

The Wealth of Nations

An Inquiry into the Nature and causes of

A. Smith

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Adam Smith has been enthusiastically appropriated by the neo-liberals. He is famous for his notion of the 'invisible hand' indicating that the intricate machinery of modern economic life is not driven by any planned purpose but appears automatically as if guided by blind forces. Those admittedly are very striking ideas and abstractly quite beautiful, as they reduce complex behavior to some very simple principles. In fact Smith appears as the Newton of social sciences, suggesting that the celestial mechanics of the former has a counterpart in the mechanics of human interaction, at least as to its economical aspects. Obviously the thinking of Smith and his followers must have had a very profound effect on Darwin when he formulated his theory of Natural Selections, likewise doing away with an intelligent planning agent in favor of some very simple principles, although as far as I know, Darwin mostly limited his explicit acknowledgment to that of the influence of Malthus. Now, while Darwin's theory is universally accepted (except of course by the lunatic fringe), a neo-liberal view of economics is still hotly contested, and although the view seemed to have triumphed at the end of the past century as a consequence of the internal implosion of the Soviet-union and concomitant speculation about the end of history, its triumph seems premature at best, and its teachings more in the nature of an orthodoxy than universally accepted premises. Why is that? Is it due to a nostalgic sentimentality? A lack of intellectual courage to face the essential meaninglessness of the human condition? Or is it due to a false analogy?

In fact the issue cuts to the core of much philosophical confusion and dithering. On one hand we have the idealistic top-down approach in which our thinking is taken as our point of departure; on the other hand the materialistic bottom-up, in which our thinking is no longer taken as basic, but just a consequence of more basic components, in particular as a part of natural evolution. One may argue that the first approach is the humanistic one, while the second the scientific one. Every person vacillates between one or the other unable to make a definite commitment, partly because no position is intrinsically consistent. The basic question is whether economics is a science or not? When it comes to natural selection most if not all of it is beyond human influence, thus it is natural to observe and describe it, as has been done by naturalists throughout history; while economics is nothing but human decisions, and thus to abdicate from the decision process, claiming that it follows abstract laws beyond us, is something rather perverse, morally as well as logically.

In fact there are two Adam Smiths at work in his book. There is the abstract thinker coining such well-known aphorisms as the one referred to above, employing such time-honored ideas of supply and demand to explain the simple principles lying below the multifarious complexities of human economic interaction. But there is also the moralist, who views the economic activity sternly and often disapprovingly, having strong likes and

dislikes, recognizing that economy is not, in the latter words of Collingwood applied to the study of nature, a spectacle, to be viewed detachedly, but something which arise from our decisions, and hence cannot escape the guidance of a moral compass. One may argue that of the two, the first is the most elegant and original, while the second is an avatar, a throwback to a more primitive mindset voicing conventional and outdated pieties. However, I would hold that the first reading of Smith, so popular among modern commentators, is an undue simplification, presenting a flat picture, with no shadows to generate relief. Admittedly reading Smith is not easy, much of what he writes is actually rather tedious, such as his long discussions about the fluctuation of the price of grain, which could be easily summarized in tables; and although his prose is, like that of his famous 18th century British contemporaries, elegant and seductive, his organization of his material is not always optional. Although set out as a piece of extended reasoning, it is not logically impeccable, contradictions between Smith the abstract theorist and Smith as the outraged moralists are legion. Some of those contradictions may only be apparent, others might be easily resolved, while inevitably there will be some which may resist any effort of reconciliation. I doubt that very many professional economists have read him through being content with digests of the 'essential Adam Smith, indeed only somebody genuinely interested in the development of ideas may have the necessary patience for such an undertaking.

The notion of price is crucial in all economical thinking. To Smith the computation of price depends on three components, the amount of labor involved, the rent and the profit. As to the first it is clearly of a moral nature and pertains somehow to the intrinsic worth of a product, while the other two, which are often conflated to the consternation of the author, are more formal and liable to the fluctuations of the market. As to the rent it clearly refers to the right of property, and the ultimate property being land¹, while profit should ostensibly be the reward for the merchant organizing the interchange of goods, or more to the point, provide incentives for initiatives, thus appealing less to justice and satisfaction than to greed. On the other hand, one of the blessings of modern economic life, exulted by Smith in his beginning pages, is the specialization of labor, which enables one man to produce at less effort and a much greater amount, and at superior quality to boot, than what an unskilled one would be able to muster. Smith in particular brings up the example of nails². This raises a dilemma. Is the inferior nail produced with painstaking effort by an inept smith worth more than one expertly dashed off? For the consumer the choice is not difficult, he or she wants a nail that does the job, and the effort, loving or not, that went into its construction, is of no concern at all. Thus on the market, the expensive inferior nail will find no buyers. It may have an intrinsic price, but what is the meaning of that price if no one is prepared to pay it? Thus the inevitable conclusion that there is no intrinsic price, only that the price of a commodity is simply what people are prepared to pay. And the lesson to be drawn from this somewhat cruel fact is simply that the inept smith should not bother but find himself an activity more congenial to his skills, or to acquire such skills, as to make this former fact an option. The overall effect would be

¹ It is interesting that land is subject to property right, but pieces of the oceans are not. Could this be due to the possibility of enforcement through fencing off?

² As well as other slightly more complicated gadgets, whose production can be divided into segments, each of which calls for a specialized and expert hand

an even greater specialization and effectiveness in the production of goods, ultimately to benefit everybody. The analogies with natural selection are obvious, the market acting as the weeder, and every economic transaction providing its actors with crucial information. And this is certainly the lesson the modern liberal economist draws from Smith. As to the folly of painstakingly produce inferior nail, everyone regardless of economic and political persuasion can agree on, but how far is it really feasible to push this? First this presupposes somehow that there is just one kind of activity, namely economic activity, and that it is the duty of each individual to maximize his economic impact. But clearly there are other activities which are not done for the sake of economic prosperity, and the influence of the market on everyday activities beyond that of material survival can indeed be specious. Smith certainly has more in common with Marx than he has with modern liberal economists. He recognizes that the market, far from being an impersonal force of nature, is easily manipulated by its actors, and through cartels and monopolies small coteries of actors can wield undue influence and pervert the process to their advantage. In fact Smith warns against the communion of merchants, any such is surely to become a conspiracy against the public interest. As to the rewards of labour, he agrees with the latter Marx, that it is easily perverted leading to the exploitation of the many by the few. He notes that a landowner extracts as much rent as possible, leaving his laborers only with enough to live on and propagate. There is an hierarchy in the economic system, and to assume that every actor participates on equal terms is a naive illusion.

However, he agrees with modern economic wisdom, that the size of a market is paramount³. Thus in particular he is against anything that restricts their expansions, such as customs or taxation, not only for manufacturers but also laborers, the market of which should be free. He also notes that there are many natural geographical limits to markets due to the problems of transportation and perishability of goods, constraints that to a large extent have been removed in the modern world.

In addition to the general lines of arguments to be gleaned from his treatise, the modern reader can extract quite a few charming asides from Smith, because in addition to be an economical theorist he is also a contemporary witness. Thus it is sobering to realize that as late as the 18th century, the superiority of the European economy was not a foregone conclusion. In fact Europeans who came into contact with the East were less impressed by the poverty they encountered than the opulent wealth, the former they were used to at home, and thus it did not, unlike today, stand out as anomalous. In particular Smith holds out China as an example of a rich society. But being a rich society is not a blessing, because as Smith points out, the derivative is more important than the actual value. He makes a distinction between expanding, stagnant and declining societies. In the former the situation for the worker is most advantageous, and he gives as an example the situation in the American Colonies; while in the stagnant society, the lot of the worker is far worse, and he reports that in China, the peddler is forced to work in the street, so desperate is his situation. Truly miserable it becomes in the declining economy. This ties up with the one generally accepted orthodoxy of modern economy, namely the need for growth and expansion, on which all politicians, from the left to the right, repeat as a

³ The economic decline of Scotland after its union with England he attributes to a restriction of its markets from France and England.

mantra.

The wealth of a Nation to Smith boils down to its ability to feed its population. Once this is taken care of all other trappings will take care of themselves. In particular he notes that the availability of corn is a better indicator of wealth than precious metals, and that the varying prices of crops mostly reflect the available abundance of the metals as metals themselves carry no value. And he points out the astonishment with which the Indian populations reacted to the passion the Spaniards showed for gold and silver. The simultaneous rise in the availability of manufactured goods and precious metals in Europe was but a coincidence he purports. In this context of agricultural wealth Smith speculates about the potato as a future crop. He correctly surmises that it is much more efficient than the other crops and if widely adopted would be able to feed a much bigger population and hence give rise to a much greater wealth. The lack of progress in this regard he attributes to the inability to store potatoes for any longer times, and thus the pressure to sell it quickly, as it cannot, unlike wheat be kept for many years. It should also be noted that Smith considers the work of an agricultural worker to be more sophisticated than the one performed by a mechanical worker. The latter works with material that tend to present stable conditions, while the former is challenged by unpredictable circumstances making far more demands on judgement and common sense. The mechanical worker is specialized, while the agricultural one has to be far more well-rounded. This is interesting, as we noted above that Smith puts great store at specialization as a motor of economic growth, while admitting that it likewise restricts a mans abilities and makes him a poorer one, because the wealth of an individual is intimately bound up with his ability to work. Once again a moral statement that connects with Marx, especially as Smith censures merchants complaints about high wages and their influence of price, when high profits are as much as if not more the culprit.

The subsequent books of the first volume, are a bit more technical, and can be seen as an elementary introductory course on economics, in a sense independent of the first book. Economics thus as what has become the conventional wisdom. Startling and revolutionary maybe at the time of Smith, now seen as commonplace.

The basic fact of economy is the division of labor. This necessitates the setting up of stock, otherwise known by the name of capital. Now capital is a dirty word, just as money is a dirty word to many people. This might be as it is but in any economical discourse neither concept can be ignored. Man needs to consume, to consume there has to be production, and production necessitates a stocking up. On the most elementary level, the air is around us for us all to breathe free of charge, no labour is involved in its production, and the effort to breath is so natural that we do not even realize it. Food in a rich tropical climate is almost the same, fish is to be caught in streams, berries picked and the stray animal struck down. Of course the effort not so much to eat as to gather and prepare the food involves some effort, but it is hardly economics as the life of so called primitive people do not significantly differ from those of wild animals and to which we all have evolved and thus in a sense our most natural. Yet even among such tribes we can find an incipient economy emerging namely that of trade. Occasionally a surplus may arise, not intentionally as nature around is but a stock of food out of which you do not gather more than you need to consume, but more to the point man is a tool wielding animal,

and tools are developed intentionally to make the gathering of food more efficient, and one surmises that trade started as the interchange of tools. Now life on seasonal latitudes would be somewhat different, a point that Smith chooses to ignore, because even if there is no lateral specialization of labor, there is one over time each individual having to do different tasks during different periods of the year, actually building up stocks for times of scarcity. The great revolution in the history of mankind is the introduction of agriculture, a revolution far more momentous than the industrial revolution that had not yet occurred during the life time of Adam Smith. Many anthropologists see it as a tragedy, the natural life of man was perverted, diseases spread, general health deteriorated, life-expectancies plummeted, and a social hierarchy evolved making the life of the multitudes no doubt barren and miserable. It had one important consequence, populations soared, what was a step down for man, was a step up or two for mankind as a whole, starting the steady progress of the human species for domination on the planet. One effect of it was economics.

So back to capital, which is, as noted above, nothing but stock, mostly of goods. First there is a division of capital into productive (or potentially productive) and unproductive. The latter refers to goods to be consumed, and once consumed leaving no trace. While the productive splits up into two parts. One part consists in raw material for production or the results of it. The point is to get rid of it as soon as possible, wealth is realized by being able to exchange it for something else. The other part consists in tools that make the conversion of the raw material to finished so much more efficient. Depending on the occupation, this might be more or less substantial. The tools of a tailor are simple compared to those of an ironsmith who needs not only many more tools but also the setting up of a forge. This part of the capital should be kept and ideally for as long as possible.

Now it is not so easy to draw the lines between unproductive consumption and productive work. To eat (up to a point) is necessary to sustain life and work, so the food that an employer purchases for his employees, is in a very definite sense a prerequisite for work to be done, and thus part of necessary expense. Likewise to keep a servant frees an employer from necessary routine work, time and effort which he could have spent more productively, thus a servant can be seen as a tool. Smith chooses not to, claiming that the work of a servant is gone as soon as it has been accomplished. Consumption is what is done and leaves no trace in the future⁴. Thus the construction of a building, how useless it may be or how frivolous the undertaking, nevertheless persists through time and makes a contribution to the stock of mankind.

Economy is about the movement of capital. Every capitalist, i.e. anyone in control of stock, strives to interchange his capital for something else. Raw material to be refined and interchanged for even more raw material keeping the circulation going. The engine that drives this is profit, a word even dirtier than those denoting stock or money. The individual only sees his own profit, and thus, in the famous words of Smith, seeing inadvertently to the welfare of society at large while only pursuing his own narrow interests. How come this is possible, that the economic activity is not just a zero-sum game? To Smith the basic activity is agriculture, in a sense no other activity gives so much return. Sow a few seeds and a hundred-fold of seeds will be returned to you. The secret is of course the

⁴ Thus even when tools are worn out and discarded, one cannot say that they have been consumed, as they leave a trace in the future, namely an increased abundance of goods

sun, the solar radiation that gives to the earth the energy that is needed, not only to maintain the planet at a clement temperature, but also to sustain the photosynthesis, the process that still involves the greatest amount of energy on earth, being larger than all the combined industrial processes going on. It is this steady influx of energy that makes life and in particular economic life possible. Smith does not of course bring this up, but human economy is ultimately a branch of ecology. Wealth is produced by agricultural surplus. Such are more likely to be effected where there is much uncultivated land easily available such in the North American Colonies. Traditionally the far greatest part of surplus food produced on the land of a feudal lord could only be used in one way, namely to feed people, and thus, according to Smith a rich lord kept a large retinue and was disposed to largesse and generous hospitality. The effect of this was to enhance his power making many people either fully dependent on him or beholden or at least well disposed. The surplus food was not used as capital, it was simply squandered, producing no new wealth, and could as well have been burnt.

The secret of economy is the interchange of capital, the faster the better, the quicker the wheels are turning. The exchange can be made in many ways. One is of course the changing of geographical location, presupposing a working infrastructure of roads and canals, and the vessels to ply them. The other refers to the movement of ownership, which often but far from always, presupposes the former. Barter is a primitive means of exchange, but it works slowly, as it presupposes fortuitous meetings and involves a lot of unnecessary physical movement. Money is the solution. For one thing rather than requiring an exchange rate between any two pairs of commodities, it is enough to fix one commodity as a reference⁵. Traditionally that is done by precious metals such as gold and silver, their usefulness for such purposes not only being their uselessness for other purposes⁶, but also due to their rarity, durability and lack of bulk. The transportation of gold is trivial compared to that of corn, a commodity that Smith proposes to be more appropriate as to getting a more direct indication of intrinsic worth. Thus gold and silver are intrinsically useless as objects of consumption, the ultimate goal of all economic activity, but they are to be considered as tools for the movement of capital. A wealthy economy has a great need for money, thus the predominance of gold and silver in flourishing economies, and the source for a widely spread and deeply entrenched conception of gold and silver being themselves the source of wealth. But gold and silver are just like water in agriculture, carrying little intrinsic nurture its chief importance being as means of transportation for the same. The Spaniards and the Portuguese were looking for gold and silver in their colonial exploits, in fact those being the ultimate motivations for the same, much to the perplexity of the natives, who saw little value in those commodities. The Iberian societies hoarded their treasures to little use for themselves. The consequence being that a lot of

⁵ This is similar to the problem of translations between languages, rather than working out dictionaries for any pair of languages, it could be advantageous to invent a reference language and only compile dictionaries with respect to that one. Thus instead of having a number of dictionaries of the order of $2n^2$ we can get away with the order of $2n$. When it comes to commodities the number n is far larger than that of languages.

⁶ At the time of Smith the only other use for gold and silver was in plates and ornaments, no market yet for specific scientific purposes.

household utensils were made of those metals, when others could have served equally well the same purpose, and that much of it remained inert in coffers and treasure chambers, in effect as useless in their new locations as they once were in their original mines. Had they but been allowed to move freely across borders, from where they were plentiful to where they were scarce, as in all interchanges a net increase of wealth would have ensued.

Now money is not the same thing as gold and silver, the latter only serving its purpose. The introduction of paper money was a great improvement, it replaced gold and silver in circulation, freeing the excess for foreign trade. But of course paper money was not a substitution for gold and silver it was based on it, being but a further level of abstraction. The crucial thing was that they were linked, any piece of paper money being on moments notice convertible to a given amount of gold and silver that the banks were obliged to keep in their coffers. Would too much paper money be issued, that is more than was needed for circulation of goods, the surplus would be useless and converted to gold and silver as quickly as possible, emptying the coffers of the banks. How much paper money is needed? That is a difficult calculation and I guess one only computable by the actual workings of the markets. Banks should thus be careful in their production of paper and as soon as there would be an increased demand on them to pay up, they should immediately stop issuing them. However, it is not an exact science, with delays and unpredictable details⁷.

Now money works ultimately on human trust. Goods are more readily exchanged for money than anything else, as the former is more versatile and can be exchanged for anything else in principle. On the other hand money cannot be consumed, ultimately they need to be converted to real consumable goods. The former buying money with goods tend to enhance the value of money, while the latter, buying goods for money (or selling money for goods) tends to diminish its value. When only gold and silver are used, their scarcity amounting almost to a fixed volume, ensures that although inflation is possible, it can never run rampant, leading to the notion that those metals actually embodies some intrinsic value, while if paper money is not linked to anything tangible, its excess knows no bounds. Thus the tendency well into the 20th century to anchor paper money to gold to insure against rampage through the control mechanism of convertibility sketched above. However, this was later on considered unnecessary, a mere fetish of fossilized thinking. But paper money itself is not the final say, money being on one hand a commodity among others, only distinguished through its abstraction, being a mover of commodities of the more direct kind, there could be likewise a third tier, that is to money, what money is to food and drink, and so forth. The proliferation of such financial instruments have accelerated in modern times, the solidity of such games being a consequence of the solidity

⁷ If banks were small their issue of notes could indeed be a risky business as the fluctuations of the need for their notes could be rather steep and unpredictable. The larger the bank, statistically a smaller relative error. Thus only very big banks could sustainably engage in it, and ultimately it became the prerogatives of a national bank with the combined resources of the entire economy and the authority this might give as well as its Royal Charter if available, making for trust, the ultimate bedrock on which the institution of means of exchange rest. However, on a smaller scale, the need might be so pressing. In Italy in the summer of 1980 I recall that there was a shortage of coins, so the small newspaper stands and tobacconists and their likes started to issue their own paper money as a substitute. This was clearly a temporary measure, but it seems to have worked for the time that was needed

of the more basic economical transactions, rather than the other way around. The money economy depends on trust and delayed gratification, would everyone at the same time demand tangible consumable value for their money, there would be chaos and collapse. The same thing with higher levels economies, would they at anyone moment be forced to be reduced to a lower level, likewise disasters would ensue. At the time of Adam Smith the financial markets were rather primitive with our standards, that does not mean however that they did not involve fairly sophisticated financial tools. Smith discusses one, involving so called bank money invented and used by a financial institution in Amsterdam dealing with foreign exchanges and bullion (I.e. precious medals in unminted conditions) and involving bills of credit and debit in a rather complicated and clever fashion, explained at length by the author, but not necessarily conclusively so in order to fully explain the intricacies.

We need food, clothing and shelter. Those are the basic needs and anything beyond are luxuries. The demand for the former is limited in the sense of being effectively bound, a human being can only eat so much, wear so many clothes and live in so many houses. An economy only geared towards the satisfaction of those needs would eventually stagnate at a level far below contemporary economies if not those at the time of Smith. But when it comes to luxuries there is no satiation, thus an economy with those in mind knows no limits, no bounds. The basic stuff is provided to us by nature, human effort and ingenuity mostly concerned with the collection of the bounty and its distribution⁸. With manufacture the situation changes. The more refined the manufacture is, the less it involves raw energy, the more it demands human ingenuity. While ecology is mostly a case of the various transformations of energy, economics once manufacture is involved, deals in the fruits of human ingenuity, thus redefining the notion of human labor, which Smith as Marx sees as an intrinsic component of the value of a commodity. While for most of history men has mostly been seen as a beast of burden performing tasks that mostly demanded his brute strength, with the finer points of manufacture, mental work became something tangible. And just as with basic needs versus luxuries, the manual labor of a man is effectively bound by physiology, while his mental powers know no such limits when it comes to pure ingenuity. Thus there will be a hierarchy of commodities and corresponding consumptions, ultimately leading to a virtual economy. But just as with financial tools, the soundness at each level is just a consequence of the soundness of those below. Economies grow from bottom up, rather than from top down. Yet, enamored as Smith is by the idea of agriculture forming the basis for all economic activity, he is not above occasionally to let the cart lead the horse. He claims that the establishment of a manufacturing center, geographically advantageously situated, provides a boon for the immediate countryside, giving them an incentive to improve their cultivation. But of course life admits local reversals and contradictions, never global.

Much of Smith thinking on economics starts from the economy of the individual, and thus that the wealth of a society as a whole is just a sum of the wealths of each individual member. In particular he thinks of nations as natural economic units in a sense analogous

⁸ In a primitive society every man only provides enough to feed and cloth himself, there never being any need to develop and refine his routines, having served in the past, they will likewise, everything else assumed constant, serve in the future, as there is no incentive to improve and create surpluses.

to individuals. One advantage of paper money, as noted above, is that it frees much of the available stock of gold and silver to be used in foreign exchange. To export the same for goods does not reduce the wealth of a nation, contrary to the mercantile point of view, fixated as it is on the abstraction of money; but on the contrary enriches it (complying with a more traditional common sense⁹). In principle Smith is for a free market, shorn off customs, taxation and other artificial means of control. The bigger the market, the more advantageous for everyone concerned. Thus Smith would opt for globalization removing the obstacles for the free flow of goods and the restriction on transactions provided by national boundaries. On the other hand he respects the rights of nations and their interests, and is more than willing to forego his economic principles. The restrictions against free shipping and the use of carriage (a third party effecting the transaction between two other foreign dealers) he approves of as they prevented the Dutch, who were commercially superior to the British throughout the 17th century, to develop a rivaling navy to the British. Likewise he approves of protection of certain manufactures lest a nation (i.e. the British) would be hampered as to their ability to arm and defend themselves, Those were rather deeply ingrained sentiments of the time (and which are as strong now as they were two hundred and fifty years ago¹⁰) and which one would not expect Smith to rise above.

As an example of a more detailed economic argument one may cite his analysis of scarcity and famine, which agrees with those of modern commentators, claiming that famines are not primarily caused by scarcity but because by inferior distribution both as to space and time. That prices rise in terms of scarcity is a good thing, it makes both people control their consumption of corn (i.e. not consume it right away but to transfer some of the consumption to the future) and gives incentives for people to bring corn where it is most needed, guided not so much because of their philanthropy (Smith is suspicious of people doing good believing that they more often than not cause more harm) as their selfish interest for profit.. A crucial actor is the corn merchant that sets the price and actually effects the distribution. To forbid those merchants to act, on the basis that they aggravate the situation as greedy middlemen, as was done in medieval times, is shortsighted and stupid. The merchants who take upon themselves the distribution of corn and thereby relieving the farmers themselves of that added duty, are just another instance of the specialization of labor, on which the efficiency of modern economy rests.

Smith is an ardent opponent of what he terms as Mercantilism. What is that? It is putting the interests of the producers above those of the consumers. What makes it possible is monopoly, i.e. the artificial restriction of markets. By establishing a monopoly profits are artificially enhanced thereby drawing needed capital away from other important activities in order to satisfy a greed. High profits are bad for the morale, according to Smith, it fosters an attitude of waste and profligate behaviour which threatens to become infectious. For the sake of the advantage of the few the welfare of the many is endangered.

⁹ The Swedish King Gustav Vasa (1497-1560) deplored the exportation of valuable goods (mostly those pertaining the the basic needs) out of the country.

¹⁰ It is a common argument in favour of the European Union to claim that free integrated trade makes warfare if not totally impossible at least irrational, if for no other reason that the armament industry would be dependent on the goodwill of the putative enemy. The German unification in 1871 was prefigured by a German custom union some twenty years earlier.

Now monopolies are in particularly prevalent when it comes to colonial trade. Smith focuses for obvious reasons on the North American Colonists. By forcing them only to trade with their mother country their markets are constricted, and the smaller the market is for sale, the bigger the supply compared to the demand, and hence the lower the price. Conversely by restricting the market from which to buy, the supply is diminished, and hence the prices rise. So what may be to the advantage of the individual trader being able to sell more dearly and buy more cheaply than what otherwise would be the case, works to the detriment of society as a whole by discouraging enterprise.

Now the bad effects in the case of the colonial trade may not be so obvious as they are being masked by the great advantage that colonial expansion involves. In North America land is cheap while labour is scarce, thus there is a great demand for the latter and hence salaries tend to be high, enabling laborers to get their own land, accelerating the process of development. Agriculture generates surplus and hence wealth the effects being obviously beneficial so much in effect being gotten for free. And Smith is aware of the deprivations suffered by the Natives. In North America they were so few and their societies so primitive that they were easily effaced, while in Africa and Asia the Native populations were too large and their societies more advanced to allow such a development.

Smith in his many asides discusses the East Indian trade pursued by the Danes and the Swedes. He disapproves of it, and proposes that it is only possible by the monopolies those companies are enjoying. Without such protection from domestic competition, the undertakings would have been too risky, now they attract adventurous and reckless individuals usurping capital in short supply. Better it would have been for those countries, Smith argues, to buy those foreign goods through intermediaries such as the English and the Dutch, even if it had been somewhat dearer. On the other hand when it comes to rich countries like Holland, monopolies prevent an expansion of the trade, there being plenty of surplus capital to be ventured would there be an opportunity.

Smith emphasis is on the individual economic actor, who is supposed to act on his own narrow interests and thus furthering the interest of society as a whole much more effectively than he would, would he try to do so consciously. But there are aspects of society which cannot be left to the individual because those interests, although crucial to each and everyone do not provide enough of a profit individually to engage his or her interest. There are three major such aspects, that of defense, the keeping of justice, and finally the maintenance of the infra-structure including that of education and by extension religion. In his discussion Smith provides a fresh and engaging perspective and by the very nature of the subjects of his discourse, his prose becomes livelier and his presentation relieved from the tedium much of his reiterations of what is supposed to become obvious generates in the reader. Yet he would not be Smith if he did not take a rather crass and economic view on such matters as well.

To start out with defense, a subject probably being closest to the concern of his late 18th century readers. He makes the point that the usual passions that might drive a man to hurt or kill another fellow being, such as envy and revenge, leave no lasting rewards; while only greed that leads to theft brings to the perpetrator tangible and sometimes enduring possessions. Theft is only possible when society has grown so advanced as to present a hierarchy of wealth. In a primitive, or as Smith often would write barbarous society,

without necessarily implying either repulsion or even censure; each individual possess not much more than he or she is able to carry, in particular no stock to be coveted. Besides a hunter is as well prepared for war as for his daily chores, his skill with the javelin or bow is as useful in one activity as in the other, primitive society having no need for specialization. In a more advanced society, such as a nomadic, likewise quotidian life does not differ much from warfare, a band of nomads need to feed themselves as they wander and they could as well add looting to their activities. Consequently for a long time in history sedentary people have been at a disadvantage when compared to their nomadic neighbours, who repeatedly have conquered and vanquished great civilizations, usually without being able to maintain those conquests for very long, as that would necessitate becoming sedentary civilizations themselves. An agricultural society can to some extent defend itself by creating militias, i.e. to train every able-bodied man for the defense of his society. The Greek city states were excellent examples of that, their education involving the perfection of their bodies¹¹. In an agricultural society the work load is not evenly spread out during the year, times of intense activity being interspersed with leisure, thus if wars were scheduled at the right time of year, the majority of the population could engage in them without jeopardizing the economic basis of the society. The Greeks also proved their mettle. The next step is the standing army, i.e. an army of professionals the soldiers of which are totally committed to train for their martial tasks. A militia is at a great disadvantage when pitted against a professional army. Supposedly, according to Smith, Philip of Macedonia was the first one to set up a regular army, and the consequences were spectacular especially under the tutelage of his son, the first world conquerer. The Romans of course made the standing army the basis of their defense, but as the morals of the armies gradually degenerated so did their fighting ability and the empire eventually disintegrated under the onslaught of neighbouring barbarous societies. In the modern world the prevalence of specialized labor, the militia is no longer a viable option, as so many people are tied to their work. Furthermore technical advances in manufacture makes war a much more formidable and sophisticated affair than previously. Professional training being of paramount importance. In former times you could see your enemy, you could protect yourself against his aggression, which normally was only possible in hand to hand combat (Smith seems to have forgotten javelins and arrows); while in modern war death is liable to strike you at any moment without warning, and thus it takes much more discipline and trust in your commander than it took in ancient times to overcome your instincts of self-preservation. Thus having argued the case for a standing army the next problem is of course how it should be maintained and how its costs should be born. A standing army is a great drain on the resources of a society but a deplorable necessity.

As to a judicial system, this was formerly handled on a feudal basis when the overlord meted out justice often receiving presents for his trouble. The trouble with such remuneration was of course the possibility of undue influence, especially if those would be the only source of income for specialized judges. Smith furthermore makes a comparison between the Greek and the Roman system of justice to the great advantage of the latter. In the Greek system there was such a multitude of judges in each case that the decision became

¹¹ Reading Plato one is often reminded of contemporary elder men frantically trying to preserve their youths by working out in gyms. Gymnasiums being in fact prevalent among the ancient Greeks.

in the nature of a poll with each individual having his personal responsibility so diluted as to be rendered moot. In the Roman system there was only one judge, who consequently become the sole individual responsible and thus alone subjected to the scrutiny and possible censure of the public, which incidentally provided an incentive for the possibilities of redress and a multitiered judicial system. This forced the judge to not only ponder the case carefully but also to formulate principles on which he could rest his argument and defend it against potential attack. As a consequence he became also very aware of precedents as a last resort to justify his decision, making this a mainstay of western judicial practice. This is all and well, but who will pay? Here once again the state through its sovereign. It is important that judges are paid good salaries and that their maintenance do not depend on their decisions. In particular they should be above bribery. This is obvious to us today, and it does provide one of the pillars of a democratic society, more fundamental in a sense than popular elections. But how much should they be paid? Smith is not explicit on this point, but judging from his temper he would as much argue against a too high salary as too low. An excessive salary, besides being unfeasible, would tend to distract a judge from his callings providing too many distractions. Besides the Scottish Smith has an instinctive repulsion as to profligacy and sloth.

When it comes to infra-structure, we have the rather boring and somewhat trivial problem of passable roads, navigable canals and reliable bridges. The initiative to construct them cannot be expected from the individual merchant, and thus some larger entity has to come into play. This leads to the larger question of the pooling of resources that does not have to take place at a national level, and can also involve other kinds of activities bordering to the infra-structural, such as oversees trading over vast distances. (He has East-Indian companies in mind.) This can be done in different ways. One is of course that several merchants pool their resources together, each assuming a financial responsibility and professional engagement proportionate to their shares in the venture. Another more spectacular one is the joint-stock company, whose speculative nature goes somewhat against the grain of Smith cautious instincts. The problem with a joint-stock company, he warns the reader, that it is usually managed by someone who has no real vested interest and hence will be tempted to reckless behaviour as one is wont when dealing with other peoples money. As to roads and such things Smith is in favor of tolls, in this way those who directly benefit from their use, such as traders and ultimately consumers who will have to pay what the traders may pass on. Then one may go into technicalities as how the toll should be computed, proportional to bulk or value? In the former case punishing the poor, in the latter case effecting a welcome transferring of funds from the rich to the poor.

Really interesting Smith becomes when he discusses education, with which as most of us he has an intimate acquaintance. First and foremost Smith believes in education for its own sake and not just as a means to enhance economical activity. He recognizes, as has already been remarked above as an example of apparent conflict and contradiction in his thinking, that the demands for economical efficiency demands extreme specialization especially in menial tasks, but that this specialization goes against human nature, that it constricts the horizons of an individual and makes his life barren. Indeed, as he has already noted, the life of a farm laborer is far more satisfying than the drudgery of mechanical manufacture, and that the life of the past in barbarous societies were far more rewarding

to the individuals. The one thing that can remedy the situation in which the poor find themselves (the rich always lead more interesting and varied lives even if they sometimes may tend to waste them) is to get them a good education which instead enlarges their horizons and allow them many more things to think of beyond the narrow activities of their gainful employment. No doubt contemporaries would have judged his scheme unrealistic, but that only adds to his merit. Then he discusses university education, not without a certain scorn. The fact that university professors tended to be salaried and there really being no direct feedback between the performance of their teaching and the execution of other duties and their salaries would make them lax in the former and reluctant in the other always trying to get away with doing as little as possible¹². Here clearly Smith the economist is talking, but he nevertheless makes a good point. Furthermore that the forcing of students to attend lectures might be reasonable for small children but hardly for young grown-ups, and such measures certainly would be redundant if the teaching was good, yes even if just mediocre. On the other hand Smith of course understands that the motivations for a scholar may go beyond that of merely monetary rewards and thus acknowledges that other means of remuneration may apply in the academic world, such as prestige among peers. As to the teaching at the universities he is bitterly resenting the fact that it is so useless, especially that the teaching of science is so much retarded and carries such a low esteem. The reason for this is of course the church out of which all institutions of learning, especially higher learning have evolved. The university curricula obviously reflect the needs of the ecclesiastical profession and thus this emphasis on Latin, and somewhat more subsidiarily Greek and Hebrew. Even worse is the great emphasis on empty subjects such as Metaphysics and Ontology, vapid speculations on the nature of being¹³. How did it all come about? He then embarks on a mini-history of Western Civilization, which is worth a chapter by itself.

The remarkable thing about Western Civilization is the power exerted by the Roman-Catholic Church, a power only recently broken at the time of Smith. There are two kinds of morals, Smith explains, one is strict and for the poor masses, and one is lax and liberal and intended for the rich elite. The poor know that their existence hinges on a thin thread, that any excesses, any waste will surely spell disaster, thus they are framed for a humble and frugal life, and looks with horror and disdain upon the rich who are indeed able to be excessive in their ways, for whom there are margins of error allowing the occasional splurge, as well as the playful dallying. The Roman-Catholic religion identified with the former morality and hence acquired the trust of the simple people. Now as long as the church was united, tolerating no dissent, it became a very powerful force which no lord could challenge with impunity. As Smith notes we should not be surprised at the deference

¹² Personally I can vouch for the satisfaction, as when getting paid for an article, that comes with having a direct connection between the work you do and its remuneration.

¹³ In addition to physical education the Greek put much store in a musical, intended to educate the morals. Smith thinks little of this, arguing his strong opinion that the Romans were actually more moral than the Greek, without having the benefit of such liberal education. Smith considers song and dance to belong to a primitive stage of society and that the Greek no doubt just kept up an archaic tradition. The parallels with the so called liberal elements of to Smith contemporary university education must not have been lost on him.

the worldly powers showed the spiritual, but rather marvel at the intermittent instances of resistance. Just as the lords maintained their power and hold by the rent they extracted from their subjects, the priests lived on the tithes, producing an excess which they were not able to consume, and thus like the lords exercised power by hospitality and generosity which in the case of the poor of the parish meant literally supporting them¹⁴. Thus in addition to the moral example, the church could also add a physical, i.e. a material and economical one, and against this the revolts of reason against patently absurd doctrines based on superstition and moral coercion, stood little chance. But then what happened to the worldly lords also struck the clergy. With the development of trade and manufacture, suddenly there were things to consume and be exchanged for excess riches which formerly had been shared among the many. Human avarice works the same in the lord as in the priest and by their egoistical greed they did exchange their power over people for trinkets. The result for the church was even more disastrous than to their worldly feudal counterparts. The back bone of the Roman Catholic Church was broken, it lost its moral as well as physical hold on the masses and the way was prepared for the protestant revolution and their subsequent political implementation in Northern Europe. To Smith it was not Luther who challenged the church singlehandedly, economical developments had already undermined it making the time ripe for the high-minded oratory à la Martin Luther. In this materialistic explanation Smith is of course very Marxist. Now the worldly powers that seized the power of the church, and to some extent its riches, were obviously not motivated by religious zeal, this would even test the naivety of school-pupils, but merely by worldly¹⁵ advancement. The most extreme example is of course the English one, in which Henry VIII usurped for private reasons the power of the Pope, and without the church being otherwise significantly reformed. In the Scandinavian countries as well as in Germany, the reformation actually made a difference, and as Smith argues, a new religion opposing the authority of the old, will enjoy a dynamics that the established will invariably lack, and in addition to enjoying a moral and popular support, they will often boast an intellectual one as well. To modern readers the parallels with radical political movements of the 20th century can hardly be lost. The protestant movement split into a more moderate Lutheran and Anglican one, in which the previous top-down power structure remained intact, and a more radical one of bottom-up Calvinism, in which priests were actually elected by their parishioners, a democratic procedure that carried its own complications, In the more moderate reformation a new kind of modus-vivendus developed between the clergy and the elite, the former being appreciated by the latter not only for their flattery but also their erudition, especially in ornamental learning, good manners and stimulating conversations, while with regard to their flock they tended to become more and more alienated the more established and ossified the church became. As a prediction of the fate of the Lutheran church in the last two hundred years this is very astute, and predictably the revival of religious sentiments have been brought about by new sects and grass-root movements nourished by a more and more secular civilian government. The proliferation

¹⁴ And not only the poor. The spectacle of down-and-out noblemen making the circuits of the abbeys and monasteries, ostensibly out of devotion and piety, was in fact just another case of hand-outs.

¹⁵ Smith is familiar with Gustav Vasa, the tyranny of the Danish king Christian II and his ally the bishop Trolle, although he spells names wrong and cannot even get the name of the town Uppsala right.

of religious sects, none of which can threaten to obtain a monopoly is of course fully to the taste of Smith. He notes that in fact a country did not have to become reformed in order to establish its power over the church, France being a prime example of a country that stayed nominally Catholic but in which the Pope had no political influence. France, not surprisingly became an ally of the Protestant Sweden in the Thirty Years War, but Smith does not discuss the fact that Catholicism did not suffer a total defeat that after its initial set-back it kept its position and became maybe even more established in Southern Europe than before. A classical explanation of this fact is the Weberian one to the effect that trade and economic development was mostly a Northern European affair, and that commerce is antagonistic to religious authority, and the greatest threat to it is, as it was in medieval times, consumerism, now not so much among its rank and file, but in the flocks themselves. Muslim fundamentalists certainly know what they are talking about and are making a correct diagnosis. But of course this is all two centuries beyond Smith, yet his analysis provides an 'analytic continuation'.

Finally Smith returns to the issue of youthful instruction and the relation between universities and the church. A common practice among the well-heeled is to send their youths abroad. The results are considered to be quite beneficial and instructive. Smith remains skeptical. Between the ages of eighteen and twenty-two youths are very impressionable and no matter what they will improve and make great progress no matter what. And what is really so beneficial about those years abroad? That they pick up a smattering of foreign languages? They are as likely to pick up bad habits. Smith foresees instead a reformation of what is to be taught at universities, and he suggests science as not only useful but as a powerful anti-dote to sloppy thinking and superstition. The church and the universities are in constant competition when it comes to the best mind of letters. If the church can offer better material prospects they will get the pick. This is what has happened in France and the Mediterranean countries, where you can almost find no real scholar of repute in the university. While if material opportunities are the same, such minds will prefer universities.

Governments are necessary, they provide the stable context without which manufacture, trade and commerce could not function, because economical transactions are built on trust and the protection from external as well as internal enemies bent on its subversion. Thus Smith acknowledges that the economy unlike the natural world, is not entirely self-sufficient, ultimately it is based on human institutions, whose need may be created by economic activity but not their existence. Government, with the sovereign on top, need to be funded. How could this be done?

First only in very small states could the governor be a businessman himself, if the state is larger, the demands upon the sovereign are so varied and pressing that he cannot have the leisure nor the energy to pursue his business it with the attention it deserves. To delegate the business to others, Smith disapproves of, this would always lead to neglect and mismanagement, because people who deal with the money of other people, tend to be reckless, only by pursuing their own private interest may we trust to their judicious application and devotion. For the same reason Smith disapproves of the government owning land, such land that is in the hands of the crown is usually neglected and undeveloped, and the crown would have reaped much more benefit from it, had it been in the hands of private

contractors. Thus the most reasonable way of generating revenue is to raise taxes. This is, however, a tricky business. Taxes can be levied on a great variety of things, land, stock, goods of consumption and wages. Taxes should be fair and predictable, easy to compute and to collect, and the collection should not infringe on the basic liberties. Some taxes interfere with workings of the economy more than others, and should thus be avoided. Examples as such are taxes imposed on the wages of poor people, or on the necessities of life. The effect of such taxes is merely to increase the wages of people, thus making labor more dear, which will increase the costs of production and manufacture, costs which in the end will be passed onto the consumer. The total effect might be nil. To tax land and buildings is fairer, unlike stock of commerce, they are transparent as to their value, immobile and hence clearly attached to the country, unlike stocks which are far more fluid and international in their possession, and of course far more difficult to assess. Taxes on luxury consumption, such as alcohol, sugar and tobacco, are of course commendable, but consumption should never be taxed too heavily, a moderate taxation by not depressing the amount of consumption too much, may generate a greater revenue than a rapacious one. In fact consumption being the engine that drives the economy, it should never be thwarted, thereby killing the goose that lays the golden eggs. Now taxes on goods can be levied at various stages, such as when brought into the country, known as customs, or when being transported inside the country, or sometimes when being merely in transit¹⁶. The problem with customs is that it sometimes is so cumbersome to impose that a large fraction of the revenues are spent on its collection, in addition it provides the temptation of smuggling, an activity that most people do not think of as morally contemptible. But the needs of the Government are not constant over time, but suddenly, as in the case of war, those may rise steeply, and the imposition of new taxes may in addition to being unpopular and resisted be too slow to meet the urgent demands. Then there is borrowing. As the Government is considered to be solvent and secure, lending to it is attractive, and done by merchants in order to make a profit. In fact credits given to the government can be sold often at a profit and thus there will be a long chain of deferments. In this context Smith also digresses on an extended discussion of annuities, without going into mathematical detail¹⁷. In fact throughout his treatise there is no mathematical formulas, and numbers only occur in the list of expenses and national debts often noted to the fraction of a penny, testifying to the conscientiousness of accountants. Smith disapproves of debt as a method of waging war. If wars would be financed by excessive taxes, there would be much more reluctance

¹⁶ Such as the king of Denmark imposing a duty on goods passing through the sounds.

¹⁷ An annuity as I understand it, is to purchase the right to get certain periodic payment, either for a limited time, or throughout ones lifetime or in perpetuity. In fact it does not significantly differ from lending a certain amount of money, to be repaid in installments. What makes annuities work is the notion of discounting the value of future payments by a fixed (and positive) discount rate. Thus we get the summing of geometric series, whose convergence make perpetual annuities possible. Now there is a twist in the presentation, by talking about annuities valid for the lifetime of a buyer, an element of chance enters. As people are bound to overestimate their remaining life expectancy, they will be willing to pay more for such annuities than they are statistically worth (and thus more than for what they can expect to sell them for, as Smith remarks sarcastically). Thus we are talking about a kind of lottery, incidentally another useful source of revenue to a government.

in waging them and a greater readiness in ending them¹⁸. While countries such as Spain, Holland and the Italian Republics early on got into debts, this happened only with Britain in the end of the 17th century, then during the wars of the 18th century, the national debt rose steeply during wars and were only moderately reduced during long periods of peace. Great Britain at the time of Smith's writing had about eight million inhabitants, but it was able to raise a revenue of ten million pounds, while France with three times the population, and being far more liberally endowed as to its soil and climate, was only able to raise half of the predicted sum. To some extent maybe due to tax being disproportionately levied, a large fraction of the population, and the richest to boot, being exempt. Smith is always partial to the ideas of taxes having an equalizing effect, that the rich should be taxed more severely than the poor and thus that at least some of their excess should be transferred to the needier. Great as the tax revenue was of Britain it was soon dwarfed by the accumulated National debt which had risen from some five million pounds at the end of the 17th century to close to 130 millions when Smith wrote.

Finally Smith discusses ways of increasing the British tax revenue. The obvious way would be to include not only Ireland into the union, but also the overseas colonies. The latter could easily support a large collection of tax, which should only be fair, as the mother country herself had gone to wars to protect it, thereby incurring large debts. If the colonies would be adverse to the idea of being fully subsumed in Britain, the best thing would be to sever the ties altogether, because the present monopoly has in effect been much more of an economic liability of Great Britain than the obvious advantage it appeared to have been.

To summarize the work of Smith one needs to first and foremost understand that this was the first serious effort to reveal the inner workings of economic activity, to go beyond the mere outward signs of it. Thus Smith inveighs against the specious articles of faith held by mercantilism. In particular to hammer in the obvious fact that gold and silver are merely the symptoms of wealth, not its sources, and that many schemes that appears to raise the wealth of a nation were in fact counterproductive. To Smith consumption is the central part of economy, and that all production has at its ultimate goal to result in the great sink of consumption, which thus provides the ultimate motivation and 'raison d'être' for all economic activity. Now when consumption, as in most primitive societies, is restricted to the necessities of life, economy is by necessity very restricted, because there is a natural bound on how much a man can consume of life's necessities. The notion of profligacy is impossible in such a primitive society, a man can never ruin himself by hospitality. According to Smith in such an economically primitive society a small elite can hold the greater part of the population in abeyance by its outright dependence on those who holds the means of production. By the introduction of manufacture, the goods for consumption becomes far more varied, and being in the nature of luxuries, do not admit to

¹⁸ However, Smith notes sarcastically, that the inhabitants of a Nations capital, or other citizens sufficiently removed from the scenes of war, experience little discomfort in the raising of war-time taxes, a discomfort more than compensated by the amusement they derive from reading in the papers about the military exploits of their country; and consequently they tend to see the cessation of hostilities as merely frustrating their wishful visions of future military glory and the treasures such would have brought in its fold

any such bounds. Thus the risk of waste and ruin become very real, and by exchanging their surplus for trinkets for their own selfish enjoyment rather than for hospitable sharing, the feudal lords, be they worldly or spiritual, also exchange their power for a spurious wealth, that is as liable to ruin them as to satisfy the insatiable. Thus modern economic activity has had an effect of democratization, although Smith does not say so explicitly, and its scope should not be restricted, hence Smith is a principled opponent to external meddling as well as monopolies, and advocates a trade freed from duties as to enable as large a market as possible. The larger the market, the greater the growth of wealth, and the more benefits to be accorded the poor, arguments which in our days are echoed by proponents of globalization.

Smith is a moralist, who values frugality and is abhorred by great inequities of fortunes, which has constituted the main criticism against the laissez-faire economics to which his name is inextricably tied. His emphasis on consumption must be understood in two senses. First that it gives an elegant basis for a theory of economics. Secondly that in the time of Smith, consumption was on the large very limited, and the few conspicuous exceptions by the very rich, more likely to provoke his censure than to stimulate his admiration and grant his approval. Thus consumption as such did not in any way threaten our long-term survival. It is of course a matter of pure speculation as to what Smith would have said on the present consumer society two hundred years after his death¹⁹. Furthermore Smith is a pioneer, he is only out to reveal the basic principles of economy, any detailed mathematical analysis is clearly beyond his ambitions, such would have to wait for the 19th and especially 20th centuries. Yet, as a basic course on economics, his work has not entirely lost its relevance, and reading it two-hundred years later it appears strikingly modern and fresh, and the triteness that we may at times detect is more due to the success of his ideas having become commonplace than to their naivety.

Finally Smith by the modernity of his language and his points of view, tricks the reader into seeing him as a contemporary, and hence to read him as if he was a foreign correspondent set back to the 18th century, vividly reporting on what is current. This belongs to the charming aspects of the work, something that is entirely missing in more modern technical treatises on economics. And occasionally, not so often as to render it tedious, as modern American jocularly tends to do, he drops some sarcastic comment, some examples of which already noted in previous footnotes.

May 21, June 13, July 18, July 31, August 8-9, August 12, 2009 **Ulf Persson:** *Prof.em, Chalmers*
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¹⁹ Any such thought experiment, if implemented, would have no doubt produced such a shock in the ancients, as to make any of their opinions moot.