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# History of Economic Thought

## VII. The Historical School (and Others)

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## VII. The Historical School (and Others)

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1. Money and Bullionism in France and Germany
2. Banking in France and Germany
3. French Positivism
4. The German Historical School
5. The German Subjective Utility Theorists
6. The British Subjective Utility Theorists



# 1. Money and Bullionism in France and Germany

## Revolution and War

- Impact on economic thinking
- “Hard money” views spread
- Skepticism of banking



## French Revolution and Inflation

- Assignats: paper money “claims” to the nationalized estates of the Church
- Used to finance revolutionary policies, war
  - Result: prices rising fast
- Law of the Maximum 1793
  - Price ceilings on grain → shortages
  - Brutal punishments for evasion

## Napoleon and Normalcy

- Gold circulation restored
- *Banque de France* 1800 – private bank, monopoly on issuing banknotes



## Hard Money

- Conclusion drawn from experience of the Revolution

## Destutt de Tracy

- Debasement and paper money are theft
- Monopoly banks vicious, and inflation as generally destructive

## Jean-Baptiste Say

- Against monopoly banks, free banks of circulation would be a great improvement
- Both for the use of units of weight over proper names like “franc”
- To emphasize that the metal was the money, not some abstract unit



## **Johann Georg Busch (1728-1800)**

- denounced inflationary banking privileged by government
- Financing of war the main purpose, since the beginning of the eighteenth century, for banking

## **Heinrich Friedrich, Freiherr von Storch**

- Denounced government sponsorship of bank credit and paper money inflation (1823)
- Also saw financing of war as the main motive
- Advocated for 100 percent reserve banking, free banking as a second-best alternative



## 2. Banking in France and Germany

- Banque de France
- French Discussions
- German Discussions



## *Banque de France* and Discussions

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- Banque de France held monopoly of note issue in France, dominated French *haute finance* down to 1848
- Challenged by the Pereire brothers, Isaac and Emile: founded *Credit Mobilier* 1852
- Expansionary banking to finance industry, railroads, and government loans
- *Credit Mobilier* collapsed 1867 and was acquired by the Bank of France





## **Henri Cernuschi (1821-96)**

- Against bank notes: their issue despoiled the holders of metallic money
- Proponent of bimetallism
- For free banking, issue of notes: this would lead to their total suppression

## **Jean-Gustave Courcelle-Seneuil (1813-92)**

- Free banking the better banking system
- A monopoly bank likely to be privileged, redemption in specie would be revoked
- An over-issue of notes impossible, notes could only enter circulation if they satisfied a real demand

## **P. J. Coulet (1865)**

- Argued for central banking
- Freedom of issue self-destructive
- Advantages of monopoly more than outweighed the danger of abuse



## **Otto Hübner (1818-77), member of the German Free Trade Party**

- *Die Banken*, 1854. Survey of existing banks, conclusion strongly supported free banking
- Not banking school! For 100 percent cover of notes
- Banks should not expand credit: the apparent boom only capital consumption

## **J. L. Tellkamp (1808-76), Prussian Senator, Professor of Political Economy in Breslau**

- Like Hübner rigorous currency-school supporter
- Note issue only with unlimited liability and when banks did not lend to the state – policy ideal centralization of note issue
- Recommended free banking in Prussia in 1850s as practical policy
  - The best way to keep out rival note issue of neighbouring states

## **Adolf Wagner, the best-known economist of his generation**

- Supporter of the banking school. First book 1857
- Close student of the English literature, critical of Peel's Act
- Free banking the best system, central banking lead to abuses
- Introduced German theory of “bankmässige” cover 1862 – version of principle of reflux



- Meeting of liberal economists, 1858-1885

## **Free Banking**

- Unlimited liability the best policy – all that's required
- Limited liability for banks would require special rules

## ***Normativbestimmungen***

- No limit on note issue, no specified reserve ratio
- Notes should be covered by bullion and “bankmässige” bills
- Government securities considered too risky
- Banks obliged to pay cash on presentation of notes on pain of liquidation



## Philip Joseph Geyer

- Strict currency-school theorist 1865
- Constant money supply ideal, note issue introduces imbalance
  - Uncovered notes “artificial capital”
- Against freedom of note issue, for free deposit banking

## Erwin Nasse

- Proponent of central bank (monopoly note issue) 1866
- In a crisis, central bank notes can provide internal circulation
  - Easier credit for stricken banks
  - No internal drain made a crisis less serious
- For “bankmässige” cover of notes



## Arguments for Central Banking

- Given bank notes, increasingly opinion shifted to central issuer
- Reserve requirement should then be imposed on notes
- Central bank could ease conditions in crisis

## Central Bank Cover – “Dritteldeckung”

- Notes 1/3 covered by gold, rest by “bankmässige” paper
- As against principle of marginal cover of Peel’s Act
- Preferred as more flexible than the British system
- Adolf Wagner 1870-73 treatise turns to central banking, ditto  
Karl Knies



### 3. French Positivism

- Saint-Simon
- Comte and Positivism



## Henri de Saint-Simon (1760-1825)

- Impoverished aristocrat and man of letters
- Positive view of industrialization, march of progress
- Society must be reorganized, regenerated through science
- Auguste Comte secretary to Saint-Simon, took over some of his ideas

## Saint-Simonism

- Prosper Enfantin continued the movement after 1825. It became... weird
- Enfantin founded a religious community, set out on a search for the “female messiah” in the east, uniting the “masculine occident” with the “feminine orient”
- Saint-Simonians influential: men of learning, skilled engineers, bankers, etc. Rose to prominence by mid-century
- Enfantin a key promoter of the Suez Canal



# Auguste Comte (1798-1857)

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- Positivism: social affairs should be managed on a scientific basis

## **Stages of History**

- Theological stage
- Metaphysical stage
- Positive (or scientific) stage

## **Religion of Humanity**

- “Counterfeit” Christianity: patterned after Catholicism, but no Christ, no mention of God
- Invented to satisfy religious impulses and to increase altruism
- Completely secular and positivist in outlook

## **Saint-Simonians’ and Positivists’ Program**

- Focus on economic and material progress
- Scientific investigation on mainly inductive lines





## Major movement in France and elsewhere

- In France, the Pereire brothers and many other industrialists, bankers and economists were positivists
- Of great influence especially under the Second Empire
- Positivism became the official creed of some American countries
  - To this day the positivist motto “order and progress” inscribed on the Brazilian flag
- Suez Canal a positivist project

## Scientific Influence Great

- Science must be inductive and quantitative
- Any science should therefore be reconstructed on positivist lines



## 4. The German Historical School

### **Wilhelm Roscher (1817-94) and the older historical school**

- Karl Rodbertus (1805-75)
- Karl Knies (1821-98)

### **Gustav von Schmoller (1838-1917) and the younger historical school**

- Adolf Wagner (1835-1917)
- Georg Friedrich Knapp (1842-1926)
- Werner Sombart (1863-1941)

“The intellectual bodyguard of the house of Hohenzollern”

“Verein für Socialpolitik” and “Kathedersozialismus”



## Jean Charles Léonard Simonde de Sismondi (1773-1842)

- *Nouveaux principes d'économie politique* in 1819 provoked first debates over Say's law
- Sismondi former Smithian, became an underconsumptionist due to post-war depression
- Abandoned the belief in general economic laws and *laissez faire*
  - Argued for welfare state and intervention
  - The market did not reach equilibrium by itself (overproduction *and* underconsumption)

## Georg Friedrich List (1789-1846)

- Main work: *National System of Political Economy*
- There is no necessary harmony of individual interests and national interest
- Therefore statesmen need to intervene, regulate the economy for the common good
- The infant industry argument for protectionism invented by List
- Theory of stages of development: 1. pastoral, 2. agriculture, 3. agriculture and manufacture, and 4. agriculture, manufacture and commerce



## Georg Friedrich Wilhelm Roscher (1817-94)

- Since 1848 professor in Leipzig, the founder of the historical school
- *Grundriss zu Vorlesungen über die Staatswirtschaft nach geschichtlicher Methode* (1843)
- Roscher focuses on the concrete historical development of economic phenomena rather than the abstract theorizing of classical economics

### **Basic approach: economics contingent, specific to time and place**

- Universal theories not possible – at best, generalizations applicable to certain societies and periods
- Historical investigation therefore the main method of economics
- Parallel to other sciences: evolution much central issue across academia
- Some sympathy for economic liberalism, but increasing focus on “the social question” – the (alleged) problems of a growing working class



## **Karl Rodbertus (1805-75)**

- Avowed socialist: but socialism only a gradual evolution
- Modified Ricardianism: rent and interest the result of exploitation
- Income shares historically contingent, not down to universal laws

## ***Verein für Socialpolitik***

- founded in 1872, to deal with the “social question”
- Advocated piecemeal social legislation and welfare interventions
- Derided as “Kathedersozialisten” by their opponents
- Became the key venue for debate in German economics
- *Kongress deutscher Volkswirte* met last time 1885



# The Historical School on Money

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- **Karl Knies (1821-98), Professor at Heidelberg**
- Key works: *Die Politische Ökonomie vom Standpunkt geschichtlichen Methode* (1853), *Geld und Credit* (1873-76)
- We cannot include money under the general categories of producer goods and consumer goods
- A third category is needed, media of exchange. The laws of value governing each different

## **Georg Friedrich Knapp (1842-1926), Professor at Leipzig and Strasburg**

- Most important book: *The State Theory of Money* 1905
- Founded the chartalist tradition: money is created by convention or legislation, not in the market
- The value of money derives from its legal status



## **Gustav von Schmoller (1838-1917), the leader**

- Professor at Halle, Strasburg and Berlin
- The younger school was more “extreme” than the older school

## **Methodology**

- No room for the deductive approach of the classical school
- All economics from empirical investigation, historical research
- *Methodenstreit* with the Austrians

## **Policy Conclusions**

- Government intervention the great solution to all social and economic problems
- A turn against classical conclusion: e.g., on the question of privileged labour unions

## **Institutional Power**

- The historical school reigned supreme: Schmoller controlled all university appointments

## **Werner Sombart (1863-1941), the apogee and end of the school**

- Some interesting sociological and historical sketches (*Moderne Kapitalismus, Der Bourgeois*)
- Late in life expressly socialist: *Deutscher Sozialismus* 1934



## English Historical School

- Thorold Rogers (1823-90)
- Walter Bagehot (1826-77)
- Arnold Toynbee (1852-83)

## American Institutionalism

- Thorstein Veblen (1857-1929)
- Richard T. Ely (1854-1943)
- Frank W. Taussig (1859-1940)

## In France

- The historical school almost completely replaced the native liberal school
- Rise of academic economics in France
- Lack of formal credentials of the French *laissez-faire* school





## 5. The German Subjective Utility Theorists

### Strong Tradition

- From foundation of classical economics in Germany
- Focus on definition and analysis of the economic good
- Mainstream in Germany until c. 1860 or so

### Eventually overshadowed by the Historical School

- But strong influence on Carl Menger



## Gottlieb Hufeland (1760-1817)

- *Neue Grundlegung der Staatswirthschaftskunst...* (1807)
- Subjective definition of goods: only through relationship to people's ideas do things become goods

“The concepts of good and value are mutually dependent and only exist through their relationship to means and ends.”

## Heinrich von Storch (1766-1835)

- German economist in St. Petersburg
- Also argued for subjective value theory
- A want is a desire for a thing that spares us uneasiness or gives us pleasure



## **Karl-Heinrich Rau (1792-1870)**

- Professor in Heidelberg, *Grundsätze der Volkswirtschaftslehre* 1826
- There are species and subspecies of goods
  - E.g., cereal grains and wheat, barley...
  - Groundwork for substitutes and complements
- Organic instead of mechanic metaphors

## **Friedrich Benedikt Wilhelm Hermann (1795-1868)**

- Professor in Munich, *Staatswirtschaftliche Untersuchungen...* 1832
- “Whatever satisfies some or other human need is called a good”
- Material goods, intangible goods, services and relationships included under concept of good



## **Peter Mischler (1821-64)**

- Taught in Prague, *Grundsätze der Nationalökonomie* 1857
- Three classes of goods: producer goods, acquisition goods, consumer goods

## **Lorenz von Stein (1815-90)**

- Professor in Vienna, *Lehrbuch der Volkswirtschaft* 1852
- Process-oriented: only active relationship with human ends make a thing a good
- Production shifts natural elements into the realm of goods
- Consumption converts goods back into natural realm

## **Albert Schäffle (1831-1903)**

- Professor in Vienna, *Die Nationalökonomie* 1861
- Focused on active human subjects, on activity of want-satisfaction
- “Value is the significance a good possesses by dint of its usefulness to the economic individual’s consciousness of economic purpose”



## 6. The British Subjective Utility Theorists

### Important undercurrent of Classical Economics

- Centered on Oxford and Dublin
- Focus on issues of value theory, money, social harmony

### Eclipse of the School

- Popularity of JS Mill
- After him Alfred Marshall



## Key figure: Rev. Richard Whately (1787-1863)

- Centre of liberal Oriel circle at Oxford (“Oriel Noetics”)
- Rationalist, revived classical logic with 1826 *Elements of Logic*
- Recommended Nassau W. Senior to Drummond chair at Oxford 1825-30, then succeeded to it 1830-31
- Anglican archbishop of Dublin from 1832, funded chair in political economy at Trinity College, Dublin

## Fundamental Position: Economics is not materialistic and anti-Christian

- Opposed attempt by Radicals (often atheists) to monopolize economics
- Their system anti-Christian, implied inherent class conflict
- The economy is a harmonious social order, testifying to divine wisdom
- *Laissez-faire* economy and divine order integrated



## Economics is Catallactics

- Rejected definition of economics as the study of wealth
- Economics is the study of exchanges – catallactics
- Man is the animal that makes exchanges, the focus is on the *acts of exchange*, not on the *things being exchanged*

## Value and Distribution

- Any exchange depends on differences in subjective evaluation
- Generalized theory of distribution and factor pricing
  - Wages, rent and interest are really payments of the same kind
  - Down to productivity
- *Introductory Lectures on Political Economy* (1831, 2<sup>nd</sup> ed. 1832)



## Nassau W. Senior (1790-1864)

- First holder of the Drummond chair at Oxford
- Developed economics as a deductive science from basic principles
- Explicit follower of Say: value depends on utility and scarcity
- Abstinence theory of interest

## William Forster Lloyd (1794-1852)

- Drummond chair 1832-37
- *Two Lectures on the Checks to Population* (1833)
  - First developed the idea of the tragedy of the commons
- Clear statement of the law of diminishing marginal utility





## Lloyd on Marginal Utility (1837)

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Let us suppose the case of a hungry man having one ounce, and only one ounce of food at his command. To him this ounce is obviously of very great importance. Suppose him now to have two ounces. These are still of great importance; but the importance of the second is not equal to that of the single ounce. In other words he would not suffer so much from parting with one of his two ounces ... as he would suffer, when he had only one ounce, by parting with that one, and retaining none. The importance of a third ounce is still less than that of the second; so likewise of a fourth, until at length, in the continual increase of the number of ounces, we come to a point when ... the appetite is entirely ... lost; with respect to a single ounce, it is a matter of indifference whether it is parted with or retained. Thus, while he is scantily supplied with food, he holds a given portion of it in great esteem, in other words, he sets a great value on it; when his supply is increased, his esteem for a given quantity is lessened, or, in other words, he sets a less value on it.



# Samuel Mountifort Longfield and John Elliot Cairnes

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## Samuel Mountifort Longfield (1802-84)

- First holder of the Whately chair at Trinity College, Dublin, *Lectures on Political Economy* 1834
- Marginal analysis of demand: consumer demand is a schedule related to prices
  - Individually falling demand schedules are the basis for aggregate market demand
  - Marginal utility therefore key to price formation
- Relevant supply for price formation is the stock of the good in existence
- Currency school economist, important but neglected critiques of banking school

## John Elliott Cairnes (1823-75)

- Studied at Trinity College, Dublin, appointed to Whately chair 1856
- *Character and Logical Method of Political Economy* 1857 influenced by JS Mill
  - Political economy is the science of wealth
  - Ricardian rent theory
- Influential writings on the gold discoveries of 1850s and 60s and their consequences
- *Slave Power* 1862 an excellent treatment of the economic problem of slavery