

## The significance of Economic History and the Fundamental Features of the Economic History of Iran

Homa Katouzian<sup>1</sup>

*St Antony's College, Oxford University, Oxford, United Kingdom*

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### ABSTRACT

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Social history is the mother of the social sciences. Economic history and the history of political economy are useful and respectable academic pursuits in their own right, just as history itself is one of the most important fields of learning and scholarship in every civilized country. Not every economist, sociologist or political scientist has to be a historian, but their work is meaningful, realistic and relevant to the extent that it is conducted against the appropriate social background and reality, which history, its logic and its sociology can provide, on the condition that these too are constructed on a realistic and relevant plain. This does not mean that every economist must be an economic historian or a sociologist. It means that economic studies, whether theoretical or empirical, whether as an academic pursuit or as a policy prescription, must have in the background the history and social framework to which they refer. So, the rules of social and economic behavior, public and private economic decision making can be, and often are, very different from the assumptions of models which are based on theories of European society and economy, irrespective of the ideology or paradigm to which they refer.

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### 1. Introduction

Just as natural history is the mother of the biological sciences, social history is the mother of the social sciences. Classical political economy was developed in a dynamic era, a period of European history where a series of long-term social developments were approaching their peak in the French Revolution and the Industrial Revolution of England. It is not at all surprising that Adam Smith and David Hume spent time with the French

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<sup>1</sup> . E-mail address: [homa.katouzian@sant.ox.ac.uk](mailto:homa.katouzian@sant.ox.ac.uk)

Physiocrats, notably Quesnay and Turgot, and with the French *philosophes*, especially though not exclusively Voltaire and Rousseau (Katouzian, 1977).

It was precisely the dynamic quality of the era that led economic and social and political theorists alike to look into the nature and causes of change, and therefore regard history as a principal source of the foundations of their knowledge. A similar process was taking place, but more slowly, among biologists who were trying to discover the nature of life and the origin of species, and the causes of long-term biological changes through time. Darwinism was in fact the end, not the beginning, of this process. It was through the historical as well as empirical approach that Adam Smith formulated his critique of feudal society and structures and attacked protectionist policies which he described as “the policy of Europe” (Katouzian, 1961).

Not every economist, sociologist or political scientist has to be a historian, but their work is meaningful, realistic and relevant to the extent that it is conducted against the appropriate social background and reality, which history, its logic and its sociology can provide, on the condition that these too are constructed on a realistic and relevant plain.

## **2. History of political economy**

Throughout the century or so in which classical political economy or economics developed – roughly from 1770 to the 1870 – history was in evidence, either explicitly or tacitly as the background to contemporary economic analysis. Even Ricardo who evidently was not much in command of historical knowledge, used historical concepts and categories created by others - but particularly Adam Smith - before him. Not only James Mill, close friend of both Jeremy Bentham and David Ricardo, but the less well-known, though not less intelligent, Richard Jones made comparative studies of Indian economy and society and helped to clarify the social and historical features which had been known before them as Oriental Despotism, and which Marx and Engels after them defined as the Asiatic Mode of

Production.<sup>1</sup> The process of mixing history and analysis, or rather theorising with a firm grasp of history and historical evidence reached its peak in the work of Marx, who may be regarded as the last of the great classical economists.

It is not surprising that in the late nineteenth century neo-classical economic theory and method emerged as a more-or-less alternative approach to classical political economy. For by then a new era had been established, the era of democracy, industry and empire. The new era presented fresh problems that needed to be sorted out, now that the process of long-term accumulation of capital and the role of social classes in economic change had been studied, and a satisfactory solution for the transformation of values into prices had not been found. There was need for a modern theory of the firm, of price and wage determination, of interaction of markets, of international trade. In other words the time had come for the static conditions of the mature industrial capitalist system – rather than the dynamics of its emergence - to be studied in detail. Both the magnificent dynamics and the aggregate economic analysis of classical economics were thus pushed aside, and with them history began to fade out of sight.

But the neo-classical system was not quite established without an argument, especially as regarded the significance of history in general and economic history in particular. In a formal debate on the general methodological problems and issues of economic and social theories, for example, Cunningham, the English historian, pointed out that:

Economic ‘generalizations’ must necessarily be relative to a given form of civilization and a given stage of historical development. This according to Mr. John Stuart Mill ‘is what no political economist would deny’...we have to thank the Comtist criticism for forcing us to remember that the material

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<sup>1</sup>. See, for example, Homa Katouzian, *Iranian History and Politics* (London and New York, 2003), chapter 1; Katouzian *Ideology and Method in Economics*, (London and New York, 1980), chapter 2; Katouzian, *The Political Economy of Modern Iran*, chapter 2; James Mill, *The History of India* (London, 1977). Richard Jones later received a round of applause from Marx (in contrast to Ricardo) for his emphasis on the significance of historical evidence for economic analysis. See Karl Marx, *Theories of Surplus Value*, (Moscow, 1968) 2: 399-403.

truth of economic principles depends on complicated social conditions, and that they have no independent validity'.<sup>1</sup>

The debate continued but, outside of the Marxist framework, it became more focussed on the abstract nature of neo-classical theory, and less on the question of social and economic dynamics or on the view that any social and economic theory was valid only for the stage of history to which it referred. Thus, a leading economic historian of the early twentieth century criticised the 'empty economic boxes', meaning models and theories which had little correspondence with empirical reality.

Yet this was long before economic theory became almost the same as mathematical economics. Leon Walras was an early neoclassical economist who virtually founded mathematical economics by presenting his general equilibrium model based on simultaneous equations. But it was the partial-equilibrium approach, which was most influential from its foundation until after World War II. This was the product of the Austrian school – of Menger, Böhm-Bawerk and Wiesser – and especially the Cambridge school – led by Alfred Marshall. Marshall and his pupil Keynes were both trained mathematicians but neither of them set much store by general equilibrium analysis and both of them explicitly rejected extensive use of mathematics in economic theory, explaining that it would divert attention from problems of the real world.<sup>2</sup>

Nevertheless, after the Second World War mathematical economics rapidly expanded and became fashionable so much so that by 1980 it had become virtually identical with economic theory itself. That is to say, in most cases, mathematical economics began to mean economic theory, and economic theory, mathematical economics. A common complaint of the

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<sup>1</sup>. Quoted in Katouzian, *Ideology and Method*: 34, and cited in R. L. Smyth, ed., *Essays in Economic Method* (London, 1962). The idea was of course not very novel. In particular it had been anticipated by Vico, Herder and Michelet. See Isaiah Berlin, "Historical Inevitability" in his *Four Essays on Liberty* (London, 1969). See also Berlin's *Vico and Herder* (London, 1975) and *The Hedgehog and the Fox* (London, 1988). See further, J. A. Schumpeter, *Economic Doctrine and Method* (London, 1954).

<sup>2</sup>. Numerous sources may be cited for this but it is clearly argued both in Marshall's *Principles of Economics* and Keynes's *General Theory of Employment, Interest and Money*. For a summary discussion of the history of this debate, see Katouzian *Ideology and Method*.

critics against modern mathematical economics was that it was too abstract. The defenders used to counter the argument by saying that no definition of ‘too much abstraction’ was ever put forward by the critics. In other words, they wondered how much abstraction would be acceptable and how ‘too much abstraction’ was defined. Or putting it another way yet again: At what point and under what circumstances may it be said that there has been *too much* abstraction?

To this question I suggested an answer. There can of course be no doubt that abstraction and generalization is necessary for any body of scientific, including social-scientific, theory. Abstract theories in any science necessarily refer to simplified problems which nevertheless may become the foundation of solving complex scientific questions. Any scientific theory necessarily refers to a simplified version of the real world, focussing on the most important variables, in the hope of shedding light on the complex problem or problems which it means to solve.

My solution to the question ‘How much abstraction is too much’ was that if an abstract theory has a counterpart in the world of reality – i.e. if it corresponds to a real-world problem which needs to be solved – then it is legitimate. Therefore, any theory which does not have a counterpart in the real world is not scientifically legitimate, and is a product of too much abstraction (Katouzian, 1980). I compared the activities of some mathematical economists (or for that matter some mathematical physicists) to those of the medieval scholastics, who, since the triumph of the Renaissance and of modern science have often been objects of ridicule, normally cited as symbols of intellectual obscurantism and social irrelevance. Now, the scholastics are laughed at (it would be too mild to say “criticised”) for trying to answer questions such as ‘How many angles can stand on top of a pin?’ This is an abstract question but, putting aside its purely metaphysical quality, it is a question to which there is no counterpart in the world of reality. In other words, not only does the question not exist outside the minds of those preoccupied with it, but far worse, there is not a single problem in the world of reality of which that may be regarded as a simple and abstract version.

I have not been looking at journals of economic theory and new economic models and theories for twenty years. But I can say with complete justice that, before then, many, if not most, theoretical economic models that were put on the market resembled the old scholastic question about the assembly of the angels, such that I even described the whole of our era as the age of New Scholasticism. That however was with respect not just of the practice of academic economics but of modern scientific establishments in general, a discussion of which is beyond the scope of this article.<sup>1</sup>

It is of course possible, perhaps even necessary, to tolerate the pursuit of such irrelevant questions, whether now or in the medieval past, as being useful to the development of sheer analytical rigor. The point however is that if it becomes the most widespread and most rewarded scientific pursuit within an academic discipline, it would be a gross waste of scientific resources; it would leave unanswered many a real question which could otherwise have been tackled, and it would result in little if any real advancement of science. Unfortunately it takes much more time to study the historical background and social setting of an economic problem, than simply setting up a little mathematical model which can be solved to its owner's satisfaction; and much more difficult to be rewarded for the former pursuit than for the demonstration of some mathematical skill.

History then provides the background, points to the social dynamics and defines the social framework in which economic and social problems emerge and demand solution. This does not mean that every economist must be an economic historian or a sociologist. It means that economic studies, whether theoretical or empirical, whether as an academic pursuit or as a policy prescription, must have in the background the history and social framework to which they refer. If this had not been the case, knowledge of economics would have stayed at the medieval level and against the social and economic background of feudal Europe, or perhaps at the age of mercantilism. Indeed classical economists and later neo-classical economists after them were successful to the extent that they had the historical background as well as the

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<sup>1</sup>. See in particular Homa Katouzian, "The Hallmarks of Science and Scholasticism: A Historical Analysis", *The Yearbook of the Sociology of the Sciences*, 1982 (Reidel, 1982).

changing social framework more-or-less firmly behind their general approaches to economic questions.

There can be endless examples of the uses of economic history and of historical approaches to economics. Here let me present two examples from my own experience the first one of which – my theory of the nature and causes of the growth of service industries – is completely apart from my studies of Iranian history and political economy. The German Historical School of the latter half of the 19<sup>th</sup> century – Roscher, List, Schmöller, Hilderbrand, Bücher, etc. – led an attack both on classical political economy and on the contemporary neo-classical economics such that may be summarised as follows. First, they argued that economics was by its very nature incapable of formulating abstract and general hypotheses. Second, that the correct procedure for the study of economic phenomena and problems was by the use of historical investigation. Third, that such historical investigation would in time lead to the formulation of historical ‘general laws’ nevertheless specific to certain stages of history, precisely because the data on which they are based would be different from one stage to another. Finally, it is implicit in the foregoing that there can be differences in policy conclusions according to the various socio-cultural frameworks or stages of history in which the subject is being studied; for example, they regarded *laissez faire* and free trade of possible – perhaps even beneficial – relevance to England but not to Germany, which was at a lower stage of economic development.<sup>1</sup>

The German Historical School had the better of the argument over neo-classical economics in three ways. First, their nationalist instinct proved right and the German economy succeeded in economic development not by

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<sup>1</sup>. This is my own comprehensive formulation, in *Ideology and Method*, of the theses of the German Historical School of economists who were numerous and came in two generations. But for a more detailed account of their ideas see, for example, Joseph A. Schumpeter, *Historian of Economics: Perspectives on the History of Economic Thought*, ed, Laurence S. Moss (London, 1996). Eric Roll, *A History of Economic Thought*, (London, 1974). Colin Clark, *The conditions of economic progress* (London and New York, 1957). Simon Kuznets, *Modern Economic Growth: Rate, Structure and Spread* (London, 1996); *Economic Growth and Structure* (London, 1966).

the application of free trade but through interventionist as well as protectionist policies. This was later reaffirmed by Japan and there are now neo-classical theories which explain why such policies aided rather than hindered economic growth and development in those countries. Second, their emphasis on the relevance and usefulness of historical knowledge and the role of cultural and institutional factors was well founded and their attack on the purely logical method of Ricardian and some neo-classical theorists was justified. The German criticism also implied the ultimate indivisibility of the socio-economic problems and the usefulness of a multi-disciplinary approach to their solution.

However, the defects of the German Historical School were no less than their merits. The biggest mistake of this School was their belief in socio-economic studies by *direct* observation – involving a detailed study of historical facts and much else besides – and the inference of ‘general laws’ through this procedure. To put their strength and weakness in one sentence, the Germans were wrong in general and right in particular: they were wrong to advocate direct generalizations from historical knowledge, but right in indicating the relevance of historical knowledge to economic and social theory, and pointing out the limits to generalization whether by deductive or inductive methods.

The theories of stages of economic progress formulated by Bücher, Schmöller, Sombart, etc., were of some value, and as a matter of fact economic analysis has since explained – i.e. established the causal relations for – these ‘empirical laws’. For example Friedrich List’s descriptive scheme of Agricultural, Agricultural-and-Manufacturing and Agricultural-Manufacturing-and-Commercial stages of economic development was later analysed in terms of the Primary, Secondary and Tertiary Stages of growth.

The personal experience I mentioned above is related to this. In the 1950s and 60s this theory was all but forgotten. Not only that. Virtually all the mainstream social and economic theories were describing the service industries as unproductive according to one or another analytical proposition. The leading Cambridge economist Nicholas Kaldor was firmly convinced that the greatest obstacle to British economic growth was the size



of the service sector in the economy<sup>1</sup>, to the extent that, in his capacity as economic adviser to the then British government, he had advised them to impose a special tax on service activities so as to encourage a shift of resources from service activities to manufacturing industry, an advice which they had accepted. The tax imposed was known as Selective Employment Tax, or SET.

Many sociologists, many of them not Marxist, misunderstood Adam Smith's and following him Marx's attack on 'unproductive labour' and firmly believed that all service activities were unproductive, and based their teaching and research on this assumption. Even Raymond Aron, the leading anti-Marxist French Sociologist, claimed that productivity was 'frequently non-existent' among services. Putting all that aside, taking a historical view of stages of economic development was totally unacceptable to mainstream economics, because it smacked of either nationalist or Marxist economic theories which they rejected. It was also justified on the basis of a misunderstanding of the meaning and methodological implications of Popper's attack on historicism.

When in 1968 I came to write my dissertation of Master of Science in Economics -M.Sc. (Econ.) - for the University of London, I decided to take a fresh look at this unfashionable historical theory. First, I wished to explain why the shares of services in output and employment were increasing despite the belief that they were unproductive or at least hindered growth. And secondly, why the share of this sector was also large in many if not most developing countries whereas the original theory had anticipated that services in poorer countries would have a small share in output and labour force. It would be too lengthy a diversion to try even to present a summary of my study and analysis here. Very briefly, I explained both the problems by pointing out the unusual heterogeneity of services as compared to both agriculture and manufacturing, and proposed three analytically distinct categories of them: 'old services', 'complementary services' and 'new services'. I explained that the income-elasticity of demand differed for these

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<sup>1</sup>. See Nicholas Kaldor, "Causes of the Slow Growth of the British Economy", *Economic Journal* (1966).

groups of services both among themselves and through time, such that on balance the service sector would steadily expand in advanced countries. I also pointed out that productivity and productivity growth was significantly different among the three categories of services which I had identified and this made the impact of each of the categories on the overall productivity growth of the economy different. Not only did I predict that services would grow steadily in advanced countries, but I even predicted – in 1968 – that the use of computer technology would help greatly enhance the productivity performance of service activities such as banking, finance and commerce.

Regarding the apparently odd case of large services in many developing countries, I pointed to the impact of the rise of international tourism, and the application of ‘new services’, the origin of both of which were in advanced, not in developing countries: on the one hand the income-elasticity of demand for tourism in *advanced countries* is high and it leads to the growth of demand for the services of *developing countries*; on the other hand, new services are products of scientific and technological progress in advanced countries which create demand in (especially the not so poor) developing countries. In addition, I analysed the impact of oil revenues on the growth of services in oil-exporting countries.

This was 1968 and the year in which I submitted an article based on this study, entitled “The Development of the Service Sector: A New Approach”, to *The Economic Journal*, which had originally published Kaldor’s article and was then still edited at Cambridge. It was turned down without argument: they even doubted my figures, apparently simply because they showed that the mainstream view of the performance of the service sector was invalid. It was subsequently published in *Oxford Economic Papers* in 1970<sup>1</sup> and made hardly any impact at the time, but not for long. In 1978, when I was invited by Germany’s Institute of World Economics to a conference to comment on their staff’s study of the service sector I realized that my theory was becoming fast fashionable because real economic events

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<sup>1</sup>. See Homa Katouzian, “The Development of the Service Sector: A New Approach”, *Oxford Economic Papers* (November 1970).

were demonstrating its relevance and usefulness.<sup>1</sup> In 1982 I was invited by the United Nations in Geneva as economic consultant to write a chapter on the service sector in the world context for the annual *Trade and Development Report* by the UN's Conference on Trade and Development, UNCTAD. This I did and it was subsequently published in *TDR* 1982 under the title of "Services and the World Economy". It was there that I fully saw the extent to which recent studies of services worldwide had been subsequently based on my theory, for example, Eves Sabolo's book-length study for the International Labor Organization – entitled *The Service Industries* (Geneva, 1976) - which had successfully applied my concepts and categories to a large number of countries, both advanced and developing.

That was a general theoretical study without specific reference to any specific country or group of countries, although it did distinguish between the cases of the advanced and developing worlds. My other main resort to historical study to make sense of a political and economic problem had already begun in the mid-1960s. This was the question of the logic of Iranian history, society and economy.

For reasons that I have explained elsewhere it became clear to me that the existing models of social and economic analysis - be they Marxist, neo-classical or other - certainly in regard to the problems and strategies of economic development, did not render realistic results in the case of Iran.<sup>2</sup> All such theories and models - regardless of their ideological origins and differences – had been developed against the background of European history and society and then supposed, both by them and by developing countries themselves, that they were universally valid. I have demonstrated in another context that while all scientific theories are general, no scientific theory can enjoy universal validity (Katouzian, 1980). Let me emphasize that the problem was not due to the existing tools and methods of the social sciences which have universal validity, but of social and economic theories

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<sup>1</sup>. See for my comments, Homa Katouzian, "Services in International Trade: A Theoretical Interpretation" in Herbert Giersch, ed., *International Economic Development and Resource Transfer* (Tübingen, Institute of World Economics, 1979).

<sup>2</sup>. See Homa Katouzian, *Iranian History and Politics: The Dialectic of State and Society* (London and New York, 2003) Preface and Introduction.

and models developed against the European background, which – if correct – are generally valid in the case of European societies alone. The question then was to discover, by means of the appropriate application of the same methods that have resulted in European social and economic theories, the logic and sociology of Iranian history as the relevant and realistic background to the current problems and efforts at their solution. This I did through a long and continuous – and, I might add, extremely lonely - process of a comparative study of Iranian and European society and history, while at the same time I was trying to develop realistic models for the political and economic development of Iran. The result was very briefly as follows.

### 3. Short-term society

Iran was a **short-term society** in contrast to Europe's **long-term society**.<sup>1</sup> It was a society in which change - even important and fundamental change - tended to be a short-term phenomenon. And this was precisely due to the absence of an established and inviolable legal framework which would guarantee long term continuity. Over any short period of time, there could be notable military, administrative and property-owning classes, but their composition would not remain the same beyond one or two generations, unlike traditional European aristocracies, or even merchant classes. In Iran, property and social positions were short-term, precisely because they were regarded as personal privileges rather than inherited and inviolable social rights. The situation of those who possessed rank and property - except in very rare examples - was not the result of long-term inheritance (say, beyond two generations before) and they did not expect their heirs to continue in the same positions as a matter of course. The heirs could do so only if they managed to establish themselves on their own merits - merits being the personal traits necessary for success within the given social context. There

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<sup>1</sup>. See, for example, Homa Katouzian, "Problems of Democracy and the Public Sphere in Modern Iran", *Comparative Studies of South Asia, Africa and the Middle East*, 18, 2, 1998, reprinted in *Iranian History and Politics*, and "Dar Ta'assob va Khami, va Tajjali-ye an dar Jame'eh-ye Kolangi" in *Kiyan*, reprinted in *Tazadd-e Dawlat va Mellat, Nazariyeh-ye Tarikh va Siyasat dar Iran* (Tehran, 2001).

thus was a high degree of social mobility, unthinkable in medieval and much of the modern European history. This did not exclude the position of the shah himself, since legitimacy and the right of succession was nearly always subject to serious challenge, even rebellion.<sup>1</sup>

The most visible example of the short-term nature of Iranian society is the habit of declaring a building – especially a residential building – as *kolangi*, a ‘pick-axe building’. Most of these buildings are no more than thirty (even twenty) years old, and they are normally sound in foundation and structure. In a few cases they may be run-down and in need of renovation, but the feature that results in their condemnation as such, and incidentally wipes off the value of the structure and only leaves the price of their site, is that their architecture and /or interior design is unfashionable, according to the latest forms, concepts or whims. Therefore, rather than building a new house or whatever, thus adding to the stock of existing physical capital, it is demolished by the owner or purchaser, and a new building is erected on its site. That is how I have come to describe the short-term Iranian society alternatively as *jame’h-ye kolangi*, ‘the pick-axe society’, a society many of whose features – political, social, educational, literary, etc. – are constantly in danger of receiving the pick-axe treatment by short-term whims of fashion.<sup>2</sup>

Lack of long-term continuity, by definition, resulted in significant change from one short period to the next, such that *history became a series of connected short runs*. In this sense, therefore, change was more frequent - usually also more drastic - and as noted, social mobility across various classes considerably higher than in traditional European societies. But, also by definition, it rendered very difficult *cumulative* change in the long term, including the long-term accumulation of property, wealth, capital, social and private institutions, even the institutions of learning. These did normally

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<sup>1</sup>. See Homa Katouzian, *State and Society in Iran, The Eclipse of the Qajars and the Emergence of the Pahlavis* (London and New York, 2000) 1-3; *Iranian History and Politics*, “*Farrāh-ye Izādi va Haqq-e Elāhi-ye Padshāhan*” in *Ettela’at Siyasi-Eqtisadi*, 129-130, 1998; “Legitimacy and Succession In Iranian History”, *Comparative Studies of South Asia, Africa and the Middle East*, 23, 1&2, 2003.

<sup>2</sup>. See Katouzian, ‘Problems of Democracy’ and ‘*Dar Ta’ssob va Khami*’.

proceed or exist in every short term, but they had to be reconstructed or drastically altered in the subsequent short terms.

Evidence of the short-term nature of the Iranian society as described above is to be found virtually in all of its aspects almost throughout Iran's long history, both pre-Islamic and post-Islamic. Here we shall present a brief analysis of three of its main features closely related to one another:

- Problems of legitimacy and succession, and the toll that this took of rulers, other royal persons, and ministers and military commanders.
- The tenuous nature of 'life and possessions' (*jan o mal*).
- Problems of accumulation and development.

Here I shall just take up the third feature, i.e. problems of accumulation and development. If there is one point on which all the major theories of economic development are agreed it is that the Industrial Revolution occurred as a result of long-term accumulation of, first commercial, then industrial capital. Long-term accumulation of capital was a necessary, even though not sufficient, condition for modern industrial development. Without it, neither the necessary investment would have taken place in the commercial sphere, resulting in the unification of the internal market and virtually continuous expansion of foreign trade, nor would there have been sufficient investment in the goods which made the innovation and application of modern techniques and processes possible in agriculture and industry. In a particularly clear and convincing historical generalization, Alexander Gerschenkron described the process of European industrialization until the 20<sup>th</sup> century in three stages, from the countries such as England which started first, through those such as Germany and Austria to Russia and Eastern Europe. In the first group of countries it was the firm which led the process of accumulation for a long time. In the second, banks played a crucial role and financing industrialization, and in the third group, the state.<sup>1</sup>

The simple but highly acute point about the necessity of long-term accumulation of capital was discovered by early classical economists, who observed that in order for the firm to expand it needed to accumulate, and in

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<sup>1</sup>. See Alexander Gerschenkron, "The Approach to European Industrialization" in *Economic Backwardness in Historical Perspectives* (Cambridge Mass, 1962).

order for it to accumulate, it had to save first. This was what they sometimes described as the process of ‘ploughing back capital’. Turgot described the process more clearly than any one before him. But it was Adam Smith who put forward a memorable argument for the necessity of prior saving for the expansion of the firm, hence the industry and therefore the whole economy. He said with a certainty – perhaps even dogmatism - uncharacteristic of his even tempered approach to most matters of theory and policy that it was not so much technical progress, but saving and investment, making its innovation and application possible, that was the principal cause of industrial development. He therefore concluded that every saver was a friend, and every spender, an enemy of the society. Thus he wrote in Book II of his renowned treatise:

Whatever a person saves from his revenue he adds to his capital [and] as the capital of an individual can be increased only by what he saves from his annual revenue or his annual gains, so the capital of the society which is the same with that of the individuals who compose it can be increased in the same manner.<sup>1</sup>

In other words, aggregate saving is the sum of the savings of all firms and individuals. Furthermore, he said, it is saving, not production, which is the initial cause of investment, of capital accumulation:

Parsimony and not industry is the immediate cause of the increase in capital. Industry indeed provides the subject which parsimony accumulates. But whatever industry might acquire, if parsimony did not save and store up, the capital would never be the greater.<sup>2</sup>

It follows that savers compensate for the habits of the spendthrift in preventing economic decline. Savers therefore help the society, while spendthrifts hinder it:

If the prodigality of some was not compensated by the frugality of others, the conduct of every prodigal...tends not only to beggar himself but to

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<sup>1</sup>. See Adam Smith, *The Wealth of Nations*, ed. Edwin Cannan 1, II, 3 “Of the Accumulation of Capital, or of productive and unproductive labor”: 320.

<sup>2</sup>. *Ibid.*

impoverish his country...Every prodigal appears to be a public enemy and every frugal man a public benefactor.<sup>1</sup>

Later, Malthus, Marx, Hobson, Tugan-Baranovsky and Keynes – using different approaches, and putting forward more or less strong arguments – showed that this theory was valid so long as aggregate demand would match aggregate supply at full employment in general. And in particular, so long as money is not hoarded, that is, so long as saving does not remain passive but is turned into investment by the saver or others who borrow from him. Yet the Keynesian criticism – at least insofar as it affected policies of achieving and maintaining full employment - was so successful that, in the practice of macro-economic policy, virtually all distinction between investment expenditure and consumption expenditure ceased. This had disastrous consequences for - certainly the British - economy between 1950 and 1980, when not only new investment but even renewal of stock was neglected so long as aggregate consumption was adequate to maintain full employment.<sup>2</sup> Indeed, Keynes himself might have said ‘And Keynes conquered England as completely as the Holy Inquisition conquered Spain.’<sup>3</sup> There can be no doubt that long-term economic growth would require a significant rate of saving and investment (from domestic or foreign sources) even for developed industrial societies.

To sum up the fundamental points made above, capital accumulation required significant and continuous saving for long-term investment. Finance for investment was supplied directly by the savings of propertied classes, by banks, the state or - in the last century and a half - by all of them. Since the 20<sup>th</sup> century, development finance has also been supplied by advanced industrial countries for investment in third world economies. Its classic and earliest example was the long-term accumulation of - first commercial then industrial - capital in England, mainly by the bourgeoisie, the commercial

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<sup>1</sup>. *Ibid*: pp. 321-323. See further, Katouzian, *Adam Smith va Servat-e Melal*: 95-97 and 153-157.

<sup>2</sup>. For an extensive account and discussion of this subject, see Katouzian , *Ideology and Method*. See also, Katouzian *Adam Smith va Servat-e Melal*.

<sup>3</sup>. Keynes said this about Ricardo, whose theory (which was directly based on Smith’s) he was attacking. See his *The General Theory of Employment, Interest and Money*, 2.



classes, although ‘enlightened landlords’ also participated in the process from mid-seventeenth century onwards.

Yet, to save continuously and at a significant rate would be *rational* only in a social framework where there was no endemic fear of plunder and confiscation. Even in Europe, long-term capital accumulation was greatly encouraged, first by the emergence of free towns - burghs, etc. - which afforded protection from feudal encroachments; and, secondly, by the rise of the Renaissance and absolutist monarchies, with the full blessing of the commercial and middle classes, which gave them protection vis-à-vis the great aristocratic magnates. It was the accumulation of financial capital which made possible the financing of technical innovations, and, through time, this led to modern technological development and industrial expansion - i.e. what used to be generally known as ‘the industrial revolution’.

There used to be a puzzle posed by classical economists, and later economic historians and development economists, to which apparently no solution satisfactory to themselves and others has been offered. It was this: Why did the process of capital accumulation not begin in societies like Iran in their rich and technologically advanced times, say in the 9<sup>th</sup> to 12<sup>th</sup> centuries. The clearest answer to that question is that it was not safe to engage in long-term saving for fear of plunder and confiscation; and that in a small number of cases where such attempts were made, or for other reasons a very large commercial fortune was amassed, later plunder and confiscation put an end to the process.

Max Weber’s solution to that old puzzle was that the other, non-accumulating, societies lacked something corresponding to Protestant ethics. Weber’s theory of the crucial role played by these ethics in shaping ‘the spirit of capitalism’ in Europe is intelligent, though it has also been subjected to serious criticism.<sup>1</sup> Notwithstanding that, the question in the context of our inquiry is whether such ethics could have become widespread in societies

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<sup>1</sup>. See Max Weber, *Protestant Ethics and the Spirit of Capitalism* (London, 1930); R. H. Tawney, *Religion and the Rise of Capitalism* (London, 1937). For a short but poignant critique of Werner Sombart (as well as Weber, in whose spirit he wrote his *The Jews and Modern Capitalism*), see Hugh Trevor-Roper, “The Jews And Modern Capitalism”, in *Historical Essays* (London, 1957). See also his “The Medieval Italian Capitalists”, *ibid.*

where, at least in practice, there was no right of long-term property ownership; and, if they did, and even lasted, for reasons which are difficult to envisage, they would have resulted in long-term accumulation of capital.

Because even if significant saving *had* taken place in such highly discouraging circumstances, it would not have resulted in long-term accumulation when it was perennially plundered. There can be little doubt that Protestantism, and especially its more radical sects, actively encouraged frugality and hard work (even in spite of Luther's emphasis on salvation by faith, and Calvin's doctrine of pre-destination).<sup>1</sup> But, from a scientific point of view, it is virtually impossible to know whether this was primarily a cause or consequence of the growth of the bourgeoisie and rise of commercial capitalism in Western Europe, i.e. the familiar scientific problem of determining the direction of causation - what in simple parlance they call 'the chicken or egg problem'. However, even assuming - as does Weber, virtually - that it was a cause, it is unlikely to have been such, if the European bourgeoisie had not had legal protection for their property, a protection which was much enhanced by the emergence of the Renaissance absolutist states with their blessing and support.

Thus in answering the fundamental historical question as to why the Industrial Revolution did not take place in countries like Iran, I wrote - in 1978 in *The Political Economy of Modern Iran* - in an attempt to explain the chief reason for lack of long-term capital accumulation in Iranian history:

The Iranian landlord...enjoyed no...right to his title, or security of his income. If European capitalist property involved an inviolable ('natural') *freedom*, and feudal property involved an inviolable ('natural') *right*, Iranian landed income and wealth were an alienable (arbitrary) *privilege*...the same state of insecurity of income and wealth applied to merchant capital, both in the merchant's lifetime and after.

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<sup>1</sup>. See further, Dickens, *The Age of Humanism and Reformation* (London, 1977); Joel Hurstfield, *The Reformation Crisis* (London, 1965); V. H. H. Green, *Luther and the Reformation* (London and New York, 1954); Mann Phillips, *Erasmus and the Northern Renaissance* (London, 1949).

Capital accumulation requires postponement of present consumption, i. e. saving; and saving necessitates a minimum degree of security and certainty concerning the future. In a country in which money itself – let alone financial and physical assets – has been under the threat of confiscation and expropriation...it is impressive that financial capital *was* accumulated and trade *was* carried out to the extent that they were...The entire course of Iranian history and the existing chronicles of its events are crowded with examples of this state of insecurity and unpredictability <sup>1</sup>...

Long-term accumulation of capital was indeed one necessary condition for industrial development. But there were other conditions, other coincidental changes that made the emergence of modern state and society possible, not least the rise of the absolutist state in Europe which made capitalist property freer than before from the encroachment of the old aristocratic magnates. This factor both helped and was helped by the ‘spirit of capitalism’ which sought to please God by low consumption, high saving and hard work.

It might have been a commonplace if the fundamental point had not been constantly in danger of being missed about long-term development that it is a process which marks a total transformation of the society from one state into another, and not just one which merely results in an increase in the share of industrial goods and services in the national output, or in secularization of the law, politics and social relations, or simply in the emergence of the mass society. It is total transformations of this kind - changes which required a long and continuous process, in some cases taking a few centuries to transform the society - that seldom took place in Iran, and on the few occasions that they did for some time, the basic norms of arbitrary state and society led to their disruption, sometimes followed even by decline and retrogression, thus turning history into a series of ‘connected short terms’.<sup>2</sup> And that is why, despite such commercial, cultural, and technical

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<sup>1</sup>. See Katouzian, *The Political Economy of Modern Iran*: 18-20.

<sup>2</sup>. See, for example, Homa Katouzian, “Arbitrary Rule, A Comparative Theory of State, Politics and Society in Iran”, *British Journal of Middle Eastern Studies*, 1, 24, 1997, and, *State and Society in Iran*, 1.

achievements in certain periods, traditional Iranian society did not reach stages of development corresponding to post-Renaissance Europe.<sup>1</sup>

Between the two Iranian revolutions in the twentieth century, arbitrary and unsystematic copying from Europe – i. e. what I have described elsewhere as ‘pseudo-modernism’<sup>2</sup> - did produce new institutions, organizations, goods and services.<sup>3</sup> This was achieved most noticeably through the 1960s and 70s with the help of large and increasing oil revenues which virtually descended like manna (*ma’edeh*) from heaven<sup>4</sup> into the coffers of the state, and which it disbursed in an arbitrary fashion. But the relationship between state and society remained essentially the same, such that in the second Iranian revolution of the 20<sup>th</sup> century (1977-79) the propertied classes either supported the revolution or remained neutral, much as they had done in the first one (1905-1909).<sup>5</sup>

#### 4. The long-term society

Development requires not only *acquisition and innovation*, but also, and especially, *accumulation and preservation*, whether of wealth, of rights and privileges, or of knowledge and science. European society was a ‘long-term society’. Major change, whether the fall of feudalism, the rise of capitalism and the emergence of the liberal state, whether the rejection of Aristotelian physics, Ptolemaic cosmography and the Greco-Roman political thought, or the Roman Catholic hegemony - all of these took a long time and a great deal of effort and struggle to occur, but when they finally did, the change was irreversible, and a new social framework, a new law, a new science,

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<sup>1</sup>. See further, Katouzian, *Iranian History and Politics*.

<sup>2</sup>. For the latest version of this author’s concept of ‘pseudo-modernism’, see *State and Society in Iran*, 11.

<sup>3</sup>. See further Homa Katouzian, “The Pahlavi Regime in Iran” in H. E. Chehabi and Juan Linz (eds.), *Sultanistic Regimes* (Baltimore, 1997) and *The Political Economy of Modern Iran*.

<sup>4</sup>. As Rumi has it: “*Ma’edeh az asmen shod ‘a’deh / Chon keh goft ‘Inzil ‘alaina Ma’ideh’*”.

<sup>5</sup>. See Homa Katouzian, “Towards a General Theory of Iranian Revolutions”, *Journal of Iranian Research and Analysis*, 15, 2, 1999, reprinted in *Iranian History and Politics*.

even a new religion was established that would once again take much time and effort to change, even to reform.<sup>1</sup>

The long-term society makes possible long-term accumulation, precisely because the law and traditions that govern it, and its institutions, afford a certain amount of security by making the future reasonably predictable. At the same time, and for the same reason, it makes major change in the short-run very difficult. In the long-term society, revolution, whether in law, politics or science is a rare and extraordinary occurrence, but when it does happen it is non-reversible and therefore has long-term effects.

For as long as the peasants lived on the most meager subsistence, and the state as well as property-owning classes spent virtually all their income on consumption, and the saving and accumulation of the very few was lost in the long run through confiscation, plunder, division in inheritance, etc., there could never have been long-term economic development in Iran of the kind that is associated with European history and society in the past few centuries. Foreign aid and international borrowing could have been used, and were to a very limited extent used, but they could not have resulted in long-term industrialization.

This then was the logic and sociology of Iran's history. But in studying the political economy of Iran in the 20<sup>th</sup> century there was another new and important factor which needed careful and precise consideration, not just to understand and predict the relationship between state and society but, as part of it, also make sense of the economic and political events. This new factor was oil.

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<sup>1</sup>. This discreet and long-term process of change in science as well as society had been well known. In the case of society it had been well documented and subjected to much theorising. In the case of knowledge and science, it had once been discussed in the original sense of Hegelian and Marxian concepts of ideology (i.e. 'ideology' as consciousness bound by the limits of moral and/or material development in its various 'stages'). Thomas Kuhn offered a new model in the case of 'scientific revolutions', though he overlooked the fact that it was equally valid for the history of all (not just scientific) knowledge, and implied that it was necessarily the best procedure for the advancement of science. See his *The Structure of Scientific Revolutions* (Chicago: The University of Chicago Press, 1970); Homa Katouzian, "T. S. Kuhn, Functionalism and Sociology of Knowledge", *British Journal for the Philosophy of Science* (June 1984), "The Hallmarks of Science and Scholasticism" and *Ideology and Method in Economics*, 4.

Oil revenues accrued to the state directly and were an important source of both income and – especially – foreign exchange to it. Much of the development of the economic infrastructures that took place under Reza Shah and from the mid-1950s under the Second Economic Plan would not have been possible without the oil revenues, not to mention the cost of military and civil administration. But it was from the early to mid-60s that the oil revenues began to grow steadily and at substantial rates, and from 1973 onwards when, in consequence of the quadrupling of crude oil prices, they virtually exploded.

In order to study the special characteristics of Iran as an oil-exporting country it became necessary to develop a general model of the political economy of oil-exporting countries. The model thus developed had the following as its fundamental features: Oil revenues are in the nature of an economic rent, because the participation of domestic factors in the production of crude oil and the return to them by way of factor payment is a tiny proportion of the annual oil revenues, which are directly received by the state, virtually like manna from heaven. They are not just an important source of income but make up a very high proportion of the country's foreign exchange earnings. They thus become the independent variable of the economic system. And in countries such as Iran where the power of the state tends to be absolute and arbitrary, they would enhance and reinforce that tendency, and afford the state the independent means by which to extend its bureaucracy, military networks and means of coercion as well as pursue its goals of economic development. In the case of agricultural, oil countries like Iran the strategy of development would tend to be biased against agriculture, especially as there seems to be no need for its contribution to foreign exchange earnings, and petrodollars can be used to import food and other agricultural necessities and luxuries.

To the extent that the oil revenues make the state independent of the domestic means of production and the social classes, the latter become dependent on the state for employment, direct hand-outs and privileges, borrowed capital for investment, as well as general welfare schemes ranging from education and health to food subsidies. Therefore, as the fount of

economic and political power, state expenditure affects the fortunes of various social classes. In a larger, agricultural oil economy, where oil revenues per head of the population are not large enough to ensure a reasonable living standard for all members of the society, this type of relationship gives rise to a new, petrolic, system of social stratification: the state has to be selective in affording even the minimum standard of comfort to individual members of the society, and those who benefit significantly from it constitute only a small percentage.

The expanding military-bureaucratic complex, the professional and other educated groups and even the business classes together make up the *clientele of the state*. Next in line are the masses of the urban population, who will look to the state for actual employment opportunities, a guaranteed minimum wage, food subsidies, health and educational schemes, etc., as well as the chance of rising to join the clientele, although both the actual and the potential aspirations of many of them are likely to be frustrated. Last come members of the rural society, the peasantry who are too poor, too numerous and politically too weak to pose the danger of direct retaliation. They are more likely to vote with their feet by marching on the cities and at their gates swelling the ranks of those urban masses whom the state would like to keep reasonably happy.

The entire system would depend on the size and strategy of state expenditure. The state's *consumption* expenditure expands its own military-bureaucratic network. The effectively unearned increases in the clientele's income lead to a high rate of private consumption expenditure. State *investment* expenditure would tend to place great emphasis on urban expansion, emphasizing construction, modern service activities and heavy industries, and employing the latest, capital-intensive, technologies. This would face the country with serious shortages of highly skilled labor, both mechanical and managerial, and also result in technological unemployment.

Whether or not monetary expansion is a 'cause' of inflation, in a society where ostentation is a most important determinant of social status (even recognition as a *person*), people would tend to spend their excess liquidity on goods and services. And when for this and other reasons inflation

becomes a feature of everyday life, even those with a great deal of cash to dispose of would buy a lot of durable goods, especially urban land and property – in order both to defend and improve the value of their liquid assets. And because of the insecure and short-term nature of the society and political economy, they would tend to spend on speculative assets and activities, whether urban property or forward purchase and sale of everyday commodities. Regarding saving and investment, precisely because of the short-term nature of the society and the state of insecurity and unpredictability, private investment in manufacturing and services, whether large or small, tends to be limited to short horizons, often being limited to two or so years and seldom going beyond five years and more. In any case, net aggregate saving out of *non-oil* output and income tends to be much too small for a developing economy – consisting of 2 to 3 rather 10 to 12 percent of the national income - most of the aggregate ‘saving’ being in fact due to the unseen hand of the oil revenues.

Such are the rudiments of an elaborate model which I developed for the study of the oil-exporting economies in the 1970s.<sup>1</sup> And it was on the basis of that as well as the historical short-termness and arbitrary nature of state and society that I was pessimistic about prospects for the long-term development of the Iranian economy, compared to predictions based on existing European models, if not all of which predicted the imminent emergence of ‘Japan of the Middle East’, they were nevertheless highly optimistic about the outcome of the oil price revolution for the Iranian economy.

And it was on that basis that, while the Revolution of 1977-79 was still proceeding, I described it not as a class war combined with a related struggle

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<sup>1</sup>. Cast in more technical and comprehensive terms than the above brief, it took a long time for it to be accepted for publication, and that by an unorthodox journal, the others not being convinced for academic or other reasons. See Homa Katouzian, “The Political Economy of Oil Exporting Countries”, *Peuples Mediterraneans* (1979). See also “Oil versus Agriculture, A Case of Dual Resource Depletion in Iran”, *Journal of Peasant Studies* (April 1978), and “Oil and Economic Development in the Middle East”, in *The Modern Economic History of the Middle East in its World Context*, Essays Presented to Charles Issawi, ed., George Sabagh (Cambridge, 1989).



against imperialism, but as the revolt of the entire society against an arbitrary state which happened to be a client state of Western powers, emphasizing that despite many differences between that and the Constitutional Revolution, they were similar inasmuch as both of them were revolts of the society against the state, much as it has been the case in Iranian revolutions since time immemorial.<sup>1</sup>

## 5. Conclusion

To conclude briefly, economic history and the history of political economy are useful and respectable academic pursuits in their own right, just as history itself is one of the most important fields of learning and scholarship in every civilized country. But they are and can be even more important than that especially when they are conducted not just in a descriptive but also in an analytical framework. Their contribution is necessary for studies of the logic and sociology of the history of the society or societies to which they refer, and therefore in helping to provide the relevant perspectives for the study of economy and society. Not every economist, sociologist or political scientist has to be a historian, but their work is meaningful, realistic and relevant to the extent that it is conducted against the appropriate social background and reality, which history, its logic and its sociology can provide, on the condition that these too are constructed on a realistic and relevant plain.

Theories of European economy and society differ insofar as they may be Marxist, liberal and other. Yet despite serious conflicts among them it is clear that they are based on the fundamental characteristics of European society, and that the historical background to all such systems and ideologies is unmistakably European history, from the Greeks to modern times. Models based on such theories can also be of some use in Iran but so long as their assumptions do not contradict the basic features of Iranian history and society where these are different from the corresponding features of Europe.

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<sup>1</sup>. See Katouzian, *The Political Economy of Modern Iran*, 18. Later I gave the question of the nature, causes and consequences of Iranian revolutions a general treatment in "Towards a General Theory of Iranian Revolutions", *Iranian History and Politics*.

Iran has been an arbitrary state and society, with an embedded and persistent antagonism between the state and society, absence of an independent legal framework, tendency towards chaos and disorder, an unusual degree of insecurity and unpredictability, high social mobility, etc., which may be summarized in the concept of “the short-term society”. And the rules of social and economic behavior, public and private economic decision making, etc. can be, and often are, very different from the assumptions of models which are based on theories of European society and economy, irrespective of the ideology or paradigm to which they refer.

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