalent returns, the drain of wealth, and annual tribute, formed the core of the theory of external economic drain, which Naoroji made his own.

Neither Naoroji himself nor his followers attempted to develop the drain theory in a formal or rigorous way. It was stated in a number of different versions and remains open to a variety of interpretations. It has, for example, been regarded as an expression of patriotic fervour against foreign rule, as an exercise in the economics of imperialism, as an outdated product of mercantilism and as an anticipation of recent neo-Marxist theories of unequal exchange. However, if one only looks at the form in which it was developed by Naoroji and his immediate followers, the theory appears to have contained a stable core. This emerges clearly from some recent characterization of the drain theory by two authors whose basic points of view are quite different. The first is Bipan Chandra:

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> In the opinion of Indian national leadership, one of the most important causes of the poverty in India was the drain of wealth to England … In fact, a great deal of the national agitation during the period under study was based on the drain theory or the belief that a part of the national wealth or of its total annual product was being exported to England for which India got no adequate economic or material return. Or in other words, India was being compelled to pay an indirect tribute to the English nation.'

The other is Barber, who describes the drain theory stated by Indian nationalists as consisting in the belief that 'the unilateral transfers that India was compelled to make to British, systematically stripped the country of resources and thus perpetuated poverty'.

On the whole, writings by Indian nationalists in this period do not suggest that they were using 'drain' as a catch-all term for the evils of foreign rule but rather show that they had a fairly specific sort of drain in mind. As Dharma Kumar has pointed out, whether or not there was a drain from Indian depends on the question of whether India received value for the sterling payments made or whether it was forced to pay too much, and this is a question which can only meaningfully be discussed item by item. According to Indian writers, the most important item was the remittance to England of a proportion of salaries, incomes and savings by civil, military and railway employees of British origin, as well as by professionals, such as lawyers and doctors. These, together with the payment in sterling by the government of India of the pensions and furlough allowances of British officials, constituted a heavy burden on the resources of a very poor country. The excessive sterling cost of Indian administration was attributed to British policies such as that of excluding Indians from the higher ranks of the civil services.

Raja Ram Mohan Roy had suggested in as early as 1831 that government expenditure could be greatly reduced by appointing Indians in place of Europeans in most administrative and judicial posts. British colonial rulers showed even less enthusiasm for such an approach than the East Indian Company had done. Efforts in this direction were made by Lord Ripon, who was sympathetic to Indian aspirations, but they were scuttled by the pressure of official opinion, which favoured keeping the civil services white. Illustrative of the gulf between the British and the Indian points of view was the controversy over lowering the maximum age limit for recruitment to the civil service, which became a point of widespread debate in India during the 1880s. Between 1853 and 1883, only twelve Indians had been recruited. The gradual lowering of the maximum age limit for candidates, from twenty-three to twenty-two, then to twenty-one and subsequently to nineteen, had, it was felt, made competition increasingly difficult for Indians, who on average graduated at a higher age than their British counterparts. It was said on the British side that the main reason for the change was to encourage English candidates to sit for the examination and go out to India when still fairly young but Indians, not without reason, regarded it as a deliberate step to exclude them. Gopal observes that there were few matters on which Indian opinion was more bitter or unanimous

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than on the reduction of the age limit, the feelings aroused being entirely disproportionate to the numbers affected.

The privileges of civil servants of British origin were also increased over time. In 1893-94, they were granted exchange compensation to the tune of 15-20 per cent so as to maintain the gold value of the remittances, a step which was criticized by Gokhale as contributing to an increase in the drain. A number of arguments were advanced by Indian economists in favour of recruiting Indians to the civil services. One, of course, was that it would reduce the drain. Another was that it would increase efficiency. After all, Adam Smith had taught that monopoly breeds inefficiency. Why then should Britain be a monopoly supplier of administrative service when Indians would foster learning and contribute to India's long-run development. As far as this particular item is concerned, the drain theory does appear at this distance of time to have had a certain measure of justification.

Another item about which Indian opinion was much concerned was military expenditure. Just as in the case of civil servants, the remittances of a proportion of salaries, incomes and savings by British military personnel and the payment in sterling by the Government of India of pensions and other allowances of British army officers, constituted an item of drain, so did the cost of military stores supplied to India and the various military charges paid in England by the Government of India. All these items formed part of the so called Home Charges. In 1880, the Indian tax payer supported 130,000 Indian and 66,000 British troops. Lord Salisbury described India as 'an English barrack in the Oriental seats from which we may draw any number of troops without paying for them'.

One important reason why the army cost so much, was the rule, laid down in 1858 and strictly adhered to afterwards, that there should be one British to every three Indian soldiers in India and that no Indian should hold a commission. Not only the expenses of the Indian army itself but also those incurred on account of British troops stationed in India had to be paid for from the Indian budget. Furthermore, Indian troops were often used by the British in imperial wars for the British colonialists. Frequently, either in the whole or a very large part of the expenses incurred in such wars had to be paid for out of Indian revenues. Indian troops served in Persia during 1856–57, twice in China during 1857-60 and during the Boxer rebellion of 1900 where they shared in the siege of Peking, in the Abyssinian campaign of 1864, the second Afghan war in 1878, the Egyptian expedition of 1882 and on many other occasions elsewhere. As Lawrence observed in 1864, India was treated quite differently from the colonies. 'No one would think of asking any of the latter to pay a portion of the expense of Afghanistan. No statesman would charge Canada or Australia.' All this not only imposed a considerable burden on the Indian budget but also involved payments to be made partly or wholly in sterling.

It was considerations of this kind that a number of Indian economists and writers, notably G.K. Gokhale, were drawing attention to. Subsequent research has borne out quite clearly that they had a point. Davis and Huttenback sum up:

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> India was a poor country and it was being asked to subsidize imperial defence out of all proportion to its position. Not only was it being forced to bear a substantial portion of the costs that should have fallen on other parts of the empire, but it was also being asked to shoulder a portion of the British burden as well. India paid the direct costs of both Indian and British troops in India, as well as some fraction of the cost of Indian troops used in largely imperial adventures. The sub-continent, thus, supported a military reserve for the entire British Empire.

The third item which Naoroji and some of his followers included in the drain was remittances made in sterling of interest on loans for construction and maintenance of public works, such as railways, irrigation works, etc. The case for regarding this item as drain is, however, much less convincing. Naoroji himself was aware of this and stated:

> I must not be misunderstood; I consider these loans as one of those things for which India is under special obligations to England. I do not allude to this item in any spirit of complain … I only mean that the interest, even supposing it to be all earned by the railways, though forming part of the exports of India, is not part of the commerce of India.

However, such a qualification was not required in the case of interest on unproductive debts such as those required for military expenditure. The refusal to accept interest payments as a genuine item of international commerce reflected Naoroji's 'physiocratic' view of the role of services. That payments for invisible exports were just as legitimate as those for merchandise remained a foreign idea to him. A similar difficulty prevented him from appreciating that payments for transport services formed part of national income, in the same way as the value of goods transported.

12.4.2 Criticisms

Let us now turn to criticisms of the drain theory, and start by considering the British response which, not surprisingly, was hostile. Earlier views, such as those of Sir John Shore, on which Naoroji had drawn attention when developing the theory, were no longer looked on with favour. Instead, the drain theory was seen as an attack on the foundations of British rule in India. Official spokesmen for the government and academics rallied to defend the Raj.

The most cogent reply was given by Sir Theodore Morrison in *Economic Transition in India*, which was published in 1911 and favourably reviewed by Keynes in the same year in *Economic Journal*. Morrison did not, however, question the validity of the concept of an economic drain. His definition of the drain as the value of that part of India's 'exports in goods or money for which she receives no material equivalent' was not much different from Naoroji's own definition. That India received no 'equivalent' return for part of its exports was common ground between Indian exponents of the drain theory and its British critics. Their difference was on how large a part this really was.

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Drain theorists, according to Morrison, had greatly exaggerated the magnitude of the drain. In part, this was because when calculating the export surplus, they had failed to allow for relevant deductions. For example, they failed to take into account the fact that part of the export 'surplus' was balanced by invisible imports such as shipping services, insurance charges and expenditure by Indian students and travellers abroad. Neither, claimed Morrison, had they taken imports of gold and silver into account.

Secondly, a part of the so-called drain represented interest on foreign capital. The capital itself, argued Morrison, was productive. It was used to build railways and irrigation works, tea plantations and jute mills. All these not only contributed to national income but also made long-run economic growth possible. Rather than complain about a drain, Indians should be grateful to British investors for making good the deficiency in India's domestic capital resources. The benefit to India was all the greater because the British connection enabled it to borrow in the world's cheapest capital market. Borrowing in India, even if it were feasible, would have been far more expensive. Indeed, the saving to India on account of cheapness of its public dept was 'not very far from being enough to wipe out the whole of the political drain'.

As regards other items of the Home Charges, Morrison admitted that India was treated differently from other colonies, but claimed that the amount involved was not high. More important, India gained the benefits of good government: peace and order, security against foreign aggression, and a modern, efficient administration. India had thus got an administration 'favourable to economic evolution' and cheaper than she could provide it herself.

Morrison's critique of the drain theory is only 'good in parts'. That Indian statistical estimates of the magnitude of drain were usually biased upwards has already been observed. On the other hand, Morrison's own treatment is selective and one-sided. Take for example his observation that Indian writers had forgotten to take the import of bullion into account when calculating the export surplus. This is not true of, say, Gokhale who, in his presidential address to the Indian National Congress of 1905, when describing the 'great and ruinous drain of wealth from the country', referred to 'the net excess of exports over imports' (including treasure). Similarly, when drawing attention to the low rates of interest at which loans were available in the British capital market, he fails to mention that G.V. Joshi, a well-known exponent of drain theory, had made the same point. Joshi had come out in favour of sterling rather than rupee loan being made to finance such enterprises as railway construction, both because sterling loans were cheaper, and because India's capital resources being limited, diverting them from industrial investment would be undesirable. Again, the case for Indianisation of the services, which was central to the nationalist argument, is not taken up by Morrison at all.

Indian criticisms of the Drain Theory

Criticism of the drain theory was not confined to British writers. A number of Indian nationalist writers, too, argued against one or other aspect of it. Bankim

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Chandra Chatterjee, in a number of essays published in the influential Bengali Journal, *Bangadarshan*, examined the drain theory from the point of view of the agricultural economy of Bengal. There was one element of the theory that he, like others, did accept, namely that remittances from salaries earned in India by government officers of European origin drained wealth away from the country. However, the view that such drain led to increased poverty in India was, he held, quite mistaken. Chatterjee anticipated Morrison in arguing both that the amount involved was small and that it was more than compensated for by the good administration resulting from British rule. Furthermore, argued Chatterjee, poverty, especially in rural Bengal was not increasing. While Bengal was poor compared to some European states, there was no reason to believe that Bengal was poorer than she had been in the past. On the contrary, there was ample evidence to suggest that wealth was increasing. Improved administration itself had helped to bring this about. There was now less fear among people at large of robbery, burglary and foreign attack or of government officials who were no longer free to rob ordinary people of their savings by hook or by crook. 'If someone wishes to save he can be confident that he and his progeny would be able to enjoy the fruits of it.' Higher levels of security and savings had encouraged an increase in population. This, in turn, had led to an increase in the extent of cultivation.

Another reason for improved prosperity, according to Chatterjee, was an increase in the volume of trade. Those who thought an increase in trade meant a loss of wealth were simply confused. This applied equally to exports and imports. Chatterjee went on to attack the argument of unequal exchange, which was an element in some versions of 'drain' and indeed is still with us. For Chatterjee, 'if we spend `6 in buying British cloth, we are getting a commodity in exchange for it. If we spend more than the fair price for it, we lose. But if we cannot buy that cloth for less than `6 from elsewhere the price is not unfair. Hence, the country does not lose. Again, domestic production is not necessarily more advantageous than imports. If we had bought `6 worth of cloth from a domestic weaver, the money would, it is true, have remained in the country rather than being remitted abroad.' This suggests that Chatterjee is not particularly relevant, for one must consider the price per unit at which the cloth is sold. 'If the domestic weaver could have sold the cloth at the same price (`6), we would have bought from him, not from a foreigner. But in that case, the foreigner would not have tried to sell it either. Consumers gain by buying from the cheaper imported source.'

What about the loss to the weaver? Because imported cloth was cheaper and Indian consumers bought foreign cloth in preference to the domestic product, weavers lost their trade. But the answer, suggests Chatterjee, was for them to take up other trades. 'Some lines of production faced reduced demand but for others was increased demand. There was also increasing demand for Indian goods in British markets. The problem, if any, was the reluctance of our countrymen to change their traditional occupation, not the increase of trade. Neither by import nor by export were foreign traders taking our money away. On the contrary, our wealth was increasing because of foreign trade.'

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A much more influential dissident from the theory was Ranade, who expressed his views on the 'drain' in his inaugural address at the first Industrial Conference at Poona in 1890. He did agree that expenses for the purposes of administration, defence and payment of pensions to British officers stationed in India could 'so far as they are not necessary for the defence and good government of India' represent an element of drain. As against this, however, we have to take into account 'the fact that we are enabled by reason of this British connection to levy an equivalent tribute from China by our opium monopoly'. Ranade regarded the drain question as essentially a political one. He exhorted his readers not 'to divert and waste your energies in the fruitless discussion in the question of tribute, which had better be left to our politicians'. There were many and more serious impediments to India's industrial progress: the want of proper organization, leadership, banking systems and a trained labour-force.

12.4.3 Long-Run Relevance

This sub-section looks back at the debate on the drain theory and considers its long-run relevance. The sub-section consists of three brief remarks. The first of these is methodological and concerns the economics analysis of unilateral, i.e., non-commercial, capital payment made by one country to another. In modern economic literature, such payments have been discussed under the rubric 'the transfer problem'. A well-known instance is Keynes' analysis of the economic consequences of the payment by Germany of war reparations imposed by the Treaty of Versailles following the end of the First World War. This analysis pays considerable attention to the link between such capital transfer and the terms of trade. Neither Naoroji nor Dutt analyzed the problem from this point of view. However, some other Indian writers on the drain do show an awareness of the relevance of its trade theoretic aspect. This they derived from their reading of J.S. Mill who had always been a favourite among Indian economists and who had brought out the link between reciprocal demand and commodity terms of trade. Thus, Iyer refers to the drain as arising not only out of a direct unrequited outlay but also because 'it forces India to exchange her produce on less advantageous terms, as pointed out by J. S. Mill in a well-known passage'. The passage in question reads as follows: 'A country which makes regular (non-commercial) payments to foreign countries, besides losing what it pays, loses also something more, by the less advantageous terms on which it is forced to exchange its production for foreign commodities'. Had Iyer, or others of the school, developed the point, they could perhaps have made a contribution to trade theory. As it is, it remains peripheral to their analysis of drain.

The second point concerns the magnitude of the drain. As we have seen, Naoroji saw 'drain' as a continuing transfer of resources from India to England without India getting any equivalent economic return. Accordingly, the excess of exports over imports, 'unrequited exports' as he called it, appeared to him to be an appropriate way of measuring the drain. In the writings of Naoroji and his followers, as Bipin Chandra has observed, this excess was 'simultaneously referred

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to as the proof of the existence of the drain, the form of its remittance and the measure of its extent'. Using this general approach, estimates of the drain were computed for various periods by Naoroji himself and others. They were expressed either in terms of rupees or sterling, and also a proportion of Indian revenue, either gross or net. Despite using a common methodology, the estimates varied widely among themselves. A widely publicized figure was due to R.C. Dutt, who found that on average 'one-fourth of the revenues derived in India was annually remitted to England'. Thus, during the last decade of Queen Victoria's reign, a sum of £159 million out of total revenue of £647 million was remitted. In recent years, a number of historians have tried to re-estimate the drain. In their view, the export surplus measure, even with adjustments, leads to over-estimates of drain. Instead, they define the drain as that part of Home Charges, which could be regarded as unnecessary or unproductive. They also tend to express the drain as a proportion of national income rather than of public revenue. The resulting estimates are low. According to Mukherjee (1972: 205), during 1870-1900, the drain was only between .04 and .07 per cent of India's national income. Charlesworth (1982) points out that even if all Home Charges are regarded as unproductive, the drain would still 'barely exceed 0.5 percent of national income'. These findings have led to a certain downgrading of the drain theory in recent historical writing.

Military expenditure was the greatest single burden on Indian revenues, running at around 40 per cent of the Government of India's gross expenditure; yet the primary functions of the Indian army was to keep India secure so that this revenue could continue to be collected. As in the case of expenditure on famine policy, there was no attempt, either conscious or implicit, towards developing a cost-benefit approach.

In retrospect, perhaps the most important contribution of the drain theory is the insight that it offers about the relationship between economic development and the balance of payments. During the last few decades, developing countries in their initial phase of accelerated growth have almost invariably experienced difficulties with their balance of payments. Despite lacking this experience to guide them, exponents of the drain theory could still sense that there was a certain incongruity between India's economic backwardness and her persistently favourable balance of trade. In late 19th century, India was a very poor country with a near-zero rate of economic growth. The export surpluses that continued to accrue were not a sign of impending take-off but rather of an investment pattern that retarded growth. The drain theory, at least indirectly, shows some inking of what was going on; the complacent official view shows hardly any. The basic weakness of the theory was pointed out by Ranade. While there is little double that the financial arrangements imposed on India by British rule involved an element of drain, it is unlikely that this was either the root cause of poverty or the binding constraint on economic growth in India. Pre-occupation with 'drain' had the effect of narrowing the focus of Indian economic thought and diverting attention from the more pressing concerns to which Ranade wished to draw attention.

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Check Your Progress

6. When was drain theory first developed?
7. In which journal Bankim Chandra Chatterjee examined the drain theory from the point of view of the agricultural economy of Bengal?

12.5 MAHADEV GOVIND RANADE

All of Ranade's economic writings address a single problem: poverty. He did not make any attempt to measure the extent of poverty, but stated that it was widespread and endemic, and regarded it as self-evident. In the inaugural address of the First Industrial Conference in Poona in 1890, Ranade stated:

> We need only to walk throughout our streets, and study the most superficial aspects of our economic situation, and the fact forces itself upon us that we are a people of little resources. Many millions among us scarcely earn a couple of annas a day. Many millions more are always underfed, and live on the borderland of famine and slow death, into which the failure of a single monsoon precipitates them.

Both in assuming the existence of mass poverty and in emphasizing the close link between poverty and famine, Ranade represented the mainstream view of Indian economic writing. However, unlike others, such a Naoroji or Dutt, Ranade regarded poverty as a legacy from the pre-British era. It is, he suggests, 'not of yesterday, and is not the result solely of foreign conquest and competition. It is an old, old inheritance. Indeed, the heightened awareness of poverty was itself seen by Ranade as an aspect of the progress that had come about under British rule: 'If we feel it more keenly now, we feel it because we are roused from the sleep of ages, and our eyes have learnt to see, and our ears have learnt to hear'. Here, as often in Ranade's writing, we bear an individual and distinctive note.

The question of whether poverty in the 19th century was more widespread or intense than that which had existed in earlier times, remained for Ranade an open question but not an interesting one. It concerned specialist historians rather than economics. In the inaugural address of the First Industrial Conference in Poona in 1890, Ranade stated: 'The question of our comparative improvement or decline under foreign rule is similarly a question of antiquarian history. The practical question for us all to lay to heart is not the relative, but the absolute poverty and the present helplessness of the country generally.'

Looking back in anger or despair would not help. The problem was how we could remedy that helplessness, and one had to begin by a diagnosis, by looking at the causes of poverty. The most important cause, according to Ranade, was overdependence of the Indian economy on agriculture. Again, Ranade made no extravagant claims for the past nor did he attempt to ascribe all economic ills to the British conquest. The traditional Indian economy had not represented a state of

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balanced growth either. In the inaugural address of the Industrial Conference in Poona in 1890 Ranade stated:

> The coordination of industries, which regulates the due proportions of men who plough the soil and raise raw produce, with those who manufacture this produce and others still, who exchange and distribute it, and the interplay of whose three-fold activity makes a nation thrive, was never a very strong factor of our collective social polity.

Like nearly all pre-modern societies, India too had been predominantly agricultural. However, the position had worsened. In the same conference, he continued: 'There can be no doubt that, whatever may have been our improvement in other respects, we have in recent times become more than ever dependent upon the single resource of agriculture, precarious and contingent as that resource is upon influences we cannot control or count upon with certainty.'

This had occurred as a result of increasing economic contact with the outside world. Freedom of exchange and competition from the products of modern manufacturing industries had led to a decline of output and employment in indigenous craft industries. Because the machine-made, imported goods were cheaper than the corresponding products of domestic handicraft, the decline itself was inevitable. Even if the Government of India had not helped the process in any way, British merchants and manufacturers would eventually have asserted their predominance in the Indian market. However, the government's efforts in support of the interests of British products helped to make the process of disintegration of domestic industry far quicker than need have been the case, and prevented the transition from occurring in a more orderly and gradual fashion. An example of such customs duties on cotton, silk and woollen manufacturers and on wrought metals, which threw out of employment a very large number of skilled artisans. They were compelled to compete in the labour-market with poorlypaid agricultural workers. The outline of the process was an increasing dependence on agriculture.

Every class of artisans, the spinners, weavers and dyers, the oilmen, the papermakers, the silk and sugar and metal workers, etc., who are unable to bear against western competition, resort to the land, leave the towns and go into the country and are lost in the mass of helpless people who are unable to bear up against scarcity and famine. But the indirect and long-run effects of the process could be even more damaging. The progress of 'ruralisation' in modern India means its rustication, i.e., a loss of power, intelligence and self-dependence, and is distinctly a retrograde move. There were a few developments, for example, the growth of seaports, and military and railway stations, which had the opposite effect but they were too weak to counterbalance the economic forces tending towards 'ruralisation'. Industrial development was needed to halt and reverse the process.

In much of his writing, Ranade appeals to a version of what has come to be known in the recent literature of development economics as the balanced growth argument. Taking a cue from the German school of historical economics led by Friedrich List, he defines economic development as the full and all-round

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development of the productive powers of society. This requires a proper coordination between different sectors, which alone can assure adequate and sustainable demand for the output of each sector. In the terminology used by List, coordination is required in particular between '*agarstaat*' and '*industriestaat*', and more generally between rural and urban employment. Given the initial conditions of the Indian economy, a substantial increase in industrial employment and output is therefore a necessary condition for sustained economic growth to occur.



Fig 12.3 *Mahadev Govind Ranade*

Source: http://en.wikipedia.org/wiki/File:Mahadev_Govind_Ranade.jpg

Rather than trying to correct the present imbalance, however, official economic policy in India often tended to make it worse. This was one of Ranade's most frequent complaints against the government's economic policy, especially in his earlier writings. India was to devote all its energies to raise the raw exports, and canals, railroads and improved communications were to be pushed on at any cost to facilitate the export of raw articles and the import of English manufacturers. India's own industrial needs were of comparatively no consequence. And he makes the point even more strongly in the following passage: This dependency has come to be regarded as a plantation, growing raw produce to be shipped by British agents in British ships, to be worked into fabrics by British skill and capital, and to be re-exported to the Dependency by British merchants to their corresponding British firms in India and elsewhere.

A second argument which is related to, though logically distinct from, the first is based on the concept of 'stages of growth'. Again, Ranade borrows from Prof List who describes a sequence of historical stages through which an economy typically must pass: hunting, agriculture, agriculture plus manufacture plus commerce. Ranade adapted the scheme to Indian conditions by distinguishing between an existing stage of agriculture plus handicraft and one of agriculture plus manufacture plus commerce, which he held out as the next stage to which India should aspire to proceed. Taxonomy of this kind can at best be no more than suggestive but it provided Ranade with a useful handle to press for industrialization.

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It explains too why he tended to think of industrial growth invariably in an open economy context.

Thirdly, manufacturing industry allowed more scope than most other sectors for what Ranade called 'art manipulation'; in other words, the application of modern technology to the production process. This helps explain why a society's aggregate output per head is found to be directly related to the proportion of its labour force engaged in manufacturing, a point duly noted by Richard Jones, one of Ranade's favourites among the English economists. A closely related argument rests on the concept of development as learning. Manufacturing activity was a more effective source of learning than traditional agricultural pursuits and, according to Ranade, perhaps more effective than formal education itself. When the country was (thus) enabled to obtain a new start, and factories and mills on a small or large scale were set up all over the land, the present paralysis would give way to a play of energies which would far more effectively than schools and colleges give a new birth to the activities of the nation.

It was Ranade's understanding of economic development as a historical process that inspired his vision of India's industrialization. There can be no doubt that the permanent salvation of the country depends upon the growth of Indian manufacturers and commerce and that all other remedies can only be temporary palliatives. The process of economic development consists generally in a switch away from primary to secondary production and more generally from commodities where value added in production was low to those where it was significantly high. It also involved active participation in the world economy. Other economists of his time, or ours, who have proposed industrialization as a means of achieving economic growth in developing countries, have often concentrated their attention on the domestic market and favoured substitution as the basic underlying strategy.

Some have even looked on autarky as a necessary condition for developing countries to achieve autonomous development. Ranade on the other hand had an open economy framework in mind and looked to export-oriented growth. In the Industrial Conference in Poona in 1893, Ranade stated:

> What we have to do … is to learn by organized co-operation to compete with the foreigner, and take in as much raw produce from abroad as we need, and work it up here, and to send in place of our exports of raw produce, the same quantities in less bulky but more valuable forms, after they have undergone the operation of art manipulation, and afforded occupation to our industrial classes.

While much of the raw materials would be domestically supplied, the import of raw materials from abroad to be used in the production of manufactured goods in India was also envisaged. In the early stages of industrialization this would help to ensure that the quality of exported manufactures was maintained at a high level. We have to improve our raw materials, or import them when our soil is unsuited to their production.

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The same reasoning led Ranade to welcome imports of skill and capital equipment from abroad. We should, he said 'Import freely foreign skill and machinery, till we learn our lessons properly and need no help. This last statement incurred the wrath of nationalists such as Tilak, whose journal *Kesari* published an article on the evils of foreign capital under the title 'Mahadev in singing the praise of foreign capital is a traitor to his country.' Ranade was not traitor. He was simply a development economist who saw clearly that difficulties in achieving industrial growth in such a country as India could arise simply from the long practice of agriculture itself. 'We have rusticated too long; we have now to turn our apt hands to new work, and bend our muscles to sturdier and honest labour. In that task both foreign trade and foreign capital could be helpful.

The task of industrializing India would not be easy. The difficulties in the way, political and social as well as economic, were formidable. Among the economic obstacles to industrialization it was a deficiency of investment finance which Ranade emphasized the most. 'Just as the land in India thirsts for water, so the industry of the country is parched up for want of Capital. Capital desirous of investment and content with low interest is a national want. The deficiency in supply of investment funds was partly due to low savings. A considerable proportion of gross savings was proportion was used to hoard precious metals. In an address to the Indian Industrial Conference in 1890, Ranade presented estimates of the magnitude of hoarding.

> Every year, we import in treasure bullion, gold and silver of the value of 12 crore worth, i.e. 3 crore of gold and 9 crore of silver. The whole of the gold disappears, and is absorbed by the soil and of the silver 7 crore are sent by us to the Mint every year, and the rest is absorbed like gold. Since 1834, this absorbing process has secured the virtual destruction of nearly 450 crore of wealth which might have been turned to better account.

The saving of 450 crore in fifty years by twenty-five crore of people was not, Ranade observed, a sign of great prosperity but we have made our position worse by buying it or using it unproductively. The shortage of aggregate savings was aggravated by deficiencies in institutional arrangements for industrial finance. The amount of savings available was almost entirely in the hands of men in a few large 'Presidency' towns who had few connections with the rest of the country. The habit of forming joint stock organization was not developed and available savings were invested in government stocks or in the Presidency, exchange and post office savings banks, rather than industry. In a way, therefore, India had more capital than it could handle. There is capital ready to hand awaiting secure investment. There is the broad ready expanse of industry, which is thirsting for capital and offering the most secure investment for its fruitful employment. What is required is the necessary skill and patience which will adjust the capacity of the one to the wants of the other, and make both work in a spirit of harmony and cooperation.

Apart from inappropriate government policies and deficiencies of industrial finance, Ranade pointed to the lack of an entrepreneurial tradition as a constraint on development. He believed that contemporary Indians by and large had insufficient

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enterprise and ambition and tended, for religious reasons, to decry the pursuit of wealth as an aim of life. In these circumstances, government had an important role to play in encouraging the process of industrialization. According to the doctrine of laisses-faire, the government should not intervene in the economy. The only exceptions permitted were those required for the purpose of carrying out the basic duties of government; protecting citizens against external attack, and preserving law and order. Intervention to enforce contracts was right and proper, not so intervention in aid of private industry. Ranade did not reject that principle outright. In certain circumstances, he thought, it might actually help industry to grow much more than active intervention would have done. This was not, however, the case in India. Because of historical circumstances, much of Indian industry was in a state of decline or even collapse. It was essential, stated Ranade, for government to take steps that could help private domestic industrial enterprise to grow.

In his inaugural address at the Industrial Conference at Poona in 1890 Ranade set out what these steps should be. In the address, as in other passages dealing with the role of the state, Ranade's was preoccupied with the problem of credit. According to Ranade, it is the state's role in facilitating the flow of financial resources into industry that is most emphasized. This is to be done in a number of ways. As Ranade saw it, to a large extent the problem was one of encouraging existing investible funds to flow in the appropriate direction. The Post Office and Savings Banks deposits, for example, were already there. 'All the government has to do's is to organize committees of Indian capitalists at the district or city level and to empower them to receive deposits at fixed rates and lend them at slightly higher rates on the security of land or house property. The excess would provide for a gradual amortization of the debt within a definite time, together with insurance charges and working expenses.

Another useful device would be for government to guarantee a certain minimum level of interest on loans advanced for investment in industry. These could come from either domestic or foreign investors. In the latter case, the aggregate supply of investment funds for industry would increase. Ranade was fond of pointing out that this did not represent a new departure for the government which had been promoting foreign investment in railways under a guarantee system, to be described later in this unit.

In most cases direct expenditure by the state would not be necessary. The state need not expend its funds. The funds will be forthcoming to any amount if it only promises to organize the Agency and set it at work. In a few instances, where domestic production enjoyed sufficient natural advantage, Ranade approved of more direct forms of encouragement by government which, however, still fell short of direct state control. This could take the form of pioneering new industries talking the 'Java system' as a model: 'The Dutch Netherlands Government have shown the way in Java, and with less selfish motives the same method might well be tired in regard at least, to the industries allied with agriculture, sugar-refining, oil-pressing, tobacco-curing, silk-rearing, etc.'

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The system was one of encouraging the planting of remunerative crops and manufacturing them for the European market, by private agency, which was also responsible for bearing risks. However, the government, apart from advancing loans at a low interest, also helped in the choice of location and in selecting the form of investment. Something on these lines could also be tried in other selected fields, but 'not at State expense departmentally. In yet other cases, the government could help domestic industry simply by extending its own custom to the products of domestic industry of a satisfactory standard of quality, instead of confining its purchase of required stores only to foreign sources, as was standard practice at the time.

In sum, by loan advance, guarantees, guidance and custom the government under the supervision of official experts would help and guide private efforts especially in the development of those industries in which India possessed special advantages. Among these, apart from the agricultural industries already mentioned, were iron, coal, paper, glass and beer (*Essays on Indian Economics*). Such help was not intended to be extended permanently but only in the transitional period till private enterprise could support itself.

Ranade was one of the few economists in modern India to recommend the state's assistance with labour migration as a means of economics development. Migration, he thought, would help relieve the pressure of population on the land. During the last two decades of the 19th century, when most of Ranade's economic essays were written, while population in India grew fairly slowly mortality rates were high and the expectancy of life at birth declined. Ranade believed that given the dependence on the land for livelihood even a low rate of population growth could have very adverse consequences. The growth of population does not represent to the same extent growth in material comforts, and this has led to the absorption of waste lands till, in some parts of the country, the last margin has been reached and millions die or starve when a single harvest fails.

While the growth of manufacturing industries would help diversity the occupational structure and reduce the degree of dependence on the agriculture, this would take time. In the shorter run Ranade suggested policies to encourage internal and foreign migration of labour. Both had in fact been occurring for a long time past. Internally, people migrated from poor and thickly populated agricultural tracts to more sparsely populated areas. This helped to improve the regional distribution of population from an economic point of view. However, internal migration could not be compared 'in its immediate and remote bearings on national prosperity' with emigration abroad. Again, quite a large number of Indian did immigrate to the British, French, and Dutch overseas colonies. This, thought Ranade, augured well for the future of India and should be encouraged by every means, both by the government of India and by private organization such as the Western India Association. Here Ranade referred to the recent success of Wakefield in his schemes of colonization by British settlers in Australia and New Zealand and also to schemes of colonization by Chanakya and practised by ancient rulers in India. The latter had not only encouraged entire village communities to move *en masse* but also helped them financially to settle in their new homes. Guilds of traders and

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artisans from distant places had, for example, been induced to settle in new towns by free gifts of land and houses. Such schemes had operated within India but something along these lines could also be done. Ranade believed, to encourage Indians to emigrate overseas. Among the countries he mentioned as having a high demand for labour and hence offering good prospects for Indian emigration are Mauritius, Natal, Trinidad, Jamaica, British Guiana, Burma and Australia.

Apart from its direct effect in reducing the pressure of population on the land, emigration abroad would also bring some indirect benefits to the Indian economy. One such would be to increase the level of aspirations among the Indian population at large. Emigration overseas, or even the prospect of it, could help break up 'the old thraldom of prejudice and easy satisfaction and patient resignation' and give rise to 'new aspirations and hopes' (*Essays On Indian Economics*). Another indirect effect would be to stimulate the demand for Indian goods abroad. Because of the influence of cultural patterns on consumption Indian settled abroad would provide a good market, among others, to Bombay mill-owners for cloth and to Indian shippers for transportation (especially when travelling to an African destination). For this purpose it was desirable that emigrants should come not simply from poor and unskilled classes but rather than from relatively prosperous middle-class and professional people. Doctors, lawyers, artisans, even priests of different sects, these were the kind of people Ranade had in mind. As he saw it, such people would also find it relatively easy to find profitable employment overseas, especially in African countries.

In the list of measures which Ranade wanted government to adopt in order to help the growth of domestic industry, there is a notable omission: protective tariffs. The omission is a little surprising, since France, Germany and the USA had used tariffs to help their manufacturing industries to develop in the face of foreign competition and these were the countries Ranade usually held up as models for India to follow.

One possible explanation could be that Ranade had been converted by classical political economy to a faith in free trade. And indeed there is evidence in his writing that he had considerable respect for free trade as a general principle. However, the free trade argument in his view did not contradict the case for protection being extended to infant industries. Adam Smith, he writes, was really arguing for fair trade rather than free trade while J.S. Mill accepted protection for new 'infant' industries as being within the framework of the classical political economy tradition. Ranade even quotes Mill as approving of exceptions to free trade 'where time is required to ascertain whether new industries are or are not adapted to the natural resources of new countries. India, suggests Ranade, may fairly demand such a 'breathing time.'

Indeed, the measures described earlier, which Ranade wished government to undertake by way of encouraging industrial growth, were all applications of this argument. An infant industry argument on the same lines for a protective tariff on, say, iron or sugar would therefore have been logically quite consistent with Ranade's position on matters of policy. His silence may rather have been due simply to a

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belief that in the circumstances prevailing at the time a proposal for protective tariff for Indian industry had little chance of success. Whatever the exceptions admitted by Mill, economic opinion in British ruling circles was almost unanimous in its adherence to free trade. Because of this, and because India did not have a government of her own, approval for tariffs or subsidies for Indian industry was hardly feasible. In the Indian Industrial Conference in Poona in 1890 he stated:

> It is not open to us to adopt certain plans of operation which, however much they might be condemned on abstract grounds, have been followed with practical success in many of the most enlightened Countries of Europe and America. We cannot, as with the Government of these countries, rely upon Differential Tariffs to protect Home Industries during their experimental trial. We cannot expect the Government here to do what France or Germany does for their Shipping Trade, and their Sugar Industry, and ask Government Bounties and subsidies to be paid out of general Taxes.

Ranade would indeed have come out in favour of protective tariffs 'if he had not realised that to ask for a tariff in 1890 would be almost equivalent to asking the British to leave India.' Ranade, it is true, frequently proposed economic policies which were against the official line, but as a realist he liked to have a 'sporting chance'. It was 'useless to divert our energies in fruitless discussion and seek victory over Free Trade.

While government action was necessary to give the process of industrial growth in India an initial push, such action still remained peripheral to the process itself. No amount of government aid to industry could foster growth unless the people learnt to help themselves. 'After all Government help can do but little. We have to resolve to work earnestly and perseveringly with a purpose and organisation which will conquer all obstacles.' And similarly, 'State help is after all a subordinate factor in the problem. Our own exertion and our own resolution must cover the difficulties, which are chiefly of our own creation.'

Thus, for Ranade, organised private effort always remained the basic means to industrial growth. In the circumstances in which India was placed at the time, state help of certain kinds was essential if domestic private industry was to thrive, but such help could not substitute for private effort, as to running an industrial enterprise as just another government department. Ranade did not regard it as an inefficient solution; he did not regard it as a solution at all: industries simply could not be run like that.

To sum up, Ranade was neither a radical nor an enthusiast: and unlike some latter-day development economists he did not put his trust in any one magic solution such as the socialist path, laissez-faire, technology transfer, big push, or foreign aid. He had a clear-headed understanding of the difficulties hindering the industrial development of India. As he saw it they were due in part to the rigid and doctrinaire attitudes of a foreign government which lacked any real commitment towards India's economic advance, but they were also the legacy of a stagnant past.

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In a country with an ancient civilisation based on millennia of agriculture the diversity and change of occupation that industrialisation would mean was a very arduous undertaking. It presupposes a change of habits, it postulates the previous growth of culture and a spirit of enterprise, an alertness of mind, an elasticity of temper, a readiness to meet and conquer opposition, a facility of organisation, social ambition and aspiration, a mobile and restless condition of Capital and Labour all which qualities are the slow growth of centuries of freedom and progress.

Ranade's historical approach to the study of economic growth precluded his ever supposing that such things could be acquired overnight. He was saying that they could eventually be acquired and that it was time to start. While Ranade's writing concentrates on the difficulties in the way, he had not doubt about long-run success provided that certain necessary steps were taken. This optimism was inspired by a conviction that the natural advantages which India enjoyed were no less remarkable than the difficulties she faced. 'Natural aptitudes, undeveloped but unlimited resources, peace and order, the whole world open to us, our marvellous situation as the emporium of Asia, these priceless advantages will secure, if we endeavour to deserve it by striving for it.

Towards the end of his life, Ranade came to believe that even in the shorter run, the prospects for industrialisation were reasonably bright. Here he parted company with fellow economists such as Dutt or Naoroji who took a more pessimistic view. Writing around the turn of the century, Ranade observed that at least the tendency towards increasing dependence on agricultural pursuits appeared to be over. During the 'last twenty years there has been a clearly distinguishable departure from the, till then, unimpeded process of ruralising a vast continent. It appeared to him that a turning of the tide in the direction of industrial progress had already begun. At the time, Ranade did not have a great deal of evidence to support this judgement but he could see some hopeful signs: jute and paper mills in Bengal, cotton mills in Bombay, Nagpur and Ahmedabad and 'pioneer attempts' at developing an iron industry in various parts of the country. Not only were natural resources in abundant supply, demand was increasing every day 'in volume and urgency'. Dr Watts' Report provided technical grounds for being hopeful about the availability of raw materials for India's industrial growth. Ranade's natural optimism supplied the rest. The real danger, as he saw it, lay in a failure of nerve, in a tendency 'to turn back from our present opportunities to a past which cannot be recalled. Ranade, especially in his later writings, often warned his countrymen against this danger.

12.5.1 Agrarian Policy

Ranade associated the predominance of agriculture with stagnation. To his mind such predominance spelt 'rustication', a loss of power, intelligence and self-dependence. The way to economic growth lay in an all-round and balanced development of productive powers. For an underdeveloped economy such as India, this implied the growth of industry and trade, especially of manufacturing industry and foreign trade. Agricultural growth remained extremely important not only because

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an overwhelming proportion of the population derived their livelihood from it, but also because many of the industries in which India had a natural advantage were based on agriculture. The future, however, lay in industrialization. It is in this perspective that Ranade's writings on agrarian policy can best be understood.

Traditionally, questions of agrarian policy in India have been seen as closely related to the appropriate method of assessing land-revenue. Ranade wrote a number of papers on this topic and proposed certain far-reaching reforms to the existing system. It is on his proposals for reform that our discussion in this section will concentrate. Here, as on issues of industrialisation, his emphasis was on how sustained increases in production could best be achieved. The existing system for the assessment of land revenues in India was, in his view, quite inappropriate for this purpose, for it had the effect of discouraging productive investment on the land.

Development of agricultural on capitalist lines alone could unleash the productive powers of land. That was a long run process but legislation on land revenue could help in initiating it. For this purpose, he stated, a permanent *ryotwari* settlement fixed in grain to be commuted into money values every twenty or thirty years can alone furnish a solution of the agricultural problem. Ranade proposed that the revenue on land should be fixed permanently as a proportion of the gross staple produce, the proportion being based on the principle of dividing the net profits in kind half and half between the government and the private holder. Since the government required cash rather than grain for its own transactions, these 'kind' payments would be commuted into money values in accordance with the prevailing trend in prices, some allowance being made for increased costs of production. All that the government would have to do was to maintain accurate statistics of changes in prices. Ranade claimed three substantial advantages for his proposed scheme. In the first instance, it would reduce friction between the *sowcar* (moneylender) and the *ryot* (peasant) and create incentives for all concerned to undertake productive investment in land.

Secondly, under the permanent settlement, the land would pass into the hands of those fit to put it to right and proper use. The existing policy was hopelessly struggling 'to keep a poverty-stricken peasantry in possession of the soil and divorce the natural union of capital and land. When this policy yielded place to the new dispensation, the indifferent and *lazy ryot* would make way for better people who would take his place to the advantage of the general interest. In course of time the prudent and thrifty classes would succeed to the ownership of land and a class of landlords would spring up all over the country, in whose interest it would be to make the most of the resources of the soil and of the great public works constructed by the government. Nor would small peasant farming vanish altogether, creating a horrendous problem of landlessness. 'A complete divorce from the land of those who cultivate it is a national evil and no less an evil is it to find one dead level of small farmers all over the land'. Both evils could be avoided by creating a system with a relatively small number of large landed estates on the Prussian model, together with a mass of productive peasant farmers.

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Thirdly, under the new order of things the peasants would have no reason to complain, as they had under existing circumstances, about the burden of the land tax when prices were low, for if prices fell, the assessment in money would fall also and thus not press very hard on the *ryots.*

Ranade examines two objections that might be raised against his proposal. The first is the possibility of a scarcity of revenue by virtue of loss of 'unearned increment'. He rejects this objection because if, on account of general prosperity, there was a rise in prices, the money commutation of the grain assessment would also rise in the same proportion, thus compensating the revenue for increased demand of expenditure. The government would, moreover, be 'free to levy special rates for facilities or irrigation actually supplied by it at public expense.' What is more, under the present system there was little incentive for agricultural improvement and hence little scope for increase in revenue. With the extension of the permanent settlement, the increment, earned or unearned, would be so great that the direct and indirect taxes would yield a sure and certain increased income from all sources, which would make up more than the deficiency arising from the loss of this unearned increment.

The other objection is that the Indian peasant is so thriftless, unenterprising and ignorant that no government measures could ever better his condition. Ranade's answer was based on 'historical' reasoning. That Ranade in general preferred a historical-inductive to a logical deductive approach to economics is brought out elsewhere in this Unit. The limitations of the latter approach, he thought, were particularly important when dealing with problems that involved dynamic change. A study of historical experience could be more relevant here. Ranade had studied several European societies for the purpose of gaining insight into the process of economic development. In the early 1880s he frequently cited England. France and Germany as examples of progress, and also used these examples to bring out the economic virtues of an independent peasantry. These virtues–thrift, exertion, technical innovation–could however come into play only after impediment arising from the prevailing institutional structure had been removed. To the charge that the Indian peasant was lacking in the virtues mentioned. Ranade's reply was that the same had been true elsewhere. The French peasant, for example was not always the abstemious and prudent citizen that he now is; there was a time when Arthur Young mourned over the condition of the Agricultural classes of France. The magic of property and of free institutions has worked all this wonderful change.

The great principle underlying all reforms was 'to remove whatever had hitherto hindered the individual from obtaining that degree of well-being which he was capable of reaching by exertions, according to the best of his ability. If the principle was applied to India the same result would follow. Two other aspects of Ranade's approach to agrarian policy merit attention. One is related to the question whether land revenue was a rent or tax, a hardy perennial in Indian economic thought. British officialdom was inclined to the view that in India the state was, and had always been, the 'universal landlord' and hence that its revenue from land was in the nature of a rent paid by the tenant.

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Ranade held that this view was simply wrong and consistently argued that land-revenue was a tax. The state had no proprietary rights in either cultivated or waste lands. Its interest was confined to a claim for a share of the produce, which was not of the nature of a monopoly of differential rent. This view, states Ranade, had the support of contemporary opinion such as that of the Court of Directors, the Secretary of State and judicial decisions without number. He could have cited too the authority of J.S. Mill, who, in a Return on Indian Tenures to the House of Commons in 1859, had stated that land throughout India was generally regarded as private property, subject to the payment of revenue. This view was also, according to Ranade, in accordance with the judgement of ancient lawgivers in India. Some British writers, like James Mill, had indeed accepted the contrary view, and regarded the state as an all-embracing landlord. This Ranade attributed to their 'utilitarian aggressiveness', which as he saw it, was not unrelated to the despotic element inherent in imperial regimes. Such writers had only too readily accepted the claims of Muslim emperors that the state owned the land, leaving tenants only temporary and tenuous rights to their holdings. The British should give up the authoritarian practice of the Muslim rulers and should go back to the more moderate claims of the government characteristic of the best in Hindu tradition. In his book, *Essays on Indian Economics,* Ranade states:

> The Government must retrace its steps, forget its Mohammedan antecedents of absolutism, and return to the old Hindu traditions, where the King's power was restrained in all directions by the rights of the people, among whom the king was more of a father and a manager than a conqueror or a sovereign lord, and cultivated land belonged in absolute right to private owners who paid as tax a fixed share of the produce to the king like any of his other subjects for the expenses of protection.

Whether land belonged to private individuals or the state could make a difference to the rate at which land-revenue is assessed. In a system where land is recognised as being privately owned the competition of landlords among themselves helps prevent that level from being too high. But in British India, where land was held to be monopoly of the state, no such check could operate; and its absence had led to enhancement of land-revenue assessment all over the country, to an extent of which the government itself was now ashamed. The re-establishment of the private ownership of land was absolutely necessary for the achievement of agricultural prosperity. The state monopoly of land and its rights to increase the assessment at its own discretion were the two most pre-eminent obstacles in the way of the growth of material prosperity ashamed. Ranade's scheme was designed to remove both obstacles together.

A second question which was closely related to Ranade's proposed solution to the agricultural problem concerned the viability of small farming. He was concerned not so much with the *general* question of whether agriculture enjoyed economics of scale, as with the more restricted one of whether, in the conditions actually prevailing in India, small farming was remunerative. That it was not was

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suggested by the facts that a large proportion of the peasants, 50-60 per cent according to Ranade, were dependent on *sowcars* for both production and consumption loans and that they usually found it impossible to repay their debts from 'the net gain of agricultural industry. While the *sowcars* often charged exorbitant rates of interest they bore risks and provided an essential service. The *sowcar* was as necessary to the *ryot* 'as the seed he sows or the rain from the heavens that irrigates his fields.' Without the *sowcar*, agricultural industry would come to a halt and he was just as indispensable for the business of government, for a large proportion of the land revenue, though directly paid by the *ryots* was actually advanced by *sowcars*. The reforms that Ranade was proposing were designed to end the helplessness of the *ryots* and to create a situation whether other, more organised and productive, forms of agricultural finance had a chance to develop. The state had an essential role to play in the process of transition. In *Essays on Indian Economics,* he states*:*

> Let the State interfere not merely with a minimum piecemeal dose of judicial reform, but by the whole dispensation of a large administrative relief. If it subsidizes or guarantees private banks against risk during the first experimental years, and enables them to rid the peasantry of their ancestral debts, and if at the same time it allows the land revenue to be redeemed or permanently settled at a moderate figure once for all, it will provide an ample fund for agricultural relief improvement without the necessity of borrowing a single rupee of fresh loans.

The *ryot* had to be emancipated and inspired with a sense that the land was his own, just as much as his home or clothes. The 'magic of property' would do the rest.

Ranade's solution to the *ryots'* problems was not the only one proposed. A large body of opinion, both in British ruling circles and among Indian nationalists, was inclined to the view that the *ryot* could survive without much more extensive, and continuing, help from government than Ranade envisaged. Legislation protecting the peasants against exploitation by *sowcars* was the answer. A number of such measures had in fact been enacted, especially following the Deccan riots of the early 1870s. With one of the most important of these measures, the Deccan Agriculture' Relief Act of 1879, Ranade himself was closely associated.

In its immediate objective, that of relieving the *ryots'* financial position, the act, by all accounts, achieved considerable success. In a review of its working, Ranade wrote that the act had helped the *ryots* to a growth in the standard of life, more variety of pursuits, a more assured sense of property in land, greater self-control, greater intelligence to cope with the *Savkars*, and increased facilities to borrow money when needed. On the other hand, the total amount of credit had declined, since creditors were less willing to lend on the security of personal property, but against critics such as Sir Raymond West he argued that this was the aftermath of famine, and represented a necessary transition to a more secure system of rural credit. It was such a secure and permanently sustainable system that Ranade's own proposals were designed to achieve. Relief measures, backed by

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judicial reform, could only provide a temporary palliative. And even the best of them had drawbacks. The Stamp and Court Fees Acts, for example, helped to organize the judicial administration of debt relief measures on a formal basis but they also made debts more costly, for a renewal not only involved payments for stamps, court fees, lawyers' fees, etc. but increased the principal itself by the amount of interest accrued on the law costs. To the existing uncertainties of nature which affected decision-making in agriculture they added a new type of uncertainty. 'The recuperative powers of nature and art are limited and cannot stand the dead weight of prohibitive rates of interest made necessary by disorganized credit, and the uncertainties and delays and expenses of civil proceedings'.

Government interference in the conditions determining land tenure, either through legislation or the courts, could provide relief to the *ryots* but could not provide a long-run solution to the agricultural problem. A long-run solution had to accept the realities of the situation and be economically viable. Inequalities between individuals and groups in respect of wealth and income were largely the result of differences in savings rates, education, intelligence, skills and foresight. Such differences could not be eliminated b social action, which should instead attempt to increase the general or average level of attainment. Perfect equality was not feasible, nor perhaps was it desirable, for 'dead mediocrity' was the likely outcome. There was a place for the rural elite, the men of wealth and enlightenment who would make 'high farming' productive and provide leadership in agricultural innovation. Others would follow. This was the rationale of the two-tier system of farming that Ranade proposed.

To conclude, Ranade's approach to economic policy was guided by an over-riding objective: the development of productive capacity. This applied to agriculture as much as to industry. In both, government had a vital role to play, but its role was to initiate, encourage and allow, rather than direct, take over or control. And the encouragement should be given to domestic producers, who had difficulty in gaining access to capital and were deficient in entrepreneurial skills, rather than to foreigners who did not suffer any such lack but had political clout with the government of India. The government, Ranade pointed out, had taken active steps to encourage the cultivation of cinchola, tea, coffee, tobacco and seri-culture. It practice was to start the enterprise on its own responsibility and when success was assured, to hand it over to 'foreign adventurers'. The state had also sold wastelands outright at nominal prices and created freehold estates in favour of the European planter class 'while steadily refusing the grant the same boon to the native population'. This, stated Ranade, amounted to a bounty to foreign investors who had neither shared in the cost of land development nor borne the risks involved. It simply created a foreign monopoly in a national field of investment. The demands on government that Ranade was making on behalf of the Indian *ryots* were far less onerous.

While Ranade's proposals for industrial development were enthusiastically received by Indian economists, his plea for capitalist development of agriculture gained little support. Even Ranade's followers tended to disagree. Among them

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was G.V. Joshi, who favoured small peasant farming, which was to be maintained by vigorous tenancy legislation, cheap credit, and a low land tax. Such a policy required just the kind of continuing, long-run, legal and financial government intervention in agricultural activity which Ranade had criticised. Although Ranade's views were not supported by government, either, and even the government of Bombay did not adopt his land policy, they were not entirely without effect. Beginning from 1884, for example, the Bombay government did take some steps to reform the laws governing land-revenue assessment. The line among which it proceeded was to introduce a large element of permanency. The classifications of soil that had been evolved were accepted as fixed: no enhancement of tax was to be made on account of improvements effected by the holder; changes of assessment were to be made only on consideration of such things as a change in the general level of prices, benefit accruing from the building of railways and similar public works; and limits were imposed on the amount of reimbursement at any one time.

12.5.2 Railway Investment

During the last quarter of the 19th century, railway investment in India was a controversial topic. Should there be further extensions to the existing railway network or should public funds be diverted instead to other items such as education or irrigation works? This was the focus of the controversy, which continued well into the present century. Throughout, British trading interests extended considerable pressure on the Secretary of State for India to continue spending substantial sums for railway development. Indian opinion on the other hand wanted a temporary halt to public investment in railways and the meagre sums allocated to irrigation, education and 'welfare' items to be increased. Gokhale, Ranade's pupil and protégé, whose views on various economic topics will be considered in a later section, summed up the Indian view in a rhetorical question: 'Are railway all? Is education nothing? Is irrigation nothing?'

To understand the lack of enthusiasm for railways that is typical of Indian economists one must go back to the early history of railway development. The basic impetus to railway construction in India had come from the needs of the Lancashire mills for good, clean Indian cotton. The carrying of cotton by cart over long distances led to dirt getting mixed up with it. The problem could only be solved by railway transport. The other main consideration was military strategy. Railways were necessary to ensure quick, reliable movement of troops and stores. They were an investment in Empire. It was the coming together of these two distinct strands that started off railway construction in India, from around 1850 onwards. The construction of railway lines was carried out entirely by private railway companies started by English merchants in the 1840s. They were under contract to the authorities in India, represented initially by the East India Company and later by the government of India. These early contracts had a number of somewhat unusual features, the two most important being: firstly, the government of India agreed to make land for railway construction available to the railway companies, on a ninety-none-year lease, free of cost. Secondly, the companies

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were given guaranteed interest on the capital they invested, at a rate ranging between 4.5 and 5 per cent annum, as well as a guarantee against exchange losses, one rupee being exchangeable at 1s.10d. Railway development under these contracts is known in Indian economic history as the Old Guarantee System (1844-69).

As elementary economic theory would lead us to expect, it encouraged over-capitalisation and high construction costs per mile, which turned out to be far higher than in England, Canada or Australia. The assurance given to the companies that operating losses, if any, would be paid by the government of India out of public revenue, did little to improve their incentive to economise on operating costs either. The system was scrapped in 1869 and during the next decade railway construction was controlled by the state and financed by the state largely out of loans. However, towards the end of the decade the fall in the exchange value of the rupee threatened the budgetary position of the government, which had a heavy burden of sterling commitments to meet. This was compounded by the costs of providing relief to victims of a number of famines which occurred during 1874-9. The government found in increasingly difficult to appropriate revenue surpluses for railway development and from the early 1880s once again entered into financial partnership with private British railway companies. This time, however, the railway lines remained the property of government while the companies, which were responsible for operating the railways, were guaranteed a certain rate of interest, usually 3.5 per cent, on the amount of their capital contribution and paid a 40 per cent share of net profit. The principle of compensation for variation in rupee-sterling ratio was not abolished, but modified somewhat, with the railway companies bearing a part of the exchange risks involved. This system, known as the New Guarantee System, was less inefficient and, for the Indian tax payer, less onerous than the old system had been, though the net earnings of railway companies exceeded the guaranteed interest for the first time only in the closing year of the century (1899-1900).

It is from this context that Ranade's views on the desirability or otherwise of public investment in railways derives their main interest. Government and its spokesmen emphasised the enormous economic and social benefits that such investment was bringing about. Indian opinion was more sceptical. Ranade tried to provide a reasoned assessment of both benefits and costs. Prima facie, he said, railways are a good thing. They provide a cheap form of passenger transport, facilitate internal and external trade, and may even help promote national solidarity. When, however, as was the case in India 'their extension is made the *ultima thule* of State action on its economic side a closer look at feasible alternative forms of investment was appropriate. There were several such alternatives to be considered, depending on the context. Part of the government's case for extension of railways was that by facilitating the quick transport of food grains to drought affected areas it would provide protection against famine. Indian writers on the other hand tended to argue that for this purpose irrigation canals were a more effective form of public works than railways. On this issue, Ranade sided with the government, mainly on the ground that the irrigation works then being considered for protection against famine were mostly of a non-perennial type.

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In years of drought and scanty rainfall, the water supply of irrigation works, with the exception of such of them as are supported by the perennial streams of the Himalayas or in the Madras Deltas, generally fails, and the works do not in consequence afford the anticipated relief in times of scarcity. Railways, on the other hand, are equally serviceable at all times. Again, in some districts of India, owing to the absence of perennial streams of suitable sites for the storage of water, irrigation works could not be established at all. In such placed too railways were 'the only means for provision against famines and scarcity. More generally, however, irrigation was not the only relevant alternative to be considered. Public expenditure could also be undertaken for the specific purpose of encouraging industrial development. And here, according to Ranade, the case for continued large-scale investment in railways was relatively weak. 'Facilities of communication are certainly desirable advantages, but more desirable still is the capacity to grow higher kinds of produce, and develop manufacturing and industrial activities.

Analytically, the question of which form of investment is more desirable can only be settled by applying specific decision criteria for public investment. This was not the way in which Ranade, or other economists of his time, looked at such questions. It is, however, to Ranade's credit that he did not confine his attention to the direct contributions of the investment to output and employment but also considered the extent to which it could indirectly help the long-run process of learning. The long-run view favoured investment in industry rather than transport, for 'The construction of railways can never be compared, in their educating influence, to the setting up of mills or Steam or Water Power Machinery for the production of manufactured produce in all parts of the country.

The direct economic benefits of railway investment had not been conspicuously high either. The financial return to government was relatively low, largely because of the high cost of construction, land being given British construction companies free of charge and large sums paid in sterling as compensation for arrears of interest. For Indian industry the immediate results had been largely negative: 'The railway policy pursued by the government has ... except in a few Presidency towns, killed our local indigenous industries and made people helpless than before, by increasing their dependence and pressure on agriculture as their only resource' (*Essays On Indian Economics*). It is important to note that Ranade's objection was neither to the railways as such nor even to the sudden and intense competition form imported goods that indigenous industries had to face as a result of their extension. Competition was, after all, a natural result of the opening up of India's economy to foreign trade. And as Ranade had pointed out when discussing problems of India's industrial development it was not simply foreign versus indigenous competition that was involved but rather the competition of science and skill against idleness and ignorance. 'If…' states Ranade, '…railways had been built by private enterprise unassisted by public funds, no objection could be urged against the effects of this foreign competition'. That, however, was not the case.

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Ranade said that it was extremely unlikely that such an arrangement could have represented an optimal economic allocation of resources from the point of view of Indian society, even though political and military advantages accruing to government were substantial.

In common with other Indian economists of his time, Ranade emphasized that resources used for investment in railways could have been used elsewhere. In particular, railway investment was seen as a substitute for investment in industry. Both development economists and economic historians now usually think of investment in railways and in industry as being complements rather than substitutes. The development of infrastructure, such as transport, is expected to contribute to industrialization in the long run. Though Ranade did not directly address this argument he was aware of it. A recurrent theme in his writings was that the very considerable expenditures that had been made by government on public works were not yielding a satisfactory rate of either financial or economic return. This he attributed to low economic growth, for which in turn the lack of progress in manufacturing industry was held to be definitely responsible. Given the special, long-standing and formidable obstacles faced by Indian industry the extension of infrastructure would not, he believed, suffice for growth of occur.

Direct steps by government to encourage private investment in industry were necessary. The development of railways *per se* would not lead to accelerated economic growth 'for unless they are accompanied by other and more important measures conducive to a better organisation of national industries, they do not add to the intensive strength of the country, which along furnishes a firm foundation to its expansive greatness. Moreover, for the purpose of industrial development, it was not just the *construction* of railways that mattered. The structure of railway rates was relevant, too. Freight rates had been so designed that raw materials destined for, and manufacturing good originating at, the ports were charged at a lower rate than similar goods travelling over the same distance between two places in two places in the interior of the country. Such a policy was hardly calculated to stimulated domestic industrial growth. On the contrary, it tended to increase the cost of production of manufactured goods in India and to impede the development of new industrial centres. This might help explain why the impetus to economic growth coming from the development of infrastructure in transport figures so little in the writings of Ranade and other Indian economists of his time.

12.5.3 Methodology of Economics

Ranade's economic writings were almost invariably addressed to specific problems of Indian economic policy. On occasion, however, he also discussed the question of the appropriate analytical framework in which such problems could best be studied. His writings on methodological issues are of interest not primarily for their intrinsic merit but rather because of their influence on the actual course of Indian economic thought in this century. Specially, it helped to divert it away from the tradition of classical political economy and towards the historical-institutional approach favoured by the German School.

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Ranade's chief objection to the classical school of economics was that the truth of its propositions depended crucially on certain underlying assumptions being valid. Because those assumptions reflected conditions in England, but not necessarily those elsewhere, classical political economy had only limited, rather than universal, applicability. In an oft-quoted passage, he suggested that the basic assumptions underlying 'the truths of economic science' not only might not apply to India, they did not. In his book *Essays on Indian Economics,* Ranade stated:

> With us an average individual man is, to a large extent, the very antipodes of the economical man. The family and the caste are more powerful than the individual in determining his position in life. Self-interest in the shape of the desire of wealth is not absent, but it is not the only nor principal motor. The pursuit of wealth is not the only ideal aimed at. There is neither the desire nor the aptitude for free and unlimited competition except within certain predetermined groves or groups. Custom and State regulation are far more powerful than competition, and status more decisive in its influence than contract. Neither capital nor labour is mobile, and enterprising and intelligent enough to shift from place to place. Wages and profits are fixed, and not elastic and responsive to change of circumstances. Population follows its own law, being cut down by disease and famine, while production is almost stationary, the bumper harvest of one year being needed to provide against the uncertainties of alternate bad seasons. In a society so constituted the tendencies assumed as axiomatic, are not only not imperative but also are actually defected from their proper direction.

The sentiments expressed by Ranade in this passage have been frequently repeated since and some have been used by sociologists to show that economists do not apply to the developing countries (but see Dasgupta 1974). Ranade states almost as 'a fact of life' that factors of production are immobile, not being 'enterprising and intelligent enough' to move from one place to another. In his paper on 'Indian Foreign Emigration' on the other hand, he argues that although considerable migration occurred in India, from the more congested areas to those more thinly populated, internal migration did not offer enough scope for the movement of labour and that for relieving the pressure of population on the land emigration abroad would be a more effective remedy. Quite a large number of Indians, he observes, immigrated to the British, French and Dutch overseas colonies, but with encouragement from the government of India as well as from voluntary organisations many more would follow suit. This clearly assumes that labour is enterprising and intelligent enough to shift from place to place and should be given every encouragement to do so. A *fortiori*, this can be supposed to be true of capital.

The question of how far labour and capital are mobile is itself part of a larger and more complex question, how far human behaviour is motivated by self-interest. Economic analysis does indeed assume that in situations which come into its province self-interest plays a strong and usually predominant part. In the passage quoted, however, Ranade goes beyond this by attributing to economists the far

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stronger view that the pursuit of wealth is the *only* ideal aimed at by human beings, rather than being one among others. There is little evidence that Adam Smith and his followers ever held such a view. When it comes to suggesting policies to encourage economic development in India, Ranade himself usually, if only implicitly, makes the assumption of self-interested behaviour. We have already seen an instance of this in his discussion of a policy for emigration. In considering whether to move or not, people do not think only in terms.

Check Your Progress

8. Which problem was focussed upon by Ranade in his writings?
9. What was necessary for the achievement of agricultural prosperity according to Ranade?
10. Why did Ranade believe railways to be good for India?

12.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. In 1935, the Tamil Nadu government officially documented 31 BCE as the year of Valluvar.
2. The diverse names of *Tirukkural* are *Tirukkural* (the sacred kural), *Uttaravedam* (the ultimate Veda), *Thiruvalluvar* (eponymous with the author), *Poyyamoli* (the false less word), *Vayuraivalttu* (truthful praise), *Teyvanul* (the divine book), *Potumarai* (the common Veda), *Muppal* (the three-fold path), and *Tamilmarai* (the Tamil Veda).
3. The government of Tamil Nadu celebrates the 15th of January as Thiruvalluvar Day in the poet's respect as part of the Pongal celebrations.
4. M.G. Ranade opposed the policy of free trade in India as advocated by the classical English economists.
5. In 1905, Gokhale founded the Servants of India Society with the object of training men to devote themselves to the service of India as national missionaries and to promote by all constitutional means the national interests of the Indian people.
6. The drain theory was first developed by Dadabhai Naoroji in a series of speeches and writings subsequently published in 1901, in a volume entitled Poverty and un-British Rule in India.
7. Bankim Chandra Chatterjee, in a number of essays published in the influential Bengali journal, *Bangadarshan*, examined the drain theory from the point of view of the agricultural economy of Bengal.
8. All of Ranade's economic writings address a single problem: poverty.

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9. The re-establishment of the private ownership of land was absolutely necessary for the achievement of agricultural prosperity.
10. Ranade believed railways are a good thing since they provide a cheap form of passenger transport, facilitate internal and external trade, and may even help promote national solidarity.

12.7 SUMMARY

- Thiruvalluvar, was a well-known Tamil poet and philosopher, also known as Valluvar. His birth place and date is still unknown, but his parents' names were Bhagavan and Aadhi. There is not much known about his family background, religion or birth place.
- In the 19th and early 20th century, European writers and missionaries variously dated the Valluvar to exist between 400 and 1000 CE.
- Valluvar's teachings intimate both the cultural values and textual values in the 13th to 14th Century Tamil Nadu. Valluvar's text can be interpreted and exercised in other ways.
- Several communities, together with those in Mylapore and Tiruchuli, worship Valluvar as the 64th Nayanmar of the Saivite tradition.
- Even though researchers vary over the assessment of the era of *Tirukkural*, it is normally believed that it belonged to the Sangam Age in Tamil Nadu, which is dated around 3rd Century A.D.
- *Tirukkural* is structured into 133 chapters, each containing 10 couplets (or kurals), for a total of 1,330 couplets. The 133 chapters are grouped into three parts or books.
- Valluvar's economic thoughts are found in his never-ending contribution, *Tirukkural*, a book of principles.
- Valluvar's economic thoughts are found in his never-ending contribution, *Tirukkural*, a book of principles. Valluvar's top seven economic ideas are: factors of production, agriculture, public finance, poverty and begging, wealth, ethics, and welfare state.
- Gokhale's economic and social ideas constitute a part of his political thinking. He was not an economist in the strict sense of the term. Neither was he a social thinker with a deep sociological insight.
- As a leader of the Congress and as a member of the legislature, Gokhale had to ponder over many socio-economic issues of the time which, in turn, gave birth to his economic and social ideas.
- Gokhale did not stop at merely criticizing the fiscal policy of the government but also advocated the cause of Swadeshi. However, he did not identify Swadeshi with boycott.

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- Gokhale pleaded for state-intervention to regulate the social and economic life of the country. Thus, the role that he envisaged for the state was very different from the role assigned to the state by classical liberalism.
- During the last two decades of the 19th century and the first decade of the 20th century, the drain theory came to be seen as the symbol of Indian economic nationalism.
- The basic message of the drain theory, namely that the financial mechanism, by which British rule in India was maintained, led to a transfer of wealth and income from India to Britain, imposing a 'bleeding drain' on the Indian economy, was not confined to scholarly writing.
- The drain theory was first developed by Dababhai Naoroji in a series of speeches and writings subsequently published in 1901, in a volume entitled Poverty and un-British Rule in India.
- British saw the drain theory as an attack on the foundations of British rule in India.
- Criticism of the drain theory was not confined to British writers. A number of Indian nationalist writers, too, argued against one or other aspect of it.
- Bankim Chandra Chatterjee, in a number of essays published in the influential Bengali Journal Bangadarshan, examined the drain theory from the point of view of the agricultural economy of Bengal.
- There was one element of the drain theory that Chatterjee, like others, did accept, namely that remittances from salaries earned in India by government officers of European origin drained wealth away from the country.
- Mahadev Govind Ranade (1842–1901) has been variously described as the father of Indian economics, the greatest Indian economist since Chanakya and the originator of the optimistic school among Indian economists.
- Ranade's work was a formative influence on Indian economics thought during the first half of this century.
- Both in assuming the existence of mass poverty and in emphasizing the close link between poverty and famine, Ranade represented the mainstream view of Indian economic writing. However, unlike others, such a Naoroji or Dutt, Ranade regarded poverty as a legacy from the pre-British era.
- In much of his writing, Ranade appeals to a version of what has come to be known in the recent literature of development economics as the balanced growth argument.
- Taking a cue from the German school of historical economics led by Friedrich List, Ranade defines economic development as the full and all-round development of the productive powers of society.
- It was Ranade's understanding of economic development as a historical process that inspired his vision of India's industrialization.

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- Ranade associated the predominance of agriculture with stagnation. To his mind such predominance spelt 'rustication', a loss of power, intelligence and self-dependence.
- For Ranade, the way to economic growth lay in an all-round and balanced development of productive powers. For an underdeveloped economy such as India, this implied the growth of industry and trade, especially of manufacturing industry and foreign trade.

12.8 KEY WORDS

- **Constanzo Beschi:** Also known by his Tamil name of Vîramâmunivar, he was an Italian Jesuit priest, missionary in South India, and Tamil language littérateur.
- **Swadeshi:** A part of the Indian freedom struggle, the Swadeshi movement was an economic strategy aimed at removing the British Empire from power and improving economic conditions in India by following the principles of self-sufficiency or Swadeshi.
- **Free Trade:** It means international trade left to its natural course without tariffs, quotas, or other restrictions.
- **Physiocratic:** It describes people who believe that the inherent natural order governing society is based on land and its natural products are the only true form of wealth.

12.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Briefly comment on everything that is known about Valluvar.
2. What was Dadabhai Naoroji's drain theory?
3. All of Ranade's economic writings address a single problem: poverty. Discuss briefly.
4. Write a short note on Ranade's objection to the classical school of economics.

Long-Answer Questions

1. Discuss the economic thoughts of Valluvar.
2. Describe G.K Gokhale's economic and agricultural ideas.
3. Discuss how military expenditure was a drain on the Indian budget during the British period.

4. Ranade was one of the few economists in modern India to recommend the state's assistance with labour migration as a means of economic development. Explain.

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12.10 FURTHER READINGS

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UNIT 13 INDIAN ECONOMIC THOUGHT II

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Structure

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13.0 INTRODUCTION

In the previous unit, you learnt about the ideas of Ranade, Dadabhai Naoroji, Gokhale and Thiruvalluvar. In this unit, we will discuss the economic ideas of Jawaharlal Nehru, Mahatma Gandhi, Periyar and Amartya Sen.

Jawaharlal Nehru, India's first Prime Minister, shaped post independent India's economic trajectory for many years. The influence of Mahatma Gandhi, the father of the nation, on Indian society cannot be denied. Similarly, E.V. Ramasamy, also known as Periyar, was hugely influential in southern India. The Bengali economist Amartya Sen on the Nobel Prize in Economics for his work in welfare economics. The ideas of all these men will be discussed in detail in the unit.

13.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain Nehru's economic policies
- Analyze the mixed economy model
- Discuss Gandhi's view of trusteeship
- Assess Gandhi's view of the state
- Describe Gandhi's view of ethics
- Evaluate Gandhi's opposition to the use of machinery
- Discuss the ideas of Periyar

- Analyze Amartya Sen's concept of welfare economics
- Examine Amartya Sen's approach to poverty

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13.2 JAWAHARLAL NEHRU

The life of Jawaharlal Nehru is a record of tireless endeavours and true devotion to his country. His mental efforts were determined by rationality and he was historically inclined. Both these features were based on his high scientific knowledge since his days as a student. These preconditions also enabled him well to deal with the economic problems in India. However, in relation with Nehru's statements on the economic policies, one have to realize that he did not produce a complete system of economic theory, but rather contributed many ideas. He always discussed economic problems in comparison with the political and social questions, with the tasks of the national liberation movement and the aims of an independent India.



Fig 13.1 *Jawaharlal Nehru*

Source: http://en.wikipedia.org/wiki/File:Nehru1.jpg

Background of Economic Ideas

As an Indian student in England, Nehru witnessed the political controversies about economic development in Europe and Asia. He was politically influenced by Bal Gangadhar Tilak and Bipin Chandra Pal, and was impressed by the personality of Gopal Krishan Gokhale. After his return to India, socio-economic problems continued to attract his interest. His public statements on Indian economic problems were first seen during the discussion on the Fiji Indenture System, which drew his attention to the conditions of Indian labourers in the manufactories and in the mines. During his travel in Uttar Pradesh in about 1920 he had his first experience with rural poverty. He strongly criticized the feudal settlement systems and the exploitation by the zamindars and *talukdars*. He also observed that these systems were maintained by the colonial administration, and that the class of feudal collaborators was a menace for a future independent India.

Nehru faced a similar situation when he dealt with problems of industrial development in India. The dependence of Indian industries on England and the underdevelopment of the Indian economy became evident for him. These

perceptions in economics mainly determined Nehru's economic approaches up to the late 1920s. In the 1920s, Nehru also showed a remarkable interest towards the socioeconomic developments in the Soviet Union. In many respects, the economic difficulties in India and Russia appeared similar, and he tried to understand how the experience in Russia could be used for the solution of Indian problems. After 1928, a weary change in his economic approach took place. Nehru became concerned with the problems of industrialisation more and more and came to the conclusion that this process was in accordance with the economic laws of history. However economic progress and industrialization to his mind could only proceed if colonial rule and dependence were abolished.

During the Calcutta Congress of 1928, Nehru declared himself a socialist and since that time, his economic ideas were in accordance with what he called the 'socialist pattern of life.' Nehru believed that a socialist pattern of society only could be achieved by planned economic development and building the capacities of the public sector. Moreover, Nehru's considerable criticism of the prevailing conditions in Indian agriculture and rural life turned his views to the problem of socialism and peasantry. From the early 1930s, these problems became more and more important for him. To his mind, in an independent India, feudal conditions in agriculture would become the biggest obstacles in politics and the greater productivity of labour could only be reached by abolishing feudal exploitation of the rural population.

Nehru's ideals of a 'physical planning' as distinguished from financial planning demanded a simultaneous development of agriculture, villages, cottage industries and heavy industry based on a system of harmonizing. One important point in his basic approach to economic policy was to make adequate preparations for changing the entire economy of India, while buying time by allowing labour intensive productions. He believed that agricultural growth should be achieved through small peasant proprietors whose dependencies were to be remedied through cooperative methods of production and a network of social services and an adequate rural education. This framework rounded Nehru's basic economic approaches. In 1936, he stressed the main ideas of his approaches in the Presidential Address at the Lucknow Congress again and summarized them as follows:

> 'I am convinced that the only key to the solution of the world's problems and of India's problems lies in socialism, and when I use this word I do not use it in a vague humanitarian way but in the scientific, economic sense. Socialism is, however, something even more than an economic doctrine, it is a philosophy of life and as such it appeals to me also. I see no way of ending the poverty, the vast unemployment, the degradation and the subjection of the Indian people except through socialism.'

13.2.1 Economic Policies of Nehru

At the time of independence, the Indian economy was in an appalling condition underdeveloped and highly reliant on external resources for finish goods and services. India was predominantly an agro-based economy, characterized with

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extremely low per capita income, widespread poverty and recurrent famines. The overwhelming majority of people were illiterate, lived in extreme poverty and did not have any access to basic healthcare. There was widespread unemployment and underemployment, with people having an inadequate and unbalanced diet, living in primitive housing, facing class and caste oppression and a heavy burden of land revenue, rent and debt. Moreover, the partition of India brought about a large share of problems, including a rift in the agricultural and the industrial sectors. After Partition, the majority of the agricultural lands fell in Pakistan, while the corresponding industries remained in India. This problem can clearly be seen in the difficulty faced by the Jute industry soon after partition. The agricultural areas of jute were in Pakistan, while jute factories were in India. This affected production in both India and Pakistan. It was in this context that Nehru formulated the economic policies of independent India. His economic policies had the wide-ranging objective of addressing urgent economic needs and achieving the long term goal of becoming a 'just and self-reliant' economy. As Nehru wrote in his autobiography, "Our final aim can only be a classless society with equal economic justice and opportunity for all, a society organized on a planned basis for the raising of mankind to higher material and cultural levels."

Early economic reforms: Immediately after being given the responsibility of becoming the first Prime Minister of independent India in 1947, Nehru launched a number of economic reforms. In order to remove economic disparities in India between the landlords and the landless class, he introduced laws regarding land redistribution. After winning independent India's first general election, he started the process of centralized planning by introducing the first five-year plan in 1951. The plan determined the mode of government expenditure and grants in important development sectors like agriculture, industries and education.

The ideology guiding Nehru's economic policies: Nehru's economic policies have often been considered to be Socialist in nature. There cannot be any doubt that socialism did play a very important role in Nehru's ideological make-up. Similarly, his short visit to the Soviet Union convinced him about the need for India to adopt centralized planning. However, at the same time, it is also significant to note that Nehru himself denied any kind of explicit socialist leanings in the economic policies implemented by him. Nehru advocated a kind of mixed economy. Nehru felt that any kind of unquestioned ideological devotion to any form of economic theory would be detrimental to India's development. Although an idealist, Nehru wanted a practical approach to India's development, where whatever economic policy that suited the country would be adopted. On the one hand, as someone who was deeply influenced by Gandhiji, Nehru believed that the rural economy needed to be developed. At the same time, Nehru understood that heavy industrial development would be the best way to serve India's economic interests.

The industrial policies of Nehru: In Nehru's view, a balance between the rural and urban sectors of the Indian economy was important. Thus, his economic policies were constructed with this balance in mind. Nehru did not think that there was any

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contradiction between the two sectors both could go hand in hand. Intending to exploit the natural resources of the country for the benefit of the people, Nehru identified the area of hydroelectricity as his focus and directed the construction of large dams, which he said would become the 'temples of modern India.' He felt that such large dams would not only harness energy, but would also help support irrigation to a great degree. For Nehru, dams were the symbol of collective growth it was a common platform where agriculture and industrial engineering could meet.

Nehru and Foreign Investment: Although inspiring industrialists to provide a boost to India's development, Nehru had strict reservations about foreign investment. As a former freedom fighter who had fought for India's freedom and an ardent nationalist, Nehru was wary of any attempt by foreign powers to recolonize India. British India's industrial policy was one where India was an exporter of resources but an importer of finished goods. The colonial British government deliberately undermined indigenous industries by creating policies to make the Indian economy dependent on foreign finished goods. Therefore, when India became independent, Nehru consciously followed an industrial policy of self-sufficiency. He firmly believed that India was self-sufficient to bolster her own growth. Although he did not officially decry the possibility of foreign investment in direct terms, Nehru stressed that the sectors of foreign investment would be regularized and that there would be strict rules in place by the government to control the terms and conditions of foreign investment. Moreover, Nehru underlined that the key sectors of the Indian economy would always remain in the hands of the government.

The question of state control in Nehru's economic policies: The most important aspect of Nehru's economic policy was the degree of state and central control on the industrial and business sectors of the country. Nehru believed in centralized planning and emphasised that the state would control almost all key areas of the country's economy. There were rigorous state laws and license rules that were put in place which held back the free execution of industrial policies.

Nehru's views on rural economy: Nehru's views on the rural economy were deeply influenced by Gandhiji. Like Gandhiji, Nehru believed that the rural and cottage industries of India played a major role in the economic fabric of the country. Nehru firmly believed that small scale industries and the cottage industry were the solutions to the serious problem of unemployment and underemployment that remained a continuous topic of concern throughout his lifetime, and indeed, continues to remain a problem even today. Most of Nehru's cottage industry development programs were meant as a part of community development.

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Nehruvian Mixed Economy

A mixed economy usually is an economic system where both the public and the private sector direct the economy. Mixed economies reflect the characteristics of both market driven liberal economies and state controlled socialist economies. Nehru favoured the mixed economy approach towards development, but he did not regard the mixed economy as a 'half-way house' between the capitalistic or liberal and the communistic or socialist forms of economic organization. For Nehru, the mixed economy was an amalgamation of the two economic systems and since it was free from both their dogmatic approaches, the mixed economy represented a higher form of economic organization. Nehru also took the position that the continuous exceptional growth of science and technology that resulted in phenomenal changes in human activity and the modes of production could only be absorbed by the mixed economy, which alone possessed the flexibility and resilience to do so.

Types of Economic Systems

Any economic system must address four fundamental questions. One can differentiate among the various economic systems based on how they answer these questions. The four fundamental questions are as follows:

- What goods and services should be produced?
- How should the goods and services be produced?
- Should producers use more human labour or more capital (machines) for producing things?
- How should the goods and services be distributed among people?

A capitalist or market driven economy answers these questions by the forces of demand and supply. In a capitalist economy only those consumer goods that are in demand and can be sold for profit in the domestic or foreign markets are produced. For example, if televisions and cars are in demand, they will be produced, Moreover, if labour is cheaper than capital, more labour-intensive methods of production will be used and vice-versa. In a capitalist economy, the goods produced are distributed among people on the basis of their purchasing power, which is the

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ability to buy goods and services, and not on the basis of what people need. Poor people in a country like India require housing, but since the poor do not have the purchasing power, their needs will not be counted by the market. Thus, housing for the poor will not be produced and supplied by market forces.

A socialist economy answers these questions in a radically different manner. In a socialist economy, the goods and services produced is decided by the government based on what people need. The assumption of socialist economies is that the government knows what people need. For example, the rich may desire luxury items, but the government will use the resources not to produce luxury items for the rich, but rather use resources to produce goods which are needed by the poor. Similarly, the distribution of goods in a socialist country is also based on what people need and not on what they can afford to purchase. Ideally, a socialist nation would provide free education, health care and other civic amenities to all its citizens.

In a mixed economy, the question of what goods and services need to produce and distributed is answered by both the market and the government. In a mixed economy, ideally speaking, the market will provide whatever goods and services it can produce well, and the government will provide essential goods and services which the market fails to do.

Salient Features of Mixed Economy

The capitalist economy did not appeal to Jawaharlal Nehru. For Nehru, the 'acquisitive society' was not suited for the present age and sought its replacement by "a classless society, based on co-operative effort, with opportunities for all." Nehru observed that "the strongest urge in the world today is that of social justice and equality" and came to the conclusion that any social structure that was based on the possession of land and capital by a few with 'the others living on the verge of existence' stood 'self-condemned' and had to be changed.

Although Nehru took the view that the capitalist system had outlived its relevance, he did not approve of a system where the state controlled the entire means of production because of two reasons, one of which was institutional and the other was historical. The institutional reason was that he felt the introduction of complete control over the means of production was not possible without introducing 'authoritarianism' and 'totalitarianism,' both of which he despised as a staunch democrat. Nehru sought a system which could "realize economic growth and social justice without the sacrifice of freedom and the democratic rights of the common citizen." He also felt that with every little growth that took place in the economy, the system would increasingly gravitate towards "monopolies and aggregations of economic power." He wanted to change the course of history but in a manner that did not break sharply with the country's geographical, historical, religious, economic and social background. Thus he favoured a mixed economy characterized by the following features:

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(i) a balance between the market economy and the planning mechanism

(ii) a clear demarcation of the boundaries of public sector and private sector so that the crucial and strategic sectors are invariably in the public sector

(iii) while profit motive influences decision-making in the private sector, the economic viability criteria for investment decisions in the public sector is based on social cost-benefit analysis

(iv) the ownership of means of production as between the public sector, private sector, joint sector and the cooperative sector is so decided that there is a balance between personal and social incentives and sectional and general interests

(v) there is occupational freedom and freedom of consumers' choice

(vi) the government intervenes to prevent undue concentration of economic power, and monopolistic and restrictive trade practices

(vii) the government endeavours to take care of the consumption levels and objectives of the weaker sections of the society through the public distribution system (PDS), poverty alleviation programmes, etc.

(viii) social objectives of equity, employment, balanced regional development, family welfare are emphasised

(ix) the dogmatic rigidities of socialism are avoided and a pragmatic approach to decision-making for promoting economic growth is usually adopted

(x) the mixed economy is not merely an economic concept, it is a economy where the rights of the individual are respected and protected subject only to the requirements of public law and order and morality

Analysis of Nehru's Mixed Economy

Different from the path taken by the majority of the former colonial and dependent countries of Asia, the development of native capitalism in India at the end of the 19th and the beginning of the 20th centuries was not only accompanied by the alignment of primarily bourgeois forces for leading the national liberation movement, but at the same time also by the emergence of socio-political concepts on the future rule of the bourgeoisie after national independence. These concepts implied fundamental changes in the political and the economical structures as well as a gradual social transformation by structural reforms and thus contained important guidelines for an original social-political strategy of development to overcome underdevelopment.

The needs and demands of the native bourgeois resting upon bourgeois-democratic ideals and reflecting the interest of the nation as a whole were the starting point for Nehru's thoughts. His idea arose from the ideological struggle with imperialism, the outdated social structure of which Nehru and the grouping of the Indian National Congress (INC) led by him regarded the personification of an undemocratic system. According to his concept, a democratic social system should

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be established, guarantying each member of society equal opportunities for development. But this system had to combine in a natural way the efficiency of state administration with the individual freedom. Since 1929, Nehru's thoughts have decisively influenced the formulation of an economic and political programme marking the guidelines of INCs economic policy till the present time.

The concept of the Mixed Economy was based on the aim to push forward the development of the productive forces by means of co-existence of a state capitalist and a private capitalist sector and by the application of planning and other regulation measures, to guarantee social progress and create the conditions of the development of native capitalism with the help of the state. In the history of economic theory, the concept of mixed economy represented the attempt to show the rising bourgeoisie in the developing countries a way how to adapt to the new situation in the utilization of capital and the consolidation of the capitalist system after the accession to power. The efficiency of this concept lies in the theoretical reasoning of state capitalism, which is now fairly spread in all developing countries with capitalist orientation, from a non-Marxist point of view.

The historical roots of this concept go back to the end of the 19th and the beginning of the 20th centuries, when as a result of the upswing in the national liberation movement new political and ideological trends emerged. As you studied previously, the leading members of the INC started to analyse the exploitative character and the economic effects of the British colonial rule in India. The discussions focused on the 'Drain-Theory' by Dadabhai Naoroji, based on the knowledge that there is a permanent drain of India's wealth to England without India receiving an adequate equivalent. The criticism of British policy about the field of industrialization necessarily led to the demand to abolish the British colonial rule and receive material independence. Several Indian economists as M.G. Ranade (1842–1901) and G.K. Gokhale (1856–1915) supposed that the development of independent India required the active participation of the state to protect the native production against foreign competition and to support the national private enterprises. Other Indian scholars like R.C. Dutt (1848–1909) believed that in an independent Indian state poverty and economic backwardness can only be overcome by a quick development of industry.

Although the majority or the INC members had a rather corresponding point of view in regard to the participation of the state in developing the national economy, their ideas of the practical forms of state participation proved to be rather vague. Starting from his youth, Nehru had been dealing with the economic and political problems, but his interest in history, policy and economy was even intensified during the time of his studies in England from 1907 till 1912. There he got to know Fabian thoughts and had the opportunity to study the concepts of the petty bourgeois socialists. During these years Nehru–as he frankly confesses–was attracted by the Fabians and socialist ideas.

After his return from England his interest in economic and political topics was again roused in connection with the situation of workers in India and the

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British colonies. At the beginning of the twenties he thoroughly studied the situation of the peasantry in India and critically investigated the economic and social conditions in the countryside. In his spectacular speech at the annual INC session in Lahore in 1929, he discussed India's social problems in detail and pilloried the defects of the existing social conditions. He emphasized that neither high crop yields nor people; most of them still living in mud cottages, could prove the glory of the British Empire and the existing social system.

Since 1929, the efforts to change the social conditions have also found their expression in the resolutions of the INC by demanding 'to make revolutionary changes in the present economic structure of the society and the inequalities in order to remove poverty and ameliorate the conditions of the masses.'

With particular interest Nehru followed the revolutionary changes in Soviet Russia, especially those in the backward areas of Middle Asia mainly with regard to the application of certain experiences in view of similar or merely presumed similar conditions in both countries. Thus, he wrote in 1928 'Russia thus interests us because it may help us to find some solution for the great problems which face the world today. It interests us especially because conditions there have not been, and are not even now, very dissimilar to conditions in India. Both are vast agricultural countries with only beginnings of the industrialization and both have to face poverty and illiteracy. If Russia finds a satisfactory solution for these, our work in India is made easier.'

The resolution on 'Fundamental Rights and Economic Policy' of INCs annual session in Karachi in 1931 represented an important stage in creating general economic and political guidelines. In twenty different items, general bourgeois-democratically demands were formulated, among them were the control of key industries and natural resource by the state and the agricultural reforms. The left wing INC members, led by Nehru and S. C. Bose, participated to a great deal in drafting this resolution, which was of special interest for Nehru not only because of its content, but also because of the clarity of thought.

In his biography he wrote 'So far the congress had thought along purely nationalist lines, and had avoided facing the economic issues, except in so far as it encouraged cottage industries and *swadeshi* generally. In the Karachi resolution (on fundamental rights and economic policy) it took a step, a very short step, in a socialist direction by advocating nationalization of key industries and services and various other measures to lessen the burden on the poor and increase it on the rich.' This was not socialism at all, and a capitalist state could easily accept almost everything contained in that resolution. At its session in Faizpur in December 1936, the INC completed this programme by a detailed agricultural programme containing basic demands of the rural masses (reduction of rents, abolition of feudal dues and debt repayment).

A programmatic highlight was the All India Conference of Congress Socialists in Patna in 1934, at which Nehru submitted a draft resolution already containing the fundamental thesis of his later concept of mixed economy. At this conference it was stated that 'the future Constitution of India should provide for the economic

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life of the country to be planned and controlled by the State, socialization of the key and the principal industries and state to have monopoly of foreign trade.'

After these demands had been rejected by the Congress Working Committee during the following weeks, Nehru found himself forced to defend his concept of establishing a new economic structure in the independent India in disputes with the elder comrades as well as with representatives of big business lasting for years. W.R. Kidwai refers to the toughness of these disputes when he writes. Nehru was bitterly opposed by the members of his own working committee as much as by the big business who adopted the practical strategy of boosting the right wing Congress leaders to protect their business interests, which were likely to be threatened by the socialist doctrine held by the Congress President. Regardless of what Nehru thought and believed in, the position of big business never stood threatened and they felt completely secure for they knew that the talk of socialism and nationalization was merely a posture for many and even those who genuinely had faith in socialist ideology would find themselves incapable to act effectively. Quite obviously there had already been two different groupings opposing each other in the INC with regard to the strategy and tactics of the national liberation movement by the midst of the thirties, and Nehru as a mouthpiece of the most progressive forces left them in no doubt about the social character of the economic and political programme to be drafted, by confessing himself bluntly to socialism as scientific economic system.

The foundation of the National Planning Committee (NPC) in 1938 initiated by the left wing around J. Nehru and S.C. Bose was another important step towards the formulation or the economic and political concepts in the INC. During the following time, the activities of the NPC contributed to the fact that even before receiving national sovereignty, disputes on fundamental economic and political problems included broad masses. Although there happened to be practically considerable differences of opinion between the different groupings, being temporarily represented in the NPC by more than 350 members, they were able to arrive at compromises in many cases. But the whole report was finished only in 1949, because the NPC had been existent in name only for several years due to the imprisonment of its president J. Nehru in 1940.

The memorandum of the leading representatives of the Indian big bourgeoisie, which contained their concept of the future development of independent India, reflected the different strategic and tactical positions within the bourgeois especially their grown power and self-reliance. In this second part of the so-called Bombay Plan, which was published in 1945, the representatives of big businesses explained their view on the role of the state in economy. In this memorandum they oriented to limit the state sector to the key branches of the industry including defence and infrastructure and to leave all remaining branches open for the access of private capital. After having founded and developed state enterprises, it was possible for private capitalists to take them over.

These diverse concepts were the verbal expression of the advancing process of formation within the bourgeois class during the forties. As a result of the

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concentrator of the economic power in favour of native concern groups during the Second World War, the right wing of the INC, which supported a rather unrestricted development of the private sector, was significantly strengthened. Therefore, the representatives of petty and middle bourgeoisie and their concepts were faced with stubborn opposition by the representatives of big businesses.

Two Principles of the Future Economic Policy of Nehru

During the rather vehement disputes between the both major groupings in the INC the left wing under the leadership of Nehru stood up mainly for the following two principles:

- Maximum increase of production by all available means and
- Prevention of a concentration of economic power in private hands

The results proved very soon that even a policy of manoeuvring and compromises was not the right means to realize the aspired role of the state only approximately. The development of state capitalism strengthened the positions of the national private capital. As early as 1964, the alarming tendencies in the concentration of production and capital forced Nehru's government to form a Monopoly Inquiry Commission, which impressively documented in a comprehensive study the accumulation of economic power by 75 native monopolies. A small upper stratum of the propertied classes, including several dozen of monopolies, managed to use the enormous efforts of the society in building up a national economy for the accumulation of private wealth.

Conflict between the state and the private sector

Nehru realized the aggravating conflict between the state and the private sector and vehemently opposed all the attempts at transforming the state sector into an appendage to private capital. Thus, he stated at Parliament in December 1963 that the state sector dominates in the Indian economy because it is the more important one for the economic policy. Otherwise it would be of no use to have a state sector in economy, because it would only serve as an appendage to the private sector. The deceleration of India's progressive development, marked by the strengthening of monopoly and big bourgeoisie and the temporary loss of INCs monopoly of power in several parliamentary elections demonstrated the limits of 'democratic socialism' and the fact that essential social reforms are not possible by means of 'harmonizing the class differences'. Nevertheless one can say those four decades after independence INC can start its further strategic reflections from positive results in development.

Ideas of autocratic rule of the private capital

The state sector as the main item of the concept of mixed economy has proved its strategic importance for the strengthening of India's independence and is now one decisive factor of the power and productivity of the national economy. Nehru's ideas of a 'socialist economic order' in the sense of democratic socialism were

mainly reflected in the concept of mixed economy. They were not in contrast to the class interests of the Indian bourgeoisie class, but on the contrary contributed to a great extent to their fulfilment. The concept of mixed economy proved to be an important instrument of the ruling class in creating favourable conditions for an independent capitalist development. It may be considered to be Nehru's historical credit that he broke the aspired autocratic rule of the private capital by developing a productive private sector, that he laid the basis for the planned development of the economic structure and popularized the vision of an independent modern national economy among the people of India.

Check Your Progress

1. What were Nehru's ideals of physical planning?
2. What was the concept of mixed economy based on?

13.3 MAHATMA GANDHI

M.K. Gandhi was a man of action, a realist and a pragmatist. He was a humanist who had tremendous faith in the essential goodness of man. He was not a politician. In his own words, he was not a politician masquerading as a religious man, but a religious man, who had been dragged into politics because of his great concern for his fellow human beings. He, therefore, practiced whatever he professed and never asked anyone to follow anything that he had not practised in his own life. He did not believe in arm-chair theorizing or system-building. Thus, it is intuition and action rather than logic and system-building, which characterizes the political philosophy of Gandhi. He entered the hot-bed of politics to emancipate the people from the yoke of foreign domination. Swaraj, therefore, was the most important thing, which he kept in the forefront of his political programme. To achieve Swaraj, Gandhi adopted certain means and worked out his programme with the help of these means. The principles, which were followed by Mahatma Gandhi, were woven into a political philosophy by his followers. Gandhi did not differentiate between thought and action; for him, to think was to act.

With his novel method of non-violent struggle against the British imperialists, Gandhi became a dynamic force in the political and spiritual life of India. The Indians could have never fought the British with force, because it would have been suppressed by still greater force, which the British commanded. The symbolic use of the weapons of non-violence and *satyagraha* were responsible for spreading patriotic fervour throughout the country. The British were not prepared for such an attack and had to surrender. During this period, Gandhi became the most vital force and his life and activities were identified with India's struggle for national independence. His spiritual and moral impact was so great that after his assassination the Manchester *Guardian* rightly commented that 'he was a saint among politicians and a politician among saints'. Gandhi's sincerity of purpose, his

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devotion to duty and the noble principles that he practiced, made him the ideal of many national leaders in India. Humayun Kabir had rightly said that Gandhi was an objective student of reality and that his method was essentially experimental and scientific. Jawaharlal Nehru, who was a close associate of Gandhi for many years, once said, 'We are associated (with him) seldom in logical debate and argument or philosophical discourses, we were associated in action'.

Influences on the Thoughts of Gandhi

Gandhi read little in the realm of political theory or political thought. But whatever he read, he assimilated perfectly. He read the *Bhagavad-Gita* and gave it a novel interpretation. He read in several times and considered it as the book of spiritual reference. He learnt about truth and non-violence from the *Bhagavad-Gita*: He was also influenced by Patanjali's *Yogasutra*, the *Ramayana* and *Mahabharata*. He read some of the Jain and Buddhist writings and was deeply influenced by the principles of truth and non-violence. From the Upanishads, he got the inspiration for his faith in non-possession. He read the *New Testament* of the *Bible* and was greatly influenced by the 'Sermon on the Mount'. The dying words of Jesus – 'Father forgive them for they know not what they do' awakened Gandhi's faith in the rightness and value of *satyagraha*.

The teachings of Lao-Tse and Confucius also influenced Gandhi's thought to some extent. Lao-Tse has taught the philosophy of non-assertiveness of ideal life. From the writings of Confucius, Gandhi learnt the principles of reciprocity. The principle means that men should not do to others what they would not have done to themselves. Secular writers like Thoreau, Ruskin and Tolstoy also influenced the moral and political philosophy of Gandhi. He learnt the principle of civil disobedience from Thoreau. Ruskin instilled in Gandhi, respect for manual labour. Tolstoy inspired him to think in terms of philosophical anarchism.

Comparing Thoreau and Gandhi, Pyarelal says, 'that neither of these thinkers was a system-builder but both were profound thinkers, truth-seekers and truth-speakers. Both had a passion for truth and both represented a philosophy in action. Both also believed in the ideal of voluntary poverty'.

The Philosophy behind Political Action: Spiritualization of Politics

Gandhi was not a politician in the ordinary sense of the term. But he exhibited unusual tact and intelligence in choosing the time as well as the methods and techniques to be used in launching his non-violence agitation. This made him the ideal of all the political leaders, who were striving for India's independence. The greatest contribution of Mahatma Gandhi to political theory and politics is the spiritualization of politics. He believed that if politics is to be a blessing for mankind and not a course, then it has to be guided by moral and spiritual principles. The leaders must be guided by a sense of sacrifice and service. Gandhi stressed the importance of means and said that right and just means must be adopted to achieve right and just ends. Only the right means, he believed, could lead to the right ends.

Thus, according to him the ends and the means are the same things, looked at from different points of view.

Philosophical Anarchism

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Gandhi believed in the essential goodness of man. Left unto himself, man can develop his spiritual and moral personality. Man alone is capable of achieving wonders in the world. The state should not interfere in the activities of the individual. Gandhi believed that the state is an instrument of exploitation. It exploits and oppresses the poor. The excessive interference of the state kills individual initiative and action. The state originates in an essentially violent society but in a society where the people are non-violent, orderly and disciplined, the state becomes unnecessary. Gandhi believed that all initiative must come from within man. Anything that is imposed by an external agency is evil, because it does not elevate the human soul. It deprives and degrades the human soul and stands as a positive hindrance to the spiritual and moral development of the individual's personality. In his introduction to Thoreau's essay on Civil Disobedience, Mahatma Gandhi (quoted by Prayelal) writes, 'I heartily accepted the motto, that government is best which governs least … carried out, it finally amounts to this, which also I believe, that government is best which governs not at all'. Instead of state activity, Gandhi preferred individual activity. The instruments of state, like force and coercion, rob and individual action of its morality. Both Thoreau and Gandhi looked upon the state as a soulless machine. The ideal society envisaged by Gandhi is a stateless democracy. About the state of his imagination, he wrote in his *Young India*: 'In such a state (of enlightened anarchy) everyone is his own ruler. He rules himself in such a manner that he is never a hindrance to his neighbour. In the ideal state, therefore, there is no political power, because there is no state'.

In spite of his distrust for the state, Gandhi did not dogmatise it. He believed that the state is necessary to perform certain functions for the good of the masses. He wanted it to exercise minimum functions, transferring more and more functions to voluntary associations. State action should be judged on its own merit and only that action which promoted the welfare of the masses was to be justified. In performing its functions, the state's object should be to serve the masses and these functions must be performed with minimum use of force. The state must follow persuasive rather than coercive methods.

The Welfare Concept of the State

According to Humayum Kabir, Gandhi was an inheritor of the liberal tradition, of the tradition of philosophical anarchism, and of the tradition of collectivism found in socialistic thought which believed that the good things in life ought to be shared. He would support a welfare state because of his great concern for the masses. Gandhi would have liked the Five Years Plans and other method of planned development if they could have originated of the people. But a plan, which increase government post, favouritism, nepotism and opportunities, corruption and laziness, would have been definitely rejected by him. He was, therefore, not in favour on

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concentration of heavy industries and the grand multipurpose river valley projects which did not benefit the people in the proportion of the huge amounts spent on them.

His concern for the misery and exploitation of human beings compelled him to start a vigorous agitation against untouchability in whatever form it might exist. He condemned the practice of untouchability and broke the unhealthy practice of the cast system by such means a temple entry and continuous propaganda against untouchability. But at the same time, he upheld the Hindu ideal of the varnash-rama dharma, according to which every person was to perform his allotted task in the society, in accordance with his training and capacities. Gandhi's ideal of classlessness was not Marxian. He called himself a weaver and a cultivator by profession and identified himself with those people with regard to food, dress, speech and the like.

13.3.1 Gandhian Economics

'When the history of economic thought in India in recent times comes to be written,' wrote Anjaria (1941-2) 'Gandhi's name will certainly occupy a place of honour in it.' However, he hastened to add, 'It does not matter in this context whether we call Gandhi an economist or not: that is partly, at any rate, a question of definition of terms'.

Indeed, Gandhi was much farther off the mainstream of economics than other Indian nationalist economists, such as Ranade, had been. Railways have spread the bubonic plague and increased the frequency of famines in India, machinery is a 'grand yet awful invention'; a doctor or a lawyer should be paid the same wage as a labourer, the law of supply and demand is 'a devilish law', tractors and chemical fertilizers will spell ruin for India', tractors and chemical fertilizers will spell ruin for India. It is for voicing opinions such as these that Gandhi as an economist is remembered. Even a sympathetic reader may find it difficult to take such statements at their face value. This could help explain why, although Gandhi has come to be accepted world-wide as one of the outstanding political and moral thinkers of our time, his economic thought still attracts little attention. Some of the methodological issue involved will be considered here. We begin by taking up a question that is likely to strike a careful reader of Gandhi's economic writings: do they simply describe a dream of utopia, or are they meant to resolve problems of the 'real' world?

Gandhi himself often likens his economic 'model' to Euclid's definition of a straight line but this is consistent with either interpretation. It could mean that like the straight line 'which cannot be drawn' the Gandhian model relates to an ideal economic order where people could well be motivated quite differently from those in any society that we know of. However, it could also mean that 'something like' a straight line can be drawn, and in economics as in geometry, the postulational method can help in achieving clarity in thought and in solving real life-problems, for

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'we must have a proper picture of what we want before we can have something approaching it'. Both versions contain elements of truth.

Gandhi was not an academic but the charismatic leader of the Indian national movement. He was inspired by a vision of 'swaraj' (self-government) which, for him, meant not just freedom from colonial rule but the achievement of self-reliance, and self-respect, by the villagers who make up most of India's population. His economics was a part of this vision, which ruled out industrialization on western lines as the 'optimal' path of economic development for India.

Thus, Gandhi was trying to describe an economic ideal to strive for rather than simply an economic plan to implement. To that extent his economics was utopian. However 'utopian' can also refer to something 'impractical' or even 'impossible'. Gandhi's economic thought was not 'utopian' in that sense. It was currently meant to apply to an actual society, that of rural India in particular. It would still apply only to a few selected aspects of that society while neglecting others but that is true of all economic models. The case for this 'pragmatic' view of Gandhian economics appears more plausible if we remember the context of his writings.

Most of them appeared in daily newspapers or weekly journals, *Young India* (in English), *Navajiban* (in Gujarati), and *Harijan* (in Hindi), and were addressed to a mass audience whose attention he tried to capture by making his points short and sharp. In this he succeeded and as a journalist, especially during the 1920s and 1930s, he exercised considerable influence. Exaggeration was the price of successful journalism. It must be remembered too that Gandhi's writings were produced and published in the heat of political battle. This led to simplified, sometimes over-simplified, conclusions.

Yet another argument in favour of this interpretation is that Gandhi regarded his conclusions on economic policy as only provisional. Thus, in his preface to *Hind* Swaraj, he described the views expressed there as 'mine, yet not mine'. They were his only in the sense that he hoped to act according to them. If, however, his views proved to be wrong he would have no hesitation in rejecting them. Gandhi's American biographer, Louis Fischer, notes this provisional aspect of Gandhi's ideas: he was always 'thinking aloud': 'He did not attempt to express his ideas in a finished form. You heard not only his words but also his thoughts. You could, therefore, follow him as he moved to a conclusion'. In the same spirit he came to admit that some of the things he had earlier condemned, e.g. railways, motorcars, and machinery, could in certain circumstances confer benefits too, and that they should not be prohibited altogether. Appropriate restrictions on their use could perhaps provide adequate safeguards against misuse

Writings on Gandhian economics have usually focused attention on the specific policies that he proposed. Opposition to modern manufacturing production based on the use of machinery, advocacy of village industries, in particular, the spinning wheel, boycott of foreign goods, it is with policies such as these that Gandhi's name is associated. In the argument presented in the unit, proper understanding of

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his views requires a rather different emphasis. The structure of his arguments, the assumptions he made, and the principles of conduct that he appealed to, must be regarded as of central importance. It is these, we believe, that make his specific policy proposals comprehensible, not the other way round. One agrees with Anjariawhen he says that 'Gandhism is not just a series of disjointed maxims of policy or a catalogue of urgent reforms and remedial measures' and with Nanda that 'What is called Gandhism is.... only a distinctive attitude to society and politics rather than an ideology; a particular ethical standpoint rather than fixed formulae or a definitive system'.

From this point of view what really differentiates Gandhi's approach to economic issues from the mainstream tradition is his extraordinary emphasis on the ethical aspect of economic behaviour. Indeed, he believed that economic and ethical questions were inseparable. Replying to the poet Tagore, who had reproached him for mixing these up, Gandhi wrote: 'I must confess that I do not draw a sharp or any distinction between economics and ethics' (*Young India* 3 October 1921). They Could, Gandhi said be considered separately, as indeed they usually were but for conclusions to be relevant and valuable, they should not.

Ethical and economic criteria must be considered together for either to be valid. True economics never militates against the highest ethical standard just as all true ethics, to be worth its name, must at the same time 'be good economics'. Since for Gandhi ethics also constitutes the essence of religion, the same two-way relationship holds as between economics and religion, and even more generally between economics and *Dharma*. 'If dharma and economic interests cannot be reconciled either the conception of that dharma is false or the economic interest takes the form of unmitigated selfishness and does not aim at collective welfare'. According to Gandhi, it is because standard economic analysis failed to take ethical considerations into account that economics itself had become largely irrelevant for either understanding behaviour or prescribing policy. Not only were the generally accepted principles of economics invalid for policy making, if they *were* acted upon they would make individuals and nations unhappy. 'Economists do not take men's conduct into account but estimate prosperity from the amount of wealth accumulated and so conclude that the happiness of nations depends on their wealth alone'. Accordingly he likens the economics that disregards moral and sentimental considerations to 'wax-works that being life-like still lack the life of the living the flesh'.

For all his distrust of economic analysis Gandhi never relinquished a belief in the vital importance of economic considerations for the life of individuals and nations nor in the possibility that a less narrowly focused and more relevant economics could be developed. He never gave up entirely, never ceased to ask: 'Can we evolve a new kind of economics?'

These beliefs are an integral part of Gandhi's view of the nature of ethics. The relationship between economics and ethics worked both ways. While economic behaviour was laden with ethical concepts ethics had to descend from the clouds

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and become 'good economics'. Ethics, Gandhi is saying, is not simply an exercise for philosophers. It must be relevant to the 'ordinary business of life' where one's options are limited by resource constraints. 'No person in this world has found it possible to maintain something which is a source of constant economic loss'. Trying to carry out ethically good policies by methods involving continuing economic loss was futile. Viable methods of financing projects had to be found. This helps explain why Gandhi, who worked all his life for the cause of protecting animals, and cows in particular, regarded schemes for conducting tanneries on sound economic lines as essential for the cause to succeed. That required exploring possibilities of profitable export, utilising by-products, and 'putting bones, hides and intestines of cows to practical use' (CW 41: 449-50); also CW 51:428 and similar reasoning explains why Gandhi strongly opposed a proposal that cotton spinners should also be encouraged to weave. 'It can be clearly shown that this involves an economic disadvantage.' He continues: 'Whatever is basically harmful on economic grounds is also certainly harmful from the religious point of view. Untainted wealth can never be opposed to religion'.

On the whole we agree with Anjaria that 'the Gandhian system of economic thought cannot be adequately appraised merely in terms of current economic theory which rests on certain limited assumptions. It is a challenge to those assumptions themselves'. In that sense, Gandhi must be regarded as a dissident from the economic tradition. There are, however, a number of methodological positions which he held in common with that tradition. Among these his adherence to the deductive method and to methodological individualism are especially note-worthy.

Gandhi was generally in favour of analytical reasoning based on the deductive method applied to a set of postulates. His writings contain numerous references to Euclid and Galileo whose approaches to problem solving he held out as models for the social sciences. While he criticised economic analysis for failing to take ethical considerations into account he was not against the method of abstraction as such. Some 'holist' critics of economics maintain that human behaviour constitutes a single 'organic' whole. Hence they argue that even in principle, the economic aspect of it cannot be isolated from all the others. On this view human behaviour can only be observed or understood 'as a whole'. Because the method of abstraction does not apply, there cannot then be any such thing as 'economic analysis'. That was not Gandhi's view. He remained committed to the validity of analytical reasoning based on the method of abstraction. 'Euclid's straight line may not be capable of being drawn on a blackboard. But the impossibility of the task cannot be permitted to alter the definition'. The problem with the economic mode, as Gandhi saw it, was not that it abstracted from some aspects of reality but rather that the particular aspects it abstracted from were central to the phenomena under study. Ethical influences on economic behaviour could not properly be treated as disturbing factors that 'prevented economic laws from having free play'. It was not reasonable to abstract from them even as a first approximation. Nevertheless, if more appropriate assumptions were made valid conclusions could be reached using the deductive method.

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Again, Gandhi's approach in ethics as in economics remains firmly rooted in methodological individualism. He opposed collectivist theories both of state and society. While he often chided his countrymen for failing to live up to the high moral norms of their own past, the norms themselves could not be derived from tradition, custom or religious text. 'It was good to swim in the waters of tradition but to sink in them was suicide' while 'to respect a tradition even when it becomes tyrannous spells not life but death and it should be discarded' . Thus, Hinduism was hemmed in by many old customs, some of which were praiseworthy but the rest were to be condemned. The *Ramayana* and the *Mahabharata* had logical and analytical truth but were not to be taken literally nor treated as historical record. Gandhi's belief in Hindu scriptures did not require him to accept every word and every verse as divinely inspires, and he declined to be bound by any interpretation, however learned it might be, if it was repugnant to reason or moral sense . Even the *Veda*s were not exempt. 'No matter what is credited with Vedic origin if it is repugnant to the moral sense it must be summarily rejected as contrary to the spirit of the Vedas and *perhaps what is more* as contrary to fundamental ethics'. Gandhi had great respect for other religions, as he held for his own, and often quoted from the Bible or the Quran to make a point. Yet they too were subject to the same judgment: 'I reject any religious doctrine that does not appeal to reason and is in conflict with morality'. Because Gandhi often used religious terminology (a 'saintly idiom' as it has been called) in his speeches and writings the critical, individual and rational nature of his approach to religion has sometimes been missed. Because it was only individuals who reasoned, had moral sense and exercised moral choice, individual conscience remained for him the ultimate court of appeal. Nation and society were not conceptually 'prior' to the individual members of the aggregate. Rather, the morality of a nation depended on that of individuals. 'If the individuals who constitute a nation do not observe moral principles, how can the nation become moral?'. And, similarly, 'if the individual ceases to count, what is left of society?'. Clearly, Gandhi did not subscribe to a deterministic view of human action, either of the historical or the sociological kind. For him 'ultimately, it is the individual who is the unit'.

Gandhi also shared with the mainstream economic tradition a consequentialist approach to choice. For him as for the economists the assessment of consequences of various alternative courses of action is always the proper basis for choosing between them. There is one important difference: Gandhi usually interprets consequences in broader terms than the economist is apt to do. For Gandhi, they include moral as well as strictly economic effects and effects on others as well as on oneself. Nevertheless, it is to consequences that he looks rather than to any one over-riding moral principle in terms which every alternative can be assessed, for 'it is not possible to enunciate one grand principle and leave the rest to follow of itself'. A recurrent theme in Gandhi's writings is that life is not one straight road. 'There are so many complexities in it. It is not like a train which once started, keeps on running' (Nanda 1985: 146). Nor can one climb the Himalayas in a straight line. As a pluralist he believes that in any actual choice a number of different

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moral principles are usually involved and there could be conflict between them. '(But) one's life is not a single straight line; it is a bundle of duties very often conflicting. And one is called upon continually to make one's choice between one duty and another'. The choice is often far from clear. 'Relative dharma does not proceed on a straight path, like a railway track. It has on the contrary to make its way through a dense forest where there is not even a sense of direction'. Looking at consequences helps us in finding a direction.

Consumption Behaviour: The Limitation of Wants

The concept of 'limitation of wants' is a typically Gandhian contribution to the theory of welfare economics. This states that an individual's welfare is best achieved not, as economic theory suggests, by attempting to maximize the satisfaction of multiplicity of desires subject only to the prevailing budget constraint but rather by reflecting on his desires and trying to choose between them. The claim is supported by arguments bearing on the relationships between desire, satisfaction, happiness and welfare. While economic analysis often regards these more or less as synonyms, according to Gandhi they are quite distinct concepts.

First not all kinds of happiness contribute to human welfare. That drink or drugs can make people happy for a while is not, for example, a relevant consideration for policy (CW 26: 175-6). Second, not all kinds of desire-satisfaction contribute to happiness. Primarily this is because an individual's desires for goods and services do not form a fixed set such that their satisfactions would make the happy: 'We notice that the mid is a restless bid; the more it gets the more it wants and still remains unsatisfied'.

Multiplying one's daily wants in this fashion merely makes a person a slave to an unending sequence of desires and there is no slavery equal to slavery to one's own desires (CW 73: 94). Such a process does not lead an individual to any sustainable steady state consumption path. Those who are in the mad rush to multiply wants, thinking that this will add to their real substance, are mistaken. On the contrary, self-indulgence and the ceaseless multiplication of wants hamper one's growth because they are erosive of contentment, self-respect and peace of mind. And it is from these that one's long-run happiness can be found, not just from obtaining what one likes at the moment. And what is true for the individual is true also for society. Indeed, individuals may be impelled towards unlimited wants not only by their own desires but also by the prevailing social ethos. In modern Western society, state Gandhi, the basis of culture or civilisation is understood to be the multiplication of all one's wants.

'If you have one room you will desire to have two rooms, three rooms and the more, the merrier. And similarly you will want to have as much furniture as you can put in your house, and so on endlessly. And the more you possess the better culture you represent or some such thing' (quoted in Iyer 1973: 384). Gandhi regarded such a culture as flawed.

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Another reason why trying to maximize desire-satisfaction may not make an individual or a society happy is that the process of trying to satisfy a multitude of wants has its own costs. Such an attempt requires the extensive use of machinery which could lead to pollution of the environment and a loss of creativity in work. Another usual characteristic is a 'mad desire to destroy and time, to increase animal appetites and go to the ends of the earth in search of their satisfaction' (*Young India*, 7 August 1927).

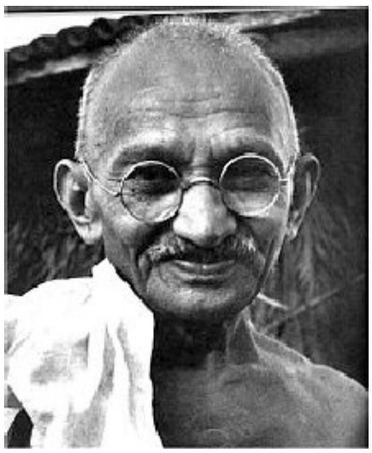


Fig 13.2 *M.K. Gandhi*

Source: http://en.wikipedia.org/wiki/File:MKGandhi.jpg

Typically, a country pursuing the quest will be 'made hideous by the smoke and the din of mill chimneys and factories' and its roadways 'traversed by rushing engines dragging numerous cars crowded with men mostly who know what they are after, who are often absentminded, and whose tempers do not improve by being uncomfortably packed like sardines in boxes'). Besides, in a country where everyone had a car, 'there would be very little room left for walking'.

Such things, observes Gandhi, are held to be symbolic of material progress but 'they add not an atom to our happiness'. Deliberate restriction of material desires by individuals by means of 'the utmost effort' offers a more rational solution. Another argument in favour of limiting wants turns on the adverse moral consequences of economic growth. As we have seen, at the heart of the Gandhian approach to economic issues is his belief that ethical and economic considerations are inseparable. The objective must be to bring about improvements in both the economic and the moral well-being of individuals, and thereby of society. But material progress can itself affect moral standards. These 'externalities' must be taken into account in the overall reckoning and a balance struck. Sometimes they could be of a positive kind. This is likely to be the case when there is mass poverty. 'No one has ever suggested that grinding pauperism can lead to anything else than moral degradation'.

Millions of people in India live on only one meal a day. 'They say that before we can think or talk of their moral welfare we must satisfy their daily wants.

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With these, they say, material progress spells moral progress' .Gandhi agrees with 'them'; but, he argues, what is true of thirty millions is not necessarily true of the universe. Indeed, such a deduction would be 'ludicrously absurd' for 'hard cases make bad law'.

> 'The only statement', suggests Gandhi, 'that has to be examined is whether it can be laid down as a law of universal application that material advancement means moral progress'. His answer is that it cannot: both at the level of individuals and societies, there are too many examples to the contrary. In general, Gandhi believes that material affluence beyond a point not only does not imply but actively hinders moral progress. Gandhi does not discuss whether, or how, one could determine just where the point was located but he was convinced that it does exist. For this reason, when discussing comparative standards of living of different societies, Gandhi always asked questions about moral as well as economic aspects. Neither literacy nor wealth *per se*, without a moral backing, had any attraction for him as a 'social indicator'. To a correspondent who had pointed out Japan's achievements in terms of material progress and the level of literacy. Gandhi responded: 'And why are you so enamoured of the material progress of Japan? I do not know whether the material had gone side by side with the moral progress'. There are echoes here of Ruskin who had written in *Unto This Last*: It is impossible to conclude, of any given mass of acquired wealth, merely by the fact of its existence, whether it signifies good or evil to the nation in the midst of which it exists. Its real value depends on the moral sign attached to it just as sternly as that of mathematical quantity depends on the mathematical sign attached to it.

The limitation of wants appeared to be a way of avoiding adverse effects of material progress.

Whichever of these various justifications of the doctrine of limitation of wants one takes as primary, they have one thing in common, namely that such limitation is not intended as a glorification of austerity but rather as an exercise in the optimisation of overall individual welfare. In taking up such a position Gandhi anticipated a basic theme of the recent literature against economic growth. Indeed, he was one of the first writers to argue explicitly and in a systematic way that non-economic aspects of welfare are important and that a single-minded pursuit of the maximum satisfaction of material wants might not lead to the best of all possible worlds. In developing this thesis Gandhi was influenced by Ruskin and Tolstoy but he had a far more positive and practical approach than his mentors.

From a practical point of view the question of what things wants should be limited to, is important. Gandhi appears to give different answers at different times. In some of his early writings he appeals to the principle of what he calls satisfying one's 'natural wants'. Each person should be able to satisfy all natural wants and no more. These are conceived as minimal, or basic, needs. One 'should make do with the fewest possible articles… and in the smallest possible quantity… no more

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than what is absolutely necessary to pay the body its hire' (CW 12: 387). However, natural wants will vary from one individual to another depending on metabolism. If one person has a weak digestion and so requires only a quarter pound of flour for his bread and another needs a pound, the former's natural want will be correspondingly lower. Natural wants also vary with climate. 'Fiery whisky in the north of the British Isles may be a necessity. It renders an Indian unfit for work or society. Fur coats in Scotland are indispensable, they will be an intolerable burden in India'. Some natural wants, according to Gandhi, could only be specified at the village, rather than the individual, level. To this category belongs transport and sanitation:

> The roads should be so scrupulously clean in this land of crore of barefooted pedestrians that nobody need hesitate in walking or even sleeping in the streets. The lanes should be macadamized and have gutters for letting out water. The temples and mosques should be kept so beautifully clean that the visitors should feel an air of tranquil holiness about them. The village should as far as possible, be full of shady trees and fruit trees in and around them. It should have a *dharamshala,* a school and a small dispensary. Washing and privy arrangement should be such as may not contaminate the air, water and roads of the village.

Elsewhere, especially in his later writings, Gandhi appears to take a rather broader view of basic 'needs'. The proliferation of material wants is still rejected as a goal. One's aim should rather be their restriction consistent with comfort, which is less narrowly interpreted than natural want. Typical of this broader outlook are passages such as the following: If by abundance you mean everyone having plenty to eat and drink and to clothe himself with, enough to keep his mind trained and educated. I should be satisfied. But I should not like to pack more stuff in my belly than I can digest and more things than I can ever usefully use. But neither do I want poverty, penury, misery, dirt and dust in India. And again, 'Everyone must have balanced diet, a decent house to live in facilities for the education of one's children and adequate medical relief'. For the same reason, spinners' wages should be adequate for ensuring 'wholesome and nutritious food, necessary clothing, comfortable houses and other amenities necessary for a happy home'. The tiller of the soil should have 'a sufficiency of fresh, pure milk and oil, fish, eggs and meat if he is a non-vegetarian', 'adequate but not fine clothing (what would fine clothes, for instance, avail him if he is ill-nourished and underfed?)'; facilities for sanitation, comfortable housing, clean drinking water, dirt-free roads and a sense of participation in decisions that affect his daily life.

More than half a century after Gandhi' death, the bill of goods that he prescribed as a minimum is still not one that the average Indian household is a position to consume. The actual consumption of both rural and urban poor falls far short of the limits to wants that Gandhi set. One the other hand, the affluent, even many of those not so affluent, is often engaged in a frantic display of luxury consumption in a way that Gandhi had supposed to be peculiarly 'Western'. In

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this perspective the limitation of wants can be seen as a means of reducing economic inequality. This aspect of the doctrine comes out clearly in some of Gandhi's later writing, for example in his statement that while he did not want to taboo everything above and beyond the bare necessities, 'they must come after the essential needs of the poor are satisfied. First things must come first'. However, it remains somewhat peripheral to the doctrine itself.

Consumption Behaviour: Swadeshi

Swadeshi means indigenous or home-grown. The Swadeshi movement was a mass movement to encourage people, especially those living in cities, to develop the habit of consuming Indian rather than foreign products. They were also urged in particular to wear only *khaddar*, i.e. cloth made of yarn spun by villagers using the *charkha* or spinning wheel. The movement was undertaken by the Indian National Congress under Gandhi's leadership. During the 1930s the movement become wide-spread in some parts of India.

Gandhi did not regard Swadeshi merely in terms of political expediency but sought to justify it by moral principles. The first relevant principle here is that of neighbourhood. One has a moral duty to help one's neighbours. While it is true that we have duties to all humankind, the duties we owe to different segments of humankind are not of equal importance. There is a hierarchy of duties based on the degree of proximity. Individuals' service to country and humanity consist in serving their neighbours. They cannot starve their neighbours and claim to serve distant cousins in the North Pole, for one must not serve one's distant neighbour at the expense if the nearest. This was the basic principle of all religions and or 'true and humane economics'.

The neighbourhood principle has a direct consequence for the interpretation of Swadeshi, namely that local products should be preferred. Inhabitants of Bengal should only consume cloth made in Bengal in preference to substitutes imported from more distant parts. This was so whether the substitute concerned came from Manchester or Japan or Bombay or Ahmedabad. 'If Bengal will live her natural and free life without exploiting the rest of India or the world outside, she must manufacture her cloth in her own villages as she grows her corn there'. For the same reason, by consuming cloth or *ghee* made in Calcutta rather than those made locally the people (of Porbandar) were being 'chained with fetters'.

Between counties, the neighbourhood principle translates as patriotism. It is sinful to eat American wheat while a neighbouring grain dealer starves for want of custom. An individual's preference-ordering over commodity-bundles should be guided by patriotism. 'The law of each country's progress demands on the part of its inhabitant's preference for their own products and manufactures'. For Indians, there is an obligation to use Indian-made things whenever they are obtainable, even though they may be inferior to foreign articles. For example, India produces a sufficient quantity of leather. It is therefore my duty to wear shoes made out of Indian leather, even if it is comparatively dearer and of an inferior quality, in

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preference to cheaper and superior quality foreign leather shoes. For the same reason products of Indian textile, sugar, or rice mills 'must be preferred to the corresponding foreign products'.

Comparisons of price or quality are not relevant for the kind of consumer's choice decision Gandhi is talking about, but patriotism is.

> 'We attend flag-hoisting ceremonies and are proud of our national flag. Let me tell you our pride has no meaning if you do not like things made in India and hanker after foreign ones.
>
> If a particular commodity is not made in India at all, the patriotism argument ceases to apply.
>
> I would regard it as a sin to import Australian wheat on the score of its better quality but I would not have the slightest hesitation is importing oatmeal from Scotland if an absolute necessity for it is made out because we do not grow oats in India.'
>
> *(Young India*, 15 November 1928)

For the same reason the argument did not apply to English lever watches, books or surgical instruments. Japanese lacquer work, Austrian Pins and pencils of Swiss watches.

While this argument applies to all home-grown products, Gandhi singles out the products of village industry for special attention. Within that category *Khaddar* claimed pride of place. Indeed, the Swadeshi movement came to be regarded primarily as a means of encouraging consumers to wear *khaddar*. Accordingly, people, especially towns-people, were asked to buy *khaddar* in preference to mill-made cloth and to boycott foreign cloth altogether. It was specifically the use of foreign cloth that Gandhi sought to prevent, not just British cloth and not all foreign goods, which he argued would be racial, parochial and wicked.

Gandhi's identification of Swadeshi with village industry, and with hand-spinning, was based on a two-fold argument: that the urban population of India owed a special moral duty towards the villages, and that this duty would be best discharged by providing a market for village products and above all hand-spun cloth. The first part of the argument is a logical consequence of the principles of neighbourhood (there are few town or cities in India that are not surrounded by villages) and patriotism (most Indians *are* villagers). Gandhi sought to support it further by introducing another moral principle, that of historical justice. Both economic and moral standards in the villages had declined through long neglect. City people as a whole were partly to blame. Reparation had to be made. 'We are guilty of a grievous wrong against the villagers and the only way in which we can expiate it is by encouraging them to revive their lost industries and arts by assuring them of a ready market' . We must, urged Gandhi, think of our household consumption requirements in terms of 'rural-mindedness', which was 'in consonance with the true economics of our country'. The second part of the argument had more to do with standard economic analysis.

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Spinning was a solution for rural unemployment. 'The whole scheme of khadi rests upon the supposition that there are millions of poor people in India who have no work during at least 4 months in the year'. Around three-quarters of the Indian population, who were agriculturists tilling their own land, belonged to the category. Even in a normal year, because agricultural work was seasonal, they remained idle for a third of the year or more. This, Gandhi believed, was the principal cause of their endemic poverty. Their normal life was lived on the border-line of starvation. If there was crop failure or famine, the extent of involuntary unemployment became much greater and many of them died of hunger and disease (CW 28:11). For the 'semi-starved' but partially employed millions, spinning provided a means of part-time employment as well as insurance against famine. Thus, Gandhi saw spinning as a supplementary industry for agriculture rather than as a means of employment for village artisans.

Why, one might ask, choose spinning, rather than some other subsidiary occupation for agriculturists? Gandhi's answer to this was strictly pragmatic. Spinning had long been practised by villagers in the past. It required only a very simple and low-cost implement and little technical knowledge or skill. It could be easily learnt, did not require too much attention, could be done at odd moments and, for these reasons, was suitable as part-time employment for masses of rural people. Neither cattle breeding nor weaving, which had been suggested as possible alternatives to spinning as a supplement to agriculture, enjoyed these advantages, even though they were more remunerative. Spinning was 'the easiest, the cheapest and the best'. Again 'the test of Swadeshi was not the universality of the use of article which goes under the name of Swadeshi but the universality of participation in the production or manufacturing of such article'. Judged by this test, spinning had a potential unmatched by other contenders.

That cotton spinning was a specific remedy for agricultural unemployment also implied that it was not recommended for universal adoption. It was not, for example, meant for individuals who already had more remunerative employment, such as urban workers in textile mills. It could not work in a district or region which did not have large numbers of people with idle hours at their disposal. Gandhi neither contemplated nor advised the abandonment of a single, healthy, life-giving industrial activity for the sake of hand spinning. On one occasion, he found that a number of women had been spinning who were not without occupation or means of living. 'Perhaps they spin in response to our appeal and because they realize it is for the good of the country'. Nevertheless, Gandhi remained firm in his resolve that their spinning should stop, 'for the *charkha* movement had not been conceived with such people in mind but only for able-bodied people who were idle for want of work'. The operative principle was quite clear: if there were no crises of semi-unemployed people there would be no room for the spinning wheel.

Gandhi's pre-occupation with the need to find a subsidiary occupation for farmers can be properly understood only if certain other considerations are kept in mind. The first is his view that the possibility of bringing about improvements in

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agricultural production itself was very limited. Because an extremely high percentage of cultivable land in Indian was already under cultivation, there was little scope for increasing the agricultural area. Also, if agriculture was to provide the sole means of livelihood, one acre was estimated to be the minimum viable area for supporting a household. In these circumstances, extension of cultivation was not a plausible means of bringing about economic development in India.

To a number of nationalist economists, including Gandhi's own political mentor, G. K. Gokhale, improving the productivity of land already under cultivation did appear to be a promising solution. Towards this end they advocated concerted efforts, especially by government, to expand irrigation facilities so as to make farmers less dependent on the vagaries of rainfall and also to encourage them to adopt higher-yielding seed and improved agricultural practices. Gandhi did not take up this line of argument, because of his belief that proposals for agricultural improvements were 'chimerical' and not immediately available a belief came to modify. He stated, 'Till now I believed that improvement in agriculture was impossible unless we had the administration of the State in our own hands. My views on this are now undergoing modification. I feel that we can bring about improvements even under the present conditions so that the cultivator my make some measure of profit form the land even after paying his taxes… The time has come to pay attention to agriculture.'

However, Gandhi continued to oppose the 'industrialization' of agriculture by large scale use of mechanised techniques which were not only contrary to the kind of village society he wished to bring about, but would also mean 'trading' in soil-fertility for the sake of quick return'. This, he thought, would prove to be a disastrous short-sighted policy resulting in virtual depletion of the soil. Without such innovation, however, it is doubtful whether agricultural productivity in India could be increased significantly.

The limitation of wants and Swadeshi both rest ultimately on the concept of ethical preferences. People should seek not simply to maximize satisfaction of self-interested desires subject to a budget constraint, but to achieve the long-run goals both of individual happiness and of helping others. The problem is that people's actual preferences may differ from their 'ethical preferences'. If Gandhian economics were taken as relating only to an ideal economic order, the difference would not much matter. However, that is not my reading. Gandhi himself was much concerned about the difference between the actual preferences of urban Indians, especially in the matter of clothing, and what he thought their ethical preferences should be. He was not, however, entirely consistent in his analysis. In his more optimistic movements he appeared to believe that a 'true and national' taste for *khaddar* (i.e. an ethical preference) was already there in a latent form and hence that demand was likely to lag only briefly behind supply. The use of *khaddar* itself 'revolutionizes our tastes'. All that was necessary was to 'revive' the national taste for *khaddar* 'and you will find every village a busy hive'. More often he seemed unsure: '*Khaddar* has yet to become popular and universal' or even despondent: '*Khadi*

has not caught the fancy of the people'. After an initial spurt the demand for hand spun cloth failed to show any dramatic rise. Unsold stocks began to accumulate in parts of the country where efforts to increase production of handspun cloth in the villages had been a success. Gandhi's conclusion was that *khadi* needed 'a great deal of propaganda'. After all, that was how all goods were sold. Textile mills 'had their own peculiar agencies and methods for advertising their wares'. In his presidential address to the Indian National Congress in November 1924, Gandhi criticized the proposition 'that supply follows demand'. Appropriate means of persuasion were necessary to encourage the consumption of *khaddar*.

Advertising campaigns were undertaken by the Congress and its agencies in favour of *khaddar*. Wearing it was made a prerequisite for membership of Congress. Exhibitions of village handicrafts were arranged to provide information to townspeople. Gandhi himself addressed mass meetings and wrote in the press in favour of *khaddar*. 'We', he declared, 'are the salesmen of swaraj'. The urban middle classes were particularly targeted. The 'thinking portion' of the population had to give a lead; for '*Khaddar* which has to find a market must command preference among enlightened men'. That remained the favoured strategy, with 'the buying middle class at the one end and the manufacturing poor class at the other'. Some attempts were also made to increase efficiency in production and marketing and improve the quality of the product. Much to Gandhi's disappointment, none of these measures succeeded in bridging the gap between ethical preferences and market demand. At an early stage of his campaign for *khaddar* Gandhi wrote somewhat wistfully about Queen Elizabeth I, who had prohibited the import of soft cloth from Holland, who herself wore coarse cloth woven 'in her own dear England' and 'imposed that obligation upon the whole of that nation'. Gandhi did not however aspire to such an option for himself. Sales talk was permissible, force never was. 'We do not want to spread *khadi* through coercion. We want to do our work by changing people's sense of values and habits'. But this was not enough for his cause to succeed.

Technology, Industrialisation and the Scale of Production

The central concern of Indian economic thought since Ranade had been the problem of industrialization. Different views were held on what constrained industrial development in India. For some it was economic drain. Others emphasised the lack of trained labour, credit facilities and entrepreneurial traditions. Yet others put the blame of the government for its failure to provide encouragement to Indian industry. All agreed, however, the industrial development was the log-run solution to poverty and famine. They agreed as well that the development of manufacturing industry on modern Western lines was desirable. Indeed, most Indian economic writing from the last decade of the 19th century onwards was concerned with how to speed up this process. Gandhi, on the other hand, did not regard industrialization as a goal that India should adopt. The overall vision which led Gandhi to his doctrines of the limitation of wants and Swadeshi also led him to

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oppose modern industrial development. The use of machinery and large scale production in urban centres were, he thought, to be avoided as far as possible.

According to him the three essential characteristics of machinery are the following: Firstly, it displaces human or animal labour instead of supplementing it or merely increasing its efficiency. Secondly, unlike human labour there is no limit to its growth and expansion. Thirdly, it appears to have a law of its own, which leads not only to labour being displaced but to it being displaced at an ever increasing rate. This occurred not because such displacement was considered by the users of machinery to be socially or economically desirable, but as a consequence of the nature of technological progress per se.

Gandhi's opposition to modern, machine-based industrial development is a natural consequence of his characterization of machinery itself. 'I am against machines just because they deprive men of their employment and render them jobless. I oppose them not because they are machines, but because they create unemployment'. The answer to the question, discussed in classical political economy since the time of Ricardo, of whether machinery leads to unemployment, was, for Gandhi, self-evident. 'If one machine does the work of a hundred men, then where are we to employ those hundred men? '. Now, one could argue that workers thrown out of work by the introduction of improved machinery would find employment elsewhere. Gandhi was perfectly aware of this argument. However, he rejected it, firstly because opportunities of employment were, in his view, fairly limited and secondly, because the division of labour resulted in workers having very specific skill, which meant they could not easily be re-employed elsewhere in the economy. The tendency of machinery to throw workers out of their jobs was, Gandhi believed, a general one which operated everywhere, but its consequences were particularly grave for a country such as India with its huge population. The proliferation of mechanized industries in such a society would create large scale unemployment with horrendous social effects.

Gandhi's second main argument against the pursuit of industrialization by means of machine-based production was that it would concentrate production and distribution in the hands of the few. More specifically, it would lead to further encroachment of the cities on the villages, making rural people even more dependent on the cities than they already were. Gandhi's vision of village swaraj could never be achieved through such a process. Because industrial production would be concentrated in a few urban centres, the economic as well as the political power of the urban elite would be strengthened at the expense of the masses of the villagers. Mass production in its usual sense, that is production by the fewest possible number through the aid of complicated machinery, could not serve the interests of the masses themselves. Gandhi's solution was production by the masses through self-employment 'It is mass production in people's own homes. If you multiply unit production a million times would it not give you mass production on a tremendous scale? Distribution could be equalised only when production was localized, in other words when distribution was simultaneous with production.

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Furthermore, when production and consumption were both localised the pursuit of economic growth for its own sake, regardless of the consequences, would be avoided; there would be no temptation to speed up production 'indefinitely and at and price.'

Gandhi's opposition to the use of machinery was neither total nor all inclusive. In a way, his objection was to industrialisation in the sense in which it is usually understood rather than to the use of machinery as such. 'I am not against machinery as such but I am totally opposed to it when it masters us'. However, 'every machine that helps every individual has a place'. His favourite example of a helpful machine was Singer's Sewing machine which supplemented human labour and increased its efficiency but did not dispense with the labour itself. Another was surgical instruments. Not only did he approve of such lifesaving appliances but also of the complicated machinery used for making such appliances, for here such machinery was absolutely essential. As he said 'we want to cultivate the hand process to perfection but where it is found to be absolutely necessary let us not hesitate to introduce machinery'. Yet another example is sanitation. Asked by a correspondent whether, because of his dislike of machinery, he opposed the adoption of flush toilets Gandhi replied: where there is ample supply of water and moderns sanitation can be introduced without any hardship on the poor, I have no objection to it, in fact it should be welcomed as a means of improving the health of the city concerned. At the moment it can only be introduced in towns.

A more important exception is the case of public utilities which could not be undertaken by human labour. In such cases Gandhi would approve of mechanized modern techniques. However, he would like them to be regarded as key industries to be owned and operated by the state in the public interest. Thus, such cases are to be treated as exceptional.

Gandhi remained, however, totally committed to his opposition to extensive use of machinery for the production of basic necessities, 'For food and clothing I would be dead against industrialization. He maintained this position to the end, strongly opposing the use of machinery for grinding corn, manufacturing cloth or ploughing the land. If Gandhi were prime minister of India he would stop all machine driven ploughs and flour mills and restrict the number of oil pressing factories. He might perhaps not destroy the existing textile mills bit certainly would not help them and in any case would not permit new ones to be set up *(ibid.).* Ideal villages which are self reliant with regard to food, which have not a single flour mill and in which the residents grow all the cotton they need and manufacture their own cloth, right up to the stage of stitching garments in their own homes, should, he stated, be awarded prizes and exempted from taxes.

Some have suggested that he was not really opposed to the use of machinery but only to its mis-use. Gandhi himself complained in various writings that his opposition to machinery was misunderstood for he was not against machinery as such. Similarly, he observes that 'machine power can make a valuable contribution towards economic progress'. Nevertheless, the role that he ascribed to machinery

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in the process of industrial development was a very limited one. 'It is said that now India is going to be industrialised. But industrialisation of my conception has to be carried out in the villages with the *Charkha* plying in every home and cloth being produced in every village' (CW 88: 84). Essentially this is a vision of self-employed villagers producing their subsistence, including food and clothing, by manual labour, using very simple tools and implements. This is very different from industrialisation. He did, it is true, accept that some large scale private industry would continue, for example in the production of cotton textiles. Trusteeship (which is theme of the next section) would help ameliorate its ill effects.

Gandhi's ideas on machinery are closely linked to his concept of Swadeshi. Neither has had any significant effect on economic policy. Developing countries, including India in particular, have not chosen to adopt village industries as an alternative to modern industrialisation. Indirectly, however, Gandhi's ideas about technology have had some influence by providing a warning that mechanisation on Western lines may not necessarily be the optimal solution for countries with a very different resource-endowment. Instead, countries with plentiful labour and relatively little capital might benefit by concentrating on light industries and on labour-intensive techniques for producing their products. In the sense his ideas may have played some part in encouraging the adoption of what has been called intermediate or 'appropriate', technology in highly populated but capital-poor developing counties.

Trusteeship and Industrial Relations

Gandhi's theory of trusteeship was developed as an alternative to doctrines of socialism and communism (the two words are used more or less interchangeably in Gandhi's writings) which started becoming popular in India following the Russian revolution of 1917. These doctrines, wrote Gandhi, had brought to the forefront the question of what 'our' attitude towards the wealthy should be. He took socialist doctrine to mean essentially that the property of the rich – princes, millionaires, big industrialists and landlords – should be confiscated and they should be made to earn their livelihood as workers. Gandhi disagreed. All that one could legitimately expect of the wealthy was to hold their riches 'in trust' and use them for the service of society as a whole. 'To insist upon more would be to kill the goose that laid the golden eggs'.

The rationale of trusteeship was that everything on earth belonged to and was from God. If an individual had more than his 'proportionate' share of wealth, or talent, he became a trustee of that part for the people as a whole. The rich should therefore use their talents to increase their wealth, for the sake of the nation. Trusteeship, thus, was a form of moral responsibility but it was quite different from either charity or benevolence and in a way it was an alternative to them. 'If the trusteeship idea catches philanthropy as we know it will disappear'.

Trusteeship is, by nature, voluntary. The wealthy should come to accept their role as trustees. In the long run trusteeship could also be institutionalised, leading to what Gandhi described as 'statutory trusteeship'. A trustee should be

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able to nominate his successor (CW 83:7), for legal ownership would still be vested in the trustee and not in the state. 'It is to avoid confiscation that the doctrine of trusteeship comes into play, retaining for society the ability of the original owner in his own right' (quoted in Ganguli 1973: 277). However, the trustee's choice of successor would be subject to conditions which would serve both as a check on the individual's choice and as a signal of social approval. Thus, a proprietor who held his property as a trust could not pass it on to his children by inheritance unless the latter agreed to become trustees. If they were not prepared for this, the owner should nominate some other person.

The concept of trusteeship implied among other things that industrial relations should be built on cooperation rather than conflict. The mill owner should stop looking on labour simply as a means of earning profit, but rather as partners in a common enterprise. This implied in particular an obligation on the part of the employers not only to pay a living wage but also to ensure a clean working environment and provide facilities for cheap nutritious food, sanitation and elementary education for workers' children. But trusteeship implied obligations for workers, too. In the prevailing system of industrial relations, while the capitalists tried to obtain maximum work with minimum payment, the workers hit upon various tricks whereby they could get the maximum pay for minimum work. The result was that a rise in wages did not mean an improvement in efficiency. When a system of trusteeship came to prevail, the mill hand would stop nursing ill will towards his employer and come to regard the mill in which he worked as his own. Such an approach had economic as well as ethical merit for if it came to be accepted, strikes and lockouts would become infrequent, productivity would increase, and the costs of maintaining a 'heavy supervisory establishment' to keep workers in order, would no longer be required . Trusteeship could also lead in a natural way to profit-sharing and to workers' participation in management.

In bringing about a change from the existing system of industrial relations, based on a conflict of interest, towards based on trusteeship, it was enlightened industrialists who had to take the lead. Gandhi himself did not regard capital to be the enemy of labour and in principle held their coordination to be 'perfectly possible'. However, as in most things in life, an ideal could only be realised approximately. 'Absolute trusteeship is an abstraction like Euclid's definition of a point, and is equally unattainable. But if we strive for it, we shall go further in realizing a state of equality on earth than by any other method' (quoted in Ganguli 1973: 271). On asking, towards the end of his life, if he knew of any industrialist who had fully lived up to the ideal of trusteeship, Gandhi replied, 'No, though some are striving in that direction'. And while the success of this, as of any, enterprise depended on voluntary participation rather than coercion, Gandhi believed some sanctions were legitimate if some industrialist simply refused to behave as trustees, even after being given every chance. Different kinds of sanction could be applied, depending on circumstances. One was to bring the force of public opinion on erring industrialists to mend their ways. This could be expressed by direct action from

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below, a form of what Gandhi called non-violent non-cooperation. If that too failed to persuade the owners of capital to act as trustees, depriving them of their possessions by the exercise of state power might ultimately become necessary, 'with or without compensation as the case demanded'. However, by and large, peaceful and rational conversion to the principle of trusteeship would remain the norm.

Gandhi put forward two main arguments in support of his belief that trusteeship was a better way of dealing with problems on inequality and exploitation than communism. The first argument was based on the unequal distribution of ability. Gandhi believed that 'although we are all born equal, that is to say, that we have a right to equal opportunities, nevertheless we have not all the same abilities'. Consequently, it was natural that some of us would be more fitted than others to acquire material gain. Entrepreneurial ability was scarce and, properly harnessed, could be socially valuable. If the rich were deprived of their wealth. This is known as Communism', and made to earn their living as manual workers 'Society will become poorer, for it will lose the gifts of a man who knows how to accumulate wealth'. Depriving society of the services of such capable people would not be in the interests of the country, especially if the country itself were poor and underdeveloped. Trusteeship, on the other hand, tries to preserve such abilities while utilizing them for the wider interests of society. Accordingly, Gandhi's advice to the eldest son of a prominent industrialist, who had been a friend and political ally, was that if he was already engaged in business he should remain so, but should use fair means and be trustee. Secondly, Gandhi justified trusteeship by the principle of non-violence. The communist alternative of dispossessing the wealthy of the means of production by confiscating their property violated that principle. The soviet communist system, even though it had some good aims, such as the elimination of exploitation of the poor by the rich, was based on the use of force which was unethical, and because of this Gandhi had strong doubts about his final success

Gandhi has been accused of double standards on this point, for as we have seen he too approved of state ownership of industry if private owners failed to accept a trustee role. However, as elsewhere, he was prepared to accept the lesser of two evils. Private industrialists, he thought, should be encouraged to cooperate with labour in a spirit of partnership and, given a chance, perhaps many would. If trusteeship did not work a *minimum* of state ownership would be necessary as a last resort but Gandhi, unlike the communists, did not regard this as either inevitable or good in itself. He had the greatest fear of the power of the state, which while apparently doing good by the minimization of exploitation can do the greatest harm to mankind by destroying individuality, which lies at the root of all progress (Ganguli 1973: 272). Elsewhere he describes the state as representing violence in a concentrated and organized form. 'The individual has a soul but the State is a soulless machine'. In his opinion 'the violence of private enterprise is less injurious than the violence of the State'. Coercion by the state could only be a necessary evil and trusteeship remained the preferred alternative.

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There was one form of state intervention with property which Gandhi did *not* regard as coercion, namely, high rates of wealth or inheritance taxes.

Riches have not yet been sufficiently taxed. In this, of all the countries in the world, possession of inordinate wealth by individuals should be held as a crime against Indian humanity. In England they have gone as far as 70 per cent of the earnings beyond a prescribed figure. Why should there not be death duties.

Gandhi fails, however, to recognize that the argument based on the scarcity of entrepreneurial talent which he had used against communism, applied in some measure against such 'democratic socialist' methods as well.

Charity, Leisure and the Sanctity of Work

We begin this section by discussing Gandhi's views on charity. As we have seen, he rejected the view that individuals' economic behaviour either was, or should be, guided solely by self-interested preferences. One would therefore have expected him to be favourably disposed towards charity, which economists themselves regards as an exception to their rules; it is the classical example of non-self-interested behaviour. Gandhi's view of charity is more complex, however.

In an early piece of writing, Gandhi quotes in full a well-known passage from the New Testament, 1 Corinthians, 13, which extols the virtue of charity. Gandhi's own writings show quite clearly that he had considerable doubt whether what was usually regarded as charitable action represented a virtue at all. He seems to have taken his cue from two particular statements in the biblical passage he referred to, which suggested that the practice of charity must itself satisfy some other norms in order to qualify as 'true charity'. 'And though I bestow all my goods to the poor and though I give my body to be burned, and have no charity it profits me nothing' and again, '…charity vaunteth not itself, is not puffed up, doth not behave itself unseemly…'. Gandhi, too, did not approve of charity irrespective of consequences. Indeed he took it for granted that charity need not be a good thing. 'There is no reason to believe that charity *per se* is meritorious'. In order to judge whether a particular charitable action is good or bad one must look to its expected consequences for recipients, donors and society at large. The effects that Gandhi was most concerned with were those on the incentive to work. For this reason, the idea of giving free meals to a healthy person who had not worked for it in some honest way was particularly abhorrent to him. Giving free meals to the poor had long been an honoured Hindu custom. It was known as *Sadavrata*, which literally means 'the constant task'. Some European authors had written in praise of *Sadavrata*, saying that the Indians had developed a system of feeding the poor that was self-organized, providing an alternative to the work-house.

Gandhi world have none of this. The system, he maintained, had done no good to India. Indeed, it was an evil custom which had degraded the nation and encouraged idleness, hypocrisy and crime. If food were available without effort, those who were habitually lazy would remain idle and become poorer (CW 28:

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7). Philanthropic businessmen in contemporary India who sought to acquire religious merit by the practice of *Sadavrata* were actually committing a grievous wrong.

During a visit to Calcutta, Gandhi came across hundreds of hungry people being provided with a free meal by a private philanthropist. The sight appeared to him: 'neither ennobling nor honourable to those who had organized the meals for the hungry people of Calcutta from day to day' (CW: 27: 464-5). Perhaps the donors did not know what they were doing but 'were ignorant of the irreparable harm they were doing to India by this misplaced benevolence'. Such misplaced charity according to Gandhi, added nothing to the wealth of the country, whether material or spiritual and only gave a false sense of merit to the donor. For the same reason, he exhorted Parsi millionaires of Bombay not to give all their money to the poor, for did they want to keep those crore of people dependent on their *Sadavratas*.

Gandhi allowed an exception to this condemnation of *Sadavrata*. It was commended for the lame, the crippled and those who were disabled by disease, for such people could not work. Even in this case however, relieving hunger was not the only objective. Preserving dignity and self-respect was no less important. 'Even the disabled should not be fed with thousands of people watching them. There should be a proper place, private and quiet for feeding them' (CW 28:8).

The able bodied poor should have no 'free lunch'. 'By their efforts, by their own work, these people should earn their livelihood and get their clothing, and they must not be taught to depend on others for their necessaries'. Philanthropists who wanted to help could open institutions where meals would be given under clean, healthy surroundings to men and women who would work for them. The ideal work, believed Gandhi, would be spinning cotton but they should be free to choose any other work that was appropriate and feasible. But the rule should be 'No labour, no meal'. The same principle applied to beggars. They should be offered work and food but if they refused to work, they should not be given food.

Those who could not work because of physical disability should be taken to institutions financed by the state, rather than left to live by begging, which only encouraged fraud. The vast majority of street beggars were mere professionals idlers 'when they are not much worse', and those who have money to spare do an ill-service to those beggars and to the country by giving them money, food or clothing.

Gandhi's view of charity is in line with his consequentialist view of ethics. In this respect it differs from the Buddhist view which regards the act of alms-giving as conferring merit on the donor irrespective of consequences. It is also in keeping with Gandhi's ethical 'pluralism'. There are a number of different moral principles which could conflict: the principle of helping others justifies charity to beggars; the principle of self-reliance requires beggars to work. Gandhi's solution is a compromise between the two, an exercise impractical reasoning from ethical principles.

As was usual with Gandhi, his remarks on charity were meant to apply primarily to a specifically Indian context. They have, however, a more general

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aspect. Governments of Western countries are under increasing economic pressure to reform their existing schemes of welfare payments, proposals have recently come up, for example, to link the eligibility of the unemployed to receive a dole to their willingness to work if jobs are provided. Such proposals have been attributed to a narrow 'economic' outlook and criticized on moral grounds. Gandhi would probably have approved of them but for moral rather than strictly economic reasons.

Of some interest, too, are Gandhi's views on leisure. A standard argument in the debate on the costs of economic growth has been that GNP fails to take the value of leisure into account and hence may actually lead to a lowering of the quality of life. Gandhi's position on the role of leisure is somewhat more complex. In a properly functioning economy, he states, everyone would be in a position to enjoy a sufficiency of leisure. Village swaraj is described as a place where 'everybody is a toiler with ample leisure'. On the other hand, the principle of limitation of wants applies just as much to leisure as to the consumption of goods and services. Leisure is 'good and necessary' only up to a point (*Harijan*, 16 May 1936). Beyond that it becomes an indulgence which is contrary to religion and ethics. Too much leisure could erode the human facilities. Whether the leisure was voluntary or involuntary, as in the case of Indian agriculturists who were unemployed for a third of the year, did not, Gandhi believed, make a fundamental difference in this regard. He felt nothing but dread at the prospect of our being able to produce all that we want, including our foodstuffs, 'out of conjurer's hat' so that we could have leisure the livelong day.

This attitude comes out also in some of his writings on machinery, which was referred to in the previous section. Industrial civilization based on the use of machinery could enable greater output to be achieved with reduced working time, a prospect that Gandhi did not welcome. 'I know that socialists would introduce industrialization to the extent of reducing hours to one or two in a day but I do not want it'.

Underlying Gandhi's ideas on charity and on leisure there is a common thread. This is the concept of the sanctity of labour and especially 'bread-labour'. A term Gandhi borrowed from Tolstoy. This implies that every individual should earn the basic necessities, such as food and clothing, by the performance of manual labour. Even those who earn their livelihood by mental labour should do some amount of manual labour.

For Gandhi, the distinction between manual and mental labour was not quite as rigidly drawn as it was for Tolstoy, for physical labour too, provided opportunities for the exercise of intelligence. Intention and purpose were important and could help increase efficiency. Intelligent body labour was the highest form of social services, 'for what can be better than that a man should by his personal labour add to the useful wealth of his country.'

Analytically, the distinction between physical and mental labour was less fundamental for Gandhi than that between work and non-work. It was the sanctity of work as such that lay at the heart of Gandhi's argument.

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Check Your Progress

3. Why did Gandhi develop his theory of trusteeship?
4. What has been the central concern of Indian economic thought?

13.4 E.V. RAMASAMY

EV Ramasamy, popularly known as Periyar, or Thanthai Periyar, was an Indian social activist and politician. He is known for his Self-Respect Movement and Dravidar Kazhagam. He is also known as the 'Father of the Dravidian movement'. He did remarkable work against Brahmin supremacy and gender and class inequality in Tamil Nadu.

Ramasamy started his political career by joining the Indian National Congress in 1919, and when he realised that the party was only working in the interests of Brahmins he resigned in 1925. E.V. Ramasamy propagated the ideology of self–respect, women's rights and the abolition of caste and rationalism. He was against the exploitation and marginalisation of the non-Brahmin Dravidian people of South India and the burden what he considered as Indo-Aryan India. His ideas revolutionized Tamil society by helping to remove caste-discrimination. He also brought new changes to the Tamil alphabet .The UNESCO described him as "The prophet of the new age, the Socrates of South East Asia, father of social reform movement and arch enemy of ignorance ,superstition and meaningless customs'.

Early years

Erode Venkata Ramasamy was born on 17 September 1879 to a Kannada Balija trader family in Erode, then a part of the Coimbatore district of the Madras Presidency. E. V. Ramasamy's father was Venkatappa Nayakar and his mother name was Chinnathyee, Muthammal. He had one elder brother whose name was Krishnaswamy and he also had two sisters named Kannamma and Ponnuthoy. He later came to be known as "Periyar" meaning the 'respected one' or 'elder' in the Tamil.

E. V. Ramasamy married at the age of 19, and had a daughter who only survived for 5 months. His first wife, Nagammai, died in 1933. E.V. Ramasamy married for a second time in July 1948. His second wife, Maniammai, helped him in his social work. And even continued social work after his death in 1973.

In the year 1929, Periyar announced the removal of his caste title *Naicker* from his name at the First Self-Respect Conference of Chengalpattu. He could speak three languages Kannada, Telugu and Tamil. He attended school only for five years after which he joined his father's business at the age of 12. He used to listen to Tamil Vaishnavite gurus who gave discourses in his house enjoying his father's generosity. At a young age, he began questioning the noticeable contradictions in Hindu mythological stories. As Periyar grew, he felt that people

used religion only as a mask to mislead innocent public and therefore decided to alert people against superstitions and priests.

Member of Congress Party (1919–1925)

He resigned from the chairmanship of Erode Municipality and quit his business before joining the Indian National Congress in 1919. After joining the Congress, he sincerely joined positive programs spreading the use of Khadi, picketing toddy shops, boycotting shops selling foreign cloth, and eradicating untouchability. In 1921, he was taken into custody while protesting against toddy shops in Erode. Later on, his wife and his sister also joined the protest, and the administration was forced to come to a compromise. He was once again arrested during the Non-Cooperation movement and the Temperance movement. In 1922, Periyar advocated for reservation in government jobs and education. Hence, he was elected as the President of the Madras Presidency Congress Committee during the Tirupur session, where he advocated for reservation. His attempts were not accepted in the Congress party due to favouritism and indifference, which led him to resigning from the party in 1925.

Vaikom Satyagraha (1924–1925)

According to the existing caste system in Kerala and all over the India, low-caste Hindus were not allowed to enter into temples. In Kerala, they were not even allowed to walk on the roads that led to the temples. In Feb 1924, Periyar decided to promote movements against untouchability. In Kerala, a committee was formed people of different castes to fight untouchability. In 1924, they decided to begin a 'Keralaparyatanam' movement to allow temple door open for everyone and the right to use public roads for every Hindu irrespective of caste or belief. The movement gained support and popularity in all over -India from far and wide.

On 1 October 1924, a group of savarnas (forward castes) submitted a request to the Regent Maharani Sethulakshmi Bai of Travancore with about 25000 signatures to allow everyone entry in the temple. Gandhiji also supported them in this movement and met with the Regent Maharani. This procession of savarnas was led by Mannath Padmanabhan Nair. Vaikom Satyagraha was a Satyagraha against untouchability and caste discrimination in Hindu society.

Thus, protest and demonstrations took place. And as on 14 April, Periyar and his wife Nagamma reached at Vaikom. They were immediately taken into custody and imprisoned for participation. In spite of Gandhi's protest to non-Keralites and non-Hindus taking part, Periyar and his supporters continued to give support to the movement until it was withdrawn. He received the title *Vaikom Veeran*, given by his supporters who participated in the Satyagraha.

Self-respect

Periyar's belief of self-respect was based on his ideology of an ideal world and a unanimously accepted one. The self-respect movement as all the three movement merged into one.

1. Women's right
2. Dalit Resistance
3. Freedom movement

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Periyar advocated for the rights of the women throughout his life; he argued that women should be given their justifiable position in society as the equal of men and that they should be given good education and also have equal right in property as men had. He was eager that women should understand their human rights and be commendable citizens of their country.

He criticised the double standards of society for women and argued that it should apply also to men, or not at all for both genders. While fighting against this, he also advocated getting rid of the Devadasi system.

In 1925, E.V Ramasamy initiated the self-respect movement in Tamil Nadu. It was also called the Dravidan movement which demanded equal rights for the backward caste. According to him, the development of self-respect in an individual will bring a halt to caste-discrimination. His beliefs teach us that human activities should be based on realistic thinking. Freedom means respect to feelings and activities considered correct by human beings on the basis of cause. There is not much difference between 'freedom' and 'self-respect'.

International Travel (1929–1932)

E.V. Ramasamy toured Malaya from December 1929 to January 1930, to spread the *self-respect* beliefs. During the same month, he went to Singapore. In December 1931, he went for a tour of Europe, along with S. Ramanathan and Erode Ramu, to personally educate himself with their political systems, social movements, and way of life, economic and social progress and management of communal bodies. He travelled to Egypt, Greece, Turkey, the Soviet Union, Germany, England, Spain, France and Portugal, stayed in Russia for three months. During his return to India, he halted at Ceylon and returned back by November 1932.

The tour helped him to develop the political ideology of the social concept of Self-Respect. The communist system of the Soviet Union impressed him a lot to deal with the social ills of the country. On socio-economic issues, Periyar was highly influenced by Marxism, but he did not agree with the idea of abolishing private ownership. After his return, he formed an alliance with the communist leader M. Singaravelar, and began to work on socio-political system incorporating communist and self-respect principles.

Opposition to Hindi

In 1937, when Chakravarthi Rajagopalachari became the Chief Minister, he introduced Hindi as an essential language of study in schools. As a result, there was opposition to Hindi all over the state by Tamil politicians and Tamil nationalists. E.V. Ramasamy planned anti-Hindi protests in 1938 which ended with several arrests by the Rajagopalachari government.

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President of the Justice Party (1938–1944)

A political party the South Indian Libertarian Federation (referred to as the Justice Party) was founded in 1916, mainly to go up against the economic and political power of the Brahmin groups. The party's goal was to provide social justice to the non-Brahmin groups. To gain the support of the people, non-Brahmin politicians began to propose the philosophy of equality among non-Brahmin castes. And when the government introduced Hindi to be taught in the school system, E.V. Ramasamy planned opposition to this policy through the Justice Party. After 1937, the Dravidian movement derived considerable support from the student community. Opposition to Hindi played a vital role in the politics of Tamil Nadu. When the Justice Party weakened in mass support, E.V. Ramasamy took over the leadership and become president of the party and was sent to jail for opposing Hindi in 1939.

Dravidar Kazhagam (1944–onwards)

During a party meet in 1944, Periyar, as the leader of the Justice Party, declared that Justice Party would from now onwards be known as the *Dravidar Kazhagam*, or "Dravidian Association". However, others who were disagreed with him started a clone group, claiming to be the actual Justice Party. The *Dravidar Kazhagam* fought for the elimination of untouchability and it also focused their attention on women's education, women's liberation, child marriage, widow marriage, mercy homes and orphanages.

Rationalism

According to E.V. Ramasamy, wisdom lies in thought and any view appealing to reason as a source of knowledge can be considered as rationalism. He stated that no other living being harms or degrades its own class. But man said to be a rational living being, does this evil.

E.V. Ramasamy accused the capitalists to be responsible for their control on machineries and creating problems for labour. According to his beliefs, rationalism, which has to lead the way for peaceful life to all, had resulted in causing poverty and worries to the people because of dominating forces. He said that there is no use of acquiring titles or increasing wealth if one has no self-respect or scientific knowledge.

Social reform and eradication of caste

According to Periyar, the duty of an administration is to run the social organization capably, while the philosophy of religion was to organize the social system. According to Periyar, the Christian and Islamic religions were fulfilling this role, and the Hindu religion is totally unsuitable for social progress.

Periyar advocated for a place where neither the name nor the circumstances or its conditions involve difference among people. He further advocated for the modernisation of villages by providing amenities such as schools, libraries, radio

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stations, roads, bus transport, and police stations. As per Periyar, he felt that a small group of silly people created caste distinctions to rule over Indian society.

Tamil language and writing

According to Periyar, Tamil, Telugu, Malayalam, and Kannada came from the same mother tongue of Old Tamil. He also said that the Tamil language is called by four different names since it is spoken in four different Dravidian states. However, the current understanding of Dravidian languages contradicts such claims.

Periyar also suggested that if words of the North Indian language (Sanskrit) are separated from Telugu, Kannada, and Malayalam, only Tamil will be left. On the Brahmin usage of Tamil, he stated that the Tamil spoken by the Andhras and the Malayali people was far better than the Tamil spoken by the Brahmins. As per his belief, the Tamil language will make the Dravidian people unite under the flag of Tamil culture, and that it will make the Kannadigas, Andhras and the Malayalees be cautious. This will continue until there is an end to North Indian domination.

Comparisons with Gandhi

Periyar and Gandhiji both cooperated and confronted each other in the socio-political sphere. In the Vaikom Satyagraha of 1924, Periyar and his followers give importance to the difference in point of view between Gandhi and himself on the social issues such as fighting against untouchability laws and abolition of the caste system. On the Temple Entry issue, Gandhiji never supported the opening of *Garbha Griha* to *Harijans* as a result of his Hindu belief. Periyar and his followers emphasised that Periyar was the genuine fighter for the elimination of Untouchability and the true fighters for Hairjans, whereas Gandhi was not. But this did not stop Periyar from having trust in Gandhi on certain matters.

Religion and atheism

Periyar opposed the evils of religious influence on society, mainly what he regarded as Brahmin control. At an early age he realised that some people used religion only as a cover to mislead innocent people and considered it as the mission of his life to make people aware against superstition and priests. According to him, Hinduism was a religion with no idiosyncratic holy book or origin, but an imaginary belief preaching the "supremacy" of the Brahmins, and the inferiority of the Shudras, and the untouchability of the Dalits.

In 1955, Periyar was taken into custody for his communal action of burning pictures of Lord Rama in public places as a symbolic objection against the Indo-Aryan domination and degradation of the Dravidian leadership according to the Ramayana epic. According to him, those who belongs to lower caste and are considered untouchable within the Hindu communities should convert to other faiths such as Islam, Christianity, or Buddhism.

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Followers and influence

After Periyar's the death in 1973, his wife become the new head and took the charge of the *Dravidar Kazhagam*, Then Tamil Nadu Chief Minister M. Karunanidhi opened Periyar's Rationalist Library and Research Institute on his birthday. This library contained his rationalist works and manuscripts and also had his recorded speeches. Over the years, Periyar's ideology has influenced Tamil Nadu's party politics. Both the major political parties in Tamil Nadu, DMK and AIDMK, consider themselves to be Dravidian parties inspired by Periyar.

13.5 AMARTYA SEN

Amartya Sen is well known for his book *Development Economics*. In the book, he laid the foundation of welfare economics. He also received the Nobel Prize for his study in welfare economics, becoming the first Indian economist to win the prestigious prize. Many aspects of his research have helped improve the condition of the poorest of the poor. For example, his research about the causes of famine and the remedies provided by him to prevent shortages of food has found practical implementation. Sen has also sought to explain the reason behind famine and stated that in democratic countries famines do not occur frequently. His research also gives information on the lower rate of women employment and the reasons for it. His empirical research paper also influenced international organizations that deal in food crises around the world.

Development Economics

Improving the quality of life and the economic wellbeing of people are the core issues in Sen's thought. According to Sen, rights have to be defined so that citizens particularly the poorer sections of the society can appropriate their rights to the full extent. For him, welfare economics can regulate and formulate policies. It will ensure the wellbeing of the society. He executed certain practical policies for the development of the nation which is based upon capacity and differentiation. According to Sen, this will result in useful alternatives for improving the condition of the poor. For Sen, states have an active role to play as far as the economy is concerned. He said that it could be generalized and regularized for a country's prosperity. Through such policies jobs can be retained and support of incomes can be materialized. This can help in improving quality of life and economic well-being for a community.

Sen in his book *Development Economics* stated that most cases of starvation and famines across the world arise not from people being deprived of things to which they are entitled, but from people not being entitled, in the prevailing legal system of institutional rights, to adequate means for survival'. His research found that in many famines where millions of people have died, there was no overall decline in food availability, and starvation occurred as a consequence of

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shifts in entitlements resulting from exercising rights that were legitimate in legal terms. The inadequate of agricultural productivity and aggregate of food supply can adversely affect a citizen's entitlement to food. The incidence of starvation of deaths among population groups was happened due to entitlement failures and overall food shortages. The people are not able to trade their labour power or skills. This study found inadequate and generalized the situations of insecure food entitlements which does not result from market failure. You will learn more about the linkages of poverty, and starvation in the subsequent sections.



Fig 13.3 *Amartya Sen*

Source: http://en.wikipedia.org/wiki/File:Amartya_Sen_NIH.jpg

Poverty, Equality and Development

A broader understanding of poverty needs to look beyond the income approach. One of the most influential concepts in this regard has been the notion of human capability. According to Amartya Sen, 'Poverty of a life, in this view, lies not merely in the impoverished state in which the person actually lives, but also in the lack of real opportunity given by social constraints as well as personal circumstances-to choose other types of living. Even the relevance of low incomes, meagre possessions, and other aspects of what are standardly seen as economic poverty relates ultimately to their role in curtailing capabilities (that is, their role in severely restricting the choices people have to lead valuable and valued lives)'.

For Sen, the freedom of opportunity available to people is influenced by their personal circumstances as well as social situations. The personal circumstances that significantly matter are not just access to 'means' like income or wealth but also the access to basic needs and amenities, like food, clothing, shelter, education and health services, safe drinking water and sanitation to list a few. Along with these material means of well-being, it is the actual states of well-being or 'outcomes' achieved by the person, like nutritional status, educational and health achievements that also impact upon the real opportunities available.

Sen believes that personal circumstances are found to be embedded in social situations. Social, political and economic relations and inequalities determine how resources are distributed and what choices are available to different sections of the society. Some of the most visible examples of these are based on caste, class and gender disparities that constrain the real opportunities available to people. Deprivations in the form of access to basic needs, actual states of well-being and social inequalities have a great role to play in the creation of economic poverty. On the other hand, economic poverty often reinforces these deprivations. And the circle is difficult to break. Thus, a uni-dimensional approach to poverty as essentially income poverty overlooks the other dimensions of deprivation that makes inequality of opportunity persist and poverty replicate itself.

According to Sen, the major dimensions of poverty that persist in India relate to deprivations in nutritional, educational and health achievements, access to basic needs and amenities, quality of physical environment and various social inequalities like caste and gender disparities. In this context, some of the other targets given in the millennium development goals (MDGs), besides reduction in headcount ratio, give a sense of the challenge facing contemporary India in terms of poverty. Sen has continuously asserted that India's progress has been much slower than needed to meet the targets in the reduction of incidence of mortality and morbidity among women and children, reduction of hunger and improvement in nutritional status, reduction of gender and caste-related disparities and improvement in general living conditions in terms of better access to basic amenities. India may not achieve many of these targets in spite of the likelihood of it becoming an economic superpower by 2015. It means that in the absence of effective measures directed at bridging the gaps, the regions doing better in terms of human development will be better placed to seize the benefits of growth. The result can be one of growing economic inequality in India. Such a scenario cannot be considered conducive (either to the process of rapid economic growth or the prospect of India becoming economic superpower) if the growing inequalities lead to increasing regional and social conflicts within India.

Hunger and Malnutrition in India

According to Sen, hunger and malnutrition are outcomes of food insecurity or the inability to access adequate food and nutrition. Hunger-related poverty remains one of the major deprivations in India. In 2001-03, every fifth Indian (20 per cent) WIIS found to be undernourished. Sen's research found that the rate of decline in the proportion of the undernourished through the 1900s was much slower in comparison to the decline in poverty-headcount ratio. In fact, the proportion of undernourished people remained stagnant at 2 per cent in the second half of the 1990s and the number of the undernourished actually increased. As a result, it is most likely that India is going to miss the millennium development goal in this regard.

For Sen, an even greater cause of concern is the status of malnutrition among children. Malnutrition directly affects the development of the child by retarding

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their physical and cognitive growth and increases the risk of infection and disease. Malnutrition also affects cognitive and motor development in children, thereby influencing educational attainment, labour productivity and future income earning ability. If lack of income means vulnerability to food insecurity and malnutrition, then the latter also reduces the lifetime-earning potential. A recent report stated that about 40 per cent of Indian children are malnourished with another 20 per cent being stunted.

The deprivations relating to hunger and malnutrition, morbidity, mortality and the physical environment often reinforce each other and the general condition of economic poverty. To give an example, an illness like diarrhoea is one of the major causes of infant deaths in India, along with malaria, pneumonia and measles contributing to the high infant-mortality rates. Diarrhoea also leads to loss of absorption of nutrients, causing severe malnutrition among children. On the other hand, malnutrition has been estimated to be associated with about half of all child deaths and more than half of child deaths from diarrhoea (61 per cent). India's achievements in terms of the proportion of population having access to either of these basic facilities are woefully low.

Sen has also stated that there is also gender dimension to hunger and malnutrition in India. Half of the country's women suffer from anaemia and the prevalence of anaemia is even higher among the pregnant women. Anaemia is one of the major causes of maternal mortality and also contributes to nearly 30 per cent of babies being born underweight. The low birth weight means that there is greater risk of growth retardation, most of which occurs by the age of two and is often irreversible. In 1998-99, about 37 million children, almost one half of children below the age of three, were chronically undernourished. Approximately, 18 per cent of the children were severely underweight. Overall, two out of three children were moderately or severely malnourished. A greater prevalence of undernourishment can be seen among the children from scheduled-caste and scheduled-tribe communities. The rate of decline of undernourishment among these sections of the population was also found to be lower in comparison to the general population in the 1990s. It leads to the widening gap in terms of nutritional status among these communities and the general population. A similar observation could be made about the divergence between rural and urban areas, in the 1990s, in terms of nutritional status. The overall picture that emerges is one of growing urban-rural, inter-caste, male-female and economic class disparities in nutritional status in the 1990s.

It is the dark irony of our times that hunger and malnutrition are so pervasive in the country, while the Indian economy has achieved self-sufficiency in food grain production. The Indian government maintains buffer food grain stocks to guard against serious food shortages arising from drought and other crop failures. But in 2001, starvation deaths were reported from various parts of the country as more than 13 states were affected by drought. This happened at a time when the Food Corporation of India was finding it difficult to manage the millions of tonnes

of surplus food grain rotting in its warehouses. Similar cases have been reported in the following years and have led to the 'Right to Food' campaign. Chronic hunger and malnutrition are not as visible and shocking as starvation deaths but they happen to be more widespread and persistent.

Civil and Political Rights: Promoting Economic Security

In his writings, Sen has also argued that civil and political rights can reduce the risk of major social and economic disasters by empowering individuals to complain, ensuring that these views are disseminated, keeping government informed and precipitating a policy response. According to Sen, civil and political rights give people the opportunity to draw attention forcefully to general needs and to demand appropriate public action. Whether and how a government responds to needs and sufferings may well depend on how much pressure is put on it, and the exercise of political rights (such as voting, criticizing, protesting, and so on) can make a real difference. Sen's empirical research has also illustrated the ways in which the denial of civil and political rights can function as an obstacle to human development.

Sen has asserted that civil and political rights can function to promote economic security. He has articulated the view that no major famine has occurred in any country with a democratic form of government. He has suggested that this statement applies not only to the affluent countries of Europe and America, but also to the poor but broadly democratic countries such as India and Botswana; while the incidence of famines in India until independence in 1947 (for example, the Bengal famine in 1943 killed between 2 and 3 million people) contrasts with the post-independence experience following establishment of a multiparty democratic system – providing inter-temporal evidence of the positive impact of democracy in reducing the risk of famine. In order to achieve economic development, Sen said that justice has to inclusive and humane. It helps to remove inequities. To him, justice must be free from the pre-eminence of the will of middle-of-the-road and one that touches lives that people actually live. In the process, it takes global concerns into account for economic development.

Check Your Progress

5. When did Periyar join the Indian National Congress?
6. According to Amartya Sen, what are the major dimensions of poverty that persist in India?

13.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Nehru's ideals of a 'physical planning' as distinguished from financial planning demanded a simultaneous development of agriculture, villages, cottage industries and heavy industry based on a system of harmonizing.

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2. The concept of the Mixed Economy was based on the aim to push forward the development of the productive forces by means of co-existence of a state capitalist and a private capitalist sector and by the application of planning and other regulation measures, to guarantee social progress and create the conditions of the development of native capitalism with the help of the state.
3. Gandhi's theory of trusteeship was developed as an alternative to doctrines of socialism and communism (the two words are used more or less interchangeably in Gandhi's writings) which started becoming popular in India following the Russian revolution of 1917.
4. The central concern of Indian economic thought since Ranade had been the problem of industrialization.
5. Periyar resigned from the chairmanship of Erode Municipality and quit his business before joining the Indian National Congress in 1919.
6. According to Sen, the major dimensions of poverty that persist in India relate to deprivations in nutritional, educational and health achievements, access to basic needs and amenities, quality of physical environment and various social inequalities like caste and gender disparities.

13.7 SUMMARY

- As an Indian student in England, Nehru witnessed the political controversies about the economic development in Europe and Asia. He was politically influenced by Bal Gangadhar Tilak and Bipin Chandra Pal, and was impressed by the personality of Gopal Krishan Gokhale.
- Immediately after being given the responsibility of becoming the first Prime Minister of independent India in 1947, Nehru launched a number of economic reforms. In order to remove economic disparities in India between the landlords and the landless class, he introduced laws regarding land redistribution.
- After winning independent India's first general election, he started the process of centralized planning by introducing the first five-year plan in 1951. The plan determined the mode of government expenditure and grants in important development sectors like agriculture, industries and education.
- Nehru's economic policies have often been considered to be Socialist in nature. There cannot be any doubt that socialism did play a very important role in Nehru's ideological make-up. Similarly, his short visit to the Soviet Union convinced him about the need for India to adopt centralized planning. However, at the same time, it is also significant to note that Nehru himself denied any kind of explicit socialist leanings in the economic policies implemented by him. Nehru advocated a kind of mixed economy.

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- The concept of Mixed Economy was based on the aim to push forward the development of the productive forces by means of co-existence of a state capitalist and a private capitalist sector and by the application of planning and other regulation measures, to guarantee social progress and create the conditions of the development of native capitalism with the help of the state.
- The state sector as the main item of the concept of mixed economy has proved its strategic importance for the strengthening of India's independence and is now one decisive factor of the power and productivity of the national economy.
- A mixed economy usually is an economic system where both the public and the private sector direct the economy. Mixed economies reflect the characteristics of both market driven liberal economies and state controlled socialist economies.
- Nehru favoured the mixed economy approach towards development, but he did not regard the mixed economy as a 'half-way house' between the capitalistic or liberal and the communistic or socialist forms of economic organization.
- For Nehru, the mixed economy was an amalgamation of the two economic systems and since it was free from both their dogmatic approaches, the mixed economy represented a higher form of economic organization.
- Nehru also took the position that the continuous exceptional growth of science and technology that resulted in phenomenal changes in human activity and the modes of production could only be absorbed by the mixed economy, which alone possessed the flexibility and resilience to do so.
- According to Humayum Kabir, Gandhi was an inheritor of the liberal tradition, of the tradition of philosophical anarchism, and of the tradition of collectivism found socialistic thought, that the good thing of life ought to be shared. He would support a welfare state because of his great concern for the masses.
- Gandhi would have liked the Five Years Plans and other method of planned development if they could have originated of the people. But a plan, which increase government post, favouritism, nepotism and opportunities, corruption and laziness, would have been definitely rejected by him. He was, therefore, not in favour on concentration of heavy industries and the grand multipurpose river valley projects which did not benefit the people in the proportion of the huge amounts spent on them.
- Gandhi himself often likens his economic 'model' to Euclid's definition of a straight line but this is consistent with either interpretation. It could mean that like the straight line 'which cannot be drawn' the Gandhian model relates to an ideal economic order where people could well be motivated quite differently from those in any society that we know of. However, it could

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also mean that 'something like' a straight line can be drawn, and in economics as in geometry, the postulational method can help in achieving clarity in thought and in solving real life-problems, for 'we must have a proper picture of what we want before we can have something approaching it'.

- Gandhi was trying to describe an economic ideal to strive for rather than simply an economic plan to implement. To that extent his economics was utopian. However 'utopian' can also refer to something 'impractical' or even 'impossible'.
- Gandhi's economic thought was not 'utopian' in that sense. It was currently meant to apply to an actual society, that of rural India in particular. It would still apply only to a few selected aspects of that society while neglecting others but that is true of *all* economic models.
- From this point of view what really differentiates Gandhi's approach to economic issues from the mainstream tradition is his extraordinary emphasis on the ethical aspect of economic behaviour. Indeed, he believed that economic and ethical questions were inseparable.
- The concept of 'limitation of wants' is a typically Gandhian contribution to the theory of welfare economics. This states that an individual's welfare is best achieved not, as economic theory suggests, by attempting to maximize the satisfaction of multiplicity of desires subject only to the prevailing budget constraint but rather by reflecting on his desires and trying to choose between them.
- The central concern of Indian economic thought since Ranade had been the problem of industrialization. Different views were held on what constrained industrial development in India. All agreed that the industrial development was the log-run solution to poverty and famine. They agreed as well that the development of manufacturing industry on modern Western lines was desirable. Gandhi, on the other hand, did not regard industrialization as a goal that India should adopt. The overall vision which led Gandhi to his doctrines of the limitation of wants and Swadeshi also led him to oppose modern industrial development.
- Gandhi's theory of trusteeship was developed as an alternative to doctrines of socialism and communism (the two words are used more or less interchangeably in Gandhi's writings) which started becoming popular in India following the Russian revolution of 1917. These doctrines, wrote Gandhi, had brought to the forefront the question of what 'our' attitude towards the wealthy should be. He took socialist doctrine to mean essentially that the property of the rich – princes, millionaires, big industrialists and landlords – should be confiscated and they should be made to earn their livelihood as workers. Gandhi disagreed.

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- Gandhi's view of charity is in line with his consequentialist view of ethics. In this respect it differs from the Buddhist view which regards the act of alms-giving as conferring merit on the donor irrespective of consequences. It is also in keeping with Gandhi's ethical 'pluralism'. There are a number of different moral principles which could conflict: the principle of helping others justifies charity to beggars; the principle of self-reliance requires beggars to work. Gandhi's solution is a compromise between the two, an exercise impractical reasoning from ethical principles.
- EV Ramasamy, popularly known as Periyar, or Thanthai Periyar, was an Indian social activist and politician. He is known for his Self-Respect Movement and Dravidar Kazhagam.
- In Feb 1924, Periyar decided to promote movements against untouchability.
- Periyar advocated for the rights of the women throughout his life; he argued that women should be given their justifiable position in society as the equal of men and that they should be given good education and also have equal right in property as men had.
- When the Justice Party weakened in mass support, E.V. Ramasamy took over the leadership and become president of the party and was sent to jail for opposing Hindi in 1939.
- E.V. Ramasamy accused the capitalists to be responsible for their control on machineries and creating problems for labour. According to his beliefs, rationalism, which has to lead the way for peaceful life to all, had resulted in causing poverty and worries to the people because of dominating forces.
- Amartya Sen is well known for his book *Development Economics*. In the book, he laid the foundation of welfare economics. He also received the Nobel Prize for his study in welfare economics, becoming the first Indian economist to win the Nobel Prize in economics. Many aspects of his research have helped improve the condition of the poorest of the poor.
- Sen in his book *Development Economics* stated that most cases of starvation and famines across the world arise not from people being deprived of things to which they are entitled, but from people not being entitled, in the prevailing legal system of institutional rights, to adequate means for survival'.
- His research found that in many famines in which millions of people have died, there was no overall decline in food availability, and starvation occurred as a consequence of shifts in entitlements resulting from exercising rights that were legitimate in legal terms.
- Sen believes that a broader understanding of poverty needs to look beyond the income approach.
- According to Amartya Sen, 'Poverty of a life, in this view, lies not merely in the impoverished state in which the person actually lives, but also in the lack

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of real opportunity given by social constraints as well as personal circumstances-to choose other types of living. Even the relevance of low incomes, meagre possessions, and other aspects of what are standardly seen as economic poverty relates ultimately to their role in curtailing capabilities (that is, their role in severely restricting the choices people have to lead valuable and valued lives)'.

- According to Sen, the major dimensions of poverty that persist in India relate to deprivations in nutritional, educational and health achievements, access to basic needs and amenities, quality of physical environment and various social inequalities like caste and gender disparities.
- According to Sen, hunger and malnutrition are outcomes of food insecurity or the inability to access adequate food and nutrition.
- Hunger-related poverty remains one of the major deprivations in India.
- Sen has also stated that there is also gender dimension to hunger and malnutrition in India. Half of the country's women suffer from anaemia and the prevalence of anaemia is even higher among the pregnant women.

13.8 KEY WORDS

- **Bourgeoisie:** Bourgeoisie is a French term used in the fields of political economy, political philosophy, sociology, and history, which originally denoted the wealthy stratum of the middle class that originated during the latter part of the Middle Ages. In Marxist philosophy, bourgeoisie denotes the social class who owns the means of production, and whose societal concerns are the value of property and the preservation of capital, in order to ensure their economic supremacy in society.
- **Trusteeship:** It refers to an economic policy under which the rich will possess all their wealth in trust for the good of the people.
- **Swaraj:** It means self-rule or home rule.
- **Swadeshi:** Swadeshi is a Hindi term meaning self-sufficiency. During the Indian independence movement the Swadeshi movement was an economic strategy aimed at removing the British Empire from power and improving economic conditions in India by following the principles of Swadeshi which entailed boycotting British products and the revival of domestic products and production processes.
- **Famine:** It refers to a situation of extreme scarcity of food.
- **Welfare economics:** Welfare economics uses microeconomic methods to assess well-being from distribution of productive factors as to desirability and economic efficiency within an economy, often relative to competitive

general equilibrium. It examines social welfare, however measured, in terms of economic activities of the individuals that compose the society that is being considered.

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13.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Discuss the background that framed Nehru's economic thinking.
2. What was Gandhi's philosophical anarchism?
3. What was Gandhi's concept of welfare state?
4. What was Gandhi's view on charity?
5. Write a short-note on the life of Periyar.
6. What was the Vaikom Satyagraha?
7. In what way is hunger-related poverty one of the major problems in India?

Long-Answer Questions

1. At the time of independence, the Indian economy was in an appalling condition. Discuss.
2. Examine the economic policies of Nehru.
3. Nehru did not regard the mixed economy as a 'half-way house' between the capitalistic or liberal and the communistic or socialist forms of economic organization. Discuss.
4. The concept of mixed economy was based on the aim to push forward the development of the productive forces by means of co-existence of a state capitalist and a private capitalist sector. Comment.
5. The Gandhian system of economic thought cannot be adequately appraised merely in terms of current economic theory which rests on certain limited assumptions. Discuss.
6. The concept of 'limitation of wants' is a typically Gandhian contribution to the theory of welfare economics. Discuss.
7. A broader understanding of poverty needs to look beyond the income approach. Discuss.
8. In his writings, Sen has also argued that civil and political rights can reduce the risk of major social and economic disasters. Comment.

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13.10 FURTHER READINGS

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UNIT 14 WELFARE ECONOMICS

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Structure

14.0 Introduction
14.1 Objectives
14.2 Meaning of Welfare Economics
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14.6 Answers to Check Your Progress Questions
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14.0 INTRODUCTION

Welfare economics is the learning of how the distribution of wealth and goods affects social welfare. It communicates straight to the study of financial efficiency and income distribution, as well as how these two aspects affect the overall well-being of people in the economy. In practical terms, the study of welfare economics, includes tools to monitor public policy to attain advantageous social and economic results for all of society. However, this field is a microeconomic study is depended on selected norms regarding how welfare can be defined, measured, and compared for individuals and society as a whole. Reaching the pareto efficiency is considered the ultimate level in welfare economics. Pareto efficiency is the situation of economy where no resources can be used any more to benefit one individual without making another individual worse off in their situation. Aiming a move of taking the economy towards Pareto efficiency might be an overall improvement in the social welfare, but it does not provide a specific target. It does not really mention the manner in which economic resources are to be allocated and used by individuals and markets to really maximize social welfare. Welfare economists to achieve this objective have theorised different types of social welfare functions. The public policy for social welfare is then worked around to maximize the value of these functions. In this unit, you will learn about the meaning of welfare economics and then learn how education, health and poverty affects and functions in the realm of welfare economics.

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14.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the meaning of welfare economics
- Discuss the role of education
- Describe the role of health
- Examine poverty and its relationship with welfare economics

14.2 MEANING OF WELFARE ECONOMICS

Economics has both positive and normative character. In learning the positive aspects of economies, especially in microeconomics, the general concern is optimum allocation of resources at the micro levels, i.e., how individual consumers and firms maximise their objective functions— consumers their utility function and firms their profit function. From the analysis of these aspects of economic theory, it may appear that if all individual firms optimise their resource allocation with a view to maximising their profit function, the total output of goods and services available to the society will be maximum. And, when all individual consumers optimise their resource allocation to maximise their utility function, the total utility enjoyed by the society as a whole will be maximum. In other words, if both firms and consumers maximise their respective objective functions, the total economic welfare of the society will be maximum. This however may not be true because private and public interests can and do conflict. Therefore, optimisation of resource allocation from an individual's point of view may not conform to the tests of optimum allocation of resources from society's point of view. Positive microeconomics leaves unanswered many economic problems regarding maximization of social welfare. Nor does it suggest appropriate policy measures that can maximise the economic well-being of the society as a whole. The branch of economic analysis which is concerned with these problems is called welfare economics.

As regards the origin of welfare economics, it is very difficult to point out the period in the history of economic thoughts which marks the beginning of welfare economics. Nor is it reasonable to associate the emergence of welfare economics with any particular economist, because 'welfare economics does not appear at any time to have wholly engaged the labours of any one economist.'[1] Some believe that Pigou's *Wealth and Welfare* and his later work *Economics of Welfare* mark the emergence of welfare economics as a separate branch of economics. But Hla Myint has pointed out, in his *Theories of Welfare Economics*, that the classical economist had a great deal to say on a subject which could reasonably be brought within the compass of welfare economics. Many textbooks, however, commence discussion on welfare economics with Pareto.

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Definition of Welfare Economics

Welfare economics is the study of economic welfare of the members of a society as a group. In the words of Oscar Lange, 'Welfare economics is concerned with the conditions which determine the total economic welfare of a community.'[2]

Reder defines 'welfare economics' as that 'branch of economics science that attempts to establish and apply the criteria of propriety to economic policies.'[3]

In his survey of welfare economics, Mishan defines 'theoretical welfare economics' as 'that branch of study which endeavours to formulate propositions by which we may rank on the scale of better and worse, alternative economic situations open to society'[4] The function of welfare economics is to evaluate the alternative economic situations and determine whether one economic situation yields greater economic welfare than others. Welfare economics may also be defined as that branch of economic science which evaluates alternative economic situations (i.e., alternative patterns of resource allocations) from the viewpoint of economic well-being of the society as a whole.

Nature of Welfare Economics

Economists hold different views on the question whether welfare economics is a positive (pure) or normative (applied) science. Although welfare economics has been closely associated with positive economics from the inception of economic thinking, 'at one point in economic thought, it was felt that welfare economics was unscientific; that it was normative and was hence a branch of Ethics. . . .'[5] It was also argued that welfare economics is concerned with 'what ought to be' and, hence, it is 'normative' in character. This view, however, has not been universally held.

Pigou, for example, was concerned, in his *Economics of Welfare*, with the causes of economic welfare and did not make any policy recommendation. Pigou's *Economics of Welfare* is, therefore, a positive study.[6]

A widely held view on this issue is that welfare economics is both a positive and a normative science. Positive economics is primarily concerned with understanding, explaining and predicting the working of the economic system. Welfare economics is a positive science insofar as it attempts to explain and predict the outcome of the functioning of the economic system. Welfare propositions 'may be subjected to test in the same way as those of positive economics,' though testing welfare propositions is much more difficult than the propositions of general positive economics.[7] The information gained through positive analysis is useful in devising appropriate policy measures to maximise the welfare of the society. The task of normative economics is to determine 'what ought to be'. Welfare economics is a normative science in that it provides guidelines for policy formulations to maximise social welfare. Maximisation of economic welfare presumes a welfare function which consists essentially of value judgements. Given the welfare function, welfare economics, as a normative science, provides guidelines for appropriate policy measures.

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The Concept and Measurement of Social Welfare

The term 'welfare' has been defined in many diverse ways, perhaps, because it is extremely difficult to give it a precise meaning. The difficulty arises from the fact that welfare of an individual or of a group of individuals depends on diverse and immeasurable factors including social, political, economic and philosophical attitude of the people towards life and society. In economics, however, the concept of welfare is used in a narrow sense: it is limited to only economic welfare. Even the term economic welfare eludes a precise definition. Nevertheless, economists have tried to give it a concrete meaning.

Cardinal Utility Approach: Social Welfare Is Sum of Individual Utility

The concept of economic welfare used in economic literature is synonymous to utility or happiness.[8] The economic welfare of an individual, thus, equals the total utility he derives from the goods and services that he consumes, the leisure that he enjoys, and deeds that he performs, but not all of these. Economic welfare of an individual equals the total utility derived from only those goods and services and only that part of leisure and deeds which can be exchanged for money or can be brought under the measuring rod of money.

On the basis of this concept of individual welfare, Bentham defined social welfare as 'the sum total of the happiness (or welfare) of all the individuals in society.'[9] Following Benthamite doctrine, Pigou defined social welfare as the arithmetic sum of the individual welfare. In a nutshell, social welfare, i.e., the aggregate of welfare of society, was regarded (by the economists of cardinal utility tradition) as the arithmetic sum of the cardinally measurable utilities of the individual members of society.

The concept of social welfare based on cardinal utility has however met with certain serious objections. First, it is argued that utility cannot be cardinally measured and, hence, cannot be added to obtain the aggregate welfare. That is, the concepts that cannot be quantified cannot be added together. It is therefore meaningless to define social welfare as the sum of the individual welfare. This objection is universally accepted. Second, since ordinal measurement of utilities is not possible, interpersonal comparison of utilities is not possible in an objective or scientific way. It would therefore not be possible to determine how a change in existing pattern of resource allocation affects the aggregate welfare unless it is unrealistically assumed that all individuals have identical income utility and commodity utility functions.

Owing to these problems, Benthamite and Pigovian concept of social welfare had become inoperational as it could not be used objectively in any policy formulation. Therefore, the cardinal utilitarian thesis that the welfares of different individuals could be added up to arrive at the welfare of society had to be abandoned.

Pareto's Approach: Social Welfare as Social Optimum

It was Vilfred Pareto, an Italian economist, who broke away from the cardinal utility tradition and gave a new orientation to welfare economics. He rejected

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cardinal utility concept and additive utility function on the ground of their limitations mentioned above. With the rejection of cardinal utility thesis, the attempts to quantify the social welfare ended, at least temporarily, perhaps because welfare is not an observable quantity like a market price or an item of personal consumption.

Pareto introduced a new concept, i.e., the concept of social optimum. This concept is central to Paretian welfare economics. The basic idea behind this concept is that while it is not possible to add up utilities of individuals to arrive at the total social welfare, it is possible to determine whether social welfare is optimum. Conceptually, social welfare is said to be optimum when nobody can be made better-off without making somebody worse-off. In the words of Boulding, 'a social optimum is defined as a situation in which nobody can move to a position which he prefer without moving somebody else to a position which is less preferred.'[10]

The basic point in regard to the concept of social optimum which need to be noted is that social optimum does not define (or determine) a quantity or magnitude of welfare. It is rather associated with the question whether the magnitude of social welfare from a given economic situation can be or cannot be increased by changing the economic situation. The test of increase in social welfare is that at least one person should be made better-off without making anybody else worse-off.

However, it is difficult to conceive economic policies which can improve the welfare of an individual without injuring another. To overcome this problem, the economists, viz., Kaldor, Hicks and Scitovsky, have evolved the compensation principle. This principle states that the person who benefits from an economic policy or reoganisation must be able to compensate the person who becomes worse-off due to this policy and yet remain better-off.

To conclude, modern welfare economics does not attempt to quantify the total social welfare. It concerns itself with only the indicators of change in welfare. It analyses whether total welfare increases or decreases when there is a change in economic situation. This approach is based on the premise that while cardinal measurement of utility is not possible, expression of utility in ordinal sense is possible and it is an adequate guide to change in the welfare of an individual. It is this principle on which the modern welfare criteria are based.

Check Your Progress

1. Why is the following statement considered to be false: 'if both firms and consumers maximise their respective objective functions, the total economic welfare of the society will be maximum'?
2. What are the questions that are unanswered by positive microeconomics?
3. How has Pigou defined social welfare?
4. State the compensation principle given by Kaldor, Hicks and Scitovsky.

14.3 EDUCATION

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Education is related to the growth of human skills and awareness of the individuals or work force. The educational opportunities provide the quantitative expansion as well as the qualitative improvement in the lifestyle of the people. It has a substantial influence in the development of economy. Education is also called as human capital and outlay on education of the persons as outlay in man or human capital. The significance of educational capital or human capital is state by Prof. Harbison in his words as: 'Human resources consti-tute the ultimate basis of production human beings are the active agents who accumulate capital, exploit natural resources, build social, economic and political organisations, and carry forward national development. Clearly, a country which is unable to develop the skills and knowledge of its people and to utilise them effectively in the national economy will be unable to develop anything else.'

The contribution of education in development of economy is huge because no country can achieve rational financial development without focussing and developing their human capital. Training and development improves the comprehension skills and knowledge of the individual as well as the world. It helps in improving the standard of living and provides extensive communal benefits to both the individual and the civilisation. Higher education increases profitability and innovativeness of the individual and inculcates in individuals entrepreneurial initiatives and power-driven developments. These cumulatively add to the development of economy of a nation or state. It undertakes an extremely critical position in safeguarding finances, general progress as well as improving income delivery. Better levels of intellectual skills of residents of the country give enormous optimistic results on the subsequent development of economy. Financial forecasters also acknowledge that investing in education, or human capital, is a critical constituent in the process of a nation financially. Statistical researches provide very deep and reliable confirmation that well educated and professionally skilled experts are more profitable and that they obtain higher incomes. In developing economies, education faces several hurdles in the form of increasingly changing technologies which alters the marketplaces as well as the low availability and access to up-to-date training facilities.

The role of education in the society can be categorised as:

- **Ethical Progress:** Value education or the good education system can be considered to be the basis of personality and ethics in the mind of an individual. Value education teaches humans a sense of modesty, bravery, honesty, acceptance, courteousness, genuineness, fellow-feeling, love, spirit of service and sacrifice and power of judgement between evil and moral which, in actual sense, forms an honourable and intelligent character in humans.

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- **Cultural Growth:** The cultural legacy along with the ancient custom is sturdily conserved and sheltered by education. Ethics are essential in culture and education works for the improvement and superiority of culture. It is recognized that ethics are the lively side of culture. As such, teaching ethics shows a significant role in the cultural development and refinement.
- **Expansion of Optimistic Approach**: Nurturing an optimistic and broader approach is the achievement of education. A good education system broadens the attitude of learners on the way to life. This broader attitude supports them to encounter the difficulties and eventualities of life confidently and bravely. This attitude drives them to be concerned in communal service and compromise their self-centred purposes for a the benefit of the society.
- **Development of Democratic Values**: Value education helps in nurturing democratic qualities like freedom, equality, communal living, righteousness, co-operative living, peaceful co-existence, respect to others, and self-respect, distribution of accountability, etc. These are essentials for the development of a nation and progress of the society.
- **Giving Direction to Nature**: Redirection of human nature towards positive mindset is vital for the development of the individual and the society. Education helps in re-routing of natures and needs for building up of the individual personality and advancement of the society. Education shapes an individual's personality and modifies his behaviour by channelizing his desires, instincts and urges in a desirable direction.
- **Resolving Conflicts and Contradictions:** In our contemporary society information is considered supreme which contributes rise to continuous disputes between conventional and innovative theories, traditional and innovative values of life. Quality education protects the society by carrying out its part as a rescuer help solve clashes among people through informed debates, discussions and facts.
- **Acting as a Basis of Humanitarianism and Altruism**: Quality education is said to be the comprehensive basis of humanitarianism and selflessness. It stands for harmony, goodwill and understanding. It helps in nurturing the association of man and unity and understanding of the world. It dismisses negative traits like discrimination, mistreatment, bribery, tragedy, self-centredness and hot-headedness. Therefore, it forms the basis of altruistic values and altruistic temper. It inspires people to hold the saying 'to live and let live'. Therefore, it leads to contentment, harmony and serenity by refining an enormous trust in superlative values of life-truth, goodness and beauty.
- **Advancement of Personality:** Personality is a part of final truth. To retain it is the need of the hour in order to live in harmony with the definitive truth in the world. Education provides nourishment to the personality for building it for a flawless and honourable use for the sake of the development of the society.

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- **Maintaining Harmony**: Quality education is important for maintaining synchronization among diverse characteristics of personality of the individual. It principally aims at developing the complete man/woman, the complete psychological and sociological creature. As such, different characters are synchronised by importance of education for creating a man/woman complete who can add significantly to the speed of advancement of the society and the nation at large.
- **Creating an Awareness:** Quality education is desirable for producing a sense of realisation to the centre point of man within man in the current culture, which is clear by a movement of de-culturalisation, dehumanization and disaffection from the typical social life. Thus, ethical awareness is essential to be educated by quality education to protect the society from all forms of calamities and misfortunes.

Hence, it is supposed that if the future of the world is to be protected from huge crisis, quality education to children is the finest way. The structure of future world rest on mainly on the basis of values. Education is the excellent pathway over which mass of values can be managed with the students; the promising citizens in a country.

To ensure education for the society, in an economy, the government can many different steps .Major initiatives taken by the Government in the education sector are as follows:

- In 2020, India's public broadcaster Prasar Bharati entered into a MoU with the Ministry of Electronics and Information Technology to launch 51 direct-to-home (DTH) education TV channels.
- The 'KAPILA' Kalam Program for IP (Intellectual Property) Literacy and Awareness Education has been launched, which is expected to create awareness on patenting of inventions.
- Two facilities—Innovation & Incubation Centre and Sports Complex—in IIT Jodhpur has been launched.
- The Strengthening Teaching-Learning and Results for States (STARS) project with a total cost of ₹ 5,718 crore (US$ 775.99 million) has been approved for implementation; the project will also receive financial support worth US$ 500 million from the World Bank.
- An MoU was signed between the Indian Sign Language Research and Training Centre (ISLRTC) and the National Council of Educational Research and Training (NCERT) to provide textbooks and other educational materials in sign language for hearing-impaired children.

- The Gyan Circle Ventures, a MeitY funded Technology Business Incubator (TBI) of Indian Institute of Information Technology, Sri City (Chittoor), Andhra Pradesh has been launched to foster innovation and entrepreneurial spirit in institutions.
- According to Union Budget 2020-21, Government allocated ₹ 59,845 crore (US$ 8.56 billion) for Department of School Education and Literacy.
- Revitalising Infrastructure and Systems in Education (RISE) by 2022 was announced in Union Budget 2020-21 with a proposed outlay of ₹ 3,000 crore (US$ 429.55 million).
- Under Union Budget 2020-21, Government proposed apprenticeship embedded degree/diploma courses by March 2021 in about 150 higher educational institutions.

The achievements of the Government in the past four years:

- In private equity (PE) and venture capital (VC) funding, companies in the education sector attracted US$ 500 million by end of 2019.
- In February 2020, Indian Institute of Technology, Delhi signed a memorandum of understanding (MoU) with New Zealand universities to establish a New Zealand Centre at the institute with an investment of US$ 50,000 each from both parties.
- Central Board of Secondary Education (CBSE) introduced artificial intelligence as a subject in class ninth from the session 2019-20.

14.4 HEALTH

Health has been recognised as a factor which leads to the rise in the wealth of a nation at the individual and community levels. Moreover, it is a definite truth that better health condition influences economic activity and economic growth. The difficulty of involvement of human resources to growth of economy has been the source for numerous debates and studies. Till now education was measured as the key factor of human resource development. Withe reference to the neo-classical theory, the growth of economy is reliant on the subsequent factors of a) Stock of capital, b) Stock of labour c) Productivity. There are four factors of society which is affected by the health: Labour Productivity, Labour Supply, Education and Investment. Let's discuss each of these here in this section.

- **Labour productivity:** Population having a good health status can yield more within a certain defined time period. High production rate is dependent on the health of person along with their physical and mental wellbeing. Persons

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with better status physically and mentally can use technology more effectively and they are likely to be flexible about their job too.

- **Labour supply:** There is direct relation between labour supply and health in some work areas. Good health condition decreases the amount of days spent as sick, therefore increasing the number of productive working days. In this context it impacts results on labour supply along with incomes. In instances where wages are linked to output, a healthy employee can yield more, thus improving wages and through this mode the labour supply. On the contrary, a healthier status assures lifelong incomes as opposed to having to take retirement or quit the job due to health reasons.
- **Education**: According to the theory of human capital, as much as people are educated can reach greater standards in relation to their productivity and incomes. Being healthier can help these individuals attain advanced educational qualifications which will help them increase their productivity in future even more.
- **Investment**: Investment in health affects the country at the micro level but somehow it also has effects at the macro level and the GDP and growth rate of country. The healthier the population tends to be, they will invest more in the areas of economy and if the population is not healthy then the people will spend more on the health treatments and will save less and invest less.

Some of the major initiatives taken by the Government of India to promote Indian healthcare industry are as follows:

- In Union Budget 2020 21, ₹ 35,600 crore has been allotted for nutrition-related programmes.
- The Government has announced ₹ 69,000 crore expenditure for the health sector that is comprehensive of ₹ 6,400 crore for PMJAY in Union Financial plan 2020–21.
- The Government of India aims to increase healthcare spending to 3% of the Gross Domestic Product (GDP) by 2022.
- In February 2019, the Government of India established a new All India Institute of Medical Sciences (AIIMS) at Manethi, District Rewari, Haryana at a cost of ₹ 1,299 crore (US$ 180.04 million).
- The Union Cabinet approved setting up of National Nutrition Mission (NNM) with a three-year budget of ₹ 9,046 crore (US$ 1.29 billion) to monitor, supervise, fix targets and guide the nutrition related interventions across ministries.
- On September 23, 2018, Government of India launched Pradhan Mantri Jan Arogya Yojana (PMJAY), to provide health insurance worth ₹ 500,000 (US$ 7,124.54) to over 100 million families every year.

- In August 2018, the Government of India approved Ayushman Bharat-National Health Protection Mission as a centrally sponsored scheme contributed by both center and state Government at a ratio of 60:40 for all States, 90:10 for hilly Northeastern States and 60:40 for Union Territories with legislature. The center will contribute 100% for Union Territories without legislature.
- The Government of India launched Mission Indradhanush with an aim of improving coverage of immunisation in the country. It aimed to achieve atleast 90% immunisation coverage by December 2018 and cover unvaccinated and partially vaccinated children in rural and urban areas of India.

The achievements of the Government in health sector are as follows:

- As of July 2019, around 125.7 million families enrolled as beneficiaries under Pradhan Mantri Jan Arogya Yojana (PMJAY). The scheme enrolled 16,085 hospitals, including 8,059 private hospitals and 7,980 public hospitals. It included 19 AYUSH packages in the treatment scheme.
- As of September 2019, about 50 lakh people received free treatment under the Ayushman Bharat-Pradhan Mantri Jan Arogya Yojana.
- The number medical colleges in India increased to more than 560 in November 2020 from 412 in Financial Year 2016.
- According to Sample Registration System Bulletin-2016, India has registered a 26.9% reduction in Maternal Mortality Ratio (MMR) since 2013.
- In November 2020, National Telemedicine services completed 8 lakh tele-consultations since its launch, enabling patient-to-doctor consultations from the limits of their home, as well as doctor-to-doctor consultations.

14.5 POVERTY

Poverty is said to exist when persons want resources to fulfil their basic needs. In this framework, the identification of poor requires a proper definition of what constitutes being poor. In one conception, it may be defined as those not having things which are 'essential for existence' or as generally as those 'replicating the dominant standard of living in the community.' The first standard would protect only those people near the margin of hunger or death; the second would extend to people whose nutrition, housing, and clothing, though adequate to preserve life, do not measure up to those of the population as a whole.

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The problem of definition is further compounded by the non-economic connotations that the term poverty has acquired. Poverty has been related, for example, with poor health, low levels of education or skills, an inability or an unwillingness to work, high rates of disruptive or disorderly behaviour, and improvidence. While these qualities have frequently been associated to be with poverty, their presence in the meaning of poverty would tend to make complex the relation between them and the helplessness to provide for one's basic needs. Although poverty is a phenomenon as old as history of humans, its importance has transformed over time. There are different types of poverty that may be categorised on the basis of different factors as time or duration (long- or short-term or cyclical) and distribution (widespread, concentrated, and individual).

- **Cyclical Poverty:** Cyclical poverty denotes to the type of poverty that may be common through the population, but the existence itself is of partial duration. Prices would rise because of scarcities of food, which bring widespread, albeit temporary, misery.
- **Collective Poverty:** In comparison to cyclical poverty, which is provisional, common, collective poverty includes quite an everlasting inadequacy of revenues to protect basic needs. It is a condition that may be as broad as to define the regular level of life in a society or that may be focused in comparatively big groups in an otherwise wealthy society. Both widespread and focused collective poverty may be communicated from generation to generation, parents passing their poverty on to their children.
- **Case Poverty:** Case property is similar to the collective property in terms of its permanent or long-term nature however dissimilar from it in terms of circulation. Case poverty discusses the incompetence of a specific or family to safeguard elementary wants even in communal environments. This incapability is normally connected to the deficiency of some basic aspect that would allow the specific person to maintain himself or herself.

Causes of Poverty

- **Growing Population:** Population is growing in India at a fast speed. This growth is largely due to lessening in death rate and rise in birth rate. The population of India was 84.63 crores in 1991, increased to 102.87 crores in 2001, as per the last census in 2011 was around 121 crores and in 2020 was close to 138 crores. This burden of population shows limitation in the mode of development of economy.
- **Unemployment Rate:** There is a constant rise in population which results into the situation of long-lasting unemployment and disguised unemployment in India. The type of unemployment prevailing in India is the educated

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unemployment and disguised unemployment. Poverty is just the replication of unemployment.

- **Capital Deficiency:** Capital is required for locating up industry, transportation and other plans. Lack of capital creates gaps in development.
- **Under-developed economy:** It is the main cause of poverty. The Indian economy is under-developed due to little proportion of development which means that there is less income and less resources to be re-distributed.
- **Rise in Price:** The upright rise in prices has impacted the deprived critically. They end to become poorer.
- **Net National Income:** The net national income of our country is pretty low in relation to the population. Low per capita income indicates the level of poverty.
- **Rural Economy:** The majority of the economic interest lies in rural areas of economy in India. There is a huge backwardness in Indian agriculture. It has boundless burden of population. The income generated in agriculture is little and disguised unemployment is more in agriculture.
- **Lack of Trained Labour:** In India, untrained labour is in plentiful and skilled labour is fewer because of inadequate industrial education and training.
- **Obsolete Societal foundations:** The societal arrangement of our country is occupied of obsolete customs like caste system, laws of inheritance and succession. These obstruct the development of economy.
- **Lack of effective Industrialists:** For development of industries, intelligent and competent industrialists are desired. In India, there is scarcity of efficient industrialists. Inadequate development of industrial areas is another major cause of poverty.
- **Improper use of Natural Resources:** India has large amount of natural resources like iron, coal, manganese, mica etc. It has continuing flowing rivers that can produce hydroelectricity. There is plenty of human resources. But there is no proper utilisation of the resources available.
- **Lack of Infrastructural Development:** The means of transport and communication have not been correctly developed. There is inadequate road transport and the railway network is less dense in relation to the geographical terrain and the rate of population of India. Due to absence of suitable development of road and rail transport, there are defects in agricultural marketing. Industries do not get power supply and raw materials in time and finished goods are not properly marketed.

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Measures to Eradicate Poverty in India

The following are the measures that can be used to eradicate poverty in India:

- **Control in Population Growth:** There is a rapid increase in the population of India. The population is growing at the rate of 1.8%. For the elimination of poverty, the population growth rate should be pulled down.
- **Growth in Opportunities for Employment:** There should be brought in place different measures to resolve the problems of unemployment and disguised unemployment. There is a need for progress in agriculture. In rural areas, there must be growth of small scale and cottage industries to generate employment.
- **Equitable distribution of Income:** Simple increase in manufacturing and putting regulations on growth of population will not eliminate poverty in India. It is indispensable that inconsistency in the distribution of income should be reduced.
- **Problem of Distribution:** The public distribution system (PDS) should be secured to eradicate poverty. Deprived sections should be able to buy food grains at subsidised rates and in reasonable quantities.
- **Increase in the output of the Deprived:** To eradicate poverty, it is indispensable to intensify the output level of the poor. The poor should be provided with more employment. The investment in the public areas need to be increased and private sectors to generate employment.
- **Alterations in procedures of Production:** India should implement labour intensive techniques of manufacturing. To achieve progress in mechanical fields, the power of our young population should be utilised by providing them employment and basic sustainable level living standards.
- **Constancy in Price Level:** Constancy in price levels helps to eradicate poverty. If prices tend to rise continuously, the poor will become poorer. So the government should do its best to keep the prices under control and take regulatory steps to ensure that the market doesn't become too volatile.

Check Your Progress

5. What are the democratic qualities which can be nurtured through value education?
6. How is there a direct relation between labour supply and health?

14.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

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1. If both firms and consumers maximise their respective objective functions, the total economic welfare of the society will be maximum. This however may not be true because private and public interests can and do conflict.
2. Positive microeconomics leaves unanswered many economic problems regarding maximization of social welfare. Nor does it suggest appropriate policy measures that can maximise the economic well-being of the society as a whole.
3. Pigou defined social welfare as the arithmetic sum of the individual welfare.
4. Kaldor, Hicks and Scitovsky's compensation principle states that the person who benefits from an economic policy or reoganisation must be able to compensate the person who becomes worse-off due to this policy and yet remain better-off.
5. Value education helps in nurturing democratic qualities like freedom, equality, communal living, righteousness, co-operative living, peaceful co-existence, respect to others, and self-respect, distribution of accountability, etc. These are essentials for the development of a nation and progress of the society.
6. There is direct relation between labour supply and health in some work areas. Good health condition decreases the amount of days spent as sick, therefore increasing the number of productive working days.

14.7 SUMMARY

- Optimisation of resource allocation from an individual's point of view may not conform to the tests of optimum allocation of resources from society's point of view.
- Positive microeconomics leaves unanswered many economic problems regarding maximization of social welfare. Nor does it suggest appropriate policy measures that can maximise the economic well-being of the society as a whole. The branch of economic analysis which is concerned with these problems is called welfare economics.
- As regards the origin of welfare economics, it is very difficult to point out the period in the history of economic thoughts which marks the beginning of welfare economics. Nor is it reasonable to associate the emergence of welfare economics with any particular economist, because 'welfare economics does not appear at any time to have wholly engaged the labours of any one economist.'

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- Welfare economics is the study of economic welfare of the members of a society as a group.
- Economists hold different views on the question whether welfare economics is a positive (pure) or normative (applied) science.
- A widely held view on this issue is that welfare economics is both a positive and a normative science.
- The term 'welfare' has been defined in many diverse ways, perhaps, because it is extremely difficult to give it a precise meaning. The difficulty arises from the fact that welfare of an individual or of a group of individuals depends on diverse and immeasurable factors including social, political, economic and philosophical attitude of the people towards life and society.
- The concept of economic welfare used in economic literature is synonymous to utility or happiness. The economic welfare of an individual, thus, equals the total utility he derives from the goods and services that he consumes, the leisure that he enjoys, and deeds that he performs, but not all of these.
- The concept of social welfare based on cardinal utility has however met with certain serious objections. Owing to these problems, Benthamite and Pigovian concept of social welfare had become inoperational as it could not be used objectively in any policy formulation.
- It was Vilfred Pareto, an Italian economist, who broke away from the cardinal utility tradition and gave a new orientation to welfare economics.
- Pareto introduced a new concept, i.e., the concept of social optimum. This concept is central to Paretian welfare economics. The basic idea behind this concept is that while it is not possible to add up utilities of individuals to arrive at the total social welfare, it is possible to determine whether social welfare is optimum.
- Modern welfare economics does not attempt to quantify the total social welfare. It concerns itself with only the indicators of change in welfare. It analyses whether total welfare increases or decreases when there is a change in economic situation.
- Education states to the growth of human skills and awareness of the individuals or work force. The educational opportunities provide the quantitative expansion as well as the qualitative improvement in the lifestyle of the people. It has a substantial influence in the development of economy.

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- Health has been recognised as a factor which leads to the rise in the wealth of a nation at the individual and community levels. Moreover, it is a definite truth that better health condition influences economic activity and economic growth.
- Poverty is said to exist when persons want resources to fulfil their basic needs. In this framework, the identification of poor requires a proper definition of what constitutes being poor.
- The problem of definition is further compounded by the non-economic connotations that the term poverty has acquired.

14.8 KEY WORDS

- **Welfare economics:** It is the study of economic welfare of the members of a society as a group.
- **Economic welfare:** For individuals, it equals the total utility he derives from the goods and services that he consumes, the leisure that he enjoys, and deeds that he performs, but not all of these.

14.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the origin of welfare economics.
2. Briefly explain the nature of welfare economics.
3. Why did the concept of social welfare, based on cardinal utility, meet with certain serious objections?
4. Write a short note on the factors of society which is affected by the health:
5. What are the different types of poverty?

Long-Answer Questions

1. Explain concept and measurement of social welfare including cardinal approach and Pareto's approach.
2. Examine the role of education in our society.
3. Discuss the causes of poverty in India and measures to eradicate it.

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14.10 FURTHER READINGS

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Endnotes

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2. Oscar Lange, "The Foundations of Welfare Economics," Econometrica , Vol. 10, 1942, Reprinted in Readings in

3. M.W. Reder, Studies in the Theory of Welfare Economics (New York, Columbia University Press, 1947), p. 13.

4 E.L. Mishan, "A Survey of Welfare Economics" in Survey of Economic Theory, Vol. 1 (London, Macmillan, 1965), p. 156.

5 Reder, op. cit., p. 13.

6 . M.D. Little has however shown in his A Critique of Welfare Economics (Oxford University Press, 1975) that Pigou's Economics of Welfare cannot be regarded as a purely objective study of the causes of welfare.

7 E.J. Mishan, op. cit. , p. 157.

8 For details see, I.M.D. Little, A Critique of Welfare Economics, Second edn. (Oxford University Press, 1957), Chapter 1.

9 Ibid. , p. 7.

10 K.E. Boulding, "Welfare Economics", in A Survey of Contemporary Economics, Vol. II.