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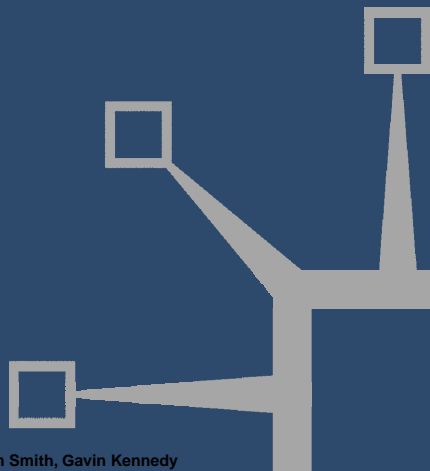
# Adam Smith

A Moral Philosopher and His  
Political Economy

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Second Edition

Gavin Kennedy



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# Preface

Authors well versed in the totality of Adam Smith's ideas have written many quality books, essays and papers on his thinking. My intellectual debts are due to many people, including Andrew Skinner, Sam Fleischacher, Jim Otteson, Jerry Evenski, Knud Haakonssen, Emma Rothschild, Istvan Hont and Donald Winch. The authors of journal articles, too many to acknowledge, personally provided confirmations and challenges, some of which I took up. Not all, if any, of the above scholars would necessarily agree with anything written here.

Andrew Skinner first sparked my interest in Adam Smith in 1973 when I repurposed lectures I had given at the National Defence College, Latimer (1972–1974), for my *Economics of Defence* (Kennedy, 1975). Professor Sir Alan Peacock was a steady source of support and enthusiasm. I have also benefited from many exchanges with Alan Thompson, Nicholas Gruen (Australia), David Simpson Lawrence White, Sandra Peart, Craig Smith, Chris Berry, Gavin Reid, David Raphael, Paul Oslington, Ian Simpson Ross and Anthony Thirlwall.

None of the above is responsible for the infelicities in what follows.

Gavin Kennedy

# Acknowledgements

All references to Adam Smith are from *The Glasgow Edition of the Works and Correspondence of Adam Smith*, © Oxford University Press, reproduced with permission from Oxford University Press.

Corr *Correspondence of Adam Smith*, 1987, ed. E. C. Mossner, Ian Simpson Ross, 2nd edition.

ED *Early Draft of Wealth of Nations* [1763] included in LJ.

EPS *Essays on Philosophical Subjects*, 1795 [posthumous], ed. W. D. Wightman, J. C. Bryce.

LJ *Lectures on Jurisprudence*, 1983, ed. R. L. Meek, D. D. Raphael, P. G. Stein.

LRBL *Lectures on Rhetoric and Belles-Lettres*, 1983, ed. J. C. Bryce includes *Considerations Concerning the First Formation of original and compounded Languages* [1761].

TMS *The Theory of Moral Sentiments* [1759] 1976, D. D. Raphael, A. L. Macfie.

WN *An Inquiry into the Nature and Causes of the Wealth of Nations* [1776] 1976, ed. R. H. Campbell, A. S. Skinner, W. B. Todd.

[References in the text are accompanied with page numbers to the above editions]

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# 1

## General Introduction: Why Adam Smith?

Graduate economists, thoroughly conversant within the neoclassical paradigm and therefore numerate, who read a few pages of *Wealth of Nations* confront an entirely different method of political economy to that which their academic training prepares them. If they persist, they find a literary style (no mathematics) that can be irritatingly obscure, seemingly long-winded and occasionally ambiguous, and given to 'diversions' of apparently questionable relevance, certainly when compared to the kinds of problems with which they are familiar. It is unlikely that they have an immediate resonance with Adam Smith's style of discourse. Yet within his books, there is much that may enlighten some of their deeper questions, and some they might find disturbing to their mastery of modern theory. Today's economists may well ask: How did modern economics develop from such an unpromising source, and why is he credited as the 'Father of Economics'?

The bright confident mornings of the post-war years, when economists brimmed with the certainties of the near-triumphant Keynesian consensus, had by the 1980s ebbed into embarrassment, and many unsettled issues of economic policy resurfaced. Perhaps coincidentally, the history of economic thought and its companion discipline of economic history began their slide into obscurity, with vacant chairs following their former holders into retirement. Meanwhile, the long march of the mathematicians continued, offering numerate economists the promised prize of their joining the ranks of the 'hard sciences'.

By the new millennium, the original conflict of 'free trade versus protection' was back in contention; markets versus state management remained as divisive as ever; and competing solutions to problems of poverty, domestic and global, were stuck, intellectually, practically where Adam Smith had left them. The dominant feature of economics

today is the divisive non-agreement on basic practical policies, and for all its hard-science pretensions, it remains in an unsettled state.

I introduce Adam Smith, not of course by a crude transfer of his ideas into twenty-first century policy debates, but more as a learning aid from examples of the application of his semi-hidden historical, social-evolutionary understanding of how societies and their economies work. I ask readers, sceptical or curious, to focus on the historical aspect of Adam Smith's works, by showing him to be a significant thinker in political economy before economics became a separate discipline.

A closer look at Adam Smith is recommended to all economists if their reading has been confined to well-worn quotations from his books and to problematic beliefs that he was the theorist of 'an invisible hand', an advocate of 'laissez-faire', in favour of small-scale government (the 'night-watchman state') and a purist advocate of 'free trade'.

## What is *Wealth of Nations* about?

*Wealth of Nations* is not a textbook on economics. It represents the application of Adam Smith's world-view to the larger historical problem of what caused the British economy to show signs of sustained improvements through slow but steady growth, what inhibited it from performing much better compared to how well it could perform if certain changes were made in its political stances towards international trade with neighbours and with its colonies in North America. His book was entitled *An Inquiry into the Nature and Causes of the Wealth of Nations* (hereafter *Wealth of Nations*), using Britain as his case study.

*Wealth of Nations* has unique features. The detail he provided is fulsome, and occasionally repetitive. Unusual topics in such detail do not grace modern textbooks. In both his books, the world of classical Greece and Rome is never far from any topic, reflecting his classical education, as shown comprehensively by Gloria Vivenza (Vivenza, 2001).

For Smith, the main theme was his observation that Western Europe showed signs of recovering its 'lost' commercial age. This was evident in the then-current literary and artistic works, in architecture and in the diffusion of technology (much of it to assist and augment the powers of labour, illustrated in Denis Diderot's magnificent multi-volume *Encyclopaedia*) (Diderot and D'Alembert, 1751–1777). The slowly rising population indicated steady growth in the share of total output allocated to subsistence, consistent with the fairly static per capita income of the bulk of the population. The slowly rising consumption, well above subsistence for middle and upper segments of the population, leaving

per capita subsistence of the poorest majority at its low historical norm, indicated steady growth in output exchanged in markets, and together these were positive indicators that something of historical significance was happening, first in Britain and later across Western Europe (Deane and Cole, 1967, 80; cf. Clark, 2007). Striking tales about voyages of exploration and discovery increased the wonders of the known world by several magnitudes.

Smith saw the philosopher's role as 'not to do any thing, but to observe every thing' (WN 21), which he practised from his wide reading of classical sources, plus recent travellers' tales of America, Africa, the Pacific and Asia – and of contemporary accounts of Europe. Visiting workplaces and listening to people of all ranks, he was most certainly a scholar who 'looked outside his window'. From these sources, he observed the changes occurring in the basic elements of subsistence and growing evidence of luxury goods among the elite: more, but not all, people were slowly becoming better off.

Compared to the wretched lives of 'savages' still in the first age of hunting in the Americas (made worse off by violent and cruel European colonists and their diseases) (Diamond, 1997), the lives of the poorest *employed* common labourers and their families in Scotland were better served by the primitive division of labour and the extent of markets (WN 24). That led him to ask 'of what did "wealth" consist?' Was it money, or access to the annual production of the 'necessaries, conveniences and amusements of life'? Observing that it was the latter (gold was a means, not an end), he asked, 'what caused the people of Europe to have access to more of the "necessaries, conveniences and amusements of life" unobtainable by the people of the "savage" world'? Smith's *Wealth of Nations* was his answer to these two questions, based on a mass of sources, some in his private library and via correspondence, and mutual loans of papers from the libraries of many of his friends (*Corr* 101, 115–120, 132, 137).

He had no *a priori* set of principles to guide him, and such short pamphlets on relevant topics to which he had access provided narrow, not comprehensive answers, where they were not hopelessly wrong. Mostly, he evaluated limited current knowledge synthesised from many indirect sources and presented his conclusions to his intended audience, legislators and those who influenced them in the British political establishment.

He concluded that the drift of national states in Europe into the political traps of 'jealousy of trade' – mercantile protectionism, internal regulation of commerce, ventures such as colonies and wars for trivial



ends – reduced the ability to realise the full fruits of expanding commerce and of improved agriculture in higher growth rates and, therefore, faster progress towards opulence, particularly for the poorest majority. He was not against government roles in principle, but he opposed those government roles that undermined or held back commerce by following the false doctrines of mercantile-minded traders, myopic protectionists and petty monopolists.

Smith harnessed his synthesis of existing knowledge of political economy to explain what had happened to Western Europe since the fall of Rome and to identify where prevailing government policies hindered progress towards opulence. And he rooted his economic analysis within the forces bringing about those changes (WN 89, 111–112).

Smith's thinking provided lucid explanations as to how the 'new world' of commerce offered historically undreamt of opportunities to resolve the ancient constant per capita subsistence problems of the stationary subsistence living conditions of the indigenous, 'inferior', majority of the population, whose predecessor generations had endured absolute poverty over thousands of years. He also identified appropriate policies that could achieve lasting security for the already relatively opulent property-owning orders and the many others that he envisaged would join them if growth continued.

Smith's theory was not a manifesto for revolutionary, or even radical, in the sense of immediate, changes. He adorned his rhetoric with the phrase 'slow and gradual' in an attempt to reassure, not to cause emotional resistance. He concluded that the norm of low subsistence conditions of the labouring poor was not going to change by benevolent redistribution; however, it could come from economic and social growth that set increasing proportions of the population to work and raised total output of the 'necessaries, conveniences, and amusements of life'.

He packed *Wealth of Nations* with detailed evidence from his sources, mainly rooted in his knowledge of history, supported by his fairly simple theory of economic growth, and submitted it to the legislative class in the British parliamentary system and those close to legislators and to fellow 'members' of the Enlightenment, influential figures and the broader reading public in Britain and their equivalent in the rest of Western Europe, including those in the British colonies in North America.

In *Wealth of Nations*, Smith speaks in the language understood and spoken among the middle and upper layers of the educated society. He did not speak specifically to the 'lower' orders – that was too dangerous in eighteenth-century Britain (as events in the years immediately

after he died in 1790 were to show) (*EPS* 309, 339; Rothschild, 2001). It was not that the 'lower or "inferior" orders' (in the 'non-pc' language of the day) were totally absent from his thinking. Where the interests and present plight of the labouring people were concerned, he generally speaks matter-of-factly without sentiment and lightly hides where his broad sympathies lay (*WN* 96).

On occasion too, he bursts out with brief strictures against 'idle' landlords, 'scheming monopolists', 'clamouring' merchants and manufacturers, and he made the words 'rulers' and 'profligates' into synonyms, which gave a sharper edge to his impatience with the 'absurdities' of the ideas that ruled the political conduct of the 'upper orders' (*WN* 144, 339–340, 434, 612–614).

## Smith's history of Western Europe

The clearest characteristic of Adam Smith's thinking throughout all of his works is his sense of history, including in his use of the sparse details of pre-history to advance his conjectures of 'savages' fearing 'surprising' earthly phenomena (*EPS* 48), of 'two savages' endeavouring 'to make their mutual wants intelligible to each other' (*LRBL* 203), of a lack of 'sympathy and indulgence' among 'savages' and of their 'most sovereign contempt of human life' (*TMS* 205, 288), to which he added the 'propensity to truck, barter, and trade', which were the 'necessary consequence of the faculties of reason and speech' (*WN* 25).

Above all else, Smith's defining characteristic was to look backwards, not forwards. He rarely made a prediction about the future; he worked towards the 'present' from a distant age, most often starting from the ancient worlds of Greece and Rome, but oftentimes from the 'early ages' of mankind. He was knowledgeable about the habits and customs of recently discovered hunting modes of subsistence in distant lands from travellers' reports, regarding contemporary savages as representative of the earlier millennia of European societies.

He expressed his theory of history in his four 'Ages of mankind', which he designated as subsistence 'states which mankind passes through: Hunters, Shepherds, Agriculture, and Commerce' (*LJ* 14). His 'subsistence' theory of human endeavour was associated with the possibility (not the inevitability) of a search for ways in which to produce a surplus of food above biological subsistence so that, from the individual's point of view, their children survived beyond infancy and lived long enough to breed. Where increased food production occurred, there was an increase in local population (but not in per

capita food consumption), perhaps through many generations; where circumstances remained unpropitious for any reason, population levels were static or declined (Clark, 2007). The failure of most of the world to develop beyond the age of hunting by the eighteenth century suggests that there was no necessary social-evolutionary 'law' ensuring the inevitability of progress.

Smith's knowledge of history from Roman times led him to wonder why some parts of the human population had gone beyond the first age of hunting; why some had stayed in the age they had reached (shepherding or agriculture); and why a minority in Western Europe, which had first experienced the age of commerce before the fall of Rome in the fifth century, was now experiencing a revival in commerce, increasingly evident since the fifteenth century.

The 'missing' millennium since the fall of Rome was not just an incidental event; it had profound effects on the social evolution from agriculture to commerce. This context explains *Wealth of Nations*. As a mere textbook of economics, it made, and makes, little sense to those who know nothing of its context. Treating *Wealth of Nations* as a philosopher's report of his fastidious enquiry into the process by which commerce had emerged again, what exactly drove that re-emergence and what subverted the natural growth-inducing effects of commerce from happening, makes eminent sense. Because of the overarching policies of mercantile political economy and its associated nation-state management, *Wealth of Nations* excels above anything else produced in the eighteenth century.

I have blended together some biographical details though my major focus is on what Smith actually wrote, and I have made occasional and brief forays into what others alleged he wrote to facilitate understanding of the interconnected nature of his work.

# 2

## ‘sufficient proofs of his fitness’

### Introduction

Adam Smith became a man for his times, and what times they were two rebellions, one at home and one at abroad; two wars with France and, at his death in 1790, the opening exchanges in the violent French revolution. In this turbulent context, *Wealth of Nations*, the iconic book of his name, analysed the slow and gradual revival of commercial society from the fifteenth century and its significance. From 1604, Scotland and England shared the same monarch, and in 1707 they formed a parliamentary union. This was the Hanoverian and Unionist backdrop to Adam Smith’s professorship and fame.

### Adam Smith, Senior

Smith’s father, Adam Smith (1679–1723), a lawyer, served the Hanoverian cause prominently between 1705 and 1707, when the majority of Scotch MPs voted for union with England, amidst what is generally agreed as not-so-subtle bribery, not a little intrigue and a not very judicious measure of skulduggery (‘Bought and Sold For English Gold’ is how one side of the debate expresses it). History is less clear-cut about the bribery, but it remains a deeply controversial event 300 years later, with neither side willing to let go of their historical stereotypes of each other’s perfidy (Fry, 2006; Watt, 2007; Whatley, 2007).

Smith Senior served the unionist cause as private secretary to Hugh Campbell, Earl of Loudoun, the Secretary of State for Scotland, and he was the Clerk of Court Martial and Councils of War in Scotland for the 2nd Duke of Argyll, commander-in-chief of the army in ‘North Britain’, during the 1715 Jacobite Rebellion (Ross, 1995, 129). In return, Smith

Senior benefited from sparse patronage, and he died in the relatively disappointing post of the Comptroller of Customs for Kirkcaldy in January 1723, a few months before his son, also named Adam Smith, was born (Scott, 1937, 4–6).

Adam Smith's father, a native of Aberdeen, married twice. His first wife died before 1718 (Scott, 1937, 18). In 1720, he married Margaret Douglas (1694–1784), a daughter of Robert Douglas of Strathenry, a prominent landowner in Fife. Several of her relatives had farming interests, some of whom also had military connections (Ross, 1995, 2–3). Adam Smith Senior died (of what is not recorded) and was buried on 9 January 1723. His son, the world-famous Adam Smith, was baptised on 5 June (his birth date is unknown; old calendar; Bonar, [1894] 1966, 208). His father left his widow sufficient income and property to live comfortably, if frugally.

The Argyll brothers (the 2nd and 3rd Dukes) were dominant influences in Scottish public appointments in the first half of the eighteenth century, and Adam Smith Junior was to benefit greatly from the patronage of the 3rd Duke of Argyll when seeking his professorial appointments.

## Margaret Douglas Smith

By all accounts, Margaret Smith was an overly indulgent and loving mother of her sickly son (*EPS* 269). And she forged deep bonds with him that lasted for 61 of his 67 years until she died in his house in Edinburgh in 1784.

Margaret Douglas was intensely religious, leading some commentators, incorrectly I believe, to conclude from the absence of Adam Smith's direct disavowal of the scriptures in his books that he was a believer in 'revealed truth', or at least a 'Deist' of some kind (Denis, 2005, 1–32; Evensky, 2005; cf. Kennedy, 2009). Throughout his adult life, the ever-present threat from religious zealots kept him, and many others, from expressing overt opposition to the prevailing religious dogma.

## Adam Smith's education

Two factors assisted Smith's education: (1) his prodigious study habits, first at Kirkcaldy Burgh School and then at Glasgow College and later at Oxford University and (2) the influence of his sponsors (Scott, 1937, 26; Ross, 1995, 18–22). His mother and his guardians sent him to Glasgow College (University). Glasgow had the advantage of potential life-long patronage for Adam from his father's service for Lord Loudoun (a former

Glasgow College student). The College recognised young Adam, aged 14, as the 'son of the late Adam Smith at Kikcaldie' (Scott, 1937, 137, 364). Glasgow University was politically close to the Dukes of Argyll, and Glasgow was a highly pro-Hanoverian town.

At 14 years old in 1737, then a normal age for entering university, Adam Smith matriculated at the College. He studied at Glasgow for 3 years until he was 17 and was much taken with 'the never-to-be-forgotten' Professor Francis Hutcheson. He also studied mathematics under Professor Robert Simson, who had restored modern interest in Greek geometry (Scott, 1937, 32). Smith maintained a lifetime interest in maths, notably through Professor Matthew Stewart at the University of Edinburgh, formerly a fellow student at Glasgow.

Smith displayed continuing studiousness prompting his professors to nominate him for a much-coveted Snell Exhibition (Addison, 1901), worth £40 a year at Balliol College in the University of Oxford. Two conditions of the Snell Exhibition, one minor and the other major, were that the candidate should have studied for 3 years at the College 'without taking any Degree from Here or elsewhere' (Rae, [1895] 1965, 9; Ross, 1995, 68) and that the candidate made a 'solemn promise' (supported by a £500 bond) (Scott, 1997, 42) to be ordained into the Church of England on graduation and become a Minister in the Episcopalian Church in Scotland.

Smith's experiences at Oxford were unhappy ones. The teaching regime consisted of twice-daily prayers and twice-weekly lectures (*Corr* 1) by tutors indifferent to the quality of what they purveyed. Thirty years after he left Oxford, Smith lamented that 'the publick professors have, for these many years, given up altogether even the pretence of teaching', showing his lifelong lingering, undiminished and angry contempt of the Balliol faculty (WN 761). Hints in Smith's correspondence about what happened to him at Oxford suggest a medical condition bordering on a form of depression (hypochondria) arising from his over-studying and insufficient exercise, an affliction that David Hume, a fellow sufferer in his youth, called the 'disease of the learned' (Mossner, [1954] 1980, 60–80). But Smith's problems were not just his 'depression'; he experienced serious life-changing stresses. His cousin William Smith, one of his guardians and steward to the Duke of Argyll, who had worked with Smith Senior during the post-1707 events, visited young Adam to assist him to settle in at Balliol. He also had access to the Duke's nearby Adderbury House and took Smith there for a summer break in 1741, and possibly on other occasions, thus keeping up Smith's loose connection with the Argyll interest (*Corr* 2).

The other major sources of stress were of an intellectual nature: from his studies, his religious convictions appear to have been under siege, and possibly he shed his faith. By 1744, and coinciding with bouts of illness, he faced a practical challenge to his career intentions for, having met the bachelor's degree requirement, he had to move on to the *sylabus* for ordination into the English Church. Somewhere in this period, his philosophical studies conflicted with his religious obligations. An unconfirmed anecdote claims that he clashed with his tutors who, visiting his college rooms, found a copy of a book by David Hume and confiscated it as 'unsuitable' reading matter (McCulloch, [1828] 1863). If true, it supports the idea that Smith's disenchantment with Oxford was more than mere homesickness.

External events also combined to drive him to break his 'solemn promise' to the Snell Exhibition. Balliol College was home to a fair amount of Tory Jacobite romanticism, a belief in the 'divine rights' of kings and a disdain for the Hanoverian usurpers. 'Scotch' students from Glasgow felt unwelcome in this setting (Scott, 1937, 35–36).

The 1745 Jacobite rising led by some of the Highland clans marched to its dénouement at Culloden Moor on 16 April 1746, and its bloody aftermath of a heady mixture of battlefield cruelty, robbery and rapine. The servants of a frightened state resorted to vindictive capital punishment of captured rebels. Three Lords were beheaded, and 116 other rebels were treated to the usual awesome recipe of hanging, drawing and quartering, plus many instances of transportation, death in prison, the 'disappearance' of over 3400 men, and of untold numbers of women raped and their children killed were also reported (Ross, 1995, 81, quoting Lenman, 1981, 271–275; Fry, 2006, 80–95).

In late August 1746, Smith left Oxford (never to return) to visit his mother for the first time since he had left Glasgow 6 years earlier. Coincidentally, Francis Hutcheson died on 8 August, leaving a vacancy in the Glasgow Chair of Moral Philosophy. Young Smith more or less had made the fateful decision not to continue his studies at Balliol; 18 months later, he resigned 'all right & title' to the Snell Exhibition (Scott, 1937, 137, 336). His resignation was made easier by the judgement of the English courts that the £500 bond was not enforceable; of the ten Snell Exhibitioners who commenced before Smith, six took orders in the Church, and of those who commenced with him only one did (Scott, 1937, 43; cf. Ross, 79).

Dugald Stewart said Smith had decided to leave Oxford because he did not find 'the ecclesiastical profession suitable to his taste' and 'chose

to consult, in this instance, his own inclination, in preference to the wishes of his friends; and abandoning at once all the schemes which their prudence had formed for him, he resolved to return to his own country, and to limit his ambition to the uncertain prospect of obtaining, in time, some one of those moderate preferments, to which literary attainments lead in Scotland' (*EPS* 272).

Among his family friends were James Oswald – a former school friend a few years older than Adam, who had become an advocate and local MP, on his way to high office in the British government – and Henry Home of Kames (later, Lord Kames, a Scottish judge). Both men were early and lasting influences on young Adam. They conceived a plan to resolve the problem of his lack of a career. His search for a tutorship of an aristocrat's son came to nought (Ross, 1995, 82). Henry Home's plan had several elements to it. Smith would deliver a series of public lectures in Edinburgh on rhetoric and moral philosophy. He would compile his lecture material from his student essays and deliver them in his English accent, demonstrating to students from the local university and their parents how they should speak if they wanted careers in the 'New Britain'. They would also benefit from hearing a fresh approach to their subjects in English (lectures at that time were usually delivered in Latin), and local adults would also benefit from revision classes in the latest modish thinking on topics related to morality that were interesting in their own right. His sponsors – Henry Home, Oswald and, perhaps another close friend of the family, Robert Craigie of Glendoik – provided the initial funds and made arrangements to commence his lectures in Edinburgh in 1748. Lecture series were popular with the Edinburgh public at that time, and sufficient numbers attended Smith's lectures to provide him with an income of £100 a year (*Corr* 24).

## A professor is chosen

Smith's Edinburgh lecture series was organised each winter from 1748 to 1751, in which he delivered lectures to what was described as a 'respectable auditory, chiefly composed of students in law and theology' (Ross, 1937, 87; Tytler, 1807, i.190). News of the death of Professor John Loudoun, who held the Chair of Logic at Glasgow College and whom Smith knew from his student days, started a chain of events that brought Smith his professorship. Loudoun died on 1 November 1750. At the news, the usual excitement of the hunt for his replacement made potential candidates take soundings as to their chances. Somewhere in the polite pack, Adam Smith's name came into contention. His senior



advisors reconnoitred the field and discreetly tested the inclinations of those who could influence the formal decision.

For a professorship, a successful contender required strong 'interest', an eighteenth-century term to describe the men with influence who decided, informally, who was appointed to almost any office in British society, from the lowest through to a Minister of the Crown. In Scotland at that time, the Argyll family had the strongest interest, and Adam Smith already had powerful, if largely emotional, connections through his father's legal services to the Duke of Argyll.

With the evidence of his successful Edinburgh lectures, Smith stood a good chance, particularly if his allies, including his cousin William Smith, who had served both the 2nd and 3rd Dukes, could swing Archibald, the 3rd Duke, behind his candidacy (Scott, 1937, 66). He could rely on the support of his sponsors: Henry Home, a rising star in the Scottish judiciary; and James Oswald MP, rising in national politics towards a British Ministry. The 3rd Duke of Argyll, was the younger brother of John, the 2nd Duke (who had died in 1743), and unusually for an English aristocrat, went to Glasgow University, not Oxford, and like his brother John, had considerable influence in Scottish affairs from delivering the votes of Scotch MPs and Lords to grateful ministries at Westminster. In return, governments left Scottish appointments to the discretion of the Argyll's, and it is estimated that the two Dukes between them secured the appointment of 55 professors, 20 of them to chairs in Glasgow University between 1723 and 1761 (Emerson, 1995, 21–39).

The University decided on 19 December to elect a successor to Loudoun on 9 January 1751. No doubt, the usual intense but subtle lobbying had continued since the vacancy was announced in November. By 27 December, George Muirhead and Adam Smith emerged as the front runners. Smith's election was not plain sailing. There was some kind of kerfuffle among the professors over Smith's appointment, involving rounds of correspondence (now lost) between them and Principal Dr Neil Campbell (*Corr* 334–336). One professor wrote to the Duke of Argyll, which annoyed the Principal and Smith. In the event, the professors – three of whom knew Smith as a student – elected him unanimously, and Robert Simson, his former teacher of mathematics, sent him a letter dated 9 January 1751 inviting him to Glasgow 'as soon as his affairs can allow him, in order to be admitted' (*Corr* 4), subject to his formal acceptance and his giving 'sufficient proofs of his fitness' by presenting a dissertation, *De Origine Idearum*, as a 'trial of his qualification', perhaps reflecting concerns about his unproven credentials among sceptics (Scott, 1937, 138).

Interestingly, Smith, wasting no time, replied by letter on 10 January and presented himself at the University on 16 January, read his dissertation (presumably in Latin as was customary for professors at that time), took the requisite oath of the Calvinist Confession of Faith, was admitted and, showing supreme confidence, promptly returned to Edinburgh on 'business', with a commitment to commence his teaching in the new session in October (Rae, 1895, 42–43; Ross, 1995, 109).

When he started teaching in October 1751, there were minor problems with the acceptance of his syllabus in place of the traditional logic syllabus taught by Professor Loudoun. John Millar, a student and later a friend and colleague, informed Dugald Stewart many years later of Smith's decision to depart 'widely from the plan that had been followed for years by his predecessors' because he found, disdainfully, the classical logic syllogisms an 'artificial method of reasoning' (*EPS* 273–4; Ross, 1995, 110).

Almost immediately, a fortuitous event unfolded. Shortly after Smith moved to Glasgow in time for the new session in October 1751, the College was informed that Professor Thomas Craigie, holder of Professor Hutcheson's Chair of Moral Philosophy, had died in Lisbon on 27 November while on sick leave. The Senate had already made arrangements in September to cover Craigie's classes, and Smith had agreed to deliver his lectures on Natural Jurisprudence and Politics. His temporary appointment to teach parts of the Moral Philosophy syllabus placed Smith in his element; he had an advantage over rival candidates, should any emerge, from his obvious superiority in his chosen field. He had attended the principal's meetings before he started teaching and had undertaken administrative chores (Scott, 1937, 66; Ross, 1995, 145–151). Interestingly, compared to his speedy election to the Chair of Logic, his appointment to the Chair of Moral Philosophy took nearly twice as long. It took 77 days to appoint Smith in 1750–1751; in 1751–1752, it took 150 days. On 22 April, the University announced that 'Adam Smith Professor of Logic in this University was elected unanimously to the Chair of Moral Philosophy', and he was formally admitted as professor on 29 April 1752 (Scott, 1937, 139–140).

Adam Smith had arrived where he wanted to be by a mixture of intellectual ability, a well-managed interest campaign, the skilful demonstration of his teaching credentials and the right measure of judicious nursing of the men of influence in Scottish society from those who had warmed towards his interests because of his father's loyal service to the Hanoverian cause. Just short of his 29th birthday, the first phase of his life concluded and his most productive intellectual phase began.

# 3

## ‘in the first ages of society’

### Introduction

Moral philosophy was taught in the eighteenth century as a broader subject than it is today. From 1751 through to 1764 Smith taught Natural Religion, Ethics, Rhetoric and Jurisprudence. Looking at Adam Smith’s writings and reports of his lectures, we can see a common theme running through them. They constitute a distinct *oeuvre*, not a series of ‘one-offs’.

### Smith’s common theme

Dugald Stewart thought it was when Smith was at Oxford (1740–1746), or not long after (*Corr* 87–88; Bonar, [1894] 1966; cf. Noordegaaf, 1977), that he ‘cultivated with the greatest care’ his interest in languages (*EPS* 272). His *Lectures on Rhetoric and Belles-Lettres* (LRBL 1985) show him seriously thinking about the origin of languages, their grammatical structures and their formation. Smith published an essay on language in *The Philological Miscellany* (1761) (LRBL 203–226) and in the third and subsequent editions of *Moral Sentiments*. His neglected essay on languages (hereafter *Language*) is regarded as a major statement of his scientific approach (Otteson, 2002).

Stewart adds that Smith’s interest in languages was ‘uncommonly extensive and accurate, and, in him, was subservient...to a familiar acquaintance with every thing that could illustrate the institutions, the manners and the ideas of different ages and nations’ (*EPS* 272). This points to the comprehensive nature of Smith’s ‘particular sort of inquiry’ and that he had a common analytical approach. Stewart continues,

When...we compare our intellectual acquirements, our opinions, manners and institutions, with those that prevail among rude tribes, it cannot fail to occur to us as an interesting question, by what gradual steps the transition has been made from the first simple efforts of uncultivated nature, to a state of things so wonderfully artificial and complicated. Whence has arisen that systematical beauty, which we admire in the structure of cultivated language... Whence the origin of the different sciences and of the different arts; and by what chain has the mind been led from their first rudiments to their...most refined improvements? Whence the astonishing fabric of the political union; the fundamental principles which are common to all governments; and the different forms which civilized society has assumed in different ages of the world?

There was 'very little information' on the history of these subjects because most of the ages they went through occurred long before they were recorded. This made it essential to reconstruct 'fact by conjecture' by 'considering in what manner they are likely to have proceeded, from the principles of their nature, and the circumstances of their external situation', or what Stewart called 'Theoretical or Conjectural History...' (EPS 292–293). These passages show that Smith conceived of them as the 'gradual steps [of] transition' in what we would call a 'social evolutionary process' (292).

### Smith's 'market model'

James Otteson uses Smith's conjectures in *Language* to illustrate an early application of what he calls Smith's 'market model':

the market model is at work in the essay on language, in [*Moral Sentiments*] and in [*Wealth Of Nations*], as well as to varying extents, in some of Smith's other works, and the model can moreover serve as an organising principle for understanding his examination of human institutions generally.

(Otteson, 2002, 258)

Otteson sees *Language* as the centre piece of the 'deep methodological unity' in 'Smith's corpus'.

Smith advanced historical views of social phenomena, using what Samuel Fleischacker succinctly describes as a 'backward-' not a

'forward-looking' enterprise (Fleischacker, 2004a, 33). The evolution of language fascinated Smith as it did many of his contemporaries (Rameau, 1737; Condillac, 1746; Diderot, 1755, Rousseau, [1755] 1984). Smith and his contemporaries had a general awareness that human modes of subsistence had developed from unknown ancestors in remote times.

He questioned the changes and progress of human language by resorting to a device, dismissed disparagingly today as a 'Just So' story (after Rudyard Kipling). The pre-history of language is closed to direct retrospective observation (sounds do not fossilise), but modern studies of genetics are an indirect indicator of the movement and mingling of human societies. Smith's story asserts what would happen if 'two savages' (a contemporary term without racist connotations) (Ellingson, 2001) met who 'had been bred up remote from the societies of men' and had 'never been taught to speak'. How would they 'naturally begin to form that language by which they would endeavour' to 'make their mutual wants intelligible to each other' by 'uttering certain sounds whenever they meant to denote certain objects' (LRBL 203). This allowed him to tease out conjectures of how they, and their descendants, could create a mutually intelligible language.

His essay on *Language* is about their progress from single-word sounds to fairly complex language structures. Smith asserts that the first word-sounds invented would have been nouns, such as 'cave, tree, [and] fountain', then, in some order, classes of objects (rivers), adjectives (green, red and blue), prepositions (of, above and below), numbers (many and few) and verbs. No affirmation can be expressed without the assistance of some verb. We never speak but in order to express our opinion that something either is or is not. But the word denoting this event, or this matter of fact, which is the subject of our affirmation, must always be a verb (LRBL 215).

It can be noted in his argument that dialogue remains strictly limited until they progress towards agreeing on the sounds to represent what they are trying to communicate, and the natural order for progress requires that they agree fairly early on, after nouns, to the sounds for verbs. Given the uncontrolled and undirected process by which words would be formed, there is no implication that any two individuals would hit upon instant, or even easy, agreement on what a spoken sound meant. Too complicated, too difficult to remember, too easily forgotten or too like another word sound, and it could prove fatal – for example, the imperative for 'danger' must be distinct and acted upon instantly. We know from studies of primates and monkeys that certain sound-sets appear to have commonly understood meanings for a particular

band – warnings about nearby predators, eagles, leopards and snakes, for instance – though there is no implication that animal cries are languages. But whether human language evolved from animal-like cries, was nurtured in human dancing and 'songs', or from other routes, we do not know.

Smith did not describe actual events from particular language formations (that would have been a conjecture too far); he only speculated on a grammatical order that a formation process might go through. Nor did he assert anything about the time it might have taken from the uttering of the first word to the functioning of a language. Given that languages change considerably in a 1000 years, modern humans with the physiological apparatus, capable of uttering speech sounds, had the necessary time to evolve from simplicity to sophistication. Word-sounds proliferated into many languages as humans migrated across the world's wildernesses. Within these limitations, Smith traced a possible evolutionary order in the evolution of word-sounds from nouns to adjectives, prepositions, participles, pronouns and verbs. His teaching of language evolution suggests that he was satisfied with the efficacy of his conjectural method.

### An exchange model?

Smith's emphasis on the deliberations of how two imaginary speakers pondered how to 'make their mutual wants intelligible to each' (LRBL 23) was a problem shared all across the human species: How did they express themselves to get what they want besides using violence or domination behaviours? His choice of making 'their mutual wants intelligible' by their attempted discourse is a subset of his central proposition that humans satisfy their 'mutual wants' through *exchange* interactions, and it is in that process that Smith's methods flower.

*Homo sapiens* had a large brain and a two-legged gait, made primitive stone tools and, with speech, what we think of as humanity became possible. In the absence of speech and language, our predecessors pursued their wants the same way all animals do, by using various, including murderous, degrees of enforcement, coercion and dominance. Speech began the long process that allowed humans eventually to choose between violence and exchange, making them different, potentially, from all other animals.

Otteson summarises Smith's purpose:

Smith's point [in *Language*] is that this natural formation of language happens without conscious deliberation – but that does not

mean it happens lawlessly or haphazardly. Indeed, if language developed without rules prescribing proper usage, there could then be no communication, and hence no satisfaction, of wants – which Smith thinks is the final cause of languages. Rules for the use of words are formed even as the words themselves are formed: this word, pronounced precisely in this way, applies to this object; that word, pronounced in that way, to that object. The rules initially constitute informally agreed-upon protocols; in time they become formal rules that get taught to children and sometimes written down as rules of grammar.

(Otteson, 2002, 265)

The rules were established by mutual consent, an aspect of interactive human behaviour of importance to Smith. He directed his intellectual output at emphasising the mutuality of human conduct through chains of exchange relationships arising from the dependence of each person in society on the services of many independent others. He did this too in respect of the human institutions of property, laws and morality. Smith celebrated man's early total dependence on others. Rousseau confused the difference between the physical chains of slavery and the voluntary chains of exchange relationships and detested mutual dependence. He made his ideal the 'manly' independence of a mythical bygone age, when man was free of dependence upon others.

## Origins

Questions of the origins of society led to imaginative debates throughout the seventeenth and eighteenth centuries. Two main camps were in evidence: (1) those who believed that humans formed societies because they were induced by 'social contracts' to do so (Locke) and (2) those who believed they were coerced or induced into societies by powerful sovereigns (Hobbes). All views of society's origins were fuelled from travellers' accounts of 'savage' societies in America, Africa and the Pacific islands (Charlevoix, [1722] 1961; Lafitau, [1735] 1974; Hawkesworth, 1773; Cook, 1777). Prior to travellers' accounts, educated Europeans only knew of predecessor societies from the ancient Greco-Roman classics and the archaeological detritus scattered across the European continent, around the Mediterranean and near Asia, and from their Bibles. From cross-Atlantic contact after 1492, they read about even older, unknown pre-civilisation societies, and it gradually dawned

that the larger part of the world had in the distant past also consisted of 'pre-civilised' societies similar to those recently found in the Americas and Africa. There were also two great but stagnant civilisations in arrested development (India and China) with populations exceeding 100 millions.

The savage societies in North America posed a unique problem: nobody (the authors of the Bible included) knew of them. How then did America fit into the biblically inspired belief in the Eden-to-Europe progression? Even the Bible's accounts of the Eden Garden reported the existence of shepherd and farming societies, against which reports of the North American Indians without shepherding and without significant farming showed their mode of subsistence to be truly ancient. The Americans had languages, art and dance cultures, and relied on their hunter-gatherer economies, with notional plant gathering for seasoning and some limited evidence of well-established farming and fishing economies (and stone structures) before the Europeans arrived in Central America.

John Locke declared that 'in the beginning all the world was *America*', and it was eventually realised that every human society had lived the life of the hunter mode of subsistence at some point in its history (Locke, [1690] 1988, 343; Meek, 1976, 22, 40–41). The 'rude' societies of America, therefore, were a veritable theme park on the lives of Europe's distant ancestors.

Imagination led to different conclusions about society's origins, one of which, for example, imagined that a war-weary people passed power to a 'sovereign' who kept the peace by pacifying its members and threatening to return them to the terrors of the 'war of all against all' (Hobbes, [1651] 1946, 82). In an alternative view, equally imaginary, society corrupted the freeborn, self-reliant man, who, after he abandoned hunting for shepherding, degenerated into a servile dependence on others for his every want (Rousseau, [1755] 1984). Smith and others presented different accounts, which are closer to modern research (Meek, 1976, 68–72). Hobbes' claim was that an approximation of the pre-civilisation life was to be found among '...the savage people in many places of America' who 'live to this day in that brutish manner' (Hobbes, [1651] 1946, 83).

## Four ages of mankind

Long before Smith sat in Hutcheson's class and heard his sketch of the 'ages of Society', he was familiar with the Bible's allegory for the origins and ages of mankind in the fable of the expulsion of Adam and Eve from



the paradise of the Eden Garden for eating the fruit of a forbidden tree (Genesis 3.1–19, 4.2–17).

According to the anonymous authors of Genesis, Cain, Eve's first-born, 'a tiller of the ground', murdered Abel, his younger brother, 'a keeper of sheep'. Encapsulated within the Bible fable, the 'Garden of Eden' represents the age of the gatherers (Adam and Eve), followed by Abel's age of the shepherds and Cain's age of agriculture, all within, apparently, the first generation of the 'first' family. God ended the mythical 'Golden Age' of the gatherers and their 'easy', because plentiful, lifestyles; Cain, for theological reasons, murdered the shepherd, and the exiled Cain's agriculture flourished in a land called 'Nod, east of Eden'. A more likely motive for the brothers' discord was a murderous row after Abel's sheep strayed and ate Cain's crops, an event sure to strain brotherly relationships. Agricultural prosperity led to permanent settlements (for example, Cain's 'City of Enoch'), which in Smith's version started the age of commerce.

The four ages thematically underlay his *Lectures on Jurisprudence* [1762–1763] and on political economy (*LJ* 14–15). However, Smith did not originate the theory (Meek, 1976; Pescarelli, 1986, 84) – he derived 'vague hints' of it from attending Hutcheson's lectures (who derived his ideas from Samuel von Pufendorf, [1729] 2005).

Smith's exposition of the age of hunters shows his acquaintance with eighteenth-century literature from voyages, travellers and explorers (*LJ* 20n21; *LJ* 201n43; Charlevoix, [1744] 1961). All theories of the ages of mankind had the benefit of real-world examples in the eighteenth century. Besides Smith's, numerous versions of ages theories circulated between 1724 and 1780 (Mandeville, 1724; Cantillon, 1755; Douglas, 1747; Montesquieu, 1748; Hutcheson, 1755; Dalrymple, 1757; Kames, 1758; Quesnay, 1759; Turgot, 1766; Ferguson, 1767; Steuart, 1767; Helvetius, 1773; Gibbon, 1776; Robertson, 1777).

Anyway, in the successive modes of subsistence theory, the anonymous authors of Genesis trumped them all.

## Smith's conjecture

Smith determined the four distinct states that mankind pass through – the Age of Hunters, the Age of Shepherds, the Age of Agriculture and the Age of Commerce (*LJ* 14) – making them the substance of his explanation of the 'original or foundation' for the motivating desire for 'treating of rights' of property (*LJ* 13). He related property rights directly to the 'mode of subsistence' prevalent during the different ages of Man. In due

course, he went beyond these to their socio-economic consequences for society's long road to the age of commerce. Smith was in no doubt that the evolution of property was the key to progress from societies of the brutes towards civilisation.

Without property, humans within their habitats remained a low-density species until some of those whose ancestors had discovered property eventually explored and found those devoid of any concept of property. Only with the development of higher forms of subsistence did armed hordes of shepherds overcome a property-conscious, successor age of man, as in the Western Roman Empire (WN 689–708).

Smith says that initially, as hunters, people would rely only upon 'wild fruits and wild animals', and 'Their sole business would be the hunting of wild beasts or catching of fishes'. It is the age of the male hunters; the female gatherers were disregarded ('the pulling of fruit can hardly be called an employment'; *LJ* i. 27), though female gatherers provided the bulk of human diets in all known hunter-gatherer societies.

A nation of hunters had 'no regular government' at all, and it was 'easy to see that in these severall ages of society, the laws and regulations with regard to property must be very different' (*LJ* 16). He tied the system of justice to a society's mode of subsistence, which was shared by most theories of human social evolution. In debates about similarities between known societies and what was reported about North America, the similarities in the scope of justice led to assertions that because of them they must be descended from the same human stock, which was in fact true, but not in the way its proponents understood it. The similarities in the scope of justice came from their similar modes of subsistence and not from implausible myths of 'lost tribes'.

Small societies consisted of a few independent families, living in the same camp and speaking the same language (*LJ* 404). When disputes broke out the whole society deliberated on the alleged offence and, where possible, reconciled the parties, but failing reconciliation, it could banish the miscreants, kill the disputants or permit an injured party to obtain violent redress. But this was not a rule by a government acting upon delegated or assumed powers, because action to enforce their justice required the entire society's consent, living as they did 'according to the laws of nature'.

Population growth drove humans through the four ages (Spengler, 1983, in Wood, volume 3, 395–406). Population growth presupposes sufficient food to reduce infant mortality and to extend longevity, and there is bound to be a period needed for one to 'catch up' with the other. As 'their numbers multiplied', Smith noted, 'they would find the chase

too precarious for their support' (*LJ* 14). This suggests that the search for new modes of subsistence followed population growth, but population growth was as likely to follow the discovery and the spread of a new technique for making an existing mode of subsistence more efficient, or the discovery of a new mode of subsistence.

Smith accelerated the process through the ages, when in historical fact the ages took many millennia. The rate of change quickened from agricultural settlements in the Near East, about 8000 years ago (though the earliest farming practices appeared about 10,000 years ago along the Turkish/Syria border areas), followed by the appearance and spread of simple commerce, 3000–4000 years ago (Sokal et al., 1991; Relethford, 2003; Weisdorf, 2006).

Societies of shepherds 'first gave rise to regular government'. Until there was property, asserts Smith, there could be no government, the purpose of which is to 'secure wealth, and to defend the rich from the poor'. In the inequality of fortune, the rich were able to muster fighting men to protect their property, and not just against the aspirations of poor people, for it is likely that rich neighbours also harboured ambitions on their property. Rich shepherds, having no domestic manufactured 'luxuries' to 'purchase', had no means of 'spending' their wealth (mainly sheep and cattle); they could only exchange sheep, surplus to their own needs, in return for services rendered by the poor. This created dependence of the poor on the pleasure of the rich, and with near total dependence (the alternative was dire), the influence of the rich grew over the indigent poor, making them, in effect, 'slaves' (*LJ* 11–12).

Smith asserts confidently that the age of shepherds pre-dated the age of agriculture, because the 'Tartars and Arabians' known to Western Europe subsisted entirely on their flocks and knew nothing of agriculture. He also insists that 'whole savage nations which subsist by flocks have no notion of cultivating the ground' (*LJ* 15).

The loose sequence of the four ages was an ideal type, rather than a dated historical sequence, and the succession of shepherding by agriculture was not a 'revolution', as is normally implied, which only took generations, nor was it a case of the physical elimination of troublesome shepherds and their flocks by vengeful farmers (Genesis writ large). It was a long drawn-out process of technological and economic change, innovation and imitation, with hunting, shepherding and agriculture coexisting side by side for many millennia, until agriculture finally triumphed.

Population growth once again drove Smith's next age. '[W]hen a society becomes numerous they would find difficulty in supporting themselves by herds and flocks' and 'would naturally turn themselves to the cultivation of land' (*LJ* 15). This may have happened, but not without the usual problems of transition. Free-ranging herds and flocks in close proximity to fields of grain and vegetables make for fractious disputes. Where there is discord, there is a role for the peaceable resolution of disputes (laws) and, for longer-term tranquillity, a proclivity among the parties for dispute avoidance, enforced when necessary by severe systems of justice.

Agriculture, Smith says, was probably discovered by observing accidental contamination and by deliberate experiments. He knew his Bible (Matthew 13.3–8) from his protestant upbringing and he paraphrased the 'some fell on stony ground' parable. Some of the seeds would come to nought, but other seeds would enter the soil and proliferate, reproducing themselves and creating a surplus for consumption (and, in time, for 'truck, barter and exchange'). Observation, he said, showed that certain trees, as well as certain plants, produced nourishing food, and by this means 'they would gradually advance into the age of agriculture' (*LJ* 15). Agriculture, in helping to develop a primitive division of labour, presaged its potential for a commercial age. People developed arts and skills in the production of a range of produce suitable to their environments, enabling some persons to cultivate different kinds of produce, others to supply different kinds of value-added services, such as clothes, household carpentry products, saddles, forges, ploughs and so on. People, said Smith, would then 'exchange with one another' their surpluses over what 'was necessary for their support' and 'get in exchange... the commodities they stood in need of and did not produce themselves', linking the ages of mankind to the exchange principle to explain ancient human history (cf. Polanyi, 1944).

What began as an occasional exchange between individuals within the same society would become an exchange between individuals 'of different nations', and with this development 'at last the age of commerce arises' (*LJ* 15–16). Smith did not predict how society and its ages would evolve in the future.

Truly, man does not live on bread alone (before farming, he did not live on bread at all). Nor did he ever live alone. We have always lived in societies, sometimes of just a few families, sometimes with the females living separately from an adjacent group of males, close enough to intermix and mingle on occasion as their biological instincts inclined

them. We know this because it is what primates do, back along the evolutionary line to the common ancestor.

Survival had to be among the most basic, even if it was the only, rule enforced by the group. The urge to live and avoid death needs no rational process of prior thought; all animals share it without thinking about it. Smith observed that 'no social intercourse can take place among men who do not generally abstain from injuring one another' (TMS 87), adding pointedly, 'If there is any society among robbers and murderers, they must at least...abstain from robbing and murdering each other' (TMS 86). These kinds of minimal conditions, and others that were added in time, were operational within societies whose members lived long enough to breed and nurture their young. If societies of humans meet minimal conditions, then social evolution – much of it captured in Smith's exchange model – explains how, without planning and pre-existing notions of morality, moral sentiments emerged after a long social evolution and long before anybody articulated what to call them.

# 4

## ‘so weak and imperfect a creature as man’

### Introduction

How do human societies hold together? What are the minimum conditions for their continuance? *Moral Sentiments* (1759) addresses these questions and much more, but our focus necessarily must be narrower.

*Moral Sentiments* discusses what constrains individuals to certain minimal standards of conduct while living with, and as, relative strangers in close proximity to each other in society. The net effect of his imaginative construct, the impartial spectator, is to show that people can and do live in relative harmony, or at least in the absence of general murderous violence common in all kinds of societies in the distant past (Wrangham and Peterson, 1996; Kelly, 2000; Seabright, 2004), and because nothing is perfect that emanates from ‘so weak and imperfect a creature as man’ (*TMS* 77). Smith’s explanations maintained their credibility when he explained the process of moral formation in societies devoid of the habits, institutions and religious teachings with which he and his readers were familiar.

If religious precepts and pulpit exhortations are not enough (Hirschman, 1977, 15) to induce people to behave morally in societies that share the same precepts, what replaces exhortation in societies where people do not share common religious precepts or are entirely ignorant of them, including those earlier pagan societies throughout prehistory? Did they have any binding moral force within them? Smith’s theory explained what curbed unruly and vicious passions arising from greed and selfishness. If exhortations failed, could they be curbed as naturally as Newton’s laws of gravity bound everything within their scope?

## The looking-glass

Smith asserts that we approve or disapprove of our conduct according to how we imagine others see, or are likely to see, our behaviour. In other words, we try to anticipate the views of a 'fair and impartial spectator' examining our behaviour, 'as it were, with his eyes and from his station', and because we can 'never survey our own sentiments and motives' or 'form any judgement concerning them' unless we view them 'as at a certain distance from us', we can do this 'no other way than by endeavouring to view them with the eyes of other people, or as other people are likely to view them'. We only approve of our conduct if it receives 'the approbation of this supposed equitable judge', the impartial spectator, and 'if otherwise, we condemn it' (TMS 110).

It is from the social pressures of living in society that we judge the merits or demerits of our behaviours. It would be easy to overlook this observation. Smith dramatised it neatly. Suppose a person grew to adulthood without contact or communication with fellow members of the human species. In these circumstances, 'he could no more think of his own character, of the propriety or demerit of his own sentiments and conduct, of the beauty or deformity of his own mind, than of the beauty or deformity of his own face' (TMS 110). He cannot do so because he does not have a 'mirror to present them to his own view'. But 'bring him into society, and he is immediately provided with the mirror which he wanted before.' And the 'mirror' in this sense is Smith's powerful metaphor for what living in society does to a person's sense of character and beauty. Society mirrors our person, giving us feedback on what is and what is not acceptable in our behaviour. The people we live with show in their 'countenance and behaviour' what they think of our behaviour. As children, we notice when relatives approve and disapprove of our conduct, and it is here that we first view the 'propriety and impropriety' of our own passions. But for the man 'outside' society, in Smith's example, whatever are the objects of what pleases or hurts him occupies 'his whole attention' and his passionate reactions would 'scarce ever be the objects of his thoughts' (TMS 110).

Bring this outsider into the society of others, and all his 'passions immediately become the cause of new passions' because some of them will be approved of or will disgust other people. 'He will be elevated in the one case, and cast down in the other', and this creates a new situation in which his passions will 'call upon his most attentive consideration' (TMS 111). We do likewise in matters of beauty and personal form, and we judge ours by 'the shape and appearance of others' and

are anxious to know how far our figure 'deserves either their blame or approbation' and place ourselves 'before a looking-glass' to 'view ourselves at the distance and with the eyes of other people'. If satisfied, we shrug off the casual judgements of others, even when they spot small defects; if we are not satisfied, we are mortified 'beyond all manner' by the smallest of instances of disapprobation, even a 'joke'. None of this would affect the man 'outside' society because he would be indifferent to the views of non-existent others (TMS 111–112).

To what extent are we indifferent to the views of other people? Robert Burns wrote a poem ('To a Louse', 1786), lines from which read (in English), 'We would save ourselves from many a blunder and foolish notion if only we could see ourselves as others see us' (Burns, [1786] 2001, 130–132).

Robert Burns was born in 1759, the same year that Smith published *Moral Sentiments*, and it is said that *Moral Sentiments* influenced Burns composition of 'To a Louse' (Raphael, 1975, 89). Unlike Smith, who theorised about the consequences of imagining how other people in the persona of 'impartial spectators' might judge our behaviour, Burns wrote of our blindness to the perceptions of others and how our vanity masks our imperfections. In truth, others who weigh us in the balance find us wanting (as we do them). 'To see ourself as others see us' expresses their different perspectives: Burns, pessimistically, reminding us of human frailty and its consequences; and Smith, optimistically, mapping how humans discover and maintain their moral senses. Smith, contrary to the poet's assertion, says we do have the power 'to see ourself as others see us', and he explains how we exercise it. We have this power from what we may crudely describe as our conscience, which has a (weak) potential to resist self-deceit. Smith is explicit:

...self-deceit, this fatal weakness of mankind, is the source of half the disorders of human life. If we saw ourselves in the light in which others see us, or in which they would see us if they knew all, a reformation would generally be unavoidable. We could not otherwise endure the sight.

(TMS 158–159)

We are not indifferent guardians of our reputations. In practice, other people are our 'looking-glass' through which we see ourselves in their eyes, not ours. Once satisfied with what we believe they see (beware hubris!), we are less flattered by the applause of some and less bothered by the censures of others if, in the main, what we believe they see indicates natural and proper approval of our behaviour. In this manner,



our 'first moral criticisms are exercised upon the character and conduct of other people' in so far as they might affect us, and we are 'very forward' in expressing our views. But the traffic is not all one-way. We soon learn that others are equally forward in their criticisms of us! This causes us to review our conduct by imagining how we appear in the eyes of others. If we wish to become less worthy of censure and more worthy of praise, we must discover how we might improve our behaviour. In effect, we become 'the spectators of our own behaviour', and we imagine how other people 'scrutinize the propriety of our own conduct' (TMS 112) through their eyes, not ours.

When other people sharply divide in their sentiments towards us, whom do we believe, our friends or our critics? If we believe what we see in the looking-glass of the spectator, we are 'tolerably satisfied' and can discount the applause and downplay any censure. On the contrary, we may be doubtful about the merits of their disapprobation, and provided we know we have not already 'shaken hands with infamy', we are doubly struck with the severity of their disapproval. But if we are secure in our beliefs that we are 'the natural and proper objects of approbation', because our imagined spectator's view of us is 'tolerably satisfied', we may reject misrepresentations of our conduct by others (TMS 112).

Smith's argument takes us right back to Burns' scepticism: do people really see themselves as others see them? Smith's response is ingenious. Society is our mirror, our looking-glass, and we create our moral compass from living in it, at least in so far as we avoid causing offence to others, but is this sufficient for us to act positively in a moral manner?

## The impartial spectator

Smith's impartial spectator contributed to the eighteenth-century debate on why society held together despite all the dreadful things that humans living in close proximity could do (and sometimes did) to each other. He begins on his road to it by introducing his notions of 'sympathy' and 'impartial spectators'. However selfish we may suppose people to be, yet their nature interests them in the fortunes of others, and they derive pleasure from their happiness and sorrow from their unhappiness. So obvious are these emotions or sentiments, like all the original passions of human nature, that Smith claimed they required no proof (Fleischacker, 2004a, 36–44). He assures us that even 'the greatest ruffian, the most hardened violator of the laws of society', is not altogether bereft of this sentiment (TMS 9). Evidently, he believed that there are principles so deep in human nature that all people feel them to some

degree, without anybody, preachers included, having to tell them how to behave. And it is good that we share this common sentiment because preachers are not always listened to or on hand to correct our failings (nor immune to their own failings).

We cannot see inside the minds of other people, nor can we have direct knowledge of how they feel or what they intend. We can only imagine what we would feel if we were in their situation (TMS 9). When we observe incidents affecting other people, we imagine ourselves in their situation. And when we observe a particularly dramatic situation – someone about to suffer a blow to their arm or leg, or a dancer on a tightrope swaying to hold proper balance – we draw back the same limb, and sway slightly in like manner to the tightrope dancer. In our imagination, we feel that we are in their situation and we know this 'by many obvious demonstrations' (TMS 10).

Smith introduces his 'attentive spectator', or the 'bystander', whose sympathetic emotions always correspond to what we imagine should be the sentiments of the persons we observe in their various situations. And what is true for us is true for most everybody else! In Smith's world, we are real players, though he makes full use the imagery of the theatre to help his readers understand his message (Griswold, 1999, 63–70). Everybody playing is aware of others watching, as if players are also spectators and spectators are also players. Players imagine how spectators regard whatever they do or experience; spectators imagine how they would feel if they experienced the player's experiences. Whichever role we play, as player or spectator, and no matter how many times we switch between them, sympathy is the common factor in both.

Smith takes the notion of the spectator a step further. He asks us to think of the spectator as present 'in the breast', in our imagination and operating on our behaviour as if we know he watches what we are doing. This imaginary spectator, no less real in his effects on our behaviour, has the same characteristics as an *anonymous* stranger observing our behaviour, specifically in his disinterest for or against our fortune or misfortune. He is neither disposed nor ill-disposed for or against us. He is impartial, and acts at all times as an *impartial spectator* of our conduct. Smith refers not just to the human sympathies of 'pity or compassion' associated with a deep and genuine understanding of the sorrows and sufferings of others. Smith specifically uses the word 'sympathy' to denote our feelings for any human passion 'of which the mind of man is susceptible', including sympathy for the great joy someone experiences from a happy event (TMS 10). Sympathy, then, is not confined to the commonly accepted sympathetic passions of 'benevolence' or 'altruism'

(TMS 10–11). Smithian sympathy applies to every passion that we can experience. We might think of ‘empathy’ (fellow feeling), or the ability to share or understand another person’s feelings, irrespective of their causes and mood, as a better name for this emotion than sympathy.

The spectator’s compassion is limited to how he imagines he would feel if he was in our situation, and because he cannot have a perfect understanding of how we feel about our situation unless he was actually in it, we cannot expect him to feel as strongly as we do about the source of our feelings. And from this, Smith explains how humans find harmony in their relationships (or at least anonymous neutrality). How, for instance, can someone else, even a friend, feel as we do in matters of love and romance? His imagination does not contemplate our lover in the same light as we do; to him, our passion appears ‘ridiculous’, though we are pardoned because ‘love’ is considered natural to persons of a ‘certain age’. A lover, notes Smith somewhat sardonically, ‘may be good company to his mistress, he is so to nobody else’ (TMS 31).

When the spectator contemplates impartially the object of his observations, as most spectators must do because we all have fewer friends, even counting distant acquaintances, than the rest of mankind added together, his compassion is unlikely to be swayed by positive or negative prejudices for or against us. To share sympathy for something that already brings us great joy enlivens it but does not change it. His sympathy when something untoward or unpleasant happens to us lessens our grief because we feel better for knowing our burdens are shared. Rehearsing the causes of our grief reminds us of the pain we felt and, sometimes, the very tears we shed. But in the process of retelling and receiving the sweetness of sympathy, we are compensated for the bitterness of our sorrows (TMS 15).

## Harmonising influences

Feelings of sympathy are proportionate. If we approve of the intensity of the passions exhibited by other persons in their reaction to a joyful or a grievous incident, we sympathise entirely, but not so when they overreact. Those observing or hearing our outburst at some trivial or imagined affront would not regard it to be proportionate if we threaten suicide or murder. The propriety or proportionality of over-reactive behaviour, remember, is judged by the impartial observer, not by the player.

The greater or lesser the dissonance between my sentiments and yours, the lesser or greater the sympathy we feel for each other (TMS 16). In common life, we observe in others their ‘excesses of love, of grief, of

resentment', and we contemplate the 'ruinous effects they tend to produce', especially when we also observe the 'little occasion which was given for them'. Nothing we see justifies 'so violent a passion' as is exhibited. In contrast, when we find that the sentiments 'coincide and tally with our own, we necessarily approve of them as proportional and suitable', but when they do not, we 'disapprove of them as extravagant and out of proportion' (TMS 19). In the extreme, if it's my love, grief or resentment, I feel and you do not have any feeling for my evident distress,

...you have either no fellow-feeling for the misfortunes I have met with, or none that bears any proportion to the grief which distracts me; or if you have either no indignation at the injuries I have suffered, or none that bears any proportion to the resentment which transports me, we can no longer converse upon these subjects. We become intolerable to one another. I can neither support your company, nor you mine. You are confounded at my violence and passion, and I am enraged at your cold insensibility and want of feeling.

(TMS 21)

In short, I am not going to tolerate your company. Sympathy has a reciprocal element to it within a circle of friends and acquaintances, and a relationship that has just begun will quickly terminate if what Smith describes in this passage materialises.

The quarrels he speaks of are about objects that affect him or the other person personally and which neither person can overlook because they breach the tolerable limits of acceptable dissonance (TMS 21). Experience of dissonance in feelings is common. Everybody has occasion to be angry at someone else's behaviour and, when we recount the cause of our anger, we sometimes find others less sympathetic to our sense of outrage. Social pressures reduce the heat of passion. A friend's sympathy calms our anger or grief somewhat, because we expect his sympathy, and if it is given even in some small degree, it reduces our outrage.

The sympathy of an acquaintance to a lesser degree has a similar effect because we expect less from them; if they proffer total sympathy, we recognise them in a new, friendlier light. The way we express our feelings to a group of strangers from whom we expect minimal or no sympathy calms us yet further but for different reasons. Anticipating lesser sympathy, we try to 'maximise' what little we anticipate by reducing the vehemence of our passion to a pitch with 'which the spectators are capable of going along'. We have to 'flatten' says Smith, 'the sharpness

of its natural tone, in order to reduce it to the harmony and concord with the emotions of those who are about' us. The two sentiments of the passion of the aggrieved and the flatter tone that is acceptable to the spectator, 'it is evident, have such a correspondence with one another, as is sufficient for the harmony of society. Though they will never be unisons, they may be concords, and this is all that is wanted or required' (TMS 42).

Harmony in society is about tolerable levels of dissonance, not its total absence, but as we know of many more strangers existing without any contact with us, and therefore do not know if what they are doing would be acceptable to us, nor whether what we do would be acceptable to them, we are able to live in societies in which the majority of people are strangers without feeling threatened by them or fear that they are threatened by us. Hence, we walk along a crowded concourse full of total strangers without flinching at every gesture or small encounter of those we pass or walk beside.

The 'ties that bind us' through the dependent interconnections we share with them are harmonious generally, precisely because most people are distant strangers. This has implications for the political economy of large societies. Mutual anonymity and our complete dependence upon them as suppliers and of them upon us as customers, two or more links in the supply chains from us, are important elements of functioning markets. This is critical to Smith's theory of the promotion of harmony in society and links directly to Smith's bargaining exchange model in *Wealth of Nations* (WN 25–29). It is exactly the same when someone exhibits joy at an event that is way beyond what we consider the event to be worth. Your continuing the celebrations of a minor accomplishment for months would tire even the most overly sympathetic person, let alone an impartial spectator. Proportionality is the rule for both sorrow and joy; modesty in both sorrow and joy is expected if you seek the approval of the impartial spectator.

While reporting to a close friend an incident that hurt us, we might express our emotional outrage privately, but we will be less emotional when explaining our distress to a casual acquaintance, and probably, we will speak with measured calmness when explaining what happened to distant strangers in public. To the vast unknown population of total and distant strangers, we would say nothing (a condition somewhat compromised in the modern age of instant mass communication).

The idea that the ego only seeks to gratify self-love does not account for the predicament of the individual living in a society of strangers, with few friends or family. Smith's contribution was to realise that the

existence of the total self-love model (Mandeville, 1724), while plausible for an individual, as if living on a desert island, it was not plausible for individuals living in close proximity and dependent upon each other. The key to how this predicament could function without society tearing itself apart lay in the simple observation of how the intensity of feelings about anybody else's behaviour diminished as the irate individual in search of sympathy interacted with others further from his immediate circle of family and friends (Montes, 2004, 40–41). His dissonance is localised, perhaps to as few as himself only and normally does not generalise into a major fissure across the whole of society. Modern media may modify the localisation of distress.

While perfect harmony of the passions between the affected individual and an impartial spectator is unlikely, the fact that the intensity with which the passions are expressed is reduced is sufficient for a degree of (workable) harmony to prevail. The individual moderates his ego-driven behaviour towards a level likely to be accepted as proportionate by the unaffected spectators who, in turn, moderate their criticism of the individual's behaviour. The spectators constantly reconsider what they would feel if they were in the position of the players they observe and, crucially, the players under observation constantly moderate what they would feel if they were only spectators and not players. Each reciprocal review of the appropriate amount of sympathy and degree of passion serves to abate the violence of the individual's passions and reduce the criticism of the spectators. From this process, Smith concludes, in a sentence of the most significant meaning for his understanding of how societies work:

Society and conversation, therefore, are the most powerful remedies for restoring the mind to its tranquillity, if, any time, it has unfortunately lost it, as well as the best preservatives of that equal and happy temper, which is so necessary to self-satisfaction and enjoyment.

(TMS 23)

Smith adds that those who 'are apt to sit brooding at home' bereft of 'society and conversation' and having many fine qualities 'seldom possess that equality of temper which is so common among men of the world' (TMS 23). We are compelled, and almost in spite of ourselves, to 'see ourselves as others see us' (TMS 23). The result for society is a greater degree of tranquillity than would be thought likely in a society composed of individual egos who ignore (or defy) their impartial spectators.

The impartial spectator restrains individuals from unbridled expressions of their passions in pursuit of their interests, preferring 'silent and majestic sorrow' in place of 'detestable...fury without check or restraint', and thereby confines individuals to pursue their interests only to the extent that is equitable and proportionate to what the impartial spectator and 'every indifferent person would rejoice to see executed' (TMS 24). From this binding relationship, it follows 'that to feel much for others and little for ourselves, that to restrain our selfish and to indulge our benevolent affections, constitutes the perfection of human nature; and can alone produce among mankind the harmony of the sentiments and passions which consists their whole grace and propriety' (TMS 25).

### Hobbesian nightmares?

*Moral Sentiments* explains why people abide by and practise the manners and associated politeness conducive to civil peace. While the prevalence of moral sentiments aided social stability in civil society, Smith acknowledged the necessity for civil magistrates to resort on occasion to dreadful punishments against those who flouted the law and disturbed the peace. Every man, Smith asserted, is 'no doubt, by nature, first and principally recommended to his own care; and as he is fitter to take care of himself than of any other person, it is fit and right that it should be so' (TMS 82).

We are deeply interested in whatever concerns ourselves and less concerned with others. We are not best judges of the interests of anybody else. However, the pursuit of self-love is not a licence to violently plunder others:

To disturb [a neighbour's] happiness merely because it stands in the way of our own, to take from him what is of real use to him merely because it may be of equal or more use to us, or to indulge, in this manner, at the expense of other people, the natural preference which every man has for his own happiness above that of other people, is what no impartial spectator can go along with.

(TMS 82)

If we are principally concerned with ourselves, is mankind incited to participate in permanent wars of the egos? Not at all! Raging self-love does not dominate the social intercourse of mankind, because, paradoxically, no ego can acquire what it wants without the peaceful co-operation of other egos, and it is that dependence, effectively total,

that safeguards society from self-destruction (though a megalomaniac can do a lot of damage until restrained).

Smith did not subscribe to Hobbes' apocalyptic 'war of all against all'. Human behaviour curbed outrageous expressions of egoism, enabling mankind to live in society, and it was human nature, not government, which preserved us from the Hobbesian nightmare of lives that were 'solitary, poor, nasty, brutish and short'.

Every person knows that no matter how egoistic we feel, others do not share our feelings; they care for themselves with the same degree of passion as we do for ourselves. For a tiny minority, untrammelled egoism leads to degrees of psychopathic paranoia, but the majority of us express concern for others and temper the grosser manifestations of our egos. Each of us may be a lonely ego in a sea of indifference to others, but none of us dare assume that other people are indifferent to the impact of our actions on them. If we do, the brute course of retribution (first learned in the school playground) soon educates us otherwise. Where our actions impinge on their self-love, they react with the same hostility as we might towards anybody impinging on ours. Observation of how others react to our intrusions on them, compared to how we react to the intrusions of others, eventually informs the dullest that mindless egoism breaches acceptable behavioural norms and provokes dangerous hostility and harmful counter-measures. We easily spot the relationship between the people inflicting behavioural atrocities on others and the retribution of those so affected. Smith asserted that no man would dare to look mankind in the face and declare his intention of acting according to the dictates of his self-love. His fellows could never go along with such an explicit, 'excessive and extravagant' disregard for their interests and such a person risked severe disapproval. The perpetrator 'must, upon this, as upon all other occasions, humble the arrogance of his self-love' and, in consequence, bring public displays of his undoubted self-love 'down to something which other men can go along with' (TMS 83).

The majority of people, whose egos are humbled by acknowledging in their behaviour the legitimacy of the self-love of others, thrive in socially stable societies in the sure and safe knowledge that their person, property, possessions and rights are secure from the depredation of neighbours (TMS 83). In the personal struggle for the place, position and prizes in life, there are constraints on each person's conduct:

But though the ruin of our neighbour may affect us much less than a very small misfortune of our own, we must not ruin him to prevent that small misfortune, nor even to prevent our own ruin.

(TMS 83)



Blatant disregard for others invites retribution and disapprobation in defence of their legitimate self-love:

In the race for wealth, and honours, and preferments, he may run as hard as he can, and strain every nerve and every muscle, in order to outstrip all his competitors. But if he should jostle, or throw down any of them, the indulgence of the spectators is entirely at an end. It is a violation of fair play, which they cannot admit of.

(TMS 83)

People cannot abide observing foul play of others. They sympathise with the injured and the offender suffers the hatred and indignation bursting out from all sides against him. The game of life has rules and norms, and players are expected more or less to abide by them. Society, for peace to prevail, ruthlessly remedies defections from its norms by submitting solitary egoists to an impartial system of justice. The shameless individual who intrudes upon the persons, property, possessions or rights of others and who is careless of the 'shame, horror and consternation' he causes suffers from those he provokes because his crimes 'call loudest for vengeance and punishment'. In the extreme, the unremitting hostility, 'vengeance and punishment' he suffers cause him the 'greatest and most dreadful distress' and 'incomprehensible misery and ruin' (TMS 84). The only way out of constant isolation and prolonged pariah status is that deep feeling of regret or 'remorse', which Smith thought was the most dreadful of 'all the sentiments', and he agreed with Lord Kames, who called it 'the most severe of all tortures' (TMS 85 n1). Smith acknowledged that there were individuals with untrammelled egos and a determination to ride roughshod over others, but he regarded them as in a minority.

It is appropriate here to consider a much-misunderstood passage in *Moral Sentiments* that is quoted whenever a major earthquake strikes somewhere (I am grateful to Sandra Peart for bringing this passage to my attention) (Peart and Levy, 2005). Smith opens with a hypothetical discussion of how a 'man of humanity' in Europe would be affected by the news that 'myriads of inhabitants' of China had been 'swallowed by an earthquake'. Having 'no connexion with that part of the world', he would, Smith surmises, express his sorrow for the misfortune of those affected and reflect on the precariousness of human life and the vanity of all the labours of man. Having made these reflections from his 'fine philosophy', he would return to 'his business or pleasure' in his 'repose or diversion' as if 'no such accident had happened', motivated

by the general attitude that 'the most frivolous disaster which could befall himself would occasion a more real disturbance'. Worse, surmises Smith,

If he was to lose his little finger to-morrow, he would not sleep tonight; but, provided he never saw them, he will snore with the most profound security over the ruin of a hundred million of his brethren, and the destruction of that immense multitude seems plainly an object of less interest to him, than this paltry misfortune of his own [the loss of his little finger].

(TMS 136–137)

Smith asks, rhetorically, 'would a man of humanity be willing to sacrifice the lives of a hundred millions of his brethren' to prevent such 'a paltry misfortune of his own'? And he addresses this question in unequivocal terms. Human nature 'startles with horror at the thought', and the world, in 'its greatest depravity and corruption, never produced such a villain'. He asks, why not? What makes a difference between sleeping soundly at the news of the distant earthquake and choosing between preventing such a catastrophe or saving his little finger? This is where most people stop reading, and conclude that such a man would prefer to save his little finger. But would he? Smith continues,

When our passive feelings are almost always so sordid and selfish, how comes it that our active principles should often be so generous and noble? When we are always so much more deeply affected by whatever concerns ourselves, than by whatever concerns other men; what is it that prompts the generous, upon all occasions, and the mean upon many, to sacrifice their own interests to the greater interests of others? ... It is a stronger power, a more forcible motive, which exerts itself upon such occasions. It is reason, principle, conscience, the inhabitant of the breast, the man within, the great judge and arbiter of our conduct. It is he who, whenever we are about to act so as to affect the happiness of others, calls to us, with a voice capable of astonishing the most presumptuous of our passions, that we are but one of the multitude, in no respect better than any other in it; and that when we prefer ourselves so shamefully and so blindly to others, we become the proper objects of resentment, abhorrence, and execration.

(TMS 136–137)

Strong language indeed. He adds that the impartial spectator shows us the 'propriety of generosity and the deformity of injustice' and that it would be wrong to do the 'smallest injury to another' to obtain a 'benefit' for ourselves. 'It is not the love of our neighbour, it is the love of mankind', a 'stronger love, a more powerful affection', and 'the love of what is honourable and noble, of the grandeur, and dignity, and superiority of our own characters' (TMS 137).

This explicit statement is one of the most important in Smith's works because it directly rebukes the many misrepresentations of his philosophy and political economy by those who conclude from second-hand accounts that he preached the supremacy of self-love and self-interest, and 'greed is good', when in fact he said the exact opposite.

# 5

## 'general principles of law and government'

### Introduction

Adam Smith considered the history of Britain's constitutional monarchy to have been a positive influence on the spread of opulence. Strictly, Cantillon's ([1734; 1931] 1964) and Turgot's ([1766] in Meek, R. L. 1973, 119–182) incomparably briefer and brilliantly original expositions of similar economics to Smith's failed to gain the appreciation of the French political class compared to the impact of Smith's *Wealth of Nations* among British (and North American) legislators. Smith wrote to gain the attention of legislators. Cantillon and Turgot wrote for far narrower audiences (in Turgot's case, he wrote for two Chinese Jesuit students, M. M. Ko and Yang; Meek, R. L. trans. (ed.) 1973: 14, 5n), and it was over a century before Cantillon's and Turgot's work was recognised by economists as original and significant contributions to economic science (Jevons, W. S. [1881] 1905; 1931: 333–60).

Reading his *magnum opus* without understanding Smith on the history of British governance is the single most important cause of concluding that *Wealth of Nations* is merely a rambling account of a long-gone episode in British history. We shall cover, briefly, what Smith taught his students (and therefore modern readers) about the role of the governance of Britain on the sustained evolution of commercial society.

### The interregnum and the fall of the Rome

The invaders who overran the Western provinces of the Roman Empire had knowledge of agriculture and property in land, and its elite largely were literate (many were educated under Roman influences). They set about dividing the Roman lands into huge tracts from which they drew

tribute from the inhabitants. The elite invaders established an allodial system of land ownership in which land was held in absolute title, ultimately by whoever could hold it against all comers.

The superior allodial owner offered hospitality to his king, the most powerful family of the new landowners, in contrast to the later feudal system, where the king received regular tribute from his subordinate lords in exchange for their legal feudal titles in land. These invasions divided and re-divided Europe among the warlords, who received great wealth in the form of surplus produce, which they distributed to large numbers of armed dependents who, in return for shares in the surplus, supplied various services, basically keeping order among the inferior labouring inhabitants, including war-fighting against rival claimants as required. Warlords often quarrelled with their neighbours, and initiated challenges to, or repelled, their rivals. Smith described the warlords and their influence on the lands they conquered and fought over:

Now at this time there were no arts practised by them. These people being rough and wild had no discipline amongst them; the country was infested by robbers and banditti, so that the cities soon became deserted, for unless their be a free communication betwixt the country and the town to carry out the manufactures and import provisions no town can subsist.

(*LJ* 244–245)

To these problems were added piratical depredations attributed to the Danes and the Normans, with the latter eventually conquering and settling in Normandy, from which territory they invaded England in time. The lords maintained hundreds, sometimes thousands, of retainers from the produce extracted from the conquered inhabitants. The lords and the king were often in conflict as the generations passed on, and the relative balance of power and ambition shifted through inheritance and marriages over time, all with uncertain blessings of the Church in Rome. For those farthest down the social scale, such times were perilous with marauding armies passing over territories with their usual habits of rapine and violence. Orderly government was tried occasionally and appeared in several versions, with a final appeal to a king's or the Pope's judgement common to most of them (*LJ* 245).

This was the norm for five centuries after the fall of Rome. The reality for long periods during these centuries was stagnation and local decline. In England, the 'great lords soon destroyed the order and harmony of its severall parts', and 'their lawless and freebooting manner of life also destroyed all the commerce and the industry of the former inhabitants'.

Any produce that the people living on the lords' lands contributed to his stocks was redistributed by the lords to their dependents. The lords could not consume it all themselves (TMS IV.ii.10: 184). Smith's is an image of disorder, low living standards for people 'little advanced beyond the state of shepherds', and fragile security of their persons, their meagre possessions and their quarrelsome families.

Within this bleak image, things were slowly changing, in themselves perhaps of little import, but cumulatively of significance. Smith details how from the conquest of England by William 'the conqueror', the lords held their lands at the king's pleasure and the lesser lords held their lands on the same terms (*LJ* 244). This was not so much a legal fact as a measure of practical policy. Lords quarrelled as ever and sought redress by fair means or foul, or by appeals to their superior lords and ultimately to their king. Dependents quarrelled and sought redress too, and as the generations turned over, their inheritors brought new mixtures of ambition and ability into contention, which installed new centres of local power. They also pruned the 'weak' from among them. On occasion, 'extraordinary service' from retainers was required, and sometimes the superior lord found it expedient to qualify his absolute 'pleasure' over an inferior's limited rights of possession of a plot of land, first by granting possession for a specific length of years, then for life and finally for life and inheritance (creating more grounds for future quarrels). These separate changes slowly and gradually transformed allodial lands into feudal tenancies (*LJ* 249–252). From the apparently unimportant transfer of small land holdings began the first unintentional steps in the eradication of the economically destructive warlord system that operated across Western Europe, exacerbated by contiguous open borders. The 'dark ages' became an unpleasant folk memory.

Thus, he emphasised the fall of the Roman Empire as the significant event in the history of Europe, citing 'the confusions which followed so great a revolution lasted for several centuries', including the 'rapine and violence' imposed on the 'antient inhabitants', which 'interrupted commerce between the towns and the country' and caused people to desert the towns and leave parts of the countryside uncultivated. In time, 'the western provinces of Europe, which had enjoyed a considerable degree of opulence under the Roman empire, sunk into the lowest state of poverty and barbarism' (*WN* 381–382).

Feudal governance in agriculture resulted in 'a few wretched cattle, maintained altogether by the spontaneous produce of uncultivated land' (*WN* 334), supposedly managed by bondsmen, virtual if not actual slaves. Those who remained bereft of property (including in their

person) were dependent on their masters for their maintenance and were at the mercy of his caprice (WN 386–387; LJ 182–186).

Vast estates claimed and contested over by lords enjoyed long-term title under the feudal laws of primogeniture and entails. In primogeniture, the eldest son inherited everything, with nothing at all for his mother and his siblings, except at his discretion; in entail, the eldest or the nearest male relative inherited title and land intact, with no subdivision of land allowed, even if the owner desired to make such arrangements should he have no direct male heir. Such practices through the generations foiled the break-up of estates and prevented a market in parcels of land developing at prices aspirants could afford. Smith regretted the consequential failure for a productive Yeoman class to emerge. Large estates also slowed, if not prevented, the needed improvements on large ancient estates because of the expense of improving all but a small proportion of them, assuming the new owners were so inclined, which apparently was not always because of a lack of capital but because of a preference for idleness. Many landlords were not given to energetic land management, or their inherited estates were so indebted and poor in rental incomes that it was beyond their means should they want to improve them (LJ 525).

Trade in agricultural produce was restrained by such ‘absurd laws’ as prohibiting traders (‘engrossers’) on pain of imprisonment, fines, confiscations and confinement to the pillory from buying produce in one locality to sell for profit in another. This drove out regular traders and brought in ‘wretched hucksters’ with little to lose, encouraging popular odium against the most efficacious solution to local dearth, namely the redistribution of surpluses from areas with plenty of food to those areas without (WN 528).

The general and long-term consequence of these prohibitions, and the restrictive privileges awarded to ‘fairs and markets’ in designated locations and under the control of town governments (Braudel, [1979] 1985), slowed but did not prevent the spread of inland commerce (WN 396). One of the many consequences of the inversion of the order in which Britain progressed to the spread of opulence was fortuitous because it unintentionally promoted the eventual development towards a constitutional monarchy (with parliaments and elements of liberty).

The inhabitants of the early towns were tradesmen and mechanics, mostly in a ‘very nearly servile condition’. They, or their forefathers, were former members of the landless villain class of peasants, beholden to their lords, without property or the appurtenances of liberty. Some larger towns were granted charters by the king that severed their

obligations to local lords, allowing them to give away their own daughters in marriage without a lord's permission, and to pass their property to their children (WN 397; LJ 48), both welcome steps to personal liberty and relief from total subjugation. Smith describes them as 'a very poor, mean sett of people', but they benefited from the plight of their kings over many decades and 'arrived at liberty and independency much earlier than the occupiers of land in the country' (WN 339).

Kings needed allies when dealing with 'awkward' individual lords and their private armies, who eyed a weak-king's throne. Such kings needed help to curb lords flitting among troublesome and mutinous coalitions. In this context, independent towns, already disposed to be resentful of the arbitrary oppressions of local lords, gradually became useful sources of taxes for the king. In exchange for his granting legal privileges to them, which did not affect his sovereignty, though it might embarrass local lords if the towns could make them stick, the king nurtured allies within the territories of his potential enemies. Gradually, in line with their energies in place of lordly lethargy, the towns' people grew in importance by maintaining the king's peace throughout his dominions. A succession of kings gradually ceded local powers to the towns that permitted them to make and enforce local laws through their locally appointed magistrates, to 'build walls for their own defence' and to mobilise inhabitants 'under a sort of military discipline' against 'all attacks and surprises by night as well as by day' (WN 400–401).

Sovereigns in this manner, wrote Smith, 'erected...independent republicks in the heart of their own dominions' to rival the armed power of the lords who oppressed the weakest of the kings' subjects, especially the unarmed servile individuals sheltering from a lord's fury in flimsy hovels and who were considered by the lords to be 'a different species from themselves'. As the towns revived, 'the wealth of the burghers never failed to provoke' the lords' 'envy and indignation, and they plundered them upon every occasion without mercy or remorse', causing the burghers to hate and fear the lords much as the king hated and feared them too. Kings had no reason to fear or hate the burghers; they collected and paid their towns' taxes and did not engage in hostilities. They were the nearest to model subjects in unsettled times, and, therefore, their mutual interests as enemies of the king's enemies 'disposed them to support the king, and the king to support them against the lords' (WN 401–402).

People, declaimed Smith, who enjoy 'the fruits of their industry' are likely to exert themselves to 'better their condition' and strive to acquire,



in addition to necessities, the 'conveniences and elegances of life', thus establishing in the towns the necessary ethos for commerce. True, the towns remained dependent on the country for their subsistence, but prosperity also provided the means by which a town, if situated conveniently close to a river or sea route, could acquire subsistence and 'conveniences and elegances of life' elsewhere than from their immediate neighbourhood (WN 405). And from these circumstances, Smith pointed out, the seeds of the destruction of feudal forms of government were planted. Feudalism was not a new mode of subsistence; it was a system of governance; food grows the same way biologically, though not with the same productivity, whether tended by serfs, slaves, communist communes, yeoman farmers or agri-businesses.

The age of agriculture as a mode of subsistence continued, as it had done under the Pharaohs, the Incas and in the wretched and pathetic state that it fell to in Europe under the barbarians. Foreign commerce introduced a 'solution' for the landed 'great proprietors' in their forlorn quest to satisfy their vanities (WN 410 *n*39). Access to 'finer and more improved manufactures' from distant markets (Holland, France and Italy) promoted the age-old enterprise of imitation to satisfy the acquisitive desires of consumers. The religious, ethnic and racial foolishness of despotic rulers, who banished into exile their fine manufacturers on religious or racial grounds, many of whom moved northwards to Britain about the time of the reign of Elizabeth I, is another example of unintended breaches of a natural order (WN 407–408).

## The decline of feudalism

In the feudal order, the king held title to all land and handed to the superior lords their feudal title in the land for life and inheritance, and their commitment to assist him militarily in times of his need. The king called the superior lords to a 'colloquium', where he sought their 'consent and advice' and, by implication, their commitment to support his chosen courses of action (LJ 254). With this step, the king compromised his absolute power, his lords compromised their independence and the government became 'aristocraticall', with the most powerful members of an aristocracy, in effect, sharing in the king's sovereignty. The king ruled as hereditary chief at the head of the aristocracy and their immediate vassals, who were regarded as 'noble'. The 'villains and slaves' – who toiled and ploughed the ground, harvested the crops, tended the animals and served as enforcers of their lords' writs – were regarded as 'ignoble and contemptible' (LJ 255).

The quiet consequence of relative order and peace returning to the country began to revive small towns that over the next few centuries brought about a major shift in the balance of power within the feudal system of land ownership and tenure. The class of 'burghers', many of which were former villains who had bought their liberty from feudal obligations, turned to various roles in trade and gravitated to small hamlets, some of which grew into towns and later into cities (*LJ* 255). Thus began the centuries-long struggle of the petty towns against the aristocracy of the countryside, which would sweep away the feudal privileges of the lords and the serfdom of the villains and, most importantly, help to revive the age of commerce.

Smith's analysis of this process is masterly. The feudal lords remained, in the main, a source of disturbances, on some occasions successfully replacing kings with other claimants to the throne. This made the kings 'very jealous of the power of th[ese] nobles', and they 'took every method to lessen their power'. Villains and vassals were often in conflict with their lords, and by raising limited legal protections for them they nurtured their limited independence within the constraints of the overall feudal order. Another more explicit example was the king strengthening the burghers in the towns by allowing them to form 'corporations' to defend themselves against the lords by 'walls and guard[s]', the latter reaching up to '300 armed men', and assigning to them the rights to try small causes in their own courts (*LJ* 259).

Successive kings opened the door to a 'parliament of the commons', separate from the 'parliament of the lords', which was of the greatest significance for the progress towards certain liberties. Kings consulted the lords for their advice and consent before imposing taxation; then, they invited selected burghers to attend separate meetings to consent on the collection of taxation from the proliferating towns. Thus taxation acquired legitimacy from the parliaments of the lords and the commons. The kings' pecuniary motives promoted a most unusual concurrence of interests. The more expense-driven reigns of the more martial kings, who fought wars regularly on the continent and who in consequence had need of more regular calls for more tax revenues, also coincided with the reign of kings who were 'most favourable to liberty', if only on grounds of expediency. Low-spending monarchs called on parliaments less frequently than high spenders. The connection did not pass unnoticed in the folk memories of those in a position to withhold their consent.

It soon became a rule, noted Smith, among the representatives of the town burghers that they 'should grant no subsidies until their requests

be granted' (*LJ* 260). 'Truck, barter, and exchange' was brought into the relationship of the sovereign with his subjects. Moreover, Smith notes, as the lords were denuded of the lesser lords and those of declining fortunes, kings found it expedient to treat with the commons first about matters relating to revenue, and the lords were consulted after consent was gained from the commons. Power thus slipped away slowly from the lords to the commons (*LJ* 260). These lasting steps towards (imperfect) liberty were sealed by the avarice of the nobility from the gradual 'introduction of arts, commerce, and luxury' into their trade with the towns, which in time removed the source of the lords' power in their command of thousands of armed retainers. As their power to cause the king mischief declined, the power of the monarchy was enhanced towards a, albeit temporary, British form of absolutism, more brittle than the absolutist continental monarchy which had remained unchanged for centuries and was, thereby, moribund.

By Smith's days, power had swung away from king towards parliament, causing a temporary reinstatement of the power of aristocrats through their command of parliament. The path from absolutism to constitutional monarchy did not run in a straight line; it took many twists and turns, of which the struggle between Charles I and parliament in the early seventeenth century was one of several decisive episodes, followed by the 1688 'Revolution', which deposed King James, and the 1707 Union of Parliaments, which unified Britain under the Hanoverian monarchy. But the main outcome of the long process was the decline of the aristocratic feudal lords in Britain.

Countries without foreign commerce and finer manufactures left the great feudal proprietors bereft of products upon which to 'spend' the greater part of the produce of their estates after they have replaced their capital stock (seeds, animal offspring and such like) and paid the maintenance of the cultivators and their armed retainers. Lords could only spend their surplus produce on maintaining a large body of retainers, dependants, hangers-on and entertainers, who lived off of their bounty and humoured their vanity (*WN* 413). Amidst the tranquillity associated with the disposal of the lord's largesse on his estates, the 'open country continued to be a scene of violence, rapine and disorder' (*WN* 418). Smith's account of the slide of the feudal aristocracy into political impotence shows his narrative style at its best. He makes no pretensions to support his broad-brush narrative with data or dates; he writes about the broad sweep of events that slowly and gradually undid the power of the feudal warlords. He contrasts the 'silent and insensible operation of foreign commerce and manufactures' that 'brought about' the dénouement

of feudalism, against which all the 'violence of feudal institutions' was impotent to avert (WN 418).

The vanity of the warlords and their ladies first tempted them into an extravagant penchant for 'luxury' purchases of manufactures, and quietly diverted growing proportions of their annual wealth to obtaining them, but as they dismissed retainers to fund their avarice, they diminished their troublesome power that incited the wrath of embattled kings. They also slowly drained themselves of the means to tyrannise defenceless tenants. Foreign and distant manufactures provided them with something besides retainers to spend their wealth upon. But without armed retainers to enforce their writ, who would do the dirty work of chastising their 'enemies' in the towns, lording it over their tenants and their families and challenging or intimidating their weaker lordly neighbours? Gradually, those drawn into the seductive avarice of expensive luxury consumption gave up increasing amounts of the exchange value of the surplus produce from their lands. They consumed themselves the items that they bought with their produce 'without sharing it with tenants or retainers'. Smith's summary judgement drips with contempt: 'All for ourselves, and nothing for other people, seems, in every age of the world, to have been the vile maxim of the masters of mankind' (WN 418). And so it was, and still is, in parts of the world where unrestrained power ruins the happiness and lives of those they subjugate. But over time, in the case of feudalism, Smith showed that the rulers reaped what they sowed:

For a pair of diamond buckles, perhaps, or for something frivolous and useless, they exchanged the maintenance, or what is the same thing, the price of the maintenance of a thousand men for a year, and with it the whole weight and authority which it could give them. The buckles, however, were to be all their own, and no other human creature was to have any share of them; whereas in the more antient method of expence they must have shared with at least a thousand people...and thus, for the gratification of the most childish, the meanest and the most sordid of all vanities, they gradually bartered their whole power and authority.

(WN 418; LJ 50–52; 420)

By his spending on luxuries, he maintained not a thousand families, all of them at his command, but fewer than 20 people or 'ten footmen not worth the commanding' (WN 419–420). It is worth noting in Smith's remarks another consequence, stated with a hint of Mandeville's

satire. The spendthrift lord, who buys trinkets and dismisses one set of retainers, also indirectly employs others who make trinkets and ships them from distant parts, and by these actions he gives 'occasion to a great amount of work and manufacturing, such as is necessary to raise so much in its value' (*LJ* 195). The spendthrift appears to be 'the most destructive member of society we can possibly conceive' of, but, paradoxically, his kind is 'in no way prejudicial to society' (*LJ* 194). The great prices of what they buy generally arise from the wages of labour and the profits of their employers, and the spendthrift indirectly contributes to the maintenance of all these workmen, their families and the employers (*WN* 420). Also a great deal of low-priced spoiled food, drink and the leftovers from the banquets common to rustic hospitality is wasted, in stark contrast to manufactures which cost too much to waste. And the tradesmen and artificers employed in manufactures, unlike tenant farmers, were many customers, not just one, and whilst they are 'obliged to them all', they were not 'necessarily dependent upon any one of them' (*WN* 420).

'Merchants and manufacturers' soon found products to tempt the lords to feed their vanities. They needed income to pay for them. Raising rents was one obvious solution, as was enlarging the tenancies and their duration and clearing smallholders off the land to create viable farms. In exchange for affording landlords with higher rents, tenants sought, and landlords offered, longer leases, which in time made tenants more independent by shedding them of the old feudal obligations of personal service (*WN* 420–421). This led to the landlords' demise as a great and often-violent political force in the governance of the country. For [h]aving sold their birth-right, not like Esau for a mess of pottage (*Genesis*, 25: 30–34) in time of hunger and necessity, but in the wantonness of plenty, for trinkets and baubles, fitter to be the play-things of children than the serious pursuits of men, they became as insignificant as any substantial burgher or tradesman in a city (*WN* 421).

Smith asserted that in the greater part of Europe, commerce and manufactures in the cities, 'instead of being the effect, have been the cause and occasion of the improvement and cultivation of the country', contrary to what he considered to be the 'natural order of things' (agriculture first, then commerce), which, because this was 'unnatural', was 'necessarily both slow and uncertain' (*WN* 422).

Having explained his view of the natural evolution of society from hunting towards commerce and what happened in its revival since the fifteenth century, he showed that social evolution can stall at any one of the four ages of the modes of subsistence, as well as bypass

an age altogether, and that stalling, even an occasional reversal, was 'normal', where geographical, climatic and institutional circumstances intervened. By taking the long view of the disequilibrium of simultaneous and successive events, rather than the shorter-term abstractions of equilibrium alone, Smith produced an analysis that was far superior compared to much of that which followed him.

## **Constitutional liberty**

Parliament, elected on a highly restricted franchise, by its control of the army's finances, could prevent, or at least inhibit, the army being used to undo steps taken to ensure the general liberty of the king's subjects. Lack of money, independent of parliamentary approval, limited a potential tyrant's recourse to the armed intimidation of his subjects (the principle over which the English civil war had been fought). For Smith, a 'system of liberty' was a constitutional arrangement secure from the tyranny of king, parliament, judges, officials of the state or any private person. In eighteenth-century Britain, the system of liberty was the foundation of its government, which had been confirmed by 'many Acts of Parliament'. While this was liberty by legal fiat and not by universal franchise, it was nevertheless in advance of what happened elsewhere, up to the Constitution of the United States of America. Consequently, he asserted that in Britain, with its liberties so entrenched, 'every one would be shocked at any attempt to alter this system' of liberty and such attempts 'would be attended with the greatest difficulties' (LJ 271).

Smith deliberated on threats to constitutional liberty potentially emanating from within the State, specifically in the form of the 'Civil List' covering the monarch's personal expenses in support of the 'dignity of his office' – a euphemism for his extravagance on his personal and public life. Fortunately, instead of spending these monies on a standing army willing to do the sovereign's bidding, kings chose to spend them on their personal extravagance. Smith writes, in the hands of 'designing, vigorous and ambitious princes [the Civil List spent on a standing army] might give them an influence superior to that which the dependence on a few officers about the palace can bestow'. In Smith's view, a few army officers, entertaining, cavorting and amusing the king, were insufficient to carry through a royalist putsch. Bluntly, a Civil List, though affording the Sovereign an all-expenses-paid free ride on the 'dignity of his office', inevitably corrupted tentative temptations to his dabbling at returning Britain to absolutism.

Other constitutional features also acted as barriers to tyranny. The courts of justice, for instance, secured the liberty of the people, and Smith details his confidence in the judiciary in six parts. First, judges held office for life, entirely independent of the king, and were 'free and independent' and accountable under law for their conduct. Self-interest prevented judges from acting unfairly against defendants if by such acts they would endanger the loss of their regular, and relatively high, personal incomes from their 'profitable offices', which would severely damage their reputations too. Crucially, nothing a king could offer the judges tempted them to act outrageously in his favour (*LJ* 271–272). Second, because judges had little power to explain, alter, extend or correct the meaning of laws, they had to, with 'great exactness', strictly observe the literal meaning of words as intended by parliament (*LJ* 275). Judges did not make the laws – that was parliament's exclusive function – they enforced them, and in England, they interpreted the 'common law', a venerable process reflecting the way that laws evolved from past practices that had proved their worth from ancient usage.

Third, the Habeas Corpus Act ('you may have the body') was a 'great security against oppression'. Before this Act, the Privy Council (appointed by the king) could put anyone they pleased into prison and detain him without trial for the uncertain duration of the king's pleasure. By the eighteenth century, no judge would oppose the Habeas Corpus Act on pain of 'infamy and a high penalty'. Habeas Corpus, asserted Smith, 'will never be allowed to be repealed, as it would destroy in a great measure the liberty of the subject' (*LJ* 272–273).

Fourth, juries heard the evidence and decided on the facts. Smith gave a brief history of the jury system from Magna Carta (the constitutional settlement regularising the relationships between the king and the barons, which enshrined a person's 'right to legal judgement by his peers', not the king). He concluded that 'the liberty of the subjects was secured in England by the greater accuracy and precision of the law' and that the 'courts of England are by far more regular than those of other [continental] countries' (*LJ* 282, 284–286, notes 90, 7).

Fifth, the House of Commons had the power to impeach the king's ministers for acts of maladministration, which 'secures the liberties of the subjects', because impeached ministers can be removed from office. Sixth, the frequency of elections was 'also a great security for the liberty of the people' because, unless the representative serves his country or 'at least his constituents', he will be in 'danger of losing his place at the next election'. The more frequent these elections, the more dependent were parliamentary representatives (*LJ* 273).

For these reasons, Smith asserted that Britain's constitutional arrangements in the mid-eighteenth century 'secure[d] the liberty of the subjects'. He believed that liberty was closest to perfection in his times (but well short of it by today's standards). He considered England's parliamentary elections were less corrupt than Scotland's (which is not saying much by modern standards) (*LJ* 272–273).

While in modern terms these are fairly modest protections of liberty, their absence may compromise the effectiveness of markets in securing general opulence, though their absence does not prevent it. Moreover, government policies could also compromise popular opulence. Smith illustrated the essential point that the existence of constitutional liberty does not of itself secure general opulence. Governments and other institutions (a dominant religion) may also pursue policies detrimental to national opulence. The establishment of the institutions of liberty are not a conscious one-way process; they could and did relapse, falter, stall and disintegrate in some countries. Today, however, those countries with credible claims to establishing degrees of liberty since the eighteenth century have incorporated versions of, and of course additions to, Smith's six characteristics of constitutional liberty.



# 6

## ‘a certain propensity in human nature’

*Wealth of Nations* opens by addressing the division of labour, which is Smith's central theme for the creation of wealth, and it is at the core of his historical conjectures.

Adam Smith is associated famously with the ‘trifling’ example of the manufacture of pins and the significant productivity gains arising directly from the division of labour within pin factories, one of which he visited (WN 15). He also, less famously, discussed the significant example of the multi-sector specialisation of labour that co-operated in the manufacture of a common labourer's woollen coat, which illustrated the linkages among many employment sectors located in different geographic regions, including overseas, from which different technologies produced disparate outputs that became inputs in the manufacture of these simple coats (WN 22–23). There were similar links among the other production chains operating in separate manufacturing, agricultural and mining processes in the society with which he was familiar.

None of this co-operation was directed by other than the relations among two, or at most a few, of the parties anywhere along or among the supply chains, who would likely have, and need, no inkling of the circumstances or interests of parties more than a couple of links away in the process. Each supply chain serviced interlinked markets in all sectors that, incidentally, were growing slowly, gradually and independently in depth and in scope to produce the ‘necessaries, conveniences, and amusements of life’ in the country in ever-greater abundance. In so far as the evidence for sustained though modest growth in living standards for those in employment and owners of capital was visible from mid-eighteenth century onwards in Scotland, it came from the wider consumption of more varied food and the widening selection of available consumption goods for increasing numbers in successive generations.

## Wealth creation

Smith opens *Wealth of Nations* as follows:

The greatest improvement in the productive powers of labour, and the greater part of the skill, dexterity, and judgement with which it is anywhere directed, or applied, seem to have been the effects of the division of labour.

(WN 13)

The division of labour was not original to Smith, as is sometimes ascribed to him, though never *by* him. He stated that the 'the division of labour has been very often taken notice of' as his educated readers would know. Sir William Petty (1690) had written on the division of labour in the late seventeenth century, as had Bernard Mandeville, [1724]; Diderot, [1755]; John Harris, [1757]; Robert-Anne Turgot, [1766] and the editors of Chambers' Dictionary [1728], and Plato had noticed the phenomenon long before them all. Smith developed his theme:

This division of labour, from which so many advantages are derived, is not originally the effect of any human wisdom, which foresees and intends the general opulence to which it gives occasion. It is the necessary, though very slow and gradual consequence of a certain propensity in human nature which has in view no such extensive utility; the propensity to truck, barter, and exchange one thing for another.

(WN 25)

Smith took his perspective on the past to the roots of what made society – any society – prosper when individuals discovered, by experiment or accident, practices that initiated changes to a mode of subsistence. He asked what brought about the division of labour and what has kept it going? He answered tersely:

Whether this propensity [truck, barter, and exchange] be one of those original principles of human nature, of which no further account can be given; or whether, as seems more probable, it be the necessary consequence of the faculties of reason and speech, it belongs not to our present subject to enquire.

(WN 25)

Smith pushed the probable origins of the division of labour back before recorded history to the acquisition of 'the faculties of reason and speech', though he thought it short of being 'one of the original principles of human nature'. If it was not 'original', it must have been learned and adapted. He linked it to 'the propensity to truck, barter, and exchange' and found in human relationships the deep significance of exchange behaviour, which is, says Smith, 'common to all men, and to be found in no other race of animals' which 'seem to know neither this nor any other species of contracts' (WN 25). James Maitland (1800), 8th Earl Lauderdale (1758–1839), a critic of Smith, correctly realised the significance of his linked concept that the 'system of the propensity to truck, barter and exchange... is the real origin of riches'.

Once the relationships involved in exchange behaviour are recognised to have commenced long before commercial society appeared, an original insight into human development becomes possible, and anticipates by two centuries what is now accepted among scholars in anthropology, evolutionary psychology, sociology and economics.

## The division of labour

Smith's account of the division of labour is of central importance to his political economy.

A single labourer, not educated in the pin business, could scarce make one pin or at most 20 pins a day, 'with his utmost industry' (WN 14; LJ 341–342, 289–291). Productivity changed when the work was divided into a 'number of branches', in all about 18 different operations (Diderot, 1755). In some factories, each operation was conducted by a different worker, and in others, the worker 'will sometimes perform two or three of them'. Smith reports, 'I have seen a small manufactory of this kind where ten men only were employed, and where some of them consequently performed two or three distinct operations.' The output achieved by the division of labour compared to individuals undertaking all of the operations themselves was significantly higher (WN 14–15; cf. Peaucelle, 2006).

Not all labour can be subdivided in this manner, but when it is, it results in a 'proportionable increase in the productive powers of labour' (WN 15), and it is this consequential advantage that motivates individuals into separate trades and employment. The process is carried furthest in countries with the highest degree of industry and improvement, where the work of one man in a 'rude' society is undertaken by many men in improved society by dividing up the work between them and,

in consequence, by working more intensely they become qualitatively better, as each becomes more proficient in their area of specialisation.

The hunter in a 'rude' society, who made, say, one bone 'pin' per day, would in like manner take as long as he had time for to produce all the other items he provided for his family's annual consumption (Smith said nothing the major contribution of female gatherers to family consumption throughout pre-history). The hunter confined his living standard to whatever he could produce for his family; of the rest, he did without. His living standards were fixed, with little prospect of his annual consumption changing, except at the margin. Whether he needed pins or other things, his annual consumption was limited by his capacity for producing them himself. He didn't need 48,000 pins, and that is the point. The ten labourers were not making pins for themselves like hunters killing prey for their families. The pin labourers were part of a vastly improved society, in which they produced pins many times above their own requirements for other people. Out of their wages for pin making, they bought the products made by others that they could afford. The division of labour meets the vastly increased consumption requirements of (much larger) settled societies enjoying the 'the highest degree of industry and improvement' from vastly improved productive powers of labour through specialisation into a multitude of 'trades and employments'.

Smith identified three circumstances promoting this outcome: first, from the increased dexterity of the labourers; second, the saving of time lost in chopping and changing between tasks; and third, 'the invention of a greater number of machines which facilitate and abridge labour' that 'enable one man to do the work of many'. Dexterity increases the productivity of labour from 'learning by doing' and from repeatedly undertaking a simple task (WN 18; LJ 345–347). Such was the nature of work activity in domestic manufacture, common at this time, when a great deal of working time was lost moving between tasks. He noted that a country-weaver 'saunters' between his loom and his farm, and back again. Two trades conducted in the 'same workhouse' saved greatly on time as labourers moved between tasks, but habits of 'sauntering and indolent careless application' adopted from country lifestyles induced 'sloth and laziness' until new work practices were introduced (WN 19).

Each workman produced a greater quantity of output well beyond that which he required for his family, and because every other workman is in the same situation of producing a surplus output well beyond his own needs, each workman exchanges the money from his wages for the items selected from the surplus outputs produced by diverse other

workmen. It is the existence of surplus output beyond their own needs that constitutes the essential difference between rude and commercial societies, which would have seemed an odd arrangement to hunters, who had the inclination only to produce what would satisfy immediate needs. The hunters' situation highlights that moving from the rude mode of subsistence to the commercial age was not something that happened in a generation, or even a few generations. In practice, it took thousands of years, and nowhere was it a simple and inevitable progression, as the majority of societies remained rude, and had not adopted shepherding or agriculture by the eighteenth century.

### Extent of the market

As the division of labour is gradually applied to sectors of the commercial economy, it 'occasions in a well-governed society that universal opulence which extends itself to the lowest ranks of the people' (WN 22). And the mechanism by which the division of labour extends to all in society results from what Smith called the bargaining behaviours of 'truck, barter, and exchange'. From the existence of multiple products and the ability of people to exchange the money value of their labour for the products they have occasion for, Smith founded his assertion that in general the exchange of products – or what became the same thing, exchange of their money equivalents – spreads 'a general plenty ... through all the different ranks of society'.

With barter, the exchange process was cumbersome and inflexible; with the exchange of money equivalents, exchange transactions became fluid and flexible within the limits of the money holdings of the participants. Throughout the history of commercial society, these limits were associated with inequalities of incomes earned from participating in the production of the 'necessaries, conveniences, and amusements of life'.

Smith's interest in the 'multiplication of the productions of all the different arts' is of greater significance for an economy's increasing returns than the narrower example of increasing returns from the division of labour in pin and other factories (Young, 1928). As with pin factories, others such as the fourteenth-century Islamic scholar Ibn Khaldun (2004) and Bernard Mandeville [1724] had also noticed the multi-sector divisions of trades and their interconnectedness.

What a Bustle is there to be made in several Parts of the World, before a fine Scarlet or crimson Cloth can be produced, what multiplicity of Trades and Artificers must be employ'd!

(Mandeville, [1724] 1988, i. 356)

*Wealth of Nations* asserts 'That the Division of Labour is limited by the Extent of the Market' (WN 31). Allyn Young (1928) considered that 'Adam Smith's famous theorem... is one of the most illuminating and fruitful generalisations which can be found anywhere in the whole literature of economics.' Modern growth theory (Romer, 1987) has recently been improved by integrating Young's insights into increasing returns along the supply chains of a complex economy.

Smith went well beyond the restricted single-product example of a pin factory, with which most people associate his name, in his crucial example of the 'multiplicity of trades' in the making of a common labourer's woollen coat, the 'produce of the joint labour of a great number of workmen', in which he displays emphatic and unusual excitement by placing exclamation marks at the end of three consecutive sentences, the last concluding, 'What a variety of labour too is necessary in order to produce the tools of the meanest of those workmen!' (WN 23). An individual firm supplies people in an economy 'abundantly with what they have occasion for' in respect of their product, and in return, the people in the firm receive products of other firms that they 'have occasion for'. Across society, these transactions amount to 'a general plenty' that 'diffuses itself through all the different ranks of the society' (WN 22).

Smith chose the simple product of a woollen coat to show 'the number of people of whose industry a part, though but a small part, has been employed in procuring him this accommodation, exceeds all computation' from the effect of the division of labour within firms and the division of labour among firms (specialisation) (WN 22). Table 6.1 lists the trades involved in the production of the coat, showing the complexity of British trade relations for a simple commodity in the eighteenth century. The table summarises Smith's narrative of the trades involved in the production of the woollen coat and other household items, and the far greater number of indirect trades contributing to these trades too. The market for any of the items used in the coat process grows from changes within the other market sectors to which they are connected; the 'extent of the market' includes all the other markets for inputs for the coat. These create opportunities for specialisation and substitution within existing production relationships, and as productivity improves in any of the contributing trades, unit costs of the inputs will fall, permitting further increases in output, which generates new forms of specialisation from the extension and deepening of 'roundabout' methods of production.

The extent of the division of labour and specialisation among firms was the cause of the gap in living standards between the hunter-gatherer

Table 6.1 Manufacture of a common labourer's woollen coat (WN 112; LJ 347)

Direct trades	Merchants and carriers	Machines and tools	Indirect trades	Conveniences of life of labourer
Shepherds	Shipbuilders	Complicated machines for sailing	Builders of the furnace	Coarse linen shirt
Sorters, pickers*	Sailors	Mill of the fuller	Fellers of timber	Leather shoes
Wool combers or carders	Sail makers	Loom of the weaver	Burners of charcoal	Bed
Dyers	Rope makers	Shearer's sheers	Brick-makers	Kitchen grate
Scribblers	Navigators*,†		Brick layers	Coals
Spinners			Furnace builders and attendants	Kitchen utensils
Weavers			Mill Wrights	Table furniture
Fullers			Forgers	Knives and forks
Dressers			Smiths	Earthen, delft or pewter plates*
Taylor‡			Miners	
Wool gatherer‡			Bakers	
Grazier*			Brewers	
Clippers*			Glazers	
			Tool makers	
			Workmen producing all conveniences	
			Coopers‡	
			Tanners‡	
			Sowers‡ Reapers‡	
			Tree fellers*	

\* ED pp. 562–3;

† Added in LJ 339;

‡ Added in LJ 489.

economies of North America and the commercial societies in Europe. This underlines his point ‘that without the assistance and cooperation of many thousands the very meanest person in civilized society could not be provided for, even in, what we very falsely imagine, the easy and

simple manner in which he is commonly accommodated' (WN 563). When prices fall for any of the coat's inputs, the quantity demanded for lower-priced coats may increase, as will the demand for all other products for which the separate inputs form a part of their costs. A more efficient ship carrying a cargo of dyes used in the making of woollen coats also carries products used in the making of many other items; the gains from increasing returns spread into many other sectors, as may the demand for shipping. For example, other products using the lower-priced dyes will also experience falling unit costs. This is an important element in Smith's growth theory.

Brad DeLong calculated the differences between the Yanomamö tribe of stone-age hunter-gatherers dwelling along the Orinoco River in South America today compared to the modern 'tribes' of New Yorkers dwelling along the Hudson River. The annual per capita income gap of \$90 for the Yanomamö compared to \$36,000 for a New Yorker is large. Taking the retailers' Stock Keeping Units (SKUs) to count the product types available to both sets of tribes, DeLong calculated that whereas the Yanomamö economy produces about several hundred SKUs in goods and services, or 'at the most' several thousand, at a rough estimate the New Yorkers' SKUs run into tens of billions (DeLong cited in Beinhocker, 2006, 8–11). In Smith's days, the gap between these tribes was significant though much less, but it has widened since and continues to grow almost entirely due to the extent of the division of labour and the exchange arrangements along both rivers.

Britain, starting about 2000 years earlier from essentially the same position that America was still in, had moved forward (despite the 'shock' of Roman and barbarian invasions) from the first age of hunting to the (revived) fourth age of commerce, during which time American hunter-gatherer societies effectively had stood still for want of a better expression, except perhaps in the accretion of their myths and rituals. The social arrangements involved in procuring the co-operation of the thousands and thousands (now millions, even billions) of independent, mainly anonymous; others are a wonder to behold.

## Exchange

If the division of labour through specialisation promoted opulence, it was worth enquiring into its causes. Smith speculated on exchange, using another 'Just So' story (his handy teaching device), this time of



a savage hunter who, finding that he made better arrows than his fellows – who envied him sufficiently to seek to obtain any surplus arrows he offered in return for a share in their kills – decided eventually to curtail his own hunting and make arrows instead (WN 27), once the ‘certainty of disposing of [his] surplus produce of labour’ became evident. Smith concluded that this kind of ‘disposition is the occasion of the difference of genius’ rather than the reverse (LJ 351).

Smith believed the division of labour was not the result of ‘prudent’ collective insight leading to a hunting band’s deliberate decision to divide labour into trades (Hutcheson, 1755). Instead, it was the outcome, over long periods, of individuals finding occasional surpluses above their own needs, which they would waste, or casually dispose of as gifts, and then, from receiving occasional reciprocal gifts in return, decide on an individual basis to deliberately create a regular exchange of their surplus outputs with a view to trading them for the other things they fancied. Where this habit persisted, a division of labour on a more or less permanent basis took root and passed on through the generations.

Exchange is the most important concept in *Wealth of Nations* (Schumpeter, 1954 disagreed):

This division of labour, from which so many advantages are derived, is not originally the effect of any human wisdom, which foresees and intends that general opulence to which it gives occasion. It is the necessary, though very slow and gradual consequence of a certain propensity in human nature which has in view no such extensive utility; the propensity to truck, barter, and exchange one thing for another.

(WN 25)

Pointedly, the exchange propensity evolved long before the appearance of commercial transactions. In support of his contention, I shall offer two brief comments.

Reciprocation behaviour preceded commercial society and was practised in hunter-gatherer societies, which for hundreds of millennia was the only mode of subsistence over the whole of the earth (‘all the world was America’). Reciprocation is a form of exchange behaviour. Work by Robin Dunbar (2005) and his team on gossip among humans links the evolutionary role that human gossip performs to a similar social role that grooming plays among primates. Dunbar showed that whilst

grooming is enforced mainly by hierarchical dominance, there is also a significant element of discretionary grooming occurring within it. Chimps also groom a selected few others who reciprocate by grooming them, and, of importance, they avoid grooming selected others. In short, reciprocation is an exchange transaction, not entirely facetiously paraphrased by the saying 'you scratch my back and I'll scratch yours'.

The main difference between reciprocation exchanges and commercial bargains is that whereas exchange transactions in commerce are simultaneously and explicitly completed (cash for goods; goods for cash), in reciprocation transactions the exchange is implicit and separated in time – 'If you groom me today, I shall groom you later.' The implicit promise, which in chimpanzees is unsupported by speech, can only be concluded by what the chimps do. Reciprocation transactions are quasi-bargains, with the important characteristic that uncompleted transactions terminate the exchange relationship.

The evolution of reciprocation into traded exchanges occurred both within the band and among bands, and there is no plausible basis by which external traded exchanges suddenly appeared without a slow and gradual transformation of implicit exchanges (delayed in time) into explicit (simultaneous) exchanges. Trading with neighbouring bands was a learned alternative to plundering each other, though this does not preclude the coexistence of violent plunder with peaceful trade; humans have for long experienced practising both methods in tandem.

Given the behaviour sets of 'quasi-bargains' and 'bargains', which plausibly arose deep in pre-history, Smith speculated correctly on the origins of the propensity 'truck, barter, and exchange'.

## Traded bargains

Smith identified the elements of bargaining that constituted the means by which trade is conducted. Surprisingly, his exposition of bargaining was more or less ignored for 200 years. When economists (Zeuthen, 1930; Hicks, 1931) became interested in bargaining, they based their entire approach on modelling conflict and coercion, which, though difficult, were easier to formulate mathematically than the mediation of self-interests as set out by Smith. Increasingly sophisticated mathematical modelling followed these earlier attempts (Nash, 1950; Harsanyi, 1956; Cross, 1965).

Smith asserts that man in civilised society 'stands at all times in need of the co-operation and assistance of great multitudes, while his whole life is scarce sufficient to gain the friendship of a few persons' (WM 26), contrasting his near-total dependence with the self-sufficiency of most other animals. Because man is in constant need of the assistance from his brethren, the main problem of total dependence becomes how to interest others in providing that necessary assistance?

Smith asserts that it would be in vain to rely on their benevolence, other than in emergency and then only occasionally, and his suggested device of interesting their 'self-love in his favour' causes flutters of indignation among those who protest that this is a dismal comment on the generosity of people towards their fellows. But Smith is not talking about occasional help for those in need, nor sneering at the good intentions of people with a high sense of moral concern for the unfortunate (which Smith shared; Ross, 1995, 406–407). He is talking about the permanent, lifelong assistance that we all need in order to subsist and which we all experience every day. 'No man', he said, 'but a beggar depends on benevolence, and even they would die in a week were their entire dependence upon it' (LJ 493). What is not arguable is that every one of the billions of us cannot become 'beggars'; from whom would we beg for benevolence if the entire population decided to rely on the charity of others?

Many scholars, uncomfortable with modelling social processes, focus instead on outcomes, the latter being more easily cast as equations. The tortured genius, John Nash, typified this approach in his classic 'The Bargaining Problem' (Nash, 1950) by assuming away the bargaining *process* altogether to define the optimal outcome. Smith summarises the bargaining process as an alternative to begging by asserting that the dependent person 'will be more likely to prevail if he can interest their self-love in his favour, and shew them that it is for their own advantage to do for him what he requires of them' (WN 26). He must be other-centred, not self-centred. The bargainer has to address the other person's self-love if he wants to get what he wants from him, and he must demonstrate how it would be to that person's advantage to do so. Expressing what he wants in a selfish manner would not secure him anything.

Bargaining is common to all humans involving a minimum of two persons acting in concert (though not necessarily in tune) and involves more than one ego and expression of self-love or self-interest. If self-love alone drove their behaviour, the propensity to 'truck, barter and

exchange' would apply only in a limited number of cases. Bargainers, locking horns, for selfish, one-sided gain would never compromise and would seldom conclude their bargains. Modern economists modelled the bargaining process as a form of 'warfare' (Zeuthen, 1930) by coercion such as strikes, boycotts and sanctions, which are a long way from addressing the 'self-love' of the other party.

Misreading Smith's presentation to say that humans are driven solely by self-love into selfishness ignores the bargaining process that intervenes between the clash of the passions initiating the interaction (commonly, at least two competing solutions are proposed for every bargaining problem) and the mediated outcome of a single solution. All people experience self-love or self-interest, but to achieve an agreeable outcome each must modify their self-love to find an outcome agreeable to both of them; for clearly, 'truck, barter, and exchange' as a process only works if both parties agree to a common solution. Negotiators square the circle by modifying their selfish passions (of each wanting it all). Selfishness is not the driver of joint decisions.

Smith wrote as follows:

Whoever offers to another a bargain of any kind proposes to do this.  
Give me that which I want and you shall have this which you want.  
(WN 26)

This is the conditional proposition and its discovery deep in pre-history, through practise not rational theory, was of immense historical importance. It opened the prospect of viable alternatives to the mutually destructive violence of plunder as a means of distributing and redistributing the bounties of nature and the fruits of labour. And Smith taught this long before he published *Wealth of Nations*.

In his 1762–1763 *Lectures*, he said of the self-love of others:

This he does not merely by coaxing and courting; he does not expect it unless he can turn it to your advantage or make it appear to be so. Mere love is not sufficient for it, till he applies in some way to your self-love.

(LJ 347)

and

Man, in the same manner, works on the selflove of his fellows, by setting before them a sufficient temptation to get what he wants; the

language of this disposition is, give me what I want, and you shall have what you want.

(LJ 219)

We all (excluding saints) on occasion want things we do not have, which do not mean that we are not nice persons. It most certainly is selfish, and not nice, however, to demand that others supply us with what we want without offering them something in return, especially if we back up our demands with a threat of doing them harm (the 'offer they can't refuse'). Our wants are infinite, our means are scarce; nature is niggardly, and so are we.

Here is his most famous paragraph:

It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity, but to their self-love, and never talk to them of our own necessities but of their advantages.

(WN 27)

Just as I must go beyond selfishness by offering you some of what you want, you must offer me something in return too. We mediate our self-interest. Our ancestors learned this truth long ago in the African savannah when they faced the cold wrath of those to whom they had not reciprocated in kind their services or support. If you do not practise these venerable principles today, you will not conclude your exchanges, because absolutely selfish people cannot conclude bargains (they resort to forms of plunder or go without). Alternatively, both parties may simultaneously modify their selfish motivations to conclude their bargains. Mutual selfishness ('give me that which I want') expresses only half of the conditional proposition. Remain selfish, and the result? Deadlock. Or, as Smith put it, 'Nobody ever saw a dog make a fair and deliberate exchange of one bone for another with another dog' (WN 26).

## Bargaining exchanges

In negotiation, both of us transact not because we like or love each other (though that is not precluded), but because we want something from each other. The negotiated decision settles the terms of exchange. The transaction transforms selfishness into a mutually wilful exchange. Each of us, in the content of our offers, exhibits our unselfish sides.

Bargaining integrates the essential linkage in what Smith described as 'a mercenary exchange of good offices according to an agreed valuation'

(TMS 86). It is the necessary means by which people, who need have no cares for each other and may not even know each other, engage in peaceful transactions to secure each other's co-operation. In modern terms:

Bargaining is the process by which we seek for terms to obtain what we want from someone who wants something from us.

(Kennedy, 1988; cf. Macpherson, 1899, 75–78)

Smith's model of the mediation between self and the impartial spectator brilliantly describes how an analogous mediation of the conflicting passions of the bargainers by the transmutation of self-interest into an 'agreed valuation' is found in the bargaining process.

Our intolerable demeanour in front of our close friends is less tolerable to the impartial spectator who disapproves of extravagant expressions of partiality. This prompts us to 'lower [our] passions to the pitch' which 'the spectators are capable of going along' with (TMS 23). In a remarkably apposite passage for bargaining, Smith adds as follows:

Society and conversation, therefore, are the most powerful remedies for restoring the mind to its tranquillity, if, at any time, it has unfortunately lost it; as well as the best preservatives of that equal and happy temper, which is so necessary to self-satisfaction and enjoyment.

(TMS 23)

Bargaining is a purposeful conversation in which the parties propose different solutions to the same problem, be it a price, terms of a contract or the disposition of rewards and penalties. Bargaining requires communication; nobody bargains successfully by brooding.

In disputes, tones and tempers can be fraught. People may passionately express their demands, feel bitterly about their grievances, remember earlier bruising events and nurse deep hatreds for the 'verbal atrocities' committed by the other party. Bargaining as an alternative to violence is not always, or even necessarily, all 'sweetness and light'.

Even in the many negotiations where a degree of 'sweetness and light' is present, different solutions necessarily lie on the table. We bargain because we favour different solutions. We start with our different valuations, and we reach for 'an agreed valuation' by bargaining towards a different solution. The process highlighted in *Moral Sentiments* corresponds to what bargainers do.

An 'agreed valuation' requires co-operation. Enmity hinders, but does not necessarily preclude, agreement. One-way compromises are seldom acceptable. The movement from their original solutions becomes each party's contribution to the joint agreement. My approval of your modified opinions is to adopt them; to disapprove is to reject them (TMS 17).

Differences of opinion are endemic in 'truck, barter and exchange'. Emotions as to worth, merit and desert run high. Smith puts it well:

But if you have either no fellow-feeling for the misfortunes I have met with, or none that bears any proportion to the grief which distracts me; or if you have no indignation at the injuries I have suffered, or none that bears any proportion to the resentment that transports me, we can no longer converse on these subjects. We become intolerable to one another. I can neither support your company, nor you mine. You are confounded by my violence and passion, and I am enraged at your cold insensibility and want of feeling.

(TMS 21)

Walkouts, denigrating rhetoric and angry threats cloud the air if bargainers let loose their passions which, in the absence of empathy, distort their perceptions. The bargainer becomes aware that only by 'lowering his passion to that pitch', which the other party 'is capable of going along with' can he hope for a 'concord of the affections' as a prelude to the harmony flowing agreement (TMS 22). And that is true for both parties. Smith says that each 'must flatten the sharpness of his natural tone, in order to reduce it to the harmony and concord with the emotions of those who are about him'. What each feels is never exactly the same because they both view their own interests from different vantages, but by lowering expressions of their self-interests to make them more acceptable and to meet the other side's movement, both sides review their passionate (often extreme) stances, looking at them in some measure with the eyes of the other party.

'The reflected passion ... is much weaker than the original one' and 'it necessarily abates the violence of what he felt' before the meeting (TMS 22). Bargainers, in short, cannot get all they want and by suppressing their selfish inclination to demand everything for nothing or little in return, 'always endeavour to bring down [their] passions to that pitch, which the [other bargainer] may be expected to go along with' (TMS 22–23). Traded convergence, prompted by Smithian conditional propositions 'are the most powerful remedies for restoring the mind to its

tranquillity, if at any time, it has unfortunately lost it; as well as the best preservatives of that equal and happy temper, which is so necessary to self-satisfaction and enjoyment' and 'which is so common among men of the world' (*TMS* 23). They 'give to get' by reducing their demands and increasing their offers. Linking conditions with offers defines the common propensity of truck, barter and exchange.

That Smith taught the conditional proposition over 200 years before it entered today's negotiation literature is remarkable, but not quite as remarkable as it lying like the making of the labourer's common coat, virtually ignored and unnoticed for so long.



# 7

## ‘had the original state of things continued’

### Introduction

Adam Smith put forward what is widely regarded as a labour theory of (exchangeable) value. There is, however, evidence of his awareness that whatever merits such a theory may have had for explaining the derivation of exchange value in the distant past, consistent with conventional knowledge and his historical perspective, it was inadequate for him to explain the exchange behaviours using prices in markets. And this created one of those conundrums forever associated with his name: to what extent was he committed to a labour theory of value? I suggest the answer is ‘weakly’. Therefore, I do not subscribe to Paul Douglas’s ([1928] 1989, 77) view that ‘it might seem to be the path of wisdom to pass these topics by in discreet silence.’

The confusion surrounding Smith’s treatment of exchange value embarrasses those who believe he was an exponent of an uncompromising pro-business philosophy (the ‘Chicago’ Adam Smith), and pleases those who see him as a closet socialist (the ‘Marxist’ Adam Smith), but his treatment merits neither of these interpretations; rather we should study closely what the ‘Kirkcaldy’ Adam Smith wrote (Evensky, 2005, 245–269).

There is no doubt that his presentation of labour as ‘the real measure of the exchangeable value of all commodities’ (WN 47–71) is less than perspicuous partly because his presentation straddled two quite different circumstances. In time, successor authorities resolved the value problem by inventing new theories of marginal utility. Meanwhile, those holding on to labour as a measure of value (Marx following Ricardo) had marched into a cul de sac, where labour theories of value were treated as an historical curiosity.

## Value in a primitive society

Smith, following John Locke, showed that in early primitive hunting societies labour was 'the source of value' in 'exchange'. Smith, therefore, considered 'value' as a ratio and not as something mystically 'inherent' or 'embodied' in a product, or somehow metaphysical (an aesthetic theory of value). However, with the division of labour and, crucially, the co-operation of separate property owners, Smith also acknowledged that labour no longer had a unique role in determining exchange value or price. Therefore, the errors of a labour theory of value applied to a commercial society, as put forward by *all* of his contemporaries and his classical and Marxist successors, should not overshadow the contribution of his theory of exchange value based on the mediation by bargaining of effectual demand with the cost elements driving supply price.

Smith approaches the subject from his familiar backward-looking historical perspective and opens by limiting the application of his labour theory of value to that 'early and rude state of society' by asserting without qualification that labour 'seems to be *the only circumstance* which can afford any rule for exchanging them for one another' (WN 65; emphasis added).

The age of the hunter was unrepresentative of what followed, not least because farming and commerce had separately owned factors of land, labour and capital, and not just one factor, labour, found in rude society. In consequence, Smith (and others) handled this change by exploring the impact of multi-factor markets on price variations. Smith and his contemporaries explained how 'market' prices could differ from their 'natural' costs of production (Smith, 1776; cf. Puffendorf, 1672; Locke, 1726; Cantillon, 1755).

In his 'parable' of the beaver and deer hunters, Smith postulated that if in a 'nation of hunters . . . it usually costs twice as much labour to kill a beaver which it does to kill a deer, one beaver should naturally exchange for or be worth two deer' (WN 65).

The parable, as an opening illustration, was applicable for a rude society, where hunters unambiguously owned the product of their labour, because nobody else had a claim on it, leaving aside the dubious implication that exchange always took place under the constraint of their trading 'equivalent values'. Such notions were derived from medieval notions of the 'Just Price'. But the parable, a teaching device of highly restricted applicability, was only a 'Just So' story. It is based on a presumption that labour is the only factor and labour is therefore the only source of exchange value. In this case, the two hunters would, perhaps,

but need not, calculate their trade (should they wish to make one) on some ratio of the toil and trouble required to hunt and kill the two animals.

Smith drew attention to the problems of determining the quantities of labour exerted by beaver and deer hunters. Despite labour being 'the real measure of the exchangeable value of all commodities', Smith concedes that it would be 'difficult to ascertain' the determinants of the quantity (including risk) of labour that constituted labour's real value because, in addition to time, other qualities enter the quantity equation, such as the degrees of hardship and the ingenuity found in individuals, degrees by which 1 hour of arduous work exceeds 1 hour of easy work, and 1 hour of work that cost years to become proficient in compared with a month's unskilled industry.

In a sure recipe for argument for the two hunters, tired, dirty and possibly bloodied from their labours, he raises problems of comparability: 'it is not easy', he says, 'to find any accurate measure of either hardship or ingenuity', and while 'some allowance is commonly made for both', the exchange ratio would be found 'by the higgling and bargaining of the market', which he suggests 'is sufficient for carrying on the business of common life' (WN 48–49, 65). But once 'higgling and bargaining' are allowed, there is no compelling reason to believe that the 'higgling' confined itself solely to the alleged labour (or any other) costs the parties claimed were involved with their products, which leads us towards a ratio based on what the beaver and deer were worth to the hunters at the time and place when they tried to complete their transaction, and this could involve wholly different considerations from the quantity of labour supposedly embodied in their kills or used up in hunting them. But Smith did not explore this matter further, and nor did anybody else for a century. By generalising these conclusions, apparently to both rude and advanced societies, Smith contributed to the subsequent confusion. He drew attention to the continuity of the problem of 'price' determination by making an assertion without evidence or explanation of how it worked:

In the advanced state of society, allowances of this kind, for superior hardship and superior skill, are commonly made in the wages of labour; and something of the same kind must probably have taken place in its earliest and rudest period.

(WN 65)

If he had stuck with developing exchangeable value, first for a rude society, assuming an acceptable numeraire could be found, with the

'toil and trouble' of labour as prime candidate as the factor owned only by whoever exerted it, and if he had demarcated exchange value very clearly from when societies moved on to the advanced state, when labour was no longer the only factor, and if he had emphasised that others, besides labourers, owned the other factors (of which there are hints), everything might have been clearer. But he kept switching between the common sources of value in different modes of subsistence, causing impatient readers to miss the significance of the differences in factor ownership. They also missed what he apparently took for granted, namely that readers would know that he was talking about two separate phenomena of 'exchangeable value' in rude and in 'improved' states of society after property was invented and became widespread.

## Signs of muddle

He opens chapter V with a statement reminiscent of Richard Cantillon (Jevons, 1879, 82n)

Everyman is rich or poor according to the degree in which he can afford to enjoy the necessities, conveniences, and amusements of human life.

(WN 47)

He speaks here of the modern state because this definition applies after the division of labour 'has thoroughly taken place', and he makes the logical assertion that in this state each person can supply from his own labour only a small part of his needs and, necessarily, he must obtain what else he needs from others. In these circumstances, their richness or poorness depends on the labour they can command by what they can 'purchase' with the products of their own labour. It is the command of other people's products through exchange (irrespective of what they cost in labour) or, more practically speaking, what they can get for what they can trade, irrespective of the supposed labour 'embodied' within them. In rude society, everything they consume is acquired by their labour and necessarily is a smaller bundle of goods than the same amount of labour they can command in a society where the division of labour is established.

In terms of the previous chapter on exchange through bargaining ('obtaining what we want from other people who want something from us'), the exchange value of the items in the transaction are a ratio of 'what we give from what we have, for what we want from what they have' (or the ratio of what we want/what they want). Smith stated this

clearly, 'Give me that which I want and you shall have this which you want' (WN 26). Interestingly, Professor Jevons, one of the progenitors of what became the neoclassical school (and a critic of Smith's) wrote, 'the word Value, so far as it can be correctly used, merely expresses the circumstance of its exchanging in a certain ratio for some other substance' (Jevons, 1879, 82n).

When labour is no longer the only factor, the notion that what everything 'really costs to the man who wants to acquire' something is purely 'the toil and trouble of acquiring it' takes on a significant meaning. People have access to vastly more goods than their predecessors ever 'needed', because in contrast their predecessors could never make the range of modern goods in a lifetime of labour. Exchange was the liberating force that expanded access to unimagined 'necessaries, conveniences and amusements of life'.

In improved society, through the division of labour and specialisation, the consumer acquires what he needs by exchanging his share of earnings (wages, rents, profits) from his budget for the products owned by others. By disposing of the money he receives from contributing to the production of exchangeable surpluses, he saves himself the *toil and trouble* of making all the other products he wants, and in so far as without the division of labour he would forego any hope of acquiring the products offered by other people in exchange, he is better off materially. In effect, he relies upon someone else undertaking the 'toil and trouble' of making everything that he wants to purchase within the limits of his income. This is the main benefit of an exchange economy with its ever-finer division of labour – we have an unimaginable increase of product variability available for our exchange transactions (as the example of the comparative availabilities open to the Yanomamö and New York tribes shows).

It misses the point to bemoan the fact that other people produce billions of things we do not want; it is our access to what we want out of those available that is the positive outcome of the extensive division of labour. All tastes are catered for; not just ours. The rich have greater access to more of what they want than the poor, but the poor in a wealthy society are incomparably better served than the poor in a poor society.

Confusingly, Smith's text leaves one foot in rude societies and the other in commercial societies where the division of labour 'has thoroughly taken place', without always clearly demarcating to which society he refers, nor drawing their distinctions out each time. In the rude, single-factor society, the identity of labour with value it commands may be sound because people use only their own labour in conjunction

with their 'open access' to nature to create their consumption goods (absolute self-sufficiency).

Individuals in improved societies consume products created by multiple others (absolute dependency with maximal access) in stark contrast to the few products their predecessors created for themselves (absolute independency). In commercial, multi-factor, multi-owner societies, the labour of an individual loses its 'monopoly' of relatively few items in favour of access to an immeasurably increased range of available products.

'Labour', writes Smith, referring to rude societies, 'was the first price, the original purchase price that was paid for all things.' Indeed, it was by labour that whatever they consumed 'was originally purchased' (by their 'toil and trouble'), and 'its value to those who possessed it and who wanted to exchange it for some new productions' was 'precisely equal to the quantity of labour which it can enable them to purchase or command' (WN 48), which was not very much. However, as noted by modern economists, 'It is one thing to charge that the true measure of value, in real terms, is labor time, and another to avow that the source of value is the necessary cost of production of each commodity' (Ekelund and Hébert, 1990, 108), that is, what is valid for simple rude societies may not be valid for complex multi-factor societies. But 'all the wealth of the world' when the world consisted of (absolutely fewer) people living in rude societies only, was incomparably minimal in quantity, quality and variety compared to 'all the wealth of the world' when produced by many more people living in successively improving societies. Originally, wealth was next to nothing; with the spread of opulence, it became almost everything.

Smith's reservations or 'adjustments' show that he had moved on from the original notion of labour values:

But though labour be the real [historical] measure of the exchangeable value of all commodities, it is not that by which their value is commonly estimated.

(WN 48)

Because of the difficulties involved in ascertaining the commensurability of two quantities of labour, our ancestors resorted to that 'certain propensity in human nature' of 'truck, barter, and exchange' (WN 25), otherwise known as the venerable behaviour of 'higgling' and bargaining, leaving the 'quantity' of labour as an abstract noun like happiness, difficult to define even for experienced economists and not directly relevant for those involved in myriad exchange transactions for whom

such a calculation was of immediate, perhaps pressing, interest. It seems unlikely that anybody tried to calculate labour's value in practice and, historically, it appears to have been ignored by buyers and sellers in practice. Smith makes no effort to provide any examples justifying his 'just so' story for other than rude societies.

In commercial societies, where the division of labour is in full effect and 'barter ceases' in favour of monetary exchange, people rely on the 'palpable objects' of the quantities of commodities (WN 49). Hence, 'it comes to pass', he writes in Biblical mood, 'that the exchangeable value of every commodity is more frequently estimated by the quantity of money, than by the quantity of labour or any other commodity which can be had in exchange for it'.

In short, there was no credible role for a pure labour theory of exchangeable value outside of the early ages of rude society and, therefore, once the division of labour became general and property became entrenched, there was no useable labour theory of inherent value. However, the 'toil and trouble' expended by individuals in an exchange society clearly generates vastly greater access for them to the products of the 'toil and trouble' of other individuals.

If only Smith had left his comments there, but no, he set out a convoluted argument to reconcile the 'abstract' with the 'palpable' and unwittingly extended by default his association with the labour theory of value, which his successors (including Ricardo) misconstrued.

What the various pioneers of economics were arguing about were different ways of trying to define a common numeraire for the exchange ratio. They were attempting to *measure* value, which is not a *theory* of value (Sowell, 2006, 66). They were trying to define value by using invariable units of any plausible numeraire (labour time, a day's ploughing or whatever) (Hutcheson, 1755, I.287–288) to calculate its 'cost' per unit. When changes occur in the numeraire, all prices change equi-proportionately, much as the invariable characteristics of weight or length change strictly according to the arithmetical rules of equi-proportionality of weight or scale. The problem was finding an appropriate numeraire, which in the case of units of labour became increasingly unconvincing (labour costs even in the mid-eighteenth century were highly variable between occupations).

Smith already knew from his essay on astronomy of the absurdities of attempting to make a prevailing paradigm fit a disobedient reality (EPS 55–59). When reality confronts an impossibly baroque theory, such as the labour theory of value in a multi-factor commercial economy, philosophers should have dumped the theory and started

again. However, he left his exposition of the 'toil and trouble', theory of value scattered among his expositions of a market-price theory of exchangeable value in a multi-factor commercial society. His problem remained because, despite his repeated qualifications, few readers in practice realised his intentions (Fleischacker, 2004a, 127).

## Be clear about rude society

In that original state of things, which precedes both the appropriation of land and the accumulation of stock, the whole produce of labour belongs to the labourer. *He has neither land-lord nor master to share with him.*

(WN 82; emphasis added)

Smith highlights the difference in the labourer's ownership of his labour in rude society. He says 'the whole produce of labour belongs to the labourer' no less than three times (WN 65, 82–83) and always in connection with the original, first age of hunting.

The hunter's ownership of the product of his labour constituted his property. An individual has a natural or perfect right in their own body and, when 'trafficking with those who are willing to deal with him' ('liberi commercii') (LJ 8–9), all persons have a natural right of ownership in their 'industry, labour or amusements', when, as Hutcheson (1755, II.CII, 58) put it, not 'hurtful to other persons or goods'. Smith taught what he had learned from Hutcheson and, through him, from Pufendorf, and he had these clear rights in mind when writing *Wealth of Nations*. His labour theory of value for man in rude society was simply an exposition of the theory of natural right. He speculates over two paragraphs about an imaginary situation, as if that first rude age when the labourers owned the entire product of their labour had continued indefinitely.

Had this state [i.e., 'the original state of things'] continued, the wages of labour would have augmented with all those improvements in its productive powers, to which the division of labour gives occasion.

(WN 82)

But this would not have worked because it 'could not last beyond the first introduction of the appropriation of land and the accumulation of stock'.



Smith identified exchange as originating from the division of labour. When in advanced society, owners of other factors (land and capital stock) joined in producing output this changed the former 'rude' situation when there was only one factor, the hunter's or the arrow maker's labour. In advanced society, the owners of the other factors do not transfer ownership to their partners. The landlord continues to own his land – he 'rents' it – and its products earn his rent; the labourer does not sell his body to others – he passes over the products to earn his wages; and the undertaker does not pass ownership of his capital – he uses it to facilitate production to earn his advances, the revenues of which replace his stock, plus a profit.

So, with the evolution of the appropriation of property in land, the situation was fundamentally different because land and everything on it as free resources ended. The arrows-for-meat transaction can be repeated over and over only for as long as the wood for the arrows and their stone points came from a free resource owned by nobody and for as long as the animals which were hunted to feed the hunters' families were owned by nobody; they ranged freely and could be chased by anybody on nobody's land. Ownership of the bounties of nature and the fruits of the combined factors of production changed the distribution of titles to shares in the product arising from their co-operation.

The invention of property was inevitable if human populations grew and remained concentrated in a relatively small area. Ten thousand humans depending on hunting for subsistence in a continent-sized territory (India, China, the Americas, Europe and Australia) could subsist in a steady state for millennia, and we assume that for a long time that is more or less what happened. They could always disperse and move on whenever, as Smith put it, the 'chase' became 'precarious', or if relations within and among the various bands became turbulent.

Once shepherding was practised, the need to keep flocks and herds from wandering away, and the need to keep wandering humans from taking them away, introduced, slowly and gradually, concepts of property, first as communal property (jealously guarded against other communities) and eventually as private property (jealously guarded against all comers). The later developments in agriculture had the same effect, only more intensely, because farming was more propitious for its evolution as a new mode of subsistence.

It also changed everything else in respect of the ownership of the products of labour and the necessary co-operating factors, which reduced the share of an individual labourer in the final product by

including the shares going to the other owners of the contributing materials, their dexterity and technology, and most particularly to the owners of the land. This was no longer a simple case of the exchanges between the arrow maker and the hunter, based on their unambiguous ownership of the products of their labour, before and after the transaction. The evolution of property was associated with the need for adjudication in disputes, the emergence of 'norms', 'rules' and 'laws', and for their enforcement by civil governments.

Because primitive exchanges made those participating in them 'better off' (a major incentive of the division of labour), they had a self-reinforcing effect over time of encouraging pair-wise exchange behaviour throughout a society. Therefore, Smith's unique vision of the propensity to 'truck, barter, and exchange' was a precursor to a social-evolutionary road for those who stepped onto it. Those that did not, there being nothing ordained about individuals engaging in social change, remained subject to their existing mode of subsistence because for them 'the original state of things' continued.

### **Constancy of the subsistence theory of labour**

While qualities of labour, or of any commodity, could vary, and thereby undermine their constancy for purposes of being a reliable numeraire, certain sets of labour were considered more or less 'constant'. Hutcheson had taught that

a days digging or ploughing was as uneasy to a man a thousand years ago as it is now, tho' he could not then get so much silver for it; and a barrel of wheat, or beef, was then of the same use to support the human body, as it is now when it is exchanged for four times as much silver. Properly, the value of labour, grain, and cattle, are always pretty much the same, as they afford the same uses in life, where no new technologies for tillage or pasturage cause a greater quantity in proportion to the demand.

(Hutcheson [1755] II.XII, 58)

But ploughing has a restricted applicability as a numeraire outside agriculture (similarly with attempts to use 'corn' as a numeraire in a commercial society).

From the labourer's point of view, asserts Smith, he 'must always lay down the same portion of his ease, his liberty, and his happiness' whenever he is working on a task that has not changed in content ('digging'

or 'ploughing') for a 'thousand years' or, if that is too long a period to consider, with (slowly) changing technologies; at least, it would not have changed much during his working life and, thereby, his awareness of little if any change would form his perceptions of its constant relative worth. In labour terms, 'the price which he pays must always be the same, whatever may be the quantity of goods he receives in return' for his day's labour.

It is the plenty or scarcity of what he buys with his labour that varies and 'not that of the labour which purchases them' (WN 50). This means that labour alone (or at least a certain form of it), compared to all other commodities, was believed never to vary in its own real value – 'it alone is their real price; money is their nominal price only.' However, the employer sees things differently. As far as he is concerned labour varies in price like anything else, some times costing him more, sometimes less, but, insists Smith, in reality 'it is the goods which are cheap in the one case, and dear in the other' and not labour (WN 51; cf. Fleischacker, 2004a, 127). This gives labour, like all commodities, a real price and a nominal price, and the real price covers the 'quantity of necessities and conveniences of life which are given for it' by the employer as wages, and 'its nominal price is the quantity of money' (WN 51).

Building on the long-lasting and unchanging technology of farming, Smith added another element that fixes a constant element in the cost of labour. While gold and silver experience scarcities and abundance, from the 'barrenness' or 'richness' of their respective mines, and their price alters in money terms, the labourer's minimum subsistence stays steady because below that minimal level of subsistence, labourers and their families die from starvation, related diseases and illnesses, and rising child mortality always being an indicator of deficiencies in their subsistence. The subsistence of the labourer, writes Smith, is the real price of labour, though he acknowledged that it was variable in different circumstances: 'more liberal in a society advancing towards opulence than in one standing still; and in one that is standing still than in one that is going backwards' (WN 53).

Adam Smith drew attention to such difficulties and advanced a different source of value, which had an important subjective element too and constituted one of his psychological constants, along with 'propensity to truck, barter, and exchange', 'self-betterment' and 'self-interest', that varied for each individual:

The real price of every thing, what every thing really costs to the man who wants to acquire it, is the toil and trouble of acquiring it. What

every thing is really worth to the man who has acquired it, and who wants to dispose of it or exchange for something else, is the toil and trouble which it can save himself, and which he can impose upon other people. What is bought with money or goods is purchased by labour as much as what we acquire by the toil of our own body. That money or those goods indeed save us this toil.

(WN 47)

## Exchangeable value in improved societies

Smith left it unclear when he leapt to a monetised economy from straight barter. One moment the reader contemplates life in rude society; in the very next sentence, the reader has to shift perspective to an entirely different society, many millennia later (perhaps Smith discarded something he had written here):

As soon as stock has accumulated in the hands of particular persons, some of them will naturally employ it in setting to work industrious people, whom they will supply with materials and subsistence, in order to make a profit by the sale of their work, or by what their labour adds to the value of the materials.

(WN 65–66; cf. Marx, 1954, 77)

The original stock of capital consisted of the subsistence (like a gold prospector's 'grub stake') and tools laid out by the owner for labourers until their work was completed and sold. It was an 'advance' to be recouped from the sale of the 'complete manufacture' which was exchanged for money, or for goods in kind at a price 'over and above the price of materials, and the wages of the workmen' and contributed something for the 'undertaker', who 'hazards' his stock in the 'adventure'.

Workmen add value to the undertaker's materials, and the added value eventually pays their wages and the cost of the materials they use, and also it pays for the profit on both wages and materials that the undertaker advanced. Crucially, the undertaker 'hazards' his capital stock in the 'adventure' only if he expects to make a profit from the sale of the output, and it is the profit motive that promotes the employment of labourers because without expectations of profit there is no motive to employ them. If a venture did not yield a profit, the undertaker withdraws from it at the earliest opportunity and from this simple imperative, undertakers focus on the costs of production. Similarly, if

the venture did not pay labourers at least their minimum subsistence, they look elsewhere for income opportunities from work.

Bringing the elements together, Smith found in the prices of all commodities that all three contributing 'owners' shared the revenue among themselves as 'wages of their labour, the profits of their stock, or the rent of their land', making wages, profits and rent the 'three original sources of all revenue as well as of all exchangeable value' (WN 69). Money lent to someone who employs it derives revenue for its owner, its 'rent' being the interest paid by the borrower. The profit from the borrower's use of it is divided between the profit for his risks in the venture and the interest for the lender who affords the borrower the opportunity to make a profit (WN 69–70). With this, Smith asserted explicitly that labour was not the sole source of value in a commercial exchange economy. Without trumpeting the change, Smith discarded a labour theory of value precisely and as abruptly as he changed the context from rude to commercial society, because that is where his analysis led him.

Smith did not have a labour theory of exchange value beyond his historical account of rude society. His different approach was shown when he unambiguously asserted that 'as in a civilised country there are but few commodities of which the exchangeable value arises from labour only, rent and profit contributing to that of the far greater part of them, so the annual produce of its labour will always be sufficient to purchase or command a much greater quantity of labour than what was employed in raising, preparing, and bringing that produce to market'. Society, in perfect liberty, spends sufficiently to employ the quantity of labour, the landlords' land and the undertakers' capital required to produce its annual output, and, crucially, to grow the capital stock through each round of the 'great wheel of circulation'. The labourers' families lived off their (socially determined subsistence) wage incomes, leaving little or nothing for savings; the undertakers' families lived off their profits and the landlords' families lived off their rents, both having a greater capacity to save than labourers. Among the undertakers and the landlords, there were a fair proportion of 'idle' persons of all ages, who consumed from their family's income streams from rents or profits. The proportion between the consumption and savings of productive and unproductive, including idle, labour determines whether net annual output increases or diminishes or remains the same (WN 71).

# 8

## ‘at last the age of commerce arises’

### Introduction

As the after-effects of the fall of Rome faded, feudal property laws weakened and commerce revived tentatively. The moral problems of new forms of wealth creation were complicated by trying to fit them into existing Christian doctrine, long hostile to money as a symbol of sin (‘eyes of needles’, ‘lilies of the fields’, ‘love of money as the root of all evil’ and such like) (Matthew 6, 28; Mark 10, 18–30). Alleged acquisitiveness and suspicions of profit did not sit easy with piety, on the grounds that profit was believed to have sprung from ‘buying cheap’ and ‘selling dear’, and therefore of questionable moral status (Meek, 1954). The Church demanded that the only acceptable explanations of all phenomena had to be presented as part of His Divine plan, the mysteries of which were beyond the reasoning of human minds. This meant that explanations of price and value were not judged by observed, secular criteria, but by their concordance with biblical doctrines.

By the time Smith published *Wealth of Nations*, philosophical enquiries into price, value and ethics still carried the deadweight of the all-embracing past terms of the debate. Neither Cantillon nor Smith completely broke away from the old forms of presenting their theories. They both remained within the well-established tradition (WN 72–81; Cantillon, [1755] 1964) of the existence of two forms of value: the natural value (intrinsic *within* the good) and the market value or price (dependent on events *outside* the good), the latter treated in religious doctrine with the prejudicial suspicion that these were unwarranted gains. Distinctions between ‘natural’ and ‘market’ price infected political economy until the 1870s (Fleischacker, 2004a, 123–124).

## Natural and market prices

Smith separated natural from market prices and derived them from an analysis of ordinary and average rates of wages and profits applying in each neighbourhood (WN 72) according to the 'general circumstances' of riches or poverty. Another influence was whether the neighbourhood was 'advancing, stationary, or declining', and on whether the average rent of local land reflected its natural or improved fertility, all of which implied that simultaneous differences in wages, profits and rent could exist among separate neighbourhoods and within different societies.

Natural prices were said to occur when precise costs were paid (rent of the land, wages of labour and profits of stock) for bringing commodities to market. The feedback mechanism could not be simpler. Factors not receiving their costs tended to move to other employments, and when factors attracted higher prices above their costs, more of those factors tended to move towards higher-priced employment, 'at least where there is perfect liberty' (WN 73). Market price, the actual price paid for a commodity, may be the same, or above or below its natural price, and it depended on the quantity brought to market relative to the effectual demand for it.

Writers have long recognised the two measures of value: (1) an ideal, cost of production measure, with antecedents rooted in theological theories of the Just Price and (2) the market-driven price based on the quantities demanded. They had separate origins: the former by prescription from theologians, and the latter by individuals acting in competitive exchange transactions in markets. The problem persisted among theorists because of ingenious, but ultimately futile, attempts to reconcile the two notions of price determination.

Turgot expressed it neatly:

The Entrepreneurs, whether in agriculture or in Manufacture, get back their advances and their profits only through the sale of the fruits of the earth or of the manufactured products. It is always the needs and *the means* of the Consumer which set the price at the sale; but the Consumer does not always need the thing which is manufactured or produced at the moment when the harvest is brought in or the work finished. However, the entrepreneurs need their capitals to be returned to them immediately and regularly in order to reinvest them in their enterprises.

(Turgot, [1766], LXVI)

Cantillon, while firmly adhering to the existence of the two notions of value, wrote, 'There is never a variation in intrinsic values, but the impossibility of proportioning the production of merchandise and produce in a State to their consumption causes a daily variation, and a perpetual ebb and flow in Market Prices' (Cantillon, [1755], 31). He recognised the 'impossibility' of 'intrinsic values' having any practical use (except as a concept of a long-run supply price). They were an abstract notion, and it is remarkable that this imbalanced dual-value theory remained in economics for so long.

Similarly, Smith's reconciliation took the natural price to be the 'central price' to which market prices of all commodities were 'continually gravitating' and were 'constantly tending towards' (WN 75), but not reaching nor resting at it. These authors noted how market prices varied according to demand, but they did not pursue their analyses of market value in which price was clearly a function of the quantity demanded (WN 77; Cantillon, 1964, 97).

The dichotomy between cost of production prices and market demand prices may be understood better by considering briefly the dichotomy between buyers' and sellers' opening prices. Opening offers express their self-interests, but self-interest, Smith said, is not enough to negotiate a common price acceptable to both. They have to mediate their interests via 'higgling' (zero sum) or by conditional bargaining (non-zero sum) across several issues. Sellers must think of their costs of production, if only to ask, 'can I stay in Business?' Buyers tend to judge price against their preferences for the item and their alternative uses of their money; they seldom, if ever, think of the seller's costs. Buyers in competitive markets compare prices of rival sellers in their desire to minimise acquisition costs; sellers in competitive markets compare prices in their desire to remain in business. Each party comes at commodity prices from different starting points as they attempt to mediate their differences through bargaining.

## Wages

In wage bargaining, Smith makes clear the different approaches of the parties consistent with his general explanation of bargaining between buyers and sellers. From the labourer's point of view, the 'toil and trouble' of work was of equal value to him, allowing for 'health, strength and spirits', and his degree of skill and dexterity, because he must sacrifice the 'same portion' of his ease, his liberty, and his happiness'. The cost the labourer pays is always the same (work is a disutility) irrespective



of what he can purchase out of his wages. His labour is the 'real price' he pays, and his money wages are their 'nominal' price. In contrast, the employer's valuation of the labourer's work varies and is 'sometimes of greater value and sometimes of smaller value'. The 'toil and trouble' of the labourer is not what he is compensating: he buys the output produced by the labourer's 'toil and trouble', which he sells for a price in markets where the buyers are unconcerned with either the labourer's 'toil and trouble' or the employer's aspirations for profits (WN 50–51).

The shares of wages, profits and rent in total revenues from selling products in markets are presented as rewards to the owners of Land, Labour and Capital, and they played an important part in Smith's analysis of the dynamics of the burgeoning commercial economy.

Labour in his day, with few striking exceptions, was not organised in large-scale enterprises. While totally independent workmen working for themselves and not for masters were uncommon, but not completely absent, most workmen worked for a master who provided them with their subsistence in the form of wage advances and the materials they needed (Smith asserted for every one who was independent, 20 others worked for masters, either alone or in concert with others; WN 83). The masters could be a craftsman, journeyman or tradesman who employed them using capital stock he had saved, and who worked alongside them, or they could be a master who employed several workmen on specific projects. Masters provided them with materials, perhaps on occasion with hand, not machine-driven, tools, in their own workplaces, commonly attached to their homes. The age of large-scale factories had not yet arrived; Carron Iron, Stoke potteries and Glasgow tanning plants were exceptions.

Contracts between workmen and masters determined wage rates, but not objectively, and each party sometimes resorted to 'combinations' to enforce their writ on the other; workmen to raise, or to prevent reductions in, their wage rates; masters to reduce or to prevent increases in the wages they paid. Smith saw this as an unfair contest (WN 83), which only underlined the overall disparity in the availability of the means to sustain a week or more without wages, which applied to every labourer, who if unemployed had no real means to resist wage offers he considered too low, or if employed was hardly in a strong position to resist unilaterally imposed reductions in wages. Even with wage rates rising making it easier to recruit more labourers, the presence of unemployed persons nearby or those able to migrate into a neighbourhood acted as a brake on the scale of any increases. The employer, on the other hand,

could in most circumstances 'hold out' to secure what he wanted 'for much longer' than could labourers (WN 83–84).

When, as occasionally happened, labourers in a neighbourhood 'combined' illegally in support of their grievances, they felt the full weight of the law if they engaged in collective action. Their desperation to settle the issue speedily, before their collective strength withered from uncertainty, stress and duress, often led to 'the folly and extravagance of desperate men, who must either starve, or frighten their masters into an immediate compliance with their demands'. The labourers' tactical plight provoked recourse 'to the loudest clamour, and sometimes the most shocking violence and outrage', which generally ended 'in nothing, but the punishment or ruin of the ringleaders' (WN 85; Logue, 1979). Smith's analytical tone is dispassionate and pragmatic, and he hints that he sympathises with labourers not the employers.

Smith alludes to what appears to be an inevitable relationship between the demand for labour, and thereby the wages offered in a neighbourhood to employ them, and the state of the economy. As demand for labour rose for any reason, the level of wages rose too (without workmen having 'occasion to combine') because competition among masters caused them to bid against each other; similarly when the economy declined, competition among labourers caused wages to fall. He states clearly that the 'demand of those who live by wages, it is evident, cannot increase but in proportion to the increase of the funds which are destined for the payment of wages' (WN 86). Increases in revenue and stock led to increases in the demand for labour 'and cannot possibly increase without it', and wages rose fastest in countries with the fastest-growing economies (WN 87). He indicated his respect for the dignity of labour by asking, rhetorically, as follows:

Is [an] improvement in the circumstances of the lower ranks of the people to be regarded as an advantage or as an inconveniency to the society? The answer seems at first sight to be abundantly plain. Servants, labourers and workpeople of different kinds, make up the far greater part of every great political society. But what improves the circumstances of the greater part of the members can never be regarded as an inconveniency to the whole. No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable. It is but equity besides, that they who feed, cloath and lodge the whole body of the people, should have such a share of the

produce of their own labour as to be themselves tolerably well fed, clothed and lodged.

(WN 96)

This reveals an important element of Smith's character. He dealt with the conditions of workpeople without overt sentiment, for he was not a missionary with a social agenda. He was trying to nudge people of influence into choosing to make changes to the mercantile policies practised over many generations. *Wealth of Nations* was not a manifesto for social change through explicit redistribution, though it implied a sharing of future affluence expected from growth through an increasing demand for labour. His conclusions, long before he published them, as shown in his *Lectures* and *Moral Sentiments*, were that a society progressing towards spreading opulence would deal in the only lasting way with the problems of what we now call distributive justice in regard to poverty, lack of education, health issues and infant mortality, and of which he produced his evidence in data and examples. For this to happen, his main goal was to identify the nature and causes of wealth creation as reminders of the obstacles in the way of achieving general opulence (cf. WN 99–104).

In place of a moral appeal to the consciences of employers or legislators, he based his case for a high-wage economy for all who depend on the productivity of labour for the growth of opulence, by appealing to the self-interest of the masters. He gives a clear example of this:

The liberal reward of labour, as it encourages the propagation, so it increases the industry of the common people. The wages of labour are the encouragement of industry, which like every other human quality, improves in proportion to the encouragement it receives. A plentiful subsistence increases the bodily strength of the labourer, and the comfortable hope of bettering his condition, and of ending his days perhaps in ease and plenty, animates him to exert that strength to the utmost.

(WN 99)

Smith recognised the patent contradiction between the reality on the ground and the conclusions drawn solely from deduction. *Wealth of Nations* shows Smith's penchant for observing the real world and its history. Smith wrote more as an historian used to working from scanty materials. For him, there were precious few theoretical constructs available. He preferred to cite evidence closest to people's experience rather than 'tedious and doubtful calculation' (WN 91). He also refers to his

direct observations of the habits and preferences of common people, with gybes at the pretensions of the well to do, for instance – 'place, that great object which divides the wives of Aldermen' (TMS 57).

Smith's discussion on 'perfect liberty' in wages and profit markets (WN 16–275) is important because it shows the significance of his use of the concept of perfect liberty in his analysis of the nature and causes of opulence. Because perfect liberty did not exist in practice (it was a philosophical construct), the nature of the obstacles this created resulted in a slower spread of opulence than would otherwise have occurred.

Smith addressed the proposition that the 'whole of the advantages and disadvantages of the different employments of labour and stock must, in the same neighbourhood, be either perfectly equal or continually tending to equality' compared to the reality he observed on the ground. In theory, wage and profit rates should tend towards equality because if 'any employment' were 'evidently either more or less advantageous than the rest, so many people would crowd into it in the one case, and so many would desert it in the other, that its advantages would soon return to the level of other employments.' This would be the case only where a society enjoyed perfect liberty, and every man was free to choose whatever employment he felt like trying and to change it as often as he liked. The general rule was that every man's interest prompted him to seek advantageous, and shun disadvantageous (to him), jobs (WN 116). He noted that 'everywhere in Europe' wage and profit rates were different and nowhere 'equal', nor tending that way, partly because other (real or imaginary) circumstances in people's employment beside wage or profit rates are important to them and partly because government policies in Europe 'nowhere leaves things at perfect liberty' (WN 116). But how valuable is a theory where it does not correspond to experience on the ground?

Smith spent no time trying to reconcile theory with practice; he used divergences from the natural law principles of perfect liberty to explain how the real world worked, and from the evidence, not the theory, he suggested how things might be changed to achieve specific improvements to progress towards the spread of opulence. Jerry Evensky (2005, 127) noted how his description of what should happen in conditions of perfect liberty is a 'beautiful capsule image of the dynamics of competition' in the 'ideal liberal order'. The divergences Smith noted were as inevitable as they were natural, and thereby acceptable within wide margins, and this clears space for him to highlight those divergences imposed by breaches of perfect liberty by monopolists, state regulations,

mercantile policies and such like, as a prelude to influencing legislators to take action slowly and gradually to remove the divergences.

Smith stated five (natural) circumstances 'as far as I have been able to observe' that make up for small pecuniary gains in some jobs and counterbalance large gains in other jobs, leaving labourers to stay where they are rather than move about in accordance with the theory. The five circumstances under which wages vary are as follows:

1. First, with the 'ease of hardship, the cleanliness or dirtiness, the honourableness or dishonourableness of the employment' (WN 117–118);
2. Second, with the 'easiness and cheapness, or the difficulty and expense of learning the business' (WN 118–120);
3. Third, with 'constancy or inconstancy of employment' (WN 120–122);
4. Fourth, according to the 'small or great trust which must be reposed in the workmen' (WN 122);
5. Fifth, according to 'the probability or improbability of success in them' (WN 122–128).

In each case, he details how they vary and why, including a supporting discourse on the improbabilities of winning lotteries.

Among the details Smith offered, he explained why

- a journeyman weaver earns less than a journeyman smith;
- a journeyman blacksmith earns less than a collier;
- the trade of a butcher ('a brutal and odious business') is more profitable than the common trades;
- the public executioner ('the most detestable of all employments') is better paid than any other common trade;
- only poor people 'hunt and fish' but receive only 'scanty subsistence' while rich people pursue these 'activities as a pastime';
- the inn keeper ('exposed to the brutality of every drunkard') 'yields so great a profit';
- expensive machines must at least produce ordinary profits;
- expensive education in acquiring 'extraordinary dexterity and skills' is akin to erecting an expensive machine and why the person with it must attract wages 'over and above' that of common labourers;
- skilled work imposes the necessity of long apprenticeships and all that follows from such laws;
- painters, sculptors, lawyers and physicians earn liberal recompense;

- hours of work vary for masons and bricklayers and hence vary their wages;
- chairmen (who carry people) also work as bricklayers;
- carpenters earn less than masons;
- journeymen artificers, subject to instant dismissal, earn more than common labourers in London;
- colliers in Newcastle and Scotland earn three times the wages of common labourers;
- coal-heavers at the docks earn four or five times the wages of common labourers;
- the constancy or inconstancy of employment does not affect the profits of stock;
- the wages of goldsmiths and jewellers are superior to other workers of similar ingenuity;
- the remuneration of physicians, lawyers and attorneys is in accordance with their 'rank in society';
- the remuneration of the most successful lawyers is so 'extravagant', and public 'admiration' of them is so high;
- the remuneration of players, opera singers and opera dancers is 'exorbitant' while they enjoy popular acclaim;
- the chance of a gain is overvalued and of a loss undervalued;
- people play lotteries;
- the young are contemptuous of risk;
- young men enlist in the army without their father's consent;
- seamen are paid less than common labourers;
- rates of profit vary with risk, but not proportionately;
- apothecaries apparently make 'uncommonly extravagant' profits;
- retail grocers make 40 or 50 per cent profit upon a stock of £100, but wholesalers make 8 per cent profit on a stock of £10,000;
- there are differences in profits and extent between retail trades in the country and those in large towns;
- speculative merchants sometimes make 'sudden fortunes' but are more likely to lose them (WN 116–131).

Typically, Smith's takes 15 pages to discuss the details of why wage rates differ in the above 32 circumstances. In this context, it is worth contrasting the approach of Smith, the philosopher, with Richard Cantillon's, the banker, who analysed what happened in the real world without any reference to speculation about natural law theories of perfect liberty. He accounts for the differences between the wages paid to time-served tradesmen and husbandmen as the cost and risk of becoming proficient

in their trades, and he considers them to be so for 'natural and obvious reasons' (Cantillon, [1755] 19, 21, 23). This expository distinction explains the attractiveness of Cantillon and Turgot [1766] to Jevons [1881]; Canaan [1896]; and Schumpeter (1954), and contrasts with their views on Smith. Cantillon, unlike Smith, provided limited evidence for his literary statements about political economy (though the influence of his considerable international banking experience is evident). Cantillon, Turgot and Quesnay's focus on pure theory, without supporting evidence of the kind that Smith offered in *Wealth of Nations*, strikes a chord with modern theorists who accord them high marks for their scientific effort. Smith, however, wrote for eighteenth-century legislators and the people who influenced them, a quite different audience to today's economists.

Two of the five circumstances noted by Smith as generating differences in wages also affected the profits of stock, namely the 'agreeableness of disagreeableness' of the business and the 'risk or security with which it is attended' (WN 128). Smith considers that disagreeableness and risk affect the owners of stock less than the labourers' wages, because the labourer is more immediately affected by the disagreeableness of a job than the owner who employs him; he more so than his employer personally undertakes the physical risks associated with an employment. Smith concludes that the 'average and ordinary rates of profit in a neighbourhood from the different employments of stock should be more nearly' equal 'than the pecuniary wages of the different sorts of labour'. And he says, 'they are so accordingly' (WN 128).

## Imperfect markets

Smith opens his first real assault on the artificial constraints imposed on commerce after discussing perfect liberty and natural divergences from it. Europe, he asserts, does not leave society at perfect liberty, and it 'occasions other inequalities of much greater importance' besides the natural divergences. His three examples of unnatural, institutionally imposed, divergences are as follows:

1. restraints on competition in certain employments;
2. increasing competition in some other cases;
3. obstruction of 'the free circulation of labour and stock' across employment groups and from place to place (WN 135).

His first target, the 'exclusive privileges of corporations', recurs throughout his enquiry, backed by numerous specific examples,

legislative interventions and comments, plus pages of supporting data (cf. Tucker, [1755] 1931).

Incorporated trades restrained competition wherever they were established. Their main feature was apprenticeship, which restrained competition to a much smaller number of men than might otherwise have entered the trade and competed to reduce prices (WN 135–145). Smith targeted apprenticeships on efficiency grounds because they misdirected capital and their customers' purchasing power by their uncompetitive higher prices, as well as being offensive to equity by denying work to the free choice of those who otherwise would have exercised their perfect rights (Rothschild, 2001, 87–115). The irrationality of restraints is shown by the coach-maker, who can 'neither make nor employ journeymen to make his coach wheels, but must buy them of a master wheel-wright;... But a wheel-wright, though he has never served an apprenticeship to a coach-maker, may either himself make or employ journeymen to make coaches' (WN 137). This anomaly arose because coaches were unknown when the statutes became law in 1563, but wheels were known, and therefore wheelwrights became protected incorporated trades.

Smith denounces, echoing John Locke, the assault of the statutes on perfect liberty in the most uncompromising terms:

The property which every man has in his own labour, as it is the original foundation of all other property, so it is the most sacred and inviolable. The patrimony of a poor man lies in the strength and dexterity of his hands; and to hinder him from employing this strength and dexterity in what manner he thinks proper without injury to his neighbour, is a plain violation of this most sacred property. It is a manifest encroachment upon the just liberty both of the workman, and of those who might be disposed to employ him. As it hinders the one from working at what he thinks proper, so it hinders the others from employing whom they think proper. To judge whether he is fit to be employed, may surely be trusted to the discretion of the employers whose interest it so much concerns. The affected anxiety of the law-giver lest they should employ an improper person, is evidently as impertinent as it is oppressive.

(WN 138; cf. Locke, [1690] 1988, 237–238)

His criticism highlights his common theme about eighteenth-century Europe: special, self-interested groups sought political and legal powers to enhance their interests at the expense of the public. Self-interest is not always benign. Where traders and artificers dominated the local



government, their manifest self-interests kept local markets understocked, allowing them to charge higher prices and, in a final irony, they used the Statutes of Apprenticeships to restrict the recruitment, and therefore future numbers, of tradesmen. Instead of, as the statutes originally intended, providing a steady stream of competent and properly trained workers (Cunningham, [1882] 1938, 27–37), they achieved the exact opposite; monopolies in the affected trades, higher prices and poorer quality of work in the absence of competition. Smith speaks of ‘the clamour and sophistry of merchants and manufacturers’ in their pretence that their private interests are in ‘the general interest of the whole’ of society (WN 154). And he follows this affirmation with that most famous (and mostly misunderstood) of his quotations:

People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the publick, or in some contrivance to raise prices.

(WN 145)

Smith, of course, is referring to incorporated ‘trades’ within a town, such as wool-combers, butchers, handicraftsmen, general journeymen, printers, retail grocers, hatters, linen stores and the like. By ‘corporations’, he was not describing anything analogous to modern corporations as is often asserted. Guilds and Incorporated Trades acted more like trade unions and professional bodies. Smith refers to the behaviour of towns run by ‘trades’, which were in fact individual tradesmen and artisans, who under law had the exclusive legal power to manage the trades within them. Naturally, being human, the original good intention was subverted by their creating monopolies and restricting competition from non-incorporated tradesmen, such as those who had not served a 7-year apprenticeship with a tradesman in the same town, even if they had served their apprenticeship in another town.

One notable victim of this policy was James Watt, who, though a talented and trained instrument maker, was denied permission by the Glasgow Incorporated Trades to practise his trade there. He was given employment by the senate of the University of Glasgow (Adam Smith was a member), which was sited just outside the town boundaries and was exempted from the authority of the Incorporated Trades. If the senate had not appointed Watt, he would not have repaired the University’s model Newcomen engine in 1763, from which he ‘improved’ it. Worse, the advanced Watt–Boulton steam engine partnership may not have happened, and the process that led to power-driven machinery might have been delayed.

Another example was the deliberate increase in supply with the effect that it lowered rather than raised remuneration in certain professions. Among the cases he identified were 'pensions, scholarships, exhibitions and bursaries', which drew people into trades that they otherwise would have avoided, such as the 'long, tedious and expensive education' for the church. As a result: 'the church being crowded with people who, in order to get employment, are willing to accept smaller recompense than what such an education would otherwise have entitled them to' (WN 146). Similarly, teachers were rewarded poorly compared to lawyers or physicians. It was easier to become a teacher because it was a profession crowded with 'indigent' people and suffered competition from 'yet more indigent men of letters who write for bread'; it was expensive and thereby difficult for a poor person to become a lawyer or physician. Before printing was invented, remarks Smith, 'a scholar and a beggar seem to have been terms very nearly synonymous' and quotes a Scottish Law (1574) giving universities the right to grant licences to their scholars to beg (WN 148–149).

His third example of unnatural inequalities is the obstruction of 'free circulation of labour and stock both from employment to employment, and from place to place'. The prime cause of obstruction of the free movement of labour, even in the same place, was the Statute of Apprenticeships, which exacerbated the problems of co-located rising and declining trades in the same place, with no crossover of surplus labour between them, even when the skill sets of each were similar enough that minimal retraining would solve the problem, except for the 'absurd laws' that prohibited this obvious solution.

The inequalities arising from this situation were felt differently by the owner of capital stock and the poor labourer who had only his labour to sell: 'It is every-where much easier for a wealthy merchant to obtain the privilege of trading in a town corporate, than for a poor man to obtain that of working in it' (WN 152). Smith discusses the impact of the Elizabethan Act for the Relief of the Poor, a favourite topic of his, though his editors cite an authority to the effect that, in practice, the effect of the Act on labour mobility was probably not as severe as Smith believed (WN 152; Marshall, 1937). In a large country, laws and regulations would be applied locally with different degrees of diligence. That a law gradually fell into disuse highlighted the need to repeal it.

Nevertheless, the prevalence of such laws was important to Smith because what began as a policy to cope with indigence in time became a policy that prolonged it; what sought to prevent unwelcome movement of unemployed labour and their families into neighbourhoods

with 'better' prospects became a barrier to the movement of labour seeking employment in expanding trades. Such obstructions delayed the progress to opulence. On the legal aspects Smith opined, 'To remove a man who has committed no misdemeanour from the parish where he chuses to reside, is an evident violation of natural liberty and justice' (WN 157). For those affected by such removals, it was no comfort to be aware of others in different parishes who had managed to move without hindrance. In a similar mood of high dudgeon, Smith makes a robust criticism of attempts by parliament to regulate wage rates in particular places, citing one such attempt in 1768. He observes that '[w]hensoever the legislature attempts to regulate the differences between masters and their workmen, its counsellors are always the masters. When the regulation, therefore, is in favour of the workmen, it is always just and equitable; but it is sometimes otherwise when in favour of the masters' (WN 158).

He ends his exposition of the unnatural inequalities affecting perfect liberty with a pointed attack on combinations to alter wage rates from their competitive gravitation towards their natural rate. Smith opposed all combinations of masters or labourers aiming to affect the rate of wages, and this and similar passages should be read with that inclination in mind:

When masters combine together in order to reduce the wages of their workmen, they commonly enter into a private bond or agreement, not to give more than a certain wage under a certain penalty. Were the workmen to enter into a contrary combination of the same kind, not to accept of a certain wage under a certain penalty, the law would punish them very severely; and if it dealt impartially, it would treat the masters in the same manner.

(WN 158)

His first biographer, Dugald Stewart, was interviewed on behalf of the authorities in 1793 about passages in *Wealth of Nations* that were evidence of Smith's potential contributions to the spread of discontent among the common people. The French Terror and the near paranoia it caused among the Establishment, should British working poor emulate the French example, soured the political atmosphere at the time. This ultra-conservative reading of Smith as an agitator, guilty of 'virtual sedition' (Rothschild, 2001, 55–61) also produced a radical reading of Smith that has continued today with attempts to use similar quotations as evidence of Smith's left-of-centre bias (McLean, 2007).

The truth, in my view, is less one-sided. As a moral philosopher, educated in the school of natural law, he favoured perfect liberty, pure and simple, and followed his analysis wherever it took him (*ESP* 46) without fear or favour to any special interest group. He favoured neither side in the determination of wages, but was not blind to the unfair consequences of the existing arrangements.

# 9

## ‘setting to work industrious people’

### Introduction

As usual, Smith opens with an historical essay on the progression towards opulence. He identified the core elements of the causes of economic growth and real wealth, in the context of the distortions of centuries of mercantile political economy.

### Accumulation of changes

The agricultural ‘revolution’ (a process that lasted several millennia) initially occurred because foragers along the modern European border with Syria gradually turned towards sedentary lifestyles in permanent settlements as global warming replaced the last ice age. From recent archaeological evidence and genetic studies of migration trends, shepherding and settled agriculture developed, possibly overlapping, and gradually radiated across Europe and to Western Asia by migration and imitation (Bar-Yosef, 1998; Akkermans, 2003).

Smith covered the gradual growth of ‘the annual produce of the land and labour’ (applicable to ‘any country’) over centuries of time. He asserts that the annual produce of land and labour in the eighteenth century was certainly much greater than under the Saxons compared with the even cruder circumstances of the country before the ‘invasion’ (more a tentative skirmish) of Julius Caesar in 55 BC. Before the Romans, the inhabitants of England ‘were nearly in the same state with the savages in North America’ (WN 344) described elsewhere as in ‘the lowest and rudest state of society’ (WN 699; LJ 107, 201).

Each step through the four ages was ‘natural’ and ‘gradual’, and apparently rule-bound too (LJ 15). As society ‘improved’ its agriculture and its

'Arts' (mainly knowledge, inclusive of crude manufactures), it experienced the gradual, occasional and dispersed production of accidental surpluses of output, which led to the possibility of the discovery of simple divisions of labour and scope for the human propensities to 'truck, barter, and exchange'.

From localised trickles of population from the land to nearby 'towns' and hamlets, their significance grew as centres for a slow and gradual change to a new subsistence mode of commerce, which meant that for the first time in human history, the unintended conditions for a continual improvement in subsistence per capita through successive generations eventually became possible. This was by no means a certain outcome, nor one sought by anybody, but it was realised in Europe first.

When agriculture spread, firmly linked to property in land, the displacement of people from their ancient hunting mode of subsistence meant that without land and without a role, their alternatives were limited; in the extreme, they could engage in brigandage or begging, and many did. Millennia later, Smith saw the towns as convenient shelters for runaway landless labourers; they were also convenient places for merchant traders to congregate and were joined by individual artisans, who sold their services to those engaged in farming, husbandry and shepherding.

Pufendorf ([1729] 2005, 7.1.6; Hont, 2005, 283) noted that 'the meaner People, having no income from Cattel or Land, are forced upon improving divers Arts and Inventions'. Small opportunities in and around rude manufacture began the long process of developing a nascent commercial age, unintentionally, from individual efforts to 'get by' and from legislation, intended to be helpful to commerce by ensuring a supply of skilled tradesmen, but the Statutes of Apprenticeship became growth-inhibiting (Cunningham, [1882] 1938, 144–170).

## Elements of commercial society

Capital stock, productive labour, land and a market-driven division of labour were the elements that induced growth in the context of a slowly expanding knowledge base and slowly expanding markets. Capital stock, originally a supply of food saved by a hunter from previous hunts, was 'advanced' for a share of the borrower's kills. Stock came from the surplus food and supplies over and above regular consumption.

The process by which stock was transformed into the new social construct called capital involved long transition periods. Labour was

characterised initially by each individual acquiring everything for himself – food, clothing, shelter and the tools he used. In the beginning, all were equal materially and were subject to a common, low standard of living and, not unconnected, with short life spans. Where there was no exchange mechanism for distributing surpluses among potential users, uneaten food simply rotted were dumped (I am grateful to Yong J. Yoon for this point). A similar untidy waste is evident in nature, allowing smaller species of scavengers to eat the scraps left over by the predators higher up the food chain. It is likely that relatively puny humans, unlike fierce rival predators, started their careers as scavengers at or near the bottom of the food chain, slowly worked themselves up by applying their accumulated knowledge and superior intelligence, and by discovering the advantages of co-operative team work, plus the potential leverage that stone tools, fibrous carrying baskets and fire gave to them.

Until the propensity of ‘exchange’ promoted the ‘division of labour’ and a useable surplus over current consumption coincided with ‘effective demand’ for items from it (crudely, an early version of the ‘extent of the market’), individuals were insufficiently motivated to risk dedicating themselves ‘to one employment’ (WN 31). It was safe to risk dependence on others only when they could exchange surplus output with others (WN 47). The need for several elements of the exchange mechanism to emerge for it to work effectively indicates how fragile, transient and, perhaps, accidental the concatenation of circumstances were before some human populations across Euro-Asia took these initial steps; its consequences were isolated economic phenomena for much of pre-history.

Smith regarded ‘that early and rude state of society’ as preceding ‘the accumulation of stock’ (WN 65), but with varying levels of repetitive primitive accumulation occurring in suitable and initially unique circumstances, the possibility for change emerged. After land was ‘appropriated’ in small areas, primitive notions of property first took shallow forms, where bands jealously contested vaguely defined hunting territories, and later their broadly defined exclusive grazing ranges for herds and flocks. Later still, agriculture spread through imitation and, perhaps, by conquest (there is academic dispute on the exact sequence; Sokal et al., 1991, 351).

The mutual dependence of the humans affected by these emerging changes eventually became firmly entrenched in viable modes of subsistence, which does not mean that the transition was smooth or necessarily always beneficial. It seldom is with humans. Social evolution

is untidy; there is no natural, necessary or irreversible imperative for societies of independent shepherds or of farmers to continue socially evolving towards the fourth age of commerce. History is about what happened and the present is always blind to the future. The civil governments that protected property rights, in time and in local circumstances, continued to evolve and some became armed governments protecting the property rights of independent shepherds and farmers.

Smith does not address the question of what made the difference in some societies but not in others. He pointed to the different psychological pressures that were present in some cases without explaining their absence elsewhere. He was in this case, as in others, ethnocentric (and suffered from an absence of data). In *Moral Sentiments*, he alluded to a partial explanation for 'all the toil and bustle' and found in 'avarice and ambition, and the pursuit of wealth, of power, and pre-eminence', that the 'great purpose of human life' is the 'bettering our condition' (WN 48). This ambition prompts some individuals, a long way along the transition from rude subsistence, to save some of their stock for future use, which as accumulated (here, he leaps across many millennia) 'they will naturally employ it in setting to work industrious people, whom they will supply with materials and subsistence, in order to make a profit by the sale of their work, or by what their labour adds to the value of the materials' (WN 65). He did not say anything about the circumstances that made unemployed labourers available for work. Marx ([1762] 1954, 77) mocked this passage by asking, 'from whence came these "industrious people"?"

Commercial societies had existed before their revival from the fifteenth century. Wherever there were temples in or near towns and trade routes, commerce became an element in their economic life and that of their nearby hinterlands (Silver, 1995; cf. Polanyi, [1944]). The four factors needed for a commercial society to emerge: capital in the form of surplus food and material products from the land; landless labour in the population; land demarcated as private property; and the accumulation of knowledge, were all present in Europe from the fourteenth to fifteenth centuries.

## Origins of capital stock

Smith's nomenclature was archaic. He used the word 'stock' interchangeably with 'capital' (plus the compound 'capital-stock')



widely. Hunters did not accumulate stock because men (and women) satisfied their immediate wants by their own efforts or went without:

When he was hungry, he goes to the forest to hunt; when his coat is worn out, he cloaths himself with the skin of the first large animal he kills: and when his hut begins to ruin, he repairs it, as well as he can, with the trees and turf that are nearest to it.

(WN 278)

A chicken-and-egg problem arose because ‘the accumulation of stock must, in the nature of things, be previous to the division of labour’ (WN 278; LJ 521–522). This makes sense when stock began as small accumulations of uneaten food or unprocessed animal hides and bones set aside as surplus to immediate requirements. Where some individuals perceived that surplus items could be used other than immediately, the notion of ‘capital-stock’ was created, eventually consolidating into social knowledge. It probably had little immediate importance to those who first stumbled on the practice of conserving surplus provisions, but we can recognise retrospectively that the slow, independent and eventual conscious realisation of its potential was truly historic. It meant that people thought about their future and gave meaning to efforts at ‘self-betterment’.

Smith credited the emergence of primitive capital from ordinary surpluses of daily labour as the original cause that led some populations, eventually, towards development. The emergence of primitive capital was an event, repeated on myriad occasions, unconsciously and without direction by anonymous individuals in some rude societies, most of whom took it no further than a mere postponement of current consumption, mostly out of necessity. For a few at first, then many, these petty accumulations of saved stock – the original savings that produced capital – became a powerful means to extending beyond their daily labour to enable them to undertake longer hunting/scavenging/scouting trips in co-operation with others. The change from scavenging to hunting in competition with rival and deadly predators required directed and disciplined team work, and was facilitated by access to enhanced capital stock compared to the efforts of scattered individuals hunting small prey.

Smith’s capital was the prelude to the division of labour, itself driven by the propensity to exchange, and as a decisive break from the rudest state of human society towards the initial divisions of labour. The transition was accompanied by a decline in nutrition as humans adapted

to the long struggle to meet the unprecedented demands of primitive accumulation of capital needed to complete the seasonal cycles of shepherding and agriculture (Cohen, 1977; Diamond, 1987, 64–66; Bogin, 1997, 96–142; Clark, 2007).

Smith meant by 'capital-stock' the supply of the daily provisions each participant required because of the time gap between capturing animals and their breeding, or seasonal fruit picking, or planting seeds and their reaping, and the absolute necessity to save stock for next season's planting. Resources were set aside and 'stored up somewhere' (WN 276) and consumed during the interval between producing and consuming. This process formed the original capital of society. The longer the duration of the necessary interval between sowing and reaping, the greater the capital stock that must first be saved by individuals for later distribution. In 1764, Smith noted that 'before a man can commence farming he must at least have laid in a year's provision, because he did not receive the fruits of his labour till the end of the season' (LJ 521). In 1766, Turgot also covered the need for advances among day labourers (Turgot, [1766], LIX, 151 in Meek, 1973).

It is clear from Smith's account that stock began as a store of food and seed, and gradually enlarged in scope to include raw materials, eventually becoming a stock of money, or what money could buy. His 'rule' was that the number of hands employed in commercial society depended on the 'stored [stock] in the kingdom', and in particular on the amount of stored stock held by each employer, because 'many goods produce nothing for a great while' (citing the case of 'the grower, the spinner, the dresser of flax'). When more hands were required, more stock was required because the produce of labour was not returned in a single day, and proportionally more stock was required to maintain them the longer the interval before the revenue from the products returned. But stock is limited by the quantity of food, clothes and other necessities paid from what manufacturers can afford (LA 365–366). The quantity of stock, Smith concluded, was a limiting factor in the expansion of employment because it was not easily acquired. When stock came from the same source that was used for 'proper consumption', it had to be replaced before, or coincidentally with, its consumption. 'This is the state', Smith asserts, 'of the greater part of the labouring poor in all countries' (WN 279). Most labourers had nothing left over from their scarce means.

Those able to harbour stock carefully, for contingencies by the accidents of fortune or from deliberate foresight, acquired the services of those searching for work by providing 'advances'. Where a person saved

from his consumption and used his stock to fund his labour within the necessary interval (days in the case of scavenging/hunting/scouting and months in the case of shepherding and settled farming), his claims to the product of his labours were unambiguous. It was his labour and his capital stock. Ownership gave him natural rights to the fruits of his labour.

When he had no capital stock (for whatever reason), he must necessarily have received stock for consumption from somebody willing to advance it to him. That implies co-operative property relations between two parties; the person who owned capital stock and the different persons who owned their labour. From this point on, a different (unequal) society began to emerge within the age of agriculture and continued in the early appearance of commerce. The early division of labour and the early form of property created new claims to the product of capital stock allied with the product of somebody else's labour. The shared claim was settled by 'higgles and bargains', just as two or more persons who co-operated to hunt for big animals divided their kills by agreed rules related to their claims. Persons would not endure the risks of a hunt, including the risk of it being unsuccessful, if they received too small a share of the kill.

The origins of capital outlined by Smith clear up much of the muddle about his alleged affinity with a labour theory of value. Legitimising a stockowner's claim to a (negotiable) share of the revenues from production motivated them to offer advances to labourers who otherwise had no work. This required a coincidence of somebody willing to borrow stock and somebody willing to lend it. Where these arrangements spread and were sustained, growth became possible; absent them, subsistence modes remained isolated and primitive. Again, in the social-evolutionary model of separate individual actions leading to unintended outcomes, where the use of surplus stock was managed successfully, labour productivity from finer divisions of labour produced more wealth.

## Forms of capital stock

Smith divided stock into two main parts: the revenue reserved for personal consumption as circumstances and inclination permit and the part that could be used to generate future revenue. The first part, says Smith, remains his 'stock', and the (new) second part his 'capital'. Within the stock reserved for immediate consumption, there is an element of stock not yet fully consumed immediately, such as clothes

(over several years), household furniture (over 'half a century or a century') and dwelling houses (over 'many centuries') (WN 281). Nowadays, this residual of unconsumed stock constitutes the aggregate assets of the people, including the poorest, in developed economies (WN 279). The difference between stock as revenue for immediate consumption and capital stock as the source of future revenues is important for Smith's general thesis (WN 10). Revenue spent on immediate consumption does not replace what is consumed; it is withdrawn from the 'wheel of circulation'. But capital stock produces output that replaces itself and adds a surplus over and above what it replaces. How society's stock is divided proportionally between these two roles is crucial to the rate of progress towards opulence.

Smith identified fixed capital, which earns revenue or profit without leaving its owner. It consists of the following:

- useful machines and instruments of trade which facilitate labour;
- profitable buildings (premises for rent), shops, warehouses, farm-houses, stables and granaries;
- improvements to land to make it 'proper for tillage and culture';
- 'acquired or useful abilities of all inhabitants of the society', known today as human capital, from education, study, apprenticeship and practice, and 'realised in his person' (WN 282).

He also identified circulating capital, which is 'employed in raising, manufacturing or purchasing goods' for resale at a profit. It passes into circulation and enables its owner to earn revenue. He identified its four constituent parts:

- money by which capital is circulated and distributed to 'proper consumers' (users);
- stock of provisions that 'the butcher, the grazier, the farmer, the corn merchant, the brewer' expect to sell to derive a profit;
- raw materials for 'cloaths, furniture, and building' remaining in the hands of growers, manufacturers, mercers, drapers, timber merchants, carpenters, joiners and bricklayers;
- completed works in the hands of merchants or manufacturers, not yet disposed of and in the shops of smiths, cabinet-makers, goldsmiths, jewellers and china merchants (WN 282–283).

Note that the trades that made up Smith's 'manufacturers' are best described as petty manufacturing and shops. When he mentions, as he

often does, 'merchants and manufacturers' in *Wealth of Nations*, these are the people to whom he refers.

In sum, circulating capital sells goods and uses the revenue to buy, or produce, further goods for resale in successive rounds. Its profit is realised on receipt of revenues from sales (WN 279). In commercial society, beyond hawkers, peddlers and wholesalers, profit was not restricted to buying cheap and selling dear, which was the image embedded in moral concerns about the source of profit that was suspected of being derived from dishonest merchants who padded their real costs. Profits in commercial society were proportioned to the value of capital employed and were independent of the effort expended. Profits were from the earnings from the use of capital in the employment of labour, and this notion marked an advance in Smith from his predecessors (Meek, 1954).

In different occupations, different mixes of fixed and circulating capital are employed. For progress towards opulence, the distinction between revenue stock (immediate consumption) and capital stock (to produce future revenue) is important. All stock maintains and augments the revenue that 'feeds, cloathes, and lodges the people', and it is upon this that their 'riches or poverty depends'.

Circulating capital provides the materials and the maintenance of the workmen employed on both fixed and circulating capital. Without circulating capital, fixed capital would not produce revenue or profit; there would be no materials to work upon and no people to do the work. These are paid for from the owner's circulating capital, which circulates when the suppliers of the materials spend their receipts and the labourers spend their wages on immediate consumption. In so far as suppliers of materials spend their receipts to hire labour to extract and prepare new supplies of materials, a portion of their revenues goes back into circulation. Any portion of their receipts that they spend on their own consumption drains their revenue stock and is not counted as capital stock. The 'great wheel of circulation' turns, some part adding to net capital stock and the remainder diminishing their revenue stock.

A nation grows richer or poorer by the growth of net capital stock, which puts into motion circulating capital to create additional net capital stock and to fund rising consumption. If capital stock is not maintained and replaced regularly, the economy enters a stationary state and, in due course, declines.

Society's general stock is the sum of the stocks of all its inhabitants and divides into three portions. First for immediate and residual consumption, which derives no further revenue or profit; second as fixed capital, which 'affords a revenue' without changing masters; and third

as circulating capital, which 'affords a revenue only by circulating or changing masters'.

There are two final points: first, every fixed capital is originally derived from circulating capital, which provides the materials and the maintenance that sustains the labour that is applied to the materials. Even improved land generates no revenue without applying labour to it; and useful machines and instruments of trade produce nothing without employing labour that is paid its maintenance. And 'the sole end and purpose' of both fixed and circulating capitals is to 'maintain and augment' the stock reserved for immediate consumption (WN 284). So great is the circulating capital that is withdrawn from the stock to be used for activating fixed capital and adding to the stock reserved for immediate consumption, that it requires continual replenishment from the produce of land, mines and fisheries in the form of provisions and materials (agriculture still dominated the British economy in 1750). Land, mines and fisheries use both fixed and circulating capital to cultivate and extract produce from them, and their produce replaces the capital they use with profit. An exchange takes place, indirectly in practice, between farmers who replace the provisions the manufacturer consumes and the materials he wrought up in the previous year; the manufacturer replaces finished manufactures that the farmer wore out in the same period. The farmer sells his produce for money and uses money to buy the produce of the manufacturer (WN 284).

From the early stage in the evolution of commercial society, people work, without central direction in interlinked production chains and networks, employing their capital stock to procure 'either present enjoyment or future profit'. In societies with 'tolerable security', Smith asserts that every man of common understanding endeavours to employ whatever stock he can command for either 'present enjoyment or future profit'. Immediate consumption reduces his stock and does not replace itself. He replaces his stock with future profits from investing in fixed or circulating capital, and 'a man must be perfectly crazy' who 'does not employ all the stock which he commands, whether it be his own or borrowed of other people', to procure present enjoyment through immediate consumption (food, clothing or shelter), or as fixed or circulating capital (WN 284).

## Money as capital

The roles of fixed capital and of money in the production of net revenue are analogous. They facilitate the production of net revenue, but are not

included in it. Fixed capital increases the productive powers of labour and enables the same number of labourers to produce a much greater quantity of output. The expense incurred by fixed capital is repaid with profit, and the annual produce is increased by a greater amount than the expense. Hence, the quantity of materials and the labour required, which have opportunity costs elsewhere, are always regarded as 'extremely advantageous' because they enable the same workmen to produce a greater quantity of output with cheaper and simpler machinery than before in ever-finer divisions of labour and specialisation, and what is saved from improved productivity can be allocated to putting displaced labourers to work and to purchase materials for them to work upon (WN 287–288).

Smith refers to money as the 'great wheel of circulation' and altogether different from the 'goods which are circulated by means of it', and he asserts firmly that 'not a single farthing can ever make any part of' either the gross or the net revenue of society (WN 289). He states this point more than once (WN 292). Having derived the origins and evolution of money into pieces of gold and silver in Book I (WN 37–46, 51–64, 195–260), Smith elaborates on money's role in its modern forms of paper as the new 'great wheel of circulation' in commercial societies, and he regards it as an improvement because paper 'replaces a very expensive instrument of commerce with one much less costly, and sometimes equally convenient' (WN 292). The basis for paper money, as for gold before it, is that when people have confidence in the 'fortune, probity, and prudence of a particular banker' and believe him to be always ready to pay on demand the face value of his promissory notes, they come to accept his notes in payment of debts much the same as when they are paid in gold and silver (WN 292). Bankers in this position learn that they do not need to keep on hand 100 per cent of that amount in the form of gold and silver in case some customers present their promissory notes for payment. This creates the possibility of 'fractional bank lending'.

Whilst customers have use of his promissory notes (if their customers and suppliers accept the promissory notes as money), they pay him interest on their borrowings. Some notes will return fairly quickly, others over longer periods and some may continue to circulate as money for years. Those that do not return quickly can amount to as much as 80 per cent, and his reserves against his notes may fall to as little as 20 per cent (WN 292).

The banker lends his remaining gold and silver as bullion abroad for profitable employment or to fund purchases from abroad for sale at a profit. Together, these profits add to the revenue of the country,

and like all net revenue, it depends on what its owners do with it: as stock for final consumption (not increasing production), or as capital for promoting industry through the application of subsistence to labourers and materials to farmers and manufacturers. By this, they enhance the annual revenue, or produce, of society and, after deducting what is necessary for supporting the tools and instruments of trade, they add to society's net revenue (WN 294–295).

Fractional bank lending, and the substitution of paper money for gold, benefits society's progress towards opulence, and Smith supports his contention with detailed evidence. His themes were consistent, as were his qualifications, which were particularly acute in the case of fractional banking. Through 'the principles of common prudence' which 'do not always govern the conduct of every individual, they always influence the majority of every class or order'. For this reason, he believes the 'greater part of' the money 'forced abroad' by banking operations 'will naturally be destined for the employment of industry, and not for the maintenance of idleness' (WN 295). Three conditions are required to put industry into motion: materials to work upon, tools to work with and the recompense for which the work is done. While the last is paid for in money, the real revenue does not consist of money but the things that money will buy (WN 295).

Smith elaborated on the role of the new banks in Scotland in contributing to the increasing value of the annual produce of land and labour. He traced the 'erection' of competing joint-stock companies, the Bank of Scotland (1695), the Royal Bank of Scotland (1727) in Edinburgh and Glasgow's Ship Bank (1750), reminding us that he was not opposed to joint-stock companies in principle. He regarded these banks as causes of the possible quadrupling of trade in Edinburgh and its doubling in Glasgow (then a smaller town), adding that because of latent 'difficulties' in banking operations (discussed below), they required an Act of Parliament to regulate their conduct (WN 97; LJ 378–379); perhaps surprising those claiming Smith's advocacy of *laissez-faire*.

He also asserted that Scotch banks invented 'cash accounts' alongside their promissory notes for use by 'any individual who could procure two persons of undoubted credit and good landed estate to become surety for him', which he had to repay on demand and for which he had to pay interest. This device (akin to a modern cheque overdraft account) on 'easy terms' was the 'principal' cause of the 'great trade' of these companies and of the benefits the country received from it. The cash circulated from merchants to manufacturers of goods, from manufacturers to



farmers for materials and provisions, from farmers to landlords for rent and from landlords to merchants for the 'conveniences and luxuries' which they supply to them (WN 299).

### Malign consequences of self-interest

These developments all look very neat and comforting, until the waywardness of human behaviour enters into the picture (or, as Pufendorf expressed it elegantly ([1729] 2005, 4.4.1; Hont, 2005, 181), 'it being much more easie to fansie perfect Men than to find them'. There are no grounds for claims by most modern economists that Smith said that people pursuing their self-interests necessarily and unintentionally, and in a benign manner, 'miraculously' benefit societies. It is remarkable that Smith's detailed critiques of the misbehaviours of many self-interested people have attracted so little comment, especially as Smith gave over 70 counter-examples from history that contradict modern myths that 'an invisible hand' supposedly ensures that self-interested (even selfish) behaviours benefit society (WN, Books I, II, III).

Smith is very clear on those not infrequent instances of malign behaviours in banking (WN II. ii, 286–329). For instance, he understood the limitations of circulating paper in place of gold. If an excess of paper was printed over the amount of gold the banks held when paper, unlike gold, could neither be sent abroad profitably nor safely employed in circulation (because people would not accept it once banks could not exchange it for gold), there would 'be a run upon the banks to the full extent of this superfluous paper', and the 'alarm, which this would occasion, necessarily' would increase the run and bankrupt the offending banks and many of their creditors too (WN 301). Smith asserts that if every bank understood and attended to its own particular interest, it would not risk becoming over-stocked with paper money, and he laments that not every bank always understands or attends to its *best* interests, and consequently becomes overstocked with paper (WN 302).

By 'particular interest', he must mean the banks' *true* interests, not their self-interests as perceived by them. If banks act on their perceived self-interests in any particular circumstance and these are judged to be different from their 'true' self-interests, then the idea of self-interest becomes contradictory. Banks overstocked on paper money act in their self-interests, though they may regret it later. Self-interests are not always benign to self, nor to society, which makes Stigler's (1975,

237) simile of the *Wealth of Nations* being 'a stupendous palace erected upon the granite of self interest' wholly inappropriate.

Interests motivate actions – few people do act aimlessly. Their self-interests, as they understand them, drive their actions. Whether others may judge particular actions as best for them is not relevant, because we cannot define self-interests only if they lead to 'best' outcomes. Therefore, acting in pursuit of self-interests can lead to malign outcomes. Smith detailed instances of individuals, and sometimes institutions, acting in pursuit of their self-interests for their own benefit without benefit to society.

Banks could pay close attention to the behaviours of their customers by observing if they make repayments of their borrowing as agreed; if they repay on time and in full, the bank may safely continue to lend; if they 'fall very much short' of their repayments, the bank 'cannot with safety continue to deal with such customers'. They could decide whether their debtors were in 'thriving or declining circumstances', and act accordingly (WN 305). When banks refused to extend more credit, the unfortunate debtors 'complained of the contracted views and dastardly spirit' of the bank's directors, and they urged the banks to extend their credits 'in proportion to the extension of the trade of the country', by which they meant the 'extension of their own projects' (WN 308).

To these instances, he added the 'wearing and clipping' (WN 303) of coins, an ancient and fraudulent practice commonly practised by kings and users of gold and silver coins long before banking was established. He also added another practice in the fraudsters' repertoire, called 'drawing and re-drawing', to which 'unfortunate traders have sometimes recourse when they are on the brink of bankruptcy' (WN 308). Regular users on the brink of bankruptcy, mainly because of the over-trading by 'some bold projectors in both parts of the united kingdom', were 'the original cause' of the 'excessive circulation of paper money' (WN 304).

The streams of money that left the victim of the fraud do not return because their debtors' promises are fictitious. The projectors conceive of an 'artful contrivance', of which some banks had not the 'most distant suspicion' of fraud, until too late, and with several projectors finding it in their 'interest to assist one another in this method of raising money', they make it 'as difficult as possible' for the victims to 'distinguish between a real and a fictitious bill of exchange'. So serious is the fraud that even when a banker discovers it, he may be in too deep to extricate himself from knowing that if he refused more rounds of drawing and redrawing, he might 'ruin himself' (WN 312–313).

A too liberal a lending policy, whether from fraud by borrowers or from the false beliefs of bankers, was ruinous of the general interest of society, and he gives the example of the 'Ayr Bank' in 1772, in the midst of what David Hume called a 'melancholy situation' of economic depression (*Corr* 162). Smith called its 'design generous, but the execution was imprudent' (*WN* 313). Subscribers borrowing excessively from their cash accounts made matters worse. The self-interests of these players worked directly against the best interests of everybody affected by their actions. His frankness about imprudent behaviour shows awareness that private interests are not always conducive to the good of society. If this point were understood among modern economists, the consensus that Smith had a 'theory of the invisible hand of markets' leading to harmony would be heard of no more.

Smith considered there was a case for intervention by government regulation in banking markets:

To restrain private people, it may be said, from receiving in payment the promissory notes of a banker, for any sum whether great or small, when they themselves are willing to receive them; or, to restrain a banker from issuing such notes, when all his neighbours are willing to accept of them, is a manifest violation of that natural liberty which it is the proper business of law, not to infringe, but to support. Such regulations may, no doubt, be considered as in some respect a violation of person liberty. But those exertions of the natural liberty of a few individuals, which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments; of the most free, as well as of the most despotical. The obligation of building party walls in order to prevent the communication of fire, is a violation of natural liberty, exactly of the same kind with the regulations of the banking trade which are here proposed.

(*WN* 324)

This passage written in 1772, 6 years after Smith met the Physiocrats, directly rejects their purist laissez-faire ideas, and it shows him not to be opposed to all interventions in free markets. He never supported laissez-faire, and this paragraph shows why. He went on to argue that on condition that bankers were restrained from issuing and circulating bank notes, or notes payable to bearers for less than a certain sum and were unconditionally obliged to make immediate payment on the presentation of their notes by bearers, their trade 'with safety to the publick' may be 'rendered in all other respects free'. Competition from many

other banks (he supported the formation of banks in greater numbers) 'obliges all of them to be more circumspect in their conduct' and 'to guard themselves against those malicious runs, which the rivalryship of so many competitors is always ready to bring upon them' (WN 329).

Legal interventions to safeguard the public interest were required and reliance on perfect liberty gave insufficient protection from the risks of uninhibited laissez-faire. He was not an ideologue in these matters.

He identified 'the causes of the slow progress of opulence' (LA 521–529). Impediments came from natural causes and from the oppressions of civil government. The 'one great cause' of slow progress to opulence is the lack of stock sufficient for a labourer to maintain himself and his family for the duration between commencing an activity and receiving revenue. It seems an insurmountable barrier: until stock is accumulated, there can be no division of labour, and before the division of labour, there can be 'very little' accumulation of stock (LJ 552). So institutional circumstances must also be addressed.

The gradual accumulation of stock was (still is) an extremely precarious and slow process, affected by unpropitious events, such as warfare and quarrels among neighbours, plus theft, cheating, corruption and discord among individuals in institutions. People robbed of their possessions and seriously harmed are unlikely to be industrious. In Natural Law, these are breaches of an individual's natural or perfect rights (LJ 8–9). Bands of barbarians caused 'violent convulsions' as they participated in plunder, rapine and pillage. Thus, 'large tracts of country are often laid waste and all effects taken away ... [and] nothing can be more an obstacle to the progress of opulence' (LJ 522). But once accumulation gets underway, the improvement in the 'great productive powers of labour' manifests itself (WN 277), subject, of course, to the counter-effects of the oppressive measures of government. Typically, he produces evidence, culled from history and includes the events, measures and attitudes that were 'prejudicial to the progress of opulence':

- the absence of stock, which discouraged the division of labour;
- measures that discouraged the improvement of non-agricultural activities;
- personal insecurity reducing or removing incentives to be industrious;
- widespread indolence of people living off the industrious;
- perpetual wars and hostile invasions preventing capital accumulation;
- measures that discourage improvement in the arts of manufacturing;

- laws that promote primogeniture and entailment that prevents the break-up of large unproductive estates among the more productive through the generations;
- cultivation by slaves;
- cultivation by serfs and villains;
- use of force to seize and hold large tracts of land by local 'strong men';
- tenants on 'strong bow' leases (where the landlord owned the farm tools, implements and cattle, which were 'not to be removed by quitting tenants') (*LJ* 189–190), who had no certainty of tenure;
- rents paid in kind when dearth ruins productive tenants;
- levies imposed on tenants at the will of landlord, king or government;
- ancient families without stock who do not improve their land;
- prohibitions of corn exports which removed incentives and encourage dearth by conversion to grassland;
- disincentives of imports of corn by premiums;
- ignorance of the cause of shortages leading to ineffectual remedies and 'highly ridiculous' attempts to oppress manufacturers with heavy taxation to force them to move to the country from the towns (Phillip IV);
- use of slave labour in manufactures, which inhibited progress (slaves have no incentive to invent machines, whereas free labour encourages improvement);
- misleading sentiments that asserted that performance without reward is 'noble'; trade is 'odious' and to barter is 'mean';
- confining trade to the lowest ranks of the people (persecution of Jews) obstructed the spread of commerce;
- attitudes that despised merchants and the levying of high taxes on them slowed stock accumulation;
- retarding effects of imperfections in the law of contracts;
- probity uncommon among 'rude' people (commerce requires 'probity and punctuality');
- difficulties of conveyance of people and goods;
- presence of 'idle people' and 'retainers' that led to 'violence and disorder';
- piracy and the risks of navigation that retarded commerce;
- enforced fairs on specific days at specific places inhibited trade, as did the punishment of 'forestallors' (people who travel in the country buying produce and who defy laws confining sales to official 'fairs');
- restrictive effects of designated 'Staple Towns';

- all taxes upon exportation or importation raised prices, lowered sales, discouraged manufactures and hindered divisions of labour;
- all 'monopolies and exclusive privileges';
- 'Bad tendency' of the Statutes of Apprenticeship not securing products against bad workmanship;
- giving bounties encouraged one commodity and discouraged others and 'hurts the natural state of commerce';
- corruption of public officials was a 'dangerous method' of their obtaining income;
- 'Grievous exactions' in taxation alienated the public's affections and weakened the will to defend the country (*LJ* 522–530).

Though not a complete list of obstacles to the progress of opulence that Smith identified, it illustrates the problems with which he was concerned (*WN* 276–375).

# 10

## ‘increasing the fund for productive hands’

### Introduction

Smith presents elements of a theory (not a model) of growth (Adelman, 1962), which was supported, in his style, by evidence and conjecture. Modern economists are not comfortable with Smith’s ‘theory’ because he weaves into his account the usual amount of historical detail.

Britain had developed from a predominantly agricultural society towards commerce before other countries gradually caught up mainly because its history and institutions over the previous two centuries had prepared the commercial foundations. As their economies grew, life expectancy and child-survival rates improved marginally. Child mortality, comparatively high for centuries, decreased slowly. The continual re-division of labour and specialisation within and among industries reduced the cost of manufactured goods, and the application of technology increased the range and quantity of goods, which in turn raised the demand for labour, partly supplied by a growing population, which in turn raised real incomes. Growth became a virtuous, if shallow, spiral.

Smith’s was an evidence-based inquiry, and he derived simple economic relationships based on an esoteric range of indirect sources (Fleischacker, 2004a, 36–44). This was imposed primarily by his isolation in Kirkcaldy from 1766 to 1773 (of which David Hume complained; *Corr* 160–163, 166–168, 185–186).

Since Smith, theories of economic growth have moved on a great deal. No student would get far professionally without spending time studying growth theory (Harrod, 1948; Solow, 1956; Swan, 1956; Domar, 1957; Kaldor, 1957; Hicks, 1965; Romer, 1986, 1987) and its rich agenda, so when graduates read Smith’s theory, they often recoil in impatient dismay, which creates problems of holding their attention.

Discussing modern interpretations of Smith's growth 'model', of which there are numerous excellent versions available (Young, 1928; Adelman, 1962; Hollander, 1973; Eltis, 1975, 1984; Lowe, 1975; Walsh and Gram, 1980; Reid, 1989b) would detract from outlining Smith's thinking. For example, Adolph Lowe (1975, 416–417) assumed that the 'natural, psychological, and institutional factors', by a 'long evolutionary process from rude society', found their 'final shape' in the 'competitive organisation' of modern Western 'system of natural liberty'. He then treated these institutional factors as actually existing as constants, and asserted (controversially) that they would not be subject to further 'historical development'.

A competitive marketplace was assumed to be protected by constitutional government through the 'preservation of law and order', which protects property, freedom of contract and personal freedoms, and operates within unequal property distribution, social and technical mobility of factors of production, the division of labour and free exchange (Lowe, 1975, 417).

There were three psychological driving forces: the 'propensity to truck, barter, and exchange', the 'desire of bettering our conditions' (WN 25, 341) and the urge to procreate, which together constitute the ever-present forces of Smith's model, but they are never in their 'final shape' (WN 25, 79, 341, 709–710). However, it is unrealistic to identify any Western economy as a 'system of natural liberty'. Indeed, the paragraph Lowe quoted opens with Smith stating the firm *prior* condition that only if all 'systems of preference or of restraint' have been 'completely taken away' would the 'the conditions of "natural liberty" apply'.

Neoclassical models, to create their formidable analysis, assume that obstacles to perfect competition are 'completely taken away'. For Smith, the 'natural, psychological, and institutional factors' were firmly embedded in society and were often obstacles to the potential beneficial effects of commercial growth. In fact, because natural liberty was presented as an unattainable ideal in Smith's enquiry (WN 471), it left his theory as a 'mixture of theoretical propositions, empirical descriptions, historical discourses, and political recommendations' spread across 'widely scattered passages'. Joseph Schumpeter (1954, 184–186) concluded that Smith did not cross the 'scientific Rubicon' into modern economics.

Smith and neoclassical economists speak different languages about growth. Smith talks about the creation of wealth in a real economy, with idealised natural liberty as background but not as agenda; neoclassical economists talk about perfect equilibrium (partial and general), absent



anything recognisable as the real world. Their purposes and scope are quite different. In Smith's mind, his theory was not about equilibrium. He outlined the sources of growth in commerce and the choices faced by people, some of whose choices inhibited the spread of opulence and others that did not (Reid, 1989, 10). As for general equilibrium theory, that took another 200 years to be specified, albeit in a mathematical format.

By assuming that natural liberty operates when it clearly does not, Lowe made his version of Smith's growth theory intelligible to modern economists, at the cost of it being unintelligible in Smithian terms.

### **Constituent elements of pure Smithian growth**

Smith discharges 'the sovereign' from attempting to superintend 'the industry of private people, and of directing it towards employments most suitable to the interest of society' (WN 687), arguing that to do so was 'delusional'. But in the real world, the sovereign, legislators and those who influence them, wallow themselves from such delusions. Understanding how an economy works is a preliminary step to recognising how governments and merchants and manufacturers behave in ways not 'suitable to the interests of society', and because of the distortions they impose, they do not meet the requirements for the optimum progress to opulence (Eltis, 1975).

Smith identified land, labour and capital as the three main factors of production, plus the crucial influence of the division of labour aligned with applied knowledge ('arts'), which over time had enormous implications beyond the mere additive influence of quantities of the factors; they could cause local increasing returns to scale in manufacturing from specialisation and roundabout production methods. Even in the famous 'pins' example, output increased from a maximum of 20,000 to 48,000 pins a day, which by any standards was a substantial. By further divisions of the work into smaller steps and the spread of roundabout methods of production in separate commercial entities, it was possible to envision continuing increases in productivity, at least up to the level of full employment. After full employment, no more subdivision of a work process can be undertaken unless labour is released from other tasks by capital substitution for labour. This disconnected the rise of output per worker from the amount of employment in an industry – output was not simply pro rata with the numbers employed (WN 17); it was related to the 'extent of the market', capital, technological change and product innovation (WN 31).

In practice, what happened in pin-making illustrates what happened across manufacturing in the nineteenth to twentieth centuries through the introduction of power-driven machinery which enabled fewer, not more, individual workers to complete the work of many men, and increase output substantially. In 1820, there were 11 pin factories in Gloucester employing 1,500 people, but by 1870, the pin industry in Gloucester was gone. By 1939, the number of pin manufacturers in the United Kingdom had shrunk to about 12, and by 1978 there were only 2, as a result of mergers, take-overs and firms leaving the trade (Pratten, 1980; Dutton and Jones, 1983; Munger, 2007).

Smith's example of the constituent elements in the manufacture of the common labourer's coat (WN I.i.11, 22–23) is significant. The multiple instances of manufacturers simultaneously and serially simplifying their production processes in response to the extent of their own markets constantly changes their supply chains and increases their productivity. This happens among their customers and among their customers' customers, most of whom have limited or no connections with each other. Improvements in hand tools from an improved division of labour not only reduces the unit costs of making shears for sheep shearing, say, but might also improve hammers for carpenters, and all manner of other metal tools for others to meet rising demand in extended markets. As output rises in response to a growth in the extent of the market, sub-operations are separated out into roundabout processes, adding to productivity across more than one industry. The division of labour is not limited to one pin factory; it affects cumulatively all processes. Thus, the 'enlarging of the market for any one commodity, produced under conditions of increasing returns, generally has the net effect... of enlarging the market for other commodities' (Young, 1928, 536; I am grateful to A. P. Thirwall for drawing my attention to Young's paper).

Young gave interesting examples of the cumulative effect of these processes in the early printing industry that promoted producers of wood pulp, inks and their ingredients, metal type, technologies for producing illustrations, and the manufacturer of specialised tools and printing machines, plus suppliers to the printing trades and other industries (Young, 1928, 537). He also advised that increasing returns are not 'discerned adequately by observing the effects of variations in the size of an individual firm or of a particular industry' because 'the progressive division and specialisation of industries is an essential part of the process by which increasing returns are realised' across 'all industrial operations' when 'seen as an interrelated whole'. He identified increasing returns as dependent 'upon the progressive division of labour, and the principal

economies of the division of labour', which cumulatively arise from 'using labour in round-about or indirect ways'. Lastly, while Smith said 'the division of labour depends upon the extent of the market', the extent of the market 'also depends upon the division of labour', and in this 'circumstance lay the possibility of economic progress, apart from the progress which comes as a result of the new knowledge' (Young, 1928, 538).

Smithian growth is an open, not closed, process driven by increasing, not diminishing, returns. It is not in a state of equilibrium in that many thousands of individuals participate in it, with no central control, quite independent of each other, with no imposed constraints on imitation, innovation or invention, with no regulated setting of prices or costs and no supervision of the process of their bargaining exchanges. There is plenty of scope for human error, for mistaken readings of market conditions, and for failures to innovate or adapt when maybe they should have, or possibly when they shouldn't. In these conditions, Smith classed business failures under his definition of unproductive labour because, like prodigality, they lowered growth rates (WN 357).

The rate of increase in employment depended on the rate of capital accumulation that afforded an increase in the division of labour, in specialisation and in more roundabout production processes. The division of labour depended on the extent of their markets (WN 277), in which technical progress produced increasing returns to scale and lower per-unit prices. Productivity will rise both from using more capital to employ more labourers to subdivide labour ever more finely and from using more capital to add inventions or to purchase machines that 'facilitate or abridge labour', assuming there is 'tolerable security'. This increased net output of the 'product of land and labour', and as revenue maintains all labourers, productive and unproductive, and their dependents ('those who do not labour at all') (WN 332), the key impact on growth depends on the proportions of the revenue that is spent on growth-inducing productive and growth-inhibiting unproductive activities.

Revenue is spent on consumption or is saved. For simplicity, Eltis assumed that spending on fixed capital (the capital consumed over several years) was a small proportion in the eighteenth century and could be safely ignored (Eltis, 1984, 78) and that spending was mainly divided between consumption and saving for circulating capital, which by its nature was also spent on maintaining productive labour and materials for production. Those who also save out of their revenue add to their capital, either by employing productive hands or by lending for a share

in profits (otherwise, they would be 'perfectly crazy') (WN 285). The only source of such capital is the saved revenue and/or the net gains of those who saved out of profits in a previous production cycle.

It was 'parsimony, by increasing the fund which is destined for the maintenance of productive hands, [which] tends to increase the number of those hands whose labour adds to the value of the subject upon which it is bestowed', and increases the exchangeable value of the annual produce of the country by putting into motion 'an additional quantity of industry, which gives an additional value to the annual produce' (WN 337). Smith's hero was the 'frugal man', whose savings afforded the maintenance of an additional number of productive hands and, in effect, 'establishes as it were a perpetual fund for the maintenance of an equal number in all times to come'. And this is brought about 'by a very powerful principle, the plain and evident interest of every individual to whom any share of it shall belong'. Should the individual cease or temper his frugality he would make 'an evident loss' from 'pervert[ing]' his capital 'from its proper destination' (WN 338).

The strong principle prompting society's savings because it affects most people 'is the desire of bettering our condition' because 'no man is so perfectly and completely satisfied' that he is 'without any wish of alteration or improvement, of any kind' (WN 341). Most men better their condition by 'augmenting their fortune' by saving and accumulating their capital and 'in the greater part of men, taking the whole course of their life at an average, the principle of frugality seems not only to predominate, but to predominate very greatly' (WN 341, 345, 405, 540). The effort to 'better their own condition' is the driving motivation and adds that it 'is this effort, protected by law and allowed by liberty to exert itself in the manner that is most advantageous, which has maintained the progress of England towards opulence and improvement in all former times, and which, it is to be hoped will do so in all future times' (WN 345).

## Necessary conditions for growth

Britain's economy was a long way from the happy concurrence of conditions discussed above, and nobody knew that better than Smith especially as his focus was on the 'policy measures [that] could be undertaken to create an environment favourable to rapid growth' (Adelman, 1962, 25). Moving to 'an environment favourable to rapid growth' in the circumstances of the time was an enormous agenda of institutional, economic and political change, little of which happened. Smith,

pessimistically, insisted that to 'expect...that the freedom of trade should ever be entirely restored in Great Britain, is as absurd as to expect that an Oceana or Utopia should ever be established in it', as indeed history since 1776 has confirmed, which raises the following question: if not 'freedom of trade', the policy for which he is famously associated, what policies short of free trade would be practicable, despite the 'prejudices of the publick' and 'the unconquerable... private interests of many individuals' who 'irresistibly oppose' any dismantling of the existing trade arrangements established in Britain since Cromwell and which have been added to continually since then? (WN 471).

He explained how the less than optimal arrangements that were in place were nevertheless viable enough to produce growth that in time would afford a form of opulence for the population, including the labouring poor. He criticised Dr Quesnay for asserting that perfect liberty was essential for progress towards opulence (WN 673); it wasn't. His proposals to dismantle mercantile political economy including the power of the local Guilds, the Statutes of Apprenticeship and the Law of Settlement, and to mitigate common-enough behaviours in society, such as public prodigality, colonial ventures, wars and 'projects of empire' through monopoly trading companies, mother-country dominance of colonial markets and 'jealousy of trade', formed a major agenda. Leaving them in place, he believed, was detrimental to securing a rapid increase in opulence within a commercial economy. Mercantile institutions and their associated policies interfered with economic growth, making it essential that the search for policies for promoting growth took account of their effects (Rodrik, 2007, 184–192).

## Productive and unproductive labour

Neoclassical economists dropped the distinction between productive and unproductive labour by aggregating all labour into a single factor, which may have improved the mathematical modelling, but it was not Smith's idea.

What circumstances took England from the near 'rude and savage' state to the vastly increased annual production of land and labour, plainly visible by the eighteenth century? Smith argued that it was caused by the slow but steady accumulation of that part of the capital stock that is employed in 'raising, manufacturing, or purchasing goods and selling them with a profit' and in 'improving land' (WN 279), and he identified the proportionate balance between what he calls 'productive and unproductive labour' as the driver in the linked

chain of capital accumulation. Smith's distinctions between productive and unproductive labour were archaic, but they carried an important sub-message; certain activities add to wealth creation and other activities do not. He was concerned with shifting the boundaries between them both.

Compared to the distinctions between 'productive' and 'sterile' labour in the work of the Physiocrats (Quesnay, [1759]; cf. Skinner, [1979], 123–141). Smith, in common with Cantillon [1734] and Turgot [1766]; cf. Chydenius [1765] ranked the labour of petty manufacturers as growth-inducing activities, a quality misattributed by the Physiocrats solely to agriculture. Smith's theory of productive and unproductive labour judged labour's productivity by whether it added to, or detracted from, growth. For Smith, one set of labour (productive) added to the value of whatever it was bestowed upon; the other set (unproductive) had no such effect.

A worker shaping hot iron on a forge produces a saleable object, which returns to the employer his cost and a profit while a domestic servant uncorking a bottle of fine wine for his master 'adds to the value of nothing', though his service provides a convenience. The usefulness, indeed the desperate need for the services of unproductive labourers (soldiers and sailors defending society from barbarous invasions, for example), had nothing to do with the accumulation of capital, and, therefore, were 'unproductive', despite their great and vital utility and their individual bravery and sacrifices.

The services of unproductive labourers does not, cannot, 'put into motion a quantity of labour equal' to their cost. Whatever their services 'produce' generally perishes 'in the very instant of their performance, and *seldom* leave any trace or value behind them' (my emphasis) from 'which an equal quantity of service could afterwards be procured' (WN 330). This leads to Smith's oft-quoted paragraph, apparently lambasting some of the most revered institutions in the society he lived in:

The sovereign, for example, with all the officers both of justice and war who serve under him, the whole army and navy, are unproductive labourers. They are the servants of the publick, and are maintained by a part of the annual produce of the industry of other people. Their service, how useful, or how necessary soever, produces nothing for which an equal quantity of service can afterwards be procured. The protection, security, and defence of the commonwealth, the effect of their labour this year, will not purchase its protection, security, and defence, for the year to come. In the same class must be

ranked, some both of the gravest and most important, and some of the most frivolous professions: churchmen, lawyers, physicians, men of letters of all kinds; players, buffoons, musicians, opera-singers, opera-dancers, &c. The labour of the meanest of these has a certain value, regulated by the very same principles which regulate that of every other sort of labour; and that of the most noble and most useful, produces nothing which could afterwards purchase or procure an equal quantity of labour. Like the declamation of the actor, the harangue of the orator, or the tune of the musician, the work of all of them perishes in the very instant of its production.

(WN 330–331; cf. Steuart, 1767, II.xxvi, 369)

Many conclude too hastily that the distinction was mainly between labour that produces tangible products and labour that undertakes services, with the implication that for Smith all services were unproductive (Fleischacker, 2004a, 134–138).

In modern times, the productive/unproductive boundary has shifted: musicians, singers, opera performers, actors and so on record their performances on DVDs and in ‘downloads’; men and women of letters, sports personalities and ‘celebrities’ sell books, stories, merchandise associated with their names, and media columns and TV clips, which last beyond their ‘live’ performances. These technical developments shift the argument from productivity about work ‘perishing in the very instant’ to whether those defined by Smith as ‘unproductive’ sell vendible commodities in markets. Many former services are now vendible. For example, paid-for entertainment is as vendible as the tangible products coming from productive labourers (cf. Eltis, 1976), while others (public servants, soldiers and so on) continue to supply their services outside markets (paid for by taxation and borrowing), and therefore they remain ‘unproductive in Smith’s sense’ where they do not produce vendible products.

I think some part of the ambiguity in Smith’s distinction comes from his not separating the consumers of goods and services for final consumption from their commercial suppliers of them. The taxpayer pays the supplier (of the good or service) and does not replace that expenditure by reselling what has ‘perished’ in the course of consumption (immediate or over time), and in that sense, the product of labour is unproductive for the consumer. However, those commercial suppliers hire productive labour and who sell the output of that labour to the consumer or the government and recover their costs (rent, capital and wages) plus a profit. Domestic servants are unproductive to

the household because their cost is not recovered; servants in a restaurant, prostitutes in a brothel (Marx, [1762]) and players in a theatre are productive because their costs plus a profit are recovered in the prices charged to customers. In the case of tax-funded defence expenditures, the government does not recover the taxes, therefore the labour employed is unproductive, but private suppliers of goods and services to the defence sector sell their outputs to the government and receive incomes that replace their costs plus profit, and therefore their labour is productive. This was the limited distinction in Smith's mind in his growth theory.

Wherever the boundary dividing productive from unproductive labourers is set, the proportions on either side of the boundary in Smith's theory determines whether 'the annual produce will be greater or smaller accordingly'. It divides into two parts, the 'largest' part destined for replacing capital, or for replacing the 'provisions, materials and finished work' that were withdrawn in the previous round, and the 'smaller part' (the profits) for the owners of the capital that may go to their revenue for spending or to their savings (WN 322). '[T]he great landlord or the rich merchant' and 'even the common workman' (if his income allows) share the habit of spending revenue on immediate consumption and all will 'maintain a menial servant', or go to 'a play of a puppet show' (surely this last is productive?), each contributing 'towards maintaining one set of unproductive labourers', or they may 'pay taxes' to maintain another set 'equally unproductive' (WN 333). All consumption expenditure out of revenue is unproductive – it does not replace the consumer's costs plus a profit, though for producers it does. It depends on which side of the transaction we look at.

The proportion allocated between capital and revenue is the result of the cumulative choices of thousands of individuals acting separately under whatever motivates their choices, and their actions regulate the proportion between 'industry and idleness'. Smith concludes, where capital predominates in these proportions, 'industry prevails'; where revenue predominates in them, 'idleness' prevails. Changes in the proportions of capital and revenue may change the number of productive hands employed, affecting 'the real wealth and revenue of a country's inhabitants'. In the search for wise prescriptions for progressing to opulence, Smith concludes, 'capitals are increased by parsimony, and diminished by prodigality and misconduct' (WN 337). Parsimony is the key to the increase in the exchangeable value of a nation's produce of land and labour.



Revenue spent on 'idle guests' and 'menial servants' leaves nothing behind; capital spent on 'labourers, manufacturers, and artificers', who reproduce with a profit their annual consumption, add to the stock of capital. The latter, in effect, is a 'perpetual fund for the maintenance for an equal number in all times to come' (WN 338). A minimal amount of unproductive expenditure on consumption is inevitable (we have to eat), but the prodigal perverts this process: he lives beyond his means, consumes his capital and 'tends no only to beggar himself, but to impoverish his country', by reducing the capital that would be available to society (WN 339). In similar vein, Smith keeps returning to the same theme – 'every prodigal appears to be a public enemy, and every frugal man a public benefactor' (WN 340). He also generalises from the prodigal, who winds his way to self-destruction, to the misconduct of the projector, from his failed vision, over-trading, naivety, bad luck or outright incompetence in managing a capital project, which also diminishes the productive funds of society (WN 341).

With idleness, individual prodigality and failed capital projects, it may be wondered how reliable are the forces within commercial society for countering what could be large leakages from the potential funds for growth. Here Smith strikes an optimistic note. He asserts that a great nation cannot be much affected either by prodigality or by the misconduct of individuals, serious as these behaviours may be individually, because the 'profusion or imprudence of some being always more than compensated by the frugality and good conduct of others'. For this compensatory force to be strong enough to overcome prodigality and misconduct, it must be propelled by fairly strong and persistent pressure throughout society. And so it is, claims Smith. The 'passion for present enjoyment' is sometimes 'violent and very difficult to be restrained' and, fortunately, the passion is lessened by 'the principle which prompts to save', namely the lifelong 'desire for bettering our condition' (WN 341).

The other major source of expenditure on final consumption was that raised in preparation for wars of varying degrees of necessity, which is a field largely non-researched for its impact on overall economic growth (Kennedy, 1975).

Thus, while 'the four expensive French wars of 1688, 1702, 1742 and 1756' cost 'a hundred and forty-five millions of debt' (WN 345–346) and the general profusion of government undoubtedly 'retarded the natural progress of England towards wealth and improvement, it has not been able to stop it' because in the midst of all the exactions of government 'capital has been silently and gradually accumulated by the private frugality and good conduct of individuals, by their universal, continual,

and uninterrupted effort to better their own condition' (WN 345). It should be noted that Smith, characteristically, does not express a point of view about the efficacy or legitimacy of the causes of the four wars, nor on whether wars in general should be undertaken. He simply states their budget costs and consequences for the progress towards opulence.

Given that England had never been blessed with a parsimonious government, he declared that it 'is the highest impertinence and presumption, therefore, in kings and ministers, to pretend to watch over the œconomy of private people' because governments 'are themselves always, and without exception, the greatest spendthrifts in the society. Let them look well after their own expence, and they may safely trust private people to look after theirs. If their own extravagance does not ruin the state, that of their subjects never will' (WN 345–346).

Capital employing productive hands is the engine of growth; spending stock on revenue above that which is necessary – prodigality in place of frugality – diverts annual produce and erodes that which otherwise could contribute to society's net increase in capital. In sum, the proportion of productive labour is at the core of Smith's theory of growth. For Smith, this was the definitive choice for all who participate in a commercial economy. How they react to that choice effectively determines the steepness of the growth trajectory of the society. He simplified what was at stake to an extreme choice between 'prodigality' versus 'parsimony'. The prodigal spends revenue and 'leaves nothing behind'. The amount spent adds nothing to his revenue in the next period because his consumption is a leakage, not an investment. If he saves something out of his revenue, it is consumed by 'a different set of people', such as productive 'labourers, manufacturers, and artificers, who reproduce with a profit the value of their annual consumption' (WN 338).

Prodigality is a sort of 'perversion' (he uses the verb 'to pervert' three times in two paragraphs) in Smith's lexicon because it wastes the prodigal's inheritance from his forefathers' frugality, it diminishes the funds destined for employment of productive labour and thereby the value of the annual produce of the country, plus it diminishes the real wealth and revenue of other inhabitants, including those among the labouring poor. It feeds, in effect, 'the idle with the bread of the industrious' and beggars not just himself, but 'impoverishes his country' (WN 339). And he writes much more about prodigals in a similar vein and temper.

Smith's ideas about growth are a mix of history, economics, evidence and assumptions, and it pointed in a broad direction – steadily growing opulence. Modern growth theorists, therefore and understandably, have problems with it because rather than a precisely balanced growth,

based on an interlinking of many technical conditions, it says nothing about the conditions necessary to produce equilibrium. In dissecting it and reassembling the parts within an equilibrium framework for which it is not suited, much is lost in translation, which loses the essential subtleties of the author's plot. Smithian growth was not about equilibrium. True, implicitly he allowed for an exception at some future terminal stage when it was no longer growing and in a sort of equilibrium (WN 111). But this situation, Smith declared, had never happened because 'perhaps no country has ever yet arrived at this degree of opulence'. He did not appear to consider it a likely contingency at any time soon, but he accepted that 'China seems to have been long stationary, and had probably long ago acquired that full complement of riches which is consistent with the nature of its laws and institutions.' Implicitly, 'other laws and institutions, the nature of its soil, climate, and situation' might produce a superior complement of riches.

Smith introduced the role of exports into growth. His observations on stagnant China imply that it was 'self-inflicted', in the sense that its government had chosen to cut itself off from the world, which illustrated the problems of economies that do not trade. Capital mobilises labour and materials to produce surplus output for sale, but a neighbourhood may not have sufficient demand to match supply, and this requires capital for 'transporting either the rude or manufactured produce from places where they abound to those where they are wanted' (WN 360). Absent such transport, 'no more either could be produced than was necessary for the consumption of the neighbourhood', and thus, it would discourage industry and decreases the 'enjoyments' of what would have been exchanged in trade (WN 360–361). Clearly, a general ban on contact and trade with the outside world damaged China more than the rest of the world (WN 680–681).

He discussed 'the progress of our American colonies', and warned that if 'either by combination, or any other sort of violence' (tariffs, prohibitions) it discontinued trade with Britain in manufactures, it would 'retard' the colony's 'progress towards wealth and greatness', because this would 'divert' a considerable part of its capital to manufacture goods which it presently imported, and would 'draw towards' manufacturing a greater share of capital than would 'naturally go to it' and force from some other industry (agriculture?) that would otherwise be employed in it (WN 366–367, 687).

Exports play an important role in his growth theory, because they promote effectual demand abroad for surplus products in exchange for products from other countries that widen domestic consumer choice.

They are integral to the progress towards opulence, drive the division of labour and roundabout methods of production and increase employment. Without foreign trade, growth would slow down; restrictions on foreign trade undermine opulence.

Growth was seen by Smith to be crucial to resolving the absolute deprivation of the majority of the population. It is from this context that we should judge his tone against mercantile political economy. Smith did not want to substitute some 'grand plan' or scheme that would remove blemishes on the economy just because they ought to be removed. He was not a 'man of system' (TMS 232–234). He was hostile to mercantile political economy, and those who would make its prescriptions worse by seeking monopoly status, because it drained the fragile growth-inducing forces that, if they were less burdened, could bring about the end of absolute poverty experienced by the majority of the population that much sooner.

He tempered the haste of others (François Quesnay and the Physiocrats, for example) because Smith's appreciation of human history showed him that perfection in human affairs was not likely and that long-run positive changes in social and economic arrangements were possibly a long way short of purist preconditions. This suggested that a platform of practical small changes, here and there, that legislators and those who influenced them could be persuaded to adopt, was a more responsible basis for advocacy than a long list of impractical demands upon the existing institutions and the men who ran them.

# 11

## ‘a very violent attack’

### Introduction

In 1780, Smith described his critique of mercantile political economy as a ‘very violent attack... upon the whole commercial system of Great Britain’ (*Corr* 251). Four years later, he stepped up his attack by adding to the third edition (1784), an equally robust broadside (*WN* 442–462; *Corr* 266).

Some major authorities have doubted whether Book IV should be regarded as economics, though it is ‘of immense value to historians’ (Robbins, 1998, 147), and assert that it was ‘an emphatic piece of free trade propaganda’ (Heckscher, [1931] 1955, volume ii, 332). They claim ‘that Smith’s attack on the mercantile system was utterly inconsistent if that system was, in fact, merely a necessary concomitant of the highest, most civilised stage of social development’, for which ‘there was surely no point in fulminating against it’ (Coats, 1975, 222 in Skinner and Wilson).

Smith’s point was that successive governments for three centuries followed the policies of mercantile political economy, which involved ‘jealousies of trade’, hostility to neighbours and spending on preparations for, and the conduct of, wars that made the participants worse off than they could have been if their ‘enemies’ were seen as sources of mutual benefit through trade. It is appropriate to understand Smith’s purpose rather than his tone; he regarded mercantile political economy as an obstacle to the spread of opulence.

History is untidy, and more than a stroll through the four ages, which engenders unwarranted images of progression, with tones of inevitability. No age was or is inevitable; different underlying modes of subsistence occurred and were compatible with variant forms of

governance. Progress can be reversed, or seriously malformed, by events. Therefore, it is consistent for Smith to criticise mercantile political economy and to prefer the adoption of different policies. Thankfully, he realised, it was not necessary to change everything to change anything.

## **Mercantile policies**

The tenets of mercantile policies interfered with the amiable inclinations of people, including the strong impulse to 'better themselves' and, by misdirecting such impulses, they undermined the natural path of economic growth through commerce. He considered exceptions to natural liberty on their merits and not on whether they offended purist doctrine when he focussed his attention on specific examples of policies that slowed wealth creation. A problem with Smith's polemic is that some of the issues he raises are no longer regarded as current (though many are). Much research was conducted into mercantile policies (Heckscher, [1931]), promoting the German name of 'mercantilism' (Viner, 1937, 3n1), which was never used by Smith, though Rosenberg (1979 in O'Driscoll, 1769, 19–34) insists that Smith 'invented' it.

Smith attacked the proposition that 'wealth' consisted of gold and silver, rather than the goods that they purchased. Policies challenging notion of money-is-wealth have since become closely associated with Smith's critique, but he was by no means the sole critic – see the excellent account of seventeenth-century economic literature by Samuel Hollander (1973, 33–44) and the longer account by Jacob Viner (1937, 1–118).

Notions of money being synonymous with wealth encouraged countries, without their own gold and silver mines, to export more than they imported. Their export surpluses earned gold and silver, which obviously was not possible for all countries simultaneously. Smith was in no doubt about the fallacy of the wealth-is-money doctrine, but was unsuccessful in pinning its origins down to anyone specifically. The notion of money is wealth was firmly embedded in popular thinking (still is): 'rich people have strongboxes of gold and silver', therefore rich countries should have the same. So widespread was this false notion that he asserted that 'all the different nations of Europe' studied, 'to little purpose', how to accumulate gold and silver. Prohibitions on the exportation of gold were easily evaded, making it pointless, but 'the balance of trade' could not be hidden and concerns about it crowded-out proper attention to other policies.

Cantillon ([1734] 1931, 193), a banker, accepted the idea that regulating the balance of trade was an important role for government, for if a country imported more than it exported, the balance of trade adjusted itself by merchants sending gold and silver abroad to meet their deficits. Individual merchants adjusted their behaviour as exchange costs became higher or lower. The understanding of the adjustment mechanism, said Smith, was 'solid', but the inference that some took from it was 'sophistical'. He queried whether gold and silver must be augmented to deal with trade balances, whereas no attention needed to be paid to the trade balance of other commodities. With 'freedom of trade' in all commodities, including gold and silver, the so-called 'unfavourable' trade balance would adjust 'without fail' and did not require the attention of government (WN 432–433):

A country that has wherewithal to buy wine, will always get the wine which it has occasion for; and a country that has wherewithal to buy gold and silver, will never be in want of those metals.

(WN 438)

Smith asserts that it 'would be too ridiculous to go about seriously to prove, that wealth does not consist in money, or in gold and silver; but in what money purchases, and is valuable only for purchasing' (WN 438). He admitted that in compiling the implications of these 'ridiculous' notions, he did so 'at the hazard of being tedious'. For Smith, theories came down to practical legislation. He summarised the errors of mercantile political economy leading to restraints upon imports and encouragements of exports, which, supposedly, were the 'two great engines for enriching a country'.

The following mercantile policies interfered with trade:

- restraints upon imports for home consumption that could be produced domestically;
- restraints upon imports of all goods from particular countries with which a country has an imbalance of trade;
- restraints imposed by means of high duties and outright prohibition;
- encouragement of exports by drawbacks, bounties, advantageous trade treaties with certain countries and by establishing colonies;
- drawbacks on the duties and excise on home manufactures when exported and when imported materials or manufactures, subject to duties on importation, are re-exported;
- bounties given to encourage new (today: 'infant') industries, or any industry judged to deserve specific favours;

- advantageous treaties of commerce to particular merchants in particular countries beyond that accorded to all other countries and their merchants;
- monopoly privileges for the goods of merchants from the country that establishes colonies (WN 450–451).

Smith's concern was that these measures tended to increase or diminish the value of a country's annual produce and, thereby, promote or inhibit progress towards opulence.

## Restraints on imports

There seemed to be two cases where it would be advantageous to 'lay some burden upon foreign' industry for the 'encouragement of domestic industry' (WN 463), and both cases breached his reputation as a free trader. But for Smith, what was advantageous was based solely on pragmatic, not doctrinaire, grounds. His discussion of when free importation should be relaxed was, first, when it was necessary for the defence of the country; and second, when a tax was imposed on domestic production of the same products for reasons of policy. He approved of the former and was sceptical of the latter.

The first case were the Navigation Acts (Harper, [1939] 1964)] dating back to Oliver Cromwell (1651), and enhanced by successive governments. Britain depended on its navy for national defence, and he said the Navigation Acts 'very properly' gave British ships and sailors a monopoly of the sea trade of their island country. Foreign owners and crews faced 'forfeiting ship and cargo' and a possible 'double alien's duty' should they attempt to breach Britain's monopoly of its coastal trade and its trade with its colonial settlements. Moreover, foreign vessels were permitted only when delivering cargoes directly from their own countries, where 'the owners, masters, and three-fourths of the mariners' were from the country that produced the cargoes (otherwise British ships could be exposed to retaliation) (WN 463–464).

Foreign fleets were regarded as hostile to British interests. And this strategic concern prompted the spirit of 'national prejudice and animosity', which promoted this most blatant breach of the principles of free trade (WN 474). All governments were persuaded that the country's island situation was a serious weakness and potential threat to its independence. Continental rivals had land borders with access to continent-wide supplies and markets; Britain was an island. In the shadow of the 'violent animosity subsisting between nations', they



preferred to sacrifice the nation's commercial convenience in favour of naval security (WN 464).

For Smith, the Navigation Acts were a defining criterion of the subordination of political economy to national interests. He knew fully and explicitly the economic cost of the Navigation Acts in making foreign imports dearer to buy and domestic exports cheaper to sell. He asserted as a high principle that the first duty of the sovereign (WN 687) was 'that of protecting society from... violence and invasion', adding, 'the act of navigation is, perhaps, the wisest of all commercial regulations of England' (WN 464–465). These Acts, though clear breaches of free trade, were tolerable in pursuit of preserving prospects for Britain trading towards opulence and natural liberty, despite their distortional effects on capital accumulation among diverse sectors of the economy. This was a pragmatic, not principled, choice brought about by Smith's judgement as to which line of attack on current British policies would be more likely to succeed in bringing about the Act's ultimate demise. In the conditions of mid-eighteenth-century Britain, he judged that there was little chance of the Acts being repealed in one step and more chance that they could be undone piecemeal.

From this breach in Smith's advocacy of universal free trade, Friedrich List was hostile to Smith's perceived role, as he saw it, of 'hiding' Britain's real intentions in 'free trade' advocacy. He picked on Smith's 'warped judgement upon the Navigation Laws', highlighted his distinction between their 'political' and 'economic' effects and took this as a contrived argument to hide the fact that 'power is more important than wealth'. List argued strongly for Smith's 'candour' as a precedent for his own nationalistic arguments in his native Germany, specifically in favour of a strong mercantile (protectionist) line in its trade policies and not to be lulled into national weakness by adopting 'English' political economy (List, [1856] 1885).

Smith, however, found the case against free importation unconvincing. He details the circumstances favouring limited qualifications to the general policy of free trade, broadly under the heading of encouraging domestic industry. He knew that the advocates of traditional mercantile policies had the ear of legislators, and they sought special protection for individual cases upon which they exerted strong influence. Smith presents the exceptions case, with signs of overt scepticism, for when

- there is a domestic tax on specific produce so as to equalise the disadvantage of purchasing a domestic and imported product (WN 465);

- 'all sorts of foreign goods' that compete with domestic produce, particularly the 'necessities of life', should have 'some duty' exacted to equalise the enhancement in the prices of domestic produce (WN 465–466);
- foreign countries retain 'high duties or prohibitions' on domestic exports to them, 'revenge...naturally dictates retaliation', particularly if there is a probability of their repeal, but not otherwise (WN 467–468).

He shows that these were expedient rather than principled policies by referring to them as 'according to some people', who 'say' or 'think' the arguments for them, and comments that they are 'certainly a most absurd way of making amends' to the problems they identify as causing the need for imposing tariffs and duties. He also lists them as being 'generally advantageous' for encouraging domestic industry, which were usually conceded by legislatures to 'stop the clamorous complaints of our merchants and manufacturers' about being 'undersold' by foreigners' goods. He also comments that judgement about imposing this or that tax does not, perhaps, belong so much to the science of a legislator, whose deliberations ought to be governed by general principles which are always the same, as to the skill of that insidious and crafty animal, vulgarly called a statesman or politician, whose councils are directed by the momentary fluctuations of affairs (WN 468).

Smith reported on policies and the people who advocated them, and was not signalling a change in his beliefs about the efficacy of free trade. His comments follow a discussion about restoring free trade and the prospects for succeeding in such policies (WN 471). He expressed concern that a clamour for revenge against countries that impose duties and prohibitions on British goods, if successful, could worsen the situation for the whole country and not just for those affected by the actions of a foreign government. A judgement whether to retaliate against another country's imposition of damaging tariffs should turn on prospects for repeal and not on the anger generated against a foreign government by those merchants losing from the foreign tariffs. Domestic prohibitions cause real injuries to others besides those affected initially by a neighbour's conduct. This called for 'deliberation' on the pros and cons in each specific situation, as did consideration of the timing of restoration of free importation that had been interrupted for some time by domestic protection. The vulgar politician's contribution to debates on issues of timing was not that of the political economist, and he put it stronger in his *Lectures*: 'they whom we call politicians are not

the most remarkable men in the world for probity and punctuality' (LJ 539).

Where an industry has enjoyed protection and expanded as a consequence to employ a 'great multitude of hands', humanity 'requires that the freedom of trade should be restored only by slow gradations, and with a good deal of reserve and circumspection' in case, when duties are removed 'all at once', the flood of cheaper imports into the home market deprives 'many thousands of our people of their ordinary employment and means of subsistence', and causes considerable 'disorder' (drawing the attention of politicians and agitators), though probably with 'much less' justification than is 'commonly imagined' (WN 469). The home market will not collapse if the transition is managed carefully. How fast a market for domestic products would decline and how many formerly employed would remain unemployed was an empirical question.

Smith the moral philosopher breaks into the musings of Smith the influencer, and he quotes the analogous peaceful absorption into the economy of suddenly demobilised sailors and soldiers (accustomed as many were to 'the use of arms' and lives of 'rapine and plunder') after 'the late war'. He also took the opportunity to draw attention to the legal exceptions to some of the domestic mercantile policies then in force that were enjoyed by ex-servicemen, and suggested that the same privileges accorded to ex-service men be accorded to all labourers by the removal of the 'exclusive privileges of corporations', the 'repeal the statute of apprenticeship' and 'the law of settlements' (WN 469–471).

He summarised the political problems obstructing the restoration of free trade in words that give no doubts as to how fragile were the prospects of succeeding. He opens with what appears to be his surrender to total pessimism. He considered the belief that freedom of trade should ever be *entirely* restored in Great Britain was 'absurd' (WN 471). This, I suggest, is not quite what it seems. It is not a prediction that no progress towards restoring free trade would 'ever' be made. He considered progress could and should be made and that any progress in this direction would help to raise the growth rate. Total free trade would not be 'entirely restored', that is all, and nor need it be to improve growth, the division of labour and employment.

The obstacles were impressive, not trivial (still are). To the prejudices of the public, there were the more 'unconquerable' private interests of those individuals who were 'irresistibly opposed' to free trade. He contrasts the master manufacturers who are against every law likely to allow rivals into the home market and, in an analogy likely to appeal to politicians, he suggests they think about the consequences if the officers of the army were to oppose with 'the same zeal and unanimity' an

analogous reduction in their number. Manufacturers incite and enflame their workmen 'to attack with violence and outrage the proposers' of any free-trade regulation and, like an overgrown standing army, they have become 'formidable to the government, and upon many occasions intimidate the legislature' (WN 471).

Smith knew many members of Parliament through his life-long friend, James Oswald MP, and from whom he heard about the fate awaiting any MP who 'supports every proposal for strengthening this monopoly' compared to the fate of those who opposed it. The protectionist acquired 'not only the reputation of understanding trade, but great popularity and influence with an order of men whose number and wealth render them of great importance', contrasted with the member who opposed them and, worse, was 'able to thwart them'. For the free trader, 'neither the most acknowledged probity, nor the highest rank, nor the greatest publick services can protect him from the most infamous abuse and detraction, from personal insults, nor sometimes real danger, arising from the insolent outrage of furious and disappointed monopolists' (WN 471). These have the ring of Smith's private conversations with both sides of the protectionist argument, which indicates something of a worrying atmosphere around the Westminster, especially to a lack of protection from 'real danger'.

He offers a conciliatory message expressing his 'equitable' understanding of the possible plight of the undertaker of a great manufacturer who 'would no doubt suffer very considerably' should his home markets suddenly be opened to foreigners – did he hear this from individual manufacturers and MPs lobbied by them? The manufacturer could move his circulating capital into some other employment, but his fixed capital 'could scarce be disposed of without considerable loss'. Smith suggests that changes 'should never be introduced suddenly, but only slowly, gradually, and after a very long warning' and that the legislature should direct its deliberations 'not by the clamorous importunity of partial interests', but from 'an extensive view of the general good' and, for the future, it should be particularly careful 'neither to establish any new monopolies of this kind, nor to extend further those which are already established' (WN 471). Smith remained convinced of the practicality of proceeding with patience over time to restore something akin to freer trade.

## Extraordinary import restraints

To the proposals for protective trade restrictions that originated from 'private interest and the spirit of monopoly', said Smith, were added 'still

more unreasonable' and unfounded 'national prejudice and animosity' against foreign trading partners and, as sinisterly, against foreigners who traded successfully with other foreigners (WN 474). In the minds of European rulers and their self-interested 'advisors', the happy successes of rival countries were seen as dire threats to their own happiness and security, every bit as dangerous as suffering territorial conquests.

The slow realisation that foreign trade might be a substitute for territorial acquisition stirred new passions among the rulers of national states, particularly the nagging vice of covetousness, wrapped in jealousy. Fears that simmered from perceptions of dangers to national security from armies marching across frontiers slowly switched to paranoia when exports crossed the same frontiers or were carried in ships under the flags of foreign kingdoms. The political economy of trade in the seventeenth and eighteenth centuries was a long way from the model of harmony and reconciliation associated with idealistic expectations for the peaceful consequences of international trade. Latent or rampant xenophobia were made worse by the proliferation of international conflicts and the associated suspicions and distrust that such wars and fears of such wars generated.

Smith took his normal stance against the 'absurd' doctrines that promoted, rather than abated, the historic attentions of 'underling tradesmen' with their false notions of the identity of their self-interests with that of the nation, which they 'erect into political maxims for the conduct of a great empire', and who believe falsely that 'their interest consists of beggaring their neighbours'. This contrasted with free traders, who purchased their 'goods always where they are cheapest and best, without regard to any little interest of this kind' (WN 493).

The ruling jealous passions of merchant interests provoked Smith into one of his more strident passages in which nations look 'upon the prosperity' of those 'with which it trades' and considers 'their gain as its own loss':

Commerce, which ought naturally to be, among nations, as among individuals, a bond of union and friendship, has become the most fertile source of discord and animosity. The capricious ambition of kings and ministers has not, during the present and the preceding century, been more fatal to the repose of Europe than the impertinent jealousy of merchants and manufacturers. The violence and injustice of the rulers of mankind is an ancient evil, for which, I am afraid, the nature of human affairs can scarce admit of a remedy. But the mean rapacity, the monopolizing spirit of merchants and manufacturers,

who neither are, nor ought to be, the rulers of mankind, though it cannot perhaps be corrected may very easily be prevented from disturbing the tranquillity of anybody but themselves.

(WN 493; cf. Hume, [1752] 1987)

In effect, he blames the merchants and manufacturers for the wars that Britain became involved in during the century, mostly fighting for hegemony over Dutch and French mercantile interests, under the false impression that trade was like a war for or against territorial expansion – the more you gained, the more your rival enemies lost (see Holt, 2005). Inflaming national animosities by taking legislative measures against another country's exports deepened these problems and that taxing, turning away or impounding cargoes provoked retaliatory actions, which added momentum to moods that 'something be done'. Smith, following Hume, pointed out the flaws in the argument. Wealthy neighbours, while 'dangerous in war', were also 'advantageous in trade' (WN 494). Hostile rich neighbours could afford superior fleets and armies, and policies to make them poorer were not thought through properly, particularly in their effects on the home country. Acts that made them poorer even if they worked effectively, of which there was no guarantee, did not lessen their hostility and also weakened the country initiating them.

Trade in lower-priced products raised domestic real incomes; imports plus imposed tariffs raised prices and lowered real incomes, a self-inflicted pain imposed by legislating for tariffs on behalf of a minority of domestic interests. Such weaknesses were exacerbated by mobilising armies and fleets manned by unproductive labour to engage in wars in pursuit of false notions about 'national interests' that were detrimental to the creation of 'real wealth' in the countries at war, and in those third-party countries peripherally affected.

Smith's (and Hume's) alternative policy asserted that 'a state of peace and commerce' was mutually beneficial because it enabled countries to produce and exchange greater values of the 'necessaries, conveniences, and amusements' of life. The richer the neighbours with whom a country traded, the better off it would become, because rich neighbours are better customers for industrious people. True, rich trading nations included 'dangerous rivals', but in the commercial sense only; they may 'undersell' domestic manufactures, which was 'advantageous to the great body of the people', who would regard, therefore, their rich neighbours as the 'probable cause and occasion' for themselves to acquire riches from trade (WN 494–495). Trade, therefore, is a race to the top,

not to the bottom. In like manner, Smith drew attention to the real cost of 'mercantile jealousy and national animosity' against France, then prevalent in Britain and mirrored in France, which 'inflames, and is itself inflamed, by the violence of national animosity'. The traders of both countries 'have announced, with all the passionate confidence of interested falsehood, the certain ruin of each, in consequences of the unfavourable balance of trade, which they pretend, would be the infallible effect of unrestrained commerce with the other' (WN 496).

If there were some other means of 'defraying the expenses of government', then 'all duties, customs, and excise should be abolished', and all countries should have 'free commerce' with Britain as a 'free port' (LJ 514). This was quite radical, but between that ultimate goal and from where the trading nations of Europe would start, there were no modest obstacles, not the least of which was the stubborn persistence of popular notions fanned by interested parties that national survival was intimately joined to the 'balance of trade'. He contrasted the 'balance of produce' with the 'balance of trade' and noted that a surplus of production over consumption adds to, and a deficit reduces, capital accumulation. A surplus of imports over exports adds to real wealth (it's a flow inward of goods and a flow outward of gold, not real wealth), and a surplus of exports over imports reduces real wealth because there is a flow outwards of real goods and a flow inwards of gold. In the extreme, a country with little or no foreign trade (China) could be compared with countries with foreign trade (eighteenth-century British colonies in North America), and the stagnation of the former with the growth of the latter proved of his proposition (WN 498).

## Mercantile political economy and colonies

Colonies vastly complicated the progress towards the spread of opulence in Smith's analysis. They added an almost ruinous dimension to the developing European nations on the economic and on the political level, when joined with the risks of jealousy of trade (especially with wars). As ever, Smith looked to the classical age of Greece and Rome for the roots of colonies and found them in the unexceptional circumstances of domestic population pressure on small territories influencing the mix of motives promoting dispersal and expansion (WN 556–558).

The 'discovery' of the islands off the Americas by Columbus in 1492 at first appeared to have no worthwhile importance; they had nothing that constituted the 'real riches of every country' in 'animal and vegetable productions of the soil' (WN 560). They consisted of 'country

quite covered with wood, uncultivated, and inhabited only by some tribes of naked and miserable savages' (WN 559). This gave Europeans in the early colonisation of the Americas different motives from the 'irresistible necessity or from clear and evident utility' of Greece and Rome, whose colonies expanded into territories already peopled predominantly by farmers and shepherd societies. Hunter-gatherers peopled the Americas in low population densities, and the few agricultural societies in and near Central America crumbled relatively quickly under European pressure.

Greed for gold, a by-product of Spain's search for a western route to China and India, became that country's sordid 'sacred thirst' (WN 562) in a despicable class of its own, dressed up, Smith noted, for the 'pious purpose of converting' the inhabitants to 'Christianity', which 'sanctified the injustice' of 'the plundering of defenceless natives' (WN 561). Spain took the entire region into its possession, all from the sight of some little 'ornaments of gold' brought back by Columbus, who offered to the crown half of all of the gold found in future. This irresistible motive initiated what was to become the most unfortunate and, in many cases, the most despicable series of acts committed by one people on another as their introduction to the 'modern' world.

Smith was interested in what made for prosperity in new colonies, at least for the colonists. He enumerated the causes for the rapid advance of the colonies to 'wealth and greatness' compared to their 'mother countries' (WN 564–590):

- they transfer with them superior knowledge of agriculture and useful arts not (yet) found in 'savage and barbarous nations';
- they transfer the habit of subordination, regular government, systems of laws and administration of justice, which they install in the new settlements;
- they acquire more land than they can cultivate, without having to pay taxes or rent to landlords, and pay but a 'trifle' to the sovereign;
- they pay labourers 'liberally', but labourers move on to land ownership themselves (land is so cheap and labour so dear);
- high wages encourage fertility and lower infant mortality, and on maturity the high price of labour and low price of land create opportunities to emulate earlier generations (WN 564–566).

Compared to relations between the mother country and the Roman colonies, the American colonies, because of their distance from 'home', were 'less in the view and less in the power' of the mother country to



intervene (WN 567). Gold kept Spain's attention firmly focussed on its American colonies; its absence in the British colonies created its own problems, not the least of which was how to pay for defending them against the ambitions of other European powers, while home governments practised benign neglect and colonial legislators engaged in the endemic factional trivia to which distant colonies were prone (WN 567–568).

Northern European colonies were usually the result of ventures sponsored by exclusive companies of merchants, which monopolised supplies to and from the small enclaves. Smith noted the harmful effects and the mitigating counter-effects of the five causes of their progress to opulence.

The government of an exclusive company of merchants, is, perhaps, the worst of all governments for any country whatever. It was not, however, able to stop altogether the progress of these colonies, though it rendered it more slow and languid... The plenty and cheapness of good land are such powerful causes of prosperity, that the very worst government is scarce capable of checking altogether the efficacy of their operation.

(WN 570; cf. 572, 637–641)

He noted that the engrossing of uncultivated lands, while practised on a small scale in the English colonies, had only a small effect on the availability of land, and it was nowhere near to the scale of the practice followed in South America, where vast lands were given to Court favourites. In contrast, in the northern colonies with limitations on, and exclusions from, primogeniture, and the moderation of taxes, greater quantities of labour were put 'into motion', and by leaving greater proportions of income in the hands of the colonists, and not their absentee landlords, they went somewhat towards meeting the optimal requirements in Smith's growth theory (WN 572–573). These happy conditions were due to the freer land laws in some of the English colonies. Proprietors who did not develop their land could have them re-granted to another person (WN 572), in contrast to neglected land in Britain, which could decay for generations. This is an example of his acceptance that there could be a useful role for government in the progress towards opulence if they adopted the 'right' laws, whereas he emphatically states that the 'liberty to manage their own affairs their own way' is a main cause 'of the prosperity of all new colonies'. In contrast, in the Spanish colonies, they imported the laws and practices of the mother

country (engrossed land and primogeniture) straight into their local laws. Land managed this way brought the negative effects of the mother country into play in the Spanish colonies, making spare land expensive, unimproved and less productive. Liberty under the wrong laws inhibits progress towards prosperity.

There is a direct line in Smith's account from the emergence of trade as a national political issue to trade becoming the focus of national animosity and jealousy, from which it seems inevitable that if competition among trade rivals is a cause of stress and discomfort, the notion of their establishing colonies of the modern kind quickly makes them exclusive monopolies for the mother country's benefit. With the competitive seaborne exploration of the unknown rest of the world, the 'race' to find, claim and hold colonies was inevitable. The major maritime powers of the fifteenth and sixteenth centuries made grandiose claims to vast tracts of territory and tried to set up small enclave colonies to 'legalise' their claims. Fortunately, the lands claimed for colonisation were vast, and while local 'incidents' featured in occasional disputes (particularly from English 'piracy'), the process was not normally violent between the European powers until the seventeenth and eighteenth centuries, by which time broad 'spheres of influence' were established.

Smith advanced an economic interpretation of European colonisation. The colonial traders had a monopoly of trade (against all comers, including 'adventurers' from their own countries), and the colonial population were obliged by law to buy all of their European goods from the exclusive company and to sell all colonial produce to them. 'It was the interest of the company, therefore,' Smith noted, 'not only to sell the former as dear, and to buy the latter as cheap as possible, but to buy no more of the latter, even at this low price, that they could dispose of for a very high price in Europe.' This had the effect of not only 'degrading the value of the surplus produce of the colony' but also discouraging and keeping down the 'natural increase of its quantity', making Smith summarise the economics of the arrangement as being undoubtedly the 'most effectual' means by which exclusive companies could 'contrive to stunt the natural growth of a new colony' (WN 575). He did not hide what he thought of the arrangement. It forced some part of the capital of Britain from the foreign trade in consumption: first, with neighbours in Europe and the Mediterranean to that of 'distant countries' across the Atlantic (WN 601); secondly, into a roundabout one (it takes much longer for capital to turnover and circulate) (WN 602); thirdly, to the carrying trade; which broke 'altogether that natural balance which would otherwise have taken place among all the different

branches of British industry' (WN 604). In consequence, said Smith, using a medical analogy, the 'body politick' is 'less healthful', liable 'to many dangerous disorders', of which the threatened 'rupture with the colonies' struck 'more terror' than was 'ever felt for a Spanish armada, or a French invasion'.

He did not believe that Britain would voluntarily surrender its authority over its American colonies because 'to propose such a measure as never was, and never will be adopted, by any nation in the world', citing the precedent that 'no nation ever voluntarily gave up the dominion of any province, how troublesome soever it might be to govern it, and just how small soever a revenue which it afforded might be in proportion to the expence which it occasioned' and noting that such sacrifices might be 'agreeable to the interest' but were 'always mortifying to the pride of every nation', and of 'still greater consequence', they were 'always contrary to the private interest of the governing part of it' in pursuit of the 'disposal of many places of trust and profit, or many opportunities of acquiring wealth and distinction, which the possession of the most turbulent, and to the great body of people, the most unprofitable province seldom fails to afford' (WN 616–617).

In contrast, he advanced the opinion that Britain should offer a peaceful separation and settle upon the American colonies a 'treaty of commerce', securing free trade, advantageous to the people, less so to the merchants, that would favour the mother country 'in war as well as in trade' and turn the 'turbulent and factious subjects' into 'our most faithful, affectionate, and generous allies' (WN 617). Standing in the way of good sense, however, was that universal fear of loss of 'national honour' and a diminished 'dignity', especially in the 'eyes of Europe', and, at home, 'the rage and indignation at the public disgrace and calamity' from 'dismembering the empire', which his parliamentary friends would have warmly exhibited in their private conversations (Gutteridge, 1933).

For such passing moods, brought on by the long practice of false mercantile doctrines, the government passed up an opportunity to find a wise settlement based on the growth of commerce, on peace between mother country and former colonies and on international political stability. But such was the stuff of politics that Smith's advised to no avail. The king was minded to offer no concessions to maintain his writ in the British colonies, and he offered nothing; the colonists chose 'to draw the sword in defence of their own importance' (WN 622), and the king, unwilling to concede anything, lost everything.

Smith proposed an alternative plan, ingenious but too late to make a difference and wrapped it in delicate language to assuage the sensitivities

of the king and his court. His proposal was for the colonists to send representatives as members of the British parliament in proportion to the amounts each colony contributed to the public revenue, to be augmented as their annual contributions augmented. For the leading men of each colony, a 'dazzling object of ambition' from 'the wheel of the great state lottery of British politicks' would be within their reach, 'instead of the piddling little prizes' of 'the paltry raffle of colony faction'. Yet, Smith also recognised that the 'shop-keepers, tradesmen, and attorneys' in the colonies who 'are become great statesmen and legislators' contriving 'a new form of government of an extensive empire, which they flatter themselves, will become, and which, indeed, seems very likely to become, one of the greatest and most formidable that ever was in the world' were unlikely to drop all these fancies and ambitions to fall back into line as subjects of the mother country (WN 623).

Moreover, Smith suggested, as others did as well, that his plan for parliamentary representation, while the best that a British king and statesmen could hope for, barring military victory, was unattractive for the colonists because the 'rapid progress' of the American colonies in 'wealth, population and improvement' would, 'in the course of little more than a century, perhaps' exceed the amount of taxation raised in the home country, causing, under his plan for representation proportional to taxable contributions, the 'seat of the empire' to move from London to America. In effect, this asked the ambitious colonists to wait until 1880 to reverse their dependence on the British monarchy, even assuming that the monarchy would be willing to agree to its eventual demise in this manner.

## Chartered trading companies

The chartered trading companies were a perfect extension of mercantile colonialism, and were founded on monopoly privileges granted by the sovereign, or acts of parliament, which, because they were driven by intense jealousy of rivals, defended their monopolies tenaciously. They were particular targets for Smith's ire; because of the force of his criticisms and their apparent, but misleading, similarities in their institutional arrangements as 'joint-stock companies' with today's international capitalist corporations, it is not uncommon to find modern scholars applying Smith's condemnations of them to current businesses, as if the contexts were similar and the institutions identical, which they are not.

There was much for Smith to criticise based on their performance over nearly two centuries. The main problem lay in the extraordinary delay

in communication between the trading companies and their governing boards. It took up to 10 months for mail to reach India and, allowing for more delays to reach the up-country centres of the East India Company, and it took the same for a reply to reach London. By then, events, governments, personnel and interest in the issues usually had moved on and dated instructions, enquiries and routine reports of governance and audits of supervision left a great deal of discretion in the hands of local managers, and massive scope for malfeasance at all levels. Smith was not coy in condemning the outcome (WN 631).

Private fortunes too were made under the protection of the monopoly. Local managers and clerks, supposedly looking after the interests of their masters in London, traded on their own account, despite occasional efforts to stop the practice. Smith noted that 'Nothing can be more completely foolish than to expect that the clerks of a great counting-house at 10,000 miles distance, and consequently quite out of sight, should, upon a simple order from their masters, give up at once doing any sort of business on their own account, abandon for ever all hopes of making a fortune, of which they have the means in their hands, and content themselves with the moderate salaries which those masters allow them' (WN 638–639).

Smith, for prudent legal reasons only, denied that he was throwing any 'odious imputation upon the character of the servants of the East India company', and made clear he was blaming the government for the 'situation in which they are placed'. He described the chartered companies as 'nuisances in every respect; always more or less inconvenient to the countries in which they are established, and destructive to those which have the misfortune to fall under their government' (WN 641).

Two general points can be drawn here. The first is Smith's unambiguous identification of the primacy of the interests of consumers over producers and 'the interests of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer' whereas 'in mercantile systems, the interest of the consumer is almost constantly sacrificed to that of the producer' (WN 660). Merchants and manufacturers were more likely to gain the ears of legislators than the dispersed mass of consumers, and the 'contrivers of this whole mercantile system' were 'the producers whose interest has been so carefully attended to' because they were 'by far the principal architects' (WN 661). This rebuts accusations that Adam Smith served the interests of the 'ruling' orders (cf. Gallagher, 1998).

Second, the original rationale for chartered companies was the need for 'extraordinary protection' of traders on the West coast of Africa. By

the time traders had moved to 'India', they insisted on 'securing their persons and property from violence' by erecting forts. But who would pay the expense of the defence of a trading interest – the traders or the government? (WN 731–733).

Two distinct company types existed, one 'regulated' and the other 'joint stock', established either by royal charter or by act of parliament (WN 740). The regulated companies resembled the corporations of trades found in the towns (WN 733); individuals joined them on payment of 'fine' and were bound by their regulations, mainly in regard to their monopoly status. Individuals who were not members of the corporation were not permitted to trade within their territory. Smith opined that the regulated companies had been less 'repressive' than 'useless', which 'is perhaps the highest eulogy which can ever justly be bestowed upon' them (WN 735). Their directors had no particular interest in the 'prosperity of the general trade' and from its decay 'may even frequently contribute to the advantage of their private trade'. The regulated company diminishes 'the number of their competitors', which enables them to 'buy cheaper, and to sell dearer' (WN 737).

In contrast, the directors of a joint-stock company, having only a share of the profits from the common stock that they managed on behalf of shareholders, and without private trade, found their private interest connected to the general trade of the company, including the maintenance of the forts and garrisons necessary for its defence (WN 737).

The chartered joint-stock companies differed from the regulated and from 'copartnery' companies. In the latter, the partners' capital is locked in and cannot be transferred to an outsider, nor can a member introduce a new partner without the consent of the other partners. They could withdraw from the copartnery and request payment of their share of the common capital. In a joint-stock company, members, or shareholders, could withdraw from the company without the consent of the other members and transfer their shares by private agreement on price to strangers, who then become new members in their own right (WN 740). Copartnery members were liable for the company's debts to the full extent of their private fortune, whereas joint-stock shareholders were bound only to the extent of their shares. The 'Court of directors' managed the joint-stock company. The proprietors were assumed by Smith to receive 'contentedly such half yearly or yearly dividend, as the directors think proper to make them' (WN 741). In the belief that limited liability applied to such companies, they encouraged 'many people to become adventurers in joint stock companies, who would upon no

account, hazard their fortunes in any copartnery' (WN 741; cf. Shannon, 1931; Campbell, 1967).

Smith's main criticism of chartered joint stock companies, and which is most often quoted today in comments on the familiar principal-agent problem, was that the directors who managed other people's money rather than their own 'cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a copartnery frequently watch over their own' and, consequently, 'negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company' (WN 741).

Smith conceded that, much like an inventor or author of a book, there may be a case for granting a monopoly for a limited number of years to a company of merchants that intends at its own expense and risk to open trade with 'some remote and barbarous nation'. But a 'perpetual monopoly' would be wrong because it taxes consumers in two ways: (1) the high monopoly prices of the goods, which would be cheaper in free trade and (2) the exclusion of others from the monopoly trade in which they might make profit if they were allowed to enter it at their convenience. The monopoly status enjoyed by the perpetual monopoly enables 'the company to support the negligence, profusion, and malversation of their own servants, whose disorderly conduct seldom allows the dividend of the company to exceed the ordinary rate of profit in trades which are altogether free, and very frequently makes it fall even a good deal short of that rate' (WN 755).

Despite these specific strictures, the principle of a joint-stock company was not completely abandoned by Smith. He suggested that there were certain circumstances where such companies would be appropriate, specifically if they required large capitals to function efficiently, and were without monopoly privileges, and where their operations could be reduced to strict rules or routine with little or no variation. These included the following:

- the banking trade (such as the Bank of England, the Bank of Scotland and the Royal Bank of Scotland, and the principal banking companies of Europe);
- the insurance trade;
- the construction of canals and aqueducts;
- the piping of water supplies (WN 756–757).

Smith regarded domestic location as crucial to workable joint-stock companies. Of the companies that operated overseas, the only exception

was the Hudson Bay Company. The nature of the terrain and climate of northern Canada precluded individual adventurers when set against the capacity of the company to generate worthwhile cargoes for the few ships calling in the 6-week weather window (WN 743–744). Importantly too, the operations of domestic joint-stock companies were under closer supervision, with early remedies in the domestic courts for fraud by company directors and officials (excluding share manias in 'bubbles').

## Colonial trade and capital distortions

The supposed gains from a thriving colony for the mother country is the access to, and the enjoyments of, the surplus of colonial produce, but the exclusive trade imposed by the mother country renders that surplus below what it otherwise would be and much more expensive (WN 593). Over a long period, the distorting effects of the colonial trade monopolies on the domestic economy came to the fore. Smith analysed these effects in line with his growth theory. First, the monopoly of colonial trade and their profits drew capital, which would have otherwise been spread across all domestic trades, in pursuit of higher profits than obtainable at home (WN 596). The effect is occasioned by the growth in foreign trade not increasing its capital in proportion to its capital requirements from its own resources and therefore having to attract capital from other domestic trades, including from trades engaged in intra-European trade, which further distorted domestic trade from having to change its product mix from being suitable for intra-European requirements to the more distant requirements of America.

Second, the trade monopoly enforced by the Navigation Acts kept the profit rate above what it would have been if all nations in Europe had been able to trade directly with the American colonies. Smith also pointed out that the higher profit rates, and not, as claimed, high wages, were the main cause of the high prices of colonial products in Europe (WN 599).

The domestic capital previously growing to support foreign trade of consumption with neighbouring European countries was forced to switch to the American trade, and because of the greater distance and time required to complete a transaction, it forced part of domestic British capital from direct foreign trade of consumption to the indirect, round-about foreign trade (WN 602). This tied up a large capital in what was essentially one great market with a slower turnaround, instead of many smaller domestic markets with faster turnarounds, and it reduced the contribution of capital surplus to other purposes, including the



improvement of domestic lands (a favourite target of Smith's) and the increase in domestic manufactures through finer divisions of labour. The ultimate effect was to reduce commerce in Britain through slower capital accumulation (WN 603–604).

The greater foreign trade with the American colonies was deceptive until the capital employed and its turnaround were considered, when set against Smith's definition of 'advantageous', namely which allocation maintains the 'greatest quantity of productive labour and most increases the annual produce of the land and labour' of the country? A capital of £1000 employed in the foreign trade of consumption, of which the returns are made regularly once a year, maintains a quantity of productive labour that can be maintained by a thousand pounds. The same capital employed domestically that can return itself 'twice or thrice a year' maintains a quantity of labour worth 2000 or 3000 pounds a year, with beneficial effects on the employment of productive labour two or three times the quantity employed in the distant colonial trade.

For Smith, the folly was obvious; in so far as it affected the minds of some of the country's decision-makers, Smith would have achieved his purpose (WN 600). The tobacco trade involved long 'roundabout' transactions, lasting 'three or four years' and sometimes 'four or five years'. In consequence, this kept in constant employment a fourth or fifth part of what could be employed productively (WN 602–603). Moreover, because the Navigation Acts required the exports of the colonies to be sent first to British ports and then to wherever they were destined, Britain outlaid a much greater amount of its scarce capital in the process, awaiting shipment to other countries in Europe and for the return traded goods to arrive for sale in Britain. It was probable, surmised Smith, that the domestic tobacco trade could be conducted with a much smaller amount of capital, leaving the excess needed under the current monopolistic arrangements to be used in other domestic commercial activities for profit. The beneficiaries of these monopoly arrangements were those engaged in the British colonial trade; the losers were the larger number of unseen people who could be employed productively, earn their maintenance and provide profits to their undertakers (WN 604).

Smith summarises his disdain for mercantile political economy, which worked to the detriment of wealth creation and the promotion of growth:

To found a great empire for the sole purpose of raising up a people of customers, may at first sight appear a project fit for a nation of

shopkeepers. It is, however, a project altogether unfit for a nation of shopkeepers; but extremely fit for a nation whose government is influenced by shopkeepers. Such statesmen, and such statesmen only, are capable of fancying that they will find some advantage in employing the blood and treasure of their fellow citizens, to found and to maintain such an empire.

(WN 613)

Before the outbreak of the 'present disturbances', defence was a charge on the revenue of the British government, plus the uncounted costs of the 'distortions' caused by the overall misplacing of capital on the economy. But when the crunch came, it was over the defence costs issue and not the far greater hidden costs of capital flows that had been raised by Smith. His inquiry came too late to impact on these issues.

# 12

## ‘an invisible hand’

### Introduction

Adam Smith did not credit ‘the invisible-hand’ metaphor with the importance that many modern economists give to it, so what then did Adam Smith mean by this metaphor in contrast to what is attributed to him across the world today?

William Grampp (2000) identified nine different meanings of the invisible hand (ten, including his own) in modern literature, Warren Samuels (2007) analysed the way the invisible hand is used by neoclassical economists, and Daniel Klein made a case for a modern interpretation of the invisible hand (Klein 2009).

I argue that Smith had no ‘theory’ of invisible hands (he used the words only three times), and he showed no inclination to treat them as anything more than an isolated metaphor. Significantly, he gave the metaphor no role in his theory of competitive markets.

Yet, three leading economists lauded his metaphor (Rothschild, 2001, 116), describing it variously as follows:

- ‘The profoundest observation of Smith’... the system works behind the backs of the participants; the directing hand is invisible (Arrow, 1987);
- ‘surely the most important contribution of economic thought’ (Arrow and Hahn, 1971, 1);
- ‘one of the great ideas of history and one of the most influential’ (Tobin, 1992);
- ‘The argument of Adam Smith (1776) that free markets lead to efficient outcomes, “as if by and invisible hand,” has played a central role in these debates’ (Stiglitz, 1991); and his recantation: ‘In 2009,

we again saw why Adam Smith's invisible hand often appeared invisible: it is not there' Stiglitz, December 2010.

How did a metaphor achieve such high status when neither he nor contemporary readers took much notice of it?

The invisible hand is called Smith's metaphor, but he was not the first (or last) to use it. There are many early references to 'invisible hands', showing substantial prior use of it before Smith, to which list of 17 below can be added an additional 40, mainly theological references (Harrison, 2010, forthcoming):

- Homer (Iliad, 720 BC): 'And from behind Zeus thrust him on with exceeding mighty hand';
- Horace (65–68 BC), Ovid (Metamorphoses, AD 8): 'twisted and plied his invisible hand, inflicting wound within wound';
- Lactantius (De divini praeio, c. 250–325): 'invisibilis';
- Augustine, 354–430, 'God's "hand" is his power, which moves visible things by invisible means' (The City of God, xii, 24);
- Richard Hooker, 'by the hand of secret, invisible and ghostly regiment' ('Of the Laws of Ecclesiastical Polity' Book 8, 1594);
- Shakespeare, 'Thy Bloody and Invisible Hand' (Macbeth, 2.3, 1605);
- Glanvill (1661): 'nature work[ing] by an invisible hand in all things'; 'invisible intellectual agents' (Andriopoulos, 1999, 739–758);
- Daniel Defoe, 'A sudden Blow from an almost invisible Hand, blasted all my Happiness', in Moll Flanders (1722a); 'it has all been brought to pass by an invisible hand' (Colonel Jack, 1722b);
- Nicolas Lenglet Dufesnoy (1735) said that an 'invisible hand' has power over what happens under our eyes;
- Charles Rollin ([1730–1738] 1821); described as 'very well known in English and Scottish Universities', said of the military successes of Israeli Kings, 'the rapidity of their consequences ought to have enabled them to discern the invisible hand which conducted them'; and in Traités des études 'thereby leads us to the invisible hand and understanding';
- Charles Bonnet (1764; whom Smith befriended in Geneva in 1765) wrote of the economy of the animal: 'It is led towards its end by an invisible hand';
- Jean-Baptiste Robinet (1766; a translator of Hume) refers to fresh water as 'those basins of mineral water, prepared by an invisible hand', and (1764) 'directed towards his end by an invisible hand';

- Voltaire (1694–1178) in *Oedipe* (1718) writes, ‘Tremble, unfortunate King, an invisible hand suspends above your head’, and ‘an invisible hand pushed away my presents’;
- Professor W. Leechman (1755; in Hutcheson, 1755, XII) said, ‘the silent and unseen hand of an all-wise Providence’;
- Kant, E. (1784; ‘Universal History’) ‘leads on to infer the design of a wise creator and not [the hand of a malicious spirit]’;
- Walpole (1764): ‘the door was clapped-to with violence by an invisible hand’;
- Reeve (1778, 13–14): ‘Presently after, he thought he was hurried away by an invisible hand, and led into a wild heath’ (Andriopoulos, 1999).

The most surprising fact is that his use of the invisible-hand metaphor appears not to have been remarked upon, while he was alive and, after his death in 1790, it was hardly mentioned at all until the late nineteenth century, though the metaphor itself was used widely by theological and literary authors through to the twenty-first century.

Dugald Stewart (1795) did not mention the metaphor in his popular 1793 eulogy of Adam Smith’s life and works (and reproduced in editions of *Wealth of Nations* and *Moral Sentiments* throughout the nineteenth century). However, he included the invisible-hand paragraph *en passant* among his excerpts from *Wealth of Nations* among the long verbatim footnotes to his lectures on political economy [1801], and he also mentioned the invisible hand in a Providential context in his *Elements of the Philosophy of the Human Mind* (1792–1827, 248): when primitive man ‘follows blindly his instinctive principles of action, he is led by an invisible hand, and contributes his share of the execution of a plan, of the nature and advantages of which he has no conception’. But Thomas Malthus (1798), David Ricardo (1817), J. R. McCulloch ([1828] 1863), J. S. Mill (1849) and Karl Marx (1887) did not comment on the metaphor. It is the absence of notice of Smith’s use of the metaphor until nearly a century after he died, which is a strange failure in light of the plaudits awarded to ‘his most important idea’, ‘concept’ or ‘paradigm’ until discovered (invented) by twentieth-century economists.

Only from the last quarter of the nineteenth century did a few academics begin to notice the metaphor, at least nominally, but most did not. August Onken (1874) and H. T. Buckle (1885, volume 1, 218–219) paraphrased the ‘invisible-hand’ paragraph without comment. However, Frederick Maitland, (1850–1906) Cambridge Professor of Laws

of England, asserted that the invisible hand was the 'strongest argument for laissez-faire', and William Smart (1899) wrote 'I am disposed to think that the "invisible hand" – however one interprets Adam Smith's reference – is bringing about these conditions (the possibility of realising their moral being, or of being what is called "happy") more quickly than any deliberate rearrangement of industry would' (Smart, 1899, x). Similarly, Leslie (1879, 154–155); Ingram ([1888] 1967, 89–90, 102, 104); and Bonar (1893, 150, 173) made brief comments.

More specific references to Smith's use of the invisible hand metaphor began to appear from the 1920s (Pigou, 1920; Gray, 1931) and then slowly in the 1940s (Lange, 1946; Samuelson, 1948). From the 1950s, however, modern economists quoted the metaphor so regularly that it became ubiquitous, and today its identification with Adam Smith is complete, with a new meaning that is universally accepted among most economists, that its actual meaning to Smith is now obscured, to which problem we now turn.

## Smith on metaphors

Many modern scholars derive a far more extensive application to the market, supply and demand, prices, perfect competition, and of much else in economics than is warranted. No distinction is made by many authors between Smith's limited use of the invisible hand as a mere metaphor for the object of his discussions and their own much wider transformations of the metaphor into a 'theory', 'concept', 'principle' or 'paradigm', working behind the scene as 'the directing hand' (Arrow, 1987).

Most modern economists may not accept this interpretation of the significance to Smith of his use of the invisible-hand metaphor, especially those (the majority?) who took their tutors' assertions without reading Smith for themselves, but I think what follows is closer to Adam Smith's meaning than the post-1950's commonly claimed as a consensus. This is not decisive; scholarship in science is sceptical and critical, and seldom declares an issue settled for all time. Consensus is a challenge to scholarship and not a justification for complacency.

For what purpose did Adam Smith use the metaphor? What was he telling us? An unwillingness to address these questions is disappointing. Happily, we are assisted in answering these questions by what Smith taught his students about the use and role metaphors in his *Lectures in*

*Rhetoric and Belles Lettres*, which he taught from 1748 to 1763 (Smith, A. 1983, 29).

So much has been written about the invisible hand that modern authors imply that the metaphor itself was its own object, which completely misses Smith's view of metaphors being 'an allusion between one object and another':

In every metaphor it is evident there must be an allusion betwixt one object and another... Now it is evident that none of these metaphors can have any beauty unless it be so adapted that it gives the due strength of expression to the object described and at the same time does this in a more striking and interesting manner.

(Smith, *LRBL* [1762–1763] 1983, 29)

Smith used many metaphors in his books; for example, he described the role of money in a commercial economy as the 'the great wheel of circulation' without implying that the wheel existed physically (WN II.ii.23, 291). Those who think that metaphors are their own object must believe that Smith's 'violent' metaphor of 'a sort of wagon-way through the air' actually described a real wagon-way, rather than being merely an imaginary metaphorical description of the staid but 'judicious operations of banking' in a 'more striking and interesting manner'. Similarly, his metaphorical image of paper money being 'suspended upon... Daedalian wings', compared to the solidity of gold and silver, captures the former's flimsy security in a 'more striking and interesting manner' (WN II.ii.86, 321). This is what powerful literary metaphors add to their objects.

## The object of the metaphor

What then is the object of which the metaphor of 'an invisible hand'? What does it describe 'in a more striking and interesting manner'? Smith practised what he taught. Because modern economists misread the invisible hand by treating it as an entity in its own right, the metaphor became a myth.

Ignoring the invisible hand in his essay on *Astronomy* (Smith, [1744–1750] 1980, 49), Smith only used 'an invisible hand' as a metaphor twice in his books and in both *Moral Sentiments* and *Wealth of Nations* their objects are clear. On both occasions Smith explains the object before appending to it the metaphor.

In *Moral Sentiments*, the 'rich', epitomised as 'proud and unfeeling landlord[s]', in reality had absolutely no choice but to feed the 'thousands whom they employ', because if they didn't act so, they would not last the winter from mass starvation and, as a consequence, without the labour of his 'inferiors', who would prepare the landlord's soil, sow his seeds, tend his growing plants, harvest his crops and prepare this food next season?

Smith excludes compassion as the motive of 'the proud and unfeeling landlord... without a thought for the wants of his brethren' (TMS IV.ii.10, 184) feeding the thousands whom he employed. He acted as he did because it was absolutely necessary to ensure that his retainers, household servants, farm labourers and their families were fed at least to subsistence level. Personal generosity was not involved, nor necessary.

It was the absolute certainty that without providing their food, clothing and shelter, however disagreeable their living conditions compared to his palatial accommodation, finery in clothing, baubles and table fare, that commonly gratify 'the vain and insatiable desires' of the rich man's family and his guests, those who supported the households of their 'superiors' would not last the winter. This consequence was so obvious; it did not require evidence to prove it to the dimmest of landlords. Without feeding his inferiors, the landlord would no longer have inferiors to do the work he didn't do himself. The edifice upon which his 'greatness' rested would crumble with the demise of his inferiors, who selected for him from the 'heap what is most precious and agreeable', who fitted 'up the palace', kept 'in order all the different baubles and trinkets', flattered 'his luxury and caprice' and ensured by their indispensable labour that each season's crops was harvested and stored to distribute the annual output of the 'necessaries of life' (TMS IV.1.ii.10, 184) for him and his dependants. For this service to continue, he had to share with his inferiors 'the produce of all their improvements' from his many fields. In short, there never was any chance at all that landlords would commit social suicide by depriving their inferiors of subsistence.

Having explained all this, Smith offers the metaphor of the rich landlords in their circumstances being 'led by an invisible-hand', in effect to do what they had to do of necessity, which necessity was the object of the metaphor, presented in 'striking and more interesting manner'!

Smith's second case in *Wealth of Nations*, where he discusses how some, but not all, merchants behaved when prudently protecting their 'own security' in choosing between participating in foreign trade (with its attendant additional risks) or participating solely in local trade, where



their 'capital is never so long out of [their] sight as it frequently is in the foreign trade of consumption'.

Foreign trade involves additional risks. Smith reports that the local merchant makes his choice because he 'can know better the character and the situation of the person whom he trusts, and if he should happen to be deceived, he knows better the laws of the country from which he must seek redress' (WN IV.ii.6, 454). The merchants were driven by the not unreasonable necessity of reducing the risks to his capital, no mean consideration when the consequences of maybe only single, certainly of serial, wrong judgements in eighteenth-century business, separated their relative opulence from their severe destitution.

So, what did the more risk-averse merchants do? They chose to avoid foreign trade and invested locally instead! And their quantity of local investment, of necessity, adds to the total of local investment (because, arithmetically, the whole is the sum of its parts) and thereby, necessarily, adds to the total capital and employment available locally and to the concomitant total of national investment and employment. That consequence is inescapable from the situation the merchants were in, and the object of the metaphor is precisely as described by Smith.

Smith uses the metaphor of the local merchants being 'led by an invisible hand', which gave 'due strength of expression to the object' – the cause of their behaviour – which he described 'in a more striking and interesting manner'.

## The imperative of necessity

In both of Smith's examples the key word is: 'necessary'. The rich landlords and the most risk-averse of merchants, necessarily, acted the way they did because they had no real choice to do otherwise, without making themselves worse-off, catastrophically in the case of landlords, and likely so, if merchants lost their capital abroad.

Landlords needed servants in their grand palaces and toilers on their lands; merchants needed access to profitable but safer uses of their capital. Hence, the former were bound by necessity to distribute at least the minimal subsistence to those who toiled for them, and the latter focussed by necessity on local trade.

In *Wealth of Nations* (1776), published after the fourth edition of *Moral Sentiments* (1774), we find nine paragraphs either side of the invisible-hand metaphor in which Smith employed the words 'necessarily' or 'necessary' nine times, and 'natural' or 'naturally' six times (WN IV.ii.1–18, 452–460). These paragraphs are highly significant. In

*Moral Sentiments*, first published 17 years earlier, the word 'conveniency' is employed 17 times before the metaphor, which is also significant: 'it is well that nature imposes on us in this manner. It is this deception which rouses and keeps in continual motion the industry of mankind' (TMS 183).

Bear in mind what Smith meant by wealth: 'annual output of the necessities, conveniences, and amusements of life' (TMS 179–187).

His references to 'necessity', 'necessarily', 'natural' and 'naturally', all closely associated to a singular reference of the common metaphor of 'an invisible hand', help identify the metaphor's 'object' and making the metaphor the object of itself misses Smith's point.

Distinguishing between people doing what is 'necessary' and avoiding what is 'unnecessary' in the circumstances is the important truth to which Smith constantly returns. For example, Smith gives his well-known example of the:

statesman, who should attempt to direct private people in what manner they ought to employ their capitals, would not only load himself with a most *unnecessary* attention, but assume an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it.

(WN IV.ii.10, 456; emphasis added)

Of course, for centuries this is precisely what 'statesmen' did, and continue to do today, but Smith's message was that their labours in these cases were an unnecessary presumption on their part. Add to these defects of people ordering their lives unnecessarily, the mercantile policies of restraints on trade 'diverted' capital from where it would likely to have gone on its own accord without necessarily increasing 'the general industry of society' (WN IV.ii.2, 453). And so on throughout his works.

Being led by 'an invisible hand' in Smith's use of it did not make the metaphor real; it is still an imaginary metaphor for its object in the direct or indirect compulsion of necessity on those who act under its influence, as it affects them, consciously or unconsciously. In both cases, Smith's use of the invisible-hand metaphor highlights his seeing men acting in accordance with necessity, as they see fit 'in a more striking and interesting manner'. It pervades all aspects of human life in society; it was the most consistent and insistent pressure upon individuals in all walks of life. Whether individuals actually act in accord with the

necessity of their circumstances is another matter, the consequences of which are visible in their progress or otherwise towards opulence, which was Smith's measuring rod of the efficacy of chosen policies.

The venerable doctrine of necessity in human life had Stoic roots, with which Smith was familiar. Individuals do not need to adopt, or even know of, philosophical ideas about necessity and its influences on their activities. The division of labour and exchange behaviours occurred long before anybody theorised about them.

Briefly, and somewhat brusquely, the extent to which individuals complied with necessity arising in their circumstances, they could, taught Smith, hasten the 'spread of opulence'. They could also act unnecessarily to unintentionally distort and deflect such outcomes from reaching their full potential. Smith put it pointedly: 'If a nation could not prosper without the enjoyment of perfect liberty and perfect justice, there is not in the world a nation that could ever have prospered' (WN 674).

## An unguarded conclusion

Smith was not party to the modern idea, attributed to him, that self-interested actions were always socially benign (his actual word was 'frequently'); his was not a generalised explanation of all unintended consequences. He acts 'in this, as in many other cases', but not in all cases (WN 456). It was not a universal benign rule for markets. In fact, it was not about 'markets' at all as commonly asserted.

First some background. The twentieth century was marked by a global struggle for the supremacy of one or other of two contending economic arrangements: capitalistic free markets versus socialistic state planning. In the 1930s, capitalist markets in Europe and the United States were in a crisis, which was not fully understood within the existing knowledge of economics. This crisis coincided with, but was independent of, the challenge of the spread of socialist planning in Russia.

The Second World War re-configured the map of Europe. The expansion of Soviet planning regimes across Eastern Europe, and by 1949 into China, heightened political tensions between East and West. The Cold War also caused tensions within economic science between advocates of the virtues of state-centred socialist planning versus capitalist markets. In the West, the ideas embodied in Keynes' *General Theory* (1936) were tried in practise; macroeconomics became part of academic economics, and microeconomics also made considerable advances from the systematic application of mathematical techniques.

With so much happening in the discipline, some attention was paid also to the works of past contributors, among them, Adam Smith, who had never quite disappeared from the oral traditions of the major universities. While not really relevant, Smith became known as the 'father of capitalism' and widely reported by selected quotations from *Wealth of Nations*; readers of which remained an extremely small minority. Paul Samuelson was the most successful author of the most successful post-war textbook, *Economics: An Introductory Analysis*, first published in 1948, and continued through 19 editions (2010). It became a global publishing phenomenon. Samuelson was also the first winner of a Nobel Prize in economics in 1973 for his classic *Foundations of Economics*, 1946, which introduced the rigorous mathematics that became the hallmark of the discipline.

Samuelson, through his millions of readers, made a slight and passing mention of the invisible hand, which in a short time embedded the myth of the metaphor as, quintessentially, Adam Smith's main idea:

Even Adam Smith, the canny Scot whose monumental book, 'The Wealth of Nations' (1776) represents the beginning of modern economics or political economy – even he was thrilled by the recognition of an order in the economic system that he proclaimed the mystical principle of the 'invisible hand'; that each individual in pursuing his own selfish good was led, as if by an invisible hand, to achieve the best good of all, so that any interference with free competition by government was almost certain to be injurious.

(Samuelson, 1948, 36)

From Samuelson's paraphrase of paragraph 9, in Book IV, chapter 1, ever-larger numbers of students and their tutors from the 1950s onwards believed this to be the central principle guiding the relationship between markets and state interventions, and they believed that Smith said so. He didn't, but they believed he did, and it became deeply entrenched in the discipline almost as a core belief. The invisible hand is now synonymous with the proposition that markets 'miraculously' transform the 'selfish' actions of individuals, without them knowing or intending to do so, into public benefits. This myth owes more to Bernard Mandeville (1724) than to Adam Smith.

Smith said no such thing as 'each individual in pursuing his own selfish good was led, as if by an invisible hand' (emphasis added). The adhesion of 'as if' to the metaphor unjustifiably generalises it, from Smith's very specific usage.

He discusses how two sets of merchants in a country react to the prospects of investing abroad or at home (not excluding investing in both) and the merchant who invests domestically. '[endeavours] as much as he can both to employ his capital in support of domestick industry and so direct that industry that its produce maybe of the greatest value' (456), which promotes 'the publick interest' by adding to domestic capital investment, which necessarily raises it higher than what it would have been if they had not done so. Be absolutely clear – this is not a general principle, as implied by the selected part of the quotation, that it applies for all 'selfish' actions of all individual merchants for all purposes on all occasions – even a cursory trawl through Smith's quotations, let alone a close reading of *Wealth of Nations*, soon disabuses readers of such an inappropriate conclusion.

There is absolutely nothing 'miraculous' about this general outcome; it derives from a simple arithmetic rule – the whole is the sum of its parts! Each incremental amount of local investment by individuals adds to the national output of the 'necessaries, conveniences, and amusements of life'. What Samuelson did was generalise a simple relationship into a belief that the same outcome applied across the individual actions of all merchants in all circumstances. Even Samuelson was uncomfortable with his 1948 attribution. He continually changed this paragraph or added clarifications throughout his following editions.

Smith was not party to the idea that self-interested actions were always or mostly socially benign. It was not a universal benign rule for markets, requiring Smith to have written, 'in this, as in all other cases'. Indeed, as Fleischacker points out,

If he had wanted to proclaim that an invisible hand always guides individual economic decisions toward the good of society, we would expect the proclamation at the opening of the book, as part of his grounding theory of economic activity. The theory Smith gives us there does support the claim that individuals generally promote the social good in their economic behaviour without intending to do so, but there is no hint that this holds in all cases, much less that it is guaranteed to hold by either empirical or metaphysical laws.

(Fleischacker, 2004a, 139)

Smith was well aware that human behaviours can and do result in sub-optimal outcomes; in the first three books of *Wealth of Nations*, he gave over 70 instances where the self-interests of individuals had less than benign outcomes for those they affected.

Samuelson also was unhappy with the general exposition by modern economists alleged to be Smith's 'mystical principle':

This unguarded conclusion has done almost as much harm as good in the part century and a half, especially since too often it is all that some of our leading citizens remember, 30 years later, of their college course in economics.

(Samuelson, 1948, 36)

Samuelson developed his invisible-hand paragraph several times, specifically by linking the invisible hand to models of perfect competition. Of Smith's alleged views that the invisible hand 'leads each selfish individual to contribute to the public good', Samuelson observed correctly that 'Smith had a point', but for allegedly expressing it Smith 'could not have earned a passing mark in a PhD oral examination in explaining just what the point was' (Samuelson, 1963, 128–390). But Smith did not express any such a view and, of course knew nothing of the neo-classical model of perfect competition, though Samuelson continued to link it with 'Smith's' invisible hand and, from his competent mathematical background, presented the puzzle to his readers as a technical challenge and a problem from welfare economics to explain under what conditions would the general statement be true?

Samuelson's line of enquiry into how his version of what Smith meant by the invisible hand led him, and the discipline, far away from Smith's actual meaning, thereby giving the metaphor a change of identity, so the speak, that is so different from Smith's that the original idea and the new one are almost unconnected except by linking them to Smith's name. In the 19th edition of Samuelson's *Economics* (2010), written with William Nordhaus, we find an extraordinary invitation to 'reread' the extract from the 'invisible-hand' passage in *Wealth of Nations* (WN 456), supported by this sentence:

'Particularly note the subtle point about the invisible hand – *that private interest can lead to public gain when it takes place in a well-functioning market mechanism*' (Samuelson, 2010, 28–29; original emphasis). The 'point' that Samuelson and Nordhaus make is so 'subtle' that the passage from Smith that they quote makes no reference whatsoever to '*a well-functioning market mechanism*'. There is no such point in *Wealth of Nations*!

The notion that it is legitimate to allege that he did make such point comes from Samuelson's original 1948 approach. He took Smith's metaphor passage as a reference to something much wider that appeared

to the fertile mindset of an extremely talented young mathematician. Smith, he alleged, made a general statement that there was order in the economic system such that the invisible hand would 'do the acts needed to promote the general interest' (4th edition, 1958). The question he asked was under what circumstances would such a general statement become possible? Indeed, until this was done Smith, in his famous passage, 'had no right to assert that a Invisible-hand channels individuals selfishly seeking their own interests into promoting the "public interest" and Smith has proved nothing of the kind, nor has any economist since 1776' (7th edition, 1967, 610). By 1973 (9th edition, 43), Samuelson said that 'undoubtedly this was a valuable insight', but 'we must recognize some of the realistic limitations of this doctrine'.

From the 10th edition (1976), Samuelson introduced his readers to general equilibrium theory, which redefined the 'humble Invisible hand doctrine' (634–635), adding to perfect competition the requirement for an 'optimal distribution of income'; that all demands by people in markets 'reflect their true well being', 'laissez-faire', plus appropriate regulations to handle externalities. Samuelson also asserted that Smith 'did not prove' his 'invisible-hand paragraph' (841), a somewhat meaningless charge given that in his specific and humble example he most certainly established its credibility (the whole is the sum of its parts). Both theories of General Equilibrium and Pareto efficiency (16th edition 1998, 266–285) were drawn into discussions of the invisible hand, adding numerous 'idealised conditions' considered necessary for it to operate. But the transformation by Samuelson of Adam Smith's use of a 'humble' metaphor into the abstract conditions of general equilibrium and Pareto optima was so far beyond Smith's point that we were no longer discussing anything remotely related to Smith at all.

The metaphor of the invisible-hand added nothing of substance to what Smith knew and wrote about. It was a 'poetic device' to keep a reader's attention by writing in a 'more striking and interesting manner' about the individual behaviours of some people reacting to their circumstances and the consequences that could follow from the choices they made.

I think it is time that the discipline abandoned claiming that Smith's use of the metaphor of an invisible hand had anything to do with modern representations of its meaning, though if it wishes to continue with the metaphor for new purposes, it should cease to link them to Adam Smith's name.

# 13

## ‘peace, easy taxes, and justice’

### Introduction

Smith wrote on the role of government for legislators and those who influenced them. Unfazed by a non-existent mass electorate (Adam Smith did not have a vote under the existing franchise), ministers, lords and MPs were sensitive, however, to their image among their peers, and they were not comfortable with anything likely to undermine the social respect they expected from their ‘inferiors’. Smith understood this and he chose his words accordingly, making his style fairly reserved and, except in his ‘compleat history of all the chartered companies in Great Britain’ (WN 731–758; *Corr* 263–264), it is devoid of rhetoric (Skinner, 1979, 183–208). The inordinately long section on church governance (WN 788–814) contrasts starkly with the section he wrote on government spending on public projects to facilitate commerce (WN 724–731).

Readers with widely differing views and perspectives lay claim to certain passages and ignore or discredit others. Take this example from a paper, written by him (later lost), in which he minimises the role of government:

Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice; all the rest being brought about by the natural course of things. All governments which thwart this natural course, which force things into another channel, or which endeavour to arrest the progress of society at a particular point, are unnatural, and to support themselves are obliged to be oppressive and tyrannical.

(in Dugald Stewart *EPS* 322; cf. Winch, 1996, 90–91)



Those who seize on Stewart's quotation from a paper only he had seen (his mentally ill son burned it) ignore his far longer exposition on the role of government in *Wealth of Nations*. Because Smith was cautious about the interpretation of the exact duties to be undertaken by the sovereign, the passage is read to proclaim him as the author of the minimal state, as articulated in the nineteenth century by the leftwing firebrand, Ferdinand Lassalle as the 'night watchman state', or in Carlyle's 'anarchy plus the constable' (Robbins, 1953, 34). Rumour being the mother of belief, these misleading labels stuck, erroneously, as Smith's.

## First duty of government

The first duty of the sovereign, that of protecting the society from the violence and invasion of other independent societies, can be performed only by means of a military force.

(WN 689)

Defence expenditures against 'the violence and invasion of neighbours' were a large proportion of government expenditures in eighteenth-century Britain, and they increased dramatically within a few years of Smith's death with the advent of Napoleon's wars (Kennedy, 1975, 23–39). Britain went to war for 70 years between the 'glorious revolution' (1688), leading to the Hanoverian succession, and the Battle of Waterloo (1816), a long-enough period to test the impact of defence expenditures in an economy. Were defence expenditure and economic growth related in some way, either negatively or positively?

War involves retarding effects, from the physical destruction of real capital, the diversion of scarce labour, capital and raw materials resources from productive to unproductive use, to the increase in the risks and uncertainties of mercantile and manufacturing enterprise; war also promotes growth to the extent of its demand-inducing effects, draws into productive use underemployed factors, stimulates output in industries whose expansion reduces costs or creates opportunities for other branches of industry and precipitates fiscal or financial or organisational developments, which redistribute incomes or opportunities in favour of innovating enterprise (Deane, 1975, 91, in Winter, 1975).

The appropriate balance between these effects is a political question (John, 1954, 344), when taken in context with whatever other events affect the data. Phyllis Deane (1975, 92) cites John's (1975) findings that for 1700–1763, defence expenditures were positively associated with growth, but less so during the American War (1776–1783), when economic activity contracted. Defence expenditures grew from £5 to £6

million a year in the early part of the century to £40 million by its end, or about 5 per cent of national income at the close of Marlborough's wars and 15 per cent by 1801 (Mathias, 1975). The impact of specific military expenditures on industrial technologies exceeded their money amounts, and may have contributed qualitatively to the initial 'take-off' stages of the industrial revolution. The connections among manufacturing in shipbuilding, engineering and war technologies were particularly close in the growth of industry and commerce. The Carron Iron works, its furnaces identified by Ashton (1948, 65) as the start of the 'industrial revolution', was sustained by government expenditures on naval gunnery, such as the 'Carronades'.

Government-purchased defence goods were from private manufacturers. These added to aggregate demand in certain industries, inciting manufacturers to increase capacity to supply the government's orders. Inevitably, some suppliers tended to specialise in defence goods (ordnance, shipping, victuals, armour, gun carriages and field goods), while for others it was just another market. A steady flow of procurement expenditures into local economies close to garrisons and ports had positive economic effects beyond the original outlays. The cumulative effect of these expenditures over many decades, and their increase over time, had beneficial effects. In Smith's view, the labour of the armed forces was unproductive (it did not replace itself), but the labour of armament manufacturers and other suppliers in the private sector was productive (it replaced itself, plus a profit).

If expenditures on defence led to capital being directed to less productive enterprises than their natural commercial destinations, this for him was a necessary sacrifice of some proportion of growth by a prudent state. Defence for deterrence was a worthwhile sacrifice of opulence in normal times (fighting wars being incomparably more expensive than funding deterrence) (WN 464–465), but if it rose too high, when survival of the country was not imperilled, it could impair longer-term opulence and provoke or promote wars.

His history of warfare through the four ages of man received his usual historical treatment, and he also detailed the growing expense of warfare in modern times (WN 689–708). He summarised the consequence:

In modern war the great expense of fire-arms gives an evident advantage to the nation which can best afford that expence; and consequently, to an opulent and civilised, over a poor and barbarous nation. In antient times the opulent and civilised found it difficult to defend themselves against the poor and barbarous nations. In modern times the poor and barbarous find it difficult to defend

themselves against the opulent and civilised. The invention of fire-arms, an invention which at first sight appears to be so pernicious, is certainly favourable both to the permanency and to the extension of civilisation.

(WN 708)

## Second duty of government

The second duty of the sovereign, that of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice, requires t[w]o very different degrees of expence in the different periods of society.

(WN 708–709)

Justice is an essential pillar of society. Its expense has to be provided for, either by the litigants or by the state from taxation. Where the officers of justice raise revenue for their recompense, it leads to corruption (whoever has the largest ‘present’ for the judge wins the case) (WN 716), and where it is dispensed free of charge, differential payment to lawyers and advisors necessarily imbalances the chances of success in favour of the hirers of the most talented and expensive adversarial advocacy.

Smith summarised in *Wealth of Nations* much of what he had covered in *Lectures*. His main conclusion, after Montesquieu (1748), favoured the separation of powers because the liberty of the individual is safer when the legislature is separated from the executive, and both are separate from the judiciary. He expressed it thus as follows:

upon the impartial administration of justice depends the liberty of every individual, the sense which he has of his own security. In order to make every individual feel perfectly secure in his possession of every right which belongs to him, it is not only necessary that the judicial should be separated from the executive power, but that it should be rendered as much as possible independent of that power. The judge should not be liable to be removed from his office according to the caprice of that power. The regular payment of his salary should not depend upon the good-will, or even upon the good œconomy of that power.

(WN 722–723)

Smith makes clear that the objective he has in mind is not constrained by considerations of budgetary frugality. The issues at stake in justice and in defence supersede considerations of their expense.

### Third duty of government

Smith divided the sovereign's third duty into three: (1) public works and public institutions for facilitating commerce, which were too expensive for private interests to erect or maintain; (2) the education of youth; and (3) the education of people of all ages.

A highway, a bridge or a navigable canal benefit commerce generally, and they should be erected out of public funds and maintained out of revenue from small tolls on users to defray the costs of management and repairs. The state should also provide coinage profitably when its face value exceeds its bullion content, and to this approved state-run business he added the post office (WN 724). These projects were characterised by their suitability for generating revenue to defray necessary expenses and to reduce the tax burden. Management and revenue collection could be farmed out to private persons, the test being utility not principle (WN 725–726).

Public works of benefit to commerce in a locality, for which their expense or maintenance could not be recovered by revenues, formed a special category of public finance. Smith concluded that they were best maintained by local or provincial administration, and thus he opened a second tier of public expenditures, which grew in political importance as towns grew into large municipal cities in the nineteenth century. He gave the example of the streets of London, the pavements and lighting that were funded by local street, parish or district taxation rather than funded from national revenue upon the general inhabitants of Britain, 'the greater part [of whom] derive no sort of benefit from the lighting and paving of the streets of London' (WN 730–731). He commented too that the 'abuses which sometimes creep into the local and provincial administration of a local and provincial revenue' are almost always 'trifling' compared to the abuses common in the 'revenue of a great empire', and they are 'much more easily corrected' (WN 731).

Where projects are required for particular branches of commerce, the costs should fall on the immediate beneficiaries who could be relied upon to pass these costs to their customers, the ultimate beneficiaries. However, the principle of state revenue for civil projects beyond the wealth of a private individual, and their management by public officials or private persons, opened the door to state intervention in other aspects

of the economy. If the governing coalition in parliament did nothing about the absence of certain large projects in the economy, nothing would be done by anybody, despite the great boost to commerce that well-placed good roads, navigable canals and deep ports could provide. However, once the state entered onto this road, the final destination was not obvious, and Smith's name ought not to be invoked with any justice in support or opposition to particular state-financed or state-managed projects. Utility, not principle, was his stance. Far from being modest by contemporary standards, if his programme had been carried out with any degree of diligence, it would have cost many hundreds of millions of pounds to build and maintain a road system at a reasonable standard, suggesting a need for major expenditure just to build a national network of adequate roads between the major cities of the country. The condition of what passed for road links between major towns and cities is unimaginable over two centuries later. Samuel Smiles (1863) reported that Thomas Telford took 20 years to build 1000 miles of roads in Scotland (an average of 50 miles a year), plus numerous bridges and canals. This description of the condition of Scottish roads paints the scale of the problem:

When Smollett travelled from Glasgow to Edinburgh on his way to London, in 1739, there was neither coach, cart, nor wagon on the road. He accordingly accompanied the packhorse carriers as far as Newcastle, 'sitting upon a pack-saddle between two baskets, one of which,' he says, 'contained my goods in a knapsack.' ... It was not until the year 1749 [two years before Smith made his 'quick' visit to Glasgow University to be elected professor] that the first public conveyance, called 'The Glasgow and Edinburgh Caravan,' was started between the two cities, and it made the journey between the one place and the other in two days.

(Smiles, 1863, ch. 4)

As late as 1763, there was as only one monthly stagecoach in all Scotland for communication with London, and that set out from Edinburgh taking 10–15 days, according to the state of the weather; and those who undertook so dangerous a journey usually took the precaution of making their wills before starting (Smiles, [1863] 2006, 35–36), as Smith did in 1773. Smith frequently took the 44-mile journey between Glasgow and Edinburgh to meet his friends, and he travelled from Scotland to London and back several times, so he wrote with feeling about the need for public expenditure on roads. To conceive that these potential expenditures were 'modest' reflects an ignorance of just how badly the

roads needed major and costly long-term investment, plus their regular maintenance when built.

## Education and health

The expense of educating youth should be met either from the general revenue of society or from the parents or guardians of the beneficiaries. Smith found himself in a bind here, as he believed that services offered in return by teachers for a salary, paid by taxation, private endowments, charities or legacies, would deteriorate to the point of indifference in their quality:

In every profession, the exertion of the great part of those who exercise it, is always in proportion to the necessity they are under of making that exertion . . . where the competition is free, the rivalry of competitors, who are all endeavouring to jostle one another out of employment, obliges every man to endeavour to execute his work with a certain degree of exactness.

(WN 759)

Salaries and their emoluments, the larger part of expenditure on education, when paid for fully (from whichever source) lead to the decline in their teachers' commitments to educating the young to whatever standards they could get away with, it being 'in the interests of every man to live as much at his ease as he can' (WN 760).

It remains a major problem in the economics of bureaucracy that the objectives of the administrators often conflict with the interests of the putative beneficiaries of their services and that the costs of administration of indifferently supplied public services are borne by taxpayers, many of whom are not even beneficiaries (Peacock, 1992, 57–83, 1978, 117–128).

Smith asserted that 'Publick services are never better performed than when their reward comes only in consequence of their being performed, and is proportioned to the diligence employed in performing them' (WN 719). Stating the solution does not deliver it. Smith, while unsure of how education should be paid for, had firm ideas on what should be achieved, particularly for the lower orders:

But though the common people cannot, in any civilised society, be so well instructed as people of some rank and fortune, the most essential parts of education, however, to read, write, and account, can be acquired at so early a period of life, that the greater part even

of those who are to be bred to the lowest occupations, have time to acquire them before they can be employed in those occupations. For a very small expense the publick can facilitate, can encourage, and can even impose upon almost the whole body of the people, the necessity of acquiring those most essential parts of education.

(WN 785)

He recommended the establishment 'in every parish or district a little school' to teach children for moderate fee 'that even a common labourer may afford it', with the master 'partly paid' by the public. If England's experience followed that of Scotland, the establishment of such schools would teach almost all the common people to read, with many able 'to write and account'. Smith suggested more 'instructive' school books than commonly found and instead of a 'little smattering of Latin', which was not of much use to them, they should be instructed in elementary 'geometry and mechanicks', which would be useful in most common trades (WN 785–786).

Examined dispassionately, Smith's proposals, modest as they were and well short of universal compulsory education, represented a substantial intervention by the state, and he recognised that intervention on the scale he proposed was not just financial, because he extended it to the curriculum too. The financial consequences of such intervention would temper the government's willingness to undertake a major financial and administrative burden. It is from such considerations that, I believe, he exaggerated the debilitating effect of the division of labour in his rhetoric in support of his reforms, which, some read solely as contradicting his analysis of the important effects of the division of labour earlier in Book I (WN 13–24; WN 781–2; Rosenberg, 1965).

In his argument for educating all children, Smith appeals to the sense of humanity in the reader's mind; in a later paragraph, he appeals to their concerns for political stability and the dangers of uneducated people listening to demagogues. By providing for the instruction of the 'inferior ranks', it would make them 'less liable' to be influenced by 'delusions of enthusiasm and superstition', and the 'most dreadful disorders'. Educated people are more 'disposed to respect their superiors' and more likely to be 'capable of seeing through the interested complaints of faction and sedition' and less likely to be 'misled into any wanton and unnecessary opposition to government'. His concluding argument was stark:

In free countries, where the safety of government depends very much upon the favourable judgment which the people may form of its

conduct, it must surely be of the highest importance that they should not be disposed to judge rashly or capriciously concerning it.

(WN 788)

Only male children of well-off parents were educated formally; the education of the children of the poor waited on opulence spreading down to their households (though the education of the poor in Scotland was better provided for at that time than in England and it aided upward social mobility), and it was unlikely that a market solution would address the problem (WN 785–786). But it was unlikely that education would happen of the scale suggested by Adam Smith unless legislators took political action to direct public funds for this purpose. To advocate that they did so underlines Smith's non-reliance on *laissez-faire* (Skinner, 1995, 70–96 in Copley and Sutherland).

Smith's recognition that the expense of education cannot be left to *laissez-faire* is of far greater significance than the modesty of his proposals. In much the same way, ingenious modern reforms to recast public funding of education into a quasi-market mode, via education vouchers, are truly Smithian in scope.

In a little-noticed paragraph in *Wealth of Nations*, Smith went much further in his advocacy of state intervention than the funding and provision of education. He proposed a small step from the general view of disease being the accepted lot of those unlucky to suffer its effects to the idea that the state should make modest funding available to ameliorate the consequences of certain diseases. And, interestingly, he did so without seeing a direct commercial advantage in such action. If adopted, it was inevitable that the range of interventions in state health provision would, in time, expand.

He approaches his subject via a discussion of the attributes of a 'coward', a man incapable of defending or revenging himself. He first proposes a remedy for the 'mental mutilation, deformity and wretchedness', which cowardice necessarily involves and therefore 'still deserve the most serious attention of government' (WN 787). In his discussion of the ancient militias of Greece and Rome, I discern a preference for regular and compulsory 'military and gymnastic' exercises, and instituting them in Britain required funds and resources (for example, instructors and public fields under the supervision of the local magistrate) (WN 696, 786). Interesting, but not as much as the rest of the sentence:

In the same manner as it would deserve its most serious attention to prevent a leprosy or any other loathsome and offensive disease,



though neither mortal nor dangerous, from spreading itself among them; though, perhaps, no other publick good might result from such attention besides the prevention of so great a publick evil.

(WN 787)

To advocate public expenditures on the treatment of the foulest of diseases opens the door to wider funding for public health, physical and mental, for lesser debilitating diseases. That Smith included the treatment of disease as well as education in his discussion of public expenditures suggests a more flexible mind than his modern and largely invented image as an exponent of *laissez-faire*.

Smith's final note on an expense that was necessary for government to function was that which supported 'the Dignity of the Sovereign'. This was a necessary expense in an opulent and improved society where 'all the different orders' were 'every day more expensive in their houses, in their furniture, in their tables, in their dress, and in their equipage'. The sovereign's expenses 'necessarily' would grow in his acquiring these articles too, for him 'to hold out against fashion' and for supporting his 'higher dignity'. Similar expenses would be required to meet the 'dignity' of any other head of state, paid for out of taxation, and for all the representatives of the country too (WN 814).

## Public revenues

Whatever amount is spent by the state on carrying out its three main duties, the money has to be raised by one means or another with 'the people contributing a part of their own private revenue in order to make up a publick revenue to the sovereign or commonwealth' (WN 824). Taxation from the private revenues of the people was the main source of government revenue. Smith did not think much of the commercial prowess of sovereigns, and thought even less of the prowess of merchants, instancing those of the East India Company for particular contempt as they were 'bad traders' and 'bad sovereigns' (WN 819).

Smith outlined the 'maxims' (not 'canons'!) for a just taxation system: equality, certainty, convenience and economy (Peacock, 1975, 561). Briefly,

- subjects should contribute taxes 'as nearly as possible, in proportion to their respective abilities, that is, in proportion to the revenue they respectively enjoy under the protection of the state';

- the amount of tax to be paid should be certain not arbitrary, because inequality 'is not near so great an evil as a very small degree of uncertainty';
- taxes should be levied at the most convenient time, such as when the person buys the goods attracting a tax, when he receives the rent or when he imports the produce;
- taxes should be 'so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the publick treasury of the state' (WN 825–826).

Smith laid no claim to the originality of the maxims (often incorrectly labelled as 'his canons'); Smith reported that the maxims had already been brought 'to the attention of all nations' by others (WN 827).

Professor Stigler (1975 in Skinner and Wilson) applied his version of the alleged Smithian principle of 'self-interest' to the politics of public finance, and he reported that he was puzzled by the abundant examples Smith provides of failures of self-interest to account for the political behaviours of legislators. The 'canons [!] of taxation', if adopted by a Chancellor of the Exchequer, writes Stigler, tongue in cheek, 'would obtain for him at least the temporary admiration of the professors of moral philosophy but this is a slender and notably fickle constituency on which to build a party.'

Stigler missed Smith's point. The maxims were only guides to taxation policy, not ironbound prescriptions for, and certainly not descriptions of, past or current taxation legislation. Today's taxation regimes are the product of many past legislatures, each consisting of 'elected' interest groups, affiliated individuals and men of party that have crowded the benches of the British and foreign legislatures since the eighteenth century. The 'two canons' substituted by Stigler (1975, 243) for 'Smith's maxims' have an air of political modernity about them: 'The revenue system must not imperil the political support for the regime' and 'The revenue system must yield revenue.'

In Smith's days, once a government achieved the necessary parliamentary votes (many of whom were MPs with agricultural interests), it was unlikely to face the electoral wrath of the (few) enfranchised electors who might be imposed upon by what they had voted for. The circumstances of electoral politics in eighteenth-century Britain produced confusing legislative programmes for the beneficiary interest groups listed by Stigler and the necessity, alluded to by Smith, to apply the maxims to the collection of the revenues as closely as practicable in the circumstances, bearing in mind that of the 26 examples

in Stigler's list 19 were not taxation measures at all (Stigler, 1975, 238–239).

Alan Peacock (1975, 566) criticised Stigler's assertions:

it is one thing to be employing one's commercial or political talents to promote self-interest in a society which has accepted the necessity for competition as a way for channelling self-interest towards the goals of society and another to do so under conditions where entrenched monopoly privileges abound.

Strangely, Stigler (1975, 244) criticises Smith's long-standing and clearly stated preference for moral suasion: 'at best this is an extraordinarily slow and uncertain method of changing policy; at worst it may lead to policies which endanger society'. If persuasion is unlikely to work, what exactly was Professor Stigler suggesting?

## Government failure

It is not sensible to leave aside Smith's recognition of the manifest failures of government and its agencies to perform the roles they assumed in the eighteenth century. It was from concepts of the weakness of primitive capital accumulation in early commercial markets that he saw a role for government to use some of the funds it collected (effectively forced savings out of tax revenues) for public projects, and it was from government failures to administer projects that he took a cautionary stance when considering extending to government any role that could not be left to competitive markets. As usual with Smith, it is not safe to attribute to him clear-cut and dogmatic views relevant to the perennial 'markets versus governments' debates of subsequent centuries.

There are two considerations for judging the efficacy of a large public works project: though it 'may be in the highest degree advantageous to a great society', it could 'never repay the expence to any individual, or small number of individuals' to erect or maintain (WN 24). The cost of erecting a public works project had to be considered separate from the cost of maintaining it in proper working order. If private individuals cannot raise the capital to erect or maintain advantageous public works (good roads, bridges, navigable canals and harbours – though individual exceptions are well documented) to facilitate the commerce of any country, who else can? Government is the only option, though this unqualified conclusion does not solve the real problems of government failure in important areas like efficiency, corruption and the diversion

of scarce capital into unproductive usage to the detriment of national economic growth. These considerations of finance take us to the heart of the concept of government failure, and Smith had plenty to say about the reality of such failures.

Setting aside the costs of erecting public works, Smith considers how they are to be maintained (a major weakness in today's developing countries). Roads and bridges need regular maintenance and repairs, canals and harbours need dredging to be kept navigable and the beneficiaries of such works should be charged small tolls for the use of them. Carriages using toll roads and bridges can be charged by their weight (WN 724) (though he also proposes charging according to the value of their contents to make the rich contribute 'in a very easy manner to the relief of the poor') (WN 725), navigable canals by the number and tonnage of the lighters, and harbours by the tonnage loaded onto, and unloaded from, ships sheltering in them (WN 724).

To these public works, Smith adds the coinage which 'defrays its own expence' and the post-office which 'over and above defraying its own expence, affords in almost all countries a very considerable revenue to the sovereign' (WN 724). In all these cases, the beneficiaries identify themselves by using the facilities with their expenses defrayed by moderate charges. It seems, he notes, 'scarce possible to invent a more equitable way of maintaining such works' (WN 724–725). Final consumers, the ultimate beneficiaries, should pay for the tolls and these too are equitable.

Because of the direct connection between the need for a road, bridge, canal or harbour and the trade carried on them, they should be built only where they are required with 'their grandeur and magnificence' determined by what 'commerce can afford to pay'. Capital diverted to their construction should not be wasted on roads serving little commercial purpose or 'where nobody passes'. Public works funded by 'other revenue than that which they themselves are capable of affording' are wasteful (WN 725).

Private persons may be driven by personal profit to keep the road or canal properly repaired and maintained, and public commissioners may neglect that which is not theirs, depending on their sense of public duty. It could go either way. Public commissioners could dissipate tolls in 'ornamental and unnecessary expenses' while letting the 'essential parts of the work...go to ruin' (WN 725–726). Private proprietors of a high road 'might neglect altogether the repair of a road, and yet continue to levy very nearly the same tolls' necessitating that the road 'should be put under the management of commissioners or trustees' (WN 726). Smith

was not dogmatic about these issues. Utility, not principle was decisive here as elsewhere, and the decision would turn on which management works best or 'least bad' in the different circumstances and cases.

A different problem arises from public management: the diversion of their surplus revenues over costs to meet the 'exigencies of the state'. Few governments can resist the temptation to invent new ways of augmenting and spending their revenues. Road tolls suffer from private owners and government commissioners raising them for general revenue or profit, with both agencies repairing the roads inadequately and both acting as a 'very great incumbrance upon' the inland commerce of a country (WN 727–728). The difference between incompetent private operators of turnpikes and incompetent government operators is that the private operators can be replaced but it is more difficult to compel government to spend the toll revenues appropriately, and the greater the revenues raised by the government-appointed 'trustees', the greater the difficulty of altering their behaviours (WN 729).

Smith's tirades against monopolies in any form implied a need for vigilance, which implied intervention by agencies of the state, to observe, evaluate and decide what if anything had to be done to prevent them being established or operated and to prevent monopolies occurring by default or carelessness. Interventions were to be preventative; nobody would be told how to invest his stock or labour, only that he could not act non-competitively. There is no doubt that competitors seek ways to reduce competition and, unless their conduct is watched, their self-interest inevitably turns them to eliminating or deterring competitive rivalry. To police a country's competitive economy requires the availability of instruments of intervention (legislation, inspection, policing, law courts and justice) as well as the political will and intention to allow justice to take its course.

In addition, the duties of the sovereign introduced into Smith's narrative specific and deliberate purposes requiring state funding. The defence sector was a serious and expensive business, and was getting more so each decade (WN 798). Justice provided publicly funded employment for the courts and their officers (clerks, messengers, judges, sheriffs, prosecutors, police, jailers and executioners) and private funding for lawyers, solicitors, barristers, advocates, legal scribes and clerks. The expenses of justice were bound to grow larger with the rapid increase in the number of Acts of Parliament towards the end of the century.

If Smith's modest educational reforms had been put into effect the annual educational budget would have grown significantly. 'Little

schools' across the land meant a large increase in expenditure on buildings and on wages for at least one teacher per 'little' school. It was, of course, a century or more before national compulsory schooling commenced (Blaug, 1975 in Skinner and Wilson, 1975, 568–599).

## Public debts

Smith's approach to public debts, raised, maintained and funded by government taxation and borrowing, is not often taken note of in modern discourses. The subject looms larger in modern economics because public debts are now an enormous element in public finance, sometimes looming so large as to cause severe problems for the economy and, occasionally, defaults on international debts. It was of concern to Smith in his analysis of mercantile political economy, to which he applied his usual historical approach.

In pre-commercial societies, when there were few or no manufactured luxuries to be purchased, the rich person had limited options to disperse his surplus agricultural products above his own limited consumption. The surplus consisted of 'plain food and coarse clothing, in corn and cattle, in wool and raw hides', and all he could do with such surplus items is 'feed and cloathe nearly as many people as it will feed and cloathe'. He could spend it in 'hospitality' among favoured retainers, serfs or tenants, and in entertainment like 'cock-fighting'. Given the multi-generational survival of the 'great land-holders', Smith took this as a sign that each generation tended to live within their means. They sold what little they did not distribute and hoarded the revenues. Social norms frowned on lending at interest (usury), so this aspect of their finances was socially inefficient (WN 907–908). Sovereigns had the same problem as their great lords – they had 'scarce any thing' to spend their surpluses upon 'but bounty to his tenants and hospitality to his retainers' and to add to their 'treasures' (WN 908).

The rougher times that countries faced with jealous and covetous neighbours, claims to thrones by superior lineage and fears of pre-emption by ambitious nearby sovereigns gave way to wars. Whereas peace produced a 'want of parsimony', war required the burdens of debt to manage the switch to war fighting. Smith estimated that the expense of war cost three or four times more than maintaining a defence force in times of peace. Moreover, because it took time ('ten or twelve months') to raise taxes above current levels, there was a short-term need to borrow the money to conduct a war when it broke out; waiting a year was not an option for the army to 'be augmented', the fleet to 'be fitted out,

and the garrisoned towns to be furnished with arms, ammunition and provisions' (WN 909).

Commercial societies had greater access to borrowed funds: 'a country abounding with merchants and manufacturers...necessarily abounds with a set of people who have it at all times in their power to advance, if they chuse to do so, a very large sum of money to the government' (WN 910). The confidence that disposes 'great merchants and manufacturers' to 'trust their property to the protection of a particular government' also disposes them 'to trust that government with the use of their property'. And participation in such a loan adds to their security because it is of lower risk in normal times than lending to other merchants. However, for governments with such access to funds it reduced the pressure to be parsimonious and inclined to save (WN 910–911).

The habit of borrowing was seductive because it was a convenient alternative imposing additional taxes to pay for contingencies in times of rising international tensions, which could cause widespread 'disgust' among the population over a drift to war. Absent direct and the visible costs of a war, people feel 'scarce any inconveniency from the war' and they 'enjoy, at their ease, the amusement of reading in the papers the exploits of their own fleets and armies', which produce 'a thousand visionary hopes of conquest and national glory' (WN 920).

Smith's analysis showed how countries drifted into ever-greater debts from borrowing. Money lent to governments in effect transfers claims on the maintenance of productive labour to unproductive labour ('to be spent and wasted'), and if this transfer becomes significant by being 'withdrawn from certain employments in order to be turned to others' (WN 924), it 'no doubt hinders more or less the further accumulation of new capital' (WN 925). One disadvantage of funding war expenditures by taxation rather than borrowing was that the people felt the 'complete burden' of war when it starts and while the war continues, and would 'soon grow weary of it'. This might have the effect of people choosing carefully before committing to 'wantonly calling for [war] when there was no real or solid reason to fight for' (WN 926).

The original source of the resort to borrowing was the inescapable need to augment insufficient public taxation to meet the need to fund ever-increasing defence expenditures. From his understanding of what were likely to be continuing and increasing requirements, Smith turned his attention to the spending of additional revenue. If defence was to be a major requirement, it was natural to examine upon what the revenue was spent. He spotted the anomaly that the British Empire was defended at a cost which was passed on to the British public, while the theatre in

which wars were fought were located abroad, and the overseas British populations did not contribute to the costs of wars to protect them from threats and intrusions by foreign European powers, primarily France and Spain and, earlier, east of the Cape of Good Hope, by the Dutch.

Smith's remedy was to spread the burden of taxation to the whole of the empire. This immediately ran up against a constitutional problem, in that the British 'constitution' did not admit representation from the colonies (nor from Ireland until 1801). He had already alluded to the possibility that the colonies should have representation in proportion to their taxation contributions (WN 622–627) and noted that 'the private interest of many powerful individuals' and the 'confirmed prejudices of great bodies of people seem' at present to oppose so great a change, and these obstacles 'may be very difficult, perhaps altogether impossible, to surmount' (WN 633–634). Because of this, he speculated that the proposal to 'extend the custom-house laws' to the colonies should be accompanied with a proposal, 'as in justice it ought to be, with an extension of the freedom of trade'. This would create 'immense internal markets for every part of the produce of all of its different provinces', which would 'soon compensate both Ireland and the plantations, all that they could suffer from the increase of the duties of customs' (WN 935). It would produce revenues that in a few years could 'discharge the whole debt' and thus 'restore completely the present debilitated and languishing vigour of the empire' (WN 938).

Smith arrived at this position from his critique of mercantile political economy, in which the dominance of the mercantile relationship with the colonies was a major factor. Events in America offered the opportunity for undoing the American economic burden of diverting British capital into 'unnatural' investments to the detriment of 'natural' capital accumulation. Others came to a similar position favouring disengagement, though for different reasons, such as Edmund Burke ([1775] 1981), who advocated conciliation, and Josiah Tucker ([1774] in Schuyler, 1931), who advocated quitting the American colonies.

Smith considered his own proposal to be eminently justified because the debt was contracted to secure for the 'protestants of Ireland' the authority they enjoy 'in their own country' and to which 'several colonies of America' owe 'their present charters' and the 'liberty, security, and property which they have ever since enjoyed'.



# 14

## Adam Smith's Legacy

### Introduction

Adam Smith's legacy has attracted a great deal of counterfeit baggage that has little to do with what is recognisably his own. Separating his legacy from that attributed to him is a task in itself and not a little controversial (Kennedy, 2005).

Rather than writing a comprehensive account of his legacy, I have selected two areas of it: first, to what extent was Adam Smith an exponent of 'laissez-faire', which is still important today because it demarcates two modern schools of political economy; and second, what were his views on the redistribution of incomes to relieve tensions between the inequalities of poverty and wealth, which is surely still a 'big issue' in the twenty-first century?

### The end of laissez-faire

Laissez-faire is associated, wrongly, with Adam Smith, whether as a compound hyphenated adjective or as a noun phrase. Jacob Viner (1892–1970) [1928] simply by noting the evidence in *Wealth of Nations* (Rosenberg, 1979) showed that Adam Smith was far from a laissez-faire ideologue. Laissez-faire had more to do with the nineteenth-century 'Manchester School' and their descendants than with Adam Smith (Hirst, 1903). Viner ([1928], 126, 133–134) observed, with characteristic sardonic wit, that 'traces of every conceivable sort of doctrine are to be found in that most catholic book, and an economist must have peculiar theories indeed who cannot quote from the *Wealth of Nations* to support his special purposes'.

Smith identified a fairly large legislative agenda for restoring or initiating natural forms of liberty, and he outlined what was wrong with the

mercantile economy. Much needed to be done, including abolition of the Statute of Apprenticeships, repeal of primogeniture and entail laws to allow free trade in land, domestic free trade and abolition of local customs taxes, and free trade in foreign commerce, through the abolition of the duties, bounties and mercantile protections, and the chartered trading companies. Viner noted Smith's central theme 'that these various restrictions and regulations are objectionable either because they operate to keep commerce, labour, or capital from following the channels in which they would otherwise go, or because they attract to a particular species of industry a greater share of the factors than would ordinarily be employed in it'. In these cases, there is an inherent conflict between private and public interests, because the interference by government 'instead of promoting, hinders, though it does not necessarily prevent, the attainment of prosperity', whereas 'under the system of natural liberty' there would be harmony (Viner, [1928], 133–134).

Viner, controversially in my view, concluded that *laissez-faire* 'had been achieved' in Britain, with the caveat that unfortunately 'the greatest of his victories, the establishment of free trade in foreign commerce, faced its first serious threat in sixty years' (i.e. since 1868) (Viner, [1928], 134; cf. Paul, 1980). *Laissez-faire* had become a political and campaigning ideology in the nineteenth century, but did not conquer widely in Europe. Campaigns for the 10-hour bill and for restrictions on child labour, and the attempted reforms of the Factories Inspectorate, were indicative that *laissez-faire* did not serve the interests of labour (I am grateful to Patrick O'Farrell for information on Leonard Horner). Viner concluded that Smith acknowledged many cases where there were necessary exceptions to the doctrine of natural harmony, which he did not make explicit. Ignoring the many exceptions, and using selective quotations, it was inevitable that an incomplete rendering of Smith's thinking gained currency from mid-twentieth century.

Smith recognised that conflicts between private interests and those of the general public undermined the case for *laissez-faire*. That free markets would resolve these conflicts with the least repulsive of side effects compared to other forms of intervention was unconvincing in practice. Where the line between market voluntarism and state compulsion should be drawn constitutes a perennial and still unresolved question. Smith's works were both a systematic treatise on 'social philosophy' and 'tract[s] for the times' (Viner, [1928], 139). Smith sought to persuade legislators and those who influenced them to terminate many existing legislative interventions, and he left 'to the wisdom of future statesmen and legislators to determine' what should replace them (WN 606).

Generally, he preferred government to curb interventions that disturbed the natural order and to encourage those that supported it (Viner, [1928], 141). He did not concede any duties to government that they pretend 'to watch over the economy of private people' (WN 346), nor was it likely that the 'government of England' could conduct a 'parsimonious administration', given that in peacetime it 'generally conducted itself with ... slothful and negligent profusion' and in wartime has 'constantly acted with all the thoughtless extravagance' that a government is apt to do (WN 818).

To the accepted roles for government (defence, justice, public works and institutions, and the 'dignity of the sovereigns'), Smith added others of a more controversial nature. For some advocates of laissez-faire, it is an issue of fundamental principle and for others a boundary dispute. Among these roles, Smith identified the following:

- the Navigation Acts, blessed by Smith under the assertion that 'defence, however, is of much more importance than opulence' (WN 464);
- Sterling marks on plate and stamps on linen and woollen cloth (WN 138–139);
- enforcement of contracts by a system of justice (WN 720);
- wages to be paid in money, not goods;
- regulations of paper money in banking (WN 437);
- obligations to build party walls to prevent the spread of fire (WN 324);
- rights of farmers to send farm produce to the best market (except 'only in the most urgent necessity') (WN 539);
- 'Premiums and other encouragements to advance the linen and woollen industries' (TMS 185);
- 'Police', or preservation of the 'cleanliness of roads, streets, and to prevent the bad effects of corruption and putrifying substances';
- ensuring the 'cheapness or plenty [of provisions]' (LJ 6, 331);
- patrols by town guards and fire fighters to watch for hazardous accidents (LJ 331–332);
- erecting and maintaining certain public works and public institutions intended to facilitate commerce (roads, bridges, canals and harbours) (WN 723);
- coinage and the mint (WN 478, 1724);
- post office (WN 724);

- regulation of institutions, such as company structures (joint-stock companies, copartneries, regulated companies and so on) (WN 731–758);
- temporary monopolies, including copyright and patents, of fixed duration (WN 754);
- education of youth ('village schools', curriculum design and so on) (WN 758–789);
- education of people of all ages (tythes or land tax) (WN 788);
- encouragement of 'the frequency and gaiety of publick diversions' (WN 796);
- the prevention of 'leprosy or any other loathsome and offensive disease' from spreading among the population (WN 787–788);
- encouragement of martial exercises (WN 786);
- registration of mortgages for land, houses and boats over two tons (WN 861, 863);
- government restrictions on interest for borrowing (usury laws) to overcome investor 'stupidity' (WN 356–357);
- laws against banks issuing low-denomination promissory notes (WN 324);
- natural liberty may be breached if individuals 'endanger the security of the whole society' (WN 324);
- limiting 'free exportation of corn' only 'in cases of the most urgent necessity' ('dearth' turning into 'famine') (WN 539); and
- moderate export taxes on wool exports for government revenue (WN 879).

Viner concluded, unsurprisingly, that 'Adam Smith was not a doctrinaire advocate of laissez-faire' (Viner, [1928], 153). That he needed to write this 150 years after *Wealth of Nations* to remind twentieth-century readers conclusively that it contained detailed and specific evidence of advocacy of breaches of laissez-faire, popularly attributed to him, suggests that a substantial drift away from important elements of Smith's legacy had taken place among early-twentieth-century economists. How could Smith be so closely linked with laissez-faire policies when he so clearly and explicitly was not? (Lubasz, 1995, 45–69; cf. Rosenberg, 1975, 377, 1979, 19n, 20).

So where did the idea of laissez-faire originate? The words were first uttered by a merchant in the French dirigiste regime of M. Jean-Baptiste Colbert (1619–1683), the French minister of finance under Louis XIV. The merchant's name was M. Le Gendre, described (MacGregor, 1949,

quoting Oncken, 1886) as a 'most sensible and plain spoken' merchant who responded to Colbert's question, 'Que faut-il faire pour vous aider?' (what do you want from me to assist you?) with 'laissez nous faire' (leave us alone). Colbert's regulation of merchants was notorious for its oppressive licensing, inspection and control, which personified French bureaucracy at its worst (plus ça change...). Jean Vincent, Marquis d'Argenson (1694–1757) – an active promoter of economic theory and a member of the world's first economics club (salon), the Club d'Entresol (1726) – turned Le Gendre's 'laissez nous faire' (leave us alone) into 'laissez-faire' (leave alone) and circulated them in manuscripts around the French intelligentsia. To govern better, he said, one must govern less. The true cause of the decline of our manufactures, he declared, is the protection we have given to them. Interestingly, However, François Quesnay (1758), the leading Physiocrat, did not include laissez-faire in his *General Maxims of Government*.

George Whatley (1774), a contemporary, friend and correspondent of Benjamin Franklin used 'Laissez-faire' in an English text. Keynes reported that Jeremy Bentham presented 'the rule of laissez-faire, in the shape in which our grandfathers knew it', and adapted it into the service of the Utilitarian philosophy. For example, in *A Manual of Political Economy* ([1843], 1952–1954), he writes, 'The general rule is that nothing ought to be done or attempted by government; the motto or watchword of government, on these occasions, ought to be – Be quiet. The request which agriculture, manufacturers and commerce present to governments is as modest and reasonable as that which Diogenes made to Alexander the Great: "Stand out of my sunshine."'

From Bentham's advocacy of his English version of laissez-faire ('leave alone'), we arrive at Keynes's 1926 advocacy of something neither laissez-faire nor state socialism:

Let us clear from the ground the metaphysical or general principles upon which, from time to time, *laissez-faire* has been founded. It is *not* true that individuals possess a prescriptive 'natural liberty' in their economic activities. There is no 'compact' conferring perpetual rights on those who Have or on those who Acquire. The world is *not* so governed from above that private and social interests always coincide.

It is *not* so managed here below that in practice they coincide. It is *not* a correct deduction from the Principles of Economics that enlightened self-interest always operates in the public interest. Nor is it

true that self-interest generally *is* enlightened; more often individuals acting separately to promote their own ends are too ignorant or too weak to attain even these. Experience does not show that individuals, when they make up a social unit, are always less clear-sighted than when they act separately.

(Keynes, [1926] 1952, 312–322)

Keynes' caution, rather than acting in accordance with an absolute, unshakable principle, one way or the other, in a choice between absolute 'laissez-faire' versus absolute state socialism, is something I feel Smith could have gone along with (Thirlwall, 1978). Sweeping laissez-faire, however, is not even a pretend option in current circumstances and socialism is discredited.

Smith's legacy, however, leaves room for an extension of state-funded, and possibly state-managed interventions, such as in health expenditures that he ever so lightly touched upon (WN 787–788). Smith in all such discussions would ask today's generations to answer 'To what ends are your proposed extensions of state funding aimed?' and 'could they be undertaken or managed a different way by private organisations?' The Smithian guiding measure, as always, would be 'what worked' and not abstract 'principle'. The acceptability of the answers would turn on the 'merits of the detail' and not whether it expanded or contracted the boundaries between private versus public sectors, especially as the constraint, highlighted by Smith that private individuals could not raise the huge capital sums involved in quite modest public works and institutions, no longer applied.

An important element in Adam Smith's legacy is that of natural liberty, mentioned several times in *Wealth of Nations*, and some concoct a connection or, worse, an identity between these two quite different ideas (Grotius, [1625]; Pufendorf, [1729]; Hutcheson, [1755]).

Natural liberty has a far larger role in his moral philosophy than as a mere synonym for laissez-faire economics. Natural law was about the fundamental individual human right to protection by the negative virtue of justice from the depredations by others on their person, reputation and estate, and his 'right of trafficking with those who are willing to deal with him' (LJ 8). It was the basis by which all societies and their political regimes were judged. It was not linked to any specific society, regime or economy. Laissez-faire was not a policy with which he could, or did, agree wholeheartedly. His suspicions, to put it mildly, of the likely (and well-known actual) conduct of 'merchants and manufacturers' are clear and often stated. Smith gives many examples of breaches of natural

liberty by governments persuaded by the 'sophistry' of 'merchants and manufacturers' to enforce their monopoly privileges. It was not enough to set all trades free by righteous declamation; the justice system was needed to prevent 'merchants and manufacturers' reverting to, or introducing, the misconduct for which they were famous. This is the inner fallacy of laissez-faire; it requires governments to enforce it, and also to monitor the behaviour and activities of state-funded agencies that act monopolistically.

Smith, like Hume, followed the Scottish philosophical tradition in asserting that 'man by nature was a creature who could not live without society' and, therefore, 'could not live without laws'. Man is a legal person with 'rights' that 'must be defined and protected by public law' and as such his primary concern is not 'the art of ruling so much as the rational pursuit of his private concerns and interests' (Teichgraeber, 1986, 21). Smith wrote of Grotius as being the 'first who attempted to give the world anything like a system of those principles which ought to run through, and be the foundation of the laws of all nations; and his treatise of the laws of war and peace, with all its imperfections, is perhaps at this day the most complete work that has yet been given upon this subject' (TMS 341–342; LJ 397, n1).

He described what he meant by natural liberty, while, notably, setting out the legitimate roles of the state (not markets!), which in *Wealth of Nations* contains a surprisingly large-state agenda, with the corollary that funding it would amount to an inescapable requirement for a higher level of taxation revenue and borrowing. Smith, in this case, used ideas about natural liberty to outline the duties of government in respect of justice, not laissez-faire, and judged its performance against the standard of natural liberty, which was applicable in law as a standard for 'those principles which ought to run through and be the foundations of the laws of all nations' (LJ 5) and to any form of government and not just a particular mode of subsistence. Smith's application of natural law was not a libertarian agenda, though neither was it a 'big' government agenda. Smith, in fact, confirmed that his notion of natural liberty was consistent with significant public taxation and regular government expenditures, ideas not normally associated with advocates of laissez-faire.

In his critique of the French Physiocrats, he focused on their strategic error of 'preferring agriculture to all other employments', and in order to promote it '[they would] impose restraints upon manufacture and foreign trade'. In this manner, should a French government adopt their policies, they would 'act contrary to the very end they propose, and

indirectly discourage that very species of industry which they mean to promote' (WN 686). And from which error laissez-faire on its own did not offer a remedy.

Smith writes that 'the obvious and simple system of natural liberty establishes itself of its own accord'. Perfect liberty is not, therefore, a previous or historical state of society before it was corrupted by encroachments on its institutions; it is a hypothetical social state established 'of its own accord' if systems of 'preference or of restraint' are 'completely taken away'. It is an option that was obtainable if 'things were left to follow their natural course' and not interfered with by contrary actions or policies imposed by fiat or by the writ of government, acting either on its own account or on the influence of special interest groups, or powerful individuals among merchants.

Smith states that for 'things' to 'follow their natural course' it was essential that 'there was perfect liberty' (WN 116, 135; cf. WN 131), but in Europe 'nowhere' is there 'perfect liberty' (WN 135). Natural liberty is, therefore, an aspiration, not an historical or a known condition; it is a benchmark and not something that had ever existed. But because all governments intervene to some degree or other; all societies, therefore, are not 'at perfect liberty', and some are not so to an extremely high degree.

It is always sobering to remember that Adam Smith, primarily, was a moral philosopher. He was well versed in natural law and natural jurisprudence, and he expected most of his readers would be comfortable when relating them to his comments on political economy. His *Lectures* opened with a discussion on 'those rights that belong to a man as a man' (LJ 8) and which expose him to injury in respect of his person, his reputation and his estate. He refers his students to Samuel Pufendorf's [1672/1691] writings, and draws the 'right of trafficking with those who are willing to deal with him' ('libiri commercii', or free commerce) within the ambit of basic rights. Perfect rights are those 'which we have a title to demand and if refused to compel an other to perform', and imperfect rights are those that 'ought to be performed to us, but which we have no title to compel them to perform' (LJ 9). We can be injured in our estate, which we possess or which is owed to us by loan or contract. Smith told his students that 'the first and chief design of all civill governments, is... to preserve justice amongst the members of the state and prevent all incroachments on the individualls' in it, from others of the same society. That is, to maintain each individual in his perfect rights. Justice is violated whenever one is deprived of what he has a right to and could justly demand from



others, or rather, when we do him any injury of hurt without a cause. (LJ 8–9)

And Smith demonstrates his grasp of the details of the legal minutia in the literature of jurisprudence and shows by his references throughout his works to natural and perfect rights that they were deeply ingrained in his thinking (Haakonssen, 1981, 99–134; Lieberman, 2006, 214–245). The rights of ‘a man as a man’ were independent of the mode of subsistence and the particular regimes of governance associated with them, precisely because they were rooted in the practice of jurisprudence from within the ‘specific historical circumstances of their emergence and subsequent development’ (Lieberman, 2006, 225) through the four ages of mankind (LJ 14–16; Haakonssen, 2001, 52–71).

In *Wealth of Nations*, we see a pattern against which he judges mercantile policies as breaches of natural liberty, in addition to their economic content, particularly in their roles in distorting capital flows. In his discussion of the exclusive privileges of the town guilds, which restrained competition by reserving rights of apprenticeship and by legitimising market restraints mistakenly devolved as a local power to the very bodies that had an interest in narrowing the market in their localities, we see the dilemma of natural justice. The consequences over the 200 years that followed were predictable, whatever the original intention; they had the effect of preventing labour that would otherwise enter a profession from doing so and thereby deprived people of employment (WN 135–159). Smith links this outcome to a person’s liberty under natural law (WN 138), and he follows with the proclivity of ‘people of the same trade meeting together’, noting that ‘It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice’ (WN 145). In similar form, when discussing the application of the 1662 Settlement Laws in Britain, he wrote, ‘To remove a man who has committed no misdemeanour from the parish where he chuses to reside is an evident violation of natural liberty and justice’. This fully exposed the problem that the standard of natural law that he and others outlined was not applied in this and many other cases because people were ignorant of what liberty meant:

The common people of England, however, so jealous of their liberty, but like the common people of most other countries never rightly understanding wherein it consists, have now for more than a century together suffered themselves to be exposed to this oppression without a remedy.

(WN 157)

He acknowledged that though 'men of reflection' had complained about the validity of the law of settlements under natural justice, it had not yet led to 'any general popular clamour', though, he noted, scarce a poor man under 40 years of age had not 'felt himself most cruelly oppressed by this ill-contrived law of settlements' (WN 157). This sort of passage may have caused concern among the legal establishment in 1793, who interviewed Dugald Stewart for signs that Smith's writings may have incited labourers to cause public disorders (Rothschild, 2001, 52–71).

He defended the 'violation' of liberty, in the case of the law preventing banks from issuing low-denomination promissory notes, though the fiction of presenting a pound note at the Bank of England and receiving 'one pound' in return is hardly noticed by millions of users, whereas in the eighteenth century the promise was for the bank to pay on demand the note's denomination in gold or silver. The temptation to issue more notes than the bank's gold or silver reserves could pay on demand endangered confidence in the banking system, with its far wider consequences for the economy.

'Such regulations may, no doubt, be considered as in some respect a violation of natural liberty. But those exertions of natural liberty of a few individuals, which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments; of the most free, as well as of the most despotical' (WN 324). Interestingly, also, he placed the burden of overriding individual liberty on both free governments and those that were 'the most despotical'.

He pressed the case for the application of natural liberty wherever it helped his critique of mercantile political economy. One notable example of this was his discussion on the restoration of freedom of trade and his concern that a 'great number of people' would lose their jobs 'in their ordinary employment and common method of subsistence' and also face restrictions under existing laws that favoured the corporate trades that administered the apprenticeship statutes. His proposal drew a parallel to the liberties to be exempted from these restrictions accorded to discharged soldiers and seamen by various sovereigns since 1660 (WN 470–471). He applied the same test of natural liberty to his proposal to replace an existing practice in the corn trade and the usual government response to dearth, which he argued threatened to turn dearth into famine: 'The law, however, which obliged the farmer to exercise the trade of a corn merchant, was by far the most pernicious of the two' (WN 530–531). Smith certainly preferred adherence to natural liberty, but he did not go so far as Quesnay in regarding natural liberty

as a precondition in the behaviour of government for the economy to function (WN 674).

This is more than a difference of emphasis. It followed from the belief that though perfect liberty and perfect justice 'ought to run through, and be the foundation of the laws of all nations', they most decidedly had not done so. While eminently desirable, they were not absolutely essential in a pure form. The slow and gradual improvement in living conditions compared to previous centuries, to which Smith drew attention, had continued through different political regimes without evidence of full-scale 'perfect liberty and perfect justice', which, mixed with the Physiocratic policies towards manufacturing and despite their interesting concepts of the circular flow of income in *Le Tableau*, meant it was obvious to Smith that a different, more modest reform strategy was viable. He expressed this in his firm dismissal of the belief that 'freedom of trade' would ever be restored in its entirety in Great Britain as 'utopian' (WN 471), and his dismissal fully informs his more gradualist approach and shows why he was sceptical of the laissez-faire policies of some of Dr Quesnay's supporters. Natural liberty was important, but justice was essential in commercial society. He summarised his firm views on the role of justice and indicates clearly where he set his priorities for the spread of opulence:

Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government.

(WN 910)

## What about the poor?

One of the major debates in the twenty-first century in the richer countries concerns the unresolved problems of income inequality, especially for the poorest people in rich societies. This is not a new problem; it has a long history, and it is not caused by the failure of commercial consumer societies, but by their very success, because before the age of commerce, there was universal poverty. Social welfare in modern poorer societies is subsumed under the general poverty prevailing across society, except for the richest elites in them. Poor societies do not afford social welfare expenditures on anything like the scales practised by some European governments, and as it is not settled as to which particular scheme (all-state, part-state, part-private and/or all-private provision) is appropriate or optimal, or even viable, the subject lends itself to

wide differences of opinion, approach and politics (see Winch, 1996, 196–222).

Where does Adam Smith stand in these controversies? To pose the question leads to not very helpful answers. Bluntly, social welfare, or distributive justice, had quite different meanings in the mid-eighteenth century than since, and Smith was only slightly different to contemporary views that addressed a quite different debate. Modern versions of distributive justice were not on the agenda in the early commercial economies. Direct redistribution via the state to relieve poverty was not an idea whose time had come, though redistribution was applied in moral teachings about private charity, alms giving and acting to relieve severe distress. This was also a time when strong social views determined that society needed to be highly structured, and poor people were ordained to remain poor and the rich people were ordained to remain rich (Baugh, 1983, cited in Fleischacker, 2004b, 64–65).

Adam Smith was one voice challenging such tenets, though they were widespread and endorsed by religious authority. People who took a different stance were far more common after Smith died and in the nineteenth-century, than they were before he was born. Samuel Fleischacker provides a concise history of the meaning of distributive justice as it was in the minds of Plato, Aristotle, Augustine, Aquinas, and the Christian tradition, Grotius and Pufendorf, and what it became after Smith (cf. Milgate and Stimson, 2009).

Smith writes that ‘perfect rights’, or ‘commutative justice’, can be enforced within a system of jurisprudence, but ‘distributive justice’ or ‘imperfect rights’ are rather a ‘system of morals as they do not fall under the jurisdiction of the laws’ (*LJ* 9). Giving money to the poor is a virtue, but not one that an individual can be punished for. Up to the late eighteenth century, there was no doubt in philosophy, or in practice, that a person’s property could not be sequestered for the purpose of giving it to somebody else. To do otherwise, even for good reason, would be an injustice, without which civil society would be at risk. Whether this would be acceptable to readers today is not relevant to the fact that it was not acceptable in law or in moral philosophy when Smith was alive. But Smith’s adherence to the traditional consensus in public life was not unqualified. He moved the boundary on a bit too.

Smith entered the debate in a distinct context. The age of permanent poverty could end but only if current trends continued; by extrapolation, abundance on a scale seen never before by the mass of the people was a tantalising prospect, though nowhere near a reality. The existing imperative of no redistribution as there was precious little to redistribute

would be weakened if opulence prevailed, as Smith thought it would. And this optimism emerged from all that he was thinking about in his four ages of mankind, which till then had been a history of subsistence for most people.

It was the appearance of a surplus over subsistence in shepherding and agriculture that marked the change in circumstances from the appearance of property, which at first created the opportunity for a richer minority to escape from the equality and limitations of low per capita subsistence. The history of the propertied rulers differentiates the property-based societies from the societies of egalitarian property-less hunter-gatherers. The social evolution of commerce from property and the division of labour created the resources for a general advance from poverty towards opulence for wider segments of the population than hitherto had ever been possible.

The age of commerce in the unique circumstances of Britain, with stable government under the Hanoverian constitutional monarchy, a firm system of justice and the rule of law, and with modest but persistent growth, raised hopes that there was a way forward from the permanent poverty of the majority of the population. The gross inequality of incomes and circumstances from participation in the division of labour and commerce was a heavy price to pay, but it was the only means for the descendants of the poor to escape from their predecessors' poverty, a prospect manifestly denied to the egalitarian societies of hunter-gatherers. The savage poor in America, Africa and Australia had not discovered the route to the spread of opulence; they remained in the age of hunting. In the more recent successor ages of shepherding and farming from around 8000 years ago, the plight of the poor, measured on the historical norms of per capita subsistence, did not fare much better than the poor had ever fared.

In these conditions, beneficent individuals with wealth to share – guided by moral views of just desert, or of Christian charity towards God's children, in the spirit of 'generosity, compassion, and foresight' to 'do good to others' – showed strong moral attributes, but in the scale of things, their gestures were palliatives rather than remedies. They merely scratched the surface, though welcome enough for the recipients. Saints could give away all they possessed and join the pitiable poor; it made no difference to the numbers of poor in need of pity. Beyond this, the morally good had nothing to offer (I ignore their spiritual gains) as a solution to the continuing deprivations of an absence of wealth, which, as always for Smith, were counted as an absence of 'the necessities, conveniences, and amusements of life'. While classical

moral philosophers debated beneficence within the strict format of voluntarism, they relegated 'distributive' justice according to the principle of 'merit' (Fleischacher, 2004b, 19), which rewarded with 'honour or political office or money' those selected in 'strict proportion to his or her merits'. Their debates, literally, were worlds away from modern debates on income redistribution and the appropriate tax transfers required to meet even modest redistributions to the poor.

Smith did not discuss the alleviation of the poor directly and this should surprise nobody. He certainly had a lot to say about the condition of the poor, about their significant contribution to society, including in contrast to the indolence, frivolity and waste occasioned by those 'above' them in the scheme of things. Downtrodden, despised and 'buried in obscurity', the labouring poor and their families supported everybody above them in society's rankings, in return for 'a very small share' of annual output per capita, and the common labourer 'bears on his shoulders the whole of mankind' which thrusts him 'down into the lowest part of the earth' for his pains (*LJ* 341).

Smith abided by his own dictum that a philosopher should 'do nothing but observe everything'. He put forward no plans, schemes or programmes to ameliorate the condition of the poor in the traditional manner. His purpose was indirect because he was never a 'man of system' (*TMS* 233–234). Attempts to relieve poverty meant somehow providing the wherewithal to feed, cloth and shelter the poor who lived in hovels. The celebration of poverty in the manner of religious aesthetics was not the answer. Transfers through government taxation were not on the agenda and therefore not part of an answer.

Smith's answer relied on drawing the labouring poor into employment to share in the annual consumption of the 'necessaries, conveniences, and amusements of life'. This could best be done by continually increasing the annual net capital available for productive purposes, from which there would be a continual increase in employment. Limitations on capital formation that limited the growth of employment slowed the division of labour and specialisation along the supply chains, and inhibited the widening of markets. Only growth in the net product would overcome that constraint and competition among businesses for additional labourers would tend to raise wages and, in Smith's analysis, to depress profits, from employers having to pay higher wages to attract and retain labour and, from the resultant increased output, to lower unit prices to attract and retain customers (raising real wages).

This simple analysis was part of Smith's critique of mercantile colonial policy, which drew away capital from its 'normal' path in pursuit

of higher profits in colonial monopolies. The pursuit of profit has both a necessary growth inducing and a deleterious effect. The deleterious effect leads profit seekers to the divergence of their interests from that of the society they live in. The employers' penchant for monopolies, protection and 'conspiracies' to raise prices, cause them 'to widen the market and narrow the competition [which] is always in the interests of the dealers', to which Smith adds a passing observation that 'profits were always higher in the countries which are going faster to ruin' (WN 267). High profits are associated with both poor countries and new products, especially from new technologies. Richer countries are associated with lower profits, though these are 'compensated' by larger capitals producing larger total profits. Individual employers may see their profit rates fall in particular trades as a disappointment despite 'a great stock though with small profits, generally increases faster than a small stock with great profits' (WN 110).

The inverse applies to wages, suggesting that the 'liberal reward of labour', a particular target for Adam Smith, raises population growth (lower infant mortality and better health) and the productivity of labour (Winch, 1996, 11). As the economy grows, wages rise and profits fall, and opulence spreads slowly and gradually across society. It is from such processes that Smith expected the alleviation of poverty to be realised and continued, provided that revenues were not dissipated on private or public prodigality, and that net capital found its way to inducing productive employment.

To the extent that the passion for self-betterment drove savings and capital investment and that governments restrained their passion for intervention in domestic and foreign affairs, the perpetual spread of opulence could continue, if not perfectly (an unattainable ideal), at least sufficiently to leave a positive and lasting mark on society. It would also raise the per capita living standards, including those of the labouring poor and far beyond, and for longer duration to which alternative schemes, then and now, realistically aspired. Adam Smith's approach to the poverty problems of the labouring poor has proven to be robust against the alternatives.

And so it was proved in the history of the nineteenth and twentieth centuries. As real wages rose (Marx got that one wrong), opulence spread among the labouring poor compared to the subsistence levels of previous centuries. Of course, initial problems and dreadful working and living conditions came with the package; but in time increasing numbers of the poor moved from hovels not to palaces, but to what became industrial slums (and their descendants moved on to 'suburbia'). The

poorest, relatively, in twenty first-century Britain are incomparably better off than their eighteenth-century forebears, or if they have migrated into Britain, they are much better off than those they left behind.

Smith saw the result of grand-scheme plans and programmes to relieve poverty, some of long duration by the eighteenth century; perhaps the grandest of them all was England's Poor Law (1601). By an Act of Parliament, every parish was empowered to collect money from the richer members of the community, and distribute it to the indigent poor in their community. The guardians of the Poor Law funds, in practice, distributed according to their own criteria, which were heavily mixed with notions of 'deserving' and 'undeserving', and 'entitlement' (folk sayings like 'as cold as charity' were literally true). Itinerant poor families were discouraged from moving into another parish community, supported by the Settlement Acts (1661), which with more justice were the 'Discouragement of Settlement Acts'. What set out to relieve the poverty of the poor in each parish became inevitably a scheme to relieve the parish of the poor. Beyond Smith's time, the 'Speenhamland' system (1795), an income-subsidy plan linked to the price of bread and the number of children, added to the misery and loss of dignity of the poor. It also became an excuse to reduce the local wages of the working poor, so far as they affected an employer's costs. Though Smith did not live long enough to see the Speenhamland 'solution', he would not have been surprised at its longer-term negative effects.

Smith's income-transfer proposals were modest but fitted in with the changes brought about by expanding commerce. Fleischacker (2004b, 19) cites Gertrude Himmelfard's assessment of Smith's role in stating these modest suggestions:

[I]f the Wealth of Nations was less than novel in its theories of money, trade, or value, it was genuinely revolutionary in its views on poverty and its attitudes to the poor.

(Himmelfard, 1984, 46)

It is clear in several passages that Smith was mindful of the situation in which the bulk of the population lived. For much of his time in Edinburgh, he lived and mixed, as was the custom in that city, cheek by jowl with people from all different ranks in society. He walked up and down the High Street to and from the Custom House from 1778 to 1790. Close contact and friendly relations during his 'social hours' with large numbers of people ensured his direct awareness of the social conditions of the poor in Edinburgh, and he would also have seen plenty



of poverty when living in rural Fife. You get a feeling for Edinburgh during this time from James Boswell's 'Edinburgh Journals' (Milne, 2003). Perhaps, the most evocative paragraph in *Wealth of Nations* is from his debate against the prevalent notion that the lower ranks of the people should not be encouraged to aspire above their station by them earning higher wages that allowed them to dress in finer clothes than they ought to wear and which would incite their 'discontent'. Smith replies with his famous (and much quoted) statement that improving the lot of the poor majority was 'abundantly plain' that it can never be regarded as an 'inconveniency' and 'it is but equity' that those 'who feed, cloath and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves tolerably well fed, clothed and lodged' (WN 96).

That is the moral case he put for a higher share of the annual wealth of society going to the poorer majority, and this meant primarily creating employment for poor people and higher wages through growth. Wages came from employment and poorer people needed jobs to realise their 'self-betterment' goals. Smith saw expanding employment from commercial societies as the real and lasting anti-poverty programme that the country and the poor needed. Employment through wealth creation is the antidote to poverty.

His suggestion was to increase taxation on those with higher incomes, indicated by his preferences (in his maxims of taxation) that the tax burden be set 'as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state' (WN 825). In conditions of a fixed low amount of government expenditure, the more the rich paid, the less the poor had to contribute.

He favoured higher toll on roads and bridges 'upon carriages of luxury' than ordinary carts and wagons, to make the rich contribute 'in a very easy manner to the relief of the poor', who would pay less for their benefits gained from the carriage of goods about the country (WN 725). He also advocated a tax on the higher rents that richer people paid for their splendid houses, which would not be 'very unreasonable' because the 'rich should contribute to the publick expence, not only in proportion to their revenue, but something more than in that proportion' (WN 842). In all these recommendations for taxation, specifically on the consumption of richer families, he was conscious of their context, namely that 'there is no art which one government sooner learns of another than that of draining money from the pockets of people' (WN 861).

He also recommended a large-scale expansion of education facilities in every parish, noting the fact of the absence of education of girls (except

when they are 'taught what their parents or guardians judged it necessary or useful for them to learn') (WN 781), which should be treated as a comment on the prevailing practice, rather than an endorsement of it. We may also note that he referred to 'children' in general and not just to boys.

## Afterword

The main difference between Adam Smith's approach to political economy and the approach of modern model builders is that Smith attempted to root his theories on the mixture of human motivations within their historical and contemporary context, while modern economists built their models on the dominant simplicity of utility maximisation and the single dimension of the 'granite of self interest'. This presents an unbridgeable gap between the two approaches and encourages a selective search for seemingly similar-sounding quotations, which are in fact often referring to completely different contexts and historical circumstances.

I shall end by referring to two 'messages', possibly worthy of consideration, particularly by those who have descended from the peoples who embraced Smith's fourth age of commerce in one form or another.

Smith made a little noticed, cautious and perhaps prescient comment in respect of the relative powers of the countries that explored the globe, took 'possession' of distant lands and formed colonies, for their own aggrandisement, and how their recent ancestors treated the native inhabitants of the 'savage' countries.

Smith's detailed knowledge of those civilisations in North Africa (including Muslim Spain), the Near East and eastwards through to China was fairly limited. Not much attention is paid to the marauding powers that ran the Arab black-slave trade out of Africa for several hundred years (and just as awful as the European black-slave trade across the Atlantic), sending some of them all the way to China. His message, therefore, to those that abused their power over peoples in hunter-gatherer societies applies to all peoples, and not just to the Europeans that Smith knew about.

The armed strength of the Europeans, for example, allowed them to 'commit with impunity every sort of injustice in those remote countries'. Hereafter, he warned:

the natives of those countries may grow stronger, or those of Europe may grow weaker, and the inhabitants of all the different quarters of the world may arrive at that equality of courage and force, which by

inspiring mutual fear, can alone overawe the injustice of independent nations into some sort of respect for the rights of one another.

(WN 626–627)

If this ‘equality of force’ was not acknowledged politically, he suggested it would come about from economic progress following ‘that mutual communication of knowledge and of all sorts of improvements which an extensive commerce from all countries to all countries naturally or necessarily, carries along with it’. It is no exaggeration to suggest that international politics today demonstrate the import of what Smith warned about.

His other ‘message’ is a general one, and should have a special resonance with peoples in the British Isles (and for those powers that have replaced the British Empire). It is from the last paragraph of *Wealth of Nations* and addresses what for Smith and his contemporaries could be classed as the ‘Americas question’. Britain’s first empire in North America ended soon after 1776. The question was: what would Britain do after it ended? Smith advised as follows:

If any of the provinces of the British empire cannot be made to contribute towards the support of the whole empire, it is surely time that Great Britain should free herself from the expence of defending those provinces in time of war, and of supporting any part of their civil or military establishments in time of peace, and endeavour to accommodate her future views and designs *to the real mediocrity of her circumstances*.

(WN 947; emphasis added)

Adam Smith’s message about ‘the real mediocrity of her circumstances’, though ignored in Britain, and indeed in Europe, in the nineteenth and twentieth centuries, is still worth considering in the twenty-first century for all the reasons implicit, and occasionally explicit, in *Wealth of Nations*.

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