

**THE UNIVERSITY OF MANITOBA**

**AN ECONOMIC ANALYSIS OF  
THE WORKS OF J.A. HOBSON  
BY  
MARIE LOUISE VAN SCHIE**

**A THESIS  
SUBMITTED TO THE FACULTY OF GRADUATE STUDIES IN PARTIAL  
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MASTERS OF ARTS**

**DEPARTMENT OF ECONOMICS**

**WINNIPEG, MANITOBA**

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BY

MARIE LOUISE VAN SCHIE

A thesis submitted to the Faculty of Graduate Studies of  
the University of Manitoba in partial fulfillment of the requirements  
of the degree of

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## ABSTRACT

It is the purpose of this thesis to provide a critical review and analysis of the works of J.A. Hobson. Hobson was a self-professed economic heretic who, throughout his career, challenged the ranks of orthodox theory. He was an idealist whose chief interest in economics derived from his desire to affect social reform.

The second chapter describes the ideas of the early twentieth century which influenced Hobson. The third chapter proceeds with a brief overview of a number of books and articles written by Hobson between 1889 and 1936. The fourth chapter goes on to examine the philosophy and methodology underlying his works while certain recurrent themes including Monopoly, Imperialism, Underconsumption and Comparison with Keynes are treated separately in the fifth, sixth, seventh and eighth chapters respectively. Chapter nine, "A Critique of Marginalism," and chapter ten "The Shortcomings of Marxian Economics," outline some of his major criticisms of both the Marginalist and Marxian schools of thought.

Influenced deeply by the ideas of Ruskin and Spencer, his work is characteristically humanist in its interpretation of economics and always policies are examined in light of their impact on the various social groups and on society as a whole. He adopted an institutional approach to the study of economics, emphasizing both the individual and social aspects of human behavior.

Hobson was concerned about monopolists and their ability to manipulate markets and influence policy. In his examination of Imperialism, he identified the political and economic aspects of this state policy, and concluded that while Imperialism was bad business for the country at large, it served the interests of a small financial elite. He recognized that economic strength constituted a powerful force in governing the appropriation of the surplus under capitalism and advocated greater state control over the surplus to improve the living standards of the poor and to ensure an adequate level of consumption demand.

The turn of the century marks an epoch in the history of ideas, this period bringing forth both the Marginalist and the Marxian interpretations of economics. Hobson reacted against neoclassicism for he could not accept that laissez-faire capitalism afforded a just distribution and efficient allocation of resources. While highly critical of certain aspects of the capitalist system, he did not anticipate its total demise and rejected the economic determinism of the neo-marxians.

Hobson was, in some respects, a forerunner to Keynes, for his concern with involuntary unemployment, his emphasis on consumption and his preoccupation with state intervention for the purpose of regulating the economy are all issues which Keynes would later redress in his General Theory. There remain, however, fundamental differences between the two, for while Hobson ardently attacks neoclassicism, Keynes builds the whole

of his treatise on the foundations of Marginalism. Consequently, while many of the issues addressed are similar, the methodology used and policy implications reached by the two authors vary significantly.

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## CHAPTER 1

### INTRODUCTION

The history of economic thought is intended to enlighten readers as to the methodology and techniques employed by writers in the past, and the resulting theories developed by them. A number of economic theories were being put forth at the turn of this century, a period which witnessed an awareness amongst certain intellectuals and artists and amongst numerous politicians in Britain of the inconsistencies and injustices of the capitalist system. Many channelled their efforts towards the creation of a socialist state. H.G. Wells in 1912 wrote

We propose to use the term The Great State to express the ideal of a social system no longer localised, no longer immediately tied to and conditioned by the cultivation of the land, world-wide in its interests and outlook and catholic in its tolerance and sympathy, a system of great individual freedom with a universal understanding among its citizens of a collective thought and purpose. (Wells 1912, 32)

George Bernard Shaw was another Democratic Socialist dedicated to the pursuit of equality and justice.

I contended that poverty should be neither pitied as an inevitable misfortune, nor tolerated as a just retribution for misconduct, but resolutely stamped out and prevented from recurring as a disease fatal to human society. (Shaw 1928, 470)

W.H. Hamilton, writing in 1915, identifies this contemporary reform movement in politics as "progressivism" and notes that the growing body of economic literature of protest "attests the impossibility of finding relevancy by defining abstractions... The economist and the social reformer alike attest a lack of harmony between the basic notions underlying the reform program and the fundamental tenets of theory." (Hamilton 1915, 563) John A. Hobson was one such social economist who saw the need for a more humanist approach to the study of economics. Through his works, he brings attention to the inconsistencies between economic theory and economic reality and criticizes the marginalist proponents of laissez-faire capitalism.

Hobson adopted an institutional approach to the study of economics. Free from the dogmatic limitations of both the Marxian and Marginalist Schools of Thought, Hobson challenged the foundations of established theories, preaching heresies and inciting controversy wherever he went.

There were writers in America, including J.R. Commons and Thorstein Veblen, who had also rejected both the Neoclassical and Marxian interpretations of economics, and had instead chosen for themselves, a more empirical examination based on the dynamics of institutional and social interactions.

Jacob Oser, in his book The Evolution of Economic Thought, identifies eight key points which distinguish the institutionalists as a unique school of thought. First, he notes that institutionalist writers generally examine the economy as a complex organic entity, and do not attempt to isolate economic phenomena for separate study. (Oser 1963, 247) Such a view typifies Hobson's own organic approach to the study of economics. Secondly, Oser points out that the Institutional School emphasizes the role of institutions in economic life, adding that "The institutionalists of the period from 1900 to 1936 were especially interested in analyzing and reforming the institutions of credit, monopoly, absentee ownership, labour-management relations, social security, and the distribution of income." (Oser 1963, 247) Hobson himself was primarily interested in analyzing and reforming the institutions of monopoly and consumption. He argued that labour's disadvantaged position in the bargaining process and the maldistribution of consuming power within society lay at the source of these institutional woes. Thirdly, Oser argues that institutionalist writers stress the dynamic nature of economics. "Instead of equilibrium there is motion." (Oser 1963, 247) Institutionalists also appreciate the contributions of writers from other disciplines including history, anthropology, political science, sociology, philosophy, psychology and social psychology, since they recognize how these various institutional arrangements influence economic behavior.

Oser points out that for the institutionalists, maladjustments in economic life are not considered abnormal, but are themselves normal, and adds that these writers generally advocate interventionist policies in order to rectify these systemic weaknesses. (Oser 1963, 247) The fifth point which Oser feels characterizes the Institutional School is their recognition of the apparent conflicts of interest which arise between the various groups in society, and the need for a "representative and impartial government" to allocate resources amongst these competing groups so as to maintain the stability of the system and promote economic development.

The institutionalists promoted liberal, democratic reforms for the more equitable distribution of wealth and income. They invariably condemned laissez-faire and favoured a larger role for governments in economic and social affairs. (Oser 1963, 248)

This school criticized the abstract, inductive method employed by the marginalists and instead advocated a more concrete and empirical approach to the study of economics. Finally, Oser notes that the institutionalist writers repudiated the pleasure-pain psychology of Marginalism, and adopted instead, a more Freudian or behavioristic approach to the study of motivational psychology. (Oser 1963, 248) It will become evident that Hobson clearly possesses those liberal-reformist traits which Oser has termed typical of the institutionalists as a separate School of Economic Thought.

It is the purpose of this thesis to review and analyse the works of J.A. Hobson and to highlight some of his contributions to economic theory. The second chapter examines the political and economic climate of the early twentieth century, focusing on those currents of ideas which inspired the long and heretical writing career of John A. Hobson. The third chapter includes a brief overview of a number of books and articles written by Hobson between 1889 and 1936. Despite the amorphous character of his theories, his writings have since influenced policy makers and economists alike.

Chapter four examines the philosophy and methodology penetrating Hobson's theories. Certain themes, recurrent in a number of books and articles written by Hobson, have been isolated for study. Chapters five, six, and seven provide a critical review and analysis of the topics Monopoly, Imperialism, and Underconsumption, respectively. Chapter eight compares and contrasts the works of Hobson and Keynes while Chapter nine, "A Critique of Marginalism", outlines some of the major criticisms levied by Hobson against marginalism. Chapter ten reviews some of Hobson's major criticisms against Marx. Hobson was not alone in this battle against neoclassical theory, for as his contemporary George Bernard Shaw writes:

[This theory] is still taught as authentic political science at our Universities. It has broken the moral authority of university bred churchmen and reduced university bred statesmen to intellectually self-satisfied impotence. It is perhaps the worst of many dogmas that have in the course of human history led naturally amiable logicians to countenance and commit villainies that would revolt professed criminals. (Shaw 1928, 110)

Marginalist economics has survived despite the onslaught of criticisms directed at it, and its disciples still adhere closely to its assumptions about perfect competition and freedom of choice. Hobson himself proposed a more humanist interpretation of economics where policies were examined in light of their effects on the various groups in society. He rejected the tenets of marginalism and exposed many of the fallacies which result from the use of purely inductive logic. It was this departure from mainstream economics which made Hobson one of the most innovative and inspirational writers of his time.

## CHAPTER 2

### THE MAN AND HIS TIMES

Vitality and change characterized the birth of the present century. Amidst the clamour of financial and commercial activity, ideas poured forth which challenged the existing orthodoxy in every field of study. The works born of this spirit of change possessed what no previous epoch had achieved. Dedicated to the ideal of truth in representation and motivated by a sense of social justice, artists and writers alike captured the vitality of the common person from within the drab and abject poverty of his environment.

Politically, the end of the French Revolution marked the decline of the aristocracy across Europe. Influenced by such writers as Marx and Engels, many sought to spread revolutionary ideas across Europe. The Fabian Society was formed by a number of intellectuals dedicated to disseminating information about socialism and social justice. This spirit of political renaissance spread across Europe, generating the formation of numerous democratically socialist institutions.

This period of heightened social awareness found expression in art, music, and literature. Artists rejected the idyllic Romanticized view of the world presented by their predecessors. Francois Millet (1814-75) and Gustave Courbet (1819-77) chose to depict rural themes which

captured the hardships of peasant life. (Ash 1980,11) Other artists such as the Impressionist painters opposed the formal techniques employed by the Academie, and though they were rejected by the critics of their day they remained faithful to their movement. Shortly afterwards, Picasso, who was to revolutionize art in the Western world would enter his blue period, where he exposed the sombre realities of poverty and the strain of physical labour. (See *La Repasseuse*, 1904)

The pursuit of realism also inspired a number of writers during this time. Charles Dickens critically revealed the despicable working conditions of the labouring poor in the factories of London. In France, Emile Zola wrote a number of books depicting the life of the French peasantry. The ignoble characters and base language he uses accurately describes the conditions of abject poverty and human degradation which existed in these French mining communities during this time.

The need for realism was paramount to Hobson who cowered at the extreme level of abstraction to which the study of economics had been taken. He criticized such economists as J.B. Clark and Alfred Marshall for their unfounded assumptions about human behavior and the operation of the economic system. Assumptions about perfect competition were unwarranted when all around monopolists exercised their unbridled power. Supply did not automatically create its own demand as attested to by the periodic excesses of consumption goods. Economic theories did not accurately reflect the economic environment of Britain at the turn of the century, and though Hobson rejected neoclassical economics, he also felt that the

narrowly determinist view of the neo-marxians provided an unacceptable account of economic phenomena. Hobson maintained that the value of economic theory was to be determined by how closely it conformed to and described the actual economic conditions at any given time, and though he was criticized by his contemporaries for his heretical views, he remained faithful to this ideal.

In order to present a balanced and realistic account of economic phenomena, Hobson attempted to elicit from the various disciplines those elements which best served to substantiate his theories.

There is no strong centralizing force to help keep the special sciences in their proper orbits in the intellectual heavens: within each science numbers of little uncoordinated kingdoms and municipalities arise: local self government is everywhere carried to a licentious extreme.  
(Hobson 1909a, 265)

Hobson felt that an integration of the various sciences would help to elucidate some of the underlying motivations for economic behavior.

In the period during which Hobson was writing, monumental changes were occurring in both the physical and social sciences. Hobson always attempted to incorporate these discoveries into his own works. Quantum Mechanics, the study of subatomic particles, was first introduced at the beginning of this century. Werner Heisenberg and Niels Bohr discovered that Newtonian physics did not work at the subatomic level, and found that in order to understand the behavior of subatomic particles, it was necessary to alter the method of scientific investigation. (Zukav 1979)

This new organic view of science provided a temporary repose to the traditionally linear pattern of Western thought, permitting an influx of new ideas.

This Eastern notion of organic interdependence was fundamental to Hobson's own conception of the economy. Unlike many economists, Hobson did not try to isolate economic phenomena for study, but rather he attempted to trace the impact of these changes on the economy as a whole. One could not understand the whole by examining its parts, instead one could better understand the parts by having a clear understanding of the whole.

During the time of his writing, there was a growing acceptance of the usefulness and applicability of the social sciences. New insights into human behavior emerged from a variety of sources. Yet, many intellectuals engaged in the traditional disciplines maintained an independence of study, often continuing their works along established lines of thought. Hobson felt that economics was to be rightly regarded as a social science.

Sociology emerged as a separate discipline around 1850. Sociologists maintained that human behavior was largely shaped by the groups to which people belong and by the social interaction which takes place within these groups. (Robertson 1977, 4) One of the first writers to explore social behavior in a scientific manner was Herbert Spencer (1820-1903), who came from the same hometown as Hobson. Spencer compared societies

to living organisms, relating the complex organization of modern societies to the organs of an animal which function as a unit and together contribute to the welfare of the total animal. It was this organic view of society which would have a profound impact on Hobson, who appreciated Spencer's insights despite his political views.

Hobson regarded the economic system and the vast array of interdependencies thus created as an organic whole. Like Veblen, he appreciated how group mentality affected individual behavior. Many economists writing during this same period concentrated on the profit-maximizing behavior of individual firms and the utility-maximizing behavior of individual consumers. They argued that the combined result of these separate acts of maximization would lead to the most efficient operation of the economic system. Hobson, on the other hand, argued reversely that the success or failure of firms was largely dependent on the state of the economy at that particular time, for during periods of depressed trade, even the most astute businessman would find it difficult to make a profit.

Financial prosperity or adversity, though due in part to the skill, energy and enterprise of its constituent members, is mainly due to the general productivity of the system as a whole, which determines how much or how little of all other sorts of wealth are obtainable for a given product of the trade in question. (Hobson 1929, 175)

Writers throughout history have addressed themselves to various questions, questions which reflect the dominant social forces of the times and yet, as time passes, conditions change and what once appeared

true is no longer so. Hobson was critical of Marginalist economists whom he felt clung to an archaic view of the economy which was no longer realistic. He felt that the changing role of the government and other institutions in society necessitated a reassessment and revitalization of the available body of economic literature.

Hobson was a social reformer with a genuine concern for the promotion of social justice. Adam Smith, writing a century earlier, felt that massive industrial change would improve the welfare of the masses. He too was a moral philosopher concerned with removing the bitter problem of poverty and improving human welfare. In The Wealth of Nations, Adam Smith systematically examines the capitalist system, producing a rigorous support for the expansion of trade and the division of labour. He felt that limited government intervention in the economy would best serve the needs of the working classes, not so much as producers, but as consumers of goods to be bought and sold in the marketplace. Yet, one hundred years later, Hobson remarks that the rewards of progress had been distributed in a very unequal fashion. The market system of exchange proved an inadequate vehicle for the distribution of goods.

The question of how the fruits of industry were to be distributed was central to the works of the early economists. David Ricardo remarks that:

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To determine the laws which regulate this distribution is the principle problem in political economy. (Ricardo 1962, 1)

To determine the origin and distribution of the surplus was fundamental to the works of both Smith and Ricardo. Marx also examined the origin and distribution of the surplus, but it was his purpose to show how it was that workers were exploited by capitalists. To Hobson, the distribution of the surplus of industry was a critical determinant of the success or failure of economic policy. What was economics if not an examination of the surplus?

In his view, the marginalist school had redirected the focus of economics away from its most fundamental purpose by simply assuming the existence of a just distribution of income. In this sense, the introduction of marginalism marks perhaps the most radical shift in the study of economic theory. (Hutchison 1953) For these writers, the subjective use of utility replaced the older emphasis of value in use or scarcity value as forces affecting demand. Alfred Marshall in his partial equilibrium analysis brought together the producer's cost schedule and the consumer's utility schedule. John Bates Clark is accredited with having developed a set of equations whereby the whole of the surplus is exhausted in payments to the various factors of production, each one supposedly remunerated according to the value of his marginal product. (Hunt 1979, 287)

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The development of neoclassical economics placed an overwhelming emphasis on the individual as the decision maker. Minimum interference with market forces would ensure maximum benefits, for it was assumed that the 'natural' forces of supply and demand would generate the most efficient distribution. Pigou, in his Wealth and Welfare asserts:

Generally speaking, a transference of resources from the relatively rich to the relatively poor, brought about by interference with the natural course of wages, at any point, is unlikely to do otherwise than injure the national dividend, and therewith, in the end, the real income of the relatively poor. (Pigou 1912, 343)

Many economists proclaimed the efficiency and justice of laissez faire capitalism and freely advocated non-intervention on the basis of this "pure" theory. There was definitely a separate movement amongst certain Western intellectuals during this time referred to as a period of Naturalism. Darwin's publication of On the Origin of the Species by Means of Natural Selection (1859) would alter the conception of historical processes. This biological determinism of Darwin's would precipitate Marx's determinist view of economic history.

Marginalist economics conforms closely to this Naturalist interpretation, for it is characterized by an amoral or fatalistic acceptance of forces beyond the control of the individual. (Pizer 1966, 11) The notion that Natural Law governed the creation and distribution of the surplus was accepted by these economists who maintained that any interference with these 'natural' forces would result in a less than optimal situation.

Hobson was a realist who rejected the notion of 'Natural Law'. In his view, the force which governed supply and demand and thereby the distribution of the surplus was economic power, and those who had acquired this power were able to extract a surplus by virtue of their superior bargaining position. It was erroneous to argue that the

wealthy had somehow deservedly achieved their positions by some natural forces of selection. Imbued by a strong sense of social responsibility, Hobson would expend a great deal of effort during his writing career exposing the fallacies of marginalism.

In his memoirs, Hobson recalls having questioned the notion that "natural law" governed the distribution of wealth. (Hobson 1938, 24) Born into a middle class family in Derby, England, he felt that he had acquired an acute awareness of class distinctions at an early age. Hobson spent four years at Oxford pursuing a literary, historical and philosophical study of Latin and Greek civilizations. He later spent some time teaching at Exeter, though he was later dismissed from this post for his heretical views. Seligman notes that Hobson was a rather modest and "retiring" individual whose participation in public affairs "was limited to the back rooms." (Seligman 1902, 221) However, in later years Hobson would become more directly involved in politics.

Politically, Hobson identified with the Liberal Party. Like Matthew Arnold, he extracts his vision of Liberalism from Ulysses, describing it as "that untravelled world whose margin fades forever and forever as I move". (Hobson 1909a, 95) The British Labour Party, founded in 1906, had gained in popularity during the war, and though they would not form a government until 1924, they provided a renewed attack against those in power. In 1918, Hobson broke away from the Liberal Party and joined the ranks of the Labour Party. He would become one of the leading economic advisors of the British Labour Party following World War I, promoting

those policies which strengthened the bargaining position of the workers and improved their working conditions. (Seligman 1962, 224) He also joined the 1917 Club, a collection of individuals including Bertrand Russell and E.M. Forster who were concerned with artistic and literary movements, as well as achieving political reforms. (Seligman 1962, 115)

During his lifetime, Hobson came into contact with a number of politicians and economists whose views he often challenged. Others such as Hobhouse shared his convictions and remained life long friends. In addition to his political activities, Hobson wrote a number of articles for journals and completed a number of books during his career. These works, though sometimes excessive, exhibited an eloquent and sometimes even poetic quality of style and vision.

### CHAPTER 3

#### REVIEW OF THE LITERATURE

This chapter provides a brief account of a number of books and articles written by Hobson from 1889 to his death in 1940. Hobson was a prolific writer, who, during his lifetime, completed over fifty books and contributed to numerous journals including The Manchester Guardian, The Speaker, "a leading Liberal magazine", and The Nation, "a weekly journal devoted to Politics, Literature, Science, Drama, Music, Art and Finance." In addition, he was a member of the ethical society along with other such influential thinkers as Ritchie and J.R. Macdonald and occasionally chaired for The Royal Institute of International Affairs. With Spencer's dedication to the unity of knowledge and a Liberal reformist mindset, Hobson subjected traditional theory to empirical tests. Often, where the two diverged, Hobson would point out the shortcomings of the existing theory, and would offer, in its place, what he felt to be a more realistic account of economic phenomena.

His first book, entitled Physiology of Industry was published jointly with Mummery in 1889. The purpose of this work was to expose the fallacies of Say's Law and show how excessive savings led to depressions. Hobson argued that there was no guarantee that the level of savings would equal the desired level of investment from the point of view of the community.

[Saving] signifies not only abstention from consumption but application as a means of further production. If the whole of this surplus can be saved, it must be necessary to show that it can be used to produce other things which are wanted. (Hobson [1889] 1956, 121)

In this macroeconomic study of the economy, Hobson emphasizes the importance of consumption as the dynamic force stimulating economic activity. He was concerned that in times of depression, both prices and incomes were falling, thus offering no assurance that falling prices would eventually trigger economic recovery. "Thus every rise and fall in retail prices will mean a corresponding rise or fall of the money income of the community. How then will a general decline of retail prices act as an effective stimulus to increased demand for commodities, when the average income of consumers has fallen correspondingly?" (Hobson [1889] 1956, 121)

Excessive savings caused the underemployment of labour and capital during a slump. During these periods it was critical to exercise demand, for it was only through increased consumption that the economy would be lifted out of a depression. This view differed markedly from those classical economists who maintained that supply automatically creates its own demand. Upon the publication of The Physiology of Industry, The London Extension Board would prevent Hobson from lecturing on Political Economy because he had committed the unpardonable sin of "questioning the virtue of unlimited thrift." (Hobson 1938, 31)

The "humanization" of economic study was a goal which Hobson adopted from Ruskin. The Problems of Poverty (1889), The Problem of the Unemployed (1896) and The Social Problem (1902) all examined social problems in terms of the human costs involved. In these works, Hobson is highly critical of Orthodox theory which he felt did not contain an accurate account of these social maladies. Too often, the onus was on the individual to ameliorate circumstances that were actually beyond his control. Poverty and unemployment were the result of structural weaknesses, in Hobson's view, and were incapable of being cured on an individualist basis. (Hobson 1902, 138)

This social approach to economics was also pursued by Ruskin, who was seen by Hobson to have a clear perception of social institutions. In 1904, he published his book entitled John Ruskin, Social Reformer in which he praises Ruskin's heretical views and his "early spirit of defiant scrutiny". This book reveals much of the philosophy underlying Hobson's own works. Like Ruskin, Hobson was critical of the marginalists for their overwhelming preoccupation with technique and method. Their high level of abstraction and use of purely inductive logic had divorced economic theory from economic reality. Instead, Hobson chose a more informal institutional approach which afforded him a more humanitarian perspective of economic phenomena.

Hobson was critical of existing theories of distribution which regarded labour as the residual claimant after the fixed charges of rent, profit and interest were accounted for. (Hobson 1891a, 263) In 1891, he

published an article in the Quarterly Journal of Economics entitled "The Law of Three Rents". In this same issue J.B. Clark submitted an article entitled "Distribution as Determined by a Law of Rent". Both writers attempted to formulate a theory of distribution using the Ricardian technique of varying one input while holding all other variables constant, in order to measure the relative factor shares. Both conclude that under conditions of free competition, the wage rate would be set by the marginal worker and the interest rate set by the marginal unit of capital. Hobson qualifies this by adding that as soon as there exists any scarcity of supply of any of these factors, payments will exceed this margin, for he is fully aware that certain factors are able to extract monopoly rents which do figure in the price. The monumental importance of these works is acknowledged by the editor who writes:

The importance of the theory discussed in the above article by Mr. Hobson and in that which follows by professor Clark, and the different methods of treatment followed by them with substantial identity of conclusion will sufficiently explain to the readers of the Journal the large portion of space given... It thus appeared that the two writers, working upon the subject independently and without knowledge by either as to the other's speculations, had come simultaneously to the important modification of all previous theories of distribution, which are now submitted for the judgement of our readers. (Editorial Note 1891, 288)

In his examination of the forces which regulated supply and demand and thus affected the distribution of the final product, Hobson continually stressed the presence of unequal bargaining or monopoly power. Certain buyers or sellers, he maintained, were able to extract a surplus element

from the bargaining process. "This surplus corresponding to differential rent for land had no rational or equitable basis." (Hobson 1938, 48) Instead, as he argued forcibly in The Economics of Distribution (1904), economic power was the main determinant of the distribution of wealth. It was in these works that Hobson began to distinguish between what he termed the 'earned' and the 'unearned' elements of income, viewing the latter as the source of excessive savings.

Excessive saving, or conversely underconsumption, was viewed by Hobson as the root cause of Imperialist aggression by European powers. "The outbreak of the Boer War in 1889 will, however, rank in history as the simplest and plainest example of political and economic motives in Imperialism." (Hobson 1938, 60) Hobson himself witnessed the blatant manipulation of state policy by powerful business interests. He subsequently wrote a number of articles on the topic for the Manchester Guardian and two books including The South African War (1900) and The Psychology of Jingoism (1901). Imperialism, perhaps his most renowned work, was published in 1902. In this book, Hobson identifies underconsumption as the economic taproot of Imperialism, and warns against the dangers of destroying the tentative bonds of internationalism which progressive trade and intercourse had forged.

The extensiveness of trade relations at the turn of the century had promoted a strong sense of optimism amongst cosmopolitan writers. In his book International Trade (1904), Hobson identifies a number of

reasons why he favours free trade over protectionist policies. He examines the incidence of protective duties, the impact of the price level on the balance of trade and the effects of barriers to trade on the aggregate level of consumption. Hobson concludes that "Protectionism, like Imperialism, serves the needs of certain classes to the detriment of the masses and promotes feelings of hostility in international relations." (Hobson 1904a, 181)

The Economics of Distribution (1904) is an attempt by Hobson to present a comprehensive theory of distribution. The theory proposed was developed earlier in his article on "The Three Rents" which appeared in the Quarterly Journal of Economics in April of 1891. In this book, Hobson argues that the relative power of those engaged in trade determines the distribution of the product to a certain degree. Competition sets the upper and lower limits within which the price is set, but within these limits, those in a more advantageous position are likely to gain extra from the exchange. (Hobson 1904c, 19)

Lawrence Laughlin comments on The Economics of Distribution in the Journal of Political Economy, June 1904. He agrees with Hobson's criticism of the concept of consumers' rent as the difference between the market price and the price that consumers might be willing to pay.

There can be no doubt of the existence of a producers' rent (the difference between the costs of production and the price) which is tangible as contrasted with the speculative abstraction conveyed by the term 'consumers' rent'. The one is capable of quantitative statement, the other is not. (Laughlin 1904, 308)

In attempting to evaluate how the various factors of production are rewarded, Hobson introduces the concept of transfer costs. In short, he argues that if a factor required for the production of A can also be used more productively in the production of B and therefore receive higher payments in the production of B, then this higher price must be paid for this factor if it is to be employed in the production of A. Laughlin disagrees with Hobson's determination of factor payments, asserting that land is qualitatively very different from both labour and capital and cannot be treated the same for the sake of developing a uniform theory of distribution. Certain concepts such as the Law of Diminishing Returns could only be applied to land, for "the limitation of the product is not in the nature of labour or capital, but in the very nature of the soil." (Laughlin 1904, 319) Evidently, certain economists found it very difficult to adapt their thinking to the changing circumstances. The shift in focus away from land and towards labour and capital reflected, in part, the diminishing importance of agriculture in terms of employment and as a percentage of National Income.

Industrial Capitalism was well advanced in Britain by the early 1900's. In The Evolution of Modern Capitalism (1906), Hobson traces the development of the machine economy and examines the changing relationship of labour to the ever-growing body of capital used in the production process. He examines the effects of technological change on labour, particularly as it affects the level of unemployment. He advocates the creation of an environment conducive to free competition

in industry, denying any natural tendencies for such conditions to exist. Once again Hobson notes that the failure of demand to keep pace with supply causes the ensuing depressions in trade. In his discussion of savings, he argues that the interest rate is not a sufficient regulator of savings and investment.

The quantitative relations subsisting between the aggregate of 'spending' and 'saving' do not rest upon any such basis of direct and accurately measured self-interest as will serve to keep a constant just balance calling forth at each time exactly that amount of saving economically required to forward the progress of industry and provide for the actual needs of further consumption. (Hobson 1906, 307)

Hobson published two books in 1909, The Industrial System and Crisis of Liberalism: New Issues of Democracy. It is during this period in his writing career that Hobson recognizes the influences of such writers as L.T. Hobhouse and Graham Wallas. "My growing repudiation of the efforts of economists to make their study an exact quantitative science, with values expressed in purely monetary terms, was fortified by a clearer conception of the humanist interpretation to which I had been moving." (Hobson 1938, 17) Hobhouse was a British sociologist who was a close friend of Hobson's. He too rejected the laissez-faire liberalism of his day and was also actively involved in social and political movements. Hobhouse pursued what has been termed 'social liberalism', "a balanced relationship between individual freedom and responsibility and state control." (Ginsberg 1908, 487) Hobson also saw the need for the state to undertake more functions than in the past. Freedman notes that "Liberal thought was taking new direction on the issue of the public and

private spheres. The traditional liberal struggle against monopoly and privilege was harnessed to a new social purpose. (Freeden 1978, 44) Hobson felt that both Hobhouse and Graham Wallas were instrumental in his pursuit of a humanist approach to the study of economics. (Hobson 1938, 80)

"The old laissez-faire Liberalism is dead". (Hobson 1909a, 3) The New Liberalism would be one of modified private and public institutions. In The Industrial System, Hobson proposes ways in which the State can affect distribution through its regulation of industry, through its direct operation of industry or through taxation. It becomes increasingly evident that the arguments put forth by Hobson are directed at affecting policy.

Hobson identified a number of critical ways in which the political process required reorganization in order to increase the accessibility and accountability of those in power. There was a need for active participation by all classes, including women. (Hobson 1909a,85) It was not until 1918 that British Parliament enfranchised all women householders and university graduates over thirty years of age and not until 1928 that the voting age was lowered to twenty-one, finally giving women complete political equality with men. (Lipson 1964, 81) To Hobson, equality of opportunity also required public ownership of the railways, public organization of credit and insurance, full freedom of education, equal access to public law and the power to either tax or control monopolies. (Hobson 1909a, 171)

In The Science of Wealth (1911), Hobson reiterates many of the tenets of his earlier theories, with an emphasis on the unproductive surplus as the source of depressions. Contrary to marginalist theory, Hobson asserts that the separate units of capital and labour only achieve their full productive potential when they are brought together. This whole, which is greater than the mere sum of its constituent parts is the rightful property of society. (Hobson 1911, 116) Hobson rejected the hedonic principles of marginalism and instead adopted to treat welfare in terms of the human costs of production and benefits of consumption. Work and Wealth(1914) is largely a critique of marginalism with its exaggerated stress on production and its reliance on 'tendencies' which falsely represent the normal facts and forces. (Hobson [1914] 1968, 175) "This distinctively mechanical character is inherent in the structure of an economic science based upon the subserviency of all human activities to a purely quantitative conception of wealth, and a purely quantitative standard of value." (Hobson [1914] 1968, 8) Hobson himself was moving further and further away from this mathematical treatment of economics towards a more and more humanist conception of wealth and value. W.C. Mitchell writes "Work and Wealth is the work of a man who is a sort of moral prophet, whose interest lies in welfare as primarily an ethical concept." (Mitchell 1969, 506)

Just before the war, Britain had been experiencing quite a rapid increase in prices. Quantity theorists attributed this rise in prices to the enlarged output of gold, but Hobson was unsatisfied with this explanation. In his book Gold, Prices and Wages (1913), Hobson argues

that fluctuations in the price of gold do not affect the general price level any more than fluctuations in the price of any other good. He observed an incredible increase in the supply of bank credit arising from the increasing variety of property which could be used as security for bank credit. (Hobson [1913] 1963, 72) He also observed that the greater demand for developmental capital in new areas exerted upward pressure on the available credit, causing a rise in prices. Keynes criticizes his monetary theory for being illogical, claiming that Hobson confuses the two meanings of the word credit and uses them interchangeably. (Keynes 1913, 396) What Hobson was attempting to show was that there was a relationship between the volume of trade, the velocity of circulation and the price level, and that it was ludicrous to treat the first two variables as constants as Fisher did.

Intense nationalism and rivalry amongst competing empires burst into the most devastating spectacle of a war ever imaginable. The war which began between Austria-Hungary and Serbia would eventually involve 32 nations, 28 of which were Allied forces including Great Britain, France, Russia and Italy against the Central Powers of Germany, Austria-Hungary, Turkey and Bulgaria.

The belief in man as a rational and thoughtful being was shaken almost to destruction by the war, and all other societies and organizations based upon this belief suffered accordingly. (Hobson 1938, 96)

Hobson felt that the war demonstrated the lack of democratic control over foreign policy. "Public opinion and a common sense of justice are found to be inadequate safeguards." (Hobson 1915, 6) In his book Towards International Government, (1915) Hobson reviewed the issues discussed in the Bryce Report of 1915 recommending the establishment of a League of Nations. He felt that European peace could only be achieved by a concensus in which the united efforts of a number of European countries would be brought against any agitator from outside or inside the union. Economic boycotts were seen to be useful weapons to be used against any offender of the new international law. (Hobson 1915, 90) The new peace also required the formal recognition of a number of underdeveloped nations who had been the victims of imperialism.

But as subject peoples are struggling for self government, it seems evident that any scheme for securing peace must recognize this liberation as an indispensable condition of effective internationalism. Before nations can live together in society they must have their existence acknowledged and safely guaranteed. (Hobson 1915, 124)

The intense competition amongst Imperialist powers had fostered anxiety amongst German businessmen as to the availability of markets. "Que la situation économique d'Allemagne soit preciaire, en ce qui concerne ses debouches étrangers, ne peut pas etre conteste." (Lambert 1915, 124) Hobson felt that the success of any union of European powers was contingent upon Germany's inclusion, for without her membership, the rest of Europe could not feel secure. (Hobson 1915, 155)

Anti-German sentiments lingered on after the war. A renewed plea for protectionism arose from those who felt that restricted trade with Germany would weaken her militarily. An economic conference held by the Allies in Paris, June of 1916 recommended that countries prohibit trade with the enemy and the London Chamber of Commerce suggested levying heavy tariffs on German imports. (Hobson 1916, 153)

The issue of protectionism had been dealt with extensively by Hobson in his book International Trade (1904). In this book, Hobson had avowedly dismissed protectionism as bad politics and economics for the country at large. The new protectionism was supported by those who claimed that it would impede German trade and thereby weaken her militarily. Once again Hobson contends the virtues of tariffs in his book The New Protectionism (1916), arguing that restrictive trade with the enemy would be more harmful to Britain than to Germany. He protests the reinstatement of the Navigation Acts, for as he points out, "British tonnage entering German ports before the war was about four times as great as the German shipping entering British ports... therefore a mutual boycott would be to our disadvantage." (Hobson 1916, 69) Protectionist policies would do nothing to stop German aggression and would merely promote and prolong feelings of hostility between Germany and the rest of Europe. Hobson so strongly opposed restrictive trade policies that though he was a strong Liberal, he actually left the party in 1918 when the Liberals abandoned Free Trade. (Hobson 1938, 126)

The size and functions of the government had increased substantially during the war and remained so after the war. Taxation in the New State (1919) deals with the issues of financing government expenditures through taxation. In addition to the higher level of government services, Britain had acquired a serious debt during the war which had to be paid off. Hobson advocates the extensive use of the progressive income tax for reasons of equity. Ability to pay should be the criterion for tax collection, for Hobson rejects the notion that citizens who benefit from public expenditure should be charged. He also objected to indirect taxation, for he felt that the incidence of the tax should be visible and known by all. (Hobson 1919, 64) In order to finance the debt, the government should tax the excessive profits made during the war. In addition, rather than carrying a large debt load, the government should levy a once and for all tax on capital, for in this way, it would not have any permanent effect on the capital/labour ratio. (Hobson 1919, 216)

Recent British Economics, written in 1923 examines the changing economic issues facing British policy makers after the war. Hobson states that London had been replaced by New York as the financial centre of the world. (Hobson 1923, 7) He appreciates the tremendous growth in the size and functions of the government since the war, and notes the implications of this expansion for tax policy. Hobson stresses the need for increased productivity of British industry if she was to remain competitive internationally. Measures designed to improve working conditions and improve the security of tenure would be most favourable

to workers and would result in the most significant increases in productivity. Hobson points out that workers are unlikely to exert more effort if they expect that the whole of this surplus will go into the pockets of their already rich employers. (Hobson 1923, 13)

Hobson wrote a number of articles for the *Nation*, a journal which he felt had "a real influence in the new trend of Liberalism." The General Strike of 1926 occurred during a period of high unemployment. "The Crisis in British Politics", written in May of 1929 reviews the election promises of the three political parties, specifically their proposals for alleviating the widespread unemployment. The Liberals' platform in issues of foreign and domestic policy so closely resembled that of the Labour Party that Hobson saw the potential for "a voluntary cooperation that might last a considerable period." (Hobson 1929c, 582)

The Labour Party commissioned a study on British industry and commerce during their brief period in office. In "A Report on British Industry", written for the *Nation* in May of 1929, Hobson reviews the findings of this committee. They regard the problem of unemployment and a lowered standard of living as resulting from a failure to maintain an adequate level of exports. (Hobson 1929b, 650) They stress the need for modernization of British industry in order to remain competitive internationally. Ramsay Macdonald, the British Prime Minister at this time, was greatly influenced by Hobson's ideas, and argued that the problem was rooted in a low wage policy, for higher working class expenditures would stimulate production and employment and thereby

facilitate the modernization of these industries. Increasing the level of domestic consumption through a policy of high wages would effectively increase national income and reduce unemployment.

In his article "Unemployment in England", written for the Nation in January of 1930, Hobson criticizes the Labour government for failing to eliminate unemployment with reasonable alacrity. He recognizes that the measures undertaken by the party will reduce unemployment, but argues that what is really required is a complete reorganization of certain industries in order to reduce costs of production without cutting back on wages. (Hobson 1930a, 97)

Few employers can yet be got to recognize that the capitalist era of individual enterprise and laissez-faire must in the staple trades be replaced by an era of combination, financial, industrial and commercial. (Hobson 1930a, 97)

After World War 1, Hobson witnessed a growing reliance on the export of manufactures in order to finance the expanding import of foodstuffs. This increased volume of trade occurred internationally, and consequently, when security values on the New York Stock Exchange plummeted on October 24, 1929, its repercussions were felt in every major capitalist center around the world. Between 1929 and 1932, stock values on the New York Exchange fell from \$87 billion to \$19 billion. (Hacker 1970, 300) A complete lack of confidence in the system produced cutbacks in production and investment, aggravating the already low levels of national income and employment.

On September 30, 1931, Hobson wrote an article for the Nation entitled "The Blundering British Budget". In this article, he criticizes the attempts of British statesmen to balance the budget by forcing cutbacks on the dole and on the incomes of the public sector workers. This reduction in consumption, he argued, would cause further cutbacks in production and would aggravate the already high levels of unemployment, hardly what the country needed at this point in history.

In December of 1931, Hobson wrote another article for the Nation entitled "England on the Edge of Chaos". The Conservative Party in power was determined to set up import barriers to protect British manufacturing from outside competition, a policy which Hobson himself was strongly opposed to.

To raise these new foreign troubles at a time like this, when every part of the world is in the throes of the greatest economic and political disaster history has ever seen, is indeed a monumental folly. (Hobson 1931b, 640)

The latter years of Hobson's career were directed at expounding the virtues of an institutional approach. His book Poverty in Plenty (1931) looks at labour and its averse position in the bargaining process. Free Thought in the Social Sciences, written in 1926, and Economics and Ethics, written subsequently in 1929 attempt to reclassify economics as a Social Science, and illustrate the essentially ethical nature of economic policy decisions. Hobson levies heavy criticisms on both the Marginalists and the Marxists for their myopic view of man and favours a more balanced approach which considers both the individual and social

aspects of human behavior. In this book he also lays out a plan for a mixed economy of public and private enterprise.

In 1937, Hobson wrote a book entitled Modern sociologists- Veblen which is a tribute to the works of Veblen for his tremendous insights into the workings of the American economy. Hobson especially admired his "depth of research into the origin and development of social institutions under the dominant pressure of economic forces." (Hobson 1937, 9) Veblen too was critical of marginalist economics, for he argued that it was not possible to balance labour's disutility in production with the consumer's utility in consumption, because each phenomenon lay within the consciousness of a distinct person. His perception of emulation and workmanship as important factors motivating human behavior reveal how Veblen, like Hobson emphasized the ultimately social character of economic activities.

Hobson's final autobiographical work entitled Confessions of an Economic Heretic (1938) is a synthesis of his career as a teacher, journalist, and foremost as a writer. His earliest heresy began with the rejection of Say's Law. Many of the social maladies which he subsequently addressed in his later works were regarded as consequences of underconsumption or conversely, over-saving. The surplus income, which would be converted into automatic savings regardless of the prevailing rate of interest, originated in the bargaining process. Capitalists, he argued, had an advantageous position in the bargaining process by virtue of their wealth and economic power. Internationally,

wealthy empires were exerting their influence on poor underdeveloped countries. The exploitation of backward areas for the purpose of financial gain by British investors was denounced by Hobson as detrimental to sound international relations.

Hobson came under attack many times during his career as a writer by those who either disagreed with his basic position or otherwise criticized his sometimes contradictory arguments. In attempting to strengthen his particular view, Hobson often overstressed certain elements while neglecting to mention the effects of other equally if not more important factors. This oversight was often interpreted by his critics to signal an ignorance, on Hobson's part, of the basic functioning of the economic system. To be sure, Hobson did not always present his readers with a consistent argument and would sometimes contradict himself from one book to the next or even within the very same book. Nonetheless, this distance from pure theory afforded Hobson a less 'intellectually tainted' perspective. His perspective was one of moral sympathy rather than the rigid logic of his contemporaries. Hobson wrote in 1938:

Looking back, I do not regret this exclusion from orthodox economic circles. For the mixed life of lecturing, controversial politics and journalism to which I was driven, though in some ways damaging to orderly thinking, had compensations that were very valuable. (Cole 1940, 355)

Often Hobson was writing for a wider audience and simplified his ideas in order to facilitate a general understanding of his argument.

Though it has been impossible to convey adequately his deep understanding of economic processes, it must be admitted that the formulation of his theory was rather crude, it being set out too often in the language of journalism rather than of science. (Coppack 1953, 20)

In The Industrial System, Hobson attempts to present a unitary method for measuring the productivity of the different factors of production and reduces them all to "units of productive power". E.J. Urwick notes that this unitary treatment "compels us to regard rent as a necessary payment for so many units of productive power of a certain kind", a conclusion which contradicts his earlier claim that all rent is necessarily unproductive. (Urwick 1909, 443) The very process of trying to somehow quantify the contributions of the various factors of production is a 'futile exercise' for which Hobson elsewhere criticizes the Marginalists. Barbara Wootton, commenting on his book Poverty in Plenty remarks "Mr Hobson's essay leaves the impression that on every page, the author is damaging a good cause by bad (and not always mutually consistent) arguments. (Wootton 1932, 98) Paul Homan questions the validity of his logic, noting that "Hobson has a case against the justice of current distribution, and is convincing in denying the applicability of competitive theory to a system in which special advantage plays so large a part. But in pressing these points home he occasionally goes to the untoward length of complete unintelligibility." (Homan 1928, 327)

Though Hobson was sometimes criticized for his lack of consistency or for his illogical conclusions, many animadversions directed at him were delivered by those who simply possessed different points of view. Edwin Cannan, commenting on Hobson's book Democracy After the War, is evidently disillusioned with the effects of nationalism and expresses his contempt for Hobson's treatment of the subject. (Cannan 1918, 93) Elsewhere in a review of The New Protectionism, Cannan rejects Hobson's assessment of the international situation, arguing that "the economic interpretation of hostile feelings is generally a fraud." (Cannan 1916, 367)

A contemporary of Hobson's, W.H. Hamilton, in 1915 writes that "his superstructure of sociology and his substructure of hedonistic economics are incompatible." Hobson struggled with the notions of wealth and welfare in these early works, and became increasingly convinced of the need for a more "human" valuation of these terms. Hamilton complains that while Hobson was critical of the marginalist school, he himself adopted an essentially hedonist calculus in his determination of costs and utilities.

The common standards of social justice, the theory of individual liberty, the principles of contract, the right of inheritance and like conventions, are all overlooked. Here, the critics are insisting, lies the real battlefield between opposing industrial interests. Yet, here the silence of Hobson is that of an individualist whose theories rest upon the immutability of the prevailing system. (Hamilton 1915, 571)

While such an interpretation hardly characterizes the essence of Hobson's early ideas, it is most certainly falsified by the bulk of his later works in which he advocated such major institutional reforms as bringing the whole of routine industry under public control. By nationalizing industries where the production process was either degrading or monotonous, Hobson felt that the conditions of work could thus be improved for these workers.

The true value of Hobson's lifelong heretical career cannot be determined by the degree of soundness of his various arguments. Hobson was a prolific writer whose ideas may have sometimes been inconsistent, but as Freedman notes: "Most inconsistencies of Hobson's, not severe enough to disrupt the general coherence of his social thought, are better explained as reflections of the intellectual gropings and hammerings-out of issues which typified the new Liberals". (Freedman 1978, 109) Rather, his invaluable contribution to the history of economic thought derives from his ability to challenge orthodox theory through his daring and provocative queries into the workings of the economic system. A.W. Flux remarks: "Though we find difficulty in accepting either the point of view or the bulk of the conclusions of Mr. Hobson, we find much that stimulates to careful and precise thought in his book; were it only that one is driven to try to follow the process by which, with the premises in many respects of the soundest, he finds himself at variance with the mode of treatment and many of the results of sound thinkers." (Flux 1900, 384)

J.M. Keynes, who later pursued many of the points raised by Hobson, comments on the idiosyncratic nature of Hobson's works.

One comes to a new book by Mr. Hobson with mixed feelings in hope of stimulating ideas and of some fruitful criticisms of orthodoxy from an independent and individual standpoint, but also expectant of much sophistry, misunderstanding and perverse thought.

Hobson was an iconoclast whose attack on orthodoxy stimulated independent thought. In tracing his works from the late 1800's to the middle of the twentieth century, one appreciates the growth of Hobson's humanist approach to the study of economics. There can be no doubt that Hobson moved further and further away from mainstream theory, particularly as the theory acquired a more and more rigorous analytical quality. Davis notes that "Indeed down to about 1909, he might have considered himself a member of Marshall's School (the Cambridge School), though decidedly a heretical one... but Hobson's later writings bring him into such sharp conflict with the concepts of neoclassicism that he seems to have broken all ties with it." (Davis 1957, 295) His own institutional approach affords a more organic view of economic processes with an emphasis on how social institutions interact to affect human behavior. "Human life in all its related activities is an art and, while the physical and other organic sciences can supply knowledge to the practitioners of this art, they cannot make it into a science." (Hobson 1938, 202)

## CHAPTER 4

### CONCEPTUALIZATION AND METHOD

Hobson was an idealist who believed in the ability of man to affect his own destiny. He held an organic view of society and saw true democracy as the expression of that social will. This chapter examines Hobson's philosophy and methodology and demonstrates how Hobson's institutional approach afforded him a more realistic and humanist interpretation of economics than that offered by either the Marginalist or Marxian writers of his day. In his view, certain critical institutional changes were necessary before British democracy could become meaningful to all of her citizens.

In his efforts to humanize the study of economics, Hobson urged a more empirical approach which accounted for the economic and non-economic factors affecting behavior. His philosophy and method are based on the observations and experiences of the author. In this way, Hobson's philosophy clearly resembles that of the Empiricists, particularly that of John Locke (1632-1704). One could, in fact, actually parallel Hobson's attack on the Marginalists with the attack which the Empiricist writers waged against the Rationalists in the late 1600's. Like the Marginalists of the twentieth century, the Rationalists accepted Descartes's claim that logic and mathematics were models for all true knowledge. (Wolff 1981, 341) John Locke, in his Essays Concerning Human Understanding, argued conversely that Reason is merely a tool for organizing knowledge and that only through experience does one attain

knowledge, for it is through Experience "that all knowledge is founded and from that it ultimately derives itself." (Locke 1924, 42)

Hobson criticized the marginalists for their overwhelming fascination with technique and their virtual neglect of actual occurrences. He distrusted reason and logic and rejected any notion of natural law as governing society and its institutions. Since the writings of Adam Smith, economists have clung blindly to the doctrine of Natural Law, even after it was abandoned in the physical sciences. (Needham 1953, 71) Hobson who himself possessed a more dynamic, and organic world view adopted an institutional approach to the study of economics.

Many of John Locke's political ideas have since become imbedded in the constitution of the United States. Hobson's ideas about government conformed closely to the tenets of Locke's theory. Locke believed that sovereignty did not reside with the state but with the people. He advocated the need for a system of checks and balances in government where the legislative body had more power than the executive or judicial body. (Macridis 1980, 34) Hobson, in his Crisis of Liberalism, argued that the public had no control over foreign policy and in the early months of World War 1, Hobson was on the executive committee of the Union of Democratic Control whose purpose was to 'secure real parliamentary control over foreign policy'. (Porter 1968, 221) He argued that constitutional reform was a necessary prerequisite to meaningful democracy in Britain. The House of Lords could and did consistently veto a number of measures put forth by the House of Commons affecting changes to the laws concerning property and licensing. The

destruction of this veto, for which Hobson lobbied extensively, was finally accomplished in 1911. (Hobson 1909a, 5)

Locke believed that revolution was not only a right but an obligation of the people. (Robertson 1977, 460) Hobson felt that equal access to the democratic process was vital. He too maintained that there existed certain "rights" of the community, and justified revolutionary action if it was necessary to secure or protect these rights. On the whole, however, Hobson pursued a more passively persuasive approach to political or economic reform. "Effective government," he argued, "in any branch of conduct requires the real consent not merely of a triumphant majority, but also of the defeated minority." (Hobson 1931a, 82) Democracy was in its infancy before the first World War, and Hobson felt that if properly applied, Democratic Socialism could effectively serve the needs of the people.

Perhaps one of the most salient features of Hobson's work which distinguishes him from his contemporaries is his treatment of man, not as a mere economic being, but rather as a complex organic entity. In his works, he attempts to synthesize the various facets of man in an effort to provide a more realistic conception of man in his economic endeavors. This notion of an organic harmony inevitably enters into his exposition of economic phenomenon, but more importantly it situates economic studies in the larger treatise of man and his environment.

Many economists, while recognizing the complex nature of man, have taken the liberty of isolating what they consider to be rational economic behavior in order to facilitate what they purport to be scientific study. Such action, Hobson felt, had produced a grossly distorted view of reality and had, thereby, limited the useful application of existing theory. To begin with, Hobson rejected the claim that man was an inherently selfish and greedy being motivated solely by individualistic goals. This, he felt, described man in a primitive state where each must struggle to meet his own basic needs. Instead, in an environment where the livelihood of each individual was largely dependent on the healthy operation of the economic system as a whole, and where the very personality of man was, to a large extent, determined by the environment in which he lived, Hobson felt that man could more accurately be described as a social being, therefore capable of being motivated by altruistic or social goals.

Like the early Greek philosophers, Hobson viewed society as an organic entity, responsible to a certain degree for the organic welfare of its members.

Now whatever view we hold about society on a physical plane as a collection of individual bodies living in some sort of union, it can, I think be made quite clear that society is rightly regarded as a moral, rational organism, in the sense that it has a common life, character, and purpose of its members. (Hobson 1909a, 73)

In the organic makeup of man, basic needs take precedence. Thus, Hobson felt that one of the most acute responsibilities of society was to ensure that the basic needs of all of its members were met, for just as society, through the making of laws, ensures the right to life of all its members, it is obligated to ensure that each individual has access to those goods which sustain life. (Hobson 1902, 90) There must be an adequate provision of public goods in those cases where, due to the imperfections of the market system, the individual was unable to provide himself with his basic needs. This, Hobson felt, was the foundation of a healthy environment.

What is necessary is that some term should be used to assist the mind in realizing that all life proceeds by the cooperation of units working, not each for its separate self, but rather for a whole, and attaining their separate well-being in the proper functioning of that whole. (Hobson [1914] 1968, 16)

Hobson saw the welfare of the individual as being determined by the interplay of social, economic, political and moral forces, not in a static sense but in a dynamic and progressive sense. Thus, poverty and unemployment and other manifestations of social disease afflicted the mental and physical well-being of all of society. The need for increased public activity in order to rectify these social disorders was essential to the organic welfare of society and therefore to the well-being of its members.

Hobson felt that there was an unwarranted bias against the public provision of goods. He argued that the enlargement of public functions was justified if it enlarged personal liberty. (Hobson 1909a, 98) The reliance on charity for such services reflected not only a distorted conception of social responsibility, it also resulted in the over-provision of some goods and the under-provision of others, depending on the whims of the privileged classes. (Hobson 1909a, 220) Thus, the balance between publicly and privately-produced goods was necessary to ensure the organic welfare of society and its members.

The notion of an organic balance as the supreme end to which men strive is most clearly expressed in Hobson's definition of wealth, adopted from Ruskin's work Unto this Last.

There is no wealth but life. Life including all its powers of love and joy, and of admiration. That country is richest which nourishes the greatest number of noble and happy human beings; that man is richest who, having perfected the functions of his own life to the utmost, has also the widest helpful influence, both personal and by means of his possessions, over the lives of others. (Hobson 1911, 14)

This view differs markedly from the economic writings of Hobson's contemporaries whose emphasis was on the individual's struggle to attain the greatest amount of material goods with the least amount of effort. Rejecting the claim that men are averse to working, Hobson emphasized the positive aspects of earning one's livelihood and the need for sufficient leisure time to cultivate other modes of human expression. Man realized himself through the fruits of his labour and this feeling of self-worth was essential to his organic welfare. It is for this

reason that Hobson saw unemployment as one of the most serious problems of his time.

Hobson was a social reformer. He rejected the theory of wage and price determination formulated by neoclassical writers. Labour was not merely a commodity to be bought and sold in the marketplace, but was a collection of individuals forced to work in order to survive. With little or no support for the poor, individuals were compelled to accept whatever conditions were offered them by their employers. In his expositions, Hobson readily addressed the issue of labour, and its disadvantaged position in the bargaining process. Marshall, in his elaborate theoretical work, explains wage and price determination under conditions of free competition as rewarding the various factors of production according to the value of their marginal products. Hobson, however, felt that the degree of concentration of ownership in industry which prevailed posited excessive gains in the hands of a small number of powerful industrial and financial magnates. "The sellers of labour are many, the buyers few." (Hobson 1911, 119)

Labour was in an initially vulnerable state when entering into the bargaining process.

The worker who sells his labour power for a living ordinarily bargains for its sale at a disadvantage; he must sell it or he and his family will starve; the employer who buys it will not starve but only lose some 'profit' if he fails to buy it. This difference between starvation and loss of profit is a perpetual handicap to the worker in his bargaining for wages. (Hobson 1909a, 167)

To a great extent, man's decision to work was not voluntary, but rather necessary for survival. Yet, man's engagement in work also presented non-pecuniary rewards such as a sense of duty, or social worth, a sense of power or some other value intrinsic to the performance of a job. (Hobson 1929a, 226) The desire to work and the necessity of doing so could not be reduced to a mere monetary contract. Indeed, man was not to be regarded as a slave to the ever-oscillating market, but rather, labour was of essence, central to man's physical and mental well-being. For this reason, imperfections in the market, as manifest in the large body of unemployed and under-employed individuals, required direct intervention by the state on behalf of its citizens.

During the time of his writings, the trade union movement in England was limited in its scope to a small number of monopolized industries. The vast majority of workers received minimal wages and functioned under poor working conditions. Hobson saw the need for legislation which protected the worker from unfair labour practices and strengthened his position vis a vis his employer. Lutz states that "possibly Hobson's most remarkable insight was his early articulation of the impact of economic security, as well as participation, on human nature. It is in this critical point that he anticipates the lore of modern humanistic psychology most brilliantly." (Lutz 1980, 253) Hobson also advocated the institution of laws which limited the length of the working day and guaranteed workers would receive a minimum wage. In addition, improving social services and increasing support for the poor would indirectly ameliorate the relative bargaining position of workers. "It is an

elaborate indirect attempt to readjust the adverse conditions of the wage bargain." (Hobson 1911, 219) Hobson, thus, rejected the neoclassical price theory presented by Marshall and promoted by his followers.

The prima facie equity of free competition and laissez-faire as a security for the fair apportionment of wealth is thus dismissed upon the grounds that there is no freedom of competition, or of bargain, between financial unequals, and that in almost every actual instance bargaining takes place between unequals. (Hobson 1929a, 212)

Instead, increased state intervention was necessary in order to compensate for certain inequities evident in the capitalist system as it had developed during his time.

Man's engagement in economic activities, either as a producer or as a consumer of goods was viewed by Hobson as inseparable, the balance between work and consumption being integral to the notion of organic stability, both for the individual and for the healthy functioning of the economic system as a whole. The separate treatment of consumption and production in the study of economics is completely artificial, and yet economists have repeatedly tried to establish the a priori "supremacy of production." Hobson felt that an excessive amount of economic study was directed towards an understanding of the production process, with little or no regard for the arts of consumption.

Modern large-scale industry has enlarged and made more distinct an unnatural and injurious separation of the arts of production and those of consumption... But since work and enjoyment are both human features, they must be organically related in the life of every individual in a healthy community. (Hobson 1906, 435)

In order to maintain this organic balance, the level of consumption must be sufficient to exhaust the output of industry. Yet, everywhere Hobson saw a tendency for the arts of production to outstrip those of consumption, inevitably leading to depressions in trade. This, he felt, was a partial consequence of focusing all attention on increasing output in the production process without paying due regard to the arts of consumption. A more dynamic theory of economics which permitted the organic treatment of man in his role as consumer and producer was fundamental to a better understanding of the economic system.

Hobson's empirical examination of the economic system permitted him to focus on issues which were almost completely neglected by his neoclassical contemporaries. The growth of monopoly power and Imperialism, the importance of consumption and the danger of oversaving and the relative position of labour in the bargaining process, these were economic phenomena which did not 'fit' into the body of neoclassical theory, yet were, nonetheless, very real. It was Hobson who would redirect attention to the imperfections of the capitalist system and who would recommend ways in which the collective could effectively overcome these barriers to meaningful participation in the economic system.

## CHAPTER 5

### MONOPOLY

The period during which Hobson was writing was one of massive consolidation and trust-building.

The greatest merger movement in American history began in 1898. Between 1890 and 1897 there were 84 new combinations, according to one list, with a total authorized capital stock of \$1.0 billion; but, between 1898 and 1902 there were 189 combinations, with capital of \$4.0 billion. (Whitney 1958, 6)

In less than half the time frame, the number of mergers had more than doubled, with the nominal value of capital stock quadrupling. This phenomenon was occurring, not only in the United States, but in advanced capitalist nations around the world.

Hobson was concerned about the high degree of economic power acquired by these monopolist firms. In his inquiry, Hobson examines the reallocation of resources due to monopoly, finding that monopolists generally cutback on production and raise prices above what they would be if they were determined competitively. He was concerned that the surplus income received by monopolists was the source of imbalances between aggregate demand and aggregate supply and advocated greater government control over the collection and distribution of this surplus income. It was critical that the economic literature present a more realistic account of the transfers of income due to monopoly power, and that the effects of this redistribution be studied in order to determine their impact on the operation of the economy at large.

In orthodox neoclassical price theory, under conditions of perfect competition, each firm is a price taker, with no considerable influence on the price. Total Revenue is equal to the price multiplied by output, with marginal revenue therefore being equal to price. Consequently, the demand curve and the marginal revenue curves are identical.

The monopolist, however, has an influence over the price of his output, and therefore faces a downward sloping demand curve. Because the monopolist must reduce his price before he can increase output, his marginal revenue curve is always below his demand curve. When he expands his output, the monopolist gains revenues from the increased output but he loses the revenue from the higher price received on earlier units. Since all profit maximizing firms operate where  $MR = MC$ , the price of the monopolist will always exceed that of a perfectly competitive firm, and the level of output will always be less. Diagram A illustrates the different pricing schemes of the two firms. The perfectly competitive firm will operate where  $D = MC$  or at  $P_1$  and  $Q_1$ . The monopolist's MR curve is lower than the demand curve and at the level of output  $Q_m$ , the price demanded by the monopolist would be  $P_m$ .

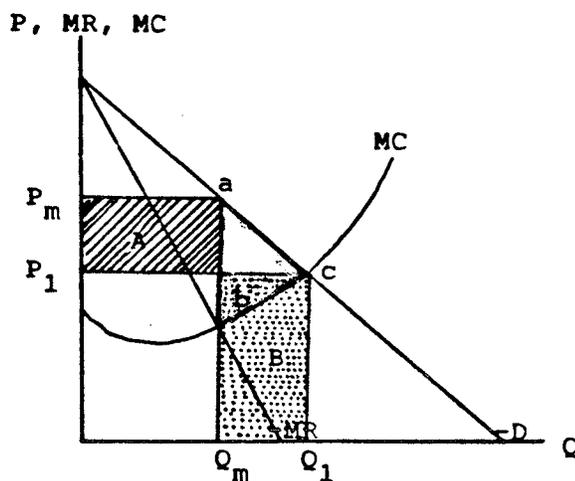


Diagram A: Welfare Loss Due to Monopoly

Neoclassical economists have identified the dead weight loss to society as  $\Delta abc$  in the diagram. The reduced level of output of the monopolist is not considered a direct loss since it assumed that these factors of production will be productively employed elsewhere. Such a view is, of course, based on the assumption of full employment, for in conditons of less than full employment, these factors would add to the existing body of unemployed labour and capital. Hobson himself was concerned that during these periods of depressed trade, the reduced level of production of the monopolist would aggravate the already low levels of employment.

In terms of distribution, neoclassical theory asserts that the transfer of "welfare" from consumers in the form of consumer surplus, to monopolists in the form of revenues (area A) represents a redistribution which warrants no judgement. The fact that this "welfare" has been transformed from an imaginary quantity (consumer surplus) to a real quantity (actual revenue to the monopolist) has never been addressed by neoclassical theory.

Hobson saw monopolists as having a lower than average propensity to consume , and argued that most of their surplus income was saved regardless of the rate of interest. To him, a greater part of the monopolists' surplus income, corresponding to area A in the diagram, represented an excessive amount of savings and investment for the prevailing level of consumption.

Hobson repudiated the existence of the imaginary quantity termed 'consumer surplus' for it was static and falsely assumed an ability to first isolate economic transactions and then add them together to determine total welfare. Hobson argued that the consumer was not to be considered a third party in distribution (Hobson 1904, 360) For him, the surplus income accruing to monopolists represented a double loss to consumers because it required them to pay higher price and because the tendency for monopolists to save and invest an excessive amount of this income caused economic depressions.

"It is incontestible that the economic surpluses, in their emergence as income, measure not productive services rendered by their recipients, but strength of bargaining due to natural, contrived or fortuitous scarcity." (Hobson 1929, 199)

There was a natural tendency towards monopoly in certain industries which exhibited large economies of scale. Hobson argued that these natural monopolies, particularly in the areas of credit, utilities and transportation, should be brought under direct government control.

There were also certain industries where a small number of participants combined to withhold output and raise prices. In these instances, Hobson argued that it was in the best interests of society to tax away this surplus and redistribute it to the community either in the form of wages to workers or as funds to be used for the provision of public works. The real source of instability, according to Hobson, was the concentration of wealth within a small group that already consumed as

much as they wanted. This redistribution caused an increase in the average level of savings and a decrease in the average level of consumption and caused an excessive amount of capital to come into existence for which there was no effective demand.

Some neoclassical economists have attempted to quantify the welfare loss due to monopoly using  $\triangle abc$  (diagram A) as representative of the deadweight loss to society. Harberger estimated this loss at one-tenth of 1 percent of GNP, a highly insignificant amount from the point of view of the economy as a whole. Other more liberal estimates have virtually confirmed these findings, if one is to accept the method employed by Harberger in his attempts to quantify this loss. (Harberger 1954)

There are dissenting views as to the effects of monopolized trades on the economy as a whole. Galbraith and Schumpeter argue that a high degree of research and development is carried on within these monopolized industries and that these firms generate innovation and technological progress. "Thus, in the modern industry shared by a few firms, size and the rewards accruing to market power combine to ensure that the resources for research and technical development will be available". (Mansfield 1974, 39) Others such as George Stigler, Edwin Mansfield, and Milton Friedman criticize monopoly, though all for different reasons. (Mansfield 1974, 39)

Hobson argued that the real loss to society was far greater than that represented by  $\triangle abc$ . For one, the higher price of the monopolist represented an additional cost to consumers. The welfare loss due to monopoly was even greater during periods of depressed trade, for at this time, the monopolists' reduced demand for inputs aggravated unemployment levels, and his tendency to save a higher than average proportion of this surplus income reduced aggregate demand and caused a redundance of capital to accumulate in the marketplace.

The ability of monopolies to cutback on production and raise prices posited a dangerously high degree of market power in the hands of a relatively small financial and industrial elite. Hobson was also wary of their ability to temporarily undercut competitors in order to drive away actual or potential competition. (Hobson 1906, 222) "The dissolution of standard oil company of New Jersey by antitrust action in 1911 broke up a corporation which at that time refined 80 percent of the country's oil output." (Whitney 1958, 182) This concentration of power, particularly in finance, constituted a dangerous threat to the healthy operation of the economic system.

Indeed the future attitude of the modern state towards the new structure of finance, whose control over industry and politics is rapidly being concentrated in a few virtually non-competing groups, opens up some of the most momentous issues of the new state craft. (Hobson 1909b, 273)

Large monopolized corporations were to be found not only in Europe and North America, but rather they spanned the globe in their search for raw materials and new markets. The concentration of wealth within this

small industrial and financial elite conferred upon this group a high degree of economic and political power. This power was often used to influence both domestic and international politics. Hobson felt that the abuse of this power undermined the democratic process and ultimately posed a threat to international peace.

The holding company and the mergers, together with the interlocking directorates, and presumably the voting trust, were all ways and means by which the banking community took over the strategic regulation of the key industries, and by way of that avenue, also the control of the economic system at large. (Hobson 1937, 73)

Marginalist economics had presented an incomplete and unrealistic account of the real social costs of monopoly by disregarding the effects of market power on distribution and by neglecting the effects of distribution on the level of aggregate demand. To Hobson, the true costs of monopoly, from the point of view of society, included the higher price of the monopolist. During periods of less than full employment, Hobson also considered the reduced level of output of the monopolists as a cost to the community. Greater government control over the growing number of monopolized firms was necessary to ensure a more just and stable source of consumption demand.

## CHAPTER 6

### IMPERIALISM

In 1902, Hobson wrote a classic book entitled Imperialism outlining the nature of Imperialism, its root causes and the direction needed to halt imperialist expansion around the world. Hobson saw domestic underconsumption as the 'economic taproot' of Imperialism, and argued that the "wholesome rivalry" of competing nations was being undermined by a barbaric struggle for markets amongst advanced industrialized nations. There have since been numerous writers who have contested this purely economic interpretation of Imperialism, and as Hobson himself would later remark, the economic determinism apparent in Imperialism was an oversimplification of the actual facts and forces operating at this time. (Hobson 1938, 63)

This period in history marks the genesis of a strong sense of internationalism. Improved transportation and communications systems brought countries closer together. The nexus of trading routes patterning the globe meant increased interaction with other parts of the world. The zenith of free migration world-wide occurred during this period. This new cosmopolitanism stimulated ideas by pioneers in the various disciplines.

Hobson regarded free trade as a dynamic and progressive force. Like Cobden, he saw increased trade as a sound basis for stronger international ties.

The larger meaning of free trade ranks as a phase of social evolution by which, on the one hand, militarism is displaced by industrialization and on the other hand, political limits of nationalism yield place to an effective internationalism based upon identity of commercial interest. (Hobson 1898, 168)

Cain argues that Hobson changed his attitude towards free trade from 1906 onwards, whereafter he began a whole hearted acceptance of free trade.

The overall result, however, was that whereas Imperialism: A Study had condemned a great deal of foreign investment as a means of perpetrating a hateful system of Imperialism and Militarism, these later works often sound like panegyrics on the wonders to be expected from the maximum freedom of factor movements and the greatest international division of labour. (Cain 1979, 577)

Contrary to Cain's belief, Hobson remained adamantly opposed to protectionism throughout his career. In his book International Trade, written in 1904, he argues that the push for protectionism is based on a false dichotomy between producers and consumers. (Hobson 1904a, 193) Hobson emphasizes the benefits of free trade, but as Porter notes, he was opposed to the notion of forcing free trade on other countries. "The 'free trade' pretensions of the open markets policy will not bear the slightest scrutiny. The working principle it avowedly involves is the supposition that England must be prepared to 'fight for markets'" (Hobson -1898, 109)

Hobson favoured a policy of voluntary trade between nations, but condemned Imperialism as a gross distortion of the principles of free trade. Hobson saw increased trade between nations as a solid foundation for stronger international ties. A number of writers at the turn of the century saw the decline of nationalism as a movement towards internationalism, though Hobson saw no necessary antagonism between the two, instead viewing a strong sense of nationalism as a vital prerequisite to genuine internationalism.

Nationalism is a plain highway to internationalism, and if it manifests a divergence, we may well suspect a perversion of its purpose. Such a perversion is Imperialism, in which nations, trespassing beyond the limits of facile assimilation transform the wholesome stimulative rivalry into the cut-throat struggle of competing empires. (Hobson [1902] 1954, 11)

Hobson felt that the adoption of Imperialist policies by a number of industrialized countries, forcefully imposing alien institutions on whole societies would retard the movement towards a genuine internationalism, and would ultimately reverse the progressive path of man through history.

In his analysis, Hobson presents a number of views supporting Imperialism as either an outlet for population, as an expansion of British political and financial institutions for the purpose of spreading democracy, or as an inevitable outgrowth of capitalist development. He then refutes these arguments by presenting what he sees as the causes and effects of Imperialist expansion. In contrast to

later writers such as Lenin, who saw Imperialism as the final stage of capitalist development, or Luxemburg, who saw Imperialism as an integral part of capitalist development, Hobson saw Imperialism as a manifestation of certain weaknesses in the capitalist system, capable of being remedied through enlightened state action.

Certain areas of Britain were densely populated during this time, though Hobson argues that it cannot be regarded as "overpopulated in the sense of a people outgrowing the means of subsistence." (Hobson [1902] 1954, 42) Rather the expansion of certain centres within Britain was a consequence of industrial development, "with every recent growth of population [contributing to] a far greater growth of wealth." (Hobson [1902] 1954, 43) Finally, with the aid of statistics, Hobson shows that the outmigration of British citizens to her colonies was a small and diminishing number.

"Politically, the new Imperialism is an expansion of autocracy". (Hobson [1902] 1954, 27) The expansion of British interests into parts of Africa and Asia was not an attempt to implant in these countries some genuine form of democracy. Instead, a small number of individuals controlled the political and economic institutions of these countries and exploited their positions of power to further their own interests. None of her possessions were granted the representative institutions and responsible government which, Hobson felt, characterized the British parliamentary system.

Britain's expansion into China was the most blatant example of Imperialist aggression. It could not be argued that Britain aimed to civilize this vast country, for by Hobson's standards, China was one of the most developed nations in the world. Her leaders were determined by intellectual tests. Small scale industry was spread out across the country, and each town, with its craftsmen and officials, enjoyed a relatively high degree of autonomy. Hobson admired the organic unity of Chinese culture which he felt recognized the dignity of labour and exhibited a "reverence for things of the mind". (Hobson [1902] 1954, 326)

Hobson appreciates that there are many different paths to development, each with its own intrinsic value. The forcible acquisition of ports and the establishment of foreign trade centres fostered resentment within China, however, and destroyed any hopes for improved international relations. "What Asia has to give, her priceless store of wisdom garnered from her experiences of ages, we refuse to take; the much or little we could give we spoil by the brutal manner of our giving. This is what Imperialism has done and is doing for Asia." (Hobson [1902] 1954, 327)

Hobson was a humanist with a respect for cultural differences and a genuine concern for international justice. Porter notes that "this cultural relativism of Hobson's was unusual in the 1890's, but it was not original", for he traces many of Hobson's ideas to those of Compté. (Porter 1968, 181)

In his book Imperialism, Hobson shows how the interests of the nation as a whole are subordinated to the vested interests of particular groups.

Although the new Imperialism has been bad business for the nation, it has been good business for certain classes and certain trades within the nation. The costly wars, the vast expenditures on armaments, the grave risks and embarrassments of foreign policy, the checks upon social reform within Great Britain, though fraught with injury to the nation as a whole, have served well the present business interests of certain industries and professions. (Hobson [1902] 1954, 46)

The huge outlays on armaments, financed out of public revenues, were being used to forcefully open up new markets in other parts of the world. And yet, as Hobson points out, this new external trade was the smallest, least progressive and most fluctuating in quantity. (Hobson [1902] 1954, 40) Britain's most dynamic trading partners were her European neighbors whom she was alienating with her aggressive Imperialist policies. Hobson felt the adoption of these Imperialist policies, by subordinating the will of the people to the private interests of a few, undermined the general principles of democracy and created a very hostile and unstable international environment. This process would culminate in the outbreak of World War 1.

Competition amongst Imperialist powers in Europe affected the development and peace of countries all over the world. Hobson saw the display of Imperialist aggressions as only symptoms of the disease, a malignant disease which was spreading rapidly amongst the advanced industrial nations. The disease was domestic underconsumption and its cure lay in social reform.

In analyzing the workings of the capitalist system, the problem of ineffectual demand was overlooked or ignored by most of the earlier economists. Ricardo, Mill, and Smith, writing during a time when market forces dominated only a small fraction of the economy, argued for the necessity of constantly expanding markets. These writers saw parsimony as a virtue, since it was assumed that it would all be productively invested to augment the existing capital stock.

J.S. Mill was aware that the export of capital abroad removed excessive capital which would otherwise have depressed domestic profits. The goods procured by this foreign investment would also secure for the domestic market a cheap source of supply of food and other wage goods which would further reduce the costs of production and enhance the margin of profits. (Mill 1903, 490) Hobson argued against the necessity of constantly expanding markets, claiming instead that "if the apportionment of income were such as to invoke no excessive savings, full and constant employment for labour and capital would be furnished at home." (Hobson [1902] 1954, 93)

Hobson eludes the stagnation thesis by regarding technological advancements and increased incomes to workers as forces sufficiently dynamic to exhaust the output of industry and stimulate further economic growth. Economists are quick to treat technology as exogenous, cloaking it under the ominous veil of "ceteris paribus". Yet, improvements in technology have been a highly dynamic force in modern industrial development, and to be sure, the period during which Hobson was writing also witnessed massive technological advancements.

Hobson saw ineffectual demand as a critical factor in explaining what was occurring during this time. In the United States, "the power of production far outstripped the rate of consumption, and contrary to older theory, was unable to force a corresponding increase of consumption by lowering prices." (Hobson [1902] 1954, 75) Instead, U.S. manufacturers, whose domestic industries were saturated with capital, sought investment opportunities abroad. (Hobson [1902] 1954, 76) This phenomenon, which was apparent in a number of advanced industrial countries, was seen by Hobson to be the driving force of Imperialism. However, Hobson argued that the necessity of constantly expanding markets in order to prevent gluts was a fallacy.

It is not industrial progress that demands the opening up of new markets and areas of investment, but the maldistribution of consuming power which prevents the absorption of commodities within the country. (Hobson [1902] 1954, 85)

The adoption of Imperialist policies by a number of advanced nations created a tense and unstable international environment. War was imminent. Change was necessary. Hobson identified the economic taproot of Imperialism as ultimately resulting from a maldistribution of consuming power within the country. The concentration of wealth within the hands of a small corporate elite enabled them to exercise a high degree of political control which, while serving their own ends, proved a serious threat to the stability of the international system.

Let any turn in the politico-economic forces divert from these owners their excess income and make it flow, either to the workers in higher wages or to the community in taxes... serving in either way to swell the tide of consumption, there will be no need to fight for foreign markets or foreign areas of investment. (Hobson [1902] 1954, 126)

There have been many writers who have contended this economic interpretation of what they view as a predominantly political phenomenon. Richard Hammond, in his article "Imperialism: Sidesteps on a Stereotype", regards the prime motive of imperialist aggression amongst European powers in the late 1800's and the early 1900's as the desire for territory.

Their chief concern was playing the good old game of power politics...The Portugese felt- and feel- that their overseas possessions have been a symbol of their independence as a nation... If I were tempted to set up a rival doctrine of economic imperialism to that of Hobson and Lenin, my choice for prophet would be Veblen, the apostle of conspicuous consumption. (Hammond 1961, 595)

Benjamin Cohen, in his book The Question of Imperialism criticizes those social theories which attempt to reduce all reality to a single causative factor.

Colonial expansion was more a product of diplomatic rivalry than of the mere profit motive. The economic interest in empire generally succeeded the political motivation, rather than preceded it; material gain was conceived as a means of policy, not an end. (Cohen 1973, 79)

Jones argues that there is no evidence that excessive domestic capital caused a fall in the rate of profit in Britain at this time and repudiates the view of those who saw Imperialism as an outgrowth of this excessive domestic capitalization. (Jones 1982, 106) "Nineteenth century Imperialism was a process of integrating the underdeveloped parts of the world into the expanding economy of Britain." (Jones 1982, 105)

Imperialism, published in 1902, had a profound impact on the Marxian school of thought, for these writers had no problem accepting Hobson's economic interpretation of Imperialism. The idea of Imperialist expansion had been informally introduced by Marx in his third volume of Kapital published posthumously in 1894. Marx criticized the use of brute force by Spain, Portugal, Holland, France and England in extending the reach of capitalist production into the colonies. This mention of Imperialism is brief, however, and it is only later that Imperialism becomes central to the Marxian interpretation of historical processes.

Hobson's analysis of Imperialism was formally incorporated into the body of Marxian literature by Luxemburg and Lenin. Rosa Luxemburg examined the imperialist policies of capitalist countries in her book The Accumulation of Capital, published in 1913. In this work she argued that "as productivity increased, the gap between the purchasing power of the working class and the potential output of consumer goods continually widened". (Hunt 1979, 337) Such an analysis of the nature of Imperialism bears a striking resemblance to that of Hobson, who identifies the economic taproot of Imperialism to be underconsumption.

Luxemburg elaborates on Hobson's critique of the use of state resources to forge markets in 'backward' areas. Hobson condemned such action by the state on the grounds that it served only the interests of a small elite, and was detrimental to the economic and political stability of the country at large. Luxemburg viewed Imperialist expansion abroad as the only means of ensuring profitable investment opportunities, thereby postponing the inevitable collapse of the capitalist system. Her analysis has since been criticized by a number of economists including Joan Robinson, for her oversight in neglecting to address the possibility of financing technological research or increasing the real wages of workers as alternative resolutions to the dilemma of capitalist expansion. (Seligman 1962, 91) It is interesting to note that Hobson advocated the expansion of social services and favoured an increase in workers wages as viable alternatives to the frequent gluts of capital and consumer goods.

Davis feels that Hobson's interpretation of Imperialism as potentially beneficial to 'backward' countries mars his record as a welfare economist, for Davis insists that Imperialism involved the direct exploitation of these areas for the benefit of the mother country. (Davis 1957, 312) This view of international relations put forth by the 'dependency' school has come under attack in recent years for its overly narrow interpretation of development. Hobson felt that these areas could experience certain benefits from their interactions with the mother country, though Lenin would later argue otherwise.

While in exile in Switzerland in 1916, Lenin completed his major work, Imperialism, The Highest Stage of Capitalism. Suffused by the characteristically determinist hues of Marxian analysis, the concomitant rise of monopoly capital and the adoption of Imperialist policies by advanced industrial nations were viewed by Lenin as acts in the play of historical processes. In his view, the dominance of financial over industrial capital coupled with the dramatic increase of monopolized institutions signalled the beginning of a new and yet final stage in capitalist development. Smaller, competitive firms would be forced out of the market by these large monopolies. The contradictions inherent to capitalism urged the growth and expansion of multinationals who enjoyed tremendous power both domestically and abroad. In the stage of advanced Imperialism, "Have" nations would dominate the "Have Not" nations simply by the export of capital. (Lenin [1916] 1966, 177) Unlike the social democrats at this time, Lenin saw the demise of the capitalist system and the subsequent dictatorship of the proletariat as the only logical and feasible course of future development.

What made Hobson's analysis so readily amenable to a Marxian interpretation? Hobson, unlike the marginalists, saw distribution as a function of power in the community. Monopoly power enabled certain industrial and financial magnates to influence public opinion through their control of the press and to manipulate both domestic and foreign policy through their close political ties. The adoption of Imperialist policies by advanced industrial nations was a manifestation of the abuse of this power by certain powerful interests. The whole notion of power

is conveniently glossed over in the marginalist literature by simply assuming the existence of equality of opportunity and freedom of competition. Conversely, economic power is fundamental to the tenets of Marxian ideology, the class struggle arising out of the contradictions inherent to capitalism as a stage of historical development.

After its publication, Hobson modified his overly determinist interpretation of Imperialism, admitting that he had "not yet gathered into clear perspective the nature of interaction between economics, politics and ethics, needed for anyone who might wish to claim the title of sociologist". (Hobson 1938, 63) Nonetheless, his examination of Imperialism at the turn of the century brought to attention certain critical issues of domestic and foreign policy facing Britain at this time.

## CHAPTER 7

### UNDERCONSUMPTION AND THE TRADE CYCLE

Hobson is well-known for his theory of underconsumption as the underlying cause of business cycles. H.B. Davis considers Hobson's theory of underconsumption as one of his most valuable contributions to the history of economic thought. "It is not the only underconsumption theory but it is certainly one of the best. Hobson maintained his position stoutly and almost alone. Then, in the 1930's, underconsumption suddenly became fashionable." (Davis 1957, 297)

This chapter reviews and analyzes Hobson's theory of underconsumption as the cause of depressions in trade. The early economists did not concern themselves overwhelmingly with business cycles because they felt that these fluctuations were of a temporary order which would, over time, automatically correct themselves. This general adherence to Say's Law continued on to the present century, with very few dissenters. Paul Homan notes that even in the nineties, "economists were largely concerned, so far as they were not quarrelling over 'concepts' with establishing the laws of the 'normal' action of the competitive system." (Homan 1928, 339)

Periodic depressions in trade were a familiar characteristic of Capitalism which, in Hobson's view, resulted from a maldistribution of consuming power. He argued that certain individuals, by virtue of their

economic power, were able to extract from the bargaining process a 'surplus' element of rent. This 'surplus' was then automatically converted into savings which, when subsequently invested, caused an excessive amount of capital to be created for which there was no effective demand.

The fallacy involved in the supposition that over-supply is impossible consists in assuming that the power to consume and the desire to consume necessarily coexist in the same person. (Hobson 1906, 289)

There have been certain economic theorists in the past who have sought to determine some sort of explanation for the periodic fluctuations in output and employment which they observed. Up to the 1800's, most business cycle theorists focused on the agricultural sector, attributing fluctuations in the general level of output and prices to the vagaries in crop levels. (Fritz 1934, 10) Considering the preponderance of agriculture over the whole economy, such a diagnosis was probably quite accurate.

Once the effects of industrialization had spread, economists claimed that business cycles originated in the production process itself. In 1820, Malthus challenged the view that supply automatically creates its own demand, arguing that over-production was possible and did, in fact, occur regularly. Malthus argued that the capitalist class did not maintain an adequate level of consumption. Their preoccupation with reinvestment created a glut of consumer goods. It was necessary to redistribute income to the landlord class, for this group would

stimulate demand without increasing output. It was futile to increase labour's share, for Malthus argued that wages would automatically tend towards subsistence.

Sismondi (in 1819) observed that there was a tendency towards overproduction under capitalism, and he also attributed the direct cause of the crisis to a glut of the market. (Fritz 1934, 47) Marx would later expound on this argument, showing in a systematic way how the expropriation of the surplus under capitalism would invariably lead to periodic depressions in trade. There was a tendency for profits to fall over time because of the tendency to increase output per worker without increasing labour's share of the output.

Hobson saw this excessive output as a result of ineffectual demand. Like Malthus, he argued that the capitalist class did not maintain an adequate level of consumption, causing a 'glut' of consumer goods to accumulate. However, unlike Malthus, Hobson pressed for a redistribution in favour of workers who he felt had not been given a fair share of the product. He rejected "The Iron Law of Wages" and saw an increase in labour's share as a viable solution to the problem of ineffectual demand. Unlike Sismondi and Marx, Hobson denied any tendencies for profits to fall over time. An increase in labour's share would provide the necessary expanded market for the output of British industry.

"The root evil of depressed trade is underconsumption". (Hobson 1906, 288) In order to avoid depressions, it was necessary to increase the aggregate level of consumption. Hobson argued that a redistribution of income from the rentier class to the workers would increase the average level of consumption, for it was well known that workers spent a larger proportion of their earnings than the wealthy.

Hobson complained that too much of economic theory was centred around the accumulation of wealth and that not enough attention was given to consumption. (Hobson 1902, 26) Traditionally, economists assumed that a wealthy class was necessary because of its greater capacity to save, since it was assumed that this would increase the volume of investment and would thereby stimulate economic growth. Hobson was in complete disagreement with these economists, and argued instead that the real threat to economic stability lay in the tendency towards over-saving.

There was an evolution of Hobson's underconsumption theory according to W.H. Richmond. In Richmond's view, his emphasis on the undue exercise of thrift as the underlying cause of trade depressions shifted to an emphasis on distribution itself as the root of the problem. (Richmond 1978, 285) In The Physiology of Industry (1889), Hobson and Mummery warn against the dangers of over-saving, arguing that excessive savings reduces consumption and results in overproduction. (Hobson [1889] 1956, v) In The Social Problem (1902) Hobson again stresses the need to maintain an adequate level of consumption and argues for the need to restore the surplus to workers in order to increase consumption. (Hobson 1902, 253) Evidently, Hobson sees the relationship between income and

savings, and feels that a redistribution of income would increase the aggregate level of demand. Hobson recognized that a redistribution of the 'surplus' to workers would raise the volume of consumption and would thereby stimulate an increase in the level of production and employment. (Hobson 1902, 253)

Keynes also argued that a redistribution of income in favour of workers would increase the average propensity to consume from the point of view of the community as a whole. (Keynes 1936, 262) There have been writers, however, who have argued that the effect of changes in income on changes in expenditure cannot be determined by cross-sectional data alone, but that such an inquiry also demands time series data, for they feel that patterns of consumption vary significantly over time.

Consumption variations over a cross section do not follow entirely from income variation. To some extent they are a matter of taste and personality. To some extent they are a function of social position. To some extent the income variation itself reflects the same tastes, as does the variation in liquid assets position, debt and so on. (Suits 1963, 52)

This relationship between income and consumer expenditure would become the focal point of economic study following the publication of Keynes' General Theory. Though there has been much debate in recent years over the relative impact of changes in income on patterns of consumption, cross-sectional budget studies have virtually confirmed that higher income individuals tend, on the average, to save a higher percentage of their incomes.

In an article written in *Economica* during the depression, Hobson argues that industrial depression is due to the excessive savings of the rich. E.F. Durbin claims that this must be false since if savings increased, then there must be a fall in consumption. Since this is not the case, he argues that there is a need to cutback on consumption until the lowered rate of interest stimulates an increase in producer goods. (Hobson 1933, 415) Hobson then refutes this, pointing out that the immediate result of a decrease in wages would be a further reduction of consumption goods. "Mr. Durbin appears to conceive the desirable equilibrium in terms of the production of consumption goods and of capital goods, whereas the equilibrium I deem desirable is that between productivity and consumption (effective demand for commodities)." (Hobson 1933, 426)

The classical economists had assumed an equality between aggregate supply and aggregate demand which was not justified. Hobson noted that the poor, while having the desire to increase their consumption lacked the means, while the wealthy, who were the recipients of a 'surplus' income by virtue of their economic status had no intentions of increasing their consumption and furthermore, converted almost the whole of this surplus into savings. This caused an imbalance to develop between the aggregate supply of goods and the aggregate demand for the output of industry.

Hobson's theory of over-saving was received with much reservation, for economists had always assumed that the market rate of interest would bring the level of savings and investment into equilibrium. Keynes would later explain how imbalances between aggregate demand and aggregate supply could be traced to imbalances in the investment demand schedule. Of course since Keynes, there have been numerous theories of the business cycle which offer different explanations for the disequilibrium between savings and investment. Some, in the tradition of Wicksell, show how an initial shock to the system will trigger a process of cumulative depression or recovery. (Fritz 1934, 215)

Kaldor, in an interesting exposition, shows the necessary and sufficient conditions under which the savings and investment functions generate cyclical movements which never come to a rest. (Fritz 1934, 314) Harrod argues that while savings are a function of the level of income, investment is a function of the increase in income, a situation which creates an inherently unstable system. (Fritz 1934, 215)

E.J. Coppack appreciates the audacious quality of Hobson's theories and notes that "Hobson's intuition seems to have led him towards the concept of dynamic equilibrium which Harrod and Domar have developed and analyzed." (Coppack 1953, 11) Harrod attempted to prove that there was a moving equilibrium level of output where savings was equal to planned investment.

Harrod takes the savings-income ratio as given and with the marginal capital-output ratio, deduces a 'warranted rate of growth' which he compares with the 'natural rate of growth' of income needed to maintain continuous full-employment. Hobson took the latter rate of growth as datum, and, using a capital-consumption ratio, deduced a warranted rate of growth of income. (Coppack 1953, 11)

Joan Robinson, in her review of Harrod's "Dynamic Theory of the Trade Cycle" recognizes what she terms the 'Hobsonesque' situation where the growth in effective demand is not sufficient to maintain the growing volume of capital at a profitable rate. She criticizes Harrod in this exposition for failing to discuss the effects of distribution on the marginal propensity to save. In her critique of Harrod, Robinson puts forth many of the arguments developed earlier by Hobson.

First of all, the effect of distribution of income and of wealth upon thriftiness has been omitted from the argument. It can be plausibly argued that the phenomenon of excessive thriftiness is a product of excessive inequality, and that measures to correct inequality, which may be advocated on their own political or humanitarian merits, would, as a by-product, permanently reverse the position and make deficient thriftiness the normal rule. There seems very little point in discussing artificial measures for absorbing excessive savings until this great question has been argued out. (Robinson [1949] 1953, 247)

In examining Hobson's theory of the trade cycle, Coppack argues that "Although his argument lacks rigour it will be admitted that Hobson gets at the heart of the problem of equilibrium, viz., that the deflationary excess savings are eliminated by the contraction in the level of income which they induce." (Coppack 1953, 7) This is a misrepresentation of his works, however, for while Hobson is aware, as Coppack notes, that "conservatism in the arts of consumption" causes changes in consumption to lag behind changes in income, he does not regard the problem of excessive savings and the depressions in trade which they cause as self-restoring. Rather, he argued for government intervention during periods of depressed trade in order to stimulate an increase in demand and raise the level of aggregate consumption.

H.B. Davis identifies three stages in the development of Hobson's trade cycle theory. The first was a theory of oversaving which emphasized the voluntary nature of savings. The second, developed in The Evolution of Modern Capitalism (1906), stressed underconsumption as the root cause of trade depression, according to Davis. The third and final theory which Davis identifies was put forth by Hobson in The Industrial System (1909) wherein oversaving "becomes a necessary implication of capitalism." (Davis 1957, 296) Contrary to what Davis believes, Hobson viewed oversaving and underconsumption as two sides of the same coin. He repeatedly uses the terms interchangeably for he felt that the real problem lay in the distribution of the surplus. Distribution was such that those who received this surplus did not increase their consumption by enough to exhaust the output of industry. Thus, from the point of view of the community, the "oversaving" of one group was considered to be at the expense of the "underconsumption" of another group.

In his examination, Hobson stresses the necessity of maintaining an adequate level of consumption demand, recognizing the tendency for 'gluts' of goods to accumulate in the marketplace. In The Physiology of Industry, Hobson distinguishes between savings considered as abstention from production, and savings which were productively invested, but yet Cole remarks, that it was unfortunate he did not develop this idea more carefully.

It was a real misfortune that Hobson, in his subsequent writings, failed to stress, or even to clearly state [the distinction between the mere abstention from consuming and the fruitful investment of the sums thus reserved from the market for consumer goods]: for this failure was largely the cause of the persistent misunderstanding of his essential ideas. (Cole 1940, 356)

## CHAPTER 8

## CONSUMPTION: COMPARISON WITH KEYNES

Upon a closer examination of his works, it becomes evident that the heretical writing career of J.A. Hobson had a profound impact on one of this century's most prominent writers, John Maynard Keynes. Keynes, like Hobson, felt that classical theory could not accurately describe the existing economic reality.

The classical theorists resemble Euclidean geometers in a non-Euclidean world who, in discovering that in experience straight lines apparently parallel often meet, rebuke the lines for not keeping straight. (Keynes 1936, 16)

There were numerous economic phenomena taking place for which no explanation was available. These occurrences were not merely unaccounted for in the available literature, but rather classical economic theory denied the very possibility of their existence. Keynes later redressed many of the controversial issues introduced by Hobson, including his rejection of Say's Law, his concern with involuntary unemployment, his emphasis on maintaining an adequate level of consumption demand, his critique of contemporary financial institutions and his promotion of government intervention for the purpose of stabilizing the economy. The treatment of these issues by Hobson and later by Keynes will be examined more closely in this chapter.

One of the basic tenets of classical theory rebuked by Hobson and later by Keynes was the notion that supply creates its own demand. Such a view, expounded by J.B. Say, Ricardo, and later by J.S. Mill laid the foundations for economic theory and marked the parameters which would confine its development for over a hundred years.

What constitutes the means of payment for commodities is simply commodities. Each person's means of paying for the production of other people consist of those which he himself possesses. All sellers are inevitably, and ex vi termini, buyers. Could we suddenly double the productive powers of the country, we should double the supply of commodities in every market, but we should, by the same stroke, double the purchasing power. Everybody would bring a double demand as well as supply: everybody would be able to buy twice as much because everyone would have twice as much to offer in exchange. (Mill 1903, 379)

The claim that supply creates its own demand was fundamental to classical theory, for it meant that there was some regulating element in the economic system keeping the two separate forces in equilibrium and at the same time ensuring full employment in the labour market. Hobson recognized the falsehood of Say's Law, for experience revealed that periodic "gluts" were possible and in fact, occurred regularly. Orthodox theory was incorrect in assuming that the market rate of interest would serve as a monitor, simultaneously bringing investment demand and savings into equality.

The claim that supply creates its own demand conveniently ensured that product markets would clear automatically and that employment would be limited to frictional or voluntary unemployment. Keynes and Hobson saw

unemployment as a ramification of ineffectual demand, both viewing involuntary unemployment as one of the gravest dangers of the market system of exchange. The classical economists argued that in the long-run, market forces would bring the supply of labour into equilibrium with the demand for labour. The waste which was incurred in the interim, not to mention the loss of human dignity and the high level of frustration associated with being involuntarily unemployed were thought to be intolerable by Hobson and later by Keynes.

The loss of employment may be only 'temporary' but as the life of a working man is also temporary, such a loss may, as a disturbing factor in the working life, have a considerable importance. (Hobson 1906, 328)

Hobson saw the need for alleviating involuntary unemployment directly through measures aimed at increasing aggregate demand. The natural adjustment of market forces occurred too slowly for Hobson. Keynes too, redirected the focus of his attentions to the short-run, pointing out that "In the long-run we are all dead". The danger that the economy might settle at less than the full-employment level of output further attested to the need for immediate attention to labour market fluctuations.

"Unemployment is the largest and most palpable waste". (Hobson 1902, 8)

Hobson was concerned that during periods of depressed trade, large segments of the population were left unemployed against their will. In addition to causing immeasurable hardships for these individuals, involuntary unemployment involved substantial reductions to national

output. These individuals were the victims of certain social and industrial disorders which were beyond their immediate control. "Social and industrial disorders which degrade the character of any class of human beings, cannot be offset by any increase in the mass of material wealth." (Hobson 1902, 8)

One of the main goals of Keynes' work was to prove systematically that involuntary unemployment was possible under capitalism. In order to do so, he made a small but highly significant alteration to the existing theory, arguing that within a certain range, workers responded to the money wage rather than the real wage. (Keynes 1936, 8)

Men are involuntarily unemployed if, in the event of a small rise in the price of wage goods relatively to the money wage, both the aggregate supply of labour willing to work for the current money-wage and the aggregate demand for it at that wage would be greater than the existing volume of employment. (Keynes 1936, 15)

Keynes argued that it was feasible that equilibrium be reached at less than full-employment. In making the supply of labour contingent on the level of demand, Keynes was once again in accord with Hobson's contention that it was the level of demand which ultimately determined the level of production. Keynes argued that it was the fluctuating nature of investment demand that caused instability in the labour market.

Hobson and Keynes saw the problem of ineffectual demand as a result of institutional factors capable of being remedied through government intervention. But while Keynes argued that because of the power of unions, wages were rigid downwards, Hobson claimed that due to workers' lack of power, wages tended towards subsistence. The two different interpretations of the same occurrence reflects, in part, the change in the relative power of workers from the end of the 1800's to the middle of the 1900's.

In all of his works, Hobson emphasized the importance of consumption in the overall functioning of the economic system. Too much of economic theory dealt with production, or the supply of goods, since it was argued that all of the output produced would eventually find a prospective consumer. Hobson argued, conversely that there was no guarantee that product markets would clear but rather he attributed periods of economic depression directly to a lack of sufficient aggregate demand. Maintaining the appropriate level of aggregate consumption was central to the prevention of trade depressions and widespread unemployment.

We are thus brought to the conclusion that the basis on which all economic teaching since Adam Smith has stood, viz. that the quantity annually produced is determined by the Aggregates of Natural Agents, Capital, and Labour available is erroneous, and that, on the contrary, the quantity produced, while it can never exceed the limits imposed by these aggregates, may be and actually is reduced far below this maximum by the check that undue saving and the consequent accumulation of over-saving exerts on production; ie. that in the normal state of modern industrial communities, Consumption limits Production and not production consumption. (Hobson and Mummery 1889, vi)

Keynes would later redirect the focus of his attentions to consumption and its critical role in promoting and maintaining economic stability. He adopted Hobson's heretical view, claiming too that "consumption is the sole end and object of all economic activity." (Keynes 1936, 104) He recognized the decisive role of consumption in affecting the level of employment and output.

The propensity to consume and the rate of new investment determine between them the volume of employment and the volume of employment is uniquely related to a given level of real wages- not the other way around. (Keynes 1936, 30)

Hobson was aware that the interest rate was an inadequate regulator of economic activities. Its apparent role in affecting both savings and investments was not decisive, for Hobson recognized that the responsiveness of both individuals and businessmen to changes in the rate of interest varied significantly depending on a number of factors. The sensitivity to price changes was different between the rich and the poor. (Hobson 1929a, 292) Also, changes in the rate of interest might cause some to save more while others, who now felt that they could accumulate the same amount with less effort might decide to save less. (Hobson 1929a, 291)

To a large extent, finance constitutes a sort of central power station for the distribution of capital and labour. But its grasp is very partial and its methods are not very accurately adjusted to supply the general needs of industry. (Hobson 1911,251)

Hobson claimed that there was no guarantee that the amount saved would be equal to the amount of money demanded by investors. He recognized that the interest rate was not a reliable regulator of the money market for a number of reasons. First of all, the rewards of saving were uncertain because interest payments were generally made in installments over a long period of time during which changes in the purchasing power of money might raise or lower the real reward of saving. Secondly, the regulatory impact of the interest rate in affecting investment decisions was limited because of the diverse sources of the supply of capital.

For instance, Hobson notes that the government, a major source of investment funds, was able to raise considerable amounts of capital through taxation regardless of the market rate of interest. (Hobson 1929, 291) Thus, contrary to economic theory, Hobson maintained that the interest rate was not a reliable stabilizer of money market transactions and that in addition, its role in affecting investment decisions was not decisive.

Investment inevitably directs the economy on its path of expansion. Yet, the requisite expenditures on long-term investment projects in vital areas of the economy was not being undertaken by private investors. Hobson, and later Keynes, had a severe mistrust of financiers and both saw the need for public investment to compensate for weaknesses in the private sector. Hobson was aware that the negative effects of this instability of private investment reverberated throughout the economy, causing major displacements of capital and labour.

Hobson was wary of the dangerously high degree of economic and political power wielded by such financial magnates as Harriman, Vanderbilt, Rockefeller and Morgan in America and Cecil Rhodes in Britain.

Nowhere in the world has there ever existed so concentrated a form of capitalism as that represented by the financial power of mining houses in South Africa, and nowhere else does this power so completely realize and enforce the need for controlling politics. (Hobson 1906, 267)

For these corporate giants, short-term economic losses were frequently conceded in order to eliminate potential or actual competition. Standard Oil of New Jersey had been accused of such practices and many feared that the growing dominion of these large multinational corporations signalled the decline of the small competitive firm. The tendency for these powerful monopolists to water down stocks and manipulate money markets reaffirmed the need for stiff regulatory measures designed to prevent such monopoly coercion. (Hobson 1906, 246)

Keynes maintained the critical role of investment demand and he too was skeptical of leaving this vital activity to the discrepancies of private financiers.

There is no clear evidence from experience that the investment policy which is socially advantageous coincides with that which is most profitable. (Keynes 1936, 157)

Keynes was concerned not only with the level of investment but with its composition as well. He observed that the investment houses rarely invested in long-term income-earning assets but rather he found that these financiers sought to earn quick returns through capital appreciation, dangerously reducing the stability of the economic system. (Keynes 1936, 157) Keynes criticized these financiers whom he likened to 'gamblers' or 'players in a game of old maid', because of their 'bugger thy neighbor attitude'. (Keynes 1936, 160) Wall Street was not an entity engaged in directing investments into the highest yielding areas but conversely these financiers preferred high risk, short-term gains due to sudden price increases or changes in the exchange rate or the like.

The measure of success attained by Wall Street, regarded as an institution of which the proper social purpose is to direct new investment into the most profitable channels in terms of future yield, cannot be claimed as one of the most outstanding triumphs of laissez-faire capitalism. (Keynes 1936, 151)

The terms of credit had a profound impact on the level and direction of investment activity. In The Industrial System, Hobson explains the increasing ease with which firms could borrow against their expected future earnings and points out that this practice tends to increase the instability of the system.

The valuation of such property is essentially precarious and lends itself to the creation of excessive speculative values ie. to overcapitalization.... That the monetary system should become more and more dependent upon the values of these intangible assets is one of the gravest dangers of our times, illustrated most dramatically in the recent American

crisis, due primarily to a rapid shrinkage in the value of collateral securities based on over-estimated earning power. (Hobson 1909, 258)

The foundations of the economic system rested largely upon its financial institutions. The rate of new investment was fundamental to the economic system, affecting both its rate of growth and its direction of expansion. Yet Hobson found that the speculative bias exhibited by Britain's investment houses and the sporadic investment decisions of large multinational corporations compromised the goals of stability and growth. In order to maintain the healthy operation of Britain's economy, it was critical to secure a high degree of confidence in her financial institutions.

Hobson felt that confidence in the banking system would increase if the government assumed a more direct role in finance. In his view, the insecurity of the present financial system was largely due to the illogical division between the government and profit-making companies.

It is confidence in the government, not in gold, which is clearly the support of this issue. (Hobson 1909, 258)

The government had a tremendous ability to extol funds through taxation. This practically "limitless" access to funds would provide ample security to individuals and would both steady and improve the character of finance. By assuming a more active role in finance, the government would also have greater leverage over the tempo and direction of economic development.

Keynes admired Hobson's defiant challenge to orthodox theory. While Keynes lauds much of the works presented by Hobson, he criticizes him for failing to include an independent theory of the rate of interest. (Keynes 1936, 167) In a fairly indepth analysis of Hobson's theory of unemployment, D.J. Coppack calls Keynes' criticism of Hobson unjustified, for he feels that Hobson did in fact have a clear understanding of the relationship between savings, investment and income.

The origin of unwarranted criticism is doubtless to be found in their different approaches to the problem. Hobson analyzed the problem of unemployment directly in terms of the dynamic aspects of growth in a progressive economy. Keynes' analysis was primarily static in character, the static concepts being used to provide a sketch of the cycle. Possibly, as a result of this static approach, he overlooked in his criticism of Hobson the feature he had noted himself, viz., that the cause of inadequate demand for new investment in depressions was grounded in the events of the previous boom. (Coppack 1953, 21)

In this exposition, Coppack follows the development of Hobson's theory of the business cycle and is led to the conclusion that Hobson was in fact, "well aware that all acts which the individual regards as 'saving' do not necessarily result in capital formation." (Coppack 1953, 3) This conclusion is not generally true, however, for in most of his works, Hobson assumes that it was the 'surplus' element of income which caused imbalances to develop between the desirable level of savings and investment and the level of consumption associated with a certain level of income. He postulated a direct correlation between efforts and rewards and argued that because the acquisition of the surplus required

no effort but was allotted on the basis of economic power, that the disposal of this surplus did not conform to the ordinary laws of demand and supply, but rather that this surplus was automatically converted into savings and subsequently invested.

Hobson argued that there was a tendency towards over investment which was not brought into check by the interest rate. He recognized that the factors motivating individuals to save or invest were different and that these forces were not always brought into equilibrium. Yet despite all this, Hobson did not concentrate on the investment savings schedule, for in his view, the real source of instability between aggregate demand and aggregate supply derived from a maldistribution of consuming power within society. In his examination of savings, he writes:

It signifies not only abstention from consumption but application as a means of further production. If the whole of this surplus can be saved, it must be necessary to show that it can be used to produce other things which are wanted. (Hobson and Mummery 1889, 47)

In commenting on the conclusions reached by Hobson and Mummery in The Physiology of Industry, Hutchison notes that "the ambiguities in their analysis of saving and investment led them back to statements dangerously compatible with the usual interpretations of the proposition known as Say's Law... Mummery and Hobson's over-saving theory is really an over-investment theory, or a theory of the investment of excessive saving." (Hutchison 1953, 120)

It was Keynes who would later examine more closely the relationship between investment and savings, showing how imbalances between the level of investment and the level of savings triggered either a stockpiling or a depletion of inventories, and further demonstrating how these fluctuations in investment demand either stimulated or retarded the general level of economic activity.

In The General Theory of Employment, Interest and Money, Keynes develops a theory of interest in which the demand for money becomes a demand for liquidity preference. Individuals, he argued, had different reasons for holding cash balances, whether it be to facilitate business transactions or capitalize on unforeseen opportunities. Keynes also identified the speculative motive for holding money, ie. "The object of knowing better than the market what the future will bring forth." (Keynes 1936, 170)

M1=transactions and precautionary motives

M2=speculative motive

$$M = M1 + M2 = L1(Y) + L2(r)$$

Where:

L1 is a liquidity preference corresponding to income Y which determines M1

and

L2 is the liquidity function of the rate of interest which determines M2.

It was the speculative demand for money which is sensitive to the rate of interest which distinguishes Keynes' theory from orthodox theory. Psychological factors such as uncertainty about the future affected the demand for cash balances and under certain circumstances, limited the effective control of the interest rate. It was possible for the rate of interest to fall so low that everyone would prefer liquidity. "In this event, monetary policy would have lost effective control over the rate of interest." (Keynes 1936, 207)

The elaborate price theory developed by Keynes had important policy implications, for by making the demand for money more sensitive to the rate of interest, Keynes changed the shape of the IS and LM curves, thereby increasing the relative effectiveness of fiscal over monetary policy. The LM curve became more elastic as the demand for money was assumed to be sensitive to the interest rate and the IS curve became more inelastic as Keynes maintained that investment decisions were a function of expectations and responded less directly to changes in the rate of interest than was assumed by the classical economists.

Keynes included in his analysis an independent theory of the investment in which the role of expectations became critical. His experiences revealed that the interest rate, while no doubt an element affecting investments, was not the only factor affecting these choices. He felt that uncertainty about the future had a profound impact on an individual's decision whether or not to undertake certain investment projects. While the exactitude of this impact could not be quantified, it conveniently reduced the decisive role of the interest rate in directing investment demand.

Both Hobson and Keynes questioned the short-run self-adjusting capabilities of the market during periods of ineffectual demand. Hobson was concerned that falling prices caused cutbacks in consumption and employment which often led to prolonged periods of depressed trade.

Thus every rise and fall in retail prices will mean a corresponding rise or fall in the money income of the community. How, then, will a general decline of retail prices act as an effective stimulus to increase demand for commodities, when the average income of consumers has fallen correspondingly. (Hobson and Mummery [1889] 1956, 121)

Hobson argued that this predicament demanded some impetus to increase consumption in order that the spiral of falling prices and falling incomes be halted and the economy be brought back to full employment. The government could stimulate an increase in demand by either redistributing the 'surplus' element of income to workers, or by utilizing this surplus to increase its expenditure on what Hobson termed 'social goods'.

In all periods of underconsumption (ie. low prices and depressed trade) taxation should clearly be directed so as to be the smallest check on consumption... A rational method of taxation will aim at restricting the motive to save, while offering every encouragement to the desire to spend. (Hobson and Mummery [1889] 1956, 203)

In addition to encouraging an increase in government spending, Hobson proposed a tax on savings. In his later works, Hobson would advocate the extensive use of the progressive income tax in order to finance government expenditures because he felt it was the most visible and

equitable form of taxation.

Throughout his career, Hobson was critical of the political opportunism of governments who financed their public works through the manipulation of money markets. "People feel more acutely the money taken from them in the form of income tax than the greater loss due to rising prices." (Hobson 1929, 40) It is often considered more politically expedient to increase the money supply rather than to levy a tax on any one group, since it involves a less visible reduction in income.

Keynes proposed increasing the money supply as a short-run solution to the problem of ineffectual demand. He argued that workers responded to the money wage rate while employers, being more sensitive to the vagaries of the market, were responsive to the real wage rate. Should the government require additional funds in order to undertake critical expenditures, there was the option of increasing the money supply. Under conditions of less than full employment, the increase in consumption demand generated by the higher level of government spending would stimulate an increase in the volume of employment. Labour would usurp the cost of the program, for while profits remained intact, the rise in the price level would have reduced the real wage rate. It was in this fashion that Keynes presented his short-run solutions for increasing National Income and maintaining full-employment.

Keynes considered short-run fluctuations in the price level as a preferable alternative to unemployment. Labour, he claimed, would be

relatively apathetic towards any reduction in their share of the product.

Since no trade union would dream of striking on every occasion of a rise in the cost of living, they do not raise the obstacle to any increase in aggregate employment which is attributed to them by the classical school. (Keynes 1936, 15)

It is somewhat ironic that while Keynes stresses the role of expectations in affecting both consumer expenditures and investment demand, he ignores the negative long-run repercussions of these short-run fluctuations in the price level. Hobson recognized that increases in the price level often triggered a wave of inflationary pressures which might accelerate and continue for a long period into the future. For this reason he discouraged such practices, insisting that "fluctuating prices for goods and securities cause instability." (Hobson 1929a, 40) Rather than advocating a policy which would reduce labour's share, Hobson suggested taxing away the surplus income received by monopolists and redistributing it to the workers, thereby actually increasing labour's share of the final product. This, he felt, would perform the dual function of raising the aggregate level of demand while simultaneously removing the source of the instability. While Keynes offers an indirect solution to the problem of ineffectual demand, Hobson proposed policies which dealt directly with the source of the economic imbalances.

Perhaps one of the most fundamental distinctions between the works of

Hobson and those of Keynes is their particular disposition towards the marginalist theory of wage and price determination. Keynes, in effect, directs his criticisms at the classical economists, generally accepting the tenets of microeconomic theory as put forth by Jevons, Walras and Menger and later refined by Marshall. His method is highly analytical and he provides a very systematic refutation of classical economics. Hobson, on the other hand, attacks conventional views on all fronts, rejecting those aspects of both classical and neoclassical economics which he felt were less than adequate representations of reality.

At the turn of the century, the marginalist interpretation of wages and prices was gaining fast in popularity. Hobson was critical of these writers for the blatant circularity of their arguments. "Prices determine (causally) margins- margins do not determine prices." (Hobson 1909b, 99) It was impossible to prove how considerations about the margin actually affected decisions. "Margins, whether extensive or intensive, are derivative, not determinative." (Hobson 1909b, 99)

Keynes was aware that the marginalist interpretation of wages and prices was based on circular logic, for in commenting on the works of a contemporary, he remarks that: "He was not wrong in assuming that the marginal productivity theory was equally circular". (Keynes 1936,140) Yet despite his awareness of this fact, Keynes builds the whole of his macro-analysis on the foundations of marginalist microeconomic theory.

If the remuneration of workers is proportional to their efficiency, the differences are dealt with by our having

regarded individuals as contributing to the supply of labour in proportion to their remuneration. (Keynes 1936, 140)

The ability of Hobson to critically review classical economic theory and his willingness to incorporate into his works new ideas which more formidably described human experience were to have a major impact on the works of Keynes. It was his defiance of orthodoxy which prompted Keynes to remark: "Mr. Hobson has flung himself with unflagging but almost unavailing ardour and courage against the ranks of orthodoxy." (Keynes 1936, 365) There can be no doubt that the prolific and heretical career of J.A. Hobson was a profound source of insight and inspiration for J.M. Keynes, contributing to the eventual publication of his General Theory.

## CHAPTER 9

### CRITIQUE OF MARGINALISM

The Manchesterian School, premised on the Utilitarian principles of Bentham, had established quite a devout apostolate by the turn of the twentieth century. This school adopted the use of highly abstract and mechanical logic and developed theories which were subsequently superimposed on Britain to describe exchange and justify prices at this time. Based on the assumptions of perfect mobility and perfect knowledge, neoclassical theories maintained that the forces of supply and demand would establish the most harmonious equilibrium attainable.

Hobson was highly critical of this school of thought. Economics could not be reduced to a mathematical tautology, but rather it required an understanding of the economic environment and the institutional factors affecting human behavior. Hobson would expend a great deal of effort during his career exposing the fallacies of Marginalism, particularly in his books The Social Problem (1902), The Economics of Distribution (1904), Work and Wealth (1914), and Veblen- Modern Sociologists (1937). This chapter reviews Hobson's major critiques against the neoclassical school, specifically against their unfounded assumptions about the economic system, their neglect of distribution, their use of purely inductive logic and their hedonic treatment of man. Contrary to their claims, the Marginalists had not succeeded in removing ethical considerations from the study of economics, but rather had produced a

rigorous support for the existing distribution of income. Hobson himself pursued a more organic treatment of man in his activities as a producer and consumer, stressing the effects of consumption, production and distribution on the welfare of the individual and on the welfare of society at large.

The assumptions underlying Marginalist theories were found to be unrealistic by Hobson. Far-removed from the economic environment of the late 1800's, Marginalism had carried the study of economics to the pinnacle of abstraction.

Some writers in Political Economy construct a theory which assumes this perfect fluidity (of prices) to exist, and then make allowances for 'friction' or 'exceptions'. But this, as Ruskin pointed out, is like starting the study of the human body on the supposition that the human body is perfectly elastic and afterwards making allowances for its inelasticity. (Hobson 1911,168)

The assumption of perfect competition was not grounded in economic reality, for Hobson observed the growth and expansion of monopoly power in certain key sectors of the economy. In addition, he denied any freedom of competition between financial unequals, and asserted frequently that labour was in an initially disadvantaged position when dealing with employers.

Hobson felt that the income of the community should be distributed in a more equitable manner, not only for moral reasons, but also to ensure a more stable source of consumption demand. Differential incomes were,

however, useful for motivating certain workers and ensuring economic efficiency. (Hobson 1929a, 232) Factors of production should be paid what is necessary to induce them into the production process. Should certain individuals refuse to work except for high wages, then they must be paid accordingly, if their services are required.

Marginalist economists devised a theory of distribution whereby factors of production are awarded the value of their margin product. Hobson recognized the circularity of this argument and maintained that piece wages do not establish the actual productivity of workers but only the relative productivity between workers. (Hobson 1902, 159)

The chasm separating Hobson from the Marginalists was nowhere greater than in questions of distribution. While Hobson was dissatisfied with the available literature on distribution, his own view on the subject would evolve during his career.

Thus under classical economics, as fortified by the marginalist doctrine, no rational account of distribution can emerge. A reasonable, natural, and equitable distribution is simply assumed. (Hobson 1904b, 52)

In 1891, Hobson reacted against General Walker's proposition that labour was the residual claimant after the fixed charges to land and capital were paid. (Hobson 1891a, 263) This logic, he contested, was completely fallacious since one could just as easily hold the payments to labour and land fixed and make capital the residual claimant. An alternative theory of distribution was necessary.

Hobson's first article dealing with distribution appeared in the Economic Journal in 1891 and was entitled "The Law of Three Rents". Using a variation of the Ricardian Theory of Rent, he claimed that the no-rent margin for the use of labour was fixed at subsistence and the no-rent margin for the use of capital was fixed at about 3s. Anything earned above this level was analogous to the rent earned on land, ie. it was a differential rent accruing to factors of superior quality. (Hobson 1891a) This early version of distribution bears traces of classical theory where the minimum level of wages is set at subsistence and fluctuations in wage-rates are determined by the size of the capital stock.

In this same issue of the Economic Journal, J.B. Clark put forth his own theory of distribution in which he, also using the Ricardian formula, holds all factors of production but one constant, and by varying that factor, attempts to measure its marginal contribution.

Labour spent on the poorest land in cultivation earns wages only. This is the marginal worker, and the product of it affords a standard from which may be measured the earnings of similar labour expended elsewhere. (Clark 1891a, 293)

Evidently, whereas Clark treats labour as homogeneous, Hobson attributes part of the differential in productivity to different grades of labour. It was against this static analysis of distribution that Hobson would wage his second attack on orthodoxy.

To begin with, Hobson viewed production as an organic process and felt that it was impossible to impute a separate productivity to the different factors involved in the production process. In his article "Marginal Units in the Theory of Distribution" (1904), Hobson criticizes Marshall's example of the marginal shepherd, recognizing that as regards the decisions of employers:

If it better for him to employ the tenth shepherd, it is because by employing him, he will make a slightly better use of the other factors, and here, ex hypothes, it is not possible to discriminate how much of what is added to the total product can rightly be attributed to the specific productivity of the tenth shepherd, and how much to the better functioning of the other factors. (Hobson 1904d, 460)

His unwillingness to assign a separate productivity to the different factors of production would bring Hobson into regular conflict with the new Marginalist interpretation of distribution.

In The Industrial System (1909), Hobson again rejects Professor Clark's theory as put forth in his book The Distribution of Wealth. Hobson argues that

If there were a free elastic system of industry in which production was merely a mechanical instead of an organic cooperation, so that a separate product could be attributed to each factor, then each factor would get what it made, no doubt. But there is no such system. (Hobson 1909b, 114)

Hobson pointed to the presence of monopoly power and the disadvantaged position of labour as evidence contradicting the assumptions which underlie the Marginalist theory of distribution. Smith, writing in the

late 1700's, was equally aware of the inconsistencies which pervaded the market system of exchange.

What are common wages of labour depends everywhere upon the contract usually made between these two parties, whose interests are by no means the same... it is not difficult to foresee which of these two parties must, upon all ordinary occasions, have the advantage in the dispute, and force the other into compliance with their terms. (Smith [1775] 1880, 69)

The marginalist interpretation, under the assumption of freedom of contract, had concluded that all factors were paid the value of their marginal product. This doctrine was, in Hobson's view, nothing more than an unwarranted justification for the status quo.

His second attempt to formulate a cohesive theory of distribution coincided with the publication of The Industrial System (1909). Herein Hobson highlights the fundamental distinction between costs and surpluses, arguing that the costs of production consisted of payments necessary for the maintenance of the existing stock of capital or for the subsistence of the body of labourers.

By claiming the existence of a surplus, Hobson came into sharp conflict with the marginalist economists who claimed instead that income was exhausted in the payments made to the various factors of production. Hobson's idea of the surplus was not unlike that of Marx, but as Richmond notes, it was not based on some vague form of tyranny by employers, but rather it arose on the basis of unequal bargaining power. (Richmond 1978, 287)

So the concept of unproductive surplus remained central to the Hobsonian theory, and its distribution remained as a keynote of social reform.

The surplus could be divided into the productive surplus, or the cost of growth, and the 'unproductive surplus' which had no economic basis and was merely taken by those with superior economic strength. It was Hobson's aim to show how government measures designed to distribute this surplus more equitably would both ameliorate the lot of the labouring classes and remove a grave source of economic instability. To this end, Hobson attempts to formulate a unitary method for measuring productivity and accords land, labour and capital each a certain number of "units of productive power". He then goes on to describe how payments are made to the various factors, although unfortunately the discussion digresses and Hobson ends up contradicting many of his earlier statements about rent as a purely unproductive payment. (Urwick 1909, 443)

Over the years, Hobson made a number of separate attempts at a comprehensive theory of distribution. Despite his own institutionalist preference, he felt compelled to produce an alternative theory of distribution from that proposed by either the Marginalist or Marxist writers of his day. Hobson was generally opposed to the static and formal techniques employed by his contemporaries and yet, he too attempted to formulate his ideas into a comprehensive theory, no doubt because of the general lack of enthusiasm for informal theories by his orthodox contemporaries. In retrospect however, his own examination of the bargaining process and his inquiry into the nature of monopoly power

provided dynamic and realistic accounts of the determination of income distribution.

Hobson was deeply influenced by Ruskin who was highly critical of the inductive work being put forth by his contemporaries. "Thus the root of Mr Ruskin's theory of art is its service to humanity through the presentation of noble ideas. Technique is taken for granted as the instrument of art, not its essence." (Hobson 1904b, 31) Hobson argued that the new doctrine of Marginalism was largely influenced by a desire to apply mathematics to economics. (Hobson [1914] 1968, 172)

Hobson criticized the use of purely inductive logic because too often the result was based on a partial truth which, when magnified, produced a wholly distorted image of reality. One could quite justifiably assume that rational individuals would prefer more to less, particularly if one holds true that individuals consider their own welfare in isolation. Most individuals do not, however, judge their own welfare in isolation, but amidst a multitude of others who are either directly or indirectly affected by their actions. To assume that individuals would prefer indefinitely more given that another would receive progressively less is no longer a question of rational behavior but rather one of morals.

In dealing with any larger economic subject we have not that thorough knowledge of conditions, that power of isolating phenomena, or, in general, that large and accurate record of series of facts, which are indispensable to the just application of inductive method. It is for this reason that the most valuable and, rightly speaking, the practical work in economics has been conducted on what logicians term the 'deductive method'- experience being used to verify or

confute the conclusions derived from the application of large and universally recognized premisses. (Hobson [1889] 1956, 166)

Inductive reasoning alone had severe shortcomings. Phenomena for which no explanation was available were occurring and reoccurring. The Classical School denied the possibility of excess supply or involuntary unemployment. They maintained that there was a natural tendency for supply to equal demand at full employment and that the economy was always at or moving itself towards this point of equilibrium. This utopia did not conform accurately with the experiences of a large percentage of the population. There was a large body of unemployed workers who would accept low wages were a job available. An over-accumulation of capital goods triggered periodic trade depressions which were often long and painful. Purely inductive reasoning had severed the necessary bond between theory and reality by denying the possibility of what was clearly observable.

Hobson was skeptical of the purely hedonistic approach of the Manchesterian School. The mathematical treatment of utility assumed falsely that all preference was quantitative or that where differences in quality existed, they could ultimately be reduced to differences in quantity. (Hobson 1902, 71) These writers also maintained that no interpersonal comparisons of utility were justified as this would involve making value judgements, a process which had no place in the study of economics.

The treatment of society as the mere sum of its constituent members was less than adequate. Hobson observed that individuals behaved quite differently in a group than they did alone, and that, in fact, every individual had a definite sense of this collective identity. In his opinion, it seemed that individuals sought their own identity within a group. Individuals displayed this collective spirit as producers in their place of work and also as consumers in their exhibitions of tastes and preferences. "Thus what was required, in Hobson's view, was a social science or a theory of social conduct which bore a direct relation to human welfare, a requirement not being fulfilled by economic science." (Richmond 1978, 291)

The Utilitarians and Benthamites, in their narrowly hedonistic presentation of man, had made individual welfare synonymous with social welfare by defining social welfare as the sum of individual welfares. This logic was unjustified, however, since Hobson argued that individuals pursuing their selfish goals cannot derive any meaningful utility from the fact that they are thereby achieving for themselves the highest degree of social harmony attainable. Utility is a state of mind, and it is vital that individuals be conscious of pursuing this social goal if they are to derive any sense of pleasure from its realization.

Pleasure (or desire for pleasure) is not itself a primary factor of consciousness... Pleasure is the feeling concomitant of certain states or modes of activity... Pleasure, in other words, results from the attainment of some already existent end of action; it is not an end in itself. (Hobson 1937, ff 50)

The purely quantitative character of Marginalist economics prohibited a satisfactory theory of human welfare. The assumption that "more is better" was far too narrow a definition, for it only recognized final consumption as a determinant of utility.

This means that more wealth per head is presumed to carry more total satisfaction, irrespective of the methods of production or the distribution of its toil on the one hand, the nature of the wealth, its distribution and the uses of its consumption on the other hand. (Hobson 1926, 101)

Hobson felt that the disutility of producing certain goods affected the general welfare of the community, for he was strongly opposed to any labour that had a dangerous or demoralizing effect on workers. He perceived that the improved character of consumption would eventually reduce the amount of routine jobs, and permit a more differentiated production process, for like Veblen, he appreciated how workmanship and the pursuit of excellence affected human welfare.

The fact that man is a social animal has also important bearing upon his instinct of workmanship. For even when man is doing his own work in his own way, his consciousness of the product as an end or object, carries some social feeling. (Hobson 1937, 192)

Hobson observed that purely pecuniary rewards were not the sole motivating force for various classes of workers, but rather that often artists undertook to produce purely for the sake of art, philanthropists were motivated by a sense of social responsibility, and that often politicians were spurred by a lust for power. (Hobson 1929a, 244) Most individuals were somewhere in between, being motivated by pecuniary and

non-pecuniary rewards. In terms of welfare, therefore, Hobson maintained that how one earned one's livelihood was just as important as how one spent it. H.B. Davis felt that this insight was one of Hobson's greatest contributions to Social Welfare Theory. (Davis 1957, 304)

Hobson rejects the assumption of isolated transactions implicit in the whole marginalist determination of value. Hobson charges that individuals, in deciding how to spend their incomes, do not consider each purchase in isolation but rather, that the relative desirability of various "packages" of goods or "patterns" of lifestyles are considered and compared against one another.

Every choice in life is a choice of life, of one life against another, of one organic complex of values against another. (Hobson 1929a, 71)

Like Veblen, Hobson observed how emulation and conspicuous consumption were powerful social forces affecting individuals' consumption patterns. The separatist treatment used in classical demand theory presupposes individuals will behave in a certain way, regardless of external forces. Such myopia is unwarranted, for it overlooks the fact that many 'rational' individuals are strongly affected by the perceptions and actions of others.

The main defect of the economic interpretation lies here. Property, beyond the means of subsistence, evidently serves less as an instrument of direct material employment than as a means of prestige and power over other persons. (Hobson 1926, 181)

The notion that economics could and should remain value free has been accepted by a number of economists in the recent past, and is still widely adhered to today. No one would deny that theoreticians, whatever their field of study, should strive to achieve the highest level of objectivity possible. Invariably, however, different interpretations of the same phenomenon will arise, elucidating the inherently subjective bias of the observer. On the other hand, to claim that the views espoused within a particular paradigm are purely objective would imply only that these views are amenable to those held by the dominant elite, and that divergent views are either suppressed or dismissed altogether. The most useful documents are those that openly express their biases in the prologue so that the reader is aware of the assumptions underlying the theories, as well as, the particular slant of the author.

Hobson had disdain for those esoteric economists who viewed their own theories as purely objective in method and universal in application, for he felt that moral insinuations infested the very core of these precarious theories.

Marginalist economists accept as given the existing distribution of income, and promote those policies which they feel will improve the efficiency of or increase the productivity of the production process. Any increase in national output would signify an improvement in the quality of life, as manifest in the upward shift of the "Grand Utility Curve". To claim that efficiency is the ultimate goal of economics involves definite ethical decisions. To dismiss as inconsequential the existing distribution of income is no small judgement.

The allocation of scarce resources amongst a number of competing groups invariably requires that moral decisions be made, some less apparent than others, though nonetheless present. Hobson notes that it was only in the nineteenth century that writers began claiming neutrality, expounding their policy proposals on the pretence of impartial laws. (Hobson 1929a, 91) The early economists were explicit in promoting the interests of a particular class whose concerns they felt were most consistent with their goals of stability and growth. The severance between economics and ethics which has occurred in recent years, while wholly artificial, has created the illusion of impartiality while in reality it serves to safeguard the vested interests of particular groups.

Hobson asserts freely that expenditures on necessities are qualitatively very different from expenditures on luxuries, the former involving no measurable computation of utility. (Hobson 1902, 72) He argues that the point of departure for any study involving utility begins only after the basic needs of every member of society are met, since up to that point, there is no question of preference, only of needs. Marshall is aware of this in his treatment of utility, for he makes his indifference curves convex as they approach the origin. This means, quite simply, that below a certain level of consumption, these goods become invaluable.

This admission in itself invalidates the service of the whole mathematical treatment of utility; for the relation between the necessary and unnecessary parts of expenditure is quite the most important thing to know and if quantitative measures cannot help us here, they are of little use in a human application of the laws of wealth. (Hobson 1902, 74)

Hobson was a social economist with a deep concern for human needs.

Social economics seeks not only to enable and maintain life but also to 'enlarge' it and fulfil it. As a direct result, values are hierarchical, from the lower (survival) to the highest (ethical, aesthetic) values. (Lutz 1980, 241)

Hobson demanded a qualitative conception of human welfare. Low mortality and disease rates, increased demand for higher education, and a diminishing expenditure per head on alcohol were concrete indicators of the quality of life. A reduction in the human costs of production through shorter working days and improved working conditions would further improve the human condition. (Hobson 1926, 141)

Hobson rejected the quantitative approach of neoclassical economics. By defining welfare solely in terms of consumption, Marginalism had neglected the importance of production and distribution as determinants of human welfare. The use of purely inductive logic and the Benthamite assumptions about pleasure and pain had made the collection of abstractions constituting Marginalism, an empty theoretical framework which bore no relation to the economic environment of Britain at the turn of the century.

## CHAPTER 10

## THE SHORTCOMINGS OF MARXIAN ECONOMICS

While Hobson remained highly critical of the neoclassical theorists and moved progressively further to the left of mainstream economics during his career, he nonetheless reserved some heavy criticisms for the Marxian School, who he felt were equally bound in vision by the limitations of their approach. Marx had centered his examination on the production process and, like the classical economists, had overlooked the importance of consumption in the overall functioning of the economic system. Hobson found the economic determinism of Marx and his labour theory of value to be inadequate representations of the actual economic facts and forces, and charged that Marx's class analysis had completely overshadowed the effects of other equally dynamic institutional factors.

Like the classical economists, Marx centres his inquiry around the production process and provides an alternative theory of production and distribution under capitalism. Hobson, on the other hand, makes consumption demand the focal point of his examinations, arguing repeatedly that "Consumption limits Production, not Production Consumption."

It was the lack of sufficient aggregate demand during periods of depressed trade which caused a general state of overproduction and high unemployment. In contrast, Marx viewed overproduction as the source of fluctuations in trade. Like the classical economist, he saw a tendency for profits to fall under capitalism due to the tendency for capital per worker to increase without a corresponding increase in labour's share. Wages tended towards subsistence. The glut of capital goods which accumulated on the market would cause a fall in the rate of profits and would precipitate a general depression in trade.

Karl Marx undertook a full scale review of the Capitalist system in his work Capital, published in three volumes. In this work, Marx systematically examines the production process and attempts to formulate an alternative theory of distribution based on the exploitation of workers by their employers. Classical theory, he argued, was itself the product of bourgeois thinking and was lacking in historical perspective. Marx himself adopted an economic determinist view of history whereby the conflicts apparent in each stage of economic development constitute the driving force of history, each epoch being replaced by a new and higher economic system.

Hobson was critical of this narrow interpretation of history, for like the doctrine of the Invisible Hand, it falsely assumed the operation of independent forces which were beyond the control of the individual. The Marxian's deterministic interpretation of economics was unacceptable as, for the most part, it offered no solutions to the injustices of the

capitalist system short of full-scale wide-spread revolution. Such critical apathy was ignominious to Hobson who saw human initiative as the vital and viable impetus for affecting social change.

Marx had attempted to provide a rigorous theory of the appropriation and distribution of the surplus by reducing all sources of value to a common unit of labour time. Hobson felt that such an exercise was futile, since one could not reduce differences in quality, either of labour or goods or anything else, to differences in quantity, no matter how useful it may be to one's examination.

This abstraction of quality and intensity of labour, in order to secure a simple single measure for all economic factors is closely analogous to the method of abstraction employed by the marginalists. (Hobson 1926, 154)

Labour was not the sole source of value. (Hobson 1931a, 60) Labour only achieved its full productive potential when it was combined with capital in the production process. At the same time, the will of the community, as manifest in the forces of supply and demand, affected the value of a commodity. Hobson believed in the social determination of value and insisted that a part of the surplus was therefore, the rightful property of the community.

These distinctively social sources of wealth must be taken as important qualifications of the cruder socialism in which the worker is held to create all the wealth and the capitalist employer to take all the 'surplus'. But they do not, of course, impair the essential truth of the exploitation of labour." (Hobson 1937, 68)

While labour was not the sole source of value, it was incontestable that labour was exploited to a degree. The disadvantaged position of labour in the bargaining process enabled employers to extract from them a surplus which corresponded directly to the degree of economic strength of the more powerful agent. While the surplus, which originated in the process of production, was a result of combining together the various factors of production, its distribution was a function of economic power.

Surplus Value, then, is not something which emerges in the dealings of capital with labour, or of land with labour; it emerges in every competitive bargain and adheres to the stronger bargainer." (Hobson 1904, 360)

The conflict between labour and capital was the major contradiction of capitalism which Marx argued, could only be resolved through the abolition of the Capitalist class.

Hobson, however, did not regard the rivalry between labour and capital as the sole source of conflict within the system. There was a serious rift between the agricultural and the manufacturing sectors of the economy, since any measures designed to safeguard the interests of one group invariably had a negative impact on the other. Within the manufacturing sector itself, workers in the sheltered trades often received higher wages than those working for the export market, creating jealousy and divisions between industries. (Hobson 1929a, 183) To be sure, the Trade Union Movement was gaining popular support and had already done much to improve the lot of its members. Yet, as evidenced

in the hostilities apparent between various factions of the working class, Marx was wrong in assuming that workers as a class would unite to pursue their own welfare. (Hobson 1931a, 83)

Marx failed to provide an accurate account of economic phenomena because he neglected to incorporate into his analysis, the impact of certain influential environmental factors. Veblen was aware of the limitations of Marxian theory, for he too stressed the importance of institutional forces. One could not, for example, impose the socialization of agriculture on the peasant class, for they held a very strong and unique view about land as a source of property. (Hobson 1937, 64)

The weakness of Marx was that he emphasized inner necessity, self-interest, as factors in the change to socialism, rather than the influence of environment. (Hobson 1937, ff. 62)

Marx had falsely identified man as a uniquely social being and had postulated that man would be sufficiently motivated by a social will once the dictatorship of the proletariat had been established. To be sure, man did possess this sense of collective identity; however, Hobson argued that it was unrealistic to assume that this collective will would be enough to motivate individuals to perform their work to the best of their ability.

But to pretend that 'social service' or the good of the community can be a leading incentive to the performance of our daily task in ordinary industry will not bear investigation. (Hobson 1926, 159)

Hobson especially saw the need for private industry to generate technological innovations, pointing out that "even if the predominantly public services could be efficiently administered, the virtual exclusion of the element of private enterprise or adventure would be seriously detrimental to progress in the arts of production." (Hobson 1931, 88)

By the end of the 1800's, Marxian rhetoric had lost much of its thunder as many came to view capitalism as a more permanent stage of development than Marx had envisioned. It is during this period that democratically socialist movements gained in popularity, their ideas eventually becoming crystalized by the new British Labour Party. (Macridis 1980, 52) Evolutionary Socialism, published by the German sociologist Edward Bernstein in 1899, outlined the new path of political reform. (Macridis 1980, 56) With faith in the principles of democracy, Hobson, like these writers, saw political reform as emanating from a gradual transformation of economic and political institutions.

While Hobson had outlined a number of flaws apparent in the system of laissez-faire Capitalism, he saw these barriers to economic democracy as capable of being surmounted through the enlightened actions of the State.

Even those conflicts of interest, those maladjustments, those manifest unfairnesses which we have cited, are flaws or friction in the operation of a system which as a whole works harmoniously and beneficially to all concerned."  
(Hobson 1929a, 184)

Hobson endeavored to affect policy throughout his career as a writer. In his view, the need for massive institutional change was vital to the further growth and development of England. The role of the State, wherever possible, was to ensure a healthy competitive economic environment. There were industries, however, where the State was to assume a major role in the regulation or provision of services. Nationalization of the railways and the electrical company would promote equal access to transportation and energy. (Hobson 1909a, 171) The need for a more active state participation in financial institutions was critical, since "Credit is an essential element of liberty and of equality of competition in modern business." (Hobson 1909a, 106) In addition, everyone should have equal access to public law and public education, from primary school to university. (Hobson 1909a, 109)

For the new economic revolution should be a process not of destruction followed by construction, but of adaptation and displacement, with a clear consciousness of the moral and intellectual nature of this process. (Hobson 1931a, 82)

There were a number of flaws in the Capitalist system but Communism was not the answer. While man was not to be regarded uniquely as a selfish egoist, nor was he completely a social animal. Both the Marxian and Manchesterian schools had adopted a narrow view of man which Hobson felt, focused uniquely on only one facet of the human character. Instead, in the organic makeup of man there was a balance between his private and his social needs and it was fundamental that the institutional environment reflect this balance. It is for this reason that Hobson advocated a mixed economy of public and private enterprises.

"While proposing, through taxation, a sweeping redistribution of wealth together with a national minimum wage and social insurance, Hobson did not contemplate the abolition of social classes. His perspective was not class war but social harmony." (Davis 1957, 305)

## CHAPTER 11

### SUMMARY AND CONCLUSIONS

The writing career of J.A. Hobson which began in the late 1800's and lasted up until his death in 1940, was rich with the experiences and visions of a man who pursued social justice with a clear and open mind. Unbound by traditional dogmas, his writings contained the seeds which would later inspire innovative works by numerous writers from the various schools of thought.

Hobson assumed the role of an economic agitator in most of his writings. His efforts were mainly directed at influencing opinion and affecting policy. He did not regard economic theory as separate from policy, but felt that the two were mutually exclusive. Unlike his contemporaries who were concerned with perfecting a mathematical framework into which all behavior could be conveniently classified and subsequently examined, Hobson chose instead a more social and holistic approach to the study of economics, focusing on the dynamics of institutional and social interactions. It was the injustices and inconsistencies around him which attracted his attention and the desire to affect change which inspired his writings.

Unlike those who resorted to complex language and involved formulas, Hobson's works were straightforward and accessible to the untrained reader. While he enjoyed the company of intellectuals, he was exposed to a wider audience through his journalism and his contacts with the

British Labour Party. To be sure, his heretic influence was felt not only in the realm of thought, but moreover, in the actual practices of the times.

The economic policies of the British Labour Party government after 1945 in respect of full employment and nationalization followed Hobson's ideas very closely, and these ideas may well go down as the most important single intellectual inspiration of that particular phase of British economic history and policy. (Hutchison 1953, 129)

Hobson has been criticized for his failure to provide a comprehensive theory to replace those which he attacked. This was not, however, the nature of his studies, for as the political and economic conditions around him changed, so too did the focus of his writings. Intense colonial rivalry brought on the examination of Imperialism. Consolidation and trust building prompted an examination of monopoly power. The changing character and functions of financial and industrial institutions necessitated for him a critical examination of the evolution of the capitalist system and its direction of growth into the future. To Hobson, political economy required an examination of the dynamic forces in society which affected the production and distribution of goods at any particular time. There was no natural law which ensured the just and equitable operation of the system, nor was there any tendency for the system to collapse.

Although his earliest heresies were rejected by his influential contemporaries, Hobson later gained the respect of a number of prominent economists for his innovative approach to economic study. R.F. Harrod in his introduction to The Science of Wealth remarks that Hobson

possesses "a fine grasp of what is valuable and enduring in the body of orthodox economics". (Hobson 1911, viii) Keynes claims that his work in The Physiology of Industry "marks, in a sense an epoch in Economic Thought." (Keynes 1936, 365) W.H. Richmond notes that "It is in large part Hobson's contribution to the development of a truly universal sociology which gives his work special significance." (Richmond 1978, 293) H.N. Brailsford, a neighbour and colleague of Hobson's at The Nation wrote a very personal account of his life entitled The Life - Work of J.A. Hobson. In it he writes, "For me he was the most original and persuasive thinker of his day on economic questions and more important still, he was a great moralist who possessed a rare gift of sympathy and a creative insight into the meaning of human society." (Brailsford 1952, 3)

There is today, as in Hobson's day an incredible bias towards orthodox economic theory. In universities across the nation, students of economics are required to take a number of courses in neoclassical price theory, whereas they are under no similar obligation to explore other schools of thought. Many become adept at the use of microeconomic tools of analysis and yet have no clear understanding of the assumptions underlying these theories. The recitation of accepted dogmas does not constitute an education.

A study of opinion is a necessary preliminary to the emancipation of the mind. Lord Keynes.

Exposed to and yet uninhibited by orthodox theory, Hobson forged his own way down untraveled paths towards new horizons where freedom of

opportunity became meaningful and wealth was defined in human terms. A journey into the voluminous works of J.A. Hobson would surely emancipate the mind of any student of economic thought.

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