David Hume on Self-Coordinating and Correcting Market Processes

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David Hume was one of the most prominent of the Scottish Moral Philosophers. He is particularly famous as a philosophical skeptic, who, in his book, *An Inquiry Concerning Human Understanding* (1748), questioned whether man's reason and reasoning ability could successfully apprehend reality with any complete degree of certainty. He also argued that reason followed men's "passions," rather than reason being a guide for or a check upon men's emotions and desires.

Hume is also famous for arguing that there is a distinct difference between factual or "positive" statements from ethical or "normative" statements. Or expressed differently, an "ought" conclusion could not be self-evidently or logically deduced, per se, from an "is" statement.

He also has been widely recognized as one of the leading contributors to the theory of social ethics and the political order, especially in his work, *An Inquiry into the Principles of Morals* (1751). Hume also wrote a widely read and acclaimed five-volume *History of England* (1754-1762), but one which Thomas Jefferson considered unsuitable for students at the University of Virginia due to his belief that Hume was too "Tory" in his interpretation of British history!

Not too surprisingly, for over two hundred and fifty years these ideas of Hume's have both been highly controversial in philosophy, yet immensely influential across many social and scientific disciplines.

David Hume's Contributions to Economics Understanding

In addition, and for our purposes in particular, David Hume was an important and distinctly original contributor to economic theory and policy. It was in a collection of *Essays, Moral and Political* (1753-1754), that he made significant contributions to the emerging subject of "political economy." It is in these essays that Hume presented a devastating criticism of Mercantilist thinking on trade and commerce, while at the same time, demonstrating the self-regulating and "balancing" forces of the market process.

Indeed, it can be argued that if his own writings on various economic themes had been more systematically developed and joined together, it might have been David Hume who became considered the "father" of modern economics instead of Adam Smith.

Hume was born in 1711 in Edinburgh, Scotland and attended the University of Edinburgh, but did not graduate believing that he learned more from reading on his own than from the professors in the university courses. He made his living in various capacities, including for a period of time in France. He returned to his native Scotland in 1769 and lived there until his death in 1776.

Commerce Brings Wealth, Refinement and Freedom

David Hume emphasized that commerce and trade were among the most important avenues to offer opportunities to raise people's standards of living, and to bring refinement and cultural betterment to a growing portion of a nation's population.

Commerce also served as an important leveler of the material inequality of a society based on political privilege and government-bestowed monopoly. Through trade, a wider variety and quality of goods became available to a growing number of the people in any society, fostering the development of a "middle class."

At the same time, growing wealth among more and more members of society acted as a means to restrain and weaken the arbitrary power of tyrannical governments, as a larger percentage of the population had the means to free themselves from government dependency and control. Or as Hume expressed it in his essay, "Of the Refinement in the Arts":

> *But where luxury nourishes commerce and industry, the peasants, by a proper cultivation of the land, become rich and independent; while the tradesmen and merchants acquire a share of the property, and draw authority and consideration to that middling rank of men, who are the best and firmest basis of public liberty.*
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> *These submit not to slavery, like the peasants, from poverty and meanness of spirit; and having no hopes of tyrannizing over others, like the barons, they are not tempted, for the sake of that gratification, to submit to the tyranny of their sovereign. They covet equal laws, which may secure their property, and preserve them from monarchical, as well as aristocratical tyranny.*

Governments and special interest groups, Hume feared, are always want to use and abuse political authority and influence to gain much for themselves at the expense of the ordinary, or common, members of society. And as a society grows in wealth there is more for the government to siphon off through taxes for its own purposes and for interested groups to use the state to plunder and manipulate. But with the emergence of a middle class that is increasingly supporting itself through commerce and industry, they have the financial means to resist these encroachments by the state. Or as Hume said in his essay "Of Commerce": "So the luxury of the individuals must diminish the force, and check the ambition of the sovereign."

Money, Prices, and Inflationary Short-Run Impacts on Production

Hume is also recognized as a significant eighteenth century contributor to monetary theory with his formulation of the quantity theory of money In his essay, "Of Money," he said that money's role in a market system is to serve as a medium of exchange and a unit of account. Looked at from a "static" equilibrium perspective, the quantity of money in a society is of little or no importance.

As long as prices in a society were sufficiently adjusted to reflect the available quantity of money to facilitate transactions, any quantity of money serves the purposes of exchange. Double the quantity of money in a society or reduce it by half, when all prices will have, respectively, risen proportionally by double their previous the level, or lowered proportionally by half their previous level, respectively, then all produced and marketed goods will "clear" off the market, with no change in the relative values or costs of the goods in terms of each other.

Any influence that money may have on the level of industry, production, or employment is, Hume argued, in the transition period between the injection or withdrawal of any part of the quantity of money in the economy, when some prices may rise or decline before others, thus influencing profit margins and cost relationships. Hume explained the process in the following way:

> *If we consider any one kingdom by itself, it is evident, that the greater or less plenty of money is of no consequence . . . It is indeed evident, that money is nothing but the representation of labor and commodities, and serves only as a method of rating and estimating them. Where coin is in greater plenty; as a greater quantity of it is required to represent the same quantity of goods; it can have no effect, either good or bad, taking a nation within itself . . .*
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> *Since the discovery of the [gold and silver] mines in America, industry has increased in all the nations of Europe . . . In every kingdom, into*

> *which money begins to flow in greater abundance than formerly, everything takes a new face: labor and industry gain life; the merchant becomes more enterprising, the manufacturer more diligent and skillful, and even the farmer follows his plough with greater alacrity and attention . . .*
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> *Though the high price of commodities be a necessary consequence of the increase of gold and silver, yet it follows not immediately upon that increase; but some time is required before the money circulates through the whole state, and makes its effect felt on all ranks of people. At first, no alteration is perceived; but by degrees the price rises, first of one commodity, then of another; till the whole at last reaches a just proportion with the new quantity of specie which is in the kingdom.*
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> *In my opinion, it is only in this interval or intermediate situation, between the acquisition of money and rise of prices, that the increasing quantity of gold and silver is favorable to industry . . . From the whole of this reasoning we may conclude that it is of no manner of consequence, with regard to the domestic happiness of a state, whether money be in a greater or less quantity.*

But when all prices, finally, will have been affected and adjusted by the change in the quantity of money, Hume reasoned, all "real" relative price and production relationships will have more or less restored themselves.

Hume's Refutation of the Balance-of-Trade Argument

David Hume's most important contributions, undoubtedly in the history of economic ideas are in his reply to the Mercantilist policy views as found in his essay, "Of the Balance of Trade," in which he challenged the argument for government's fostering a permanent "positive" balance of trade.

David Hume constructed what has become known as the "specie-flow" theory of the movement of money and goods between nations to an assure equilibrium among international prices and the distribution of specie (or commodity) money among countries that are trading with each other.

Hume supposes two cases, that the amount of gold or silver money in Great Britain is either reduced or increased in quantity. In the first instance, prices would decrease in Great Britain, making it more attractive for, say, French buyers to take advantage of less expensive goods purchasable in Britain; in the other instance, the resulting high prices in Great Britain would make it attractive for British subjects to purchase less expensive French versions of products they previously had been buying at home. In the first case British exports to France would increase (and imports from France would decrease), and in the second case British imports from France would increase (and exports to France would decrease).

Again, in the first case, the lower and more attractive British prices would bring about an increase in gold and silver into Great Britain as the French buyers' means of paying for the increased amount of British exports into France. In the second case, the higher and less attractive British prices would bring about an outflow of gold and silver from Great Britain to pay for the increased amount of imported French goods.

In both cases, this would be setting in motion counter-acting forces to restore an international price equilibrium between these two countries and their export-import trade. In the first instance, the inflow of gold and silver into Great Britain would bring about a rise in British prices, which would continue until prices had risen and French prices had fallen (due to the, now, the small quantity of gold and silver money in France) to eliminate the price and profit motives to import more goods from Great Britain and export specie money from France to pay for them.

In the second instance, people in Britain would export a portion of their enlarged quantity of gold or silver money to France, to purchase less expensive goods from French manufacturers. The gold supply would increase in France and decrease in Great Britain. As a result, prices would begin to rise in France, and decrease in Britain. This would reverse the process until the price differential making French goods more attractive to those in Britain had been reversed, and restored the international price equilibrium.

Hume on the Specie-Flow Mechanism of Coordinated Trade

In David Hume's own words from "Of the Balance of Trade":

> *Suppose four-fifths of all the money in Great Britain to be annihilated in one night, and this nation reduced to the same condition with regard to specie, as in the reigns of Harrys and Edwards, what would be the consequence?*

Must not the price of all labor and commodities sink in proportion and everything be sold as cheap as they were in those ages? What nation could then dispute with us in any foreign market, or pretend to navigate or to sell manufactures at the same price, which to us would afford sufficient profit?

In how little time, therefore, must this bring back the money which we have lost, and raise us to the level of all the neighboring nations? Where, after we have arrived, we immediately lose the advantage of the cheapness of labor and commodities; and the farther flowing in of money is stopped by our fullness and repletion.

Again, suppose, that the money of Great Britain were multiplied fivefold in a night, must not the contrary effect follow? Must not all labor and commodities rise to such an exorbitant height, that no neighboring nations could afford to buy from us; while their commodities, on the other hand, become comparatively so cheap, that, in spite of all the laws which could be formed, they would be run in upon us, and our money flow out; till we fall to a level with foreigners, and lose that great superiority of riches, which had laid us under such disadvantages? . . .

From these principles we may learn what judgment we ought to form of those numberless bars, obstructions, and imposts, which all nations of Europe, and none more than England, have put upon trade.

From an exorbitant desire of amassing money, which never will heap up beyond its level, while it circulates; or from an ill-grounded apprehension of losing their specie, which never will sink below it."

Could any thing scatter our riches, it would be such impolitic contrivances. But this general ill effect, however, results from them, that they deprive neighboring nations of that free communication and exchange which the Author of the world has intended, by given them

> *soils, climates, and geniuses, so different from each other.*

People and governments had no reason to fear that gold and silver money would continue to hemorrhage out of a country until that nation was penniless; nor should they think that there was no natural market check or response to a continuous increase of gold and silver money into a country. Both types of money flows brought with it their own price and profit responses to assure restored balance and coordination in the buying and selling of goods across borders, and a market-determined distribution of specie money between and within countries participating in such international trade.

David Hume's analysis has been considered the devastating critique of one of the fundamental assumptions underlying the Mercantilist system. The famous Austrian-born economist, Gottfried Haberler said in his *Theory of International Trade* (1933) that, "Mercantilism received its death-blow in 1752 when Hume published his *Political Discourses*."

And University of Chicago economist, Jacob Viner, who was recognized as one of the twentieth century's most knowledgeable experts on the doctrines and history of global trade, argued in his *Studies in the Theory of International Trade* (1937):

> *In so far as the classical theory of the mechanism of international trade had one definite originator, it was David Hume. His main objective in presenting his theory of the mechanism was to show that the national supply of money would take care of itself, without need of, or possibility of benefit from, governmental intervention of the mercantilist type . . .*
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> *The entire mechanism was kept in operation by the profit motive of individuals, 'a moral attraction, arising from the interests and passions of men,' acting under the stimulus of differences in prices. The mechanism, therefore, was according to Hume automatically self-equilibrating, was intranational as well as international, was bilateral, involving adjustments both at home and abroad, and consisted of such changes in the volume of exports and imports, resulting chiefly from changes in relative prices but also in minor degree from fluctuations in exchange rates, as would bring about or maintain an*

> *even balance of trade, so that no further specie need move to liquidate a balance.*

Having disproved the Mercantilist theory of trade, David Hume, in his essay on "Of the Jealousy of Trade," argued for the wider benefits to all from international commerce and association. Through international trade each nation, he argued:

Learns new skills and technologies to improve their own productive potentials; widens the circle of goods and services a nation can have access to from countries possessing different resources and climates; stimulates innovation and creative change arising from the competition of foreign manufacturers and merchants; and increases the potentials for intensified division of labor and the higher productivity from more specialized production.

Hume concluded this essay on the jealousy of trade in words that have been famous ever since, in warning of dangers and absurdities resulting from government restrictions and controls on international trade, and on the benefits to all parties by leaving markets free to the peaceful and voluntary associations of trading partners, themselves:

> *Were our narrow and malignant politics to meet with success, we should reduce all our neighboring nations to the same state of sloth and ignorance that prevails in Morocco and the coast of Barbary. But what would be the consequences? They would send us no commodities; They could take none from us; Our domestic commerce itself would languish for want of emulation, example and instruction. And we ourselves should soon fall into the same abject condition, to which we had reduced them.*
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> *I shall therefore venture to acknowledge that, not only as a man, but as a British subject, I pray for the flourishing commerce of Germany, Spain, Italy, and even France itself. I am at least certain, that Great Britain, and all those nations would flourish more, did their sovereigns and ministers adopt such enlarged and benevolent sentiments towards each other.*

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