Chapter 6

Trade, Money, and Debt

Introduction

We have seen that according to Hume a commercial society provides several benefits. It allows people to engage in cooperative partnerships to create goods and services; it allows for increasing levels of production, which lowers the prices of goods and services, allowing more and more people the ability to procure, use, and consume them to increase the "ornament and pleasure of life"; it generates a "storehouse" of resources on which a state can draw in times of emergency; it leads people to become industrious, to increase their skills and knowledge, and to become more refined and sociable. In all these ways, commerce can improve society. Hume argues that we should therefore advocate a government that neither prevents commerce nor destroys the natural incentives people have to engage cooperatively with one another in a search to improve their lives and conditions.

Hume's support for markets, trade, and commerce were almost unqualified, and he made these arguments before Adam Smith published *The Wealth of Nations.* But Hume also made groundbreaking contributions to our understanding of economic policy matters like the balance of trade, the role of money and the use of currency, the role of prices, the role of interest, and public credit.

Trade and money

Hume was an early and unapologetic defender of free trade. He opposed tariffs, trade restrictions, monopoly trade charters, and any other measure that prevented or imposed costs on anyone who wanted to trade with anyone else. He regarded trade to be one of the main vehicles through which people could improve their lives, and through which countries could prosper. In making his case for free trade, he developed several important ideas that later economists would expand and incorporate as settled parts of their discipline. Among these ideas were that voluntary trade was positive-sum, not zero-sum; that wealth consisted in consumable goods and services, not in gold coins; and that different people and countries enjoyed what later economists would call comparative advantage, which, if exploited, could lead to mutual gains. Let us consider these in turn.

Hume began his essay "Of the Balance of Trade" with these words: "It is very usual, in nations ignorant of the nature of commerce, to prohibit the exportation of commodities, and to preserve among themselves whatever they think valuable and useful. They do not consider, that, in this prohibition, they act directly contrary to their intention" (EMPL: 308). Prohibitions on trade, as well as other restrictions like tariffs, are intended to protect the interests of countries, but Hume claimed they arise from "ignorance in the nature of commerce" (EMPL: 309). Hume argued that such policies in fact make two errors: first, they are based on the false assumption that trade is zero-sum, instead of positive-sum; second, they are based on the false assumption that wealth consists in "gold and silver," instead of consisting in increased resources to use and consume (EMPL: 283).

If one country conquers another and appropriates its land, property, or other resources, that is an example of a zero-sum exchange. The conquering country enriches itself, but it does so at the expense of the other country. If I take your land, I gain the land, but you lose it. The gain to me is proportional to the loss to you: a transfer from you to me constitutes no net increase in land or other resources. It is thus a "zero-sum" exchange. By contrast, if an exchange or transaction is mutually voluntary, each party to it must gain (or, at least, believe it gains), or they would not have done it. Such transactions, then, are not "zero-sum" but "positive-sum": a gain to me *and* a gain to you entails a net overall gain. If British citizens buy wine from France, they send gold and silver to France and they get the wine from France. Assuming both the British and the French did this voluntarily, each side to the transaction got what it wanted: the French got the gold and silver, and the British got the wine. It is a win–win, or positive-sum transaction.

Suppose, however, that the British believed wealth to consist not in goods and services but in the gold or silver itself. In that case, if British citizens bought wine from France and sent their gold or silver to France, then France (the British would believe) would be enriching itself and Britain would be impoverishing itself, because gold and silver goes from Britain to France. Thus, Britain might be inclined to put tariffs on goods imported from France to discourage British citizens from buying French wine. If France believed the same thing about wealth—that it consists in gold or silver—then it might impose tariffs on British goods to discourage French citizens from buying from the British. The result would be mutual disincentives to trade. But that would mean that it would be harder for both British citizens and French citizens to get what they want, what they believe would improve their situations. Both countries would maintain their reserves of gold and silver, but people cannot eat gold or silver. They cannot build houses or roads or bridges or schools or hospitals with gold and silver, but with the materials and labour that gold and silver buy. This exposes the fallacy: gold and silver are not valuable in themselves,[10] but rather because of what goods and services they enable people to procure. Thus, it is the goods and services that matter, not the gold and silver. If, therefore, we care about people improving their situations, or about our country having the resources it needs for infrastructure or in times of emergency, then what we should care about is enabling people to increase overall prosperity through increasing the goods and services at their disposal to use or consume.

Gold and silver, then, have no (or very little) value in themselves. Their value is instead instrumental, comprised by their ability to procure goods and services. That exposes another economic fallacy, Hume contends, related to the rates of currency. If we were to believe (fallaciously) that wealth consists in gold and silver itself, we might wish simply to possess ever more gold and silver. Suppose we found a cache of gold in our country; would that make our country richer? No, it would not, Hume argued: "suppose, that all the money of Great Britain were multiplied fivefold in a night, must not the contrary effect follow? Must not all labour and commodities rise to such an exorbitant height, that no neighbouring nations could afford to buy from us; while their commodities, on the other hand, became comparatively so cheap, that, in spite of all the laws

10 The exception to this is when gold and silver are used to make jewelry or other products.

which could be formed, they would be run in upon us, and our money flow out; till we fall to a level with foreigners, and lose that great superiority of riches, which had laid us under such disadvantages?" (EMPL: 311–12). If we suddenly increased our country's money supply, in other words, domestic prices would rise proportionately. This would constitute no gain to us in our country, because it would not constitute an increase in the supply of goods and services. And if other countries had no similar increase in their money supply, the prices of their goods and services would decrease relative to ours; in that case, our citizens would buy from them, inducing our citizens to send gold and silver to them to procure the goods and services we want. All of this points, again, to the conclusion that what matters are the goods and services, not the gold and silver. What we should care about, then, according to Hume, is the quantity of goods and services, not the quantity of gold and silver.

Yet virtually every country's leaders not only prize possessing gold and silver, but they frequently increase the money supply as well. Why? One reason is that they believe that gold and silver are valuable, instead of the goods and services they can buy. But there is another reason. If any individual—you or I, or the Crown—suddenly comes to possess a large increase in gold or silver, eventually prices of commodities will calibrate to the larger supply of money. But it does not happen instantaneously: "though the high price of commodities be a necessary consequence of the encrease of gold and silver, yet it follows not immediately upon that encrease: but some time is required before the money circulates through the whole state, and makes its effect be felt on all ranks of people" (EMPL: 286). There is, in other words, a time lag, or "interval of intermediate situation" (EMPL: 286), during which the first possessors of the new gold and silver can buy more commodities at the prior, low prices, constituting an artificially high gain to themselves, before prices rise in reflection of the increased money supply. If they act quickly, they can thus exploit this time lag. The increased money supply will raise the price of goods and services eventually, but in the meantime the first possessors can enrich themselves at the expense of other producers and citizens, who are still selling based on the prior supply of money.

"There is always an interval," Hume wrote, "before matters be adjusted to their new situation; and this interval is as pernicious to industry, when gold and silver are diminishing, as it is advantageous when those metals are encreasing" (EMPL: 288). "All augmentation [of the money supply] has no other effect than to heighten the price of labour and commodities"; in "the progress toward these changes, the augmentation may have some influence, by exciting industry; but after the prices are settled, suitably to the new abundance of gold and silver, it has no manner of influence" (EMPL: 296). Thus, in the long run, increasing the amount of gold and silver has no effect on the actual condition of people's prosperity; in the short run, however, it can benefit those—like the pirate, the buccaneer, or the Crown—who first get the increase. Yet because actual prosperity can "proceed from the encrease of industry and commerce, not of gold and silver," the first-possessors are enriching themselves by exploiting others' ignorance of the increase in gold and silver, procuring resources beyond what the actual state of commodities would allow, and thus impoverishing others as a result.

The best money policy, then, according to Hume, is to have a stable supply of currency, so that no one can exploit others with sudden increases or decreases, and to turn our attention to the goods and services themselves instead of to the money supply.

Mutual advantage and comparative advantage

As we saw, a consequence of the false belief that wealth consists in gold and silver is often the imposition of tariffs on foreign goods and other restrictions on trade. Another motivation for such policies, Hume argued, is nationalistic prejudice and hatred of other countries. "Our jealousy and our hatred of France are without bounds," Hume wrote of the British, and that led the British to be interested not only in themselves prospering but in the French becoming impoverished. Such nationalism can lead us to prefer to enrich ourselves through zero-sum policies, instead of positive-sum policies where we both benefit. But this is a short-sighted policy that will eventually limit our own prosperity as well as that of other countries. In "Of the Jealousy of Trade," Hume wrote: "Nothing is more usual, among states which have made some advances in commerce, than to look on the progress of their neighbours with a suspicious eye, to consider all trading states as their rivals and to suppose that it is impossible for any of them to flourish, but at their expense" (EMPL: 328).

This is an example of the zero-sum fallacy, which assumes that the only way for one person, group, society, or country to benefit is at the expense of some other person, group, society, or country. That belief is as common as it is false. There is indeed another way to benefit: by mutually voluntary cooperative association with another in which *both* parties benefit. Hume called the belief in a zero-sum fallacy a "narrow and malignant opinion" (EMPL: 328). To the contrary, Hume argued, "the encrease of riches and commerce in any one nation, instead of hurting, commonly promotes the riches and commerce of all its neighbours"; moreover, "a state can scarcely carry its trade and industry very far, where all the surrounding states are buried in ignorance, sloth, and barbarism" (EMPL: 328).

What Hume realized was that hatred of other countries had multiple negative effects. First, it encouraged animosity and conflict with other countries, which could often lead to violence and destruction. Second, it could limit the ability of the citizens of one's own country to improve their own situations by capitalizing on the labour and skills, and goods and services, of the citizens of other countries. In other words, in the long run it would hurt us too, not just them. "Were our narrow and malignant politics to meet with success, we should reduce all our neighbouring nations to the same state of sloth and ignorance that prevails in Morocco and the coast of Barbary. But what would be the consequence? They could send us no commodities: They could take none from us: Our domestic commerce itself would languish for want of emulation, example, and instruction: And we ourselves should soon fall into the same abject condition, to which we had reduced them" (EMPL: 331).

By contrast, what would benefit us is allowing wide scope of liberty to buy and sell, to trade and associate, to hire and partner—including with people from other religions, other ethnicities, and other countries. Hume concluded with a powerful exhortation: "I shall therefore venture to acknowledge, that, not only as a man, but as a British subject, I pray for the flourishing commerce of Germany, Spain, Italy, and even France itself" (EMPL: 331). Even France! We may care only about our own prosperity, or, more generously, we may care about that of other countries as well; either way, however, the policy prescription is the same: free trade. A generous spirit should lead us to be concerned for the well-being of other countries in addition to our own. Even if we cannot overcome our animosities toward other countries, however, then wanting to serve even only our own interests should enable us to see that putting aside our hatreds will enable us to make far better lives for ourselves than if we indulged our prejudices and enacted restrictive trade policies.

Hence, free trade, according to Hume, is of mutual benefit, and is a surer way for a person or a country to prosper than by restricting or closing off opportunities to cooperate with other people or counties. In making his argument, however, Hume added another insight that does not become fully appreciated by political economists until the nineteenth century: what is now called "comparative advantage."[11] Hume wrote: "Nature, by giving a diversity of geniuses, climates, and soils, to different nations, has secured their mutual intercourse and commerce" (EMPL: 329). People have differing skills, abilities, and opportunities, and thus allowing for free trade and exchange among differing peoples allows them and their diversity to benefit one another. Comparative advantage is when one person, firm, group, or country can produce a good or service at a lower cost than can another person, firm, group, or country. This, in turn, gives the former the ability to produce and sell the good or service in question at a lower price. This holds even when one firm or country, say, could conceivably be better at producing any number of things than any other specific firm or country. If country A has highly skilled workers who could do any number of things well, but country B has less-skilled workers who would not be as good as A at any of those specific things, nevertheless A and B would *both* be better off if A specialized in some particular thing (or range of things), while B specialized in something else. That allows A to focus on something it can do particularly well, and to benefit from the fact that B is focusing on something it does particularly well; if A and B are allowed to trade freely, they can then both benefit from each other's respective specializations. As Hume argued, even "when any commodity is denominated the staple of a kingdom," nevertheless "by the encrease of industry among the neighbouring nations, the consumption of every particular species of commodity is also encreased" (EMPL: 330).

As trade and markets expand, however, and people's wealth increases, their preferences and desires can change. Perhaps they lose a taste for English

11 Although Smith would also hint at comparative advantage in *The Wealth of Nations,* it was David Ricardo (1772–1823) who would articulate it more fully in his 1817 *Principles of Political Economy and Taxation.*

wool, and begin to prefer instead Italian silk, and this leads to decreasing demand for English wool manufacturers. Is that not a loss for England? "If the spirit of industry be preserved, it may easily be diverted from one branch to another; and the manufacturers of wool, for instance, be employed in linen, silk, iron, or any other commodities, for which there appears to be a demand" (EMPL: 330). Another way to put this is to say that in markets with free trade there will be "creative destruction," in twentieth-century economist Joseph Schumpeter's famous phrase. One industry may wane, but others will arise, and consumers are the gainers by getting more of what they want for increasingly lower prices. The lesson, Hume argued, is not to give any one industry special protections but instead to let people choose their vocations, and change their vocations, in response to changing demand. If the wool industry in England goes away, but other industries arise, that is not a loss to be lamented but a gain to be celebrated. If England were instead to be beholden to the success of a single industry, in that case if demand were to decrease, England would have few options and would thus suffer; if, by contrast, England had an open and decentralized market, its citizens would be able to adapt spontaneously to changes in demands, making its economy, and its pursuit of prosperity, much more robust and able to withstand changes and shocks. Hume: "any people is happier who possess a variety of manufactures, than if they enjoyed one single great manufacture, in which they are all employed. Their situation is less precarious; and they will feel less sensibly those revolutions and uncertainties, to which every particular branch of commerce will always be exposed" (EMPL: 330).

Hume's conclusions: protect each citizen's lives and property; allow free trade, free association, and free cooperative partnerships; and let people produce, buy, and sell however they please. This set of liberal economic policies will enable people to improve their own lives, to find lines of work that give them meaning and purpose and at the same time benefit others as well, and will allow countries to increase their real wealth—in commodities, not gold or silver—to the benefit of citizens, the country, and even other countries. Hume's liberalism was, therefore, a humane and cosmopolitan one. It is motivated by a sincere wish to allow people to improve their situations, and it is not hampered by nationalistic or other prejudices. Hume offered free markets and free trade as the only paths toward long-term, sustainable prosperity, not just for one group or one country, but for all.

Public debt

We should mention one final economic policy that Hume discussed as it relates in particular to a growing practice in many countries in the world today—namely, the issuing of public debt to finance various government projects. Under the constraints of the liberal political order Hume endorsed, the primary duty of governments is to protect the lives and property of its citizens. This constrains government significantly, however, making it far more difficult for it to not only to wage war (particularly wars in which it is the aggressor), but to finance large-scale infrastructure or welfare programs, because it has to get permission from citizens first. Hume thought that is an asset, not a liability, of the liberal political economy he endorsed, because it limits the predation, usurpation, and adventuring to which governments are ever liable. But politicians being politicians, they chafe under these constraints to their ambitions, and so they look for ways around the constraints.

One expedient they have hit upon is to issue public debt. Hume wrote, "our modern expedient, which has become very general, is to mortgage the public revenues, and to trust that posterity will pay off the incumbrances contracted by their ancestors" (EMPL: 350). However appealing and seductive such an expedient may seem, Hume argued that it is "ruinous": "the abuses of mortgaging are more certain and inevitable; poverty, impotence, and subjection to foreign powers" (EMPL: 350–351). We become subject to foreign powers because it is they who hold our debt, and whoever holds one's debt has power over one: "As foreigners possess a great share of our national funds, they render the public, in a manner, tributary to them" (EMPL: 355). Moreover, public debt leads to poverty because eventually someone will have to pay off the debt, and inevitably it will be future generations who will find their incomes and wealth taxed at exorbitant rates to pay for benefits to previous generations, thereby impoverishing the later generations. Finally, public debt can render us impotent because, if our resources are owed to debtors, we have far less capital available in cases of emergency.

The incentives involved with public debt are perverse. The king or sovereign benefits from issuing debt, but, because he himself will not pay it, he faces no natural incentive not to engage excessively in it. If a private person takes on too much debt, he will go bankrupt; the prospect of such a negative consequence naturally disciplines him to be wary of too much debt. For the government, however, this natural discipline is absent. Hence, "It is very tempting to a minister to employ such an expedient [namely, issuing public debt], as [it] enables him to make a great figure during his administration, without overburthening the people with taxes, or exciting any immediate clamours against himself. The practice, therefore, of contracting debt will almost infallibly be abused, in every government" (EMPL: 352). Public debt is a way for the current administration to indulge their ambitions without themselves paying for it, and without asking current citizens to pay for it either. In fact, they can claim that it is costless, because those who would actually pay for it are not yet alive (or not yet voting).

Many today claim, however, that we need not worry about increasing national debts because we merely "owe it to ourselves."[12] Hume anticipated this claim: "We have, indeed, been told, that the public is no weaker upon account of its debts; since they are mostly due among ourselves, and bring as much property to one as they take from another" (EMPL: 356). Hume argued that this is "specious" reasoning, however, because someone will still have to pay off the debt. Eventually, one of two things must happen, according to Hume: "either the nation must destroy public credit, or public credit will destroy the nation. It is impossible that they can both subsist" (EMPL: 360–361). Either the interest payments—to say nothing of the principal—will grow so large that we will be unable to keep paying, or we will have to confiscate the wealth of future generations. Either way portends financial ruin. Suppose we gamble and take the second route, raising taxes ever more to finance the increasing debt. Hume: "But our children, weary of the struggle, and fettered with incumbrances, may sit down secure, and see their neighbours oppressed and conquered; till, at last, they themselves and their creditors lie both at the mercy of the conqueror.

12 As of this writing, Canada's gross national debt is $3.188 trillion, or some $84,000 per Canadian; for context, Canada's current gross domestic product is $1.755 trillion. The national debt of the United States currently stands at over $27 trillion, or some $82,000 per American; for context, the current gross domestic product of the entire United States is $21 trillion.

And this may properly enough be denominated the *violent death* of our public credit" (EMPL: 365).

It would also be the death of our prosperity, and that long before we would be conquered by another country or group. If to benefit ourselves today we issued so much debt that we impoverished our posterity, we are setting in motion our own "seeds of ruin" (EMPL: 357). To foresee the calamity to which this would lead requires, however, no great power of future-telling or "gift of prophecy," Hume claimed; "in order to deliver such prophecies as these, no more is necessary, than merely to be in one's senses, free from the influence of popular madness and delusion" (EMPL: 365).

Given the seductive allure of issuing public debt, then, the better part of wisdom is to disallow it in the first place. And the best way to do that is to restrict government within very specific limits, namely, the protection of our lives and property, and to let citizens engage in productive association and exchange that leads to increasing prosperity. They can use their increasing wealth to address progressively more of the problems they continue to face in life, and, though they will never be able to address all problems, they will thereby be enabled to continue addressing ever more of them without at the same time imperiling the process by which they are enabled to do so.

Are money and wealth the only things that matter in life, however, or the only things that government policy should address or protect? And are all preferences and desires that could be satisfied by a commercial society's increasing wealth equally good? Let us turn to those questions in the next chapter.