

THE DAVID HUME INSTITUTE

THE FIRST DECADE

EDITED BY: NICK KUENSSBERG &
GILLIAN LOMAS



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Edited by Nick Kuenssberg & Gillian Lomas

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Original cartoons by Emilio Coia

A note from the editors

When we first discussed this review we decided that, in order to produce a publication which would celebrate the achievements of The David Hume Institute over the last decade and persuade new subscribers and donors to lend their support, we should solicit contributions from our panel of distinguished advisers and past and vice presidents. The response exceeded our expectations.

We have edited lightly and have not tried for total consistency. Each piece has its own language and style and we hope to have retained these. Contributions have been grouped into four sections: the vision and history of the Institute; David Hume and his writings; a variety of public policy questions and finally a section about the Institute's main output, its publications. The illustrations, generously produced by Emilio Coia, contribute wit and humour. The views expressed are those of the authors but we, the editors, take responsibility and apologise in advance for errors and omissions.

In addition to this report, the Institute's tenth anniversary was celebrated by the 1995 Hume Lecture, given by Sir Stewart Sutherland, Principal of Edinburgh University and to be published shortly, and a Subscription Dinner, hosted by Sir John Shaw at the Bank of Scotland. A further publication will complete the programme: *Well temper'd eloquence*, a special collection of David Hume's letters.

Nick Kuenssberg
Gillian Lomas
December 1995

Letter from George Stigler, University of Chicago, 21 May 1984

On being invited to be the first Honorary President of The David Hume Institute;

'I am as great an admirer of David Hume as Adam Smith was, so I shall consent to being a more or less dignified Honorary President. I am sure that David will be pleased that his name is to be in your custody.'

The First Decade

Foreword

Sir John Shaw

In 1984, Professor Alan Peacock returned to Edinburgh with the vision of creating a new independent research institute. It would be distinctive in having a Scottish base, an agenda linking economics and law and would be vigorously independent of government. By 1985, a Chairman and Board of Trustees had been identified, a President appointed and funding secured. The first Chairman of Trustees, Gerald Elliot, and the first Executive Director, Alan Peacock, cast the mould of The David Hume Institute.



All those who have been involved with its work during this first decade can take genuine satisfaction from all its achievements, reflected in the breadth of its interests, the variety of its activities and the sheer volume of its publications. Significant and dedicated intellectual investment has produced results quite disproportionate to the Institute's slender financial resources (themselves the result of individual generosity).

This publication marks its first decade with essays and comment from all those who brought the Institute into life and from many of its other important contributors. The wealth of contributions offered has been overwhelming – so much so that a companion volume with a focus on education and the arts is planned. This volume reflects clearly the international nature of the Institute's

concerns and bears out the validity of the original vision. This celebration of 'The First Decade', skilfully edited by Nick Kuenssberg and Gillian Lomas, will claim attention for The David Hume Institute and for its work.

We hope to reinforce our effectiveness by winning a wider individual and corporate membership, and by attracting dedicated funds for specific projects. We are particularly anxious now to engage younger people still in education, in business and in public administration, on subjects within their competence and responsibility. But The David Hume Institute will continue to produce ideas relevant to the needs of those engaged in public policy. It will maintain its programme of papers, lectures and seminars to inform others and encourage them to join the debates.

The First Decade is just that – we look forward to the next milestone!

A vision of the Institute

Sir Alan Peacock

On 30 December 1983 Alan Peacock, then Vice-Chancellor and Professor of Economics at the University of Buckingham, wrote a paper proposing the foundation of an institute of economics and law which was to become The David Hume Institute. The original document, which provided both the vision and an effective framework, is reproduced below with minor amendments in the interest of space.

I Background

1.1 Although there has been a proliferation of research institutes in economics and related studies set up in recent years both inside and outside universities – the much publicised Centre for Economic Policy Research being the latest example – there are three good reasons for seeking to establish another one.

1.2 The first is that almost without exception these institutes are to a major extent dependent on direct government funding. This is not take a conspiratorial view of their activities but merely to draw attention to the fact that their activities become concentrated on the immediate concerns of government departments. These concerns may require, not unreasonably, that the research findings cannot be published without the permission of the relevant government department.

1.3 The second is that their activities are concentrated in London, which is a reflection of their dependence on government sources of finance and information. The process of concentration has gone so far that more 'libertarian' research institutes, notably the Institute of Economic Affairs (IEA) and the

Adam Smith Institute, regard it as essential to site themselves within easy reach of the sources of political power, though calling upon talent from universities and individuals widely dispersed throughout the UK and other countries. This concentration sometimes develops a metropolitan perspective of economic events and a tendency to pursue 'fashionable' subjects and techniques. The obverse of this situation is a belief inculcated in supporters of economic research that the rationale of support for extra-metropolitan investigation lies in the researchers' interest and expertise only in local or regional problems. There are exceptions, of course, but one hazards the guess that their survival powers depend on how long a particular personality with an established reputation is able to resist the lure of the South, and how far he or she can retain young and outstanding staff who are similarly tempted.



1.4 The third is that the growth of economic research in relation to policy problems has been notably lop-sided. It is only within recent years that young, talented economists have found it professionally respectable and profitable to concentrate on the development of micro-economics and its application to policy problems. The lines of enquiry opened up by micro-economics lead to attempts to solve very difficult problems which require much more 'roundaboutness' of production of research results, particularly if analysis is to be backed up by careful empirical enquiry into the activities of firms and other economics agents. There is also strong emotional resistance to the application of micro-economic analysis to non-profit institutions, at least in the UK. Furthermore, the policy implications frequently point towards the futility of government policies directed at controlling or influencing particular markets. Such conclusions appear to threaten the job opportunities of a large

proportion of the working population as well as those of economists who play a role devising interventionist instruments. It is no wonder that until recently, young economists saw their future in the excitements and quick returns which appeared to be derived from macro-economic model building and the associated crystal-gazing.

1.5 In connection with this third point, it is to the great credit of the IEA and its supporters that policy makers have become much more mindful of the importance of market forces. At the same time, having, as it were, won the intellectual battle, the IEA has realised that it must re-assess its function. While there is never likely to be a dearth of problems for study using micro-economic analysis, the 'technique of thinking' associated with the IEA has now been applied to an important range of social problems by their Social Affairs Unit. This perception of its own 'market position' is worth bearing in mind in seeking to promote a complementary venture which will now be described.

II The Proposed Hume Institute

2.1 The proposal put forward in this memorandum is designed to fill a gap in the market for policy research which has been identified in Section I above. There is a definite place for an institute of economic policy research like the IEA which is genuinely independent of government support though anxious to put forward proposals for consideration by governments of all persuasions, which exploits talent and encourages expression of opinions on national and international economic issues which is not metropolitan-based, and which has a firm intellectual foundation in the study of the links between economics and law.

2.2 The intellectual foundation is most important and requires further explanation. The spur to the development of micro-economic analysis has been the supposed 'failure' of markets to deliver important goods and services which the community may desire and to avoid undesirable side-effects such as pollution. The conventional wisdom has been to seek solutions to these problems by the extension of government interference in markets. Apart from the obvious and important philosophical objections to such interference which are often reflected in jurisprudence, there is much evidence to show that such interference does not achieve its object. 'Market failure' is often increased and not decreased by government intervention for as legislation designed to correct market failure becomes more extensive and complicated, compliance costs may become onerous and regulators and regulated become locked in a wasteful bargaining process which absorbs the energies of intelligent and able people who might be better engaged on more profitable pursuits. The challenge to both lawyers and economists faced with the realities of extensive regulation is how to devise policy measures which minimise the need for complicated legislation and growth of bureaucracy, while recognising that contracts involving exchange relationships between two persons or groups do produce 'externalities' which affect the interests of other persons or groups.

2.3 The study of the links between economics and law were recognised by the German economists who opposed Nazi planning, several of whom suffered for their views. They formed the so-called ORDO-Kreis as early as 1936, which became the intellectual powerhouse of the German social market economy. Their interest lay in the devising of an economic constitution which would define and limit state intervention so that such intervention should work through and not against market forces. Latterly, US economists, under the intellectual leadership of George Stigler, Nobel Laureate in Economics, have revolutionised the approach to the development of economic legislation, closely allied with US lawyers. Such intellectual movements which have had a major influence on policy have no counterpart in the UK, although individual economists and the IEA have recognised their importance. It is noteworthy that the ORDO-Kreis was based in Freiburg-im-Breisgau and not in Berlin or Frankfurt, and the US movement emanates from Chicago and not from New York or Washington.

2.4 The way seems open, therefore, for the institution of a policy research centre which concentrates, though not exclusively, on forging links between economists and law with the primary aim of improving understanding of both short and long term problems of implementing sensible economic policies.

2.5 Edinburgh chooses itself as the location of such a centre. It has a long intellectual tradition in economics, it has great potential as a focal point for promoting discussion of law and economics, being the main legal and financial centre outside London. It is proud of its international professional and artistic contacts, though it lacks centres outside the state-financed universities to promote such contacts with more independent institutions abroad. It has many of the advantages of a capital city yet, in the business and financial community at least, it can ill afford to be unreceptive to what is happening in the outside world.

2.6 The association of the proposed institute with the name of David Hume would be entirely appropriate. Although known throughout the world as an outstanding philosopher, his intellectual contributions to economics, though based on narrower foundations than his great friend Adam Smith, are becoming increasingly recognised as seminal. His essays on economics and on political philosophy and jurisprudence are the point of departure for much of the contemporary discussion of 'public choice economics' as well as of international monetary economics.

III The Institute's Activities

3.1 As the Institute's main object would be to stimulate informed discussion of issues concerning economic policy and law, it would require to reach out for an audience which will be very well aware of the opportunity cost of their

time. The Institute would have much to learn from similar ventures in the metropolis where close attention is paid to reducing the 'time costs' of participation in being well-informed on economic issues.

3.2 The first activity would be publication of reports from occasional paper to book length. These would be commissioned from outside experts and the 'in-house' contribution would be largely directed towards advising contributors on how to present their ideas to the audience in view. To arrest the attention of busy professional people as well as students and scholars is not easy, particularly in a town such as Edinburgh which (on a rough count) has 25 golf courses within its own boundaries. This has a pronounced bearing on the staff appointed.

3.3 The second activity would be complementary to the first – the arrangement of meetings at which new publications would be presented, and to which eminent speakers could be lured. Such meetings would have to be short and snappy, perhaps combined with a sandwich lunch, rather than follow the conventional Scots pattern of a (frequently) dull evening formal lecture, where a fair proportion of the audience is fighting off somnolism. The correct milieu for audience participation is the carefully prepared short conference where escape to the golf-course is difficult and proper notice is given. The Institute might act as an 'honest broker' for conference preparation, but would hardly have a comparative advantage in the initial stages of its existence.

3.4 I believe that the Institute would be well advised from its inception to keep its name to the forefront by a regular information bulletin. This might differentiate the product of the Institute by regular commentary on recent legislation concerning economic policy, perhaps including commentary from overseas correspondents. It could also 'trade' information with like-minded institutes. It must attract an international clientele.

3.5 An interesting feature of the activities of departments of law and economics in US universities has been running of courses on economics for judges, magistrates and legal officials with a bias towards legal economics. Courses on legal economics are rare enough in the UK and are designed for law and economics students, and there might be intense sales resistance from the practising lawyers. Some experimentation seems called for and the Institute might test the market.

3.6 In sum, the activities of the Institute must be designed to achieve a bed-rock of local support, attracting such support by the entrée it gives to economic ideas of relevance to both national and international problems and not merely to understanding of issues of a short-term and parochial nature. Above all, it must seek to generate activities which attract an international clientele through its concentration on the links between economic and legal analysis.

IV Finance and Organisation

4.1 The extent of the Institute's activities clearly depends on the input of resources available. The stance of its founders must surely be that of highly efficient use of limited resources. For example, it would be unwise to set up an elaborate 'in-house' research effort. Even if resources were available it would not be desirable to do so because a major purpose of the Institute would be to 'put out' projects to young professional accountants, economists and lawyers who wish to report how their research results have a bearing on policy. At the same time, the Institute would need the advice of persons who know what kind of projects to encourage and must have a skeleton editorial and administrative staff with the requisite experience.

- 4.2 Initially at least, I believe that the Institute might be organised as follows:
- (i) It would be an educational charity registered with the Charity Commissioners. (In an imperfect world a private institution cannot forgo tax advantages!). It would therefore need a small Board of Trustees.
 - (ii) It would have a small Governing Body chosen from its international Advisory Council who would approve the budget and its allocation to Institute activities.
 - (iii) The Advisory Council would consist of perhaps twenty five persons of national and international standing, including several lawyers with an interest in economic matters.
 - (iv) The Institute would have a Director who would be an ex officio member of the Governing Body and initially might only be part-time.
 - (v) It would have an Administration Officer working to the Director who might also undertake some of the editorial functions.

4.3 The ultimate aim should be to make the Institute self-financing.

Brief history: 1985–1995

Sir Gerald Elliot

Alan Peacock has described in his 'vision' how he arrived back in Scotland with, like Oscar Wilde, nothing to declare but his genius, and conceived the idea of a Scottish think tank, modelled on the vigorous and successful Institute of Economic Affairs, but broader based. That struck an immediate spark. It had always seemed wrong that Scotland, with its then five universities, its own legal system and flourishing business communities, had never set up an intellectual focus for research and debate on public policy issues. There was no reason for London to monopolise creative thought in those areas. People in Scotland might even do it better. But the Institute's work was not to be confined to Scotland. Most of it would be related to the framework of UK

government and its relations overseas. In this it would follow the philosophers of the Enlightenment, similarly broad in their interests.

Without setting dogmatic boundaries we expected that our work would be firmly based on the liberal market economy and would be sceptical of solutions involving greater weight of government. We were particularly interested in the interaction of law and economics, a subject till recently comparatively neglected in the UK.

The history of the Institute's publications in the ten years that have passed is recorded elsewhere in this volume. They cover a very wide area, and their number is remarkably high considering our very modest size. Many of them were brought to birth by the initiative of the Executive Directors, first Alan Peacock and then Hector MacQueen, reflecting their respective interests in economics and law. Others have arrived unsolicited. The only criteria have been the quality of the paper and its ability to make a practical contribution to public policy. Apart from the papers we have arranged numerous confer-



ences, seminars and lectures, less enduring than publications for historic record, but very valuable in launching ideas and getting them publicly discussed and developed.

One of our first conferences was on *The Deregulation of Financial Markets*, addressed by our first President, George Stigler, Nobel Laureate in Economics. It brought out some of the problems that subsequently have come home to governments. Another early one was on financing the Health Service, a first attempt to open up the debate north of the border on fundamental issues. Other subjects which have been pursued in more depth than a single paper have been the regulation of public utilities (now an area of special interest for IEA), student loans, corporate governance, broadcasting, intellectual property, the cost of law, morality of business enterprise. Our conference in 1994 on *The Costs of Justice*, led by the Lord Chancellor, was one of the first public airings of that issue. A visionary excursion was Professor James Meade's *Agathotopia: The Economics of Partnership*. Recently we have come closer to

home in assessing the political and economic arguments for separation of Scotland from the UK. And occasionally we invoke the spirit of David Hume by linking current ideas to his principles.

In 1990–92 we were commissioned by the Joseph Rowntree Foundation to undertake a survey of corporate takeovers, directed by Alan Peacock with a strong committee drawn from UK finance and business. The report, as might be expected, gave no single answer on the issues involved, but made some valuable proposals, and collected an immense amount of evidence and comment, published in 17 Hume Occasional Papers.

Every think tank starts expecting to change the world. None of them do, though in our time the Institute of Economic Affairs, in its championship of the market economy, has got close to that. What we can hope for is that some of the ideas we have brought out will move forward, inspire others, and, however transmuted, finally help to build a more harmonious and successful society. Though sometimes lineal descent is obscure and parentage disputed, numbers of ideas which we have generated can be traced in later policy action. It is sometimes hard for the businesses which support us to see what benefit they are getting from our mixed bag of activity. We have to persuade them that the long-term consequences of policy and behaviour in the future are just as important to them as today's tax or regulation. Pension policy and savings are central to insurance companies; industry depends on good education systems; crisp legal processes are needed to support business contracts.

Institutions should continue only as long as they are needed and supported. The David Hume Institute's short history shows that it has many more years of vigour and value.

Hume starts to hum

Jock Snaitth

In its earliest days the Institute was a creature of no fixed abode. We met in the University Staff Club, chez Peacock or chez Blight. The official address was my house at Penicuik and the administration was carried out from a corner of my room there. My wife was rightly suspicious of this intrusion, for she had memories of the early days of the University of Dar es Salaam which started in the dining room of our house there and soon spread to the bedrooms. The Institute's letters and papers were typed either on my ancient portable or by a lady who lived on the other side of Penicuik. As she predicted, my wife soon became an unpaid courier/receptionist and proof-reader.

The difficulties of peripatetic administration were trivial compared with those of securing registration under the Companies Act. The problem was our title, The David Hume Institute. The Companies Registrar wrote to us stating that 'the word Institute is one of the most sensitive words that the Secretary of State considers.' One pictured him, thesaurus in hand, scuttling down a

Scottish Office corridor like the White Rabbit in Alice. ‘Oh that Institute! Oh that Institute! She’ll get me executed!’ The fear was that we would debauch academic standards. In vain I pointed out that our Chairman was one of the most distinguished businessmen in the country, that our Executive Director was a Research Professor of Heriot-Watt University and had held a Chair in the University of Edinburgh, a distinction denied even to David Hume himself. Indeed, he had been the Chief Economic Adviser to the Department of which the Edinburgh Companies Registration Office was a small cog. Even the Institute’s humble Honorary Secretary was also an Honorary Fellow of a College of the University of London. We had some credentials in the maintenance of academic standards. Dust in the balance!

References must be produced. Lord Grimond kindly wrote one. Not good enough! He had no direct experience of research institutes. Lord Harris of the Institute of Economic Affairs, no doubt duly registered by the London Companies Registrar, wrote generously supporting the establishment of a potential competitor. No use! He had too much knowledge to be objective! Patience cracked. I fear that a few of my words may indeed have been among the least sensitive that the official concerned had to consider. We were, I explained, to hold a meeting that evening to launch the Institute into the business community. I named a few of the guests and the journalists who had accepted invitations. I would be obliged to announce that we were not considered sufficiently respectable to be registered. Derision would descend upon the Companies Registration Office. That afternoon, I received a ‘phone call from the highest level protesting about my rudeness. ‘You can have your little institute but we shall watch your activities very carefully.’ Curiously, I received no reply from the official when, a little later, I invited him to attend our conference on Financial Deregulation, presided over by a Nobel Laureate and graced by the Secretary of State, whose choice of words about our activities was, as ever, sensitive.

Once a board of trustees had been recruited, we began to meet in Sir Gerald Elliot’s room in Christian Salvesen plc’s offices, afterwards lunching in a room looking out on the marvellous Edinburgh Old Town skyline. We organised a conference on pensions policy attended by The Rt. Honourable Tony Newton when he was the Minister responsible. Our list of publications began to grow as, indeed, did our list of non-publications. Following Anthony Dnes’s Hume Paper on the Common Fisheries Policy, we commissioned a paper on the Common Agricultural Policy. We explained to the author our aim of producing papers comprehensible to the lay reader and asked that any essential professional jargon should be relegated to appendices. After reading a few pages of the manuscript, I was utterly lost. The author valiantly tried to make his text more accessible but, alas, was unable to do so. Perhaps this is one reason why it is so difficult to reform the CAP. *Pour pardonner, il faut comprendre.*

We gradually built up our lists of donors and subscribers, I by painfully bureaucratic methods, Sir Gerald and Sir Alan more successfully by the direct method of knocking on doors up and down George Street! Equally gradually, it became clear that our method of wholly voluntary working was becoming

a constraint on the growth of the Institute. The office was moved from Belwood House to Alan's room in Heriot-Watt University's Chambers Street building. He combined the offices of Executive Director and Secretary and I withdrew briefly to become a Trustee. Under this dispensation, the Institute grew even faster and before long I was recruited back for another stint. By great good fortune, Kathy Mountain, who acted as Alan's secretary in his capacity as Research Professor in Heriot-Watt, decided to throw in her lot with the Institute. She has become a key figure in its continuing success.

When Heriot-Watt moved out of Chambers Street on to its new Campus, we were fortunate in securing the lease of a basement in 21 George Square. From there we conducted the major research project on Corporate Takeovers and the Public Interest on behalf of the Joseph Rowntree Foundation. The report, published in March 1991, has been, I understand, more influential than has been widely recognised. After completing the administrative tasks of this project I withdrew to the role of an Individual Subscriber and am continually amazed by the quality of the publications I receive and the variety of the occasions that the Institute organises. When drafting our first Prospectus I wrote that the objects of the Institute were 'to promote discourse and research on the economic and legal aspects of public policy questions.' Under Hector MacQueen's leadership, the emphasis has naturally shifted a little towards the legal side. The quality continues to rise, as does the varied elegance of the disclaimers of responsibility for authors' views which conclude the Foreword to each new publication. Nothing could add to the lustre of David Hume's name but I think that, even in the Companies Registration Office, it will be conceded that we have not besmirched it.

Well temper'd eloquence

Hector MacQueen

To commemorate the tenth anniversary the Trustees of the Institute have commissioned a selection from Hume's correspondence and essays. *Well Temper'd Eloquence* will contain 60 pages of annotated text including facsimile reproductions of selected excerpts from his works.

The Institute counts itself fortunate to have identified Ingrid Merikoski as editor of this through a workshop of the Atlas Economic Research Foundation. Ingrid, a graduate of the Sarah Lawrence College, New York, worked at the Institute of Humane Studies at Fairfax, Virginia, completed her MSc at the University of Edinburgh and is now writing her PhD thesis *Religion, commerce and politeness: the making of the social ethics of the Scottish Enlightenment* under the supervision of Dr Nicholas Phillipson.

This Hume collection will be structured round a set of themes reflecting his interest in public policy, the law, justice, commerce, finance, property, the role of Scotland in Britain, morality and social issues, subjects remaining at the



forefront of contemporary social and political debate. The editor will also include quotations of a more personal nature highlighting Hume's friendships with many of the leading thinkers of his day including Adam Smith, James Steuart and other literati of the Scottish Enlightenment.

While this volume is intended to serve primarily as an introduction to David Hume for those who have not had access to his letters or other works, it is believed that it will also prove a useful tool for the Institute's friends in the academic community.

David Hume: Insights

His own life

Ingrid Merikoski

These are short extracts from David Hume's autobiographical account, *My Life*, written in April 1776, shortly before his death (in August of the same year). The full text, together with letters specially selected from archive material, appears in *Well temper'd eloquence*, to be published as a limited edition to celebrate the tenth anniversary of The David Hume Institute.

'It is difficult for a man to speak long of himself without vanity; therefore, I shall be short. It may be thought an instance of vanity that I pretend at all to write my life; but this Narrative shall contain little more than the History of my Writings; as, indeed, almost all my life has been spent in literary pursuits and occupations. The first success of most of my writings was not such as to be an object of vanity.

I was born the 26th of April 1711, old style, at Edinburgh. I was of a good family, both by father and mother: ... My family, however, was not rich, and being myself a younger brother, my patrimony, according to the mode of my country, was of course very slender. ... I passed through the ordinary course of education with success, and was seized very early with a passion for literature, which has been the ruling passion of my life, and the great source of my enjoyments. My studious disposition, my sobriety, and my industry, gave my family a notion that the law was a proper profession for me; but I found an insurmountable aversion to every thing but the pursuits of philosophy and general learning; and while they fancied I was poring upon Voet and Vinnius, Cicero and Virgil were the authors which I was secretly devouring. ...

... In 1734, I went to Bristol, with some recommendations to eminent merchants, but in a few months found that scene totally unsuitable to me. I went over to France, with a view to prosecuting my studies in a country retreat. ...

... During my retreat in France, ... I composed my *Treatise of Human Nature*.

... At the end of 1738, I published my *Treatise* ... Never literary attempt was more unfortunate than my *Treatise of Human Nature*. *It fell dead-born from the press*, without reaching such distinction, as even to excite a murmur

among the zealots. But being naturally of a cheerful and sanguine temper, I soon recovered the blow, and prosecuted with great ardour my studies in the country. In 1742, I printed in Edinburgh the first part of my *Essays*: the work was favourably received and so made me entirely forget my former disappointment....

... (In 1749) my bookseller, A Millar, informed me, that my former publications (all but the unfortunate *Treatise*) were beginning to be the subject of conversation; that the sale of them was gradually increasing, and that new editions were demanded. ... However, I had fixed a resolution, which I inflexibly maintained, never to reply to any body; and not being very irascible in my temper, I have easily kept myself clear of all literary squabbles. These symptoms of a rising reputation gave me encouragement, as I was ever more disposed to the favourable than the unfortunate side of things; a turn of mind which it is more happy to possess, than to be born to an estate of ten thousand a year.

In 1752, were published at Edinburgh, where I then lived, my *Political Discourses*, the only work of mine that was successful on the first publication. It was well received abroad and at home. In the same year was published at London, my *Enquiry concerning the Principles of Morals*; which, in my own opinion (who ought not to judge on that subject), is of all my writings, historical, philosophical, or literary, incomparably the best. It came unnoticed and unobserved into the world.

In 1752, the Faculty of Advocates chose me their Librarian,... I then formed the plan of writing the *History of England*.... I was, I own, sanguine in my expectations of the success of this work. I thought I was the only historian, that had once neglected present power, interest and authority, and the cry of popular prejudices; and as the subject was suited to every capacity, I expected proportional applause. But miserable was my disappointment; I was assailed by one cry of reproach, disapprobation and even detestation....

But, notwithstanding this variety of winds and seasons, to which my writings had been exposed, they had still been making such advances, that the copy-money given me by the booksellers, much exceeded any thing formerly known in England; I was become not only independent, but opulent. I retired to my native country of Scotland, determined never more to set foot out of it; and retaining the satisfaction of never having preferred a request to one great man, or even making advances of friendship to any of them.

In spring of 1775, I was struck with a disorder in my bowels, which at first gave me no alarm, but has since, as I apprehend it, become mortal and incurable. I now reckon on a speedy dissolution.

To conclude, historically with my own character. I am, or rather was (for that is the style I must now use in speaking of myself) ... I say, a man of mild dispositions, of command of temper, of an open, social and cheerful humour, capable of attachment, but little susceptible of enmity, and of great moderation in all my passions. Even my love of literary fame, my ruling passion, never soured my humour, notwithstanding frequent disappointments.'

Political economy and policy: the economic essays

Andrew Skinner

It is usual to identify nine essays, eight of which date from 1752; (the ninth 'Of the Jealousy of Trade' was written in 1758). They are *essays*, rather than a treatise, which from one point of view can be seen to address separate subjects such as money, public credit, taxation, interest, population and the balance of trade. Yet it should be noted, first, that Hume believed economic questions to be amenable to scientific treatment largely as a result of his belief in the constant principles of human nature and the emphasis which he gave to self interest. In a famous passage he asserted that 'it is certain that general principles, if just and sound, must always prevail in the general course of things, though they may fail in particular cases; and it is the chief business of philosophers to regard the general course of things' (*Essays*, ed. E. Miller, Liberty Fund, 1987, p. 254). He also noted that there are areas of experience where generalisation is difficult.

Hence the point that the 'domestic and gradual revolutions of a state must be a more proper subject of reasoning and observation than the foreign and violent'. Hence too the argument that it is easier to account for commercial phenomena than for the rise and progress of the sciences:

'Avarice, or the desire of gain, is an universal passion, which operates at all times, in all places, and upon all persons' (*Essays*, p. 113).

Secondly, it should be observed that the separate essays show evidence of a unity of purpose. It is this unity of purpose (and of method) which enables us to identify three major themes; historical dynamics, the use of the historical method, and the deployment of both in the treatment of economic development and international trade.

Historical Dynamics and the Exchange Economy

This theme is addressed primarily in the essays 'Of Commerce' and 'Of Refinement in the Arts' where it is suggested that:

'The bulk of every state may be divided into *husbandmen* and *manufacturers*. The former are employed in the culture of the land; the latter work up the materials furnished by the former, into all the commodities which are necessary or ornamental to human life. As soon as men quit their savage state, where they live chiefly by hunting and fishing, they must fall into these two classes; though the arts of agriculture employ *at first* the most numerous part of the society' (*Essays*, p. 256).

In an early anticipation of the theory of stages Hume continued to note that 'Where manufactures and mechanic arts are not cultivated the bulk of the people must apply themselves to agriculture' in a situation where there is little

stimulus to change. In this situation men have no temptation to 'encrease their skill and industry' since they cannot exchange any superfluities for other commodities, as a result of which the 'greater part of the land remains uncultivated. What is cultivated, yields not its utmost for want of skill and assiduity in the farmers.'

In contrast, Hume continued:

'Everything in the world is purchased by labour; and our passions are the only causes of labour. When a nation abounds in manufactures and mechanic arts, the proprietors of land, as well as the farmers, study agriculture as a science, and redouble their industry and attention. The superfluity, which arises from their labour, is not lost; but is exchanged with manufactures for those commodities which men's luxury now makes them covet' (*Essays*, p. 261).

In short, Hume was suggesting that there is likely to be a gradual progression to a situation where the two main sectors of activity are fully interdependent, supported by merchants who were described as 'one of the most useful races of men, who serve as agents between those parts of the state, that are wholly unacquainted, and ignorant of each other's necessities' (*Essays*, p. 300).

The argument has its roots in Hume's deployment of the thesis that men have natural wants which gradually extend in a self-sustaining spiral. It was this thesis which Mandeville addressed with such amusing consequences and which drew from Hume the comment that to 'imagine, that the gratifying of any sense, or the indulging of any delicacy in meat, drink, or apparel, is of itself a vice, can never enter a head, that is not disordered by the frenzies of enthusiasm' (*Essays*, p. 268).

But there is more to the argument than a concentration on a gradual institutional change; it was also Hume's view that the emergence of what came to be known as the stage of commerce would induce an accelerating rate of change due to changes in habits and manners – notably by encouraging the desire for gain and by giving progressively increasing scope to man's active disposition. The essays are also remarkable for the emphasis which Hume gave to other, non-economic advantages which accrue from the process of historical development:

'where luxury nourishes commerce and industry, the peasants by a proper cultivation of the land, become rich and independent; while the tradesmen and merchants acquire a share of the property, and draw authority and consideration to that middling rank of men, who are the best and firmest basis of public liberty' (*Essays*, p. 277).

This development was associated in turn with major constitutional changes, at least in the case of England:

'The lower house is the support of our popular government; and all the world acknowledges, that it owed its chief influence and consideration to the encrease of commerce, which threw such a balance of property into the hands of the commons. How inconsistent then is it to blame so violently a refinement in the arts, and to represent it as the bane of liberty and public spirit' (*Essays*, p. 278).

This environment, buttressed by 'equal laws' further enhanced the possibil-

ities for economic growth. It is interesting to note in this context, that Hume offered a critique of egalitarianism:

‘... however specious these ideas of *perfect* equality may seem, they are really, at bottom, *impractical*: and were they not so, would be extremely *pernicious* to human society. Render possessions ever so equal, men’s different degrees of art, care and industry will immediately break that equality’ (*Principles of Morals*, 3.2).

The Historical or Institutional Method

Hume’s interest in the historical process led him quite naturally to develop a distinctive technique in dealing with purely economic questions; a technique which caused him to give prominence to the importance of the institutional background and in particular to the role of customs and manners. While the technique informs all the essays, most notably the one devoted to population, perhaps one example will suffice for the purposes of illustration.

In the essay ‘Of Money’, Hume rejected the conventional wisdom that money can be regarded as wealth (*Essays*, p. 281) and stated the famous relationship between changes in the money supply and the general price level.

Less familiar is the point that Hume consistently contrasted the situation of a primitive economy with a more sophisticated version. It is, he argued, ‘the proportion between the circulating money, and the commodities in the market, which determines the prices’ (*Essays*, p. 291). In the primitive economy, ‘we must consider that, in the first and more uncultivated ages of any state, ere fancy has confounded her wants with those of nature, men, content with the produce of their own fields, or with those rude improvements which they themselves can work upon them, have little occasion for exchange, at least for money, which, by agreement, is the common measure of exchange’ (*Essays*, p. 291).

In a more advanced state of society:

‘Great undertakers, and manufacturers, and merchants, arise in every commodity; and these can conveniently deal in nothing but specie. And consequently, in this situation of society, the coin enters into many more contracts, and by that means is much more employed than in the former’ (*ibid.*).

The changed form of economic organisation heralds a change in manners by giving greater scope to individual effort and must therefore massively increase the supply of commodities which are subject to exchange. Hume thus concluded that although prices in Europe had risen since the discoveries in the Americas and elsewhere, these prices were in fact much lower than the increase in the money supply might of itself suggest:

‘And no other satisfactory reason can be given, why all prices have not risen to a much more exorbitant height, except that which is derived from a change of customs and manners. Besides that more commodities are produced by additional industry, the same commodities come more to market, after men depart from their ancient simplicity of manners. And though this increase has not been equal to that of money, it has, however, been considerable, and has preserved the proportion between coin and commodities nearer the ancient standard’ (*Essays*, p. 292).

The technique just considered counsels caution in offering generalisations in economics in that the way in which economic relationships unfold must be affected by manners and by the institutional structure which prevails. It is therefore important to note Hume's awareness of a further point, namely, that economic relationships will be affected by the condition of an economy even where the institutional structure is given.

International Trade

A further major theme in Hume's thought relates to the problem of international trade; a theme which, here as elsewhere, unfolds at a number of levels.

To begin with Hume drew attention to the general benefits of foreign trade. In the essay 'Of Commerce' for example he made the point that if 'we consult history, we shall find that in most nations, foreign trade had preceded any refinement in home manufactures, and given birth to domestic luxury'. In the same context he made a point, which also appears in Smith's historical analysis (Book III of the *Wealth of Nations*), in drawing attention to induced changes in taste and to the point that imitation leads domestic manufactures 'to emulate the foreign in their improvements'. The argument was repeated in the essay of the 'Jealousy of Trade':

'Compare the situation of Great Britain at present, with what it was two centuries ago. All the arts both of agriculture and manufactures were then extremely rude and imperfect. Every improvement which we have since made, has arisen from our imitation of foreigners; and we ought so far to esteem it happy, that they had previously made advances in arts and ingenuity' (*Essays*, p. 328).

This sentiment sets the tone of the essay, added in 1758, in which Hume explicitly criticised what he took to be a characteristic feature of mercantile policy treated as a zero-sum game.

'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. In opposition to this narrow and malignant opinion, I will venture to assert, that the encrease of riches and commerce in any one nation, instead of hurting, commonly promotes the riches and commerce of all its neighbours; and that a state can scarcely carry its trade and industry very far, where all the surrounding states are buried in ignorance, sloth and barbarism' (*Essays*, p. 328).

In passages reminiscent of the treatment of historical dynamics, and which may well have struck a chord with J.B. Say, who first formulated his famous law in exactly this context, Hume continued:

'The encrease of domestic industry lays the foundation of foreign commerce. Where a great number of commodities are raised and perfected for the home market, there will always be found some which can be exported with advantage. But if our neighbours have no art or cultivation, they cannot take them; because they will have nothing to give in exchange. In this respect, states are in the same

condition as individuals. A single man can scarcely be industrious, where his fellow citizens are idle' (*Essays*, p. 329).

Hume concluded the essay in a manner which must have attracted the attention of Adam Smith:

'I shall therefore venture to acknowledge, that, not only as a man, but as a British subject, I pray for the flourishing commerce of Germany, Spain, Italy, and even France itself. I am at least certain, that Great Britain, and all those nations, would flourish more, did their sovereigns and ministers adopt such enlarged and benevolent sentiments towards each other' (*Essays*, p. 331).

The second aspect of Hume's analysis supports the position just stated on grounds that are essentially technical. Building upon the analysis of the essay 'Of Money' Hume examined the case of two or more economies with no unemployed resources with a view to demonstrating the futility of the mercantile pre-occupation with a positive balance of trade. Against this, Hume contended that a net inflow of gold would inevitably raise prices in the domestic economy, while a loss of specie would reduce the general price level elsewhere – thus improving the competitive position in the latter case and reducing it in the former. In the essay 'Of the Balance of Trade' Hume concluded that 'money, in spite of the absurd jealousy of princes and states, has brought itself nearly to a level' (*Essays*, p. 314), just as 'All water, wherever it communicates, remains always at a level' (*Essays*, p. 312).

'From these principles we may learn what judgement we ought to form of those numberless bars, obstructions, and imposts, which all nations of Europe, and none more than England, have put upon trade; from an exorbitant desire of amassing money, which will never heap up beyond its level, while it circulates; or from an ill-grounded apprehension of losing their specie, which will never sink below it. Could anything scatter our riches, it would be such impolitic contrivances' (*Essays*, p. 324).

But the third dimension to Hume's treatment of foreign trade is much more complex. It is based upon the premise that countries have different characteristics and different rates of growth, thus opening up a different and distinctive policy position as compared to those so far considered; one which significantly qualifies the doctrines of free trade and of the specie-flow as a result of formally allowing for variations in economic performance. This line of argument was to be followed by Sir James Steuart (*Principles*, 1767), rather than by Adam Smith. The *presence* of an argument which reflects a judgement to the effect that economic conditions are likely to be diverse is not perhaps surprising in a writer such as Hume whose perspective was Euro-centric, rather than Anglo-centric. While critical of Montesquieu's thesis regarding the role of physical factors Hume was nonetheless conscious of the fact that different countries could have different factor endowments and aware that climate could have some influence upon economic activity (*Essays*, p. 267). But there is also a sense in which the rich country/poor country thesis reflects strands of thought which we have already identified in dealing with the comparative and dynamic branches of Hume's argument.

It is worth recalling in this context that the use of the historical method

involved the *comparison* of different economic types, while the dynamic element draws attention to the importance of individual effort and to an accelerating rate of change as institutions and manners themselves change. On the one hand the reader is reminded of the phenomenon of a 'diversity of geniuses, climate and soil' while on the other attention is drawn to the point that the extent to which men apply 'art, care and industry' may vary in one society over time and between different societies at a given point in time. Other factors which will affect the rate of growth and cause variations in rates of growth in different communities include the form of government (where England had a marked advantage) and the degree to which public policies such as trade regulations, taxes and debt are deployed with intelligence.

Hume's treatment of the performance of the modern economy, especially in the context of the essays 'Of Money' and 'Of Interest', implies that an increase in productivity may give the developed economy an advantage in terms of the price of manufactures. He also recognised that an inflow of gold in the context of a growing economy need not generate adverse price effects, but rather further stimulate economic growth.

Hume had already noted in the essay 'Of Money' that:

'Where one nation has gotten the start of another in trade, it is very difficult for the latter to regain the ground it has lost; because of the superior industry and skill of the former, and the greater stocks, of which its merchants are possessed, and which enable them to trade on so much smaller profits' (*Essays*, p. 283).

But he observed that the historical increase in the quantity of money which had 'quickened diligence' might also result in a general increase in the price level which could be disadvantageous in the context of international trade. The advantages enjoyed by a relatively advanced economy, he continued:

'are compensated, in some measure, by the low price of labour in every nation which has not an extensive commerce, and does not much abound in gold and silver. Manufactures, therefore gradually shift their places, leaving those countries and provinces which they have already enriched, and flying to others, whither they are allured by the cheapness of provisions and labour; till they have enriched these also, and are again banished by the same causes. And, in general, we may observe, that the dearness of everything, from plenty of money, is a disadvantage, which attends an established commerce, and sets bounds to it in every country, by enabling the poorer states to undersell the richer in all foreign markets' (*Essays*, pp. 283–84).

Hume clearly felt that these trends were beginning to manifest themselves in England which feels 'some disadvantages in foreign trade by the high price of labour, which is in part the effect of the riches of their artisans, as well as of the plenty of money' (*Essays*, p. 265).

The possibilities which Hume outlined are not without their implications for economic policy. A relatively backward economy might, for example, find it in its interest to adopt a policy of protection for infant industries. More advanced economies confronting a general loss of markets might have to adopt a policy of protection in order to sustain the level of employment; a situation which Hume regarded with some equanimity in noting that 'as

foreign trade is not the most material circumstance, it is not to be put in competition with the happiness of so many millions' (*Essays*, p. 265).

While there is in Hume's writings a marked presumption in favour of free trade, it was also recognised that policy must always be related to the circumstances which prevail; a perspective which is entirely consistent with that adopted in dealing with questions of a more purely analytical nature. Joseph Schumpeter's description of the work done by the contemporary Italian economist Ferdinando Galiani thus applies equally to Hume:

'One point about his thought must be emphasised . . . he was the one eighteenth-century economist who always insisted on the variability of man and of the relativity to time and place, of all policies; the one who was completely free from the paralysing belief, that crept over the intellectual life of Europe, in practical principles that claim universal validity; who saw that a policy that was rational in France at a given time might be quite irrational, at the same time in Naples . . .'

(*History of Economic Analysis*, 1954, pp. 293–94).

This was exactly Hume's position, and reflects his awareness of variations in economic, social, and political conditions in different countries engaged in trade. But the same argument also applies domestically in that throughout the *Essays* Hume demonstrated a keen awareness of change over time and of the point that the state of 'habits and manners' at a given point in time would be affected by the institutional structure which happens to prevail.

If we need to be reminded of the important principle of relativity in the sphere of political economy, Hume would not have been surprised. In a passage which appears, significantly, in his essay 'Of Public Credit', he remarked that:

'though men are commonly more governed by what they have seen, than by what they foresee, with whatever certainty; yet promises, protestations, fair appearances, with the allurements of present interest, has such a powerful influence as few are able to resist. Mankind are, in all ages, caught by the same baits: the same tricks, played over and over again, still trepan them' (*Essays*, p. 363).

The contemporary relevance of David Hume

Robert Pringle

This is an abridged version of Robert Pringle's paper *The contemporary relevance of David Hume* published by The David Hume Institute in 1992 as Hume Occasional Paper No.34.

Why freedom is necessary

At the centre of Hume's justification of liberalism is the process that Hume thought he was engaged in – the pursuit of truth. Though he cultivated his

image as a well-known sceptic, Hume saw himself as a scientist engaged like Newton in the pursuit of truth and he demanded the right to follow his passion and his reason wherever they might lead him. His concept of liberty was not a demand for ‘personal’ freedom to pursue his preferences and whims, whether in politics or in matters of personal morality; but rather, he demanded what he called ‘public liberty’, i.e. the freedom to publish, proclaim, and pursue the truth. Only individuals could uncover the truth – whatever bits and pieces of truth could be wrested from nature – and that is why they needed to be free. But the benefits flowed out into society, just as society had nourished the individual and given him friends and family. The individual is seen as embedded in society.

‘Although the exercise of genius be the principal source of that satisfaction we receive from the sciences, yet I doubt if it be alone sufficient to give us any considerable enjoyment. The truth we discover must also be of some importance.’

The ‘lover of truth’ was the ‘first source’ of all his enquiries.

Whatever his ultimate beliefs – and he took care to conceal them – Hume demanded for himself and therefore for everybody else the public freedoms to pursue the truth. But these freedoms only derive significance because there is a truth or truths to discover – the freedoms would otherwise be meaningless, the merest absurdity and self-indulgence.

The Friends and Enemies of Liberty

Liberty is seen as surrounded by many enemies, and as needing ‘friends’ (as Danford says, philosophy becomes *political* if it wishes to preserve an environment where it can be carried on). Its enemies include ‘superstition’, the clergy, political parties, government debts, ‘popular opinion’ (as distinct from an informed public opinion) and all large nations, like China. Its friends include ‘enthusiasm’, creative scepticism, international trade, religious toleration and small states such as Holland (Hume actually refers to China and Holland by name, showing how little has changed in 200 years).

Hume hated religious intolerance and suffered from it. Bishop Warburton held him up to ridicule: ‘He is an atheistical Jacobite, a monster as rare with us as a hippogriff’. Through religious intolerance, Hume lost his chance to get chairs at Edinburgh and Glasgow (though perhaps it was remarkable that ‘the great infidel’ should even have been considered for appointment as a professor), and had to ‘castrate’ his *Essays on Miracles* and suppress publication of several other essays. Yet he was able to maintain close friendships with moderate clergy, and conducted a famous correspondence with Dr. Wallace. In this they were self-consciously creating a new art – the art of polite discussion among people holding radically different beliefs and opinions. Hume sadly asked: ‘Why cannot all the world entertain different opinions about any subject as amicably as we do?’ Montesquieu congratulated them on this achievement, and both were aware how unusual it was.

Hume would have been saddened by the modern uncertainty about the

justification for liberty. Like today's inhabitants of former communist countries, most people in his day could recall times when they had been forbidden to say the truth, and when people who had opinions at variance with the official doctrine were spied on and abused – even for making what to them was the most obviously true statement.

In his time, religion was of course the most sensitive subject (as sensitive as, say, racial issues today). In the *Natural History of Religion* Hume accepts the argument from Design for the existence of God, but he analyses religion thenceforth as a natural product of the mind. Yet, as he often proclaims, he is not such a sceptic as many supposed and he concludes the work on a note of what he calls 'deliberate doubt'.

'The whole is a riddle, an aenigma, an inexplicable mystery. Doubt, uncertainty, suspense of judgment appear the only result of our accurate scrutiny concerning this subject'.

Although sociology, politics and economics could, he hoped, (eventually in another 3,000 years?) be reduced to sciences admitting of general laws of a Newtonian type, nature and the Supreme Being would, be believed, always retain their secret mysteries. Each person had to have the right to be free to discover the truth about them – and that was the real justification for liberty. The value of liberty reflects the belief that it is a necessary condition for the discovery and dissemination of truths. Economic prosperity is essentially a by-product of conditions established for and justified by other reasons.

Underlying all the constituent parts of his system of liberty is the observation captured in the quotation from Tacitus: in general people appreciate being free to think what they like and say what they think. But it is rare for them to be free in these ways. What Hume teaches is that, in order to maintain these freedoms, people need to share an understanding of how *public liberties* can be protected and why they should be. Without this understanding, the zeal for the *public interest*, few will have the spirit to resist the enemies of liberty and truth.

Postscript from 1750 to 1992

All this is a far cry from the current debate in the West about how to help Russia and other countries seen as struggling to move to democratic systems of government. To read the newspapers in 1992, you would think that the only important issues were whether the G7 group of individual countries would help stabilise the rouble, or whether \$20 billion in aid would be 'enough' to 'save the reforming government', or whether the 'price liberalisation' could be expected to have a 'supply side response'.

Hume teaches instead that a successful 'transition' (to use the 1990s jargon) to a market economy requires a widespread public understanding of a different range of issues. (First of all, it is doubtful whether Hume would have classified Russia, say, as a society at all, rather than as a mere agglomeration of people in a state of nature). These include, as first principles, rules of justice establish-

ing property rights, assignments of these rights to individual people, a constitution supported by public opinion, government by consent, strict limits to the powers of the government of the day, a respect for (but not an uncritical worship of) each country's own traditions, a spirit of liberty, and 'enthusiasm' (a willingness to embrace unpopular causes and to stand up and be counted in their defence).

But perhaps the greatest contribution Hume's teaching can offer is his view of the ultimate justification of a liberal society – for this is where the West is currently most weak and uncertain. There is little confidence in the traditional justifications of freedom – other than the argument that it seems to produce the goods. Even if we like it for ourselves, we are no longer confident we are entitled to recommend it to others (after all, they may be quite happy and 'flourishing' under their own quite different systems of government): we are not quite sure what it is for. This is not a problem for Hume.

Public Policy Questions

The objects of The David Hume Institute are to promote discourse and research on economic and legal aspects of public policy questions. The seven papers which follow, some of which are new, some revisions or extracts, deal with a selection of the questions which the Institute has addressed during its first decade. Unless otherwise indicated, papers have been produced especially for this report.

Society and democracy

James M. Buchanan

I. Introduction

My thesis is simple. 'Society' takes precedence over 'Democracy.' By this statement I mean that while democratic processes of governance, in which all persons have some participatory role, may well be necessary in any well-functioning civic order, the converse relationship does not hold. The presence of 'democracy,' as such, does not guarantee, or even promote, the construction and maintenance of those constitutional-institutional parameters which inclusively define the civic order (or 'society'). In the absence of such parameters that define the very framework within which government as well as private agencies operate, no civic order, no 'society,' can exist that warrants positive evaluative designation.

I can summarize my argument by repeating here a statement made in an earlier paper. I stated that the political structure of any society that embodies respect for individual liberty must be one that is described by the term 'constitutional democracy,' but that of the two words in this couplet, 'constitutional' is prior to 'democracy.'

I propose to develop this thesis with reference to the demonstrated proclivities of modern democratic politics to extend beyond meaningful constitutional, or within-parametric, limits, and to take on attributes of a negative-sum contest that becomes akin to a game without rules. In a very real sense, the distributional politics of what Anthony de Jasay (1985) has appropriately termed 'the churning state', has become this age's version of the Hobbesian war of each against all. Particular interests seek to get, and succeed in getting, the assistance of the state at the expense of others, and all within the

processes of democratic institutions. Until and unless we come to an understanding that the principle of generality must be operative in politics in some manner that is at least akin to that which is ideally present under the notion of equality before the law, the observed excesses of 'democracy' will continue to undermine the public's confidence in our ability to govern ourselves.

II. Politics without romance

My inaugural lecture at the Institute for Higher Studies in Vienna, Austria, in 1979 was entitled 'Politics without Romance.' I have since found this three-word title to be quite useful in summarizing the whole research program in Public Choice, that program within which my own work has been classified. This title is descriptively accurate because it contrasts the public choice conception or explanatory model of politics and political process with the traditional alternative one that could be described as 'politics with romance.' And, surprising as this may seem to Spanish realists, such a romantic model has been central in 'political theory' since the ancient Greeks. In this traditional conception, the whole enterprise of politics is understood to be a continuing search for what is 'good, true, and beautiful' for the polity. To the extent that individual participation is explicitly considered at all in this conception, the emphasis is on participation in the ongoing dialogue and discussion. The teleological nature of the whole enterprise suggests that the good and the true, once discovered, are to be universally accepted and acclaimed by all 'right-thinking' and 'morally responsible' citizens. In this romanticized conception of what politics is about, the specific features of a decision rule that may be used to close off discussion, temporarily or permanently, do not demand critical analytical attention. What matters is that the uniquely determinate results be attained and implemented, not that individual expressions of preference be embodied in such results. To the extent that separate individual preferences are counted or measured in some amalgamation process, such procedure qualifies only as one possible means of discovering that which exists. I have often referred to the multi-person jury as a means of determining guilt or innocence in criminal proceedings as an analogue to the place of democratic voting procedures under this conceptualization of politics. Individual preferences differ, one from another, here only because persons may be differently informed or may have differing theories as to how the good and the true may be generated. In this model, they do not differ because individuals have differing interests or purposes for the whole political enterprise.¹

The realist or non-romantic conceptual model of politics is dramatically different from that just sketched out. First of all, there is no room for the notion that there exists some ultimate 'truth' in the political enterprise, just waiting out there to be discovered, one way or the other. Secondly, the basic legitimization of politics, and of government as a coercive force, lies in the expressed consent of individuals, who judge that collective action is necessary

¹ For further discussion, see Vanberg and Buchanan (1989).

for them, individually, to accomplish purposes that they cannot readily achieve through private action. And, in the organisation of collective action, that is, in the activity of politics, individuals express their own interests, which may differ, as well as their own theories. Politics is an enterprise in which persons and groups seek to further shared, but still private, purposes.

In this realist conception of politics, which informs the public choice research program, it is immediately evident that individual participation matters in quite a different way from its role in the romantic or idealist conception. Precisely because individuals do have separable interests, which may conflict, it becomes relevant and important that they be allowed access to the participatory enterprise. And not only potential access, but also the specific features of the decision rule become significant. A vote is more than a voice. Further, the domain of society over which politics is allowed to enter and to dominate emerges as a critical variable. In sum, politics as a 'compromise of interests' is different in kind from politics as a 'discovery of the good or the true.'

III. The electoral fallacy

The intellectual leaders of the 18th century Scots Enlightenment and the American Founders, in particular, were political realists; they were highly sceptical of politics, government and politicians as promoters and guarantors of the public or general interest of the ordinary citizenry. They sought to constrain governmental intrusions into the lives of citizens, whether economic or personal. They interpreted constitutions to have such constraint as a primary purpose, and they did not distinguish between forms of government in terms of the applicability of constitutional limits. Whether or not governments qualified as democratic was not considered directly relevant to the need for constraint on the domain of society over which politics was allowed to operate.

Unfortunately, confusion emerged as previously despotic regimes came increasingly to be replaced by constitutionally guaranteed democratic electoral systems. What I have called 'the electoral fallacy' emerged in the 19th century, reflected in the notion that, so long as there existed constitutional protection that guaranteed universality in the franchise, open and periodic elections, freedom of entry into the formation of political parties, and the generality of enforcement of laws enacted through majoritarian processes, politics would be kept within bounds. Democracy was considered to be the guarantor of the discipline that it imposed upon itself. There was little or no understanding that electoral democracy, in particular, requires its own constitutional constraints. This absence of understanding was acerbated by the resurgence of the romantic image of politics in early 19th century political philosophy. The constitutional wisdom of the 18th century was lost, and democracy, treated as almost synonymous with majoritarianism, was allowed to move almost at will into areas of civic society that remained unprotected by constitutional barriers.

IV. The natural limits of majority rule

In much modern discourse, democracy means majority rule. But this understanding is seldom followed up by its consequence. Majority rule means rule by the majority which, in its turn, means that those in the minority are ruled. They are coerced into an acceptance of political results that they do not prefer. This very elementary definitional starting point is too often overlooked because of an implicit assumption that the alternatives for collective or political selection are themselves exogenous to the process or rule through which selection is made. In such case, while individuals in the minority may prefer some alternative other than the one imposed by the majority, there is no overt exploitation of the minority, as such. In this conceptual framework, the collective selection process contains elements of a coordination game within which members of both the dominant majority and the minority are predicted to benefit from the result, quite independently from status.

But where do the alternatives for political action come from? Are these alternatives 'out there' as potentialities, waiting for some process, any process, to make a selection and put one of them into being? Or are the alternatives for political action themselves created endogenously by political entrepreneurs, who seek to further the interests of those persons and groups whom they represent? Do political entrepreneurs emerge to invent and discover alternatives for political action that are aimed primarily if not exclusively to promote the interests of those represented in the relevant coalition? In this perspective on democratic politics, the alternatives among which some selection is to be made do not exist independently at all. And in this perspective it is perhaps clear that, while alternatives may well be 'public' along some relevant dimensions, the differential interest of members of the majority coalition is likely to be furthered by 'private' elements (Flowers and Danzon, 1984). It is equally clear that the set of political alternatives brought up for consideration will depend upon the decision rule in operation. A voting rule that requires only a simple majority of a legislative assembly will generate quite different options than would a voting rule that requires a five-sixths qualified majority.

Unless there exist explicit constitutional constraints on the type of alternatives to be considered, or, more generally, on the activities of society subject to politicization, the natural tendency of majoritarian decision processes is to move toward actions that benefit members of the majority at the expense of members of the minority. Aided and abetted by imaginative political entrepreneurs, majority coalitions will succeed in securing political approval for programs that provide differential or special benefits to their own members, while imposing costs, either generally on all citizens, or differentially on members of the dominated minority. Or, conversely, majority coalitions will secure approval for programs offering general benefits to the whole citizenry while being primarily financed by taxes imposed differentially on members of the minority. Or, in further extension of this natural proclivity of political majoritarianism, programs that quite explicitly involve overt transfers from minority to majority members may become commonplace.

In any realist model or understanding of political process, majority rule

becomes more than either a means of closing off discussion or of discovering truth. Majority rule becomes a means through which the interests of those who make up the successful coalition may be advanced, if necessary, at the expense of those who are outside this coalition. And when it is recognized that the makeup of majority coalitions shifts through time, we should scarcely be surprised at the growth of the politicized sector of society in the age of majoritarian democracy.

V. Generality in politics

What can be done to keep democracy within some appropriate limits? How can the natural extension of majority rule be held in check, while at the same time preserving those elements of political equality that are deemed necessary for the functioning of civic order? How can the game that is majoritarian politics be controlled to insure against minority exploitation? How can steps be taken to guarantee that this game be positive sum, that political action generate net benefits to all members of the inclusive polity?

These are, of course, questions that have been discussed through the ages. But they are, nonetheless, as relevant at the end of the twentieth century as they were in Athens in the centuries before Christ lived. The fears of democratic excesses expressed by the early Greeks also describe modern attitudes. The central problem of democracy has by no means been resolved.

James Madison, the most important of the American Founders, sought to forestall the emergence of coalitional or factional politics by incorporating several procedural checks and balances into the constitutional structure. Governmental authority was to be divided, deliberately, between executive, legislative, and judicial branches, each of which is responsive to a different constituency and with differing institutional traditions. The legislative branch itself was to be further limited by bicameralism, with separated, if overlapping, constituencies for the two bodies. Further, power was to be divided between the central and regional or provincial governments, with central domination restricted by the potential for secession. These several structural parameters for governance were to be implanted in an explicit constitution, which also stipulated the limits on the extension of political power, no matter how exercised.

We now know that the Madisonian enterprise failed. The great American Civil War in the 1860s removed forever the threat of secession by the states, and this basic constitutional change more or less ensured that, eventually, the United States would be transformed into a centralized majoritarian democracy, with few, if any, checks on ultimate political authority. In this modern setting, democracy dominates society.

The parliamentary democracies of Western Europe were even less successful in holding back the forces for Leviathan. Confused by the electoral fallacy discussed above, these societies were allowed to drift into the politicized domination reflected in the modern social democracies of the expanded and intrusive welfare state, with little or no discussion of the appropriateness of limits to majoritarian control.

Observation suggests that democracy, in modern practice, is out of control. The great revolution of 1989–1991, which displaced centralized collectivism as a viable form of economic order, seems to have exerted little or no influence on the continued overreaching of majoritarian democracies, and on the ideas that sustain this movement. Is it possible even to imagine some means through which democracy can be limited, without, at the same time, replacing majority voting itself, which, unfortunately, has come to represent the meaning of democracy, at least in public attitudes? We do, indeed, find ourselves caught up in contradiction here. We want to define democracy as ‘majority rule,’ while, at the same time, we recognize that, under any realistic modelling of politics, majorities will act to exploit minorities.²

I suggest that the application and enforcement of the *principle of generality* can remove the contradiction here. We can reform our politics so as to reduce substantially if not totally eliminate majoritarian exploitation without in any way removing majority voting from its central place as the basic decision rule, and, also, without placing specific areas of social activity beyond the boundaries for politicization. The principle of generality is almost self-explanatory. If political or collective action is to be taken at all, it must be general in application over all persons and groups in the political community. Politics cannot be allowed to take differential or discriminatory action. This principle would, indeed, close off many options for majoritarian choice. But within the whole set of alternatives that satisfy the generality criterion, majority voting may be allowed to make final determination.

The importance of the principle of generality was emphasized by Professor F.A. Hayek in his comprehensive treatise, *The Constitution of Liberty* (1960), although he did not discuss its applicability in the context of majoritarian politics. Hayek recognized, however, the relevance of generality as traditionally embodied in the rule of law, which he identified as a central norm in any society that would lay claim to classification as a liberal order. ‘Equality under the law’ as a norm implies that specific exemption or special treatment is out of bounds. In enforcing legal rules, the judiciary is simply not allowed to differentiate among individuals and groups. Of course, this principle of generality, even in law, has existed, and exists, only as a widely-acknowledged norm for judicial action rather than a strictly followed directive for behaviour. Violations have, and do, occur. Nonetheless, the rule of law continues to retain its viability as an ongoing principle for legal order in all Western societies.

Why have social scientists and social philosophers, other than Hayek, failed to recognize that differential or discriminatory treatment in politics is, at base, equivalent to differential or discriminatory treatment in law? Why can a legislative or parliamentary majority pick out particular constituency groups for special treatment, either favourable or unfavourable, when a judge, in enforcing law, is prevented from comparable discrimination? The answer lies in the combination of the idealist model of politics and the electoral fallacy,

² Norman Barry (1993) identifies a comparable contradiction in Hayek’s position on parliamentary sovereignty.

both of which were discussed earlier in Sections II and III. Majority coalitions, both because their authority is presumed subject to electoral feedback and because they are presumed to be engaged in a search for truth rather than advantage, have been essentially immunised from critical behavioural scrutiny. And, indeed, the modern role for members of legislative assemblies has been transformed into one that involves the promotion of differential constituency interest as its defining characteristic.

Only if, as and when effective constitutional constraints are imposed on the discriminatory actions of majority coalitions, can modern democratic politics be forced back into some appropriate relationship to the more inclusive society. It may be helpful at this stage to note several examples that would illustrate how a principle of generality would work if applied to politics.

Consider trade policy. The differential interest of each producer group (or industry) is to secure protection of its own market from potential competition by foreign suppliers. There are profits to be gained by investing in political activity that will impose such protection. And if a sufficiently influential coalition of producer groups can be organised, majoritarian politics will install the desired protectionist regime (Buchanan and Lee, 1991). The groups that succeed in this effort will, however, increase profits only if the restrictive policy remains non-general. If a principle of generality is in place, protection for any industry or producer group would require that like protection be extended for all industries. But, in this case, the differential or particular interest of any single group in protection no longer exists. Given an effective generalization requirement, the interest of each group is in a non-restrictive regime of free trade. Support for protectionist majority coalitions would largely disappear.

As a second example, consider the familiar patterns of pork-barrel spending. A single legislator is deemed praiseworthy by constituents if a governmental project is located in his or her district, quite independently of the overall net benefits of the project. Under a principle of generality, the approval of any locationally-specific project would require the comparable location of other projects in all districts, rather than only in those areas represented by the members of the majority coalition. In such a case, the interest of the electoral constituency shifts and support for cost ineffective projects disappears, but without in any way subverting the ultimate authority of a majority to take decisions for the whole electorate.

As a third, and final example, consider taxation. Somewhat interestingly, some elements of the generalization principle do describe tax structures in modern democratic regimes. Overtly discriminatory tax treatment of persons and groups as classified by political status would be deemed constitutionally out of bounds, and attempts to impose such treatment would be prevented by judicial mandates in most jurisdictions. But important features of constitutionally acceptable tax structures clearly violate any generality norm. Democratic majorities can impose discriminatory taxes on particular sources and uses of income, on particular professions, occupations, industries, or products and services, and, perhaps, most importantly, rates of tax can be different for persons in differing income categories. The progressive income

tax clearly represents a departure from the generality principle, and only a uniform proportional or flat rate tax, without exemption, deduction, or shelter would fully qualify.

VI. Changing the public mind-set: from the particular to the general

One way of interpreting the central argument advanced here is as a reconciliation between the teleological feature of the romantic notion of politics and the reality of interest-seeking political behaviour. Politics, as an activity, *should* be aimed at furtherance of 'good' for society. But political activity as it is observed to take place in majoritarian democracy does not match this philosophically legitimating purpose. The infusion of the generality principle or norm, as a restriction on the domain of politics, as a limit on any ability of politics to further the defined interest of one group over another, would go far toward closing the gap between the ideal and the reality of democracy. Individuals will, of course, continue to seek to further their own interests, and these interests will differ among separately classified groups of persons. But potential disagreement over policy alternatives that are known to be generally applied are likely to be dramatically less intense than disagreement over non-generalizable polity options.

A shift in the public mind-set toward politics is required if the generality principle is to gain adherence as a prospective avenue for structural reform. The remaining residues of the romantic image of a disembodied political authority seeking the 'good' and the 'true' must be swept away. In such an image, the 'good' might, of course, involve the furtherance of the particular. The genuinely benevolent government might discriminate among groups in terms of criteria for overall 'goodness.' But in the absence of any plausible presumption of benevolence, the 'general welfare' cannot be promoted by other than *general* measures. Particular interests can be arrayed in support of generally applied alternatives only if and when the differentially superior profits from non-general alternatives are eliminated. A majority coalition will, of course, select a somewhat different mix of the feasible generalizable options than that mix preferred by members of the minority. But the difference would be reduced to a dimension along which all relevant alternatives tend to generate mutual advantage to all participants. The game of democracy would tend to be positive sum.

VII. Society and democracy

Only through the accomplishment of structural reform along the lines broadly suggested by the argument here can 'society' and 'democracy' be brought into the ultimately necessary symbiosis that is preferred by everyone. Democracy, as a basic organisational form, becomes the means through which persons in a civic order, a society, can secure the mutual benefits of peace and prosperity. Democracy cannot be allowed to trump society in the sense that the basic

structure of civil order is determined by the relative success or failure of particular coalitions of persons and groups.

As such reform is implemented, politics, politicization, and the outreach of the state must recede from the extended current margins as elements in the inclusive civic order. Within its own limits, as defined by its constitutional structure and as guided by the generalization norm, the state can, and should, remain strong. A weak state insures only that factionalism, whether private or public, will emerge to subvert the genuinely productive collective action that a properly functioning constitutional democracy can facilitate.

Is it naive to hope that individuals can begin to think more seriously about the relationship between society and democracy so as to allow constitutional entrepreneurs to organise public support for specific reform? Until and unless there comes to be a general public understanding of the philosophical grounding of democracy *in* society, rather than the other way around, the march of history offers little basis for optimism. Such an understanding, translated into practice through structural reform, can help to create a twenty-first century that is dramatically different from the twentieth, and better by all standards of comparison. Are living and future members of the post-socialist world up to the challenge?

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A role for economists?

George J. Stigler

Professor George Stigler was one of the outstanding economists of this century and one of the first to be awarded the Nobel Prize in Economics. His distinguished academic career culminated in his appointment as Professor of Economics at Chicago in 1958.

He became President of the *American Economic Association* and Editor of *The Journal of Political Economy*, one of the world's leading professional economics journals. He made major contributions to the economic theory of markets, to the history of economic thought and to economic and statistical analysis of public policy. George Stigler was first Honorary President of The David Hume Institute from 1985 to 1987. As part of his Presidential Address on 1 May 1986, entitled *The Regularities of Regulation*, he analysed the role of economists.

I have not concealed my deep scepticism of the role of opinion, and the leaders of opinion, in bringing about basic changes in direction of a society. Does that leave any important role for the academic scribblers whose influence Keynes assessed so high? I believe it does – in fact as an economist I had better believe so – and in a thoroughly old-fashioned way.

When a scientist discovers something that is new and true, a rational society must accept that finding whether it be benevolent or hateful. A rational person cannot disregard an established finding such that X is a wonderful antibiotic, Y a lethal poison and Z a reliable pattern of human behaviour under governmental price-setting. Different people may wish to use a new finding in different ways, but only at one's own peril may it be ignored.

Therefore, the truly established findings of economists are incorporated into all economic policies. No one disputes the fundamental law of demand, that buyers will seek to purchase more of a thing when its price is reduced. When a government introduces effective price ceilings without formal rationing, it does not disregard the law of demand: it simply decides that it prefers the pattern of purchases that will result with queuing. I would claim that a modest role in the deregulation of the financial markets has been played by the modern theories of efficient markets and of economic regulation.

It follows that the most important economists are those who discover and prove general relationships in economic life. They are vastly more influential in the long run than those other economists who become famous on the stage of public discussion.

This second role of economists – the formulating of desirable public policy – fills a different and less influential function.

Whether the circumstances of a society dictate little or extensive use of the state in any area of economic life, it is appropriate to devise philosophies or theories to describe these general practices. When the state makes few interventions in economic affairs, it is natural for this practice to be articulated in a philosophy of *laissez-faire*, and that philosophy is then the first, general, reaction to any new proposals for state action. When the state is vigorous and far-ranging in an area (as, for example, in my country as regards environmental protection) it is equally natural for new extensions of that programme to be welcomed, and attacks upon it to be repulsed, by a philosophy of state responsibility.

These philosophies are useful summaries of the general state of contemporary political equilibrium: they provide a first answer to proposed changes in policy that are reasonably good predictors of how the new proposals will fare. If they are widely used, we may be confident that they will not be rigorous and abstract, and therefore they are better named philosophies than theories.

These philosophies are constructed out of actual practices and trends in these practices, by spokesmen of the groups that support or oppose the practices. These spokesmen are representatives of the affected groups, and they include political representatives and that class with the flattering name of 'intellectuals'. The philosophies or ideologies are not simply descriptive of actual (or desired) policies: inevitably they codify and put a measure of consistency in the approved practices, and therefore exert an influence on what is acceptable.

This second role of articulating and preaching the philosophies of important groups in society is obviously useful, and commands both prestige and income. Nor is it a role that requires a spokesman to support policies that he personally does not wish to be followed: there are many groups from which one can choose. A good measure of the integrity of the spokesmen of various classes is whether they are earning approximately equal rewards.

The interests of the various groups in a society are durable: there have been identifiable farm blocs, unionised workers, urban poor, manufacturing and other such interests for many years or even many decades. Opinions usually change more rapidly than these economic and social classes. It therefore follows that shorter-term changes in public policies may be due to the changeable winds of opinion as well as to the shorter-term changes in economic environments. If I believed that an economist could say much that was useful about the short-term changes in public policy, I would have given more time and especially more thought to opinions.

On this reading of the nature of the fundamental forces in the political process, the scope for reformers is narrowly confined. That should hardly be news to anyone, and especially to economists whose two-century-long efforts to achieve freer international trade have seldom prospered. Yet I find a consoling merit in the dominance over long-term social and economic policy by the social and economic structure of the society. If our nations will not listen closely to the excellent advice we economists give, these same nations will be equally deaf to the score of nonsensical and pernicious proposals that spring up with the frequency of general elections. If we cannot achieve authority, perhaps we should be satisfied with predictability.

The 'utility maximising' government adviser

Sir Alan Peacock

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One of the striking contributions of public choice analysis has been the analytical transformation of the government bureaucrat from being a guardian of the public weal into a common-or-garden rent seeker, or at least, a mean

sensual maximiser like everyone else. Economists are employed by governments in many different grades and capacities. They even run bureaux – in my own case I was for three years joint head of the Economic and Statistical Divisions of the UK Department of Trade & Industry which meant directing the work of over fifty economists and about double that number of statisticians. In the literature written by economists on the provision of economic advice to government there is copious information supplied on the process of advice-giving but little is made of the motivation of those who give it. I have tried elsewhere, albeit tentatively, to fill this gap by raising the following question: ‘If the economist firmly believes in the robustness of utility theory, then presumably (s)he accepts that utility maximisation is as much a characteristic of an economist as of other human beings. Why should economists analyse the behaviour of bureaucrats, often concluding that they are ‘rent seekers’ rather than dispassionate guardians of the public interest, without recognizing that the pot may be calling the kettle black?’

My short answer, admittedly based on introspection and casual empiricism, is that economists are utility maximisers like everyone else. Career prospects embodying long-term income opportunities are therefore an important argument in their utility functions. Like other professional cadres they trade off material wealth against job satisfaction and reputation with their peer group. Of course, investment by an economist in reputation may not be at the cost of income if promotion prospects, as in reputable university institutions, are based on peer group assessment.

The position may be less clear-cut in the case of economists employed in government. Take the position, as in the UK, where there has been a career structure for an economist within government. In the more junior posts, technical competence is likely to be the most important criterion for promotion and income improvement will depend on assessment carried out by senior economists. Hence the position may not be very different from that in universities. At more senior levels however, where economists are directly involved in giving advice on the effects of policies and come into contact with senior administrators and with politicians who form the government in power, there are two differences. Communication and management skills as well as technical competence will be an important element in the job specification. Promotion will be governed by the decisions of the most senior administrators, endorsed by the political head of the relevant department; and posts may sometimes be filled by ‘lateral’ transfer from outside government, as in my own case. For positions with the equivalent of Permanent Secretary rank, the approval of the Prime Minister may be required. In short, any economist in the higher echelons faces important constraints if (s)he wishes to maximise professional reputation. The dilemma is similar to that faced by those attracted to become chairpersons of large economics departments, or deans of social science faculties in universities, but who wish to continue contributing to major professional journals.

I reject the proposition that it is in the interests of senior advisers to ‘trim’ their advice for the following reasons:

- i) While a minister will prefer advice which goes with the grain of policy

proposals, it is merely inconvenient if it does not. Official policy advice can be ignored, given the choice of alternative sources. Even then, the advice given by a senior economic adviser which is rejected may be worth studying carefully because it may marshal the arguments to be deployed against the minister's position by his political rivals and in the public debate of his/her proposals. The problem for the adviser is not that of being forced into 'slavery' but the effect on job satisfaction if advice is repeatedly ignored.

ii) The trimming of advice to suit the predilections of a minister can be a high-risk strategy for a utility-maximising economist who is employed in a technical capacity. For one thing, the 'customer', that is the occupant of a ministerial post, may change, and frequently in the longer run, and so may the complexion of the government in power. A reputation for doctoring advice to suit a change in taste reduces its credibility, even when that advice is congenial to the new political incumbent. For another, were such an adviser to run an economic service as part of the task of executing policies and reviewing how existing policy instruments work, his administrative counterparts would be less inclined to trust the technical results and any associated recommendations for changes in bureaucratic procedures and practice. The consequences could be more serious than a loss of job satisfaction if senior administrators are consulted on his/her promotion or continuation of appointment.

iii) An economist interested in long-term prospects and job satisfaction will wish to keep options open about the pursuit of a career solely within government service. That being so, (s)he will be particularly mindful of their professional reputation. While experience gained in government may enhance that reputation, particularly if it pays off in improving knowledge of how economic analysis may contribute to the study of political and bureaucratic motivation and action, it will be discounted if that reputation has been sullied by trimming. It may be granted that the experience of those who admit to doctoring their advice to suit their political masters may have an anthropological interest, but the memoirs of rogues, however divertingly presented, usually have to be taken with large pinches of salt.

Nothing in what I have said is meant to question the analysis of the dangers which beset economists who attempt to derive policy recommendations from a set of normative propositions and then enter the business of selling their ideas to policy-makers. What I question is their conclusion that government economic advisers must necessarily become politicians' slaves. If they do so, then they cease to be economists.

Legal pluralism

Thijmen Koopmans

The concept of legal pluralism is often associated with situations in colonial territories. The rules imposed by the representatives of the colonial power

were considered as part of the law given by the State. However, the population of these territories generally lived in accordance with quite different rules. Most groups continued to respect traditional legal systems based on tribal allegiance or on pre-colonial political or religious affiliations. The colonial administration had to put up with this state of affairs, as there was often no way of compelling African or Asian populations to live according to other rules than those their ancestors had handed down to them through the ages.¹ A similar situation continued to exist after independence of these countries, as the new rulers very frequently tried, with varying degrees of success, to impose a modern legal system, emanating from the new State, on societies which used to live under their own law.² The term 'pluralism' was coined to characterize such a legal situation.

In Western States like Britain and France, the legal situation was supposed to be completely different. From the early 19th century onward, and until very recently, the country and its people were considered to live under one legal system, established by one legislative body or, at least, authorized by it. In the terminology of the French Revolution, the sovereign nation gave itself a constitution and thereby delegated its legislative power to an elected assembly.³ The people's representatives were thought to be exclusively competent to shape and to change the law of the country. From this point of view, and for all its difference of language, Britain adopted very much the same stand. The famous doctrine of the sovereignty of Parliament embodied, apart from its political implications, the idea of the unity of the legal system, with Parliament in command of its contents. Different developments contributed to achieve this result: the codification movement on the European continent; the growth of the powers of national parliaments, chiefly legislative powers; the consolidation of the modern nation-States; and the progressive increase of State intervention in social, economic and cultural matters.

This monolithic view of the law was elaborated in legal theory. Law was defined in such a way as to exclude anything not being, or based on, coercive norms created by the State. The 'pure theory of the law' (*reine Rechtslehre*), which expressed this frugal concept of the law eloquently, is probably one of the most celebrated legal theories of our century.⁴ As a result, theories on sources of law were subjected to a slimming process. In earlier periods, legal philosophers could muse on the role of Roman law, or of natural law such as developed by scholastics or rationalists. They could also try to delimit the sphere of the State from that of ecclesiastical law, or from the jurisdiction of the family, the city or the provinces. As the 19th century progressed, however,

¹ See M.B. Hooker, *Legal pluralism, an introduction to colonial and neo-colonial laws* (Oxford, S1975), ch. 1-3.

² I refer to two case studies: E.A.B. van Rouveroy van Nieuwaal, *A la recherche de la justice – quelque aspects du droit matrimonial et de la justice du juge de paix et du Chef Supérieur des Anufòm à Mango dans le Nord du Togo* (Leiden, 1976); J.E. Goldschmidt, *National and indigenous constitutional law in Ghana* (Leiden, 1981).

³ See Articles 1 and 2 Title III, French Constitution of 1791. See also Article 3, French Constitution of 1958.

⁴ It found its apogee in the works of Hans Kelsen, written between 1910 and 1960.

such considerations were swept away by a new consciousness founded on feelings of respect for the nation (or Nation), for its legislative authority and for the powers of Parliament.

The experience of practising lawyers is, nowadays, that the monopoly position of the nation-State and its institutions, as sole law givers, is over. However, most of legal theory still seems to cling to the old assumptions. Moreover, authors who are dissatisfied with these assumptions often substitute one simplistic theory for another. Instead of accepting the sovereign State as the sole source of law, they uphold the thesis of the duality of sources: national law and European Community law, or national law and European law in a somewhat wider sense, or national law and international law generally. Some authors have tried to find a different approach to the problem of sources.⁵ According to them, we are approaching an age of new pluralism comparable to the kind of pluralism prevailing in Europe – at least in continental Europe – in the late Middle Ages and in the immediate post-medieval period.

In my view, this doctrine of new pluralism is confirmed by legal evolution at the grassroots level. It reveals itself in such dissimilar developments as the growing influence of European Community law; the importance of the European Convention on Human Rights for the protection of individuals; the increasing resort to general principles of law in the process of interpreting and applying legal provisions; and the changed attitude of courts with regard to their role as law makers. I shall try to make a short comment on each of these four developments.

The influence of European Community law manifests itself mainly in three ways. First, the EC-treaty embodies some basic rules which have been interpreted and applied in such a way as to penetrate deeply into the daily life of the law. Examples of such rules are the free movement of goods and the equal treatment of men and women in employment.⁶ Secondly, some areas of the law have been entirely or partially harmonized by means of EC-directives. This is, for example, the case for value added tax and for company law. And thirdly, the Community pursues a policy of its own in certain matters, such as restrictive trade practices, fisheries and agricultural production. These policies have their own rules, their own institutions and their own management systems. Some of these systems are very bureaucratic (dairy products), others are, when compared to their counterparts in national administration, relatively light (cartels). The applicable principles, rules and decisions are sometimes developed by independent institutions like the EC Commission and the Court of Justice, and sometimes by the Council, where a Member State can, however, be outvoted. Reducing the validity of these principles, rules and decisions to the will of participating States may serve the monolithic view of the law, it is far removed from the actual reality. 'But it is theory and has no

⁵ Examples: Walter van Gerven, Court decisions, general principles and legal concepts, ingredients of a common law of Europe, in: Witte and Forder (eds.), *The common law of Europe and the future of legal education* (Maastricht-Deventer 1992) p. 339; Michael Akehurst, *Equity and general principles of law*, ICLQ 25 (1976) p. 801.

⁶ Respectively: Article 30-36 and Article 119, EC-treaty.

relation to realities', as Lord Sankey said in 1935, when he considered that, from a legal point of view, the British Parliament was entitled to revoke the independence of Canada.⁷ According to current views, such a theory is a bad theory: it has no explanatory power.

The European Convention on Human Rights is the cause of the second development. Contracting States have to comply when the European Court of Human Rights judges that human rights as defined in the Convention have been violated, and they even have to do so on issues which they consider as particularly sensitive, like the prison regime, discipline in the army, the fight against terrorism or media exposure of public figures. The European Court goes one step further: it holds that it is not only to be guided by the provisions of the Convention as they were agreed upon by the initial Contracting States, but that it has to take account of changes in the perception of certain rules or values which have meanwhile taken place in society.⁸ The impact of the Convention is very strong in States like France and the Benelux countries, where the courts consider that citizens can rely on the Convention's provisions defining human rights. This direct application of these provisions may imply that national legislation, statutes included, will not be enforced when the courts consider that this is incompatible with the Convention. It is the interplay between the case law of the European Court and that of the national courts which determines the extent of the obligations of the Contracting States, and of the rights of their citizens, under the Convention.

The third development consists of the evolution of legal principles. Courts resort more easily to general principles of law than they used to do in the first half of our century. The first reason for this is that our political and legislative machineries are not quite able to cope with the rapid rise of new problems of society. Consequently, courts are faced with many novel questions to which no answer can be found in the codes, in the statute book or in earlier case law: questions raised, for example, by the progress of information technology and of bio-technology, the growth of a real menace to our natural environment, mass migration, organized crime, the almost general availability of advanced and dangerous weapons, urban decay in the great cities, etc. Courts cannot refrain from deciding on the ground that their legal system appears to have no ready-made answers; what they tend to do is resort to principles of law. Old concepts reappear in the cases: natural justice, due process, rule of law, *principes généraux du droit*, *Rechtsstaat*; but applied to new problems, the old concepts come in a different attire.

There is, however, a second reason for the recourse to general principles: the Court of Justice and the European Court of Human Rights provided a stimulus for this development. The Court of Justice had hardly any choice: the EC-treaty, though giving detailed rules on the composition and powers of the institutions and on economic and social law, gives little guidance on the limits to the exercise of powers under the treaty. General principles such as legal certainty and the principle of proportionality enabled the Court of Justice to

⁷ *British Coal Corp. v. the King* [1935] A.C. 500.

⁸ *Marckx v. Kingdom of Belgium* [1979] ECHR Series A vol. 31.

do what the treaty requires it to do, namely to ensure that in the interpretation and application of the treaty 'the law is observed'.⁹ In deciding on the legality of obstacles to intra-Community trade, the Court of Justice relies on the principle of proportionality. According to the treaty, prohibitions or restrictions of such trade are allowed when justified by the protection of health and life of humans, animals and plants. The Court holds consistently that trade restrictions founded on such a legitimate reason can be justified only in so far as strictly necessary for ensuring public health, and that they are illegal when they go beyond that necessity.¹⁰ The European Court of Human Rights found general principles by analyzing the provisions of the Convention and by trying to find their pith and substance. The rule that everyone involved in a criminal case shall have a 'fair trial' is, for example, taken to mean that there must be 'equality of arms' between the prosecution and the suspect, a concept implicating standards by which to gauge the compatibility of national criminal procedure with the requirements of the Convention.¹¹ Both courts, the Court of Justice as well as the European Court of Human Rights, stress the vital importance of access to the courts: access to justice, and the right to a remedy, are based on a general principle of law, says the Court of Justice, which finds its expression in the European Convention on Human Rights.¹² One of the consequences of this case law is that national courts feel free to resort to the same principles in purely national cases.

Finally, a word should be said on the general tendency to strengthen the role of the judiciary. Judicial review of legislation, exercised by specialized constitutional courts, is now part of the legal landscape in great parts of continental Europe (though not in the Netherlands). In Germany, decisions of the federal constitutional court have slowly developed standards by which to assess the constitutionality of federal and state legislation. Administrative action has been brought under judicial control in all countries of Western Europe. Systems of specialized administrative courts have been established in most continental countries, most notably in France and Germany. In Britain, two separate developments brought English law closer to its continental counterparts. The first was the courts' refusal to accept unfettered discretion of public bodies or institutions; even if the applicable statute seems to confer complete discretion, the courts consider that its exercise is limited by the rule of law.¹³ The second development consists of the introduction, in 1977, of the general petition for judicial review, which removed a number of procedural obstacles to judicial control of administrative action. Thus, England is slowly moving towards a comprehensive system of administrative law.

⁹ Article 164, EC-treaty.

¹⁰ Example: food additives. See case 178/84, *Commission v. Federal Republic of Germany* "purity of beer" [1987] ECR 1227.

¹¹ Article 6 European Convention on Human Rights. See *Kostovski v. Kingdom of the Netherlands* [1989] ECHR Series A vol. 166.

¹² Case 222/84, *Johnston v. Chief constable of the Royal Ulster Constabulary* [1986] ECR 1663.

¹³ See *Padfield v. Minister of Agriculture, Fisheries and Food* [1968] A.C. 997. There is a famous passage in *Wade, Administrative law* (5th ed., Oxford 1982) p. 355-357: "... in a system based on the rule of law, unfettered governmental discretion is a contradiction in terms".

The role of the courts has also been strengthened by the diminishing significance of legislation for the evolution of private law. The importance of the old codes of law is decreasing; in important areas like tort and contract, judge-made law occupies the field, even in countries of the French tradition which used to have a strong belief in law making and law reform by legislative action. When new codes are prepared, such as the new Dutch Civil Code, they recognise that certain matters should be left to the courts; in this way, concepts like good faith and reasonableness give an important leverage to the judiciary. Particularly in the field of liability for tort, the law is in the cases, not in the codes, in France as well as in other continental countries. On the basis of very simple code provisions¹⁴, courts have built a sophisticated regime of tortious liability in such diverse areas as unfair competition, traffic accidents, manufacturing errors, air, soil and water pollution, chemical or pharmaceutical mishaps or catastrophes, negligence by public authorities etc. Courts developed into independent and autonomous law makers.

Taken together, the four developments I tried to describe inaugurate an era of pluralism. It is new pluralism, as opposed to the old pluralism which virtually disappeared under unitarian pressure in the early 19th century (and in Germany a century later). The old pluralism was characterized by the peaceful coexistence of Roman law, regional and local rules, customary law of international origin, like in commercial law, and remnants of canon law, occasionally replaced by prescripts of reformed churches, for example on marriage.¹⁵ The United Dutch Republics provided an example of this old pluralism. It was only after their collapse, under the victorious feet of the revolutionary French soldiers, in 1795, that a central legislative body was created. The new pluralism is not completely unlike its predecessor. There will be a kind of institutional competition, between national and European institutions, but also between the political institutions and the courts. There will also be a more complex legal situation than in the heyday of the sovereign law-givers, as statutory law will have to compete with constitutional principles, uniform rules of private or public law, and written and unwritten general principles of law. Legal developments will, in this new climate, tend to be less isolated and more in tune with what happens elsewhere. But they may become less predictable.¹⁶

Legal theory will have to adjust to the new realities. It should abandon the idea that a theory on sources of law can be centred round the sovereign State, as such a theory cannot explain the course of legal evolution of these last twenty or thirty years. Besides, a pluralistic theory should accept that the legitimacy of legal rules and government decisions can not be exclusively derived from the consent of the governed through representative channels. Apart from the democratic legitimacy, which has always been hailed in literature on constitutional law, there is a legitimacy founded on certain values,

¹⁴ Articles 1382 and 1384 of the French and Belgian civil codes.

¹⁵ See Helmut Coing, *European common law: historical foundation*, in: Mauro Cappelletti (ed.), *New perspectives for a common law of Europe* (Florence, 1978) p. 31.

¹⁶ See also R.C. van Caenegem, *Judges, legislators and professors* (Cambridge 1987) ch. 2

on the rule of law. Judicial review of legislation, now very common in the entire Western world, could hardly work if it had not its own, value-oriented, justification.¹⁷

There is still some work to do for legal philosophers. They should perhaps start by facing the real issues.

Rational barbarians: the innovators of the corporate world

Norman Barry

The victory of market capitalism over communism has not produced universal acclaim for the type of economic arrangements familiar to Britain and the US. Erstwhile proponents of central planning have recently turned to other market systems, especially those of Germany and Japan (which are apparently superior in both efficiency and ethical terms) for inspiration. Certain allegedly undesirable features of Anglo-American capitalism can, it is claimed, be replaced by institutional practices which are not only morally pleasing but also make better use of resources. The favoured target for the critics is the excessively individualistic and short-term profit-based financial institutions of Britain and America. They apparently not only inhibit long-term growth but are also likely to generate communal hostility to markets, largely because the sometimes vast earnings that they generate are said to be based not on genuine productive activity but on mere 'paper churning' on Wall Street and in the City of London.

The takeover and merger era of the 1980s (features of which are now returning after a lull in the early nineties) is perhaps the best example of this. Although the pace and intensity of corporate restructuring that occurred then were probably comparatively less than in the 1890s, that age became notorious as the 'decade of greed'. It was claimed that the 'break-ups' and reallocations that occurred were not only economically harmful but they also left victims in their wake – pockets of severe unemployment, ruined careers of people who had invested their human capital in enterprises seized by raiders, and devastated local communities. The less emotional objections concentrated on the alleged inefficiencies brought about by the obsessive concern for share price movements shown by institutional investors (who were not concerned about long-term growth prospects of a company but only with short-term profits), the neglect of research and development and the question of the distribution of the profits that were created.

There was considerable disquiet at the devices and tactics used in takeover battles, notably 'poison pills', 'greenmail' and 'golden parachutes'. Also some of the biggest insider dealing scandals were connected with takeovers. The

¹⁷ See Mauro Cappelletti, *The judicial process in comparative perspective* (Oxford 1989) Ch. 2.

critical argument depended on the claim that there is something different about takeovers and mergers; they are not like ordinary aspects of business change and development. They seem not to be instances of the benign effect of Adam Smith's 'invisible hand' but malign consequences of a particular form of corporate organisation. It is a form which is not common to all market capitalist systems and one which, it is said, we could well do without.

Before these issues can be tackled it is advisable to look at the nature of takeovers, to explain why they occur and to contrast this particular method of business organisation with its alternatives.

Why Takeovers and Mergers?

A hostile takeover tends to occur when an outsider notices that the share price of a publicly-quoted company does not reflect the underlying potential value of the assets. This may be because the management is simply inefficient and the company is heading for serious trouble, or because the outsider has novel ways of boosting shareholder value unnoticed by the incumbents. He will then buy up the stock at a premium to take control of the company and reorganise it, probably dismissing existing management. In its most controversial form, a takeover takes place when a 'shark' realises that the break-up value of a company is greater than its current share price, even though it may be currently profitable and its management might have made long-term investments, the value of which is not immediately visible. The raider simply offers the shareholders a big enough premium to effect a possibly harmful deal.

This last example is comparatively rare, although it does provoke headlines. Most takeovers are not hostile but are actually friendly mergers, as when two companies get together to realise profitable 'synergies' (where complementary activities do better when combined in one organisation). But hostile takeovers do have a rationale.

Theoretically they are a method of disciplining managements. Because of the separation of ownership from control in Anglo-American business, the nominal owners (the shareholders) have little direct influence over a company. This presents an 'agency' problem: for the principals (the owners) need some way of ensuring that their assets will be used productively and not dissipated through opportunistic activity (high salaries, perks etc) by their agents (the managers). The corporate raider Gordon Gekko's famous speech to the shareholders in the Hollywood film *Wall Street*, in which he attacked slothful and exploitative managers, illustrates this point better than any textbook does.

This problem does not arise in the economies of Germany and Japan because, in varying ways, banks as substantial owners (or effective controllers) of large amounts of equity perform this monitoring and supervisory function. In the US banks are forbidden to hold equity stakes in companies and in Britain they do not do so by convention. The takeover mechanism therefore is the only method of maximising shareholder value. Furthermore, the maximisation of this seems to be the over-riding purpose of the Anglo-American corporation. In other regimes, companies may aim at different things, such as

increased market share or the pursuit of growth for its own sake. There may even be political aspirations that lie behind some of their economic strategies as in French banking or Italian holding companies.

A further difference between the rival forms of organisation is that in non-Anglo-American businesses other 'stakeholders' (employees, suppliers, members of the local community etc) are given some weight in decision-making processes; an influence which is perhaps equal to that of the stockholders. This may not be merely a recognition of the importance of 'community' in social and economic life but it may also have an economic justification. After all, the relationships of trust, and the presence of non-contractual obligations that this approach encourages, reduce the need for law – and heavy legal costs (especially in takeovers) are a much-criticised feature of the 'arms length' world of Anglo-American enterprise.

The market for corporate control is a substitute for these superficially benign solutions to the agency problem. In fact, it might be better described as the market for managerial talent, for what the owners really want to ensure is that agents are appointed who will maximise shareholder value. Historically Anglo-American economies are stock-market driven while their rivals rely to a much greater extent on bank borrowings, though one important aspect of the 1980s was the emergence of debt-financing for American companies. Ironically, this last feature was one of the reasons for criticism of the frenetic takeover activity of that era.

The underlying argument for the takeover method is that the stock market is the best guide to economic value. The Efficient Markets Hypothesis supposes that all relevant information about a company is embodied in its share price. Of course, not all relevant information may be publicly disclosed (hence the problem of insider dealing) but the argument is that the market is a superior knowledge transmitter than any known alternative, such as government, or some other agency, that thinks it has a better idea of economic prospects than that indicated by current prices. Nobody supposes that the Efficient Markets Hypothesis is an infallible guide to value; if it were, it would describe an economy in static equilibrium and no entrepreneurial activity would take place at all. Rather, the Hypothesis is an *ex ante* argument about the impossibility of 'beating' the market over the long haul. Market prices embody all the value that has been created through entrepreneurial activity, although it is impossible to know in advance of the market process what that value is. Corporate raiding is a type of entrepreneurship, for it depends on someone spotting a difference in prices which can be exploited for profit, i.e. income earned above marginal productivity. However, the case for the takeover mechanism rests largely on a belief in the stockmarket's ability to reflect value; the successful raider creates value by reorganising assets in a more efficient way than hitherto.

However, even the most enthusiastic proponents of takeovers and mergers are not saying that they are all necessarily value-enhancing. Indeed, a common, and highly plausible, argument is that much of the corporate reorganisation that took place in the 1980s was a correction of the mistaken corporate expansion of the 1960s and 1970s. Then the managements of cash-rich companies, in the US especially, embarked on empire-building,

taking over enterprises that had little to do with their core activities and about which the acquiring managements knew little. Thus unwieldy, and ultimately unprofitable, conglomerates were created which increased managements' income and status rather than shareholder value.

One good explanation of this is given in Michael Jensen's (1988, pp. 28–34) theory of 'free cash flow'. He argues that profitable companies generate cash considerably in excess of what is required to keep their operations going. This 'free cash' was not paid out to shareholders in the 1960s and 1970s but was dissipated in pointless expansion, which actually lowered long-term shareholder value. His most telling example is the oil industry. In the 1970s, profits were very high and the big companies spent them on ultimately unprofitable exploration ventures. It was the notorious raider, T. Boone Pickens, who noticed that cheaper oil could be obtained by buying up oil companies on Wall Street. Thus the market for corporate control proved to be an effective co-ordinator of economic activity.

Controversial takeover devices

What caused particular concern in the 1980s was the development of novel methods of financing takeovers and mergers and the discovery and perfecting of various innovative market strategies. Whether one regards their emergence as a tribute to the fecundity of the free exchange system in generating new value-creating opportunities, or whether they are to be condemned as innovative ways of encouraging greed, will depend very much on the device under consideration. Some were highly effective in value-creation, others appeared to be designed merely to protect the self-interest of certain market participants.

Perhaps the most controversial, and the most misunderstood, device was the 'junk bond', pioneered by Michael Milken and the Wall Street investment bank, Drexel, Burnham Lambert (see Barry, 1991, ch. 5). It was this financial innovation that enabled the debt-financed takeovers of the 1980s to take place. It caused great controversy because its invention shook up the conventional and deeply-conservative banking and finance community in New York and, more important, enabled entrepreneurs to launch their raids on established corporate power structures.

A junk bond is simply a bond of less than investment grade value. It is thought to be risky and therefore pays a very high rate of interest. Investment grade bonds are issued by established corporations, which are unlikely to default on their contractual obligations. The original users of junk bonds were start-up companies that couldn't get an investment grade classification from the established rating agencies (Moody's and Standard & Poor's) and therefore had great difficulty in raising funds from conventional sources. Milken's entrepreneurial discovery was to notice that the default rate on non-investment grade bonds was very low. They were, in the beginning, not that risky. Milken was alert to the fact that the agencies based their ratings on the past performance of companies, an approach that was bound to favour established corporations and undervalue new and adventurous enterprises.

Intriguingly, the phenomenon illustrates a point in the philosophy of science. The rating agencies relied on crude empirical data and assumed, erroneously, that past evidence can be used to found inductive 'laws' describing corporate behaviour. It was unthinkingly accepted that evidence about the past can generate reliable predictions about the future. But, as David Hume pointed out long ago, no amount of past evidence can support a universally true generalisation. The future may not be like the past. As we know now, scientific knowledge advances by individuals making bold conjectures which can be falsified (Popper, 1963). It does not progress by the mere accumulation of data in the hope that this may support an inductive law. With regard to finance, Milken made a series of bold conjectures about the future performance of companies, based on his flair for spotting successful innovators. Indeed, many now famous American entrepreneurs, including Ted Turner (who created the original Turner Broadcasting System), started their business careers with Milken's bonds.

Eventually, junk bonds were used to effect takeovers. Indeed, it became possible for small companies to take over much larger ones because of the availability of finance. Hence the fear that Milken provoked in the boardrooms of established corporations, some of which had done little to enhance shareholder value. The creation of vast amounts of debt led to the unpopularity of the method, although of course debt is not necessarily a bad thing. In fact, it is one way of disciplining incumbent managements through the threat of bankruptcy; in that event, bondholders have first claim on resources.

The most important additional phenomenon that the 1980s generated was the return of the owner-manager to business life. The separation of ownership from control had so developed that managements tended to have very little equity stake in the corporation; they therefore had a much reduced incentive to act in the interests of the owners. Interestingly, Adam Smith had great doubts about the joint-stock company; he thought that only owners would have the incentive to create value precisely because it was their money that was at stake.

However, the highly-leveraged management buyouts created a new class of venture capitalists with a direct stake in the operations they managed. The 'barbarians' eventually became managers themselves. A variant of this was the emergence of firms specialising in buyouts (see, Anders, 1992,). For example, Kohlberg, Kravis and Roberts (KKR) executed some spectacular buyouts in the 1980s (and continue to do so). With its large equity stakes in companies it is able to put in its own expert management teams and closely supervise their activities. Although its involvement in the biggest ever takeover (the \$25 billion buyout of RJR Nabisco) did not turn out to be very successful, this should not distract observers from the real innovations that KKR has made. Additionally the development of the demerger trend (focus on 'core' business) accompanying and facilitating MBO/MBI mechanisms has further accentuated this move such that the distinction between ownership and control is being continually eroded.

The 1980s takeover boom ended in some disarray, largely because of greed,

hubris and the actions of incompetent imitators of the successful methods (see Taylor, 1992). Milken, of course, ended up in prison, though there is now serious doubt about the justice of his convictions (see Barry, 1991, pp. 81–83, Frischel, 1995) and much criticism of the zeal and the dubious methods of his prosecutors. Nevertheless, genuine innovations were made in the 1980s, the importance of which has not been fully recognised in the furore that the events caused.

Other practices that emerged in the 1980s are less conducive to successful business enterprise. A good example in the US is the invention of the ‘poison pill’, which is forbidden under the British takeover code. A poison pill is a special type of stock issued to shareholders in a target company. They are given enhanced rights to sell their shares at favourable prices to the company that effects a takeover. The pill is designed by managements to make a takeover prohibitively expensive. Its use entrenches corporate power. It also enables managements to choose a favoured suitor in a takeover battle because it prevents a straight auction of the company. In 1989 the Delaware courts upheld a poison pill put in place by the management of Time Inc. in order to effect a friendly merger with Warner Brothers, despite a higher offer from Paramount Communications. It was decisions such as this, in addition to some prohibitive legislation from the states, that were instrumental in bringing the 1980s takeover era to an end. There is still some doubt, however, in American corporate law as to whether and when such strategies are legal.

In most cases, poison pills would appear to be against the interests of shareholders. However, occasionally shareholders might approve of one if it is designed to put off a raider who threatens the long-term value of the company. Here managements who promote poison pills and other defensive devices could conceivably be defended on the grounds that they are making genuine business decisions rather than preventing the sale of a company in order to protect their own interests.

‘Greenmail’ has aroused similar economic and ethical controversy. It occurs when a potential raider, who has built up a stake in a company prior to a bid, has his shares bought back at a premium on the understanding that he will not proceed with the bid. Of course, such a premium is not available to other shareholders. The practice is condemnable, in terms of fairness (at least), since one of the major ethical requirements of takeover activity is that all shareholder be treated equally. But it is important to understand who the offender is. It is not the greenmailer; after all, he is simply offering a better price to the shareholders. The real culprits are the managers who load their company with debt to pay greenmail. Justice would require that the board refuse to pay it, and then wait to see what happens.

An equally controversial device is the practice of awarding ‘golden parachutes’ to personnel in the target company who are potentially liable to be displaced in a takeover. These are normally very generous severance packages, which may increase the costs of the deal quite significantly. However, they are not necessarily morally wrong or founded on bad economics. If the board is to fulfil its fiduciary duty of securing the best price for the shareholder then payment of the money is economically justifiable. It makes

the deal possible. Without the prospect of substantial compensation the managerial personnel have a reduced incentive to act in the best interests of the owners. Parachutes have the additional advantage of offering some insurance to firm-specific human capital that might be threatened by a takeover (Ricketts, 1994, p. 257).

A danger would only occur if too many people were offered parachutes or if managers were tempted to initiate non-economic deals just to secure generous payouts. Furthermore it is important that such arrangements are approved by the shareholders.

Gainers, losers and economic society

A perennial question concerns the distribution of income that results from corporate restructuring. Although there is naturally some doubt about the exact figures here, there is a general consensus that the biggest gainers are the shareholders of the target company. They have to be offered a premium to persuade them to part with their shares; sometimes it can be as high as 50% above the current market price. In the takeover wave of the 1980s it has been suggested that, overall, shareholders of target companies gained 30% in value while the shareholders of the acquiring companies realised only 4%. Some research suggests that the latter's gain was zero or even negative. Still, observers favourable to the activity maintain that, over the long-run, shareholders of acquiring companies do gain. It is hard, for example, to imagine that the stockholders of Hanson, a company whose profits derive more from takeovers than internal growth, were unhappy with its performance.

It is also true that financial intermediaries, investment bankers, accountants, lawyers and so on, gain considerably from takeovers and mergers. Indeed, they are perhaps the major targets of the critics of corporate restructuring. It is probably true that some of the takeover activity in the US in the late 1980s was initiated by intermediaries anxious to secure gains from the process rather than by enterprising individuals who had seen a genuine economic opportunity. But this is far from saying that the whole process was irrational. It is also true that the accounting regulations, particularly on goodwill and provisioning for restructuring costs, provided opportunities for enhanced paper value, opportunities now increasingly circumscribed as the regulations are tightened. Like any revolution, the financial one in that decade produced its excesses, but that should not disguise the fact that much of the deal-making of the era, especially in its early stages, was driven by sound economic logic.

The familiar criticism derives as much from a generalised critique of Anglo-American business culture as it does from takeovers themselves. It is undoubtedly heavily legalistic, but it is difficult to see what can be done about this. Business normally takes place between more or less anonymous agents who deal at arms length with each other. And the separation of ownership from control undoubtedly gives a bias towards the takeover mechanism.

Non-legal notions of trust and loyalty seem to have little role to play in the

Anglo-American world, certainly in comparison with Japan. This is perhaps an unfortunate fact of life. But what would be more unfortunate would be to attempt to transplant the Japanese business culture to an environment where it would almost certainly be entirely inappropriate. Such an attempt would undoubtedly be made by the way of regulation and government intervention, which have the well-known adverse side-effects. Differing business cultures develop spontaneously and their evolution is explicable in terms of general social mores. It is hard to imagine Anglo-American shareholders tolerating for very long the way Japanese corporations treat their nominal owners – they rely on high price-earnings driven capital values and are paid very low dividends and deliberately excluded from the business.

But the major question is whether society gains from the typical method of industrial reorganisation in Britain and the US. There is real disagreement here which can only partially be resolved by empirical evidence. Peacock and Bannock (1991) reach the conclusion that it is hard to show that there are real social gains from takeovers. But even they doubt that there are better alternatives. In fact, their argument really turns on the tax and other incentives that make takeovers and mergers more likely. Most commentators on Britain and the US stress the claim that these methods are encouraged by the fact that corporate debt is tax deductible while payment of dividends is not.

It is certainly true that many of the takeovers and mergers in the 1980s were promoted because of the tax advantage of debt financing and the laxer accounting regulations already referred to. Still, it is hard to imagine that this is the only reason they took place. If there are entrepreneurial gains to be made, alert individuals will make them without the lure of tax advantages. Peacock and Bannock are probably right to stress the importance of a more or less neutral tax environment.

The issue almost always turns into a debate about short-termism and the alleged under-investment that occurs because of the supposed myopia of management (which probably does exist) and the similar short-sightedness of the stock market (which probably does not). Institutional investors are especially blamed since they are supposed to be solely concerned with the share price and take no interest in the running of the company. In one sense this is simply an implication of specialisation, an essential feature of a market economy. Managers are hired because they are supposed to be good at handling the assets of a company. But still the owners, especially institutional investors, are blamed for the shortcomings of industry. Apparently, they will not encourage investment and research and development (Hutton, 1994) unless a more or less immediate gain can be predicted; they are apparently responsible for the alleged decline of manufacturing and for the failure to make economic conditions favourable to the training of workers.

Much of this is prejudice and it is doubted even by sceptics of the takeover and merger process (including Peacock and Bannock). In fact, what evidence there is, as well as basic theory, refutes it. A series of short-term decisions, not driven by rational investment criteria, will simply produce poor performance in the long-run; to the ultimate cost of shareholders and managers. Indeed, Jensen (1988, pp. 25–26) quotes reliable evidence that successfully challenges

many of the popular objections. He shows that increased R & D actually leads to a rise in share price, that institutional investors are not associated with hostility to it and that the market in general responds positively to investment news. It is very difficult for the sceptics to explain how the US, the paragon of short-termism, has established such a commanding lead in the computer industry and in other aspects of high technology. They are areas in which the much-vaunted German industrial system has been particularly laggard.

But clearly not everybody gains from the aggressive corporate restructuring with which we are now familiar. Undoubtedly jobs are lost, expectations disappointed, communities disturbed and, from a more technical point of view, some firm-specific human capital may be rendered unemployable. As always, caution is required before a final evaluation can be made. It is probable that the real 'victims' come from the upper ranks of management rather than from workers. It is also true that more unemployment resulted from the inefficient practices of the discredited (and eventually displaced) old corporate structures than from the activities of the raiders. The obvious counter – what would have happened in the absence of takeovers and mergers? – is highly relevant here.

One stricture frequently raised against free market capitalism, its alleged tendency to develop monopolies immune from market discipline, clearly has not emerged from the takeover and merger process. If anything, the corporate reorganisation of the 1980s produced a deconcentration of industry (Jensen, 1988, pp. 22–23). This should have been predicted from the theory of corporate reorganisation. The whole point of the raiders was to break up the sprawling and unwieldy conglomerates that had developed through managerial imperialism in the 1960s and 1970s, to spin off unwanted parts and to realise greater value from the remaining, and now viable, companies. Thus corporate reorganisation was invariably accompanied by strategic divestitures.

Those communitarians worried about the social effects of apparently unbridled individualism have some difficult questions to answer. How could a formally legitimate process like a takeover, which is nevertheless motivated by 'greed', be distinguished from ordinary commercial processes, such as the buying and selling of assets, which goes on every day? Could a rule be devised which clearly distinguished desirable from undesirable business reorganisation? Which 'community' are we to be concerned about: that which is adversely affected by a plant closure due to a takeover or that which will gain from the reallocation of capital that the process produces?

None of this should be taken to be a denial that ethical problems can occur through the sometimes ruthless corporate reorganisation that does take place. It is indeed true that the spokesmen for the process do not address these questions. Its proponents are concerned with efficiency not 'social' justice. There is still, though, a question of ordinary justice, since crime does occasionally occur in takeovers (though not as often as critics suppose). Yet there is some point to the division of intellectual labour that these writers are implicitly creating. The logic of industrial reorganisation is merely different from the rationale of ethical arguments, it does not exclude them. It is indeed a source of serious intellectual error when the critics of current methods of industrial reorganisation confuse efficiency issues with general social welfare arguments.

At the heart of the criticism of the takeover method is a fundamental dispute over the purpose of the corporation. Is it there to maximise shareholder value or to pursue some superficially more worthy aim, such as the well-being of its employees, the good of its customers or the interests of that nebulous entity, 'society'? The answer to this question derives precisely from the scepticism of philosophers like David Hume. The point that he would stress is the we cannot know what the purpose of spontaneously evolving organisations is. Only the conceited rationalist claims to know, in advance of experience, what the aims of organisations should be. But these arrangements are the products of a myriad of human intentions; not one of the actors had an overall structure in mind. From an evolutionary perspective, business organisations emerge in response to the needs of dispersed individuals striving, in Adam Smith's modest description, to 'better themselves'. The maximisation of shareholder value may be the purpose of Anglo-American corporations now but we cannot tell what their aims will be in the future (though it is hard to imagine any that depart too much from this). The imposition of goals and purposes on free individuals by allegedly better-informed rational planners has, of course, produced some of the horrors of the twentieth century.

Still, we have to return to the original question – why do the spontaneously emerging corporate forms in Britain and the US apparently do worse than the rival organisations of Germany and Japan? Why does capital apparently not flow to its highest valued uses, as free market theory predicts? The key word here is 'apparently', for the debate between the different types of capitalism is by no means over. If anything the current state of the argument favours Anglo-American capitalism. Its great virtue is its flexibility and its ability to respond quickly to market change. The fact is that capital does tend eventually to flow to its highest valued uses. The prevailing corporate structures that the takeover movement disturbed were responsible for the impediments to this process.

The more closely-held, and almost impenetrable, industrial structures of countries like Germany are now proving to be rigid and inflexible in the face of rapid change. The same is true of Japan, which is now in the throes of a deep recession. Its virtually fixed and unchangeable industrial structure is undoubtedly prolonging the economic malaise. And flexibility seems to be the key word used by today's business gurus in their advice to economic agents facing the twenty first century.

The board of directors in the American corporate form as the instrument for more effective governance

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A quiet revolution in decision making has taken place in the last ten years in the American corporate governance process. The resulting shift towards the board of directors is just beginning to have effects on corporate performance that by and large will be salutary. But there is already concern that this has gone too far.

While, in the United States, the corporate laws of individual states generally do not explicitly set out the responsibilities of directors,¹ it is agreed in practice that the powers of the board of directors include: selecting, evaluating, compensating and, where necessary, replacing senior executives; oversight of the business; reviewing and, where appropriate, approving and even initiating, objectives, strategies and plans; reviewing the adequacy of compliance with all applicable laws and regulations, including the adoption of appropriate auditing and accounting principles; and, providing advice and counsel to top management.² The corporate community, enforcement agencies and the courts have given, and continue to add, content to these directives. Indeed, the content today is orders of magnitude greater than just a decade ago; it has been pushed into the directors' role by egregious cases of executive failure, and widespread commitment to the position that mismanagement has created inefficiencies to the detriment of the competitive position of American industry. However, at least one area remains largely unexplored and, given the increasing activity of boards, needs further exploration and debate. It is best demonstrated by the following statement:

As a practical matter, the initiation and formulation of major corporate plans and actions must depend in large part on an intimate knowledge of the business of the corporation, and this knowledge is more likely to be possessed by the senior executives than by the Board. Section 3.02 (a)(3) therefore contemplates that while ultimately responsibility for approving major corporate plans and actions is vested in the Board, and the Board also has power to initiate their formulation, in practice these plans and actions will usually be initiated and formulated by the senior executives.³

As guidance for boards accepting greater responsibility for the well being of the enterprise, this doctrine falls short. Whatever role the board chooses for itself regarding major corporate plans and actions, information is the critical input for decision analysis. For example, if initiation of strategic plans requires 'intimate knowledge' of the business, is it true that 'oversight' and 'approval' of those plans do not? If not 'intimate' knowledge, then how much knowledge and what kind of knowledge, and how to obtain it, are real questions with which a board must wrestle. And, should the board ever overrule, or even

¹ See, e.g., De. Gen. Corp. Law Sec. 141 (a) ("The business and affairs of every corporation shall be managed by or under the direction of the board of directors.")

² See The Business Roundtable, *Statement on Corporate Governance and American Competitiveness* (1990); American Law Institute, *Principles of Corporate Governance* (1984) (hereinafter "ALI").

³ ALI, *Principles of Corporate Governance*, at Sec. 3.01 cmt. f.

significantly modify, a management proposal based on management's assertedly 'intimate' knowledge, when the board has less than 'intimate' knowledge?

In this essay, we open a debate on this issue of an emerging role of the board in developing and implementing the corporate strategic plan. While there is no single, optimal scheme for this involvement which applies to all corporations, certain principles are emerging. Even though the scope of board involvement is not unbounded, the board's 'oversight' and 'review' functions do allow for more intrusion in areas which traditionally have been left to management. In this essay, we first outline considerations which help to define the border between board and management authority. We argue that the board should engage in those activities about which enough information may be obtained in order for it to make effective decisions and for which those decisions yield added management efficiency in the company. We then examine strategic planning as an area which lends itself to greater board involvement; and finally we consider compensation policy, which of course is vital to corporate success, as the ultimate area of board responsibility.

The Role of the Board

As asserted by Alfred D. Chandler in his treatise, *The Visible Hand – The Managerial Revolution in American Business*,⁴ the success of American corporations has been due largely to managements capable of marshalling the resources required to operate at a very large scale both efficiently and profitably. The separation of ownership from management made possible these large infusions of capital and the resulting increase in the corporation's scale of operations. To the extent that cost reductions were inherent in larger scale, management aggregated capital and maintained decision rights as to its disposition to attain that scale. And while investors committed their capital, they retained their decision rights inherent in investment liquidity and in the opportunity to determine asset disposition to 'outsiders.'

Even so, management faced only very loose constraints on how it used that capital. As agents for the investors, whose capital funds they solicit, managers should pursue the enhancement of shareholder returns as the basic goal of the enterprise. But we have recognized for more than sixty years, since Berle and Means authored *The Modern Corporation and Private Property* in 1932, that management may serve as agent for itself rather than for investors, utilising the resources of the corporation to increase invulnerability to change, protect jobs, and increase its own compensation. Thus the conundrum has been to develop a system of governance by which to ensure that the personal interests of management – to enhance its own welfare or that of other interested groups – do not win out over increasing shareholder value.

Perhaps that cannot be achieved. A necessary tension exists between managers' prerogative to make decisions while being accountable to share-

⁴ Alfred D. Chandler, Jr., *The Visible Hand* (1977)

holders. The control by management of utilisation of the enterprise's assets is absolute; the governance dilemma involves the means for balancing the opportunity to make utilisation decisions against limits that ensure accountability to the shareholders. For decades, little thought was given to this basic dilemma because management was presumptively able to organize not only the financing and structure of production but itself as well. Management could best do its own strategizing and organize its own incentive and succession systems to discharge its responsibility to investors. When management did not successfully do so, the market for corporate control was expected to 'work' so as to sweep away those who did not perform and replace them with those who would do better just as other markets function regarding the distribution of capital and human services.

But it has become apparent in the United States that the market for corporate control has functioned imperfectly. When management failed to organize resources effectively, often the shareholders – not management – were 'swept away,' first as share prices and then investment funds declined, then as assets were reorganized and share values reduced, and ultimately, sometimes, by bankruptcy. The CEO was the last to go, not the first, when the company failed to achieve its promise. The method for dealing with management misdirection of the 1980s was the tender offer for shares by other corporations (and their managements), which in turn 'swept away' the management but, frequently, also the investors. While such methods did yield efficiencies, transaction costs were high, and in many cases the resulting consolidation remained inefficient because it was motivated by the surviving management's quest for growth and size for its own sake. Buyouts of various forms have certainly been mechanisms for changing management (and boards). But these are blunt, mostly after-the-fact instruments, and we view them not with disdain but as supplements to perhaps a better system, that of effective board governance.

Board governance is nothing more than a process by which the board seeks to assure that managers operate at a high level of efficiency for the shareholders. The role of the board of directors should be to make sure that there is in place a management which makes it unnecessary to resort to emergency measures such as direct shareholder involvement in management change, or increased governmental encroachment into the corporation's internal affairs. Such measures may, from time to time, be adopted or accepted, but not as rescue operations after damage is incurred. The board's responsibility is to direct the available managerial resources to do at least as well as extreme measures – to avoid rescue operations whenever possible. We believe therefore, that the board's role is more than just removing and replacing managers either itself, or by unwanted changes of control, through the variety of means currently in vogue. The question is how much more.

While careful oversight of management decisions is clearly central to a board's duties, the difficult issue is, after asking the hard questions, when should the board advance its own judgement with respect to the ongoing problem-solving activities that constitute management practice. The extreme answers are that, on the one hand, if the board takes a 'hands off' attitude

beyond satisfying itself of management's diligence, it will not prevent management from undertaking self-serving projects not in the interests of investors. On the other hand, by deeply involving itself, the board conditions management to 'supervision' that makes it tentative or 'communal' in making the key risk-taking decisions. Both extremes are unsatisfactory. But, in between, boards should become aware of the costs of going beyond just careful monitoring. The board does not understand in many, if not all, cases the corporation's operational resilience and thus the board could take actions which would prove to have drastic results. For example, when performance reports over six months indicate that operating income has been reduced by half, this could imply to management that seasonal variation has been abnormal, but to the board that the market has collapsed. If the board insists that management cuts production and inventories, but management is correct in its appraisal of the situation, then cutbacks would add to losses. The lack of conceptual grasp, by the board, of the organization's flexibility in reducing costs or in responding to market change may prove to have the effect of replacing adequate with inadequate board management. The basic questions are: does the board have access to the same information on operations as management, and does the board have the capacity to use that information better than management?; and will board involvement in a matter improve overall corporate performance, taking into consideration board-related information costs?

Strategic Planning

The board's function relating to major corporate processes, as we have noted, can be seen to be two dimensional: monitoring the existing plans and policies, and developing new plans and policies. We'll deal with monitoring first.

There is much more economic intelligence both within and outside the corporation that could help the board anticipate whether future operations will fall short of benchmarks in the strategic plan. Changes in capacity utilisation, inventories, and shipments indicate the changing status of operations, and orders, buyer inventories and forecasts of industry sales anticipate changing status of sales. Such data series supplemented by continuous forecasts of costs and prices lead to more accurate assessments of future earnings division by division. The board can go so far as to put itself in the place of an investor and perform discounted cash flow analyses of division operations. If first-year graduate business students can determine whether a corporation's stock value exceeds or falls short of present value cash flow, then so can directors. Such continuing investigation would frame the question whether the company is going to accomplish the plan. Rather than 'how well have we been doing,' the focus is on prospects, either from business on plan, or from change in plan.

Of course, there are limits. If board evaluation of operations descends to the merits of a contract, or of replacing the marketing vice-president, then the board is over the dividing line into the realm of micro-management. And the board is over the line when it takes a position on recurring wildcat strikes at

the Hartford Plant; but not so if it is asking hard questions about management's decision on whether to close Hartford so as to be sure that management has in fact weighed the alternatives.

Turning to the development of the plan, the same type of arguments can be made for reaching further into the process. Strategic plans are now developed by staff of the Chief Executive Officer, after being drafted by senior management in the divisions. The board, or individual members of the board, could work with the division managers on the forecasts and concepts inherent in these plans so that the board would come away with its independent judgement of the likelihood of realisation of each part of the strategic plan. This example of information gathering, beyond listening to presentations, could prevent boards from rationalizing away repeated failures to achieve plan goals by attributing shortfalls to 'unforeseen events.'

Again there must be limits. Although the board can and should vigorously debate and critique the plan in terms of its vision and direction, it cannot write the plan. To do so would be to reduce management's responsibility for carrying out a plan that belongs to the board and not to management. But such involvement in the development of the plan means access by the board to more information; and involves far more understanding of the business than is possible by simply listening to reactions. The board will have to dedicate more time to the development of the plan itself than is now generally the case.

Compensation Policy

By setting strategy and then holding management to it the board would discharge its monitoring function and would remove the excuse that the board was insufficiently informed. The board should not stop there however. Corporate performance depends not only on accountability, but on management motivation for extending operations to the limit of profitability. If the organization is to achieve maximum wealth for its shareholders, incentives must be in place which motivate corporate actors toward that objective. Directors have to align the self-interests of managers and employees with the interests of shareholders. To do so, the board has to develop its management of executive compensation to a greater extent than is found in current practice.

Currently, the practices followed by decision makers in the United States on annual salary and benefit changes (increases) are straightforward. The board compensation committee reviews data provided by a consultant on industry standards (what everyone else is paying), and makes decisions to make more than half the package equal to the industry average salary, and the remainder a bonus and stock award tied to company performance.

This standard-based practice of making awards annually has the result of making CEO compensation the same across the industry. This is certainly the case in industries with low growth rates and uniform corporate size. Pay and performance across corporations is much the same because pay is the same and performance is the same. But the concern is with that corporation among the five large corporations that has the opportunity to break away from the

rest of them to a much higher level of performance and therefore with the creation of an incentive package for that CEO that makes it worthwhile to develop a more ambitious and competitive strategic plan. There should be more compensation tied to company performance in the package. But such performance-based pay requires that the board obtain the information it needs to judge relative performance. If the CEO controls the sources of such information – the accountants, the consultants and the human resources – then boards do not control the process.⁵

As a matter of course, in improving governance, some progress has been made in the United States in tying executive compensation more closely to performance related to that corporation. In the past five years, public concern that executives were receiving too much pay in light of poor corporate performance, together with proxy reform requiring greater executive compensation disclosure, and amendments to the tax code limiting the deductibility of executive compensation, have led to widespread restructuring of executive compensation plans. Changes in plans have led to the inclusion of long-term incentives, *i.e.* options, restricted stock awards, and performance plan stock pay-outs.⁶ Better-performing companies have tended to compensate executives with packages that have more long-term incentives.⁷ But boards should pay managers still more in equity shares and less in cash so that equity represents a substantial portion of the total. It should dismantle existing benefit programs, while avoiding the creation of new ones, that promote management longevity.

Eliminating existing benefit programs and paying managers in stock instead is consistent with the board's imperative. This change is not a radical notion. In the United States, most companies already include a stock-based component in the compensation package. But stock plans should be further refined to motivate the managers to achieve longer term growth and to sharpen their concern for the value added from improved strategies. Stock grants can be programmatic, but with sales restrictions, or even postponement of sales until retirement, so as to focus incentives on the long term.

One important drawback is that share price change with stock market performance is a greater source of variation than share price change with increasing excellence of the company relative to others in that market. Thus

⁵ National Association of Corporate Directors, *Report of the NACD Blue Ribbon Commission on Executive Compensation: Guidelines for Corporate Directors* at vii (1993) (stating that since shareholders are more closely scrutinizing executive compensation decisions, there is a greater need for informed and well-reasoned board actions in compensation).

⁶ See, *e.g.*, KPMG Peat Marwick, *Executive Compensation Practices in Financial Companies* 23 (1995); KPMG Peat Marwick, *Executive Compensation Practices in Manufacturing and Services Companies* 27 (1995).

⁷ In the financial sector, executives at top performing companies in terms of shareholder return receive forty-one percent of their salary in long-term incentives, compared with twenty-three percent for the lowest performing of companies. KPMG Peat Marwick, *Executive Compensation Practices in Financial Companies*, 24. In the manufacturing and service sectors, the highest performing companies offer forty-eight percent of salary in long-term incentives, compared with twenty-seven percent for low performing companies. KPMG Peat Marwick, *Executive Compensation Practices in Manufacturing and Services Companies*, 27.

the value of the incentive package varies widely because of forces outside the purview of management – much of ‘pay’ change is going to be unrelated to ‘performance’ change. Sophisticated instruments can be developed which factor out of stock price movements the co-variance of that share price with the market, and the effects of size of the company relative to average market capitalisation. The remaining ‘appreciation’ of the share price would then relate to changes in the value added of improved management.⁸ This involves offering the director not only shares, but also a ‘hedged’ position in a basket of derivatives, a package that would give pause to many executives and creates complex tax and liquidity problems. But this process should be undertaken.

Stock-based long-term incentives could be supplemented with other returns that link pay with performance. One such method is the ‘economic value added’ approach or ‘EVA,’ which actually could apply to both executives and directors. Under EVA, a corporation’s performance is measured by subtracting a charge for capital employed in the business from net operating profits. The resulting net amount represents the residual income earned on investments of capital and is a measure of value that management brings to the corporation. Bonuses and stock purchase options could be given based on target values of this residual – the more the corporation surpasses a benchmark EVA, the more the bonus and stock options form part of the package.

The traditional compensation package is increasingly viewed as out of place. Not only does it fail to provide performance-linked incentives, but it encourages management to focus on the company itself at the expense of the shareholders. In fact the power of future compensation plans may be in their non-conformance with this orthodox model.

Determining effective compensation calls for real judgement on the part of the board. Just as no plan will cover all companies, no single mix of cash, stock and other forms of compensation will effectively motivate every executive. While shifting the mix of compensation more toward stock and long-term incentives is better practice, a board’s or compensation committee’s deliberative process should take into account unique features of the individual corporation as well as the individual executive’s circumstances. No matter the form of compensation, how directors address the compensation issue implicates their credibility with shareholders. By debating, setting and awarding compensation, directors are in a position to establish their position of accountability to shareholders rather than to managers. For this reason, a deliberative and objective process in establishing compensation and disclosure of compensation practice is critical.

Indeed, the most important element of the process is full disclosure. As Justice Louis Brandeis wrote, ‘Sunlight is the best disinfectant: electric light the most efficient policeman.’ Currently, however, the SEC does require disclosures regarding compensation to a significant degree for executives. The

⁸ For the determinants of stock prices see E.F. Fama and K.R. French, “Permanent and Temporary Components of Stock Prices,” *Journal of Political Economy* 96 (1988) 246–273.

proxy rules render executive compensation transparent so that pay across good and poor performing executives is easily comparable. In the spirit of Brandeis' admonition, the next step is to perform present value cash flow analyses of these awards, and determine whether the direction of change of both compensation and corporate performance is the same.

Finally, the board should begin a full-scale effort to determine whether pay-for-performance compensation systems should be extended from the executive office to the factory floor. Doing so pushes risk and reward downward to managers and employees alike. It is an approach that emphasizes the importance of the individual's contribution to the company's performance, while creating incentives for every corporate actor to contribute to the overall wealth of the enterprise. But extending the basic elements of compensation alignment from managers to the line workers may be close to impossible. Margaret Blair's book, *Ownership and Control*,⁹ and Joseph Blasi and Douglas Kruse's book, *The New Owner*,¹⁰ both describe a variety of means available to make stock performance a part of employee compensation. But the percentage of stock participation has to be so small, to meet worker's liquidity requirements, that aligning worker economic interest and corporate performance becomes lost in the process. It might yet be the board's most important contribution to the enterprise's success but there is a significant amount of experimentation yet to be done to achieve this alignment.

Conclusion

The dividing line for intervention by the board extends beyond hiring and replacing managers and deciding whether to accept changes in control or changes in ownership. Certainly it is the board's responsibility to assure itself by tough questioning that management has been diligent and careful in reaching whatever conclusions it holds concerning the corporation's major plans and actions. The board has to monitor performance of management against the plan using forward-looking indicators of performance so as to forestall misdirection and poor decision making. But we suggest further that there are at least two other areas where boards have yet to become involved in effective procedures: in formulating the strategic plan and in designing compensation plans to provide incentives across the spectrum of corporate personnel to achieve long-term net profitable corporate performance.

A good deal of work is required by boards to develop each corporation's unique information needs for thoughtful board interaction with the executive office on these initiatives. And we still urge caution on intervention. We question, as each key issue for decision making is formulated, whether the board will have the information and capacity to decide as effectively as would management. We do not intend to see the focus of power shift so far over to

⁹ Margaret M. Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Brookings 1995)

¹⁰ Joseph R. Blasi & Douglas L. Kruse, *The New Owners* (Harper Business 1991)

the board that it discourages management from taking responsibility. We question whether the current shift of the initiative to the board has gone that far.

The novelists's view of the market economy

Allan Massie

This is an abridged version of the 1987 Hume Lecture, given by Allan Massie, the text of which was published as Hume Occasional Paper No 7.

Why do so many of our novelists seem to have felt such hostility towards the market economy? Or, if you like, why did they get it so wrong?

Some historians and journalists of course agreed with them. Others got it right, I think we can say, seeing that catastrophe hasn't taken place, and seems indeed to have been postponed indefinitely, and seeing that on the whole, with the odd hiccup here and there, the market goes on delivering the goods.

A.J.P. Taylor wrote:

'Literature, according to historical convention, reflects contemporary life and reveals its spirit . . . To judge from all leading writers, the barbarians were breaking in. The writers were almost alone in feeling like this, and it is not easy to understand why they thus cut themselves off . . . By any more prosaic standard this was the best time mankind, or at any rate Englishmen, had known'.

So how do we try to understand this which is not easy to understand? George Watson attributes the lack of interest shown by writers of the thirties in Keynesian ideas of reform, or any other, to 'some deep ideological prejudice'.

But this can only be true up to a point. What caused the prejudice? Why did so many bourgeois individualists spit on the world that nurtured them? After all, the novelist is a property owner himself; his novels are his copyright; and it's noticeable that novelists, whatever their family background, tend, if they have any success at all, to come to live middle-class lives. And the market sustains them. It has, ever since it got going two hundred years ago, made many of them rich. Scott made a fortune by writing, lost it in the Ballantyne publishing business, and retrieved his position by his pen. Dickens was a fantastic success; George Eliot got £7,000 for *Romola*, the copyright reverting to her after six years, and some £9,000 for *Middlemarch*, equivalent to six-figure sums today. And so on: if the picture of the novelist starving in a garret is true to life, so is the picture of a successful one, wallowing in the stuff. Maugham lived in the greatest style in the Villa Mauresque; *Forbes Magazine* regularly lists novelists among new millionaires; Norman Mailer has to make – what is it? – three-quarters of a million dollars a year to pay alimony and school fees, and succeeds in doing so; and we all know that, according to the former Deputy Chairman (now Lord Archer) of the Conservative Party, the

shortest way from the dole queue to great wealth is by the writing-desk, and countless chat shows and signing sessions.

Of course many novelists are aggrieved property owners. They feel cheated and obstructed by publishers. Their title to their property too often seems merely nominal. They suffer from dilatory payments, unfair competition from public libraries, hack reviewers – in how many other businesses are products routinely reviled – and so on. But I think it is going too far to explain the critical attitude to the market economy, which I have endeavoured to trace, by this sort of stuff.

It is more tempting to attribute it to the nature of bourgeois society itself. Certainly novelists have poured scorn on its characteristic faults. They have suffered – or many believe they have suffered – from its Philistinism. It has been exposed by Flaubert and Henry James, for example. And that there is something in this, I don't doubt. All artists have felt themselves in some way outcasts, Ishmaels viewed with suspicion by the *douce bourgeois*; and, like many exiles, they have turned bitter.

There is some truth in this, but it won't do. You come back for instance to Dickens. Why was he, whom the market loved, so critical of the market economy?

I think there are two reasons and they both relate to the novel rather than the novelists. First, as I have said, the novel is an opposition art. It is, inevitably among other things, a criticism of society and the way we live now. In a market economy, it will criticise that. It may even advocate or seem to advocate a reform of society which the novelist himself would find uncomfortable if he had to experience it. But in such a society – in the Soviet Union – what does the novelist do? Why, he speaks up for individualism, or religion, and, if he can get away with it, he criticises, pillories, the state. In the market economy he draws attention to the distortions and cruelties of the market; in a collectivist one, to the absence of markets, that is, of choice.

And the second reason is that the novel is by its nature a humane art. The novelist devotes himself to trying to breathe life into imaginary creations. He writes of the bonds and discords between human beings. The novel has a horror of the abstract, and the novel deals with the details of individual life.

Now the market is concrete enough in its effects, but it is also abstract and rarefied. It deals in long periods of time and wide swathes of country. Its morality is claimed, but is not always apparent. Adam Smith tells us that enlightened self-interest will work for the general good; he points to the importance of sympathetic association as softening the hardship of economic laws. But I think it is fair to say that market economics is prepared to take a grand philosophical view of human life: one man's loss may indeed be another man's gain, and some must suffer that others – and eventually – society as a whole may grow rich. But the novel tells of individual people and the effect of experience on them; and that alas is often horrible.

Market economists can pretend that man is only an economic animal, just as some political enthusiasts would have us believe he is an altogether political one. Society depends on the creation of wealth, but it depends on other things too, and sometimes the creation of wealth may make it impossible for these

other things – human sympathy, love, the religious sense, art and beauty – to flourish. And the effect of wealth on the individual and those he lives among is not always either admirable or pretty. These are things that novelists are concerned to point out.

Finally, if I may end on a personal note, which may sum up my argument: I work as both a journalist and a novelist, writing among other things a column about public life in a Sunday paper. These two activities can be harmonised, but they are nevertheless inconsistent. Let me give a hypothetical example. The sacred cow of Scotland is Ravenscraig. Now it may be that the market economy will work in such a way that Ravenscraig becomes an insupportable burden, and that a decision would be taken to close it. Writing my column I could justify and probably support that decision. All businesses have a natural life, and when this is artificially prolonged, they can only be maintained at the expense of other enterprises. But writing a novel I would be on the side of the steelworkers: I would be aware of the human suffering, of the despair men would feel who knew that they might never work again, of families who saw their way of life, to which they were attached by habit, cruelly uprooted.

This is why the relationship between the market economy and the novel can never be other than uneasy. The first is utilitarian; the second poses the questions 'What is happiness? What is right conduct? What is the end of life?' It is aware that the creation of wealth involves destruction of something else. This is also why the market economy needs novelists and other artists: to remind people that there is more than one kind of wealth, more too than one kind of impoverishment.

Hume Publications

One of the main means of fulfilling the objects of the Institute is its publications. Since 1985, these have numbered some 80 titles in all. The Institute's publications programme has been reinforced by eight Hume Lectures, three Presidential Addresses, eight major conferences and over a dozen seminars, lectures and symposia.

The **Hume Papers** series, superseded in 1990 by **Hume Papers on Public Policy**, published as a quarterly journal by Edinburgh University Press, presents the results of original research in plain language. The **Hume Occasional Papers** are shorter pieces, including the texts of lectures organised by the Institute. From time to time reprints and specially commissioned volumes are published. Subscribers to the Institute receive free copies of regular publications as they are produced. In 1996 a new series, **Hume Monographs**, is to be introduced, for longer pieces on topical public policy questions, and changes are to be made to the process of commissioning papers for **Hume Papers on Public Policy**. Editors for **Hume Monographs** and **Hume Papers on Public Policy** are Professors Hector MacQueen and Brian Main.

The following section contains brief notes and commentaries on a variety of Hume publications, from 1988 to 1995. A full list of publications, some now out of print, is produced for the record, at the end of the section. Further details and prices together with information for potential contributors to **Hume Papers on Public Policy** can be obtained from the Institute's office.

Sex Equality: Law and Economics

Hume Papers on Public Policy Vol 1 No 1 (1993)

edited by Hector MacQueen with four other contributors

What exactly are equality and inequality between the sexes? Do lawyers and legislators differ from economists in their understanding of what constitutes discrimination? If there is inequality, is it a matter of market failure where rectifying intervention is required? How effective or worthwhile an instrument of social policy has the law been? What is the role of the European Community in these matters? – a question rendered particularly pertinent in Britain by the debate over the Social Chapter of the Treaty of Maastricht. The contributors express divergent views on these matters and their views serve to show how difficult the determination of policy in this area is and will continue to be.

Money Laundering

Hume Papers on Public Policy Vol 1 No 2 (1993)

edited by Hector MacQueen from the proceedings of a Hume Conference in 1992

Money laundering evokes conflicting responses: the public interest in ensuring that wrongdoers are not allowed to enjoy the proceeds of their activities, but on the other hand, the increasing risk to all those in the 'money' business that they might lay themselves open to criminal sanctions as a result of ever tighter controls. A distinguished team of experts from law, banking and finance sets out the likely effects of legislation which is due to extend the scope of money laundering offences still further and offers a perspective on the extent and limitations of regulation for the future.

Scotland and the Union

Hume Papers on Public Policy Vol 2 No 2 (1994)

edited by Patrick S Hodge with eight other contributors

The United Kingdom has come under increasing strain as a single political unit and some change in the structure of the country is likely, particularly if further political integration of the European Union occurs. The coverage by the Scottish-based media of the arguments on the future government of Scotland has not been informative. This book seeks to contribute to an open and informed debate. In a series of essays which call for clear heads as much as brave hearts a team of writers involving an industrialist, economists, a lawyer, a diplomat, historians and a journalist set out the case for the continuance of the Anglo-Scottish Union of 1707. The book is not an uncritical apologia for the status quo. It argues that the cost of independence is likely to outweigh the benefits and that Scotland's interests, both economic and cultural, are better pursued in the wider British and European contexts.

The Small Entrepreneurial Firm

Hume Paper No 8 (1988)

by Gavin C Reid and Lowell R Jacobsen

In the days when 'enterprise' has become the watchword of Governments, they lavish much attention on the small entrepreneurial firm (SEF). In Britain alone the count of government measures to assist small firms runs to four columns of Hansard. Although much has been written on policies towards SEFs, this paper is unique in giving a 'firm's eye view' of these policies and how they bear on the struggle of SEFs to gain entry into highly competitive markets. A special feature of the paper is an in-depth analysis of the relation between SEFs and Enterprise Trusts. This analysis is then used to offer an original critique of current (*at the time*) policy measures. 'It seems to us that insufficient attention has been given to the efficacy of a hands on approach by private agencies, of which the Enterprise Trusts (ETs) provide one obvious example. The counter-arguments offered seem weak: the suggestion is that such services could be privately provided, but that they are time-intensive services because the provider has to have such a detailed knowledge of the requirements and position

of the business he advises. This type of understanding is far more likely to be present in the ETs who have rich local information. Furthermore they are manned by businessmen, who have experience of market conditions.'

Student Loans: The Next Steps
Hume Paper No 15 (1989)
by Nicholas Barr

Dr Barr writes: 'Everything in the book has stood the test of time. The only change is that, at the time of writing (1989) the participation rate in higher education was 14% whereas today it is 30%. At the time of writing, therefore, the key aims were improved access and expansion; today, now that expansion has taken place, the aims are improved access and the maintenance/improvement of quality.

'The aims of higher education policy should be to improve access and to enable the system to expand. The strategy for achieving these aims without any increase in public spending has two legs.

- Start-up funds should come from the private sector, and the savings in public expenditure, at least through the 1990s, used to expand the system; this contributes to access on the supply side.
- Loans with income-related payments will not discourage applications, thus addressing access on the demand side. Other policies include additional assistance for 16–19 year-olds and the phasing out of the parental contribution.

Loans with repayment related to the student's subsequent income can be organised via income tax or National Insurance contributions, and can take the form of a loan or graduate tax. The proposal (here) is for a genuine loan scheme (i.e. one in which no-one repays more than they have borrowed), with repayment collected by employers through the National Insurance system.'

The Remuneration Committee as an Instrument of Corporate Governance

Hume Occasional Paper No 35 (1992)

by Brian G M Main and James Johnston

Appearing shortly before the publication of the famous Cadbury report, this paper takes a careful look at the institutional arrangements that influenced the determination of top executive pay in large British public companies in 1990. Since its publication, this paper has been widely cited – sometimes even to boost a board's argument against the establishment of a remuneration committee! The Greenbury Committee has recently attempted to move the governance of top executive pay forward by being considerably more directive in the area of board sub-committee structures and procedures. In this context, the final sentences of the paper are worth quoting:

'Remuneration Committees . . . can only operate in the shareholders' interests if there is available a sufficiency in quantity and quality of outside directors on the

Board. This makes the selection and election process for outside directors of crucial importance. The nomination process, as it is sometimes known, currently rests almost entirely in the gift of the incumbent management. This is one area in which reform is necessary before any meaningful upheaval in corporate governance can become a reality. Simply grafting on an additional Board subcommittee will of itself do little either for the disciplines of top executive pay or for corporate governance in general.'

On the Wrong Tracks: Railhead Revisited **Updated views on The Government's Proposal for Franchising Passenger Rail,** **Hume Occasional Paper No 40 (1993)**

by Antony W Dnes

The privatization of the railways can encourage cost efficiency and improved responsiveness to travellers' needs. However, current plans are over-influenced by public finance considerations. Briefly, a newly created public enterprise, Railtrack, provides the railway infrastructure and is also responsible for timetabling. Access to routes ('railpaths') is being sold off with private companies competing for around thirty operating franchises for passenger services.

In rare cases like the East Coast InterCity line where a rail route is profitable, an operating franchise will be auctioned to the highest bidder in terms of an annual rental fee to be paid to Railtrack. Unfortunately, 'rental' franchising leads operators to seek profits at the expense of travellers. As long as firms pay franchise fees, fares must be higher than if they only faced cost-driven access charges from Railtrack. The best way to offer the greatest fee is to keep fares as high as competition allows, although obviously Railtrack would draw off most of the profits. Rental bidding might benefit the taxpayer if there were an increase in profits going to the Exchequer compared with operations by British Rail.

Most routes are not profitable and franchises will be awarded to companies offering to accept the lowest annual subsidy. Rather than aiming to minimise public subsidy as an end in its own right, we should be looking to maximise the surplus of passenger benefits over costs. An estimate of the value of benefits (social and environmental) attached to rail routes, explicitly valued, could form a basis for passenger subsidy.

A franchising scheme for passenger rail needs the contract-management approach first proposed by Sir Edwin Chadwick in 1859. Chadwick's franchising procedure periodically auctions routes in terms of the lowest price an operator would charge for a ticket. A minimum acceptable quality of service would be specified and environmental subsidies conferred where appropriate. Bidders would compete in terms of the prices they would charge for the service, after receipt of subsidy. The scheme would still raise revenue for the Exchequer owing to cost-based charges levied by Railtrack. The bidding over price removed any need for price capping. Current evidence from studies of auctions suggests that three or more bidders would give adequate competition.

Problems over the possible short investment-planning horizon implied by

fixed-term franchise contracts need to be overcome by devising rules for transferring long-lived assets between incoming and outgoing franchisees. A further concern is that separate franchises will fail to run a sufficiently integrated ticketing system. One solution to this would be the creation of a ticketing company selling its services to franchisees.

The privatization of passenger rail is a sensible step in a world where there is considerable evidence of the superior cost efficiency of private enterprise and where innovation is required. Two years into the privatization of passenger rail, events still make me think that it can be put on the right track by adopting Chadwick's bidding scheme.

Scotland's Housing? A systems solution

Updated views on A Flexible Housing System for the Global Market by Sir James Mellon, Hume Lecture 1994, published as Occasional Paper No 45 (1994)

The housing problem which Scotland faces is not an output problem. We have more houses than households. The problem is a systems problem. We need a flexible housing system that will allow us to respond to the needs of the new context. The new context for our jobs, education and social welfare, is the Global Market. We need a housing system that can respond flexibly to the requirements of that new context.

Our present housing system has neglected the overall context and regularly produced very expensive failures in the public sector, because its housing took little account of the context of jobs, education and social welfare. The housing problems of Scotland in the 1990s and beyond will not be solved by *allocating* people to nice, semi-detached houses if the housing does not relate to *their* requirements and wishes for jobs, education and social welfare.

Examples of deprivation in Scotland due to loss of industries can be found in rural as well as urban areas. But most of our deprivation is housing-led. Moreover, given the present housing system, a national increase in wealth and employment would not be enough to remove the blight of deprivation.

The Single Market is already being felt in Scotland. Competition acts through the whole of the Market. Gearing yourself for competition has to be in terms of attracting investment and jobs against all the potential suppliers in the European Union and beyond. Housing is only one part of your competitive strategy. Before you start on the individual parts of that strategy, you need a sense of where you are going. It is no use asking for better housing for Castlemilk unless you know why Glasgow needs Castlemilk, and therefore what Glasgow is going to be like, and what Glasgow is for. Councillor Pat Lally has concluded that he has to have a "Vision for Glasgow". He is right. There are a dozen Councils in Scotland seeking a coherent strategy for jobs, education, social life, attractiveness to investors, their ability to hold onto good labour, to motivate and encourage people who are born and have their lives in their area. Without this, to deal in housing alone, is a waste of resources – an insufficient solution. Worse still, if the present inflexible housing system persists it will deprive more and more people of the chance to participate in the wealth and benefits created by the world economy. It will segregate and

exclude them from the rest of society. For the sake of a just as well as an efficient society the aim has to be to produce a flexible housing system for Scotland in the Global Market.

The Rôle of Law in the Rule of Law

Commentary by David A O Edward on his Presidential Address, November 1993, published as Occasional Paper No 42 (1993)

It is paradoxical that those who boast most loudly that we live under the Rule of Law are frequently those least disposed to accept the logical corollary of that boast that the Rule of Law must mean, in some sense and to some extent, the Rule of Judges. The boast that official power (state power) can be exercised only within legal limits is a hollow one if you are not prepared to make the exercise of power justiciable. If you feel that it is morally superior, as well as politically more acceptable, that the Rule of Law should be a principle of government, you must ask yourself to what extent you are prepared to accept the justiciability of issues that have political, social and economic implications. Outside the context of the debate about a Bill of Rights, that is a question that is too little asked by people in this country.

The role of courts has, or should have, something to do with the realities of democracy. The citizen expects more of democracy than that he be permitted the occasional opportunity to give *carte blanche* to others to shape his destiny. And I think the citizen is increasingly aware that, in truth, it is not those whom he elects who exercise the greatest power in shaping his destiny.

I do not wish to claim for courts and judges more than they deserve, or more than they can deliver. "Natural justice" rules correspond to the expectation of the ordinary citizen. They do so in two, often contradictory ways: first, in satisfying the demand for rationality, predictability and fairness, as opposed to arbitrariness, in the exercise of power; second, in responding to the need to believe, in a free society, that the truth will out and justice will be done.

If the Rule of Law responds, in some rather ill-defined way, to the citizen's expectations about freedom and democracy, it does so because judges and what they do are a necessary part of the structure of a free society – not simply in repressing crime and arbitrating the private disputes of citizens – but in defining the limits of power and its exercise, and, to some extent, regulating the balance of power between the institutions of the state.

The judiciary, like all other institutions, needs checks and balances to temper its power. Cases reach courts because litigants – or at any rate, people other than judges – bring them there. It is the litigant who identifies the abuse of power and calls for it to be restrained. It is the litigant dissatisfied with the lame bureaucratic excuse who calls for a proper explanation. It is the litigant, refusing to lie down under political pressure or administrative high-handedness, who makes a nuisance of himself and goads his lawyer into action.

If and insofar as the Rule of Law is the Rule of Judges, it is the rule of judges prompted and incited by those who believe, however wrongheadedly, that they have a cause to try. For our part, as judges, it behoves us to be modest about the extent to which we do more than respond to the democratic demand of the

citizen to be heard. We are the guardians of rights and the arbiters of power only so far, and for so long, as the citizen, by legal process, invites us to be so.

**Copyright, Competition and Industrial Design
Hume Papers on Public Policy Vol 3 No 2 (1995)**

Hector L MacQueen

The first edition of this work appeared in 1989 and was essentially an explanation and critique of the provisions on the protection of industrial designs contained in the Copyright Designs and Patents Act 1988. A second edition has been prompted by the appearance of European Commission proposals for the protection of designs, and the sometimes controversial case law on the British legislation since 1989. The technical discussion is set against a background of the general considerations currently affecting intellectual property law, in particular its relationship with competition law. It is argued that in exceptional circumstances it is appropriate to bring competition considerations to bear upon intellectual property rights, since the principle economic justification for such rights is the public interest in competition by innovation and creative activity. Where intellectual property in fact stifles rather than facilitates such activity, control is legitimate and necessary. Further, the scope of intellectual property and its role in a market economy is always in need of supervision and review, to ensure that its goals continue to be achieved.

Publications: 1985–1995

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Peter Sloane
- 4 The European Communities' Common Fisheries Policy: A Critique
Antony W Dnes
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- 43 The Costs of Justice *Hector L. MacQueen*
- 44 A Future for the Past: The Political Economy of Heritage *Alan Peacock*
- 45 A Flexible Housing System for the Global Market *Sir James Mellon*
- 46 UN Peacekeeping: Past Lessons and Future Prospects *Malcolm Rifkind*

Books

- The Deregulation of Financial Markets
edited by Richard Dale, Woodhead-Faulkner, London, 1986
- Governments and Small Business
Graham Bannock and Alan Peacock, Paul Chapman, London, 1989
- Corporate Takeovers and the Public Interest
Graham Bannock and Alan Peacock, Aberdeen University Press, 1991
- Social Policies in the Transition to a Market Economy: Report of a Mission to the Russian Federation organised by the United Nations January 1992
Michael Hay and Alan Peacock, Alden Press, Oxford, 1992

Hume Reprints

- 1 The 'Politics' of Investigating Broadcasting Finance *Alan Peacock*
- 2 Spontaneous Order and the Rule of Law *Neil MacCormick*
- 3 Governance and Accountability: Corporate Governance *J.C. Shaw*

Finances and Programme

The activities of The David Hume Institute could not and cannot continue without appropriate financial support. During its first decade such support has been forthcoming in the form of subscriptions, both corporate and individual, substantial and generous donations from various institutions, trusts and other benefactors, and grants and occasional sponsorship in respect of particular activities, most notably the Joseph Rowntree Foundation, the Esmée Fairbairn Charitable Trust and the Binks Trust. The Bank of Scotland, celebrating its own tercentenary this year, has generously provided the funds for this anniversary publication.

The Trustees would like to record their gratitude also to the following individuals, trusts and other organisations which have provided major grants and sponsorship to support the Institute's activities during the first decade.

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While current reserves are sufficient today, a regular annual income of £65,000 is targetted to support the planned level of activity. Income at present oscillates around £45,000 per annum but is largely dependent on donations; this means that the subscription income must be increased substantially.

On the occasion of its tenth anniversary the Institute is seeking to raise its public profile and build upon the work to date. In order to extend its programme, as shown below, more potential supporters need to be both made

aware of its existence and encouraged to take out a subscription or to provide other forms of financial backing.

Information about subscription rates and benefits can be found in the enclosed leaflet or obtained from The Secretary, The David Hume Institute. The Directors are always pleased to discuss specific research interests with potential sponsors.

Programme summary 1995–1997

This Programme (shown here in summary form, without costs) has been agreed after considerable discussion and represents an attempt to marry the benefits of opportunism (a distinguished speaker on a topic of immediate relevance to public policy happens to have a spare afternoon in Edinburgh) with the more lasting influence of well-planned and well-advertised lectures and conferences linked to a prestigious journal, a monograph series and occasional papers. The Trustees, obviously, seek to optimise gains from their efforts and from the amount they spend. Thus the contents of each publication should be brought to the attention, not only of subscribers, but to a wider audience, especially young people, through the media and through the Institute's own special efforts.

The Institute does not employ research staff but relies on a vast range of contacts and influence to engage the competence to address public policy issues, in collaboration with, or on behalf of, sponsors or others. Research topics shown in the Programme reflect the interests and experience of leaders of research for The David Hume Institute and their commitment to the pursuit of their ideas.

The notion of a special Student Programme is intended to focus opportunities arising from new technology – desk-top publishing with graphics, colour printing, the Internet – and harness these to provide young people with soundly-based and clearly-stated ideas and analysis of public policy matters.

1995

PUBLICATIONS

Hume Papers on Public Policy. Quarterly journal edited by Hector MacQueen, published by Edinburgh University Press

Volume 3 No 1 Managing Doctors; Bruce and Hill

No 2 Copyright, Competition and Industrial Design; MacQueen

No 3 Deregulation and Privatization in the USA; MacAvoy et al.

No 4 Corporate Governance II (in hand)

Occasional Paper: UN Peacekeeping, text of lecture by Malcolm Rifkind

Monograph Series: titles for 1996 under discussion

The David Hume Institute: The First Decade. Eds. Kuenssberg and Lomas

Special publication of Hume letters: Well temper'd eloquence; Merikoski

CONFERENCES, SEMINARS AND OTHER EVENTS

Managing Doctors seminar at Glasgow Caledonian University

The Price of Ignorance 1995 Hume Lecture, Sir Stewart Sutherland, Edinburgh University

Tenth Anniversary Subscription Dinner, the Bank of Scotland

RESEARCH AND DEVELOPMENT

Negotiation for Internet Home Page as preparation to Student Programme; production of future programme and research proposals.

1996

PUBLICATIONS

Hume Papers on Public Policy. Edited by Brian Main and Hector MacQueen, published by Edinburgh University Press

Volume 4, Nos. 1–4. To include Regulation of Chemical Weapons; Access to Justice; Franchising Water and Sewage; Economics and law of fisheries.

Procedure for inviting submissions is to be amended; potential contributors should contact the Editors.

Hume Monograph Series: three issues

Occasional Papers: as appropriate

Student Briefing Notes: two issues. Briefing Notes will identify main issues and arguments and present them in a form suitable for undergraduates. Notes will be based on topics addressed in 1995 Hume Papers on Public Policy.

CONFERENCES, SEMINARS AND OTHER EVENTS

Mergers Policy. Seminar by John Bridgeman, Office of Fair Trading

Presidential Address. Sir Samuel Brittan, The Financial Times

Global Finance. Lecture to be arranged

Competitiveness. Colloquium to be arranged

RESEARCH AND DEVELOPMENT (subject to funds)

Measures of Economic Performance, Peacock and others

Legal Control of Ideas, MacQueen, Elliot and others

Implement and monitor Student Programme

1997

PUBLICATIONS

Hume Papers on Public Policy

Volume 5, Nos. 1–4. To include papers on Economic Performance Measures and Control of Ideas resulting from Hume research projects, as well as papers submitted by outside contributors.

Hume Monograph Series: four issues

Occasional Papers: as required

Student Briefing Notes: three issues

CONFERENCES, SEMINARS AND OTHER EVENTS

Major conference, subject to be decided early 1996.

1997 Hume Lecture

RESEARCH AND DEVELOPMENT (subject to funds)

Tertiary Education: Organisation and Finance Shaw and others

Contributors

- Norman Barry** Political theorist and writer on political economy, politics and ethics: Professor of Politics, University of Buckingham
- James M. Buchanan** Professor of Economics and Director of Centre of Study of Civic Choice, George Mason University: Nobel Laureate in Economics
- David A.O. Edward** Judge of the Court of Justice of the European Communities: Honorary Professor, University of Edinburgh
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- George J. Stigler** Former Professor of Economics, University of Chicago: Past President, American Economic Association: Nobel Laureate in Economics, (*deceased*)

THE DAVID HUME INSTITUTE THE FIRST DECADE

Edited by Nick Kuenssberg & Gillian Lomas

This anniversary volume celebrates the first ten years of The David Hume Institute. The conception, the birth, the history and the activities of the Institute are reviewed and supplemented with commentaries and essays from a wide-ranging group of contributors. New writings include some thoughtful and thought-provoking articles from Norman Barry, James Buchanan, Thijmen Koopmans, Paul MacAvoy and Andrew Skinner.

The David Hume Institute is an independent non-political organisation aiming to promote discourse and research on economic and legal aspects of public policy questions. The Institute was registered in January 1985 as a company limited by guarantee: its registration number in Scotland is 91239. It is recognised as a charity by the Inland Revenue.

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