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Hume and Reid on Political Economy*

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Abstract

While Hume had a favorable opinion of the new commercial society, Reid envisioned a utopian system that would eliminate private property and substitute the profit incentive with a system of state-conferred honors. Reid's predilection for a centralized command economy cannot be explained by his alleged discovery of market failures and has to be considered in the context of his moral psychology. Hume tried to explain how the desire for gain that motivates the merchant leads to industry and frugality. These, in their turn, benefit all society. Reid still saw the desire for money as a degenerate form of the desire for power. The contrast between Hume and Reid, however, must not be taken too far. On some particular matters of economic policy, such as paper credit, Hume and Reid eventually came to similar views.

1. Introduction

It is a tempting oversimplification to see in Thomas Reid (1710–96) an archenemy of David Hume (1711–76). According to this view, Reid's various criticisms of Hume's philosophy would be yet another episode of an unending war being played out throughout the

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centuries.[1] Since our age of "culture wars" is not immune from understanding philosophical and theological disputes as having far-reaching practical consequences, it is easy to see Reid and Hume as being at odds on almost every conceivable issue. This view has perhaps some foundation of truth. For example, in the late 1750s and early 1760s, while a regent at King's College, Aberdeen, Reid was busy writing drafts of *An Inquiry into the Human Mind on the Principles of Common Sense* (1764), a book in which he sees Hume's philosophy as the inevitable skeptical outcome of what he calls "the way of ideas." On the back pages of one of the drafts, he was also penning an essay on justice, attacking Hume's view that justice is an artificial virtue. This paper on justice would eventually be expanded into a lengthy chapter of the *Essays on the Active Powers of Man* (1788).[2]

Reid and Hume also had conflicting opinions of the value of the emerging commercial society. It is difficult, however,

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1. In his biography of Reid, Alexander Campbell Fraser speaks of the philosophical alternatives present at the time of his writing as representing "an unending struggle between skeptical distrust of the Universal Power, ignorantly worshipped, and reasonable ethical faith in the Universal Power, with consequent hope for men. It is in Scotland a new form of the war with David Hume to which Reid's life was given. It has been going on since Socrates argued with the Sophists at Athens and since Job justified the morality of Providence among the Eastern emirs" (Alexander Campbell Fraser, *Thomas Reid* [New York: Scribner's Sons, 1898], 155). As can been seen, the two sides of this unending struggle are variously described.

2. See Aberdeen University Library [hereafter referred to as AUL], MS 2131/1/I/1. See *Essays on the Active Powers of Man*, ed. Knud Haakonssen and James A. Harris (Edinburgh: Edinburgh University Press, 2002), essay 5, chap. 5, on pp. 301–27. In this chapter, Reid argues that the right of property is not innate, and yet it follows naturally from the right to life and liberty. There are, however, limits to the exercise of the right of property. Most likely, the notes on the back of AUL MS 2131/1/I/1 are part of a draft of a question discussed by Reid for a meeting of the Aberdeen Philosophical Society on 22 November 1758: "Whether justice be a natural or artificial virtue?"

to find out the precise connection between this disagreement and their more widely studied views in epistemology, ethics, and moral psychology. My ultimate goal is to render intelligible the connections between these philosophers' economic positions and their moral theories. The present essay is to begin this task by focusing on their respective evaluations of the entrepreneur's moral character.[3]

I will also show that the thesis of a constant and inevitable rift between Hume and Reid is not borne out by their views on particular issues of economy policy. Although Reid entertained a maximalist project of abolition of private property, he did offer practical suggestions for promoting welfare without fundamentally altering the state of the society in which he lived. We will thus see that Hume and Reid were closer to each other in their views on paper credit, a contentious issue in the eighteenth century.

2. Reid's Utopia

We are familiar with Hume's qualified but generally favorable view of the nascent commercial society, of what Adam Smith called the "natural system of liberty."[4] Reid, however, like many others, was not enthusiastic about the new commercial society. After all, in his late paper, "Some Thoughts on the Utopian System" (1794), he proposed

3. The expression "entrepreneur" may sound anachronistic when applied to the eighteenth century, and it would be better to speak merely of the emerging class of merchants. But a generic notion of entrepreneur was not unfamiliar, as can be seen from the quote I give below, in section 7, where Reid speaks of "heads capable of contriving and executing schemes of trade more extensive than their own fortunes without credit can enable them to carry on" (AUL MS 2131/2/II/16, fol. 1r). As can be seen from this quote, it also would be proper to distinguish "the capitalist," who lends money at interest, from "the entrepreneur," who conjures up and executes plans in which this money is employed productively in order to yield a profit out of which the capitalist can be paid. However, this distinction is not so important for our characterization of the new commercial mindset on which Hume and Reid had a different opinion.

4. See Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. R. H. Campbell, A. S. Skinner, and W. B. Todd (Oxford: Oxford University Press, 1976), bk. 4, chap. 9, para. 51, in 2:687–88.

an ideal form of government that would necessitate the abolition of private property and a centralized command economy.[5] The profit motive as incentive for productivity would be replaced in this new commonwealth by a system of state-conferred ranks and honors to which the best and brightest could aspire.[6] This form of government would thus discourage greed, the source of so many evils, and would, rather, appeal to the natural desire for public esteem, an affection naturally allied to virtue.[7] At the same time, Reid thought that his utopian protosocialist republic should trade with other countries.[8]

In Reid's mind, the abolition of private property would have as a consequence the abolition of the taxes that the government must levy on private companies and individuals in order to finance its activities. All property would be public, and everybody would work for the government in Reid's republic. This means the disappearance of a whole parasitic sector of the economy: in Reid's system, there would not be any need for corporate lawyers and

5. AUL MS 3061/6, in Thomas Reid, *Practical Ethics: Being Lectures and Papers on Natural Religion, Self-Government, Natural Jurisprudence, and the Law of Nations*, ed. Knud Haakonssen (Princeton, NJ: Princeton University Press, 1990), 277–99. The paper was read at a meeting of the Glasgow Literary Society in 1794.

6. See Reid, *Practical Ethics*, 290–91.

7. Ibid., 282 and 285. A state with a centralized command economy, where all the means of production are owned by the state and no free exchange of goods and services is allowed among its citizens, can be properly called a socialist state Nevertheless, it must be noted that "socialism" was not a category of contemporary analysis understood in Reid's time.

8. Ibid., 292. The utopian republic's trade with other countries would be directed and controlled by the state, and so, strictly speaking, could not be called "free trade." But the republic as a whole would participate in an international market system: "It is obvious that in a Utopian state the Subjects can have no Traffick either with one another or with Foreigners: but the State may be Commercial. It may be so with great advantage; having the whole Stock of the Nation in its disposal. And it ought to be so, that what, in the produce of the Nations Industry is over and above its Consumption, may be disposed of to other Nations or Individuals for its Value & that the Utopians may be supplied with such foreign Commodities as are necessary or convenient" (292).

tax consultants—even better, there would not be any need for most private law, including inheritance law. Thus, the legislative activity of the government would diminish: no private property, no need for laws to regulate it and tax it.[9] With characteristic candor, Reid acknowledges that one drawback of his system might be the expansion of the "executive" branch of the government.[10] In different terms, he rightly predicts an increase in the bureaucracy necessary to keep tabs with whatever people are doing, and with how much they are producing. Like many supporters of centralized command economies ever since, Reid thinks that busybody bureaucrats and "technicians," armed with statistics and census, will solve all problems in the allocation of scarce resources.[11]

9. Ibid., 295.
10. Ibid.
11. Ibid., 294–95. Reid's protosocialist ideas were not original. Reid was influenced primarily by Sir Thomas More's *Utopia*, but also by James Harrington's *Oceana*, and the writings of his Aberdonian friend, William Ogilvie. For a discussion of Reid's utopian scheme and his sources, see the introduction by Knud Haakonssen to Reid, *Practical Ethics*, 76–85; Knud Haakonssen, *Natural Law and Moral Philosophy: From Grotius to the Scottish Enlightenment* (Cambridge: Cambridge University Press, 1996), 216–25; Paul Wood, "Thomas Reid, Natural Philosopher: A Study of Science and Philosophy in the Scottish Enlightenment" (PhD diss., University of Leeds, 1984), 182–86; and Shinichi Nagao, introduction to *Politics and Society in Scottish Thought*, ed. Shinichi Nagao (Exeter: Imprint Academic, 2007), 18–20. Notwithstanding his radical utopian ideals, Reid made clear to his audience in 1794 that he was not advocating any violent revolutionary change to the then-existing system of government: "The Change made at the Revolution in 1688 was violent indeed but necessary. [. . .] Since that time, we have had no Revolution, but such gradual and peaceable changes, by new Laws, as have improved the Constitution and greatly promoted the Prosperity of the Nation; and it is to be hoped we may long continue to have such" (Reid, *Practical Ethics*, 280). According to Reid, two questions have to be distinguished in politics. First, we can ask which form of government best contributes to human happiness. Second, we can ask in which way an existing form of government "can be changed, and reduced to a Form which we think more eligible" (277). At the end of the paper, he further says: "If we see, or think we see, Imperfections in the Constitution or in the Government, we ought to consider that there never was a perfect human Government on Earth; We ought to view such Defects, not with a Censorious and Malignant Eye, but with that Candor and Indulgence

3. The Justification of Reid's Utopian System: Market Failure?

We can make a few observations concerning Reid's utopian system. First, although the system does away with private property, free enterprise, and a free market, its centralized command economy is meant to produce, not an egalitarian society, but rather a society where higher productivity is rewarded by the central committee of experts with a higher rank, and consequently with all the goods proper to that rank. Among these goods, Reid stresses some eighteenth-century status symbols, such as "Servants, Horses, Chariots, Houses and Furniture": their "Splendor and Magnificence" constitute the highest reward that the state can give.[12]

What Reid has in mind is a gigantic rank-awarding bureaucracy, similar to a university or an army encompassing the whole society.[13] Indeed, the primary goal of this system is not simply the most efficient allocation of scarce resources but the promotion of virtue and knowledge in people (these are listed among the subordinate goals of government in his lectures on "police").[14] Reid

with which we perceive the Defects of our Dearest Friends. It is onely Atrocious Conduct that can dissolve the Sacred tie. While that is not the case, every prudent and gentle mean should be used to strengthen and confirm it" (299). Reid had some reason for concern. He had supported the French Revolution and, as late as 1791, he had agreed to serve as steward for a Bastille Day celebration of the "Glasgow Friends of Liberty." The prefatory remarks were published in a journal with the title "Observations on the Dangers of Political Innovation." On Reid's attitudes to reform and revolution, see the works listed above, in this note, by Haakonssen, Nagao, and Wood.

12. Reid, *Practical Ethics*, 291.

13. The comparison with the university is explicit (Reid, *Practical Ethics*, 290).

14. See AUL MS 2131/4/III/9, fol. 2r. According to Reid, the chief ends of political society are (1) security from foreign enemies and (2) the maintenance of peace and justice among subjects. He also recognized some subordinate ends that "tho' not necessary to the being and continuance of it may yet conduce greatly to its well-being & Prosperity" (AUL MS 2131/4/III/9, fol. 2r). Among them, he lists population, virtue, learning and knowledge, riches and opulence, public revenue, and arms. See also AUL MS 2131/4/III/10, fol. 1r.

wants philosophers to be kings (or more simply, he wants the professors of philosophy to be kings).

Second, Reid does not conceive of this republic as a world government; rather, it would exist in a single country, which may then engage in commerce with other countries, if so needed. Reid's system is thus only one of "socialism in one country": countries would continue to trade with each other and draw benefits from this commerce. Reid's prima facie acceptance of "free" trade among countries should make us skeptical of a purely economic explanation of Reid's rejection of a free commercial society. This economic explanation has been suggested by Shinichi Nagao in his comprehensive study of Reid's papers on political economy.[15] According to Nagao, Reid rejected a free market economy because of what he saw as its inevitable failure in efficiently allocating scarce resources.

Nagao's interpretation is brilliant: in his Glasgow lectures on political economy, Reid had come to subscribe to Adam Smith's theory concerning the natural price of commodities.[16] He then noticed the role that expectations

15. See Shinichi Nagao, "The Political Economy of Thomas Reid," *Journal of Scottish Philosophy* 1, no. 1 (2003): 21–33.

16. The first edition of Adam Smith's *Inquiry into the Nature and Causes of the Wealth of Nations* appeared in 1776, but Reid's references to natural price and a labor theory of value in his lectures on "police" are from the 1760s. Nagao conjectures that Reid may have had access to Smith's lecture notes: this is "a very attractive hypothesis" supported by what Reid says in his inaugural lecture delivered on 10 October 1764 (see AUL MS 2131/4/II/9). In this lecture, as Nagao notices, Reid declares his willingness to "borrow light" from his predecessor's theory. Nagao also notices the differences between Reid and Smith: "Reid explained the function of natural price in his lectures. Natural price is defined in terms of the costs of producing a commodity by labour. Reid's definition of natural price looks more simplistic than the one that Smith formulated in his lectures at Glasgow University. It is rather a primitive labour value theory because Reid's natural price includes neither profit not rent" (Nagao, "Political Economy of Reid," 24). Reid's labor theory of value can be found in AUL MSS 4/III/15, fol. 1r–v, and 4/III/17, 1r–2r (in Reid, *Practical Ethics*, 162–66). For a comparison with Smith's labor theory, see Smith, *Wealth of Nations*, bk. 1, chap. 5, in 1:47–64. Reid's labor theory of value is modest in its aim: it states simply that the natural price of commodities is ultimately determined

and inventory play in making actual market prices depart from their natural price. According to Nagao, Reid took these price deviations as instances of the failure of markets in making supply and demand meet: "For Reid, the market prices of commodities fluctuate not only in proportion to changes in demand and supply. In the argument, it looks as if he was trying to demonstrate the unstable nature of market prices."[17] The argument Nagao alludes to is to be found in this example given by Reid:

> Thus Suppose two Countries A & B have a Mutual Commerce in Corn & that Neither of them deals with any Other Country in that Commodity. [Country] A commonly furnishes B with 10.000 Quarters of Wheat & has no more to Spare. In a Certain Year B has a demand for ten thousand Quarters as usual but A can onely spare 7000. I apprehend that in this Case the price would rise more than in the proportion of 7 to 10. [. . .] On the other hand if A has 15.000 quarters to spare and has no other Market than with B this would probably sink the price more than in the proportion of 15 to 10.[18]

In the case of a fall in supply, Reid would suggest, the price will rise more than in proportion to this fall because buyers, predicting a further reduction in supply, will try to buy as much as possible (but the supply will not fall more). In the case of an increase in supply, the price will fall more than in proportion to the increase of supply because sellers, predicting that the demand is much smaller than it is, will try to sell as much as possible (but the demand has not changed). Nagao draws a more general conclusion from this situation:

by the cost of labor, but this latter is still a money price. There is no attempt to reduce money prices to something else.

17. Nagao, "Political Economy of Reid," 27.

18. AUL MS 2131/4/III/15, fol. 2r. Reid lists one factor that would limit the increase in price in the case of a reduction in supply of corn: "However, it must be acknowledged that much would depend upon the possibility or easiness of Supplying the Want of Corn by other provisions" (Ibid.).

> The buyers and sellers of both countries behave according to subjective demand and supply curves that are different from actual ones, because they cannot have exact knowledge of how much the demand and supply will be in the countries where their customers and suppliers are living. [. . .] The results of the exchanges described above are not likely to achieve market equilibrium, for the prices are not determined at the balancing point of demand and supply. Under these conditions, there will be much more unsatisfied demand and unsold goods than those created solely by the movements of demand and supply.[19]

In the next section, I will make a few remarks on Nagao's reconstruction and show that Reid himself never thought that the wheat market example is an instance of market failure. Admittedly, Nagao circumscribes the scope and import of his thesis. First, he acknowledges that Reid does not mention explicitly expectations in the case of the wheat market example. Second, Nagao acknowledges that Reid's argument and the additional arguments Reid makes on inventory are only about short-term changes in prices. These short-term changes are compatible with the long- or medium-term adjustment process whereby natural price is eventually reached.[20] As a result of these remarks, it will become clear that Reid's case against a commercial society cannot be based merely on an argument about its inefficiency in allocating scarce resources.

19. Nagao, "Political Economy of Reid," 28.

20. Nagao says: "There is a possibility that these arguments could have been mounted in order to demonstrate the logical defects of the market mechanism as well as to point out the actual difficulties of determining how much the natural price of a commodity really is." He adds: "The importance of these remarks on price, however, must not be emphasised too much. [. . .] Reid repeats that prices, once they have deviated from natural price, have a tendency to return to it. For, theoretically speaking, his argument is about short-term changes of prices, while Smith's argument is about the long or medium-term adjustment process, a process that presupposes the existence of the movements of capital between sectors. Thus, both could be combined in the same theory. Nevertheless, if the capital flow does not occur for some reason, then the strength of Reid's argument becomes obvious" (Nagao, "Political Economy of Reid," 30).

4. Expectations and Inventory

4.1. Supply and Demand

In his discussion of the wheat market example, Nagao collapses the distinction drawn by Reid between two different mechanisms of price formation. Reid indeed distinguishes the laws of supply and demand from a theory of natural price. In Reid's theory, natural price is ultimately determined by the cost of production, or, more specifically, the cost of the human labor that goes into the production of a good. After mentioning the natural price of commodities, Reid proceeds to isolate further mechanisms in the determination of market prices, and, first of all, supply and demand. Changes in supply and demand make the prices of commodities depart from their natural prices. Thus, the particular case of price formation discussed by Reid in the example above mentioned would at best be a departure from the equilibrium expected according the laws of supply and demand, rather than a departure from natural price. It would not be simply an exception to natural price, but an exception to supply and demand equilibrium—in different words, an exception to the exception. Indeed, Reid introduces the wheat market example just after the exposition of the laws of supply and demand with these words: "The Increase or Decrease of the price of Commodities is not alwise [*sic*] in the Simple proportion of the Causes above mentioned, but Commonly as I apprehend in a Greater."[21] The causes to which Reid alludes are (a) the increase of demand or reduction of supply of a commodity and (b) the reduction of demand or increase of supply of a commodity. While the first makes prices go up, the latter makes prices go down, but, as Reid claims, the change of price is not always in the simple proportion of these causes. It turns out, as I will explain below when I come to discuss the role of inventory, that the wheat market example is not even an objection to the laws of supply and demand, but rather an

[21] AUL MS 2131/4/III/15, fol. 1v.

explication of them. It is in the context of this discussion of inventory that Reid opposes price as determined by supply and demand, to price as determined by natural value.

4.2. Opinions about Supply and Demand

As Nagao himself acknowledges, while Reid explicitly discusses the role of inventory in relation to the wheat market example, he does not explicitly mention the role of expectations.[22] Nagao's reading may be justified by what Reid says in a previous passage of the manuscript whereby he introduces the first law of supply and demand that relates increases in price to a reduction of supply or an increase in demand:

> When Commodities have once come to settle at their Natural price, That price cannot be afterwards increased [. . .] but by an Increase of the Demand or a Decrease of the Commodity. Or at least by a general Opinion of the Increase of the Demand or Decrease of the Commodity.
>
> In either of these cases the fear of the Commodity lying on hand decreases in the Seller & makes him insist on a greater price. The buyer is prompted to offer a higher price lest the Commodity be all taken up by other buyers.[23]

A widespread belief in the increase of demand or in the reduction of supply of a commodity has the same effect as an actual increase of the demand or an actual reduction of supply: this opinion increases the price of the commodity. If we apply this view to Reid's example, a general opinion among buyers and sellers of a reduction in the supply of wheat greater than the actual reduction determines an additional increase in the price of wheat.

Reid mentions "opinion" in his presentation of the second law of supply and demand: "The Decrease of the price

22. Nagao acknowledges that only inventory is mentioned explicitly by Reid in the discussion of the wheat market example. Expectations are mentioned explicitly by Reid in the case of another factor that makes prices depart from natural price, taxation (Nagao, "Political Economy of Reid," 29).

23. AUL MS 2131/4/III/15, fols. 1v–2r.

of a Commodity must [. . .] be occasioned by an Increase of the Commodity or a Decrease of the Demand, either Real or in [the General] opinion."[24] The law tells us that a reduction of demand or an increase of supply makes prices fall. In a similar fashion, a general opinion of the reduction of the demand or of the increase of the supply of a commodity determines a reduction in its price. If we apply this view to Reid's example, a general opinion of a reduction of the demand of wheat, even when the demand for wheat has not actually diminished, determines an additional reduction of its price on top of the reduction of price due to a real increase in its supply.

4.3. Expectations and Supply-Demand Equilibrium

Although Reid says that opinions about the status of demand and supply make prices depart from the equilibrium expected according to real demand and supply, this point is not an objection to the laws of supply and demand. The cases described by Reid describe how equilibrium, as determined by real supply and demand, is eventually reached.

It is certainly unrealistic to think that buyers and sellers always and perfectly know the status of supply and demand, but it is also unrealistic to infer from this obvious fact that actors in the market are always and systematically deluded about the status of supply and demand (unless some explanation is given for this systematic delusion). Reid himself is quick to circumscribe the role played by opinions:

> A General opinion of the Increase of the Demand or Decrease of the Commodity will have the same Effect for a Time. But Commonly Such Opinions if ill founded do not last long in a Civilized Country people being very attentive to their Interest and not easily deceived in that Respect where their passions do not blind them.[25]

[24]. AUL MS 2131/4/III/15, fol. 2r. In this passage, Reid crossed out the words I put in square brackets: "in [the General] opinion."
[25]. Ibid.

Buyers and sellers in "a civilized country" are attentive to their interests and not easily deceived (unless blinded by passions). Hence, they will not be long deluded by wrong opinions. Rather than objecting to the laws of supply and demand, Reid seems here to allude to the harsh but civilizing discipline of the free market. Anybody who indulges in fantasies about changes in supply and demand will be driven out of business by those buyers and sellers who guess right. The account of profits and losses in balance sheets makes people prudent and cool-minded in their dealings.

Let's now address Nagao's point about the role of expectations in the wheat market example. Expectations are opinions about the future status of demand and supply, and therefore about future prices. Buyers and sellers act in the role of speculators whenever they bid prices on the basis of their expectations. Some speculators buy more wheat and bid up its price when they behave in the expectation of a reduction in supply greater than the actual one. They hope that a reduction in supply greater than the actual one will determine a further increase in the price of wheat, from which they will somehow profit. In different terms, these speculators change their demand schedule, but not those buyers who guess right about future supply. In the second case described by Reid, some speculators will try to undersell others in the expectation of a further drop in price. In Reid's description of the expectations of sellers, this drop in price would be the result of a reduction in the demand of wheat greater than the actual one. But those sellers who guess right about future demand will not change their supply schedules.

Eventually, those buyers and sellers who engage in wrong speculations in these two situations would realize that their predictions are mistaken. In the first case, the supply does not fall as much as speculators predicted and a surplus of wheat develops: buyers and sellers start underbidding the misguided speculators and will eventually bring down the price to equilibrium. In the second case, demand has not fallen as much as the misguided speculators predicted, and a shortage of wheat develops: buyers and sellers start overbidding these speculators and will eventually bring up the price to equilibrium. So, both the surplus and the shortage that result from wrong speculations about future prices are the mechanisms that ensure that prices eventually reach the equilibrium predicted by the relative change of supply and demand. It would then really seem remarkable if Reid took these temporary rises and falls above and below the new equilibrium prices as symptomatic of a market failure.[26]

As Nagao suggests, Reid could have constructed such deviations as failures of the laws of supply and demand only by mistaking a temporary deviation from equilibrium price for a permanent deviation from equilibrium price. In other words, Reid would have to have thought that the unregulated free market leads to inefficient allocation of goods, with permanent shortages and gluts. Hence, he could have justified, in mere economic terms, the necessity of a "scientific," centralized, top-down management of the economy of his ideal society.

This interpretation of the role of opinions (or expectations) in the transition between one equilibrium price and another is a feature of Reid's analysis that is worth comparing with what Hume says concerning another case of transition between one equilibrium price and another. In his discussion of the balance of trade, Hume famously analyzes the effects of increases and reductions in the supply of money. A higher supply of money in a market, hypothetically sealed-off from foreign markets, leads to a corresponding reduction of the price of money: fewer units of a good than before are needed to buy a unit of money. That means, in different terms, that a unit of money can buy fewer goods. In short, the money prices of goods rise. Conversely, a smaller supply of money leads to an increase in the price of money: more units of a good than

[26]. My reconstruction of the role of speculation in Reid's wheat market example is based on the discussion of speculation in Murray N. Rothbard, *Man, Economy, and State: A Treatise on Economic Principles*, 2nd ed. (Auburn, AL: Ludwig von Mises Institute, 2004), 130–37.

before are needed to buy a unit of money. That means, in different terms, that a unit of money can buy more units of a good than before. In short, the money prices of goods diminish. Hume then famously proceeds to show how, in an open international market, higher prices at home will make the money leave the country to chase cheaper foreign products, eventually reestablishing the old equilibrium between money and commodities. Lower prices at home, on the other hand, will attract foreign buyers and bring back the money to the old ratio.[27] In this famous analysis of the specie-flow mechanism of the balance of trade, there is no mention of the effect that expectations about the future may have, a point that can be found, at least according to Nagao, in Reid's wheat market example.[28]

27. See David Hume, *Essays: Moral, Political, and Literary*, ed. Eugene F. Miller (Indianapolis, IN: Liberty Fund, 1985), 308–26.

28. According to Murray N. Rothbard, one of the flaws of Hume's analysis of money "was his propensity picked up and magnified by Smith, Ricardo, and the classical school, for leaping from one long-run equilibrium state to another, without bothering about the dynamic process through time by which the real world actually moves from one state to another. It is this brusque neglect (or 'comparative statics') that leads Hume to omit the Cantillonian analysis of micro-changes in cash balances and income, and that causes him to neglect income effects in the price-specie flow mechanism of international monetary adjustment" (Murray N. Rothbard, *Economic Thought before Adam Smith: An Austrian Perspective in the History of Economic Thought, Volume 1* [Auburn, AL.: Ludwig von Mises Institute, 2006], 428). It is beyond the scope of this essay to assess the truth of the particular claims made by Rothbard: we are here only noticing that a neglect of the role played by opinions or expectations in price formation would be compatible with an exclusive focus on long-run equilibrium. A very detailed discussion of the problems raised by trying to distinguish the long-run and short-run effects ensuing respectively from the specie-flow mechanism and the sudden injection of cash from abroad can be found in Margaret Schabas, "Temporal Dimensions in Hume's Monetary Theory," in *David Hume's Political Economy*, ed. Carl Wennerlind and Margaret Schabas (London: Routledge, 2008), 127–45. Schabas also tries to determine whether Hume may have had some awareness of the role of arbitragers in eliminating price differentials (see Schabas, "Temporal Dimensions in Hume's Monetary Theory," 141).

4.4. Inventory and the Mechanism of Supply and Demand

As I pointed out earlier, Reid does not discuss explicitly the role of expectations in relation to the wheat market example, but he does mention the role of inventory. Once seen in this context, the point that he makes is perfectly consistent with the laws of supply and demand. As a matter of fact, it turns out to be an explanation of how the laws of supply and demand actually work in particular cases.

Reid claims that changes in the price of commodities are not in the simple proportion of changes in supply and demand: "The Increase or Decrease of the price of Commodities is not alwise [*sic*] in the Simple proportion of the Causes above mentioned but Commonly as I apprehend in a Greater."[29] Reid then goes on to present the two cases we have seen: a reduction in the supply of wheat from 10.000 to 7.000 quarters increases prices much more than in the proportion of 7 to 10. An increase in supply from 10.000 to 15.000 quarters brings down prices much more than in the proportion of 15 to 10.

While the laws of supply and demand predict that prices will fall or rise in relation to changes in supply and demand, they do not tell us anything about the precise proportions between price changes and changes in supply and demand. These depend on the particular supply and demand schedules for particular commodities at particular times and in particular circumstances.

Consider Reid's second case, the fall of the price of a commodity due to an increase in its supply. Let's imagine that the supply of two kinds of goods having the same price, A and B, doubles. Good A can only be destroyed or stored at a great cost while good B can be stored easily at a low cost. Then the price of A will fall more than the price of B. Moreover, at different times and in different circumstances, sellers may have different supply schedules about the same type of good A. For example, in one market, sellers are "opulent" and will not sell good A below

29. AUL MS 2131/4/III/15, fol. 2r.

a certain price while, in another market, sellers are not "opulent" and therefore are more willing to sell good A at a lower price. The same increase of supply of the same commodity A in the first circumstance will not bring down the price as much as in the latter circumstance.[30] In Reid's terms,

> If the Commodity be such as will not keep to another year or if the Sellers are in such Circumstances as that they cannot keep it, It must be sold at any Rate & the price will fall one half or perhaps more. But if the Corn will keep to another Year & the Sellers in Opulent Circumstances & furnished with Conveniences, they will keep up the price nearly in proportion to the Natural Value. And this will be more easy if the Buyers have also ability & convenience to buy & keep it for one or More Years.[31]

Reid then proceeds to draw two general lessons. The first lesson is about shifts in the supply and demand schedules of goods that can be stored: in this case, it is the nature itself of a commodity that determines the particular way its price responds to changes in supply and demand. The second lesson is about the difference that the "opulence" and skills in "management" of sellers and buyers make to the supply and demand schedules of a good: in this case, circumstances about the actors in the market determine the way price responds to changes in supply and demand. Reid continues:

> 18. Hence, it is obvious that Commodities that may be long kept do not rise or fall in their prices so much in proportion to the Causes above mentioned as those which cannot be long kept.

30. In the first case, the supply curve is bent more toward the horizontal axis: if the demand curve remains the same, a shift to the right of the supply curve (i.e., an increase of supply) will not lower the price to a great extent. In the second case, the supply curve is bent more toward the vertical axis: if the demand curve remains the same, a shift to the right of the supply curve will lower the price to a greater extent.
31. AUL MS 2131/4/III/15, fols. 2r–2v.

> 19. It is likewise Evident that the Opulence of the Buyers & Sellers & their Accomodations for Store are a Means of preventing the fall or Rise of Commodities that may be kept.
>
> 20. Vice versa, a great Rise or fall of such Commodities as are mentioned in the last article above or below their Natural Value is an Indication of Poverty or Bad Management in the Dealers that suffer by it.[32]

Reid here explicitly speaks of a departure from the "natural value" of a commodity, where natural value is determined by the cost of labor, or, in more general terms, the cost of production. In general, changes in either supply or demand make the price of a commodity depart from its natural price. However, in the case of commodities that may be kept in storage, changes in supply and demand may not cause a significant rise or fall from price as determined by natural value (points 18 and 19 in the quotation above). Various factors, then, affect the precise way the equilibrium based on supply and demand is determined: (1) the nature of the commodity, in particular, whether it may be stored or not; (2) if the commodity can be stored, the actual ability or inability of buyers and sellers to store it ("the Accomodations made for Store" together with what looks like their opposite, the "Bad Management in the Dealers"); and (3) the "Opulence" or "Poverty" of the sellers and buyers.[33]

Given these circumstances, it may then turn out that an increase in supply or reduction in demand of a commodity that can be stored may not cause a significant fall from the natural price as determined by cost of production. In its turn, a reduction in supply or increase in demand of a commodity that can be stored may not cause a significant rise in price above the natural price as determined by cost of production. More precisely, Reid may have thought that, in the case of commodities that can be stored, various

32. Ibid., fol. 2v.

33. The opulence of sellers and buyers is a circumstance that may affect their ability to store the commodity.

scenarios may occur that prevent a significant rise or fall of the price from an antecedent price level. We can try to reconstruct what Reid had in mind and distinguish six cases:

(1) An increase in the quantity produced (output) does not determine an increase in supply, since the surplus is stored by the sellers: thus the price remains the same as the previous one.

(2) In the case of a reduced demand, the sellers reduce their supply (and store the quantity not supplied): the price-lowering effect of a reduced demand is counteracted by the price-raising effect of a lower supply and thus the sellers manage to keep the price close to the previous one.

(3) In case of a lower supply, the buyers, who have stored the commodity, reduce their demand and consume the stored goods: the price-raising effect of a lower supply is counteracted by the price-lowering effect of a diminished demand and thus the buyers manage to keep the price close to the previous level.

(4) In case of a higher demand, the sellers bring the stored goods to the market: the price-raising effect of an increase in demand is counteracted by the price-lowering effect of an increase in supply and thus the price does not change much from the previous level.

(5) In case of an increase in supply, the buyers, who are opulent and have made accommodations for store, increase their demand: the price-lowering effect of an increase of supply is counteracted by the price-raising effect of an increase of demand and thus the price does not change much from the previous level.

(6) A higher consumption among buyers does not cause a higher demand, since the buyers are consuming the goods they have stored in the past: the price remains the same as the previous one.

In all these cases, markets clear at the point of equilibrium between demand and supply. Whatever part of goods remains in the inventory of either the sellers or the buyers does not come to the market and so, strictly speaking, is neither supplied nor demanded. Thus, there are no shortages or surpluses: the buyers manage to buy all the goods they were willing to buy at that price, and the sellers manage to sell all the goods they were willing to sell at that price. The equilibrium price would remain roughly the same as the original one (and exactly identical in cases 1 and 6). The equilibrium quantity of goods sold and bought will be (a) the same as the original quantity in cases 1 and 6, (b) smaller than the original one in cases 2 and 3, and (c) larger than the original one in cases 4 and 5.[34]

We can also notice that in the case of goods that can be stored, cases 1 and 6 may occur: (1) a higher output by itself does not bring about a higher supply, and (6) a higher consumption by itself does not bring about a higher demand. In describing the operation of supply and demand in price formation, Reid speaks explicitly of an increase and decrease of demand, but, in the case of supply, he uses more ambiguous expressions: "increase" or "decrease" of the commodity. These expressions may refer

34. According to Nagao, inventory would either (1) keep the price "higher than market equilibrium" or (2) "stop the unnecessary decrease of prices below equilibrium." In Nagao's reconstruction, the term "equilibrium" stands for "natural price"; that is, equilibrium as determined by the cost of production. In the short run, the sellers, by withholding the good they have produced, can sell it for a price higher than the one approximating the cost of production (the demand remaining the same as before): in this case, the price is determined by equilibrium of supply and demand, but this price could be much higher than cost of production. Inventory also prevents "an unnecessary decrease of prices below equilibrium." Presumably, the decrease from natural price equilibrium would be "unnecessary," in the sense that it is not desirable for the survival of the firm, since the total cost of production has not gone down at the same time. It is not clear what scenarios Nagao envisions. It may be the case of a reduced demand, where the sellers, by withholding the good from the market, can keep the price from falling below the previous equilibrium level. However, since the sellers would sell fewer units of the good than before, they would probably not be able to cover the costs of production. Or it may be the case of a reduced supply unaccompanied by a reduction in the total cost of production (and this would amount to an actual increase of the cost of production per unit of good). In this case, an increase in demand from the previous level may keep up the price to the previous level and may save the firm from failure (see Nagao, "Political Economy of Reid," 29–30).

simply to the increase or decrease of quantity produced (that is, the output). An increase or decrease of output does not always lead to an increase or decrease of supply, as we have seen in the case of storable goods. In a similar manner, Reid may have used the term "demand" somewhat ambiguously: what is now called demand presupposes the willingness and ability on the part of buyers to spend certain amounts of money for certain quantities of a commodity. Reid may still have confused this notion with the simple desire for the commodity. An increase in demand, understood as a mere increase of the desire to consume more of a commodity, does not always translate into a willingness and ability to buy certain quantities of a good at certain prices, as can be seen in case 6, above: in that case, an increase in the desire for a commodity leads to an increase in the consumption of the stored commodity without changes in the demand schedule of the buyers.[35]

To sum up, once properly understood, the case of storable goods does not involve any shortage or surplus, and thus any failure of the markets to satisfy demand or allocate supply: markets clear at the equilibrium point of supply and demand. What is clear in Reid's text, and Nagao points this out in his article, is a distinction between short-term equilibrium, where markets adjust to variations in supply and demand, and long-term equilibrium, which is based on the cost of production.[36] Reid describes how the supply

35. Consider another instance of difference between desire and demand: a poor person may strongly desire to consume some good without at the same time being willing and able to pay anything for it. In this case, there would be an unsatisfied desire but no unsatisfied demand. The paradigmatic case of unsatisfied demand is a shortage brought about by a price ceiling imposed by the government: a certain quantity of a good is offered at a certain price imposed by the government, but not enough quantity can be supplied to meet the demand of all people who want to buy the good at that price.

36. See Nagao, "Political Economy of Reid," 30. Nagao also considers another case where the seller, by storing the commodity, makes the price go above the natural price. Reid mentions the case of a tax levied on glass. In this case, the price set by the seller was above the rate of increase in the seller's expense as determined by the tax. This can happen for two reasons: (1) the seller represents the tax increase as

schedule and the demand schedule are actually formed in real markets and therefore how market-clearing prices are formed in the short run. In describing the mechanisms of supply and demand, he is aware that various factors determine what the supply schedule of the sellers and the demand schedule of the buyers will be. He remains confident, however, that price in the long run is determined by natural value: "When Commodities by any of the Causes Mentioned are raised above or brought below their Natural Value they have still a tendency to return to it in the Natural Course of Things."[37] For example, if the sellers decide to

being heavier than it is in order to increase the profit margin; (2) the seller withholds some of the goods foreseeing a drop in demand among buyers as a result of the price increase caused by the tax itself (so this is an instance of a wrong expectation about the size of the demand). Thus, by withholding the good, the seller eventually sends the price higher than the expense incurred because of the tax. Nagao includes this case in the section about inventory, as an example of how both expectations and inventory lead to "an unnecessary reduction in supply" and "a superfluous growth in demand" (see AUL MS 2131/4/III/15, fol. 2v, and Nagao, "Political Economy of Reid," 29). But if this case is construed as a failure of markets, then the government that introduced the tax should be held responsible for it.

37. AUL MS 2131/4/III/15, fol. 2v. Nagao notices that this description of the price mechanism is "expressed in exactly the same phrase as Smith's" (Nagao, "Political Economy of Reid," 24). In the remainder of the manuscript, Reid goes on to enumerate other factors that affect prices, beside natural value and the mechanisms of supply and demand. He is confident, however, that price in the long run is determined by natural value. See Nagao, "Political Economy of Reid," 29–30, for Reid's complete list of factors affecting prices. According to Nagao, Reid's papers include the following factors: (1) changes in demand and supply; (2) taxation; (3) changes in the living expenses of workers, including ones from cultural reasons; (4) the role of expectations; and (5) the amount of liquidity accessible to sellers and buyers (what Reid calls "opulence"). We have seen how factors 4 and 5 are either compatible with or reducible to factor 1, changes in demand and supply. On Reid's price theory, see also AUL MSS 2131/4/III/4, 2131/4/III/10, and 2131/4/III/17 (MSS 2131/4/III/4 and 2131/4/III/17 have been published in Reid, *Practical Ethics*, 160–66). From these manuscripts, it appears that Reid, while endorsing the labor theory of value, rejects the view that there is an objective and permanent measure of labor. In this regard, Haakonssen observes that "Reid's attempt to combine a traditional subjective analysis of the concept of value with a labor concept of the measure of

withhold part of the output and reduce their supply, they can raise the price of their commodity well above the price determined by the cost of production. This would be the short-term effect of a reduced supply, provided the demand remains the same as before. But, in an open economy with movements of capital among various sectors, competitors will eventually enter the market for that commodity: the supply will increase and the price will tend to fall back to a level approximating the cost of production.

5. The Love of Riches in Hume and Reid

As Nagao himself has shown, Reid's manuscripts can be read as simply pointing to the temporary deviations from the natural price that eventually obtains: as we have seen, Reid explicitly claims that eventually the natural price prevails. Nor do we find any reference to market failure as a justification for government intervention in Reid's paper on the utopian system of government.[38]

Reid's papers, to be sure, bear witness to his inclination to advocate government interventions and regulations in various sectors of the economy.[39] But beyond the economic

value should be compared with Adam Smith's famous and controversial attempt in the same direction" (Reid, *Practical Ethics*, 350n108). Thus factor 3—changes in the living expenses of the workers, including ones from cultural reasons—is part and parcel of Reid's labor theory of value: the natural price of a commodity reflects the price of labor. This is still a money price, and it can change according to the different historical conditions of society, including the mutable opinions about the tenor of life that certain categories of workers are expected to have.

38. Reid, however, is confident about the economic superiority of the utopian system. By keeping registers of what is produced and consumed, the government would be able to allocate scarce resources in a more efficient manner than in a society where production and distribution is left to the free initiative of individuals (see Reid, *Practical Ethics*, 294–95).

39. Two questions discussed by Reid for the Aberdeen Philosophical Society include several examples of policy recommendations to the government. See AUL MS 2131/6/I/13, "What are the Best Expedients for preventing an extravagant rise of Servants' Wages & for obliging them to bestow their labour when Agriculture and Manufactures require it" (12 January 1762), and AUL MS 2131/2/II/17, "Whether By proper

reasons that might have made Reid suspicious of commercial society, there are more fundamental reasons for his distaste: these are his views on moral psychology. Here, the comparison with Hume is enlightening.

In the classic liberal tradition, it is not unusual to defend a free market system either by showing that such an order respects the fundamental rights of every person (in particular, property rights) or by showing that this is the best system for bringing about the greatest material prosperity for the greatest number of people. But these considerations do not seem to be central to Hume's defense of commercial society. In the essay on commerce, a comparison is drawn with ancient polities. These states were able to rely on the martial spirit and the sense of civic duty of their citizens for their defense and expansion. Hume defends modern commercial society by arguing that its higher efficiency can be exploited by the state for its own goals. In case of war, fully employed factors of production that would remain idle in a poorer society can be diverted to war. Even in times of peace, the higher prosperity of civil society can be exploited by the state through taxation. So it seems that what is great about trade and manufacture is that they provide a larger tax base on which the state can draw.[40]

Along with this political justification of commercial society, we find a moral justification. Commerce, so Hume argues, makes people more industrious and frugal. Hume's accent is not only on the material prosperity that the exercise of these virtues brings about.[41] Hume also claims that the increase of industry, characteristic of the new commercial society, eventually leads to an increase of knowledge and humanity among people.[42] Whereas Hume's approval

Laws the number of Births in every parish might not be doubled, or at least greatly increased?" (8 June 1762).

40. See Hume, *Essays*, 253–67 and 272.

41. Ibid., 301.

42. The demand for "luxury" goods in commercial societies brings about a general increase in industry, knowledge, and humanity among people (see Hume, *Essays*, 270–71).

of frugality is qualified—too much frugality would thwart the incentive to work harder in order to get rich—he gives the impression of approving of industry as a superior moral trait, no matter what its consequences may be.[43]

Eugene Rotwein, in his study of Hume's economic psychology, has drawn a comparison with other cases, on the basis of which he thinks Hume could understand the "love of riches" that animates the merchant and, more generally, the capitalist entrepreneur.[44]

Hume first considers riches in the context of his analysis of the indirect passions of pride and humility in Book 2 of the *Treatise of Human Nature*. Here, the desire of riches is seen as a species of the desire of power: "Now riches are to be consider'd as the power of acquiring the property of what pleases; and 'tis only in this view they have any influence on the passions"[45] What pleases, by being associated to one person by the relation of property, eventually causes the passion of pride by the mechanism of double association of ideas and impressions. Hence, power, as a

43. While Hume's approval of industry and condemnation of indolence are a constant feature of his writings, the approval of frugality is qualified: in one essay, "Of Interest," he paired frugality and industry as characteristic virtues of the merchant; other industrious professions—he mentions lawyers and physicians—beget frugality in their practitioners, but only merchants beget industry "by serving as canals to convey it through every corner of the state" (*Essays*, 301). In other terms, merchants make everybody more industrious, either directly by providing employment to people or indirectly by giving an incentive to people to work harder in order to produce commodities than can be bought. Thus, a certain degree of demand for "luxury" goods is an incentive to industry among people. By their frugality, merchants acquire power over that industry and accumulate large stocks of money. On the contrary, the excessive "prodigality and expence" of the old landed gentry prevented the accumulation of capital (see *Essays*, 301–2). On the centrality of the concept of industry ("diligent, systematic, intelligent labor") in Hume, see Carl Wennerlind, "The Role of Political Economy in Hume's Moral Philosophy," *Hume Studies* 37, no. 1 (2011): 43–64.

44. See David Hume, *Writings on Economics*, ed. Eugene Rotwein (New Brunswick, NJ: Transaction Publishers, 2007), xxxii–liii.

45. David Hume, *A Treatise of Human Nature*, ed. David Fate Norton and Mary J. Norton (Oxford: Oxford University Press, 2000), bk. 2, pt. 1, sec. 10, on p. 203.

means of acquiring the property of an object, can produce effects that are similar to the actual property of the object: some kind of pleasure similar to the pleasure derived from the object and the indirect passion of pride. The miser feels happy at the possession of money, even if he never actually gets to spend the money on things that can give him pleasure. As long as he imagines that he can always spend the money to acquire what pleases him, he will be happy:

> A miser receives delight from his money; that is, from the *power* it affords him of procuring all the pleasures and conveniences of life, tho' he knows he has enjoy'd his riches for forty years without ever employing them; and consequently cannot conclude by any species of reasoning, that the real existence of these pleasures is nearer, than if he were entirely depriv'd of all his possessions. But tho' he cannot form any such conclusion in a way of reasoning concerning the nearer approach of the pleasure, 'tis certain he *imagines* it to approach nearer, whenever all external obstacles are remov'd, along with the more powerful motives of interest and danger, which oppose it.[46]

However, the miser who hoards money, who never spends nor lends to anybody, is different from the capitalist entrepreneur who spends money (or lends it at interest) in order to gain more money than what he has now.[47] In order to explain the peculiar psychology of the capitalist entrepreneur, Rotwein considers the section "Of curiosity, or the love of truth," in part 3, book 2, of the *Treatise*. Here Hume argues that a philosopher's or scientist's[48] ultimate goal, knowledge, just sets the passion for learning in motion, but what really seems to give enjoyment is the exercise of genius, the difficulty of the process of learning.[49]

46. Ibid., bk. 2, pt. 1, sec. 10, on pp. 204–5.

47. Hoarding may have an indirect beneficial effect on the economy by diminishing the quantity of money in circulation and thereby lowering prices: see, below, section 6.

48. The term "philosopher" used by Hume includes the "natural philosopher," as was common at the time.

49. In Hume's terminology, a direct passion, the desire of an object, seems ultimately to produce a desire for the action that usually brings

The experience described by Hume is a familiar one: what really excites the philosopher or scientist is the search after truth, rather than the ultimate possession of truth and its utility. One would not find as much satisfaction in getting to know from somebody else the solution to a difficult problem as in finding it by oneself. In a similar way, Hume says, what makes hunting interesting is not so much the

about the object. The vivacity of one passion gets transferred to, or drained into, an associated passion. The process is facilitated by the fact that action, in general, is enjoyable, insofar as it "quickens" and "enlivens" the spirits. It may also be argued that the desire for action is primary and the desire for the end merely plays an instrumental role. In this regard, Rotwein distinguishes two different interpretations of avarice or the desire for gain. One interpretation makes the desire to acquire money depend on the association that money has with the pleasures it can buy. A different interpretation links the desire for gain "not to the desire for pleasure but rather to the pursuit of 'lucrative employment' *qua* action" (Hume, *Writings on Economics*, xlv). The desire for action would be primary, and the desire for wealth would be merely "an instrumental end." As Rotwein claims, "[T]he fundamental motive here at work is the desire for action, while the desire for the apparent 'end' is but an 'image' of the passion" (Hume, *Writings on Economics*, xlv). Rotwein refers to the parallel drawn by Hume between the love of truth and the love of hunting. Hume says that the utility or importance of the end pursued "causes no real passion, but is only requisite to support the imagination; and the same person, who over-looks a ten times greater profit in any other subject, is pleased to bring home half a dozen woodcocks or plovers, after having employ'd several hours in hunting after them" (Hume, *Treatise*, bk. 2, pt. 3, sec. 10, on pp. 288–89). However, as Rotwein points out, Hume thinks that we may eventually acquire an interest in the end insofar as it is "a token of the action successfully consummated" (Hume, *Writings on Economics*, xlvi). Rotwein quotes this passage by Hume: "To make the parallel betwixt hunting and philosophy more compleat, we may observe, that tho' in both cases the end of our action may in itself be despis'd, yet in the heat of action we acquire such an attention to this end, that we are uneasy under any disappointments, and are sorry when we either miss our game, or fall into any error of reasoning" (Hume, *Treatise*, bk. 2, pt. 3, sec. 10, on p. 289). A few paragraphs before, Hume makes the general point on which this remark depends: "[W]here the mind pursues any end with passion; tho' that passion be not deriv'd from the end, but merely from the action and pursuit; yet by the natural course of affections, we acquire a concern for the end itself, and are uneasy under any disappointment we meet with in the pursuit of it" (Hume, *Treatise*, bk. 2, pt. 3, sec. 10, on p. 288).

object pursued. What makes hunting exciting is precisely the difficulty of it. However, the idea of utility of the object pursued remains important, since the hunter, so Hume thinks, would not engage in the pursuit if he knew that partridges and pheasants are of no use to anybody:

> 'Tis evident, that the pleasure of hunting consists in the action of the mind and body; the motion, the attention, the difficulty, and the uncertainty. 'Tis evident likewise, that these actions must be attended with an idea of utility, in order to their having any effect upon us. A man of the greatest fortune, and the farthest remov'd from avarice, tho' he takes a pleasure in hunting after partridges and pheasants, feels no satisfaction in shooting crows or magpies; and that because he considers the first as fit for the table, and the other as entirely useless.[50]

In a similar manner, the idea of truth fixes the attention of the philosophers and scientists. As Hume remarks,

> The truth we discover must also be of some importance. 'Tis easy to multiply algebraical problems to infinity, nor is there any end in the discovery of the proportions of conic sections; tho' few mathematicians take any pleasure in these researches, but turn their thoughts to what is more useful and important.[51]

A similar psychological mechanism is at work in gaming, and by extension, as Rotwein thinks, can be seen at work in the activity of the merchant and the capitalist entrepreneur.

What is remarkable about this mechanism is that the interest in the goal that is pursued gives way to an interest in the action. At the same time, the interest in the action can only be sustained by the idea of the utility of the object pursued. Greed eventually leads to industry and frugality, which are required to multiply riches. These, by way of capital accumulation, benefit all society. Thus, the industrious and frugal merchant is neither a miser nor a

50. Hume, *Treatise*, bk. 2, pt. 3, sec. 10, on p. 288.
51. Ibid., bk. 2, pt. 3, sec. 10, on p. 287.

simple lover of luxury: he neither simply subtracts money from circulation by hoarding it nor spends what he earns for mere consumption; rather, he reinvest it to earn more (although he would not derive any satisfaction if he were told that the money he earns is not real and could not purchase anything). The love of pleasure gives way in the merchant to the love of gain.[52] But the love of gain of the merchant is different from the love of gain of the miser. In the merchant, the love of gain becomes "love of the game." At the same time, the merchant's industry and frugality are sustained by an idea of the utility of the object pursued. The love of the game of the merchant is thus also different from the love of the game of the person who wastes time in difficult but ultimately useless pursuits.

Hume then sees this way out of the usual accusation of greed leveled against the character of the merchant. He can do so because the associative psychological mechanisms that he recognizes allow, so to speak, the transmutation of base metals into gold.[53]

52. Hume says, "It is an infallible consequence of all industrious professions, to beget frugality, and make the love of gain prevail over the love of pleasure" (*Essays*, 301). As we have seen, according to Hume, while other professions beget frugality, only commerce begets both industry and frugality (see n. 43, above). Till Grüne-Yanoff and Edward F. McClennen argue that "Hume in fact takes a more ambivalent position regarding the love of gain, in that he allows that, in certain cases, it may prove to be most disruptive" (Till Grüne-Yanoff and Edward F. McClennen, "Hume's Framework for a Natural History of Passions," in Wennerlind and Schabas, *David Hume's Political Economy*, 95–96). They refer to this passage in the *Treatise*: "All the other passions, besides this of interest, are either easily restrain'd, or are not of such pernicious consequences when indulg'd [. . .] This avidity alone, of acquiring goods and possessions for ourselves and our nearest friends, is insatiable, perpetual, universal, and directly destructive of society" (Hume, *Treatise*, bk. 3, pt. 2, sec. 2, on p. 316). Hume also condemns avarice in the unpublished essay "Of Avarice" (see *Essays*, 569–73). On Hume's economic psychology, see also Margaret Schabas, "Hume on Economic Well-Being," in *The Continuum Companion to Hume*, ed. Dan O'Brien and Alan Bailey (London: Continuum, 2012), 332–48.

53. Harro Maas explicitly connects Reid's statism to dualism and the rejection of mechanisms that would account for spontaneous emergence of order out of self-interest (Harro Maas, "Where Mechanism

But, according to Reid, what is wrong about the merchant and the entrepreneur is precisely that they do not spend their money to buy things they can use directly for their own or other people's consumption. In the *Essays on the Active Powers of Man*, Reid describes the love of money as an acquired desire. Originally, the love of money is merely a species of the love of power, and the love of power is a natural desire, along with the love of knowledge and the love of esteem. These natural desires are generally useful to society (even the love of power when properly directed). Power can be either good or bad according to the end we propose. In a similar fashion, money is not good in itself, but only for what it can buy. The conversion of power as a means into an ultimate end is a perversion of the natural desire for power. The miser who hoards up money is to be condemned because he takes the means to be an end in itself.[54] But Reid seems not to appreciate

Ends: Thomas Reid on the Moral and the Animal Oeconomy," *History of Political Economy* 35, annual supplement [2003]: 338–60).

54. See Reid, *Essays on the Active Powers of Man*, essay 3, pt. 2, chap. 2, on pp. 105–6. According to Reid, we naturally desire power for its own sake, and not simply with a view to any advantage to us that power might bring about. Thus, the natural desire of power is not a selfish desire and, in itself, is neither vicious nor virtuous. There is a degree in the desire for power that is "natural" and not blameworthy. Reid seems to imply that, so long as the desire of power is subordinated to higher principles of action, it will be kept to its proper and natural degree. Reid explains that the desire for money becomes a principle of action only when money is sought for its own sake rather than for the things it can procure. As Reid says, "Being useful for many different purposes as the means, some men lose sight of the end, and terminate their desire upon the means." He goes on to say that "[m]oney is also a species of power, putting a man in a condition to do many things which he could not do without it; and power is a natural object of desire, even when it is not exercised." In the same way, a man may acquire "the desire of a title of honour, of an equipage, of an estate." Given that, after all, money is a species of power, and that power is a natural object of desire, it would seem to follow that money could be legitimately desired for its own sake insofar as it is a species of power (provided that this desire is not excessive and is kept within its proper bounds). Reid does not spell out this thought. Rather, he reiterates that "acquired desires are not only useless, but hurtful and even disgraceful." One way to keep the desire for money within its proper bounds would be by reference to the ends that

the peculiar figure of the merchant. The merchant does not simply hoard money: the merchant spends money in order to make more money (money that he would then reinvest). But for Reid, this ultimate goal taints the moral character of the merchant. Rather than to rely on the love of money to make society better, we should rely on the love of esteem, which is naturally more allied to virtue than the love of power. Instead of the love of money as a spur to industry, we should have badges of honor conferred by our superior officers.

6. Hume on Paper Credit

In the previous section, we have seen that Hume and Reid had a different understanding of the love of riches that animates the merchant and, as a consequence, had a different opinion about the value of the emerging commercial society. However, we should be wary of drawing from this analysis facile inferences about their respective positions on particular issues of economic policy.

Among the various eighteenth-century debates on economic policies, a particularly contentious issue was that of paper money. In the next three sections, I will try to give an account of Hume's and Reid's views on this issue: they will turn out to be not too distant in the end. In general, Hume disapproved of paper money, whether in the form of paper credit, bank credit, or public credit. [55]

are served by money: "To love money, titles or equipage, on any other account than as they are useful or ornamental, is allowed by all to be weakness and folly" (Reid, *Essays on the Active Powers of Man*, essay 3, pt. 2, chap.. 2, on p. 105).

55. Maria Pia Paganelli refers to James Steuart's *An Inquiry into the Principles of Political Economy* (1767), for a detailed account of the three forms of paper money available in Hume's time (Maria Pia Paganelli, "David Hume on Monetary Policy: A Retrospective Approach," *Journal of Scottish Philosophy* 7, no. 1 [2009]: 73 and 84n12). Carl Wennerlind distinguishes between privately issued paper money, such as bills of exchange and bank credit, and state-issued paper money, "more precisely, securities backed by national debt." Hume endorsed "fully backed paper-credit," but "he did not endorse the practice of using this form of money to expand the overall money stock." Although Hume recognizes

However, he appears to have become relatively more favorable to some form of paper money in later editions of his *Essays*. Reid appears to have been a strong supporter of paper credit in comments on a question proposed by David Skene for a meeting of the Aberdeen Philosophical Society. In his lectures in Glasgow, Reid appears to have been in favor of hard money while recognizing some of the advantages of paper money. We will begin by outlining the main features of Hume's views on money.

As Maria Pia Paganelli has pointed out in her essay on Hume's monetary policy, two elements characterize Hume's notion of money. (1) Money is whatever is voluntarily accepted as a medium of exchange: in Hume's words, money is "only the instrument which men have agreed upon to facilitate the exchange of one commodity for another."[56] Thus, Hume's notion of money is different from our contemporary notion of *fiat* money, "unconvertible and unbacked paper money" that is imposed by the state as legal tender (that is, as the unique form of money that should be accepted as payment).[57] (2) Hume

some of the benefits of state-issued paper money backed by national debt, he "ultimately opposes this form of paper money." Even if this money is backed by a security, "this security does not provide a built-in discipline, since the national debt is likely to spiral our control" (Carl Wennerlind, "An Artificial Virtue and the Oil of Commerce: A Synthetic View of Hume's Theory of Money," in Wennerlind and Schabas, *David Hume's Political Economy*, 113–14). See also Carl Wennerlind, "David Hume's Monetary Theory Revisited: Was He Really a Quantity Theorist and an Inflationist?" *Journal of Political Economy* 113, no. 1 (2005): 235. It is not always clear in Reid's and Hume's references to paper money whether they are merely talking about money substitutes, that is, claims that are payable on demand in real specie money and are perfectly secure (100 percent convertible), or they are talking about forms of credit money, that is, claims that are not payable on demand and are not perfectly secure. The practice of fractional reserve banking expands the money supply beyond the current stock of money and therefore results in the creation of a form of credit money. On the distinction between commodity money, money substitutes, credit money, and *fiat* money, see Ludwig von Mises, *The Theory of Money and Credit*, trans. H. E. Bateson (Indianapolis, IN: Liberty Fund, 1980), 73–76.

56. Hume, *Essays*, 281.

57. Paganelli, "Hume on Monetary Policy," 66–67. Paganelli points out

that Hume followed the view, common in the mid-eighteenth century, according to which money is "*a sign* of all commodities in the world" and, more precisely, a measure of their value. Exchange was still not seen as resulting merely from the inequality of subjective values; rather, it was seen in the way described by Aristotle in book 5 of the *Nicomachean Ethics*, as the exchange of two goods having the same objective value: "Given the difference in goods, the consequent difficulties in comparing and equating things of different values, and the requirement of equality to exchange, a 'measure of everything' is needed [. . .]. A physical commodity—traditionally, but not exclusively and not necessarily, precious metals—is conventionally introduced as money to compare the most diverse goods and to be exchanged for any good" (Paganelli, "Hume on Monetary Policy," 68). Thus, it appears that something can eventually work as a universal medium of exchange only because it is accepted as a universal measure of value for all the commodities that are to be exchanged. Speaking from a modern standpoint, Ludwig von Mises thus explains the old view of money: "Although it is usual to speak of money as a measure of value and prices, the notion is entirely fallacious. So long as the subjective theory of value is accepted, this question of measurement cannot arise. In the older political economy, the search for a principle governing the measurement of value was to a certain extent justifiable. If, in accordance with an objective theory of value, the possibility of an objective concept of commodity values is accepted, and exchange is regarded as the reciprocal surrender of equivalent goods, then the conclusion necessarily follows that exchange transactions must be preceded by measurement of the quantity of value contained in each of the objects that are to be exchanged. And it is then an obvious step to regard money as the measure of value" (Mises, *Theory of Money and Credit*, 51). According to Hume, "money is money because it is conventionally accepted as such" (Paganelli, "Hume on Monetary Policy," 67). An object becomes money because it is conventionally accepted as a measure of value for all commodities and as a medium of exchange. The precise circumstances that give rise to such uses are variously described in the recent literature on Hume. At some point, Paganelli speaks of money as emerging in order to meet the need to overcome the double coincidence of wants present in barter (Paganelli, "Hume on Monetary Policy," 67). Other interpreters stress the role of money in a universal system of deferred payments. If we describe money as solving the problem of the double coincidence of wants in a barter economy, then money allows me to trade what I own and you do not want (and a third party wants) for what I want and you do not own (and a third party owns). In the case of deferred payments, money would allow me to trade what I cannot deliver to you *now* and you want from me for something you can deliver to me *now* and I want from you. Money would then originate as a form of credit, as a symbol of a commitment to pay later in kind. According to Wennerlind, who refers to the account of promises was familiar with two forms of money: real specie (precious metals) and paper money. According to Hume, only precious metals (gold and silver) enjoy the full status of money (although not all precious metals are money, but only those that are accepted in exchange for other commodities, that is, those in the form of coins). Precious metals enjoy the full status of money because they are *universally* "agreed upon" as a media of exchange and therefore as means of payment.[58] Paper money, unlike precious metal money,

in *Treatise*, book 3, part 2, section 5, Hume sees money as originating from "a convention [. . .] whereby people can signal their commitment to a system of deferred payments by using a standardized symbol. [. . .] [I]f an entire society agrees by convention to accept a symbol as a promissory note and redeem it with property when presented, then the symbol acquires the capacity to mediate any conceivable transaction and thus operates as universal equivalent" (Wennerlind, "An Artificial Virtue and the Oil of Commerce," 107). Schabas stresses the primary role that money has as a measure of value in Hume: "[T]he justification of money replacing barter is not the problem of double coincidence of wants, but rather the preferability of a uniform measure of value as trade and industry become more 'intricate'" (Schabas "Temporal Dimensions in Hume's Monetary Theory," 130).

58. Paganelli, "Hume on Monetary Policy," 67. Some interpreters seem to think that since money, according to Hume, is a conventional measure of value that allows us to equate commodities in an exchange and a symbol accepted as a promissory note in a system of deferred payments, then, in principle, objects of any material could serve as money. As Christopher J. Finlay observes, referring to Wennerlind's work, "Hume understands money theoretically as a fiduciary currency. [. . .] [B]ecause money's function is symbolic—representing value rather than embodying it intrinsically—its material substance may be *theoretically* unimportant" (Christopher J. Finlay, "Commerce and the Law of Nations in Hume's Theory of Money," in *The Empire of Credit: The Financial Revolution in Britain, Ireland and America, 1688–1815*, ed. Daniel Carey and Christopher J. Finlay [Dublin: Irish Academic Press, 2011], 59). Hume's preference for precious metals would be dictated by practical considerations: Hume was "a fiduciary theorist and practical metallist, rather than the theoretical metallist he is often thought to be" (Carl Wennerlind, "The Link between David Hume's *Treatise of Human Nature* and His Fiduciary Theory of Money," *History of Political Economy* 33, no. 1 [2001]: 140). The limited supply of precious metals would ensure that money is not "multiplied without end" and thus that its value does not sink to nothing (see Hume's letter to the abbé Morellet, in Hume, *Writings on Economics*, 214). Precious metals also happen to be accepted in transactions with foreign traders. Thus, the preference for

precious metals is a matter of monetary policy rather than of monetary theory. On the distinction between theoretical and practical metallism, see Joseph A. Schumpeter, *History of Economic Analysis*, ed. Elizabeth Boody Schumpeter (New York: Oxford University Press, 1994), 288–89. Modern Austrian economists conceive money primarily as a medium that allows indirect exchange. According to this view, only commodities that were relatively more marketable than others could originally have come to be accepted as media of exchange. Things with little or no use value and in no demand could never have acquired exchange value and have come to be accepted as money. Many different commodities have been used as media of exchange at different times and in different places. Precious metals were sought out only for their ornamental use before they came to be accepted as universal media of exchange. Factors contributing to their high marketability have been their great demand as ornaments, their scarcity in relation to other commodities, their divisibility into homogenous units, their durability and portability (see Rothbard, *Man, Economy, and State*, 192; Carl Menger, *Principles of Economics* [Glencoe, IL: Free Press, 1950], 257–71; and Mises, *Theory of Money and Credit*, 42–46). According to Austrian theorists, an account of the exchange value of money must ultimately make some reference to its original use value as a commodity in order to avoid an infinite regress in explanation (see Mises, *Theory of Money and Credit*, 129–44; and Rothbard, *Man, Economy, and State*, 268–76). In a letter to the abbé Morellet, Hume acknowledges that "money must always be made of some materials, which have intrinsic value, otherwise it would be multiplied without end, and would sink to nothing" (letter to the abbé Morellet, in Hume, *Writings on Economics*, 214). However, he adds: "But when I take a shilling, I consider it not as a useful metal, but a something which another will take from me; and the person who shall convert it into metal is, probably, several million removes distant" (214). He lists examples of debased coins whose precious metal content is much below their nominal value: these pass as currency, a circumstance that "can arise only from tacit convention" (214). He further gives the example of sheep, oxen, and fish being used as money and of paper money backed by land in Pennsylvania. It is clear from these examples that, for Hume, money does not necessarily have to be made of precious metals. However, he appears to think that only a commodity or something that is backed by a commodity (or something, at least, that looks like a commodity and is taken as such for the time being) can serve as money. Indeed, even the convention to accept debased coins emerges tacitly and requires as a background an original use of coins that are not debased. When Hume recommends that authorities increase the nominal value of coins rather than deflationary recoinage at full value, he implies that this debasement must be done more or less surreptitiously and in a small degree in order to "preserve the illusion" that no debasement really occurred (Hume, *Essays*, 287–88n7). In this cannot travel abroad, since it is not accepted by foreign traders as payment. According to Hume, paper money is a “counterfeit money, which foreigners will not accept in any payment.”[59] Hence, a widespread introduction of paper money will eventually drive out precious metal money from a country. Speaking of stocks in public credit, Hume says that “being a kind of paper-credit, [they] have all the disadvantages attending that species of money. They banish gold and silver from the most considerable commerce of the state, reduce them to common circulation, and by that means render all provisions and labour dearer than they would otherwise be.”[60] As economists would later say, “[B]ad money drives out good money.”[61] Hume explains the phenomenon in these terms:

> I scarcely know any method of sinking money below its level, but those institutions of banks, funds, and paper-credit, which are so much practised in this kingdom. These render paper equivalent to money, circulate it throughout the whole state, make it supply the place of gold and silver, raise proportionably the price of labour and commodities, and by that means either banish a great part of those precious metals, or prevent their farther encrease.[62]

By driving out money based in precious metals from the domestic economy, an increase in paper money will have an inflationary effect; thus, the proportion of paper money to specie, and to commodities will increase. People will bid up the prices in units of paper money they would accept in exchange of their goods and services. These prices are

regard, C. George Caffentzis opposes metallic money as a natural fiction that is “arrived at unconsciously and universally through conventions” to paper money understood as an artificial fiction or counterfeit “arrived at consciously and particularly” and expressed as promises (C. George Caffentzis, “Fiction or Counterfeit? David Hume’s Interpretations of Paper and Metallic Money,” in Wennerlind and Schabas, *David Hume’s Political Economy*, 150).

59. Hume, *Essays*, 284.
60. Ibid., 355.
61. This is known as Gresham’s law.
62. Hume, *Essays*, 316.

higher than the prices they would bid in exchange of units of real specie money. Labor and commodities will end up costing more, and that would be detrimental to the manufacturer and the merchant.[63] The solution, as Hume saw it, was to establish a 100 percent gold and silver reserve bank so that all the paper money would be readily convertible in real specie money.[64]

Stimulus schemes based on paper money had been proposed and experimented with during the eighteenth century. The most famous case is the scheme implemented by John Law (1671–1729) in France, during the regency period, after the death of Louis XIV. The Mississippi Company scheme led to runaway inflation and eventually to a debt crisis.[65]

Hume's plan for economic growth was different from any inflationary scheme based on paper money. As Paganelli explains, hoarding real specie money, or, even better, converting it into silverware and jewelry, would naturally decrease the quantity of precious metals in circulation that are used as money. That would diminish the proportion of money to commodities, and therefore would sink their price at home.[66] This, in its turn, would attract money from abroad that manufacturers could use to employ unused factors of production at home. In the interval between the acquisition of money and the rise in the price of commodities, the increasing quantity of money, passing from

63. Ibid., 284.
64. Ibid., 284–85.
65. See Douglas E. French, *Early Speculative Bubbles and Increases in the Supply of Money*, 2nd ed. (Auburn, AL: Ludwig von Mises Institute, 2009), 51–74. Another famous inflationary scheme was the so-called South Sea Bubble (see French, *Early Speculative Bubbles*, 75–104). On public debt and new forms of credit emerging in the eighteenth century, see also the articles in Carey and Finlay, *Empire of Credit*, and Carl Wennerlind, *The Casualties of Credit: The English Financial Revolution, 1620–1720* (Cambridge, MA: Harvard University Press, 2011).
66. Paganelli, "Hume on Monetary Policy," 74–81. According to Paganelli, "The kind of hoarding that Hume seems to promote is done *privately*, and it is achieved through the alternative uses of precious metals" (Paganelli, "Hume on Monetary Policy," 77). At some point, Hume condemns hoarding of money in a public treasure as destructive (see Hume, *Essays*, 320).

workmen to farmers, would be a spur to their productivity.[67] Once wages and the price of commodities had caught up with each other, the operation of taking away money from the domestic economy could be repeated.[68]

7. Skene's Question on Paper Credit

While in Aberdeen, Reid wrote comments on a question proposed by his friend David Skene (1731–70) for a meeting of the Aberdeen Philosophical Society, held on 24 February

[67]. See Hume, *Essays*, 286–87. Paganelli refers to Hume's proposal of a continuous annihilation of money in order to sink prices, favor sales, and keep the money coming back in (Paganelli, "Hume on Monetary Policy," 77). This is a paradoxical way to make money increase by deflationary means. Wennerlind claims that Hume sees the influx of money from abroad as resulting primarily from a previous increase of industry that has lowered prices at home. Only in such a case is an increase in money supply favorable to economic development. Hume says that "[t]he good policy of the magistrate consists only in keeping [money], if possible still encreasing; because, by that means, he keeps alive a spirit of industry in the nation and encreases the stock of labour, in which consists all real power and riches" (Hume, *Essays*, 288). However, according to Wennerlind, "[T]his passage cannot reasonably be considered a proposition for an inflationist monetary or trade policy" (Wennerlind, "An Artificial Virtue and the Oil of Commerce," 116). Thus, Hume would not favor policies designed to artificially increase the money stock (see also Wennerlind, "Hume's Monetary Theory Revisited," where this thesis is illustrated at length). According to Caffentzis, there is an important difference between policies of monetary expansion based on an increasing paper money supply and the policy of debasement that Hume appears to advocate in a footnote (see Hume, *Essays*, 287–88n7): According to Caffentzis, Hume "saw that debasement might answer the conundrum posed by this tension between the need for monetary expansion and paper money scepticism" (Caffentzis, "Fiction or Counterfeit?" 162). Debasement is acceptable as long as is done in a way that preserves the illusion of identity between the new coins and the old coins.

[68]. In order to avoid the cyclical nature of this process, Hume seems to propose that the operation of annihilation of money should be continuous. As Paganelli explains, "[A] one-time decrease in money supply will generate a temporary increase in sales, which brings money in to the economy and prices back to their original level. But if money keeps being annihilated, money will keep coming back in—it will 'keep encreasing'" (Paganelli, "Hume on Monetary Policy," 76).

1761.[69] This document shows that Reid was familiar with discussions surrounding the controversial issue of paper money since his days in Aberdeen.[70]

Reid saw paper money essentially as paper credit, a form of credit that arises when trade develops in a nation and the demand for credit cannot be met by credit in the form of real specie money. In order to satisfy this demand for credit, creditors no longer lend real specie money; instead, they provide a piece of paper that stands for the estimated value in terms of real specie money of assets held by the creditor.

According to Reid, credit has the important function of making available money that has been hoarded or is otherwise unused:

> There must be many moneyed people who cannot themselves employ it [this money] in trade [. . .]. Now, if there is no Credit, the Money belonging to such people must be hoarded up lie dead and produce Nothing. But Credit makes it all active and Industrious. [. . .] So that it would seem that as long as there are Idle hands in a nation or labouring hands that might be more profitably employed, as long as there are heads capable of contriving and executing schemes of trade more extensive than their own fortunes without credit can enable them to carry on, as long as there is money lying dead and inactive, Credit is the proper Remedy of these Evils, bringing such heads and hands and Money together to cooperate for the public utility which before by being disunited were partly useless and partly burthensome to the publick.[71]

As trade develops in a country, a higher rate of interest on credit will make the hoarded money available for use. Reid conjures up the following scenario: “Let us suppose that there is still Demand for more Money to be employed in

69. See AUL MS 2131/2/II/16, fols. 1r–2r.

70. Other papers by Skene are considered by Istvan Hont, *Jealousy of Trade: International Competition and the Nation-State in Historical Perspective* (Cambridge, MA: Harvard University Press, 2005), 279. Hont also gives reference to Bernhard Fabian, “David Skene and the Aberdeen Philosophical Society,” *Bibliotheck* 5 (1968): 81–99.

71. AUL MS 2131/2/II/16, fol. 1r.

trade after all the hoarded Money has been brought forth."[72] In order to meet this demand for credit, Reid suggests, either you borrow money from abroad or you issue paper credit. The second solution is the one favored by Reid: "If Credit in general be beneficial and necessary to a Trading Nation, It is not easy to conceive that Paper Credit should be hurtfull."[73]

Reid then offers two objections. First, he objects to the quantity theory of money, the view, usually ascribed to John Locke and Hume, that an increase in the quantity of money in relation to the quantity of commodities in a country leads to a proportional increase in their price. Second, he objects to Hume's view that an increase in paper credit (and, consequently, of paper money) "has the same Effect in raising the price of Commodities as real Specie [. . .] that paper credit increases the price of Commodities in the same proportion as it increases the Current Money, and therefore must be prejudicial to Trade."[74]

As I said, Reid's first objection is to the quantity theory of money. However, he wrongly assimilates the quantity theory of money to the view that the wealth of a nation is represented by the quantity of money in its possession. Moreover, the examples he uses to attack the quantity theory of money can make sense only if the quantity theory is correct.

Let's see first how he describes the quantity theory of money. This theory, which relates prices to the relative quantities of commodities and money, makes the assumption that the demand for commodities remains the same. Like many alleged laws in economics, it has to be assumed ceteris paribus. Reid so describes the theory:

> It is said that the Money that circulates is the representative of all the Commodities of a Nation and is equal to them in value. So that if the money is doubled or trebled the commodities continuing the same the price of everything will be raised in the Same proportion.[75]

72. Ibid., fols. 1r–1v.
73. Ibid., fol. 1v.
74. Ibid.
75. Ibid.

The first sentence states that the money that circulates in a country is representative of all the commodities in a country and is equal to them in their value. The consequence drawn from it is that an increase in the quantity of money would lead to a proportional increase in the price of commodities. This consequence would be true only under the assumption that no other money, except the one circulating in the country, were used to buy commodities and therefore to determine their price. This is precisely what the quantity theory of money assumes as a ceteris paribus clause. If no other money but the one present in the country at any given moment were available to buy commodities, then an increase in the quantity of money, from one time to another, would lead to a proportional increase in the price of commodities. The assumption made is that the only money that represents commodities is the one that is present in the country. But this assumption, according to Reid, is clearly false. He gives an analogy to illustrate his point:

> [W]hy Should the Money of a Nation be a representation of the whole [stock of] commodities? There is as much reason to estimate every mans Stock by his ready Cash, which appears at first Sight ridiculous. If a Mans house is robbed and all the Money in his possession carried off he does not lose perhaps the fiftieth part of what he is worth.[76]

What Reid says is true, but only insofar as the commodities in possession of the man can be exchanged for money that he does not have and that other people have. Mutatis mutandis, we see that the example that Reid gives to debunk the quantity theory of money presupposes that there is other money besides the money "present in a country." This extra money could immediately be used to buy commodities in a country. In different words, Reid assumes that other money, which is presently outside a country, can immediately be exchanged for the commodities without

76. Ibid.

first becoming money that is, so to speak, "present in a country." If this is the case, then an increase of only the money "present in a country" by itself would not lead to a proportional increase in the price of commodities. Price would indeed be determined not only in relation to the "money present in a country" but also in relation to the sum of the money "present in a country" plus the money that is outside the country. But this amounts to saying that the money that really circulates in a country is not only the money "present in a country" but also the money abroad. In short, Reid can drive his point home only by presupposing the quantity theory of money. The price of commodities is ultimately determined by the relation between the overall quantity of money and the overall quantity of commodities.

Moreover, Reid also seems to suggest that the quantity theory of money goes hand in hand with a simplistic view, reminiscent of mercantilism, that makes the money in a country identical to the wealth of a country. This view is suggested by the use of an ambiguous expression: "the Money of a Nation [is] a representation of the whole [stock of] commodities."[77] Clearly, this view is false, as the analogy with the robbed man shows. But this is not what quantity theorists claimed. Thus Reid seems to confuse two different claims: (1) money is representative of the riches of a country in the sense that is used as a universal medium of exchange for the commodities in a country and (2) money is identical to the riches of a country.

After his remarks on the quantity theory of money, Reid objects to Hume's view that an increase in paper credit (and, consequently, of paper money) "has the same Effect in raising the price of Commodities as real Specie [. . .] that paper credit increases the price of Commodities in the same proportion as it increases the Current Money, and therefore must be prejudicial to trade."[78] First, Reid claims that it is not true that an increase in paper credit will have an inflationary effect. For each increase in credit, there is

77. Ibid.
78. Ibid.

an increase in debt. As a consequence, the introduction of paper credit makes no real addition to the wealth of a nation: "No Man therefore is richer or thinks himself richer on account of these Notes."[79] Therefore, neither individuals nor institutions will end up spending more and pushing up prices. Second, even if it is true that paper credit will increase spending and therefore will eventually raise prices, this inflationary effect will be more than compensated by the beneficial stimulus given to trade within a nation: "[T]he price of Commodities may gradually be raised, but this is the necessary effect of an extended Trade and must be more to the benefit of a nation than to its detriment."[80]

8. Reid's Lectures on Money and Paper Credit

It would require further research to determine whether and to what extent Reid's comments on Skene's question reflect the views of other members of the Aberdeen Philosophical Society like Skene. Stimulus policies based on government-backed issue of paper credit would appear to have been more consonant with Reid's penchant for state intervention. In his Glasgow lectures on political economy, he supports hard money while acknowledging some of the benefits of paper money.[81]

79. Ibid., fol. 2r.

80. Ibid., fol. 2v. Reid's discussion of Skene's question on paper credit ends with some brief remarks on the Mississippi scheme: "The Notion of the French ministry in Law's time that the Paper Money in the nation could not exceed in value the cash and that therefore it behoved them either to raise the value of the Coin or Reduce that of the Paper produced all the Confusion ruined & beggared Law and occasioned the ruin of thousands" (AUL MS 2131/2/II/16, fol. 2v). These final remarks appear to have been written at a different time. Evidence of Reid's and Skene's shared interest in political economy can be seen in a 1767 letter from Reid to Skene, where Reid extols the newly published *Inquiry into the Principles of Political Economy* by James Steuart (1712–80) (see *The Correspondence of Thomas Reid*, ed. Paul Wood [Edinburgh: Edinburgh University Press, 2002], 61).

81. On Reid's theory of money, see Nagao, "Political Economy of Reid," 26–27. According to Nagao, "[Reid's] arguments on money may have developed from critical readings of Hume's [essay] on money [. . .], which advocated a quantity theory of money and contained an important

He agrees with Hume in rejecting the notion of *fiat* money: money does not receive its value from the "Laws or Edicts of princes."[82] He describes "the practices of Princes and their Ministers in debasing the Coin" as "defrauding their Subjects and Creditors."[83] Just like Hume, he takes an antimercantilist stance: among the fallacious notions concerning money are the views "that it may be kept in a Country by laws prohibiting the Exportation of it" and "that the Riches of a Nation Consist in the Quantity of Money that Circulates in it."[84] However, just like in the manuscript on paper credit, Reid rejected the quantity theory of money (although no explicit argument is presented).[85]

observation about the continuous effects upon demand. Reid seems to have agreed with this, and acknowledged the disadvantage of paper credit" (Nagao, "Political Economy of Reid," 27).

82. AUL MS 2131/4/III/10, fol. 1r. On Reid's views on money, see also AUL MS 2131/4/III/4, fol. 2v, MS 2131/4/III/15, fols. 4r–v, and MS 2131/4/III/16. In MSS 2131/4/III/4 and 2131/4/III/15, Reid speaks forcefully in favor of gold and silver. In MS 2131/4/III/4, from March 1765, money is described as a measure of the price of things. Among the properties required to be a measure of price are "Universal Estimation & permanent Value." Money must be "Durable easily conveyed. Divisible into Small parts. Silver & Gold fittest for this purpose." The practices of princes in debasing coins are wrong because "Money is not barely a Measure of the price of things but it is a commodity which has an intrinsick value according to its weight and finenesse" (AUL MS 2131/4/III/4, fol. 2v, in Reid, *Practical Ethics*, 165–66). In MS 2131/4/III/15, Reid claims that "Gold and Silver [are] a proper Measure of the Price of Commodities," since, being "durable and always esteemed," they do not rise and fall much in value. Moreover, silver and gold are divisible into small parts, their quantity and purity may be easily ascertained, they are "easily conveyed," and "they keep without waste." Reid further remarks that "Gold and Silver must have [a] Value that depends not on the will of Princes and States 1 Because it cannot be found out dug from Mines and Refined without much Labour and Expence 2 Because it has always been in demand as a commodity and is usefull for Vessels for ornaments for Utensils." Thus, gold and silver have a natural price determined both by their cost of production and by their high demand for use. The price of gold and silver cannot be raised or lowered artificially by the state "without bringing distress to the country" (AUL MS 2131/4/III/15, fol. 4r).

83. AUL MS 2131/4/III/10, fol. 1r.

84. Ibid.

85. Reid describes the quantity theory of money in this way: "That the

In his lectures, Reid lists some advantages of paper credit. Paper credit "answers the same purpose as money as a measure of Value of Commodities" and is "a means of facilitating the Exchange of Commodities."[86] Moreover, it is not liable to clipping and wearing, and there is no need of assaying it. However, he recognized that, contrary to hard money, paper credit has no intrinsic value of its own: its value depends upon that of a corresponding quantity of hard money the issuing institution has pledged to redeem against it. Thus, paper credit is a form of payment not accepted where the issuing institution is not known and trusted. Hard money, on the contrary, "is current in all nations and loses nothing of its value by being carried beyond Seas."[87] These are points made by Hume, too, and Reid seems to have been aware of Hume's ideas on public debt. On this topic, the references to Hume are explicit:

> Of Mortgaging the Revenue & of the Public Debt. This enlarges the Power of the Crown. [It] Creates a Moneyed Interest. Where the Money is due to foreigners, [it] diminishes the Riches of a Nation. [It] increases the Number of Taxes. Whether the Multiplying of Taxes does

price of Commodities will be doubled if the Quantity of Money in a Nation is doubled & raised or diminished in proportion to the Quantity of Money" (AUL MS 2131/4/III/10, fol. 1r). On the margin of the manuscript, Reid refers to Montesquieu, *De l'esprit des lois*, book 22, chapter 8.

86. AUL MS 2131/4/III/10, fol. 1v. In AUL MS 2131/4/III/16, fol. 1r, Reid says that "Great Commerce requires much Money to carry it on." Thus, it would seem that paper credit, having the same function as money, could enhance commerce. In AUL MS 2131/4/III/15, fols. 4r–v, Reid lists as number 7 among "False Notions concerning Money" the view that "Banks & Paper Credit [are] hurtfull to the Nation."

87. AUL MS 2131/4/III/10, fol. 2r. In MS 2131/4/III/16, fols. 1r–v, Reid lists some commodities that have been used as money in various parts of the world at different times: it is the same account found in Smith, *Wealth of Nations*, bk. 1, chap. 4, para. 3–4, in 1:38–39. See also Adam Smith, *Lectures on Jurisprudence*, ed. R. L. Meek, D. D. Raphael, and P. G. Stein (Oxford: Oxford University Press, 1978), report of 1762–63, vi.98 [reference by volume number of the original and by paragraph number], 367, and report of 1766, para. 235, 499.

> not increase Industry & how far see Hume. It makes the burthen of War less Sensible.[88]

Hume, on his part, moved closer to the views of the Reid on paper credit. In later editions of the *Essays*, beginning from 1764, he acknowledged the limited benefits that paper money can have in stimulating the economy: in some cases, industry and credit may be promoted by the right use of paper money.[89] He described at length the system of bank credit in Scotland. This allowed a merchant to monetize a loan from a bank by giving as security his belongings:

> As a man may find surety nearly to the amount of his substance, and his bank-credit is equivalent to ready money, a merchant does hereby in a manner coin his houses, his household furniture, the goods in his warehouse, the foreign debts due to him, his ships at sea; and can, upon occasion, employ them in all payments, as if they were the current money of the country.[90]

He appears to have been aware that this form of bank credit would involve a fractional reserve banking system: after the system had been developed, "a stock of five thousand pounds was able to perform the same operations as it were six or seven."[91] However, he was still cautious about the benefits of paper credit: "[W]hatever other advantages result from these inventions, it must still be allowed that besides giving too great facility to credit, which is

88. AUL MS 2131/4/III/11, fol. 2v.
89. See Hume, *Essays*, 318–20. Apparently, Hume changed his mind after talking with the financier Isaac de Pinto in Paris. See Ian Simpson Ross, "The Emergence of David Hume as a Political Economist: A Biographical Sketch," in Wennerlind and Schabas, *David Hume's Political Economy*, 44–46. Hume's involvement in the settlement of Canada Bills may also have played a role in qualifying his view on paper credit (see Robert W. Dimand, "David Hume on Canadian Paper Money," in Wennerlind and Schabas, *David Hume's Political Economy*, 168–79).
90. Hume, *Essays*, 319.
91. Ibid., 320.

dangerous, they banish the precious metals."[92] Hume also maintained his opposition to public debt.

As we have seen, Reid's opposition to commercial society is not justified by the alleged inefficiency of markets in the allocation of scarce resources, but is mostly rooted in a moral evaluation of the character of the merchant. Hume, on the contrary, was more appreciative of the new figure of the merchant. On the contentious issue of paper credit, Hume's and Reid's positions, however different, seem to have been much closer than in their general evaluation of the benefits and drawbacks of a commercial society. Reid outlined a practical program of economic policies in his lectures, but this clearly had not much to do with his radical utopian ideals. In his turn, Hume, also motivated by pragmatic concerns, qualified his original condemnation of paper credit. This shows us that a fundamental disagreement in political ideology may not necessarily and always translate into a disagreement about policies.

92. Ibid.