

Adam Smith: An Historical Perspective on the Wealth of Nations*

Introduction

In 1976 Bob Black delivered a lecture on the subject of 'Smith's Contribution in Historical Perspective'. The lecture was delivered on the occasion of the bicentenary conference held in Glasgow, and published in the same year. Black recalled that his brief was to review the ways in which Smith **as an economist** had been evaluated at various points in history, making the valid, but disturbing, point, that economists had tended to see Smith in the light generated by their own current pre-occupations, in terms of both policy and analysis (1976, p 62).

I

The two pillars of Smith's success may be represented by his contribution to economic analysis and the advocacy of free trade. Richard Teichgraeber has noted in this connection that there is 'no evidence to suggest that many people explored his arguments with great care before the first two decades of the nineteenth century' (1987, p 339).

In this context, Murray Rothbard recently complained that 'Smith's work was the reverse of coherent and systematic' to such an extent that his successors were set the task of forging a 'coherent' account 'out of the Smithian muddle' (1995, p 437). Salim Rashid offers an interesting comment in the same vein (1998). But Black's judicious conclusion is the more perceptive, suggesting that for Smith's early nineteenth century successors, the WN was 'not so much a classical monument to be inspected, but as a structure to be examined and improved where necessary' (op cit, p 44).

Black quoted Lord Robbins to this effect: 'There is a vast extent of analysis and prescription which the generation of Malthus and Ricardo more or less take for granted, the essential work having been done by Hume and Smith; and a great deal of what they do themselves is to be regarded, not as a series of propositions thought out in a void, but rather as an attempt to correct and improve propositions and explanations which are already to be found in the **Wealth of Nations** (Black, p 44; Robbins (1958), p 233).

Among those who 'inspected' the system we must number Dugald Stewart who was profoundly to influence pupils such as Francis Horner, James Mill and J R McCulloch (cf Winch, 1994, pp 101-3; Rothbard, 1995, pp 478-81). Mill and McCulloch were to widen the circle through contacts with Malthus, Ricardo and J B Say.

These familiar contributors to a new classical edifice passed over without significant comment Smith's preoccupation with a macro-economic system wherein all magnitudes were dated – the style of period analysis which Smith had inherited from the Physiocrats, to whom he owed much (cf Skinner, 1996, 1999). But they did accept many of Smith's judgments with regard to the efficacy of the allocative mechanism, the role of money, and the assumption that acts of saving would typically be transformed into acts of investment.

Equally the authors of the new orthodoxy were able to identify important criticisms of specific areas of analysis, such as the theories of value, interest, rent and population; criticisms which resulted in **models** of the economy which represented it in terms of a series of (short-run) self-regulating mechanisms and of a theory of growth; a theory which W J Baumol (and others) were able to translate into mathematical terms (1962).

But if Smith's successors found merit in the great 'principia', the deficiencies which were identified in the treatment of particular topics led to a rising tide of criticism. Interestingly, one focal point of criticism was macro-economic in character, in that Malthus, Lauderdale,

and Sismondi, all drew attention to the importance of the distribution of income as it affected consumption and savings and thus the performance of the economy. The theme was continued in J S Mill's troubled **Essays on Some Unsettled Questions of Political Economy** (1844). As Donald Winch has noted, Mill believed that 'The **Wealth of Nations** is in many parts obsolete, and in all, imperfect' (p 000, below).

Later in the century, the main pre-occupation was with the analytics of Book I. Black records Bagehot's opinion that:

'although...Adam Smith had the merit of teaching the world that the exchangeable value of commodities is proportioned to the cost of their production, his analysis of that cost was so very defective as to throw that part of Political Economy into great confusion for many years, and as quite to prevent his teaching being used as an authority upon it now' (Black, p 55).

Even more remarkable to modern eyes was the assessment offered by Edwin Cannan, Smith's distinguished editor, who noted that:

'Very little of Adam Smith's scheme of economics has been left standing by subsequent inquirers. No one now holds his theory of value, his account of capital is seen to be hopelessly confused, and his theory of distribution is explained as an ill-assorted union between his own theory of prices and the Physiocrats fanciful Economic Table' (Black, p 57; Cannan (1926), p 123; see O'Brien, 1999).

The theme was repeated by Paul Douglas in his paper on Smith's theory of value and distribution; delivered on the occasion of the Chicago conference in 1926:

'the contributions of Adam Smith to the theory of value and distribution were not great, and in commemorating the publication of the **Wealth of Nations** it might be seen to be the path of

wisdom to pass these topics by in discreet silence and to reserve discussion instead for those subjects, such as the division of labour, where his realistic talents enabled him to appear at a better advantage' (Black, p 58; Douglas (1927), p 77; Rashid, p 31, cf p 36).

In commenting upon this assessment, Black made the interesting point that 'the lack of emphasis on growth in the thinking of 1926 can perhaps be explained in terms of the dominance of the neo-classical approach at that time' (op cit, p 61). The deficiency was only made good in the aftermath of Professor Myint's pioneering work in the 1940s (Black, op cit, p 61).

II

System

Why then should a modern student of political economy (now reduced, even in Glasgow, to 'economics') trouble to add, or be recommended to add, Adam Smith to an expanded syllabus and reading list, however philosophically circumscribed? The answer may lie in Smith's concern with **system** in the sense that he (and many others at the time) often sought to provide a coherent and all-embracing account of the phenomena to be studied.

Even in the context of the WN there were contemporaries who, while not uncritical of the treatment of individual topics, nonetheless understood the overall analytical strategy. Hugh Blair, Professor of Rhetoric in Edinburgh, observed for example that:

'Your arrangement is excellent. On chapter paves the way for another; and your System gradually erects itself' (Corr, letter 151, dated 3 April 1776).

Governor Pownall, one of Smith's most trenchant critics, nonetheless recognised that the WN constitutes 'an INSTITUTE OF THE PRINCIPIA **of those laws of motion**, by which the operations of the community are directed and regulated, and by which they should be examined' (1776, Corr, p 354). Dugald Stewart, writing in his **Memoir** delivered before the Royal Society of Edinburgh in 1793, considered that:

'it may be doubted, with respect to Mr Smith's **Inquiry**, if there exists any book beyond the circle of the mathematical and physical sciences, which is at once so agreeable in its arrangement to the rules of a sound logic, and so accessible to the examination of ordinary readers' (Stewart, IV.22).

These are compliments which Smith would have appreciated, conscious as he was of the value of systems which connect together 'in the fancy those different movements and effects which are already in reality performed' (Astronomy, IV.19) and of the 'beauty of a systematical arrangement of different observations connected by a few common principles' (WN, V.i.f.25). Smith might have been less satisfied with Stewart's final assessment:

'The skill and comprehensiveness of mind displayed in his arrangement, can be judged of by those alone who have compared it with that adopted by his immediate predecessors. And, perhaps, in point of utility, the labour he has employed in connecting and methodising their scattered ideas, is not less valuable than the results of his own original speculations' (Stewart, IV.27).

The point was echoed by Schumpeter who, despite his critical assessment of 'A Smith', still regarded the WN as the 'peak success of this period'. He added, 'though the **Wealth of Nations** contained no really novel ideas, and though it cannot rank with Newton's **Principia** or Darwin's **Origin** as an intellectual achievement, it is a great performance all the same and fully deserved its success' (1954, p 185).

Having dismissed Smith's contribution to the theories of value and distribution, Blaug also concluded that:

'In appraising Adam Smith, or any other economist, we ought always to remember that brilliance in handling purely economic concepts is a very different thing from a firm grasp of the essential logic of economic relationships. Superior technique does not imply superior insight and vice-versa. Judged by standards of analytical competence, Smith is not the greatest of eighteenth century economists. But for an acute insight into the nature of the economic process, it would be difficult to find Smith's equal (1962, p 57).

But there is another aspect to this concept of 'system', duly noted by Black, in adverting to the fact that the **Theory of Moral Sentiments** and the **Wealth of Nations** should be 'seen afresh as two parts of one system' (op cit, p 62), thus reminding at least one of the bicentennial congregations of Smith's wider purpose, while noting that Cliffe Leslie had been among the first to appreciate the point in the previous century (op cit, p 53).

Seen in retrospect, Leslie's position is hardly surprising. Olivier Grese (University of Paris I) has drawn my attention to the fact that Leslie urged economists to adopt an historical, inductive, and synthetic method and that he was convinced of the 'indissoluble nature of the connection between the moral, intellectual, legal and economic phases of social progress'. Indeed in a paper delivered to the 1999 ESHET conference, Grese argued that there was a distinctive **English** Historical School whose main figures included Leslie and J K Ingram, William Ashley, William Cunningham, Frederick Harrison, and Arnold Toynbee (cf Coats, 1954; Koot, 1975, 1987).

Ethics, Jurisprudence and economics were certainly subjects which Smith treated as the separate but inter-related parts of a system of the moral or social sciences. The point was

clearly made in the concluding sentences of the first edition of TMS and repeated in the advertisement of the sixth edition which was published thirty-one years later. We also have the advantage of knowing that Smith taught his students in a particular order: ethics, jurisprudence and economics. It may well be that he encouraged his students to view aspects of the human predicament through three distinct lenses – with the ultimate object of persuading them to view that predicament through all three lenses at the same time.

III

Ethics

Smith's **Theory of Moral Sentiments**, based on the second part of his lecture course, is a work on ethics which addressed the two main questions confronting the philosopher: first, how and by what means are moral judgments formed, and, secondly, wherein does virtue consist? But there are additional dimensions to the work to which attention should be directed, namely Smith's demonstration of the point that social order involves a balance of opposed forces, and his account of the manner in which men erect barriers against their own self interested passions; a basic pre-condition if economic performance is to be sustained.

Smith's argument, like that of his great friend David Hume, places a good deal of emphasis on 'sympathy' (akin to the modern psychological concept of empathy) by which he means 'fellow-feeling', that sentiment which expresses our interest in the situation of other people. This kind of 'sympathy' can be instinctive, as, for example, when we contemplate an expression of joy or sorrow; a reaction which may later cause the observer to enquire into the circumstances of the person judged with a view to understanding the emotion which he expresses. Thus sympathy arises not 'so much from the view of the passion, as from that of the situation which excites it'. It is this which leads the spectator to form a judgment as to the **propriety** or **impropriety** of an expression or feeling, where such qualities are found to

consist in the 'suitableness or unsuitableness, in the proportion or disproportion which the affection seems to bear to the cause or object which excites it' (TMS, I.ii.3.6). It followed for Smith that where the spectator of another man's conduct seeks to form an opinion as to its propriety, he must 'bring home to himself' both the circumstances and the 'affections' of the person judged. In short, the spectator of another man's conduct must try to **visualise** how he would feel and act under the circumstances prevailing.

It was Smith's contention that any judgment as to the propriety of an action or reaction must involve some effort of the imagination, in that when 'we judge...of any affection as proportioned or disproportioned to the cause which excites it, it is scarce possible that we should make use of any other rule or canon but the correspondent affection in ourselves' (TMS, I.i.39). At the same time, Smith recognised that since we have no 'immediate experience of what other men feel', it follows that an action which is considered appropriate by the spectator must involve some restraint on the part of the agent. Smith went on to suggest that the degree to which the spectator can visualise the feelings of the person judged **of** may involve the virtue of sensibility, while the extent to which the person **judged** is capable of moderating the expression of his feeling may involve that of self-command' (TMS, I.i.5).

It was Smith's opinion that men would tend to practice both virtues since 'nothing pleases us more than to observe in other men a fellow feeling with all the emotions of our own breast'. In particular it is suggested that we are impelled to self-restraint, since:

'Nature, when she formed man for society, endowed him with an original desire to please, and an original aversion to offend his brethren' (TMS, III.2.6).

Yet important as this general disposition may be as a source of social control, Smith drew attention to the fact that it was unlikely to be sufficient, for two main reasons.

The first problem to be confronted relates to the basic mechanisms by virtue of which judgments are formed, and specifically to the role of the spectator, who must be at once well informed and impartial if the judgment made is to be accurate. To begin with, our knowledge must be imperfect with regard, for example, to the **motives** which prompt an action taken by another person.

Smith solved this problem by developing the argument that the way in which we judge our own conduct must be similar to that in which we judge others, in that in so doing we 'suppose ourselves the spectators of our own behaviour'. It will be apparent that the ideal or imagined spectator of our conduct always **can** be supplied with all the information which would be needed to frame an accurate judgment (TMS, III.i.6).

The second aspect of the problem arises from the fact that man is presented by Smith as an active, self-regarding being. Interestingly enough, Smith often develops this theme within the context of broadly 'economic' aspirations, while reminding the reader that self-interested activities have a 'social' reference. He observed that 'it is chiefly from this regard to the sentiments of mankind, that we pursue riches and avoid poverty. For to what purpose is all the toil and bustle of this world? What is the end of avarice and ambition, of the pursuit of wealth, of power, and pre-eminence?' (ibid). Perhaps with his old teacher Francis Hutcheson in mind, Smith positively warmed to his subject in remarking that a person appears 'mean-spirited' who does not pursue 'the most extraordinary and important objects of self-interest' with 'some degree of earnestness', in referring to those great objects of which the loss or acquisition 'quite changes the rank of the person' (TMS, III.6.7).

The basic problem which arises in the present context is that we may upon particular occasions fail to judge our own actions with the required degree of **impartiality**, even where we have the necessary information. As Smith put it, 'When we are about to act, the

eagerness of passion will seldom allow us to consider what we are doing, with the candour of an indifferent person' (TMS, III.4.3). The argument would thus seem to suggest that there will be many occasions on which men are unlikely to be able to form accurate judgments with respect to their own activities, and that they would therefore be unlikely to impose upon themselves the kind of restraint which the 'inhabitant within the breast' would normally recommend.

Smith's solution to the problem thus raised involves no principle in addition to those already considered. He suggests that our capacity to form judgments in particular cases permits us to frame general rules (including those of justice) by a process of induction – thus formally admitting **reason** to the discussion of morality (TMS, III.4.8).

IV

Jurisprudence

The argument which illustrates the way in which we judge on **particular** occasions is important in the sense that it explains the origin and something of the nature of **general** rules of conduct, including those of justice. This suggests that Smith rejected the rationalist approach to ethical questions, while implying that general rules of behaviour must be related to the experience of what, on particular occasions, is thought to be appropriate. This in turn raises the possibility that since experience may vary, then so too will the content of general rules – a position which is explored to a limited extent in the **Theory of Moral Sentiments** where Smith considers the influence of custom and fashion on moral judgment.

The theme was continued in the **Lectures on Jurisprudence** where Smith considered the relationship between environment and law. As John Millar recalled when commenting on this part of Smith's lecture course:

'Upon this subject he followed the plan that seems to be suggested by Montesquieu; endeavouring to trace the gradual progress of jurisprudence, both public and private, from the rudest to the most refined ages and to point out the effect of those arts which contribute to subsistence, and to the accumulation of property, in producing correspondent improvements or alterations in law and government' (Stewart, I.19).

The association of Montesquieu with economic forces and with the dynamic processes of change through time may be somewhat overdrawn, but is, as Millar suggested, very much a feature of Smith's thought. It was in this connection that he made use of four types of economic organisation, or modes of earning subsistence, the now famous stages of 'hunting, pasturage, farming, and commerce' (LJ(B), 149). These stages are deployed in the discussion of 'public jurisprudence' where Smith was concerned with broad questions of constitutional law, and in the discussion of private law where the lecturer addressed man's rights as a member of a family and as an individual. As Neil McCormick has pointed out, the approach is a fruitful one which:

'brings sharply to our attention the way in which laws and legal institutions are an inherent part of the economy of a society and must be understood and explained as such if we wish to proceed beyond purely formal and structural analysis of legal systems considered in the abstract' (1980, 1982).

On the other hand, an argument which seems to emphasise the importance of environment and change does raise the question as to the extent to which Smith was justified in describing jurisprudence as 'that science which enquires into the general principles which ought to run through and be the foundation of the laws of all nations' (TMS,VII.iv.37). Haakonssen has recently drawn attention the normative element in Smith's thought; to his emphasis on natural rights (such as life and liberty) which are so basic 'that they can be

taken as universal' (op cit, p 148). More striking still is Haakonssen's thesis that for Smith jurisprudence was to be seen 'as a critical tool rather than a set of positive doctrines'; a critical tool used by the 'spectator' to subject rules of behaviour to the tests of impartiality, coherence, and consistency (op cit, ch 6; cf 1982). The proper understanding of environment gains new significance if this interpretation is accepted, and may further explain Smith's pre-occupation with the origin and nature of the present (socio-political) establishments in Europe (WN, Bk III).

The nations which over-ran the Western Empire were represented by Smith as having been at exactly the state of development which had been attained by the early inhabitants of Greece. Primitive peoples whose military power was of the awesome proportions appropriate to the stage of pasture were thus shown to have come in contact with a much more sophisticated society, but one whose power was already on the decline. The result, as Smith duly noted, was the destruction of civilisation as then known, but also the creation of an environment from which a higher form of European civilization was ultimately to emerge.

Smith's explanation of this general trend begins with the fact that the primitive tribes which over-ran the empire had already attained a relatively advanced form of the pasturage economy, with some idea of agriculture and of property in land. He argued therefore that they would naturally use existing institutions in their new situation and that in particular their first act would be a division of the conquered territories. In this way the argument moves from a developed version of one economic stage to a primitive version of another; from the stage of pasture to that of 'agriculture'.

Under the circumstances outlined, property in land becomes the source of power and distinction with each estate forming a separate principality, featuring a high degree of dependence of those who own the means of subsistence on those who own property. This is essentially the **allodial** version of the stage of agriculture, and was followed by the **feudal**,

featuring, **inter alia**, complex tactical alliances between the lesser and more powerful magnates, and between the latter group and the monarch.

Smith argued that these changes took place from about the ninth to the eleventh centuries, and that by imposing some limitations on the free enterprise of the proprietors contributed thereby to a more orderly form of government. Yet the problem presented by the military capacity of the great proprietors, and the relative weakness of kings, remained and was to lead, according to Smith's account, to a still further development, which should be of interest to the political economist.

The policy in question was the encouragement given by kings to **cities** as a means of acquiring increased revenues and a countervailing power to that wielded by the **proprietors**; a policy which featured the grant of significant powers of self-government. It was a political act, but one with economic consequences in that the creation of self-governing units established an important claim and an essential pre-condition for economic growth, namely justice and personal security. Such cities as were located near the means of transportation were thus in a position to grow rapidly through trade and manufacture, thus increasing in absolute terms at least the financial capacity of the crown.

In particular Smith emphasised that the great proprietors, when faced for the first time with a means of spending their surpluses would tend to accelerate their own decline; partly through the dismissal of retainers, and partly through the substitution of a cash for the service relationship, which had prevailed between those who owned the means of a subsistence, and those who worked the soil. As Smith put it when summarising his most complete statement of the argument:

'A revolution of the greatest importance to the publick happiness, was in this manner brought about by two different orders of people, who had not the least intention to serve the publick.

To gratify the most childish vanity was the sole motive of the great proprietors. The merchants and artificers, must less ridiculous, acted merely from a view to their own interest, and in pursuit of their own pedlar principle of turning a penny wherever a penny was to be got. Neither of them had either knowledge or foresight of that great revolution which the folly of the one and the industry of the other, was gradually bringing about' (WN, III.iv.17).

V

The features of the 'great revolution', and the reasons for these features being of interest to the student of political economy, were, for Smith, quite clear.

First, Smith suggests in effect that the economic structure which is consistent with the fourth stage (of commerce) is not to be regarded as a model (although it may be modelled) but as a structure with a history. The historical process suggests the emergence of an economic system with interdependent sectors of activity wherein all goods, services, and factors command a price.

Secondly, he argued that this new structure would feature new forms of activity and sources of wealth; a development which would bring with it a shift in the balance of economic and therefore of political power. The point owed much to David Hume, as Smith acknowledged. Hume wrote that in England 'the lower house is the support of our popular government, and all the world acknowledges, that it owed its chief influence and consideration to the encrease of commerce, which threw such a balance into the hands of the commons' (Essays, 277-8).

Third, Smith confirmed that in the case described there must be a major change in the pattern of dependence and subordination as compared to the feudal period. Since all goods and services command a price, it follows that while the farmer, tradesman or artificer must

depend upon his customers, 'though in some measure obliged to them all...he is not absolutely dependent upon any one of them' (WN, III.iv.12).

Finally, it is suggested that the type of institutional structure described will be associated with what Hume described as a particular set of 'customs and manners'. The link here is once again with the analysis of the TMS and man's desire for social approbation.

For Smith, 'Power and riches appear...then to be, what they are, enormous and operose machines contrived to produce a few trifling conveniences to the body, consisting of springs the most nice and delicate' (TMS, IV.1.8). But Smith continued to emphasise that the pursuit of wealth is related not only to the desire to acquire the means of purchasing 'utilities' but also to the need for status:

'From whence, then, arises that emulation which runs through all the different ranks of men, and what are the advantages which we propose by that great purpose of human life which we call bettering our condition? To be observed, to be attended to, to be taken notice of...are all the advantages which we can propose to derive from it' (TMS, I.iii.2.1).

Smith also suggested that in the modern economy, men tend to admire not only those who have the capacity to enjoy the trappings of wealth, but also the qualities which contribute to that end.

Smith recognised that the pursuit of wealth and 'place' was a basic human drive which would involve sacrifices which are likely to be supported by the approval of the spectator. The 'habits of oeconomy, industry, discretion, attention and application of thought, are generally supposed to be cultivated from self-interested motives, and at the same time are apprehended to be very praiseworthy qualities, which deserve the esteem and approbation

of everybody' (TMS, IV.2.8). Smith developed this theme in a passage which was added to the TMS in 1790:

'In the steadiness of his industry and frugality, in his steadily sacrificing the ease and enjoyment of the present moment for the probable expectation of the still greater ease and enjoyment of a more distant but more lasting period of time, the prudent man is always both supported and rewarded by the entire approbation of the impartial spectator' (TMS, VI.1.11).

But such values are specific to a particular type of culture; Nicholas Philipson has argued that Adam Smith is best understood as a writer who was offering a response to matters of contemporary relevance, in presenting him as 'a practical moralist who thought that his account of the principles of morals and social organisation would be of use to responsibly-minded men of middling rank, living in a modern, commercial society'. Indeed Dr Philipson has gone so far as to suggest that Smith's ethical theory 'is redundant outside the context of a commercial society with a complex division of labour' (Philipson, 1983, 179, 182; cf Dwyer, 1987).

Professor Pocock concluded that:

'A crucial step in the emergence of Scottish social theory is, of course, that elusive phenomenon, the advent of the four-stages of history. The progression from hunter to shepherd to farmer to merchant offered not only an account of increasing plenty, but a series of stages of increasing division of labour, bringing about in their turn an increasingly complex organisation of both society and personality' (Pocock, 1983, 242).

Pocock associated these trends with the emergence of what has been described by others as a 'bourgeois' ideology.

While the implications of this argument will be elaborated upon below, it is appropriate to note in this place that Smith's treatment of the 'economic man' is more complex than many modern accounts. Both the pursuit of wealth, and the deployment of it in purchasing utilities are subject to the scrutiny of our fellows and should be compatible with respect for the rights of others and for the rules of propriety – as defined by the spectator. Smith's celebration of the prudent man provides one of the major hinges linking the TMS and the WN.

VI

A Conceptual Model

If the **Theory of Moral Sentiment** provides an account of the way in which men erect barriers against their own passions, thus meeting a basic precondition for economic activity, it also provided an account of the psychological judgments on which that activity depends. The historical argument on the other hand explains the origin and nature of the modern state and provides the reader with the means of understanding the essential nature of the exchange economy. For Smith:

'the great commerce of every civilised society, is that carried on between the inhabitants of the town and those of the country...The gains of both are mutual and reciprocal, and the division of labour is in this, as in all other cases, advantageous to all the different persons employed in the various occupations into which it is subdivided' (WN, III.i.1).

The concept of an economy involving a flow of goods and services, and the appreciation of the importance of intersectoral dependencies, were familiar in the eighteenth century. Such themes are dominant features of the work done, for example, by Sir James Steuart and David Hume. But what is distinctive about Smith's work, at least as compared to his Scottish contemporaries, is the emphasis given to the importance of three distinct factors of

production (land, labour, capital) and to the three categories of return (rent, wages, profit) which correspond to them. What is distinctive to the modern eye is the way in which Smith deployed these concepts in providing an account of the flow of goods and services between the sectors involved and between the different socio-economic groups (proprietors of land, capitalists, and wage-labour). The approach is also of interest in that Smith, following the lead of the French Economists, worked in terms of period analysis – the year was typically chosen, so that the working of the economy is examined within a significant time dimension as well as over a series of time periods. Both versions of the argument emphasise the importance of capital, both fixed and circulating.

Taking the **economic system as a whole**, Smith suggested that the total stock of society could be divided into three categories:

There is, first, that part of the total stock which is reserved for immediate consumption, and which is held by **all** consumers (capitalists, labour, and proprietors) reflecting purchases made in previous time periods. The characteristic feature of this part of the total stock is that it affords no revenue to its possessors since it consists 'in the stock of food, cloaths, household furniture, etc, which have been purchased by their proper consumers, but which are not yet entirely consumed' (WN, II.i.12).

Secondly, there is that part of the total stock which may be described as 'fixed capital' and which will be distributed between the various groups in society. This part of the stock, Smith suggested, is composed of the 'useful machines' purchased in preceding periods but currently held by the undertakers engaged in manufacture, the quantity of useful buildings and of 'improved land' in the possession of the 'capitalist' farmers and the proprietors, together with the 'acquired and useful abilities' of all the inhabitants (WN, II.i.13-17), that is, human capital.

Thirdly, there is that part of the **total** stock which may be described as 'circulating capital' and which again has several components, these being:

1. The quantity of money necessary to carry on the process of circulation.
2. The stock of provisions and other agricultural products that are available for sale during the current period, but are still in the hands of either the farmers or merchants.
3. The stock of raw materials and work in process, held by merchants, undertakers, or those capitalists engaged in the agricultural sector (including mining), etc.
4. The stock of manufactured goods (consumption and investment goods) created during the previous period, but remaining in the hands of undertakers and merchants at the beginning of the period examined (WN, II.i.19-22).

The logic of the process can be best represented by separating the activities involved much in the manner of the physiocratic model with which Smith was familiar. Let us suppose that, at the beginning of the time period in question, the major capitalist groups possess the total net receipts earned from the sale of products in the previous period, and that the undertakers engaged in agriculture open by transmitting the total rent due to the proprietors of land for the current use of that factor. The income thus provided will enable the proprietors to make the necessary purchases of consumption (and investment) goods in the current period, thus contributing to reduce the stocks of such goods with which the undertakers and merchants began the period.

Secondly, let us assume that the undertakers engaged in both sectors, together with the merchant groups, transmit to wage labour the content of the wages fund, thus providing this socio-economic class with an income that can be used in the current period. It is worth noting in this connection that the capitalist groups transmit a fund to wage labour which formed a part of their **savings**, providing by this means an income that is available for current **consumption**.

Thirdly, the undertakers engaged in agriculture and manufactures will make purchases of consumption and investment goods from each other, through the medium of retail and wholesale merchants, thus generating a series of expenditures linking the two major sectors. Finally, the process of circulation may be seen to be completed by the purchases made by individual undertakers within their own sectors. Once again, these purchases will include consumption and investment goods, thus contributing still further to reduce the stocks of commodities that were available for sale when the period under examination began, and which formed part of the circulating capital of the society in question. Looked at in this way, the 'circular flow' could be seen to involve purchases that take goods from the circulating capital of society, which are in turn matched by a continuous process of **replacement** by virtue of current production of materials and finished goods – where both types of production require the use of the fixed and circulating capitals of individual entrepreneurs, while generating the income flows needed to purchase commodities (and services). Smith elaborated on the argument:

The expenditure of the consumers of particular commodities in effect replaces the outlays of those who retail them, just as the capital of the retailers replaces, together with its profits, that of the wholesale merchant from whom he purchases goods, thereby enabling him to continue in business (WN, II.v.9). In turn, the capital of the wholesale merchant replaces, together with their profits, the capitals of the farmers and manufacturers of whom he purchases the rude and manufactured product which he deals in, and thereby enables them to continue their respective trades (WN, II.v.10). At the same time, part of the capital of the master manufacturer is 'employed as a fixed capital in the instruments of his trade, and replaces, together with its profits, that of some other artificer of whom he purchases them. Part of his circulating capital is employed in purchasing materials, and replaces, with their profits, the capitals of the farmers and miners of whom he purchases them. But a great part of it is always, either annually, or in a much shorter period, distributed among the different

workmen whom he employs' (WN, II.iv.11). The farmers perform a similar function with regard to the manufacturing sector.

This complex view of the working of the system is further complicated by the fact that Smith's model of 'conceptualised reality' also employs a dual-circulation framework, involving cash transactions at the level of the household and credit at the level of the firm. It was this perspective which led Smith to advocate some degree of regulation of the rate of interest and of the banking trade (see for example, Skinner, 1996, chapter 8; Zallio, 1990).

As an aside, it is worth recalling that Jeremy Bentham objected to Smith's arguments regarding the regulation of the rate of interest on the ground that it was inconsistent with his general position (Corr, app C). Dugald Stewart concurred (Stewart, IV.28.n.J).

VII

A Conceptual System

The 'conceptual' **model** which Smith had in mind when writing the **Wealth of Nations** is instructive and also helps to illustrate the series of separate, but inter-related problems, which economists must address if they are to attain the end which Smith proposed, namely an understanding of the **full range** of problems which have to be encountered. Smith in fact addressed a series of areas of analysis which began with the problem of value, before proceeding to the discussion of the determinants of price, the allocation of resources between competing uses, and, finally, an analysis of the forces which determine the distribution of income in any one time period and over time.

The analysis offered in the first Book enabled Smith to proceed directly to the treatment of macro-economic issues and especially to a theory of growth which provides one of the dominant features of the work as a whole (cf Skinner, 1996, ch 7). The idea of a single, all-embracing conceptual system, whose parts should be mutually consistent is not an ideal which is so easily attainable in an age where the division of labour has significantly increased the quantity of science through specialisation. But Smith becomes even more informative when we map the content of the 'conceptual (analytical) system' against a model of the economy, which is essentially descriptive.

Perhaps the most significant feature of Smith's vision of the 'economic process', to use Blaug's phrase, lies in the fact that it has a significant time dimension. For example, in dealing with the problems of value in exchange, Smith, following Hutcheson, made due allowance for the fact that the process involves judgments with regard to the utility of the commodities to be received, and the disutility involved in creating the commodities to be exchanged. In the manner of his predecessors, Smith was aware of the distinction between utility (and disutility) anticipated and realised, and, therefore, of the process of adjustment which would take place through time. Jeffrey Young has recently emphasised that the process of exchange may itself be a source of pleasure (utility): (1997, p 61).

In an argument which bears upon the analysis of the TMS, Smith also noted that choices made by the 'rational' individual may be constrained by the reaction of the spectator of his conduct – a much more complex situation than that which more modern approaches may suggest. Smith makes much of the point in his discussion of Mandeville's 'licentious' doctrine that private vices are public benefits, in suggesting that the gratification of desire is perfectly consistent with observance of the rules of propriety as defined by the 'spectator', ie, by an external agency. In an interesting variant on this theme, Etzioni has noted the need to recognise 'at least two irreducible sources of valuation or utility; pleasure and morality'. He added that modern utility theory 'does not recognise the distinct standing of morality as a

major, distinct, source of valuations and hence as an explanation of behaviour' before going on to suggest that his own 'deontological multi-utility model' is closer to Smith (1988, pp 21-4) than other modern approaches.

Smith's theory of price, which allows for a wide range of changes in taste is also distinctive in that it allows for competition **among** and **between** buyers and sellers, while presenting the allocative mechanism as one which involves simultaneous and inter-related adjustments in **both** factor **and** commodity markets; a perspective pursued in Hay (1996).

As befits a writer who was concerned to address the problems of change and adjustment, Smith's position was also distinctive in that he was not directly concerned with the problem of **equilibrium**. For him the 'natural' (supply) price was:

'as it were, the central price, to which the prices of all commodities are continually gravitating...whatever may be the obstacles which hinder them from settling in this center of repose and continuance, they are constantly tending towards it' (WN, I.vii.15).

Schumpeter remarked in this connection that:

'The rudimentary equilibrium theory of Chapter 7, by far the best piece of economic theory turned out by A Smith, in fact points towards Say and, through the latter's work, to Walras' (1954, p 189); cf Jaffe (1984), Piel (1999), Blaug (1999), Hutchison (1999).

The picture was further refined in the sense that Smith introduced into this discussion the doctrine of 'net advantages' (WN, I.x.a.1). This technical area is familiar to labour economists, but in Smith's case it becomes even more interesting in the sense that it provides a further link with the TMS, and with the discussion of constrained choice. It was Smith's contention that men would only be prepared to embark on professions which

attracted the disapprobation of the spectator if they could be suitably compensated (Skinner, 1996, p 155) in terms of monetary reward.

Smith introduced a further dimension to the discussion in referring to differential rates of return in the different employments of capital, where he paid particular attention to the problems of social attitudes, risk, and labour. Smith noted that resources could be continuously switched between different uses, as befits a system in movement. As Turgot put it, in passages which may have influenced Smith (Groenwegen, 1969):

'In a word, as soon as the profits arising from on employment of money, whatever it may be, increase or diminish, capitals either turn in its direction and are withdrawn from other employments, or are withdrawn from it and turn in the direction of other employments' (Meek, 1973, p 172).

But perhaps the most intriguing feature of the macro-economic model is to be found in the way in which it was specified. As noted earlier, Smith argued that incomes are generated as a result of productive activity, thus making it possible for commodities to be withdrawn from the 'circulating' capital of society. As he pointed out, the consumption goods withdrawn from the existing stock may be used up in the present period, or added to the stock reserved for immediate consumption', or used to replace more durable goods which had reached the end of their lives in the current period. In a similar manner, undertakers and merchants may add to their stocks of materials, or to their holdings of fixed capital while replacing the plant which had reached the end of its operational life. It is equally obvious that undertakers and merchants may add to, or reduce, their **inventories** in ways which will reflect the changing patterns of demand for consumption and investment goods, and their past and current levels of production.

Smith's emphasis upon the point that different 'goods' have different life-cycles means that the pattern of purchase and replacement may vary continuously as the economy moves through different time periods, and in ways which reflect the various age profiles of particular products as well as the pattern of demand for them. If Smith's model of the 'circular flow' is to be seen as a spiral, rather than a circle, it soon becomes evident that this spiral is likely to expand (and **contract**) through time at variable rates.

It is perhaps this total vision of the complex working of the economy that led Mark Blaug to comment on Smith's sophisticated grasp of the economic **process** and to distinguish this from his contribution to particular **areas** of economic analysis (cf Jensen (1984), Jeck (1994), Randive (1984)).

Taking the model(s) as a whole, it is not difficult to see why Smith's successors could find, in his writings, the building blocks of a classical orthodoxy, both static and dynamic (O'Brien, 1975). Nor is it difficult to see why critics of the orthodoxy could find materials which formed the basis of an alternative tradition.

VIII

Government: Policy and Constraint

Having assessed the content and the implications of Smith's economic **analysis**, with its attendant emphasis on the role of the individual, Lord Robbins concluded that Smith's advocacy of economic freedom 'rested on a two-fold basis; a belief in the desirability of freedom of choice for the consumer, and belief in the effectiveness, in meeting this choice, of freedom on the part of the producer' (1953, p 12).

While it is doubtful if many of those who attended the dinner given by the Political Economy Club in 1876 (chaired by Gladstone) fully understood the analytical sophistication of Smith's work, there was general agreement regarding the doctrine of free trade. Black recorded that Robert Lowe celebrated the message of 'this simple Glasgow professor' while William Newmarch 'took Lowe's point about the future of Political Economy a stage further' by predicting that 'there will be what may be called a large negative development of Political Economy tending to produce an important and beneficial effect; and that is, such a development of Political Economy as will reduce the functions of government within a smaller and smaller compass' (Black, pp 50-1). One hundred years later, on the occasion of the 1976 celebrations in Glasgow, George Stigler made a related point in claiming, not without humour that 'Adam Smith was alive and well and living in Chicago'.

But in the years after 1926 there was another view of Smith's position which was profoundly influenced by Jacob Viner's truly seminal paper on 'Adam Smith and Laisser-Faire'. Viner concluded that:

'Adam Smith was not a doctrinaire advocate of laissez-faire. He saw a wide and elastic range of activity for government, and he was prepared to extend it even further if government, by improving its standard of competence, honesty and public spirit, showed itself entitled to wider responsibilities (1928).

This passage reminds us of Smith's newly topical pre-occupation with what he took to be the baleful influence of mercantile and manufacturing interests, but also of further links with the analysis of the origin and nature of the exchange economy.

It may be recalled that Smith associated the fourth economic stage with the advent of freedom in the 'present sense of the term': that is, with the elimination of the relation of direct dependence which had been a characteristic of the feudal/agrarian period.

Politically, the significant and associated development appeared to be the diffusion of power consequent on the emergence of new forms of wealth, which, at least in the particular circumstances of England, had been reflected in the increased significance of the House of Commons and in the emergence of a situation where liberty was secured 'by an assembly of the representatives of the people, who claim the sole right of imposing taxes' (IIV.vii.b.51). Smith was far from equating political with personal liberty, nor did he suggest that absolutism was incompatible with the fourth economic stage. But what he did seem to recognise was that 'free governments', especially of the kind which had been confirmed by the English Revolution Settlement, now operated within a relatively sensitive political and economic environment. A number of points may be offered by way of illustration.

First, it is interesting to note how often Smith referred to the constraints presented by the 'confirmed habits and prejudices' of people, and to the necessity of adjusting legislation to what 'the interest, prejudices, and temper of the times would admit of' (IV.v.b.53).

Secondly, Smith drew attention to the fact that the government itself was a complex instrument. In this connection Smith felt that the management of Parliament through the distribution of offices was 'a necessary feature of the British mixed government' (cf, WN, IV.vii.c.69); a point which is in turn linked to the fact that the pursuit of office was itself a 'dazzling object of ambition'; a competitive game with as its object the attainment of 'the great prizes which sometimes come from the wheel of the great state lottery of British politics' (IV.vii.c.75).

This point leads on to another which was greatly emphasised by Smith, namely that the same economic forces which had served to elevate the House of Commons to a superior degree of influence had also served to make it an important focal point for sectional interests.

It is recognised in the **Wealth of Nations** that the landed, monied, manufacturing, and mercantile groups all constitute special interests which could impinge on the working of government. Smith referred frequently to their 'clamorous importunity', and in speaking of the growth of monopoly pointed out that government policy 'has so much increased the number of some particular tribes of them, that, like an overgrown standing army, they have become formidable to the government, and upon many occasions intimidate the legislature' (IV.ii.43, cf I.xi.p.10).

Important as the role of government may be, Smith was clearly aware of the pressures operating upon an imperfect instrument, operating in an imperfect environment.

IX

Conclusion

Adam Smith came to be regarded as the 'founding father' (Rothbard, p 435; Rashid, p 140), of the discipline of political economy. If this was indeed the classical perception of Smith, then the results were to prove unfortunate, not least because the history of the subject was seen to date from 1776. Rothbard has claimed that Smith was believed 'to have created the science of political economy, **de novo**' (op cit, p 435). Donald Winch quotes an important passage from J B Say, a committed disciple, to the effect that:

'whenever the Inquiry into the **Wealth of Nations** is perused with the attention it so well merits, it will be perceived that until the epoch of its publication, the science of political economy did not exist' (Winch, 1994, p 103).

Scant wonder that Dupont de Nemours, who edited Quesnay's works under the significant title of **The Origin and Progress of a New Science** (1767), should have been moved to protest:

'This idea that occurs to you to **reject** us, and which you do not hid well, my dear Say, does not do away with the fact that you are through the branch of Smith a grandson of **Quesnay**, a nephew of the great Turgot' (Winch, 1994, p 103).

The perspective generated real problems.

Hutchison has argued that 'the losses and exclusions which ensued after 1776, with the subsequent transformation of the subject and the rise to dominance of the English classical orthodoxy were immense' (1988, p 370). One such loss was the Physiocratic concept of the 'circular flow' (to which Smith owed much). The use of the historical or institutional method was a further loss and so too was the concern (shared by Hume and Steuart) with structural unemployment and the model of primitive accumulation. In addition, the classical orthodoxy showed little interest in the problems presented by differential rates of growth in the context of international trade.

Ironically, the new orthodoxy also made it possible to think of economics as a discipline quite separate from ethics and jurisprudence, thus obscuring Smith's true purpose. In referring to the way in which Smith organised his 'system of social science' Hutchison has observed, in a telling passage, that Smith was led as if by an Invisible Hand to promote an end which was no part of this original intention, that of 'establishing political economy as a separate autonomous discipline' (1988, p 355). A L Macfie made a related point in observing that 'It is a paradox of history that the analytics of Book I, in which Smith took his own line, should have eclipsed the philosophical and historical methods in which he so revelled, and which showed his Scots character' (1967, p 21).

In concluding his lecture of 1976, Black returned to the theme of Smith's wider system.

'Many economists today are disenchanted about the prospects and results of economic growth, and many are likewise dubious or defensive about the long-vaunted idea of economics as a science, positive and value free. It is little wonder that such authors can find fresh interest in a system of thought which placed economic problems firmly in the context of ethics and jurisprudence and which was informed throughout by a concept of justice. This may well prove to be the aspect of Smith's ideas which the next generation of economists will see as vital' (1976, p 62).

In the same year, but on the opposite side of the Atlantic, Eli Ginzberg made a related point:

"I hope that the bicentennial celebrations of the **Wealth of Nations** will impress those now entering upon the study of economics that Smith's broad-scale historical, comparative, and institutional approach is more apposite to the present and the future than the narrow preoccupations of the applied mathematicians who continue to dominate the subject" (1979, p 36).

Hopefully, Bob Black may be proved correct with regard to the incoming generations of economists. Historians do not have to repeat the errors of our contemporaries or predecessors, but do urgently need to find ways of persuading our colleagues, and through them our students that there are, as Winch suggests, valuable lessons to be learned from books about old times.

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