# ADAM SMITH

### Selecting from the *Wealth of Nations*

**1st week:**

Book I (Chapters 1-4, 7-8), Book II (Chapter 3), and Book IV (Chapters 1-2).

**2nd week:**

Book II Chapters 1-2 (but stop at 322!), Book III Chapter 1, the discussion of the American Colonies in Book IV (663-75), and the very important discussion of education in Book V (819-46); I also recommend 981-6, 1025-8.

**Book I**:

Smith’s basic framework

Chapter 5, first 3 pages: Discussion of division of labor and his approach to the notion of value

Chapter 7: (Beginning) Equilibrium arguments about the stabilization of prices as a result of supply and demand.

Chapter 8: very important because of Smith’s discussions of the stationary state, and the “liberal reward of labor” (a crucial notion for correcting the common stereotype of Smith as uninterested in issues about the distribution of wealth).

**Book II:**

Opens with a characterization of the capitalist entrepreneur

Chapter 2: Smith’s answer to the implicit question of his title (311 tells us how to measure the wealth of a nation).

Chapter 3 provides a sketch of the moral perspective behind Smith’s political economy, and also contains important briefs for the operation of the free market (373, 377).

**Book IV**

The classic defense of free trade, perhaps the doctrine most closely identified with Smith by his modern admirers; the famous discussion of the “invisible hand” occurs in Chapter 2 (485).

**Book III**

Smith’s attempt to show how economic factors are deeply involved in the history of western civilization (warm-up for Marx’ historiographical project).

**Book IV**

Passages on colonies and colonialism in are amazingly prescient.

**Book V**

Under-read. Explores the public goods that are needed as backdrop to the smooth operation of the market. Wonderful way of posing questions about the arenas in which a society might not want to leave everything to market forces. The discussion of education culminates in a recognition of the consequences of the division of labor that leads to the brink of the early Marx.

### Background and Life

Smith lived from 1723 to 1790. A younger contemporary of David Hume, he became a professor at Glasgow University in 1751, where he taught a wide variety of subjects. After 1764 he became private tutor to the Duke of Buccleuch, and eventually received a pension that enabled him to live in Edinburgh and write.

In 1759, Smith published *The Theory of Moral Sentiments* (TMS), a work that went through six editions in his lifetime. Like Hume, and like their common teacher Francis Hutcheson, Smith develops an approach to morality based on our emotional responses. For most of the twentieth century, TMS received less attention than it deserves. WN was published in 1776, and was well-received. Smith was offered an administrative position (as Commissioner of Customs for Scotland), and he eventually became Rector of the University of Glasgow. Late eighteenth century politicians sought his advice. According to a famous anecdote, on one occasion when he visited London, the leaders of the government rose in respect until he was seated.

### Homo economicus

One obvious way in to WN is through the concept of the person Smith articulates and presupposes in his economic analyses. In arguing for the response of prices to supply and demand, or in exploring the consequences of free trade, he supposes that individuals will pursue their economic well-being. It’s very easy to view Smith as the father of the concept of rational agents deployed in contemporary microeconomic theory.

One of the most famous lines in WN occurs relatively early: “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest” (15). From this line, you might expect that Smith has a very simple – even simplistic – psychological view. Interestingly, TMS provides a rich notion of the person; beginning from the assumption he shares with Hume, that people have a natural disposition to sympathize with those around them, Smith argues that our propensity to want to be in harmony with the emotions of those around us, leads us to regulate our conduct by submitting our decisions to the judgment of conscience, conceived as an internal impartial spectator (“the vicegerent of the deity”, “the man in the breast”). Out of this comes a wide range of emotional tendencies and dispositions. The psychology of TMS seems to go very much beyond the very simple story of *Homo economicus*, the butcher or brewer dedicated to his own interest, narrowly defined in terms of wealth, and concerned with nothing else.

This gives rise to one of the most discussed issues about Smith – the “Adam Smith Problem” (or, more exactly, *das Adam Smith Problem*). Some commentators suppose that there’s no need to reconcile TMS and WN, that it’s perfectly reasonable for Smith simply to leave out of account some of the dispositions he introduces in TMS when his attention is on a specific context of human behavior. I don’t think this can be right. The analyses of WN depend on *identifying exactly* the aims the agents are trying to achieve. If some of the agents’ goals are left out of account, there’s an obvious danger of arriving at erroneous conclusions. You can see this by supposing that the butcher has an interest in seeing that all those around him are well-fed. In a situation where many can’t afford the standard price of meat, a sufficiently strong disposition of this kind will lead to lowering the price beneath the level it would otherwise attain. If there are strong sympathetic tendencies, or a propensity to listen to the voice of a conscience that demands generosity, then the claims of WN are going to be wrong.

The right answer to the problem is to recognize the more complex psychology of TMS, and argue that certain features of it would inevitably have to be neglected in economic contexts. To carry this through, you’d need to look at the places in which Smith appeals to the notion of *Homo economicus* and try to show that agents who deviated would be driven out of the market. So, for example, the generous butcher wouldn’t be able to sustain his program against competition from rivals. This presupposes, of course, that there isn’t a sufficient background of generosity to boycott butchers who failed to act similarly. The next step would have to be to suppose that groups who insisted on generous policies of distributing goods to those unable to afford them would be outcompeted by more ruthless groups. Plainly this can lead into fundamental issues that have dominated economics and political theory ever since Smith.

### Political Economy

WN is often seen as the first treatise in political economy, and Smith is viewed as founding a new discipline. Critics sometimes argue that it’s not genuinely original: the standard charge is that all the main conclusions were stated by earlier thinkers and that Smith’s achievement was to bind previously separated material together. I think this is a bit unfair. What’s most innovative about WN is Smith’s clear vision of a host of interrelated problems about the functioning of societies, and his articulation (and refinement) of previous concepts, techniques and claims to address those problems.

Smith was extremely influential. The later work of Malthus, Ricardo, James Mill, and John Stuart Mill builds on his agenda and on his attempts at solution. When political economy gives way to neo-classical economics, it’s quite easy to see economists from the late nineteenth century to the present as giving precise mathematical expression to ideas that are formulated qualitatively in Smith. In his *Economic and Philosophic Manuscripts of 1844*, Marx clearly takes the conclusions of standard political economy from Smith – the famous “Alienated Labor” is preceded by three essays that are summary and commentary on WN, with occasional references to later updates (Marx is completely accurate in beginning “Alienated Labor” by asserting that “we have begun from the premises of political economy”). Later, Marx adopts a much more negative view of Smith, and, in *Capital*, the heroes of political economy are taken to be Ricardo and a new candidate for founder, Sir William Petty. (Some of the dismissal of Smith surely rests on Marx’ revisionist history of political economy.) Petty was a member of the early Royal Society, a contemporary of Pepys, who wrote on the economic and social issues of Ireland.

Another way of introducing WN is to try to locate its place in the history of economics and of social science generally. I like to ask my students why they think topics like money, wealth, and commerce start to get discussed in the seventeenth and eighteenth centuries. An interesting way to approach the question is to point out that, in the late fifteenth century, the Spanish and Portuguese seem to gain access to extraordinary sources of wealth – they are the ones who open up “Eldorado” in the New World, and who find their ways to the spice islands of the East. Yet, by the seventeenth century, the wealth – and the political power – seems to have been transferred to three European nations, France (a traditionally strong power), Britain (rather backward from the perspective of the fifteenth century), and the Netherlands (recently emancipated from Spain). These countries seem to control only the least profitable bits of the Americas. So how do they come to be so wealthy?

I think this puzzle sparks interest in the sources of wealth and power. It’s really surprising that all the Spanish and Portuguese gold doesn’t result in lasting wealth. One of the main themes of WN is its insistence that wealth consists in productivity (311). Smith’s diagnosis is that gold only generates wealth if it’s used in starting a form of manufacture. Again and again, throughout WN, he campaigns against the idea that you ought to restrict the flow of gold out of a country (Book IV Chap 1 is a great source).

### Division of Labor

Because Smith takes the key to productivity to be division of labor, this is where WN starts (see the opening sentence of Book I Chap1). You should probably emphasize to your students that Smith’s work antedates the industrial revolution; he’s explaining the dynamic of an earlier form of capitalism. You’ll probably want to talk about the pin factory, but it’s useful, even at the beginning, to isolate and discuss Smith’s psychological assumptions. Allegedly, specializing on a task enables people to work more speedily and efficiently (7), but, as he’ll note much later, there are costs resulting from boredom (840). I’ve often contrasted the passages with students, and asked them why they think Smith didn’t go back and rewrite the entire book, once he’d understood the full implications of the intensification of the division of labor.

The opening two chapters of Book 1 make it seem as though there’s a seamless transition from the division of labor to something very like capitalist manufacture and trade. Smith writes as though the division of labor issues in a situation in which each worker will have a surplus of goods (12), but this doesn’t seem to be an immediate result of the specializations in a primitive state (16). Although he doesn’t distinguish them, there are two modes of the division of labor: in one, the members of a social group apportion the necessary tasks for the group according to the individual talents (each gets to do that job for which he/she is most suited), and this results in a more efficient production of all the goods and resources needed for the group; the second mode goes further, using the apportionment to yield a stock of goods and resources in excess of the group’s needs. On the first scheme, division of labor is simply a way of increasing leisure time; each of us does what we do best so that the work can be finished more quickly (even here there’s an assumption that the talents fit the distribution of tasks and that each of us has some special skill). On the second scheme, division of labor is able to generate goods and resources that can be traded with other groups. Smith leans heavily on the idea of a natural propensity to “truck, barter, and exchange one thing for another” (14).

I like to introduce this distinction as the basis for a discussion of the inevitability of capitalism. Smith leans heavily on his conception of the interests of *Homo economicus* in claiming that we’ll be led to the second mode of the division of labor. From this point on, we learn that the motivation to accumulate will lead to the expansion of the market, and ultimately to the introduction of money as a medium of exchange. It’s interesting to contrast this account with that provided by Marx.

### Setting Prices

Smith’s account of prices is complicated by the fact that he offers a theory of value. After making the standard distinction between use-value and exchange-value, he suggests that the ultimate measure of exchange-value is labor (33). The point of this account of value is to be able to distinguish two possibilities when relative prices shift: if the price of bread declines in relation to the price of iron, then it may be that the value of bread has fallen or the value of iron has risen. Contemporary economists feel no need of a standard by which these possibilities can be distinguished. Essentially, they would count bread as losing value if the relative prices of most other quantities were now higher. For Smith and his contemporaries, however, there are important questions about which kinds of goods retain their value most consistently. Hence, like Marx after him, he wants a theory of value.

The two theories are apparently similar, since both talk about labor. But Marx has a quite sophisticated concept (socially necessary labor time), while Smith tends to think of the value of a product in terms of the amount of labor it can actually command. He’s not entirely consistent about this: sometimes value is measured in terms of the amount of labor that went into the production process, but the more common idea is the amount of labor you can *save yourself* by exchanging the product for the labor of another.

Unless you are going to discuss the material from the beginning of Book I Chap 5, you should probably try to talk about price setting without taking up the complications of the theory of value. The crucial idea behind Smith’s analysis is that markets will tend to operate to equilibrate prices. If the prices of X rise then there will be an incentive for people producing other goods to transfer their production to making Xs; supply will therefore rise and the price will fall. Contemporary economists have proved general theorems about “market-clearing equilibrium” that essentially develop and refine the arguments of Book I Chap 7. I recommend looking at the discussions in this chapter with an eye to identifying what Smith needs to assume. There’s an obvious sense in which the model he sketches is *frictionless*. He supposes that capital and labor can flow immediately, without any check or cost, to the ventures which are, at the moment, offering the best profits. You can ask your students how realistic they think this is. How much of a handicap to the free-market economy is it that, in actual fact, workers may have a bundle of non-transferable skills and entrepreneurs may have capital already invested in plant and technology?

After Smith, there’s an interesting debate about which of the three classes he identifies within capitalist societies – entrepreneurs, landlords, and workers – have aligned interests. In keeping with ideas of French economists, he’s inclined to stress the fundamental importance of land (this is already seen in the discussion of the development of markets in Book I Chap 3, and it’s a recurrent theme of the history of Book III), he tends to think of the landlords and workers as potential allies against the possible depredations of the entrepreneurs (284-8). Ricardo later offers an analysis of rent according to which the relations are different: entrepreneurs and workers have common interests, and landlords are the potential villains.

### The Liberal Reward of Labor

Smith is commonly viewed as a social conservative who has little interest in, or sympathy for, the plight of poor workers. This stereotype descends from the plaudits heaped on Smith by Thatcher and Reagan (although I think it’s arguable that part of their enthusiasm for Smith is that they accept his attempt to show that workers will be better off under free-market capitalism). Interestingly, Smith not only advances this argument, but also insists on the inequity of permitting collusion among entrepreneurs while disallowing unions among workers (see 75-8). I like to discuss the passage (90) in which Smith commits himself to the view that just societies require providing for the least fortunate members.

Smith’s account of how to help the poor (and you might point out that this is the first time that poor workers have surfaced as a source of concern in CC) begins quite early in WN. He sees very clearly that the notion of poverty involves both an absolute and a relative notion; the praise for the division of labor ends with the thought that, in a productive society, even those at the bottom may have access to goods not available to those at the top of a less productive society (the European peasant and the African king; 12-13). You can be poor, then, by not having much, or by having less than those around you. It’s worth asking your students how these factors trade off in their conception of poverty.

The *stationary state* is that condition in which the returns to the workers are just sufficient to enable them to survive and to leave behind them exactly the same number of replacements. In effect, the productivity of the society supports a population level that remains constant across the generations. Smith points out that you can have societies with different levels of productivity and both (or all) in the stationary state. In these societies, the workers won’t be well-rewarded. He concludes (79, 81) that the situation of the workers isn’t a function of the absolute wealth of a nation. Instead, it depends on the rate at which the economy is growing. Wages are higher if labor is relatively scarce, so that, from the workers’ point of view, the best situation is one in which there are plenty of opportunities for entrepreneurial investment.

Unlike some later thinkers (e.g. J.S. Mill), Smith doesn’t offer a general discussion of *distribution*. This isn’t because he’s unconcerned with the plight of the poor, but because he thinks that a growing economy will automatically transfer wealth to the bottom strata. He thinks there’s historical evidence for the fact that the situation of the poor has improved (87-89). The worry is that the liberal reward of labor can only be temporary. Smith recognizes the Malthusian point about population expansion (the point Darwin made central to the idea of the struggle for existence – 91). If the workers are receiving resources beyond the level of replacing the workforce, then it seems that the workforce will inevitably grow; or, more exactly, workers’ children will have a higher probability of survival. Hence the workforce will be larger, and the shortage of labor will decrease. Eventually, the workforce will be adequate to the demand for labor, and the liberal reward of labor will disappear.

After Smith, political economy becomes haunted by the threat of the stationary state (this is particularly evident in J.S. Mill’s *Principles of Political Economy*). Does population growth make it inevitable, even in the most productive society? A standard contemporary answer is that economies can continue to avoid the stationary state by technological development. You can have very good discussions with your students about this – and it makes a good warm-up for arguments about the inevitability of the demise of capitalism.

### Productive and Unproductive Labor

Chaps 1 and 2 of Book II are useful if you want to probe Smith’s account of the entrepreneur (perhaps by looking at his claim that those who don’t invest are crazy [309]) or if you want to consider his views about the role of money (seen as a “wheel” for circulating goods [314] and explicitly divorced from any measure of the wealth of a nation). But the principal interest of Book II for CC lies in the contrast between productive and unproductive labor and the consignment of government to the unproductive category.

Smith anticipates his historical story in Book III by classifying some occupations – particularly those that were most prominent in medieval society – as unproductive labor. What distinguishes unproductive labor is that it leaves nothing tangible behind (361): so the actor, the musician, the servant, the priest, the doctor, and the lawyer are all unproductive. The division is pejorative. From Smith’s perspective, you’d like to assign as large a percentage of your population as possible to the productive category. But this seems a mistake. For you might think of the allegedly unproductive labor as making possible or enhancing the output of the productive part of the workforce.

There are two ways to put the point. One is to argue that Smith’s distinction is misconceived. Some forms of allegedly unproductive labor ought to get credit for a part of the output of the supposedly productive workers. If a doctor makes it possible for a group of workers to work a larger total of days than they would have been able to without the doctor’s ministrations, then it seems that the doctor ought to be credited with the excess production. The second way to put the point is to concede the distinction as Smith draws it, but to argue (in accordance with 311) that the important measure is the productivity of the whole nation. If a nation were to assign all the unproductive labor to productive work, it’s not obvious that the total output would increase. Although you get something from the former doctors, the loss of workers to disease and premature death may be so large that you suffer a net deficit.

This seems highly plausible for doctors, lawyers, some forms of service industry, and so forth. Will it also work for the clergy, for artists and for entertainers? You can get your students to discuss this. Some will probably claim that there are psychological effects on workers that lead to an increase in production. But even if that’s right, is it a convincing defense? Is the relentless emphasis on the simple psychology of *Homo economicus* getting in the way here?

As Book II Chap 3 develops, Smith’s moral perspective becomes evident. There’s a clear bias against luxury, prodigality, unfruitful hoarding, and for prudent investment, supply of necessities, and hard work. You might ask your students whether it’s reasonable to take these moral qualities as parts of human nature. They might reflect on the echoes of Calvinism in Smith’s phrases.

The eventual point of this discussion is a critique of government interference. Employing a large number of courtiers is obviously an exercise in unproductive labor. But the serious question for us – one that I don’t think Smith answers completely at this point – is whether some kinds of administrators are needed to enhance productivity from the “productive” part of the workforce. The argument from 372 to 377 is worth close analysis. You should ask whether Smith’s critique is intended to apply only to the private spending of rulers (on “trinkets”), or whether it also covers public expenditures. This is an opportunity to explore the necessity of certain kinds of public goods within a capitalist economy (even though that topic doesn’t receive extended discussion until Book V).

### Free Trade

Smith’s famous advocacy of free trade occurs in his attack on the “Mercantile System”. Scholars incline to think that this way of setting things up is somewhat unfair in that there was no such “system”; rather, Smith was criticizing common practices of restricting imports and encouraging some kinds of domestic industry. The basic argument is simple. Imagine that Scotland can’t produce wine as cheaply as France can, and that the Scots government protects the domestic wine production by imposing a tariff against *vin*. It follows that wine-drinking Scots are going to pay a higher price than they might have done in the absence of a tariff. Consequently, there will be some wasted resources within Scotland that might have been put into another form of production (woolens, say). If we imagine two scenarios, one where the Scots make tariff-protected wine and one where they import *vin* and make woolens, the output of the Scots economy will be greater if they pursue the latter.

Nor is there any real hardship for the erstwhile winemakers if they switch to woolens. For they can obtain at least the same return on their investment from a more productive employment of their capital. Further, they won’t be tempted to transfer their winemaking to another place – Bordeaux, say – because Smith thinks that they can’t increase their profits by doing that, and they do run a greater risk; the risk is greater because of the difficulties of supervising an operation at a distance from one’s home. Hence everybody benefits from a policy of pursuing private economic interests.

This is the point of the famous “invisible hand” (483). Collectively good outcomes result from uncoordinated pursuit of individual interest. Smith’s basic normative theory of society conceives social institutions as devices for bringing about this harmony. The governmental task is to set things up so that each individual does well and, in doing well, serves the public good. Free markets are viewed as important devices for achieving this, but it would be quite wrong to conclude that Smith favors free markets in everything. As I interpret Book V, a large part of the business of designing a well-functioning society is to identify those areas in which arrangements can be left to the market, and those places in which some non-market plan is required to set up the conditions that allow the markets to work their magic. Even if you don’t assign Book V, you can ask students to consider what kinds of securities are needed for Smith’s analysis of unprotected domestic business to go through. (You’ll need some mechanisms of defense, for a start.)

The argument about free trade is also a good place for considering fundamental conditions presupposed not only by Smith but also by contemporary analysts. As with the account of Book I Chap 7, things are supposed to be frictionless – capital and labor can move smoothly into profitable channels. Smith sometimes recognizes that this can be problematic (499 suggests that you may need a gradual relaxation of tariffs so that workers can be retrained). But the whole account is dominated by the optimistic assumption that each country will have some aspect in which it can be economically competitive (see, for example, 496). Is this always true? Further, you might discuss with your students whether the technological conditions of today undermine Smith’s claims about the greater profitability of domestic investment. Does Smith have a defense against the worry that globalization combined with a completely free market will inevitably force a precipitous decline in the wages of workers in hitherto affluent nations?

Colonies

Smith gives an extensive analysis of the economics of colonies – plainly an important topic in an era in which different countries were experimenting with different styles of colonial intervention. He’s very clear that setting up “an exclusive company of merchants” is a bad idea (615). The best arrangement, he claims, is that found in the British colonies of North America (616-7). This sets the stage for his response to “the troubles” of the 1760s and early 1770s. He attacks the idea of insisting on an exclusive trade with the mother country (650, 655, 657).

I recommend discussing Smith’s attempt to resolve the issue between Britain and the Colonies (663-75), either in considering WN or in your treatment of the American Revolution. This passage not only reiterates Smith’s opposition to artificial protections and monopolies, but also recognizes the need for background conditions to secure production and trade (military defense, judiciary etc.). There are also some interesting claims about the nature of political representation, and the political motivations of the colonists. But the most important idea is the suggestion of a full political union between the mother country and the colonies, with the seat of government to be determined by economic factors (674-5). Smith sees very clearly that the economic potential of North America could easily lead to a situation in which the former colonies would be the principal partner in any union.

### Education

Book V is full of interesting discussions about the background conditions that free markets need for their smooth operation. The points about education are particularly interesting, and, in my experience, students often have strong views about Smith’s claims. He insists that education should be useful and attacks a classical curriculum. He holds that teachers, especially at the University level, should be subject to the pressures of the market, so that remuneration should depend on teaching success. He suggests that there is likely to be a serious human problem posed by intensifying the division of labor, so that workers will become dull and “torpid” (840, 846). This problem is to be solved by setting up a system of education in which all young people (or boys?) learn the “useful arts” – reading, writing, arithmetic, and parts of mechanics. If these schools are not subject to the pressures of the market, then they are not likely to do their job well. But the parents of the children will probably be unwilling to invest in education.

The resultant position is contradictory in several different ways. Smith wants education to be both a backdrop to the market, and to be subject to market forces. He wants universal support for an institution he thinks is unlikely to attract the support of those whose children will benefit from it. He believes that the division of labor is the key to the success of nations, that the success of nations requires the happiness of the workers (90), but that division of labor leads to a state of numb alienation. It seems to me that this is the point at which all the tensions within WN become clearly visible. We might wish that Smith had used it as the point of departure for a reappraisal of the doctrines advanced earlier. But he didn’t, and that shows something important about the difficulties of his theory of capitalism.

### Sources

If you have time to read more than you have assigned, I think the best use of it is to read more widely in WN. After that, I recommend the following sources:

Robert Heilbroner *The Worldly Philosophers* (there’s a good chapter on Smith, and the whole book is well-written and informative).

Emma Rothschild *Economic Sentiments*

Pierre Force *Self-Interest Before Smith*