David Hume: Monetarist theorist?

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In this insightful and rigorous study, Marcus Spray uses the prism of Monetarism to discuss the work of influential thinker and theorist David Hume. He finds much evidence for the notion of Hume as monetarist in his views on many issues, but raises questions over his views on inflation and free markets. As a result, he concludes that while Hume was undoubtedly influential in the monetarist sphere, he was perhaps not fully monetarist himself.

Introduction

In this essay, I aim to establish whether David Hume can truly be seen as a forerunner to modern monetarist thinking.

David Hume has traditionally been seen as a father to monetarist theory and has indeed been a great influence on many monetarist theorists such as Milton Friedman (Friedman, 1968; Murphy, 2009; Meyer, 1980; Wennerlind & Schabas, 2008). However, certain aspects of Hume's work such as his apparent fondness for inflation have caused academics to question this view.

Among his variety of works, Hume only published one book on economics, Political Discourses. The work is split into 13[1] different essays and they predominantly deal with the topic of macroeconomics[2]. The use of the word 'discourses' is important as Hume applies a philosophical method to his analysis of economics (Murphy, 2009, p.100). For instance, Hume poses questions such as 'is money wealth', or 'is the accumulation of money beneficial (Ibid, p.100)? However, this ambitious philosophical approach may be the reason behind many equivocations and hesitancies found in the text. Hume, the perennial sceptic, would naturally doubt and question any apparent assumptions or assertions. This inconsistency in his work has thus caused difficulty for economic historians in assigning Hume a definite place within monetarism.

1 The 13th essay – 'Of the Jealousy of Trade' – was added 6 years after the first publication.
2 Seven out of the thirteen essays deal with macroeconomic issues.

In a very narrow sense, monetarism describes the view that 'changes in the money stock are the predominate factor in explaining changes in money income'[3] (Mayer, 1978 p.1). But in a broader sense, the term covers a wide variety of propositions apart from the basic quantity theory (Ibid, 1978). Nevertheless, not all monetarists would subscribe to the same set of propositions and certainly some propositions would carry more weight than others. In analysing whether David Hume is a forerunner to monetarist theory, it is pointless to apply a modern day list in the effort to see whether the theories and ideas match up. Many monetarist ideas that are important today were not invented or were utterly irrelevant in the time of Hume. For instance, the question of what the targets and indicators of monetary policy should be would be meaningless (Meyer, 1980). Instead, it is better to look at some of the central economic ideas espoused by Hume, and ascertain whether they display monetarist aspects or indeed shaped future monetarist views.

Thus, in this essay I will first look at money neutrality and Hume's formulation of the theory. I will then analyse how Hume believed the interest rate was determined and whether this was similar to Monetarist theory. Following this I will look at Hume's view on private sector stability, free markets, and free trade, all of which are generally supported by monetarists. Finally, I will look at Hume's views on inflation, an occurrence that is not favoured by monetarists.

Money Neutrality

The neutrality of money in the long run is the central proposition to monetarist thinking. (Meyer, 1978). Hume was the forerunner of this idea – while he may not have been the first theorist to describe it, he was, according to Shrumpeter, the first to show that on an abstract level there is no specific level of nominal money that a country needs. (Mayer, 1980) Hume writes:

> "If we consider any one kingdom by itself, it is evident, that the greater or less plenty of money is of no consequence; since the prices of commodities are always proportioned to the plenty of money… It is a maxim almost self-evident, that the prices of everything depend on the proportion between commodities and money, and that any considerable alteration on either has the same effect, either of heightening or lowering the price… All augmentation (of gold and silver) has no other effect than to heighten the price of commodities and labour. Money is not, properly speaking, one of the subjects of

3 I.e. money neutrality.

> commerce, but only the instrument which men have agreed upon to facilitiate the exchange of commodity for another."
>
> (Hume, 1752, p.41)

Thus, money for Hume was merely a unit of account, one that could loosen the wheels of trade but not drive it itself. Essentially, he believed money does not play a strong role in determining economic activity. In other words, Hume was subscribing to the classical theory on the neutrality of money
Thus, Hume firmly understood the distinction between the real and nominal quantity of money which is so stressed by monetarists. (Mayer, 1980)

Interest Rate Determination

Related to this was Hume's theory of real interest rates which is very similar to the view subscribed to by monetarists (Mayer, 1980). He believed that a high stock of money does not necessarily imply low nominal interest rates, instead it would just increase prices:

> "The lowness of interest is generally ascribed to plenty of money. But money, however plentiful, has no other effect, if fixed, than to raise the price of labour… Interest in Batavia and Jamaica is at 10 percent, in Portugal at 6; through these places, as we may learn from the price of everything, abound more in gold and silver than either London or Amsterdam."
>
> (Hume, 1752, p.61)

This theory is remarkably similar to Friedman's theorising in his 1968 essay 'On the Role of Monetary Policy', the only differences being that Friedman has the benefit of the Fisher effect and he describes money growth rate rather than money stock:

> "High and rising nominal interest rates have been associated with rapid growth in the quantity of money, as in Brazil or Chile or in the United States in recent years, and… low and falling interest rates have been associated with slow growth in the quantity of money, as in Switzerland now, or in the United States from 1929 to 1933."
>
> (Friedman, 1968, pp6-7)

Furthermore, Hume attributed the interest rate to the level of profits. A low interest rate was the consequence of the growth of trade rather than a cause of it (Murphy, 2009). According to Hume, it was merchants who were crucial to interest rate determination. These merchants[4], by stimulating economic activity and by pooling their subsequent savings, would drive down the interest rate. Hume greatly admired these merchants and felt they were the 'most useful race of men' in society (Hume, 1752, p.68). This is not unlike many monetarists who also display great gratitude to modern day merchants such as businesspeople (Meyer, 1980). Also by reversing the causal effect whereby lower interests rate lead to increased economic activity, Hume was espousing views very similar to modern day real business cycle [RBC] theorists who believe interest rates are endogenous to economic activity rather than exogenous. As RBC theory is seen as a subset of monetarism, this bolsters the case for Hume as a forerunner to monetarist thought.

Private Sector Stability

Monetarists tend to believe that the private sector is naturally stable if it is left to its own devices and not interrupted by irregular monetary policies (Mayer, 1978, p.14). In this respect, Hume was firmly in agreement. At the time, mercantilists fought to preserve a country's supply of specie in order to stabilise the private sector. Hume however was firmly against this idea, believing that the supply of specie should be left to look after itself. What is more, Hume maintained that prices are highly flexible and that this fact would ensure the stability of the private sector:

> "Nor is it probable, that the diminution of circulating money was ever sensibly felt by the people, or ever did them any prejudice. The sinking of the prices of all commodities would immediately replace it, by giving England the advantage in its commerce with the neighbouring kingdoms."
>
> (Hume, 1752, p.94)

Furthermore, Meyer (1980) points out that Hume was a man of great social sympathy and if he had thought unemployment was a serious problem, he would have likely discussed it at length.

Therefore, by placing firm faith in private sector stability Hume is adhering to monetarist theory.

Free Markets

Hume is often credited with following the monetarist practise of preferring the free market to government intervention. One conspicuous example is Hume's criticism of a large public debt that was proposed by his contemporaries:

4 Or Entrepreneurs as Cantillon would refer to them.

> "The practice therefore of contracting debt will almost infallibly be abused, in every government. It would scarcely be more imprudent to give a prodigal son a credit in every banker's shop in London, than to impower a statesman to draw bills, in this manner upon posterity."
>
> (Hume, 1752)

Consequently, it seems Hume would not look kindly on government intervention within the market.

Although, Viner claims that laissez faire doctrines can only be found in Hume's writings by implication, if at all (as cited in Mayer, 1980). Furthermore, Hume's free market convictions are possibly tempered by his support of taxation. He believed that mild taxation could be very positive since it stimulated industry (Mayer, 1980). His idea was that the imposition of a tax would actually increase the supply of effort, ingenuity, and enterprise, so that income rose to compensate for the tax (O'Brien, 1975, p.242). However, this must be qualified by the context of the time; most of Hume's peers advocated much harsher taxes, and Hume's support of tax was much more constrained in comparison (Humphreys, 1932).

A much more damning finding is Hume's description of spontaneous motivation found in his ground breaking philosophical work 'A Treatise of Human Nature'. Hume (1739, p. 125) claims that 'reason alone can never be a motive to any action of the will; and… that it can never oppose passion in the direction of the will'. For Hume (1739, p.127), 'reason is and ought only to be a slave of the passions'. This suggests that realms such as the market could be subject to irrational human behaviour and unintended consequences. His theorising sounds very similar to and must have been an influence on Keynes' idea of Animal Spirits:

> "Even apart from the instability due to speculation, there is the instability due to the characteristic of human nature that a large proportion of our positive activities depend on spontaneous optimism rather than mathematical expectations, whether moral or hedonistic or economic. Most, probably, of our decisions to do something positive, the full consequences of which will be drawn out over many days to come, can only be taken as the result of animal spirits – a spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities."

(Keynes, 1932, pp.161-162)

It is hard to reconcile Hume's ideas on human motivation with him being a free marketer. In this respect, Hume sounds far more like a Keynesian than a monetarist.

Free Trade

Monetarists have generally been in favour of free trade, praising the mutual benefits experienced by all participants. In this respect it seems David Hume was firmly monetarist. Interestingly, this viewpoint was not popular in Hume's time, with most of his contemporaries espousing mercantilist ideals of protectionism and specie accumulation (Murphy, 2009). In a similar vein to how monetarists reacted against Keynesianism, economic historians have argued that Hume was reacting against the dominant mercantilist views (Meyer, 1980).

Hume's writings on trade are contained in the essays 'Of The Balance Of Trade' and 'Of The Jealousy Of Trade', which was published 6 years later. First of all, in 'Of the Balance of Trade', Hume demonstrated the self-defeating nature of specie and bullion accumulation through his price specie flow mechanism. He described how an increased money supply would lead to higher prices due to the increase in expenditure. As a result, exports would become less competitive while imports would become 'so cheap in comparison' (Hume, 1752, p. 83). Consequently, a balance of payments deficit would emerge, which would in turn cause the money supply to return to its previous level. The whole exercise thus would be completely pointless. Accordingly, Hume has been recognised for first applying monetarism to the open economy (Murphy, 2009; Wennerlind & Schabas, 2008).

However, it was left to 'Of The Jealousy Of Trade' to extoll the virtues and advantages of fully fledged free trade. Thus, Hume set out to show that trade was not a zero sum game. Open trade between nations would lead to great wealth and prosperity to all those involved:

> "That where an open communication is preserved among nations, it is impossible but the domestic industry of every one must receive an increase from the improvement of others… the increases of riches and commerce in any one nation, instead of hurting commonly promotes the riches and commerce of all its neighbours."
>
> (Hume, 1955, p.78)

It seems like Friedman (1968) was echoing Hume when he wrote in his article

'The Case for Free Trade', that 'free trade is in the best interests of trading countries and of the world'.

However, O'Brien (1975, p.36) questions Hume's free trade credentials, calling him a 'mild protectionist'. For instance, Hume feels imports on certain goods would be favourable, noting that that 'a tax on German linen encourages home manufactures, and thereby multiplies our people and industry' (as cited in O'Brien, 1975). Hume was also concerned with increasing the strength and power of Britain relative to other states. Johnson (1937, p.177) writes that although Hume considered that the 'happiness of individuals should be the purpose of policy, the greatness of the state should always be regarded as an even more important goal'.

Regardless, Hume clearly believes in the benefits of free trade and is only willing to accept trade protection for certain budding industries (Wennerlind, 2005). Hume, therefore, was predominantly a monetarist when it came to free trade and was a huge influence on the monetary approach to the balance of payments.

Inflation

The most prominent problem with Hume's supposed monetarism is his view on inflation. Unlike most monetarists, Hume did not display any great concern about inflation. He failed to acknowledge any great losses with inflation and felt that it was an important ingredient in driving the economy (Meyer, 1980). In a famous passage he writes:

> "The good policy of the magistrate consists in only keeping it, if still possible, still encreasing; because, by that means, he keeps alive a spirit of industry in the nation, and the encreases the stock of labour… a nation whose money decreases, is actually at that time, weaker and more miserable than another nation, which possesses no more money, but is on an encreasing hand."
>
> (Hume, 1752, p.50)

While monetarists have at times argued for an expansion in the short run, Friedman for example refers to a money illusion whereby consumers feel wealthier than the reality and therefore increase expenditure, they do maintain that the benefits will be short-lived. Hume on the other hand, while he also refers to this illusion in monetarist fashion, seems to argue for a permanent expansion in the money stock. This apparent faith in the long term advantages of inflation seems to contradict his views on the quantity theory.

By claiming a monetary expansion can have positive effects on employment and output, Hume, according to Pearlman, writes 'one of the most controversial passages' in his economic writings (as cited in Wennerlind, 2005). The consensus therefore is that Hume favoured the policy of maintaining a gradually increasing monetary policy – thus, an inflationist policy. An idea that would run in direct opposition to the monetarists of the 20th century.

However, Wennerlind (2005), an expert on David Hume's economic writings, does not believe Hume should be labelled as an inflationist. By recognizing that Hume made an analytical distinction between endogenous and exogenous money supply, Wennerlind believes this inconsistency can be solved. Thus, a rise in the money supply should occur only if it is preceded by an increase in industry. Therefore when Hume claims that the magistrate's good policy consists of, if possible, increasing the money supply, he is really advising the state to promote industry through the creation of favourable laws. Hence, if read differently the passage does not imply that Hume is an inflationist and thus maintains his monetarist credentials.

Then again, while Wennerlind makes a strong case, his supposition is unconvincing as it does not take into account the gap between Hume's understanding of the economy and the underlying financial reality of the world they lived in (Murphy, 2009). For instance, in 'Of Public Credit', Hume was very inaccurate in his understanding of the financial innovations and the financial services sector which would later become an essential part of the British economy, and also made a foolish prediction that either Britain should 'destroy paper credit or public credit will destroy the nation' (Hume, 1752, p.135). Also, when Wennerlind (2005) makes his argument he presupposes that the law of one price holds. But as Murphy (2009), and Wennerlind and Schabas (2008) show by identifying the correspondence between Oswald and Hume, Hume does not recognise this law.

I would conclude therefore that Hume did favour an inflationist policy in a manner unlike Monetarists.

Conclusion

David Hume succeeded in many realms of intellectual thought. He published respected books in philosophy, political science, history, and as well of course economics. His macroeconomic work had a profound influence for years to come, even prompting Friedman to comment in 1975 that economists had learnt little since Hume (as cited in Wennerlind & Schabas, 2008).

This essay sought to establish as to whether Hume can be truly credited as being a forerunner to modern monetarist thought. Certainly, his formulation of money neutrality exerted a huge influence on monetarism, becoming its central proposition. Hume's idea of interest rate determination was also very influential, as was his price specie flow mechanism, his belief in the stability of the private sector, and his preference for free trade. However, as I have demonstrated in this essay, his less than convincing faith in the free market and his fondness for inflation challenge his monetary pretensions. As discussed in the introduction, Hume's philosophical method also undermined his ideology and thus made the 'sceptic' hard to place within any school. Regardless, even with these caveats, Hume's enormous influence within monetarism should not be ignored. While not always monetarist in detail, Hume undoubtedly was a forerunner to many monetarist ideas.

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