

“Opulence and Freedom”: What Adam Smith Could Teach Us about the Future of Capitalism*

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“Opulence and freedom, the two greatest blessings men can possess” (LJ (A) iii.111)

I. Introduction

I have started my career as a Smith scholar: I wrote my BA and MA theses on Adam Smith at Waseda University, studied John Rae, Scottish-born Canadian economist and a fierce critic of Adam Smith at Graduate School of Economics at the University of Toronto, and written my first paper on Adam Smith’s division of labor. Since then, my interest has drifted partly because Japan experienced the Lost Decades where deflationary recession became the major issue for economists. So, I have started studying the interactions between economic ideas and policy during the Great Depression and other economic and financial crises, commenting also on the contemporary Japanese economy (Wakatabe 2015b). Then I happened to have become Deputy Governor of the Bank of Japan from March 2018 to March 2023, getting

* This is a keynote speech I delivered at the International Adam Smith Society Conference held at Waseda University, Tokyo, Japan on March 11-13. I would like to thank Maria Pia Paganelli, Tatsuya Sakamoto and Shinji Nohara, main organizers of the conference for giving me such an honor.

involved in policymaking process in the central bank myself. Although I must admit that the last paper which I wrote on Smith appeared in 2015 (Wakatabe 2015a), and I have not been closely following the current flourishing literature, Adam Smith has been always near and dear to me. Let me explain what I mean by that in this paper.

Capitalism is in trouble.¹ Or, so have we been told. Recently there has been a surge in interest in capitalism and criticisms thereof. For example, *The Economist* carried a special feature article on “The Next Capitalist Revolution” (The Economist 2018). *Foreign Affairs* published “The Future of Capitalism” (Foreign Affairs 2019). Within a short space of time, there are a great deal of books published including *The Future of Capitalism: Facing the New Anxieties* (Collier 2018), *Capitalism in America: A History* (Greenspan and Wooldridge 2018), *Radical Markets: Uprooting Capitalism and Democracy for a Just Society* (Posner and Weyl 2018), *Can American Capitalism Survive?: Why Greed Is Not Good, Opportunity Is Not Equal, and Fairness Won’t Make Us Poor* (Pearlstein 2018), *The Myth of Capitalism: Monopolies and the Death of Competition* (Tepper with Hearn 2018), and *Capitalism, Alone* (Milanovic 2019).

These titles were published before the COVID-19 pandemic hit the world. Since then, the trend did not end; rather it accelerates with a growing sense of urgency as is shown by a stream of books including *Deaths of Despair and the Future of Capitalism* (Case and Deaton 2020), *Reimagining Capitalism in a World on Fire* (Henderson 2020), *The Crisis of Democratic Capitalism* (Wolf 2023), *The Capitalist Manifesto: Why the Global Free Market Will Save the World* (Norberg 2023), and *Capitalism and Crises: How to Fix Them* (Meyer 2024), to just name a few. *Oxford Review of Economic Policy* featured 17 articles on “Capitalism” by the most distinguished economists in 2021 (Vol.37, Issue 4, 2021).

No doubt this surge of capitalism studies reflects the Global Financial Crisis of 2008 to 2009 and the subsequent Great Recession. A crisis casts doubt about the existing policy, institutions, and ideas, demanding their revision. A post-crisis world is a world of policy controversies.² Needless to say, not all of challenges and issues we now face is necessarily related to the Global Financial Crisis, and many of them have been already discussed before the Crisis. Also, those seemingly contemporary challenges and issues are not unique to capitalism. However, the Crisis has been a catalyst to reveal

¹ The word “capitalism” is often too ambiguous to be defined, whose meaning may vary depending on the authors. I shall just use the word since they are using it and there is no good substitute for it. For an etymology of the term, see Sonenscher 2022.

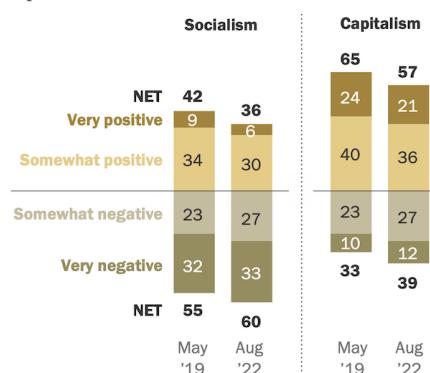
² For the relationship between economic crises and controversies, see Wakatabe 2015b, Chapter 1, and Wolf 2023, Chapter 4. Tooze 2018 chronicles how the Global Financial Crisis changed the world.

challenges that today's world faces are ones that today's capitalism faces. This post-crisis developments spilled over to politics as the rise of "isms" including protectionism, nationalism or populism testifies. Also, moral criticism against corporation gains momentum.³

Against this background, it is noteworthy that the public shows a very mixed feeling toward capitalism. According to Pew Research Center (2022), positive views for "capitalism" has slipped from 2019 to 2022 (Figure 1). On closer inspection, however, there are variations in their views for capitalism and socialism depending on gender, ethnicity, age, education, and family income. Especially, for the younger people aged from 18 to 29, views for socialism are more positive than those for capitalism (Figure 2). Among the so-called "millennials" and Gen Zers⁴ the favorable views toward "socialism" are almost the same as those toward capitalism (Saad 2019; Figure 3).

Positive views of both 'socialism' and 'capitalism' have slipped since 2019

% who say they have a ___ impression of socialism and capitalism



Note: No answer responses not shown.

Source: Survey of U.S. adults conducted Aug. 1-14, 2022.

PEW RESEARCH CENTER

Source: Pew Research Center

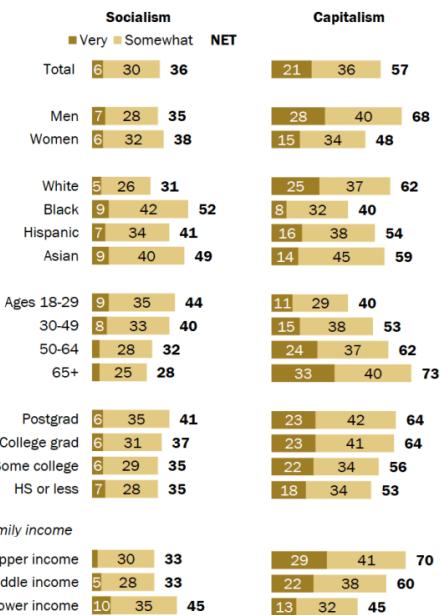
Figure 1: Both socialism and capitalism are losing popularity

³ This reminds me of the fact that moral criticisms against the current economic and financial system surged in the post-Bubble years of the early 1990s Japan.

⁴ They refer to the generation who came of age around 2000. Pew Research Center defines it as those who were born in the years from 1981 to 1996. See Dimock 2019. Those who were born after 1997 are now called Generation Z.

Age differences in views of socialism, capitalism; women far less positive than men toward capitalism

% who say they have a ___ positive impression of socialism and capitalism

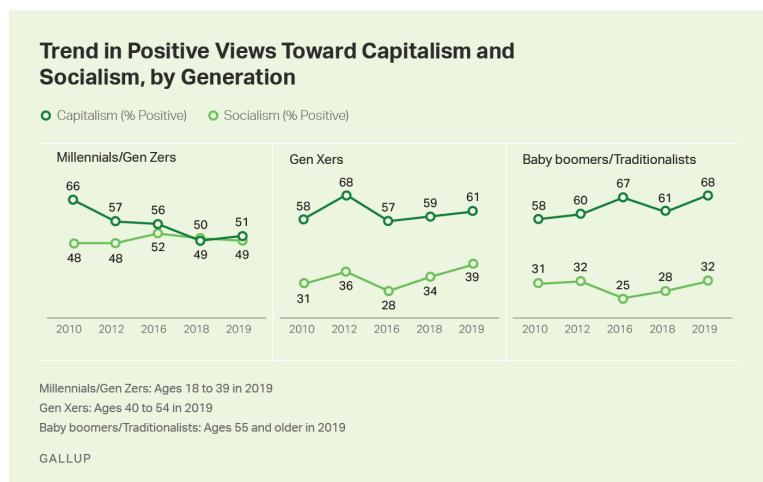


Note: Family income tiers are based on adjusted 2021 earnings; see methodology for details.
Source: Survey of U.S. adults conducted Aug. 1-14, 2022.

PEW RESEARCH CENTER

Source: Pew Research Center

Figure 2: Younger people are more positive toward socialism than toward capitalism

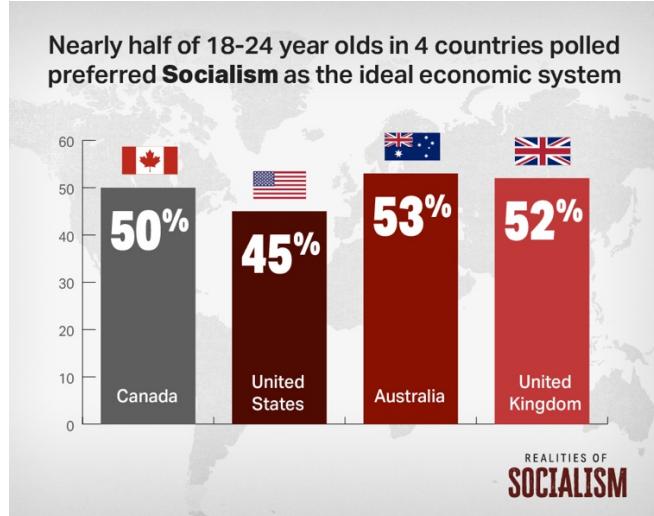


Source: Gallup

Figure 3:

This pattern that the younger generations prefer socialism as much as capitalism can be confirmed by another survey by Fraser Institute (Clemens and

Globerman 2022). Figure 4 shows that about half of people aged 18-24 in four English-speaking countries prefer socialism as the ideal economic system.



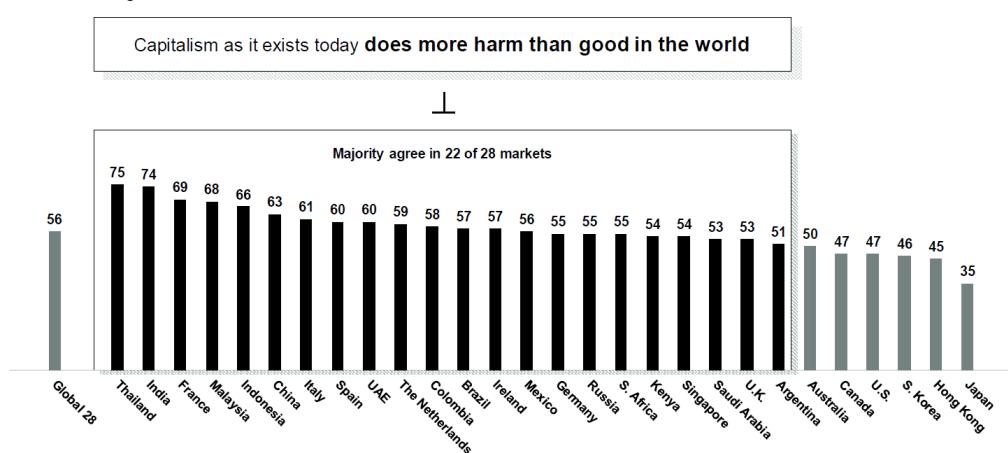
Source: Clemens and Globerman (2022)

Figure 4: Younger people prefer socialism as the ideal economic system

Discontents with capitalism are not limited to the youth in those countries. When Edelman Trust Barometer asks the question whether you agree or disagree with the following statement that “capitalism as it exists today does more harm than good in the world” to citizens of 28 countries, the majority of 22 agree with it.

CAPITALISM IN QUESTION AROUND THE WORLD

Percent who agree



Source: <https://www.edelman.com/trustbarometer>

Figure 5: Capitalism is perceived to be more harmful than beneficial

This recent surge in interest in capitalism is associated with an appreciation of Adam Smith as a potential source of insights for conceiving new, and presumably

better, capitalism. Paul Collier criticizes the moral degradation of the society since the 1970s, arguing that capitalism and economics needs a renewed sense of shared morality, one based on the Smithian sympathy among people (Collier 2018). Steven Pearlstein envisions a better capitalism where the pursuit of self-interest “is tempered by moral sentiments such as compassion, generosity and a sense of fair play”, with reference to Smith’s *Wealth of Nations* and *Theory of Moral Sentiments* (Pearlstein 2018, 205). The recent assessments of Adam Smith make forceful case for relevance of Smith in contemporary capitalism (Berry 2018, Norman 2018). Colin Mayer, calling the *Theory of Moral Sentiments* “arguably one of the most important books of the Age of the Enlightenment” (Mayer 2024, 14), attempts to “provide the glue that cements the wealth of nations with our moral sentiments in a form in which, as Adam Smith intended, they are conjoined at the head as well as the hip”.

In this paper, I shall argue that Adam Smith has indeed a lot to teach us about the future of capitalism, although it is unhistorical to claim that everything is already in Smith’s works since the current capitalism is also the product of history. I shall first examine recent discussions about the current challenges and criticisms against capitalism. The major themes involve the current productivity slowdown, the waning competition, the role of globalization, the rising inequality and climate change. Through this exercise, I would emphasize the following: there are indeed some global trends, but there are also important national and regional differences reflecting differences in institutions and policy; in this sense, not only natural scientific technology but also social scientific technology, i.e. governance, policy and institutions, matter. Then, I shall argue that what Smith could teach us on in five aspects. First, it should be noted that Adam Smith conceived a truly inclusive capitalism: he took income distribution into account when he argued for the desirability of economic development. For Smith, economic development is desirable when the well-being of the majority of people is improved (Levy 1995). Secondly, an inclusive capitalism requires broad knowledge formation and sharing among the people. Smith’s inclusive capitalism is based on the division of labor principle, markets or broad exchange basis to foster the division of labor, and policy measures to alleviate side effects of the division of labor (Wakatabe 2015a). Thirdly, the expansion of exchange and trade has beneficial effects, but we should be aware of its distributional consequences. Fourthly, Institutions matter. Markets are the most fundamental institutions, but it is imperative to preserve competition in markets, especially free entry. Fifthly, proper law and institutions are essential to the well-functioning market economy, the “system of natural liberty”. However, the “system of natural liberty” is not automatically achieved. Policy and

institutions are history dependent, therefore history matters. Here “relatively cautious sense of progress” of the Scottish enlightenment thinkers including Smith should be reminded of (Berry 2018, 14).

The paper is organized as follows. The next section surveys the recent challenges of capitalism. Section III turns to what Adam Smith could answer to those challenges regarding the future of capitalism. Section IV concludes the paper.

II. A Comparative and Historical Tour of Challenges in the Spirit of Montesquieu-Hume-Smith

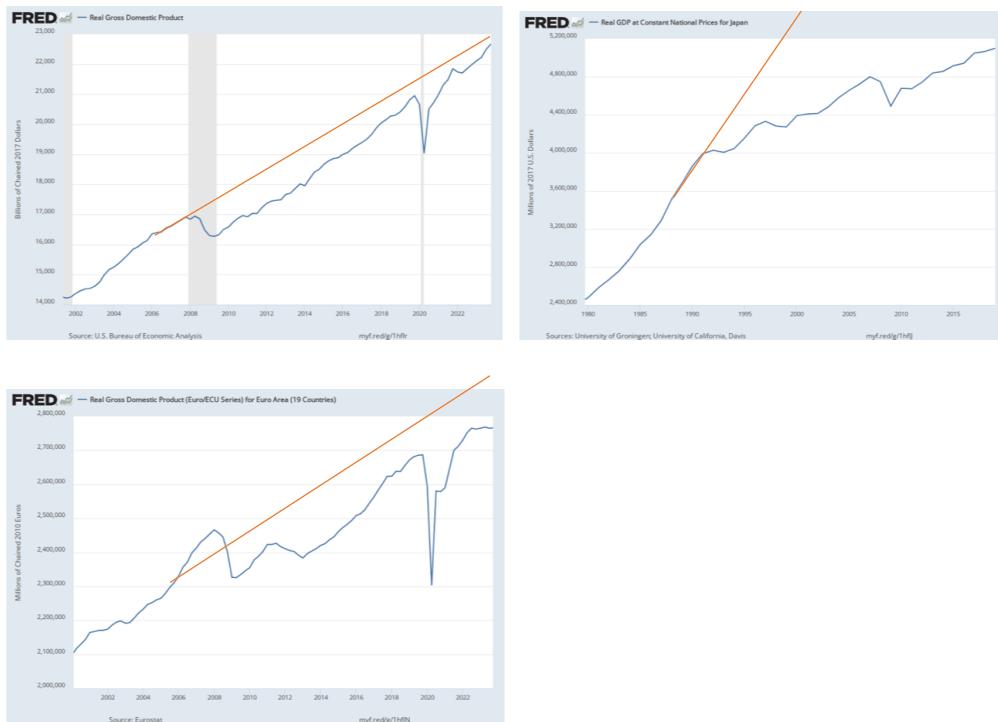
Capitalism or not, the world faces several challenges. I shall lay out five challenges,⁵ but let me start with something which is every central banker’s concern, i.e. inflation.

Before the COVID-19 pandemic, there were concerns about Secular Stagnation, aka Japanification; the combination of low inflation rate (deflation in case of Japan), low growth rate, and low interest rate. The Global Financial Crisis (GFC) of 2007 to 2008 and the subsequent Great Recession have posed several challenges to macroeconomic policy conduct. As Japan has pioneered, after financial crises, there might be a persistent period of low inflation or deflation, and low growth, which would lower the potential growth rate in turn, further lowering actual growth rate. This is called the Secular Stagnation hypothesis.⁶

The following figure 6 shows that there has been a persistent output gap after the burst of financial crises.

⁵ For a comprehensive overview of those challenges from economic point of view, see Tirole (2017), and Wolf (2023).

⁶ For secular stagnation, see Summers (2014), and Bernanke (2023). As of 2024, Summers no longer believes in secular stagnation for the U.S. given the potential surge of demand for investment due to green transition, U.S.-China rivalry, and AI (Singh 2024).



Source: FRED

Figure 6: Secular stagnation

After the COVID-19 pandemic hit the world in early 2020, it has experienced a surge in inflation. This was mainly caused by negative aggregate supply shock, but governments and central banks acted to sustain the economies by expansionary fiscal and monetary policy. Although the 2022 Russian invasion of Ukraine exacerbated negative supply shocks, as those negative shocks wane and central banks raise interest rate, inflation has been decreasing.⁷

The question now, however, is whether this elevated inflation will remain in the foreseeable future, or the world will revert to the age of Secular Stagnation. Modern central bankers and macroeconomists focus on the future evolution of the natural rate of interest, or the neutral rate, an interest rate which is determined by the supply for and the demand for savings, which is consistent with full employment of resources. If this natural rate of interest is low, central banks must set the policy rate to keep the economy at full employment.⁸

What factors affect this natural rate of interest? These factors are summarized in the following table:

⁷ For multi-country analysis, see English, Forbes and Ubide (2024), especially Bernanke and Blanchard (2024).

⁸ For my view on this issue, see Wakatabe (2022).

Factors	Impact on the natural rate of interest
Productivity growth	+
Aging: lengthening life expectancy	-
Aged	+
Growing inequality	-
Fragmentation of the world: waning globalization	+
Rising corporate market power	+/-
Activist fiscal policy	+
Rising public debt	+
Ambient uncertainty	-
Green transition (investment or cost)	+/-

Source: Obstfeld (2023), IMF *World Economic Outlook*, April 2023

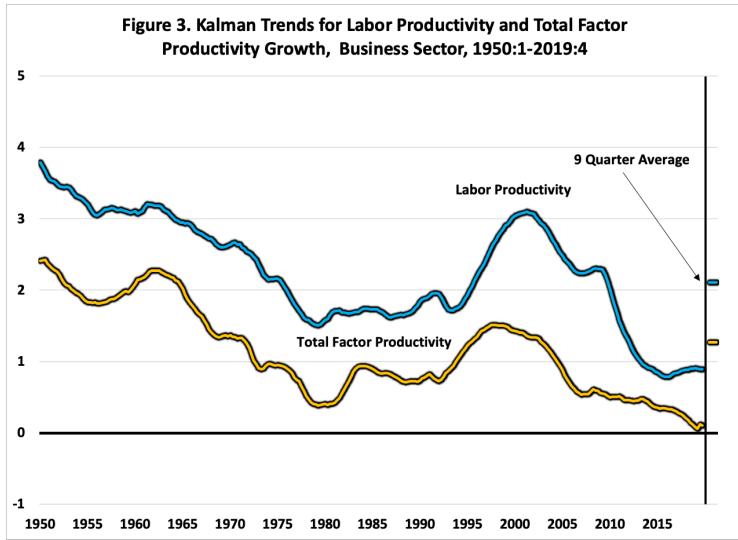
Figure 7: Factors affecting the natural rate of interest

Although they became noticeable and visible after the GFC and the subsequent Great Recession, some of these underlying trends have taken a long time in making. They are exactly the challenges which today's capitalism faces. Among the above determinants of the natural rate of interest, I will discuss five challenges as follows:

1. Productivity slowdown
2. Waning globalization
3. Growing inequality
4. Rising corporate market power
5. Climate change

Challenge 1: Productivity slowdown

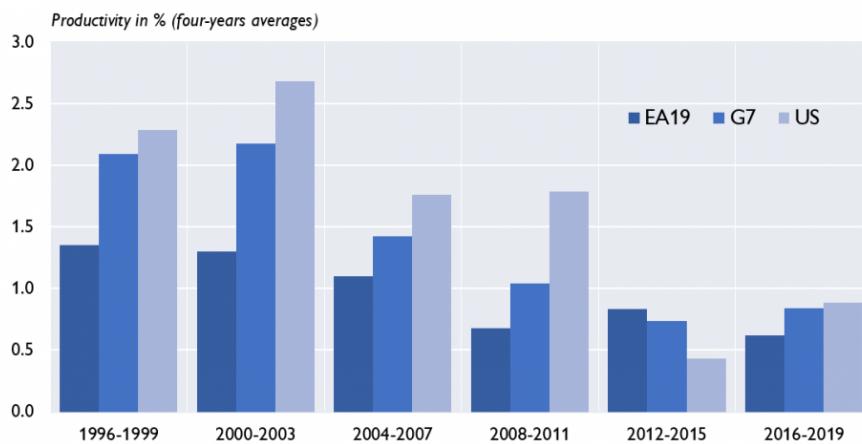
All over the world, productivity is still growing, but its speed has been slowing down. As Robert Gordon at Northwestern University argues, one may say that the 1950s and 1960s were the exception in terms of productivity growth, and today is closer to the historical normal (Gordon 2016). Gordon shows that growth in total factor productivity in the U.S. recorded very high growth rate in the 1950s, but not so in recent decades. For example, even during the period when the IT revolution was hailed, productivity growth rate was not that high. Also, productivity slowdown is prevalent in other advanced economies including Canada, Japan, Germany, France, U.K, and Italy.



Source: Gordon and Sayed (2022)

Figure 8: Productivity is declining over time

Figure 2: Labor Productivity Growth (GDP per hour worked)



Source: OECD (2022) and authors' calculations.

Notes: EA19 - Euro area member states, G7 - Canada, France, Germany, Italy, Japan, UK, US, EU. Latest observation: 2019.

Source: <https://www.suerf.org/publications/suerf-policy-notes-and-briefs/9-stylized-facts-on-productivity/>

Figure 9: Labor productivity growth is declining

Then, what determines productivity? Once Paul Krugman famously quibbled “Productivity isn’t everything, but in the long run it is almost everything” (Krugman 1994, 13). On the other hand, he flatly denies what we could do about it: “what are we

going to do about productivity growth in the United States? Nothing” (Krugman 1994, 22).

The question is still not clearly answered: in fact, the whole history of economics has been trying to answer this question. Gordon thinks that productivity gains during the 1950s and 1950s was driven by a cluster of innovations, further arguing that Secular Stagnation should be caused by supply side factor.

Related to the question of productivity, what about the rise of Robots and AI? First, throughout the history, there are similar patterns in discourse regarding the effects of automation or mechanization on society. It has been a history of people alternating between those who say “This is a revolutionary thing that will change society in a big way” and those who say “It will lead to job losses”.

Secondly, currently, there is no definitive consensus on the impact on productivity and employment. Some say, “productivity will go up” (Brynjolfsson and McAfee 2011), while others say “it won't go up that much” (Gordon 2016, 2021). Regarding the impact on employment, some say that “AI will cause job losses, 90% of the people who are there now will lose their jobs” (Ford 2015), while others say that it will not, and the assessment is very divided.⁹

However, the most recent studies point to more positive impacts of AI on productivity and employment. For example, Brynjolfsson, Li and Raymond (2023) show that a generative AI increases productivity, worker retention, and customer satisfaction, decreases inequality, while Noy and Zhang (2023) show that ChatGPT substantially raises average productivity and decreases inequality between workers. In a similar vein, David Autor argues that AI as a tool for facilitating decision making could be enhancing the productivity of the lower-skilled workers, thus it could reduce skill gaps and inequality between high-skilled workers and lower-skilled workers (Autor 2024).

Without a consensus at hand, nevertheless, there is an interesting interaction between globalization and the rise of Robots and AI. With today's globalization, products that used to be made entirely in Japan can now be manufactured at local production bases by simply taking the design specifications for what to be made

⁹ An excellent economic analysis of AI is Agrawal et al. (2018). They argue that artificial intelligence will make “forecasting” more accurate and cheaper, but the role of humans will remain for the “decision” part. They also argue that since prediction depends on data, humans have more knowledge about matters that machines do not (yet) know and are better at making decisions when there is not enough data available, compared to machines. However, it is possible to automate at least some part of decisions, so this may be also a matter of degree.

overseas. In the case of services, it is now possible to use overseas services without having to leave Japan. What used to be done with domestic services in the past can now be done with overseas services via the Internet or through teleconferencing using the Internet. In this context, it is possible to predict that as Robots and AI evolve, coupled with increasing globalization, the demand for certain types of services in Japan may decrease (Baldwin 2019).

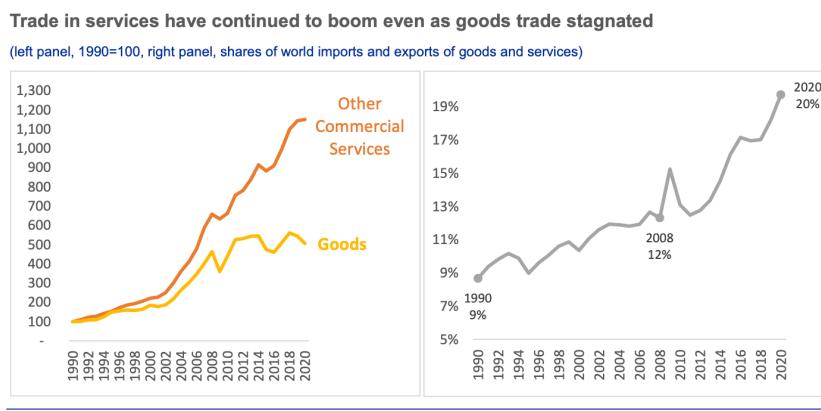
Challenge 2: Waning Globalization

Globalization has been one of the focal points of criticisms against current capitalism. As a matter of fact, global volumes of trade in goods and services and stock of financial assets relative to nominal GDP have become flat after the GFC. This has been sometimes cited as a sign of the end of globalization, or the crisis thereof.

However, there is a change in the composition of trade. Trade in goods is indeed stagnating but trade in services is increasing. Baldwin (2022) further predicts that trade in intermediate services continues to grow. In this sense, the news of the death of globalization may be exaggerated.

Chart 4

Trends in world trade in goods versus world trade in services since 1990



Sources: Data downloaded from stats.wto.org.

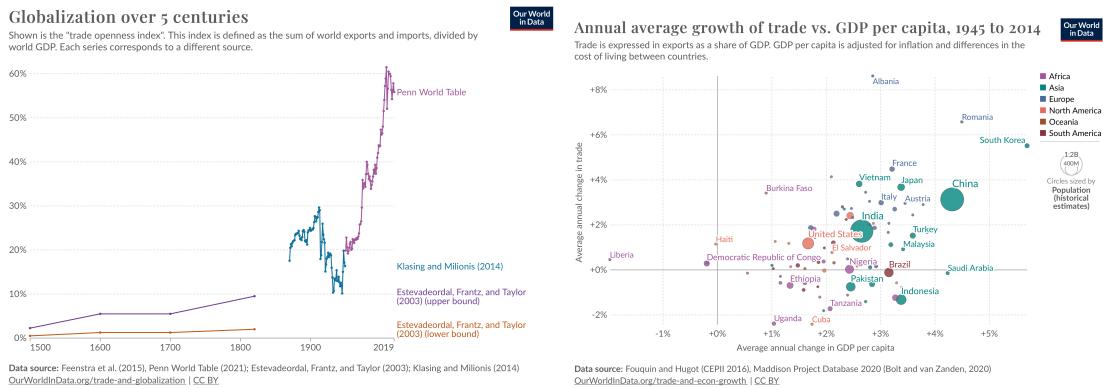
Notes: These flows are not normalised by world GDP. The charts stop in 2020 since the pandemic had severe and historically unprecedented effects on services trade (see Box 1).

Source: Baldwin (2022)

Figure 10: Trade in goods is stagnating, while trade in services continues to grow

Take a broader historical view, first, it is globalization or freer trade that has been the driving force behind the improved living conditions of the world. Globalization

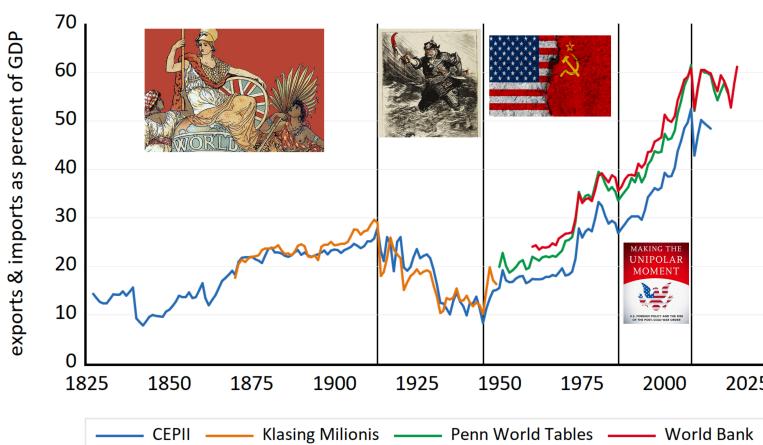
has contributed to economic growth.¹⁰ It also has achieved lengthening of average life expectancy and the reduction of the people living under the poverty line: Globalization has enriched India, China, and African countries.



Source: Our World in Data

Figure 11: Globalization has increased throughout history

Secondly, however, globalization has ebbed and flowed depending on the race between technology and policy and institutions (Irwin 2024). Globalization progressed when communication and transportation technologies improved (Baldwin 2016), or institutions such as GATT and the WTO functioned with eased geopolitical tensions; it receded when geopolitical tensions such as World Wars rose, economic crises such as the Great Depression occurred, or national security concerns, protectionism and trade wars erupted.



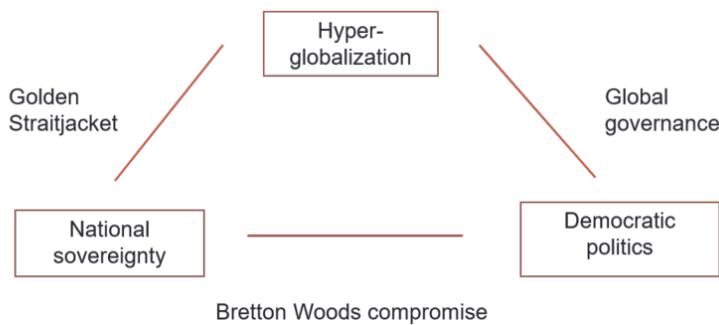
Source: Irwin 2024

¹⁰ Frankel and Romer (1999) argues that trade causes economic growth.

Figure 12: Globalization ebbs and flows

Nevertheless, the fruits of progress may not be shared by evenly within or across countries. Therefore, thirdly, globalization has distributional consequences. The most famous example is the “China Shock” (Autor, Dorn and Hanson 2016) where the US manufacturing jobs were “lost” due to the imports from China, although the authors note that there are still net benefits from trade with China.

Another example is the New Trilemma. Globalization may have broader implications in terms of political economy (Rodrik 2011). The more globalization progresses, the more matters are regulated only domestically. Thus, the more globalization progresses, the less is decided domestically, a trade-off, or rather, a tension exists. The following diagram shows the paradox of globalization, the political trilemma of the world economy, as proposed by Dani Rodrik proposes the concept according to which all three of the following items such as deepening economic integration, nation-states, and democratic politics cannot be established at the same time. According to this view, the current halt in globalization can be interpreted as a movement to defend the nation-state and democratic politics at the expense of deeper economic integration since the Global Financial Crisis.



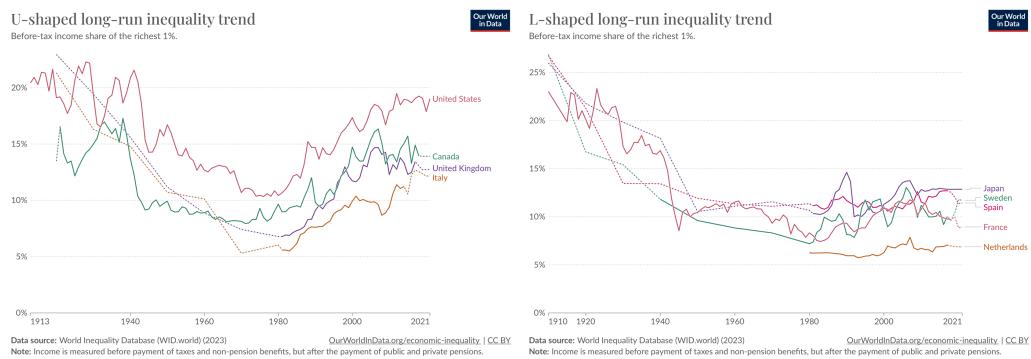
Pick two, any two

Source: https://rodrik.typepad.com/dani_rodriks_weblog/2016/06/brexit-and-the-globalization-trilemma.html

Figure 13: Rodrik’s New Trilemma

Challenge 3: Rising Inequality

Thomas Piketty's pioneering work (Piketty 2014) gives us the impression that inequality in income and wealth has been rising since the late 1970s all over the world. However, inequality trend varies across countries. US, UK, Canada, and Italy show an upward U-shaped trend, while Japan, Sweden, France, Spain and the Netherlands show a stable flat trend, as Piketty himself has shown that result as well as Hasell (2023b).



Source: Hasell (2023b)

Figure 14: Income inequality varies across countries

Also, they are before-tax income inequality, while there are several redistribution institutions and policy in place. Once they are considered, income inequality is not as much as before-tax shows.



1. **Gini coefficient:** The Gini coefficient is the most commonly used measure of inequality. It is typically used as a measure of income inequality, but it can be used to measure the inequality of any distribution – such as the distribution of wealth, or even life expectancy. It measures inequality on a scale from 0 to 1, where higher values indicate higher inequality. This can sometimes be shown as a percentage from 0 to 100%; this is then called the ‘Gini Index’. A value of 0 indicates perfect equality – where everyone has the same income. A value of 1 indicates perfect inequality – where one person has all the income and everyone else has none. In other words, the Gini coefficient is a measure of relative inequality. What is the Gini coefficient?

2. **Equivalization:** Equivalization is a statistical technique used in household income surveys to allow for fairer comparisons in living standards between households of different sizes or age compositions. With each additional member, a household's needs grow but – due to economies of scale in consumption – not in a proportional way. A household with three members does not need three times the housing space, electricity, heating etc., as a single-person household to achieve the same standard of living. In the process of equivalization, each household's actual income level is scaled up or down to find the “equivalent” income that would be needed for a given standard household size to achieve that same standard of living. This requires making assumptions about the economies of scale in household consumption, and different ‘equivalence scales’ for making such an adjustment are in common use.

Source: Hasell (2023a)

Figure 15: Redistribution policy reduces income inequality

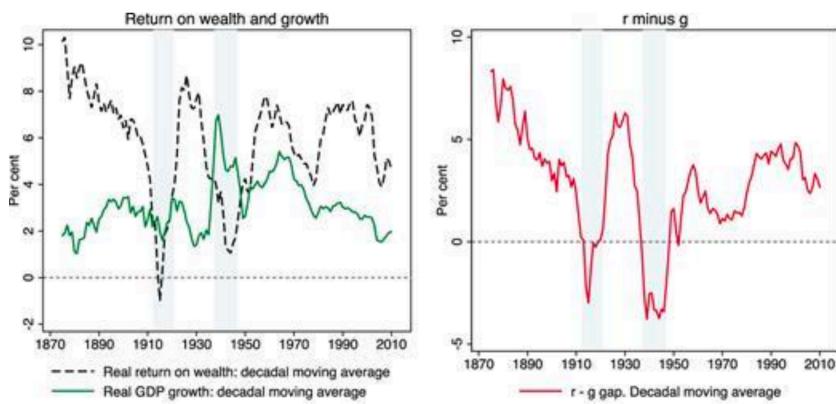
Hasell summarizes the implications of inequality studies eloquently:

The differences in these trends tell us something important: high and rising inequality is not an inevitability; it's something that individual countries can influence. A universal trend of increasing inequality would support the idea that inequality is completely determined by global economic forces like technological progress, globalization, or capitalism. The very different trends we see among countries exposed to these same forces suggest that national institutions, politics, and policy matter a lot (Hasell 2023b).¹¹

Second, the causes of this widening inequality are also the subject of many theories and are difficult to determine. For example, it was Thomas Piketty who famously pointed out that it is because the rate of return on wealth (r) exceeds the rate of economic growth (g) (Piketty 2014). Other arguments include, for example, that it is because of declining labor union organizing rates or changes in the tax system.

Historically, the relationship between r and g varies. According to Jordà et al. (2019), the relationship that r is greater than g does hold for most of time, but not always. Especially when the major war broke out, r is smaller than g . This implies that forces for increased inequality is also a product of history.

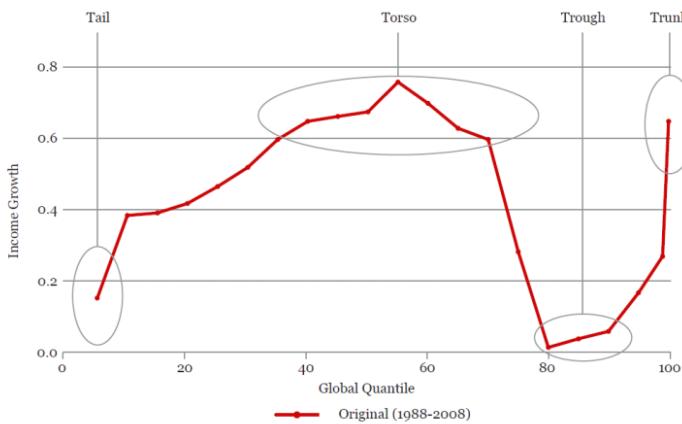
¹¹ Historically speaking, it is quite difficult to equalize the gap when there is a large disparity, if any. It is only when there is a war that mobilizes the entire population that taxation of the wealthy takes place and becomes entrenched (Scheve and Stasavage 2016). Typically, it is World War I or World War II. In such times, income and property taxes on the wealthy also occur. For example, in the United States, the federal income tax was introduced in 1913, the year before World War I, but the rate was subsequently increased during the war. However, since the form of war itself is now changing from a total mobilization type, it is questioned whether the argument for taxation of “paying money in exchange for not being drafted” is valid or not. Walter Scheidel also goes further back in time and says that it is difficult to correct income inequality without a major event (which he calls the “four knights of the apocalypse”) such as the collapse of the state, a catastrophic plague, or a major revolution in addition to a total mobilization-type war (Scheidel 2017).



Source: Jordà et al. (2019)

Figure 16: r is greater than g , but not always

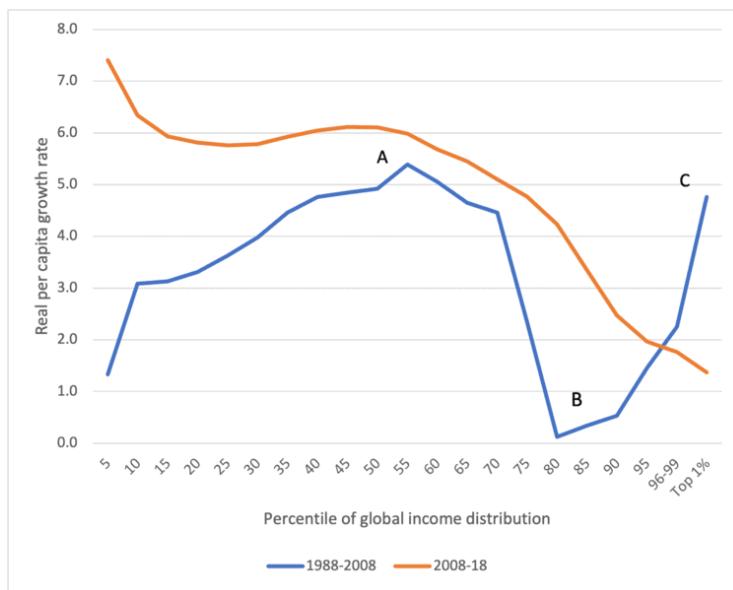
Thirdly, in terms of global inequality, a graph called the Elephant Chart has become famous in recent years (Milanovic 2015). This chart shows the income growth of the world's poorest to richest people on the horizontal axis from left to right and plots the growth of income for each group on the graph. The middle part of the elephant's nose is almost zero, which is interpreted to mean that the people in this area are the ones who are losing the most or gaining the least. It was interpreted that the working class and middle class in developed countries were being undercut by the very rich people in developed countries who were at the tip of the elephant's nose and the newly rich people in emerging countries, such as China, who were getting richer at the head of the elephant.



Source: Kharas and Seidel (2018)

Figure 17: The original Elephant curve

However, the original elephant curve needs a major correction: it now does not look like an elephant at all. Branko Milanovic, one of the originators of the curve re-estimates and revises the curve as shown in the next figure. The lower income group gains more, the global “median” or middle class is more growing, while the top income group, especially the top one 1% is growing less: the world is becoming less unequal. This has owed to the slowdown in the West after the GFC, the continued growth of China, India and other Asian countries.



Source: Milanovic (2022)

Figure 18: The Elephant curve is disappearing

Challenge 4: The Rise of Big-Tech Corporations and Waning Competition

Globalization has led to the rise of global big tech companies. The first thing to point out is the role of intangible assets. Today, big tech companies, the so-called GAFAMs (Google, Apple, Facebook, Amazon and Microsoft) run their businesses using intangibles.¹² In other words, intellectual property rights, algorithms, and data are becoming increasingly important. They have different properties than ordinary tangible assets. If it is data, it will not wear out no matter how many times it is used (non-rivalry), and the more data you have, the more of an advantage you have (economies of

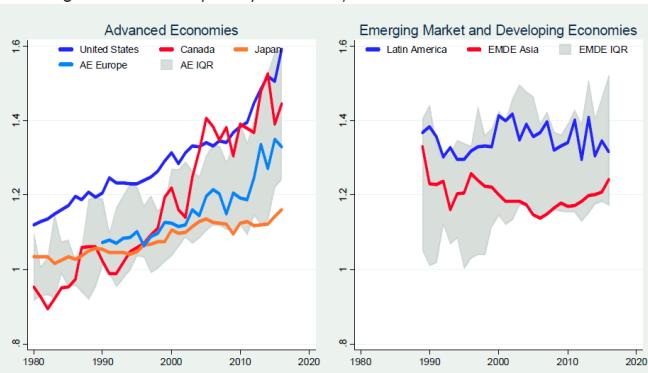
¹² For the economics of intangible assets, see Haskel and Westlake (2017).

scale). The more data a company has on its customers, presumably the more of an overwhelming advantage it will have over companies that have less data. This would lead to what economists call a natural monopoly, or oligopoly. For example, when people search the Internet, they will tend to use a particular company's search engine. This is thought to be the reason, if not the only reason, for the ongoing decline in the level of competition in developed countries.

Secondly, it has been noted that as oligopoly increases and the degree of competition decreases, there is an inverse U-shaped relationship where investment and innovation initially increase but eventually decrease (Díez, Leigh and Tambunlertchai 2018). Joseph Schumpeter once argued that the greater the oligopolistic market power, the more innovation is promoted. However, recent empirical studies show that in reality this is true only up to a certain point, after which the relationship declines in innovation. This is also regarded as one of the reasons for the decline in productivity discussed in Challenge 1. In other words, productivity is declining because firms are investing less and innovation is slowing down.

Looking at the advance of oligopoly in terms of the markup of firms, which is its proxy variable (a variable that expresses the degree of oligopoly), markups have risen significantly in developed economies, especially in the United States. It can also be seen that the degree of oligopoly of Japanese firms differs considerably from that of foreign firms. On the other hand, in emerging economies, the trend toward oligopoly has not yet been observed. This supports the view that big tech companies may be creating an oligopoly in the economy.

Figure 6. Evolution of Estimated Markups Across Economies
(Sales-weighted mean for all publicly listed firms)



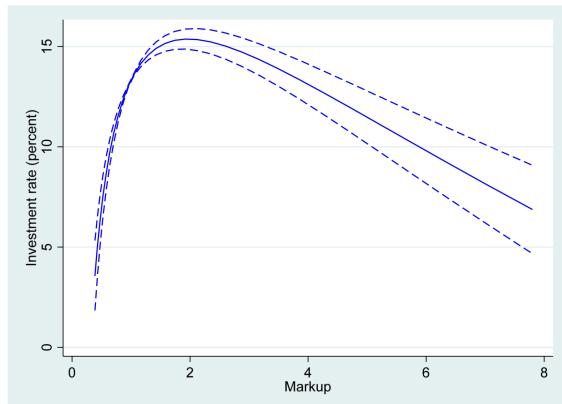
Note: Figure reports markup estimates for 33 advanced economies (AEs) and 41 emerging market and developing economies (EMDEs). For country groups (AE Europe, Latin America, and EMDE Asia) figure reports median of included countries. IQR denotes inter-quartile range.

Source: Díez, Leigh and Tambunlertchai (2018)

Figure 19: Markups are increasing in advanced economies

The next figure shows an inverse U-shaped relationship. As the markup increases, the investment rate increases up to a certain point, but as the markup increases beyond that point, the investment rate rather tends to decrease.

Figure 8. Investment Rate vs. Markup



Note: Figure reports fitted value of investment rate vs. markup across sample range of markup based on estimates reported in Table 2 (column 1). Dashes indicate 90 percent confidence interval.

Source: Díez, Leigh and Tambunlertchai (2018)

Figure 20: Investment increases and then decreases as markup goes up

However, there are debates as to the origin of waning competition in the US economy. Thomas Philippon points out that GAFAMs owed their presence and rise to the US Department of Justice's decision to prevent "Microsoft from monopolizing the Internet in the late 1990s" (Philippon 2019, 273). He summarizes the "evolution of economics and politics in the United States over the past twenty years" in three points:

First, US markets have become less competitive: concentration is high in many industries, leaders are entrenched, and their profit rates are excessive. Second, this lack of competition has hurt US consumers and workers: it has led to higher prices, lower investment, and lower productivity growth. Third, and contrary to common wisdom, the main explanation is political, not technological: I have traced the decrease in competition to increasing barriers to entry and weak antitrust enforcement, sustained by heavy lobbying and campaign contributions (Philippon 2019, 205).

On the other hand, although markup has been rising in advanced economies, there are important national and regional differences, reflecting differences in competition policy and institutions. Philippon compares Europe and the US on

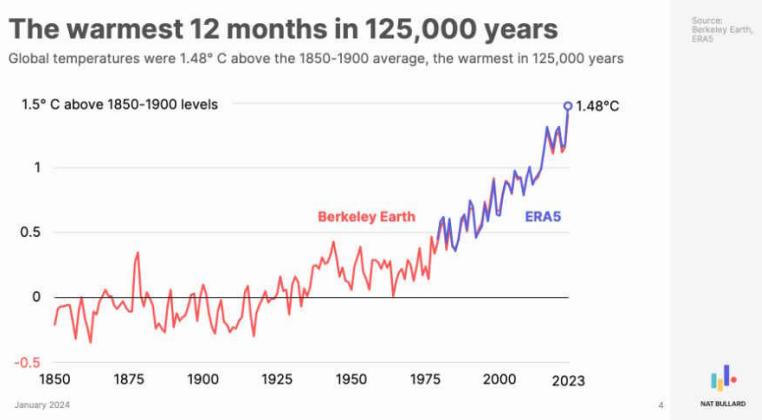
competition policy, arguing that the current “EU competition policy has become stronger US competition policy, and EU consumers are better off for it”. Ironically, the EU used to be not advanced in competition policy, but learned from the US when the EU refined the Single Market. He concludes: “I was surprised by the power and persistence of institutions beyond their original intent” (Philippon 2019, 289; Gutiérrez and Philippon 2020).¹³

Challenge 5: Climate Change

Some economists say climate change is the most pressing existential threat to us (Rodrik 2024). Noah Smith summarizes facts about climate change succinctly (Smith 2024)¹⁴:

1. Climate change is starting to get severe.
2. Climate change is manageable, but we’re not there yet.
3. The U.S. and Europe are no longer the biggest problem.
4. Green energy is for real.
5. Cutting emissions doesn’t require degrowth.

First, the planet is getting warmer as the following figure shows. It is not yet certain that global temperature is coming down to the target level.



Source: Bullard (2024)

Figure 21: Global temperature is rising

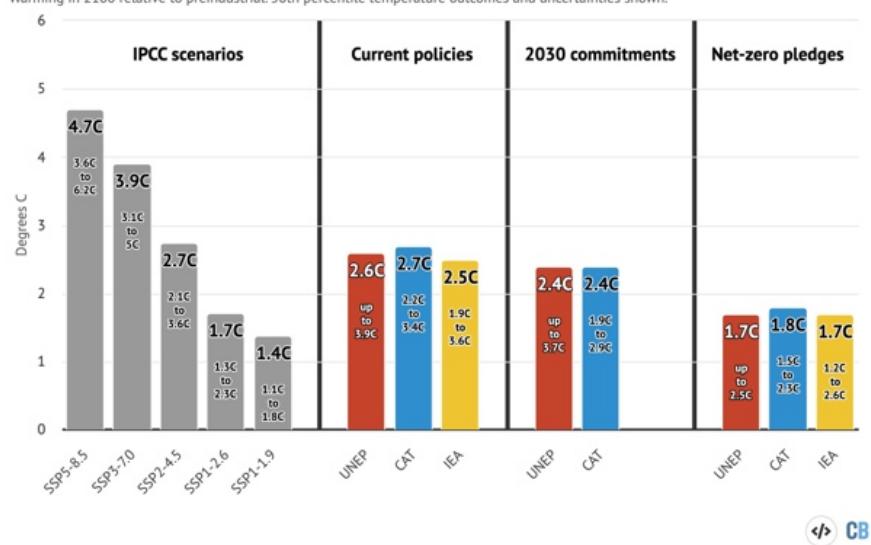
¹³ See also Aghion, Antonin, and Bunel (2021, 65-67) for a counterargument.

¹⁴ Most of charts come from Nat Bullard’s presentation on decarbonization in January 2024 (<https://www.nathanielbullard.com/presentations>).

Second, climate change has been caused by human activities, therefore it can be changed on principle. As Bill Gates and others stress (Gates 2021), it is imperative to have technological breakthroughs to achieve the net zero CO₂ emission economy. New cleaner energy technologies which replace fossil fuels such as solar, wind, and batteries have been advancing. Also, policies tackling climate change have begun around the 2010s.

Comparing the latest 2100 warming projections for different scenarios

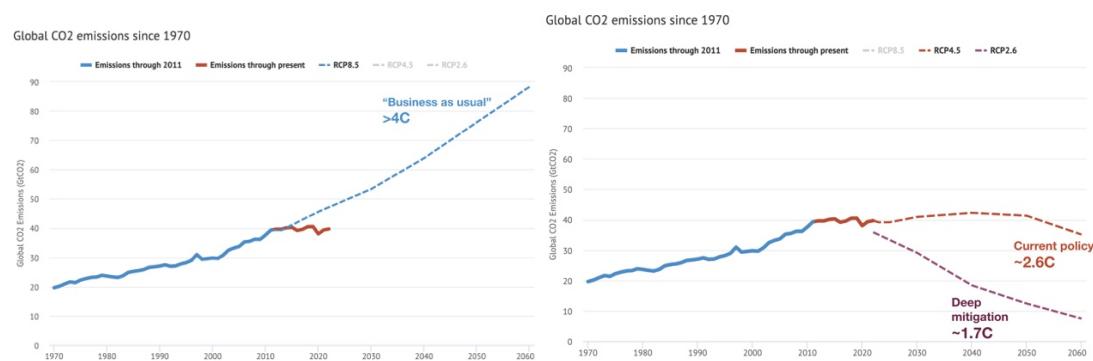
Warming in 2100 relative to preindustrial. 50th percentile temperature outcomes and uncertainties shown.



Source:

https://twitter.com/hausfath/status/1755681397229113836?utm_source=substack&utm_medium=email

Figure 22: Different impacts of different policies



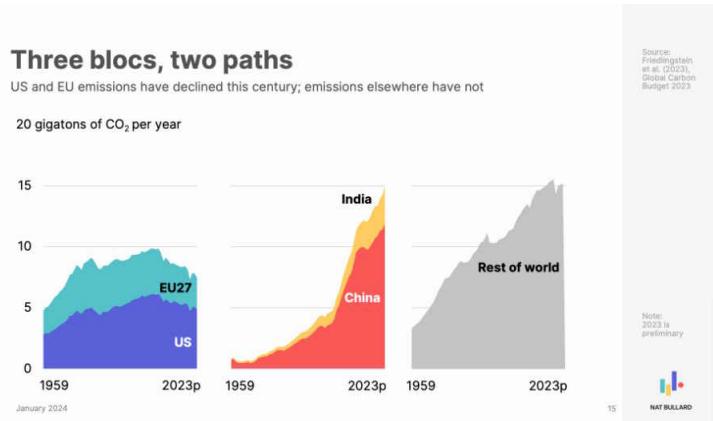
Source:

https://twitter.com/hausfath/status/1755681397229113836?utm_source=substack&utm_medium=email

Figure 23: Global CO2 emissions and global temperatures are stabilizing in the future

As a result, global CO2 emissions began slowing down from the 2010s, and even the current policy would stabilize the global temperature with an increase of around 2.6 C degree. The current policy falls short of the goal of 1.7 C with zero-emission pledges which leaves 0.9 C degree discrepancy.

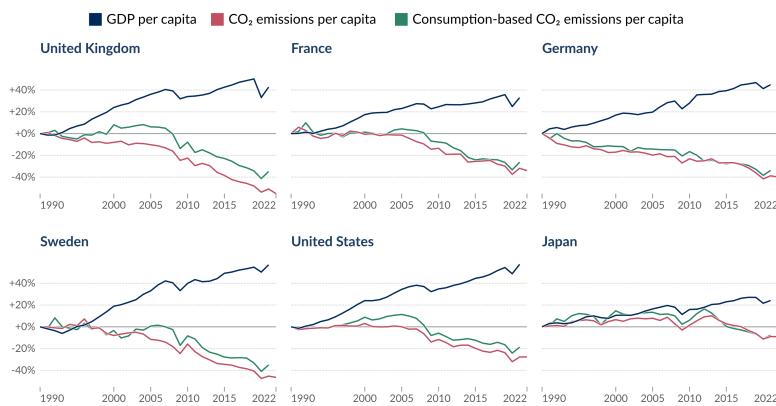
Thirdly, there are once again difference in regional responses. Advance economies are reducing CO2 emissions, while other regions especially China and India are increasing CO2 emissions.



Source: Bullard (2024)

Figure 24: CO2 emitters are diverging geographically

Fourthly, advanced economies are succeeding in decoupling CO2 emissions from economic growth by reducing CO2 emissions while maintaining economic growth. As consumption-based CO2 emissions per capita shows decoupling is not due to exporting CO2 emissions industries to developing economies.



Data source: World Bank (2023); Global Carbon Budget (2023); Population based on various sources (2023)

Note: GDP figures are adjusted for inflation.

OurWorldInData.org/co2-and-greenhouse-gas-emissions | CC BY

1. Consumption-based emissions: Consumption-based emissions are national or regional emissions that have been adjusted for trade. They are calculated as domestic (or 'production-based' emissions) minus the emissions generated in the production of goods and services that are exported to other countries or regions, plus emissions from the production of goods and services that are imported. Consumption-based emissions = Production-based - Exported + Imported emissions

2. Fossil emissions: Fossil emissions measure the quantity of carbon dioxide (CO₂) emitted from the burning of fossil fuels, and directly from industrial processes such as cement and steel production. Fossil CO₂ includes emissions from coal, oil, gas, flaring, cement, steel, and other industrial processes. Fossil emissions do not include land use change, deforestation, soils, or vegetation.

Source: Our World in Data

Figure 25: CO₂ emissions are being decoupled with economic growth

These Challenges are not only about technology, but also about institutions and policy

It is true that people are feeling anxious today. Behind the growing criticism of capitalism is the fear of what will happen to their jobs when globalization, AI, and robots evolve. Regardless of whether the jobs are actually disappearing, the fact that such fears exist is itself amplifying the anxiety. Whether or not globalization is really making people poorer, the fact that globalization is progressing is associated with the anxiety that people have. When there is such anxiety, it is easy for various isms to spring up, one of which is populism.¹⁵

Populism has many aspects. One basis is opposition to the old establishment or elite class, which forms the core of populism. Since the establishment and elite are the architects of today's society, they become the targets to which one can voice one's concerns that society is not doing well. Populism has a very dangerous element, because if it takes the wrong form, it can become a force that destroys the social order itself. However, it is not without its positive elements in the sense that it can point out current

¹⁵ Eichengreen (2018) and Wolf (2023) discuss the history of populism from the perspective of people's anxiety over the economy.

issues and serve as a driving force to change the status quo. However, if it becomes xenophobic, anti-scientific, and anti-knowledge, it will rather impede progress.

Perhaps the anxiety about the future that people are feeling is not only caused by the GFC but is also influenced by various underlying changes. For example, the technological changes that are occurring now are creating oligopolies in the form of changes in the market structure. This is slowing the growth of productivity and lowering the rate of economic growth. Stagnant economic growth could also affect income inequality. According to Piketty's view, a decline in the rate of economic growth will lead to an increase in income inequality.

Therefore, what matters in understanding these challenges is not only technology, but also policy and institutions. The following is the list of what one could learn about the current challenges:

1. The productivity slowdown is a complicated issue, but there is some element of institution and policy; to the extent that the current productivity slowdown is related to the weakened investment and competition, which in turn is caused by political influences, the productivity slowdown is a social phenomenon (Philippon 2019). Even for the advent of AI and Robots, there are promising signs that they are not reducing employment of workers.
2. Globalization. Trade in goods is stagnating, while trade in services continues increasing despite recent growing tensions in US-China trade and decoupling or derisking.
3. Inequality in income and wealth is not uniform for all countries, varies across countries reflecting differences in redistributive policy and intuitions (Piketty 2014, Hasell 2023a, 2023b). To the extent difference between r and g is driving inequality, changing r and g will affect inequality.
4. The waning of competition and increased concentration has been reducing investment. To the extent the waning of competition is driven by restriction of free entry by political influences, changing restriction of free entry will affect competition (Philippon 2019).
5. Climate change is posing a great existential threat to the humanity, but even on this front, we have been making progress in reducing CO₂ emissions due to both technological and institutional changes (Smith 2024).

In addition to this list, we may also argue that it was austerity policy after the GFC and the Great Recession that exacerbated the damage to economies and contributed to the

rise of populism. In this sense, what we should focus on is a social scientific technology, the technology of governance, institutions, and policy.

III. The Smithian Vision for the Future of Capitalism

Despite many challenges, capitalism or the current economic system has delivered a great deal of progress (Norberg 2017, 2023; Pinker 2011, 2018; Rosling et al. 2018). Overall, the humankind has progressed. Take two questions posed in *Factfulness* (Rosling et al. 2018, 51, 53).

Question 1: what is the average life expectancy of people living in the world today?

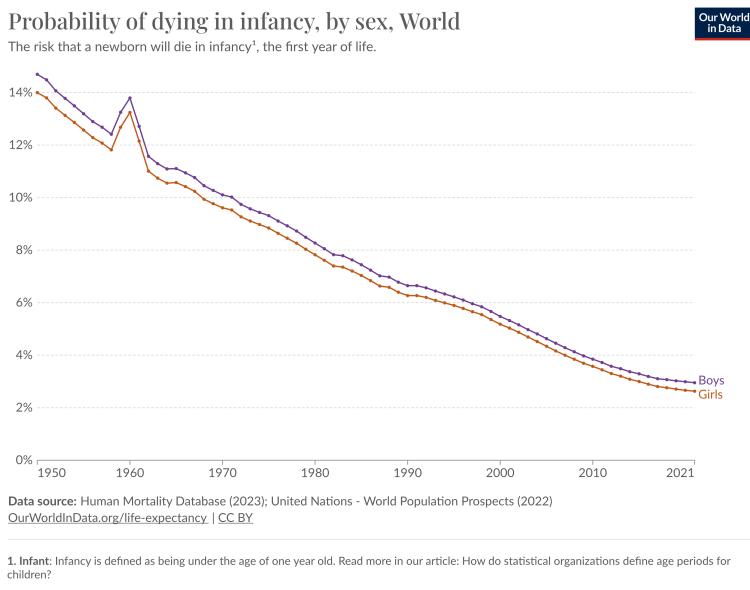
- A: 50 years old
- B: 60 years old
- C: 70 years old

Question 2: In the past two decades, the proportion of people who live under extreme poverty has

- A: almost doubled.
- B: almost remained the same.
- C: almost halved.

The correct answers are C and C, respectively.¹⁶ Although there are still countries whose average life expectancy is lower, as the next figure shows, the average life expectancy has been longer. Also, the number of people under extreme poverty, hunger or without literacy has been decreased considerably within twenty years, mainly due to the economic development of the developing countries including China and India.

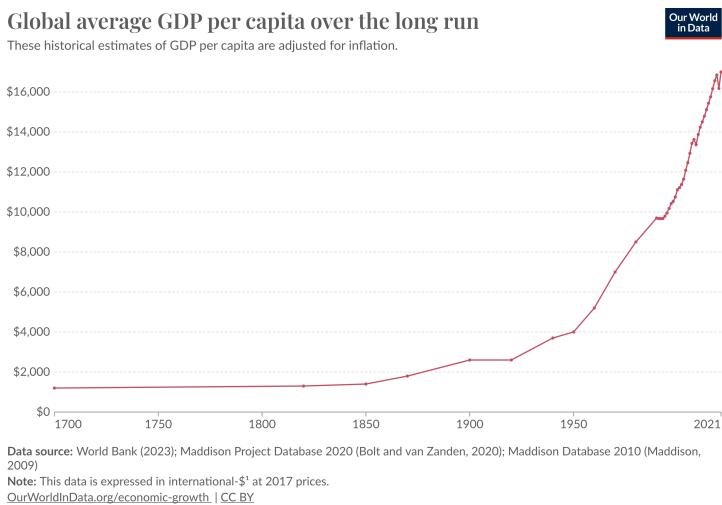
¹⁶ According to the recent statistics released by WHO on April 2019, the average life expectancy of the world has reached 72 years old.



Source: Our World in Data

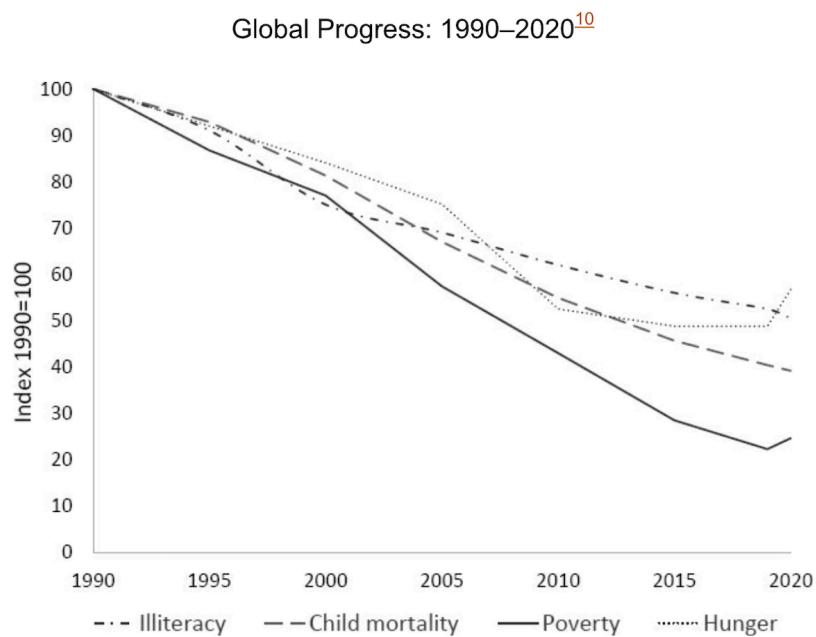
Figure 26: Less and less children are dying in infancy

The world is getting richer and richer. This Great Enrichment is one of the Smithian achievements.



Source: Our World in Data

Figure 27: The World is getting richer

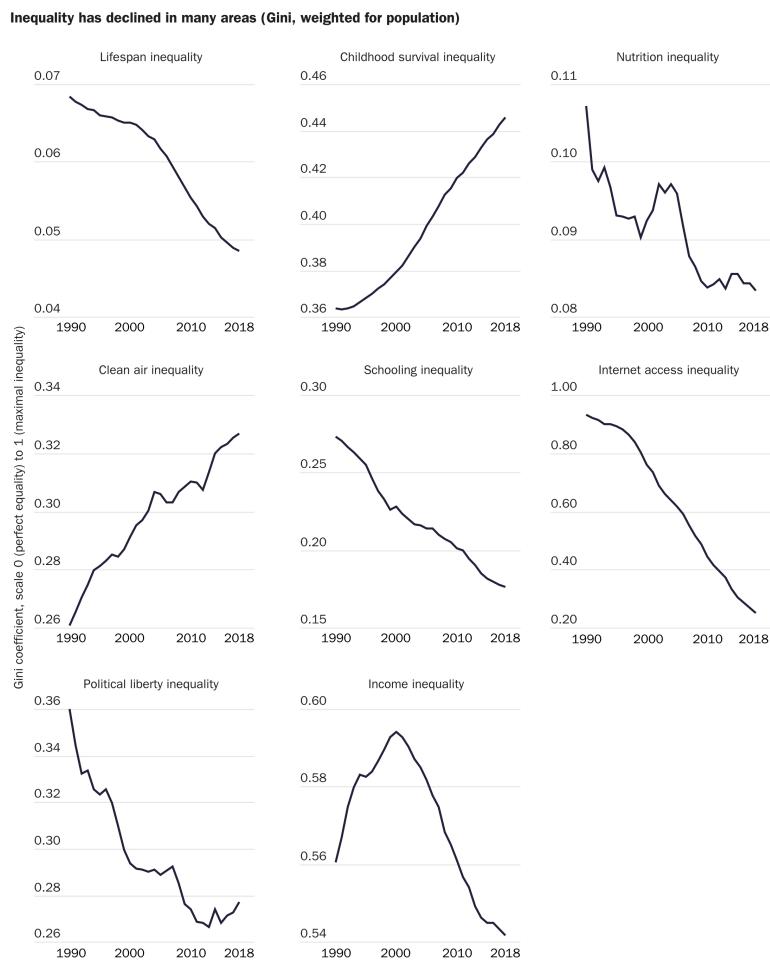


Source: Norberg 2023, 22

Figure 28: The World has progressed on key indicators

Although inequality across countries persists, and it is even increasing on childhood survival and clean air, the overall trend is reduced inequality.¹⁷

¹⁷ Lifespan is measured by life expectancy at birth, years, Childhood survival by infant mortality rate, per 1,000 live births, Adequate nutrition by food supply, per person, per day, Safe environment by outdoor air pollution death rates, Access to opportunity by mean years of schooling, number, Access to information by internet users, per 100 people, Political freedom by democracy versus autocracy over time, scale 0 to 40 (rescaled from source), Income by GDP per person.



Source: Authors' calculations.

Source: Follet and Geloso (2023).

Figure 29: Global inequality is decreasing in many areas

What contributed to these remarkable achievements? Herbert Simon, Nobel laureate in economics, once said “humans are social animals who solves problems and use skills to solve them” (Simon 1965, 110). To perceive problems and to use skills to solve them require knowledge. First, recognizing the role of knowledge itself is the part of human progress, and the driving force behind it, which includes the rise of Enlightenment and scientific thinking (Mokyr 2016; Pinker 2017). But, as we discuss later, this does not mean progress being automatic. Secondly, it is important to note that scientific and technological knowledge entail not only natural scientific and engineering technology, but also social scientific and social engineering knowledge, i.e., policy and institutions. Thirdly, globalization has been playing a vital role in diffusing and disseminating knowledge. When one think of globalization, one might imagine

international movements of goods and services, capital, and people, but that of knowledge is far more important part of globalization.

In this light, the direction to upgrade capitalism is also clear. Economic growth is still desirable. We should continue to maintain and improve the system that improves people's lives, and a competitive market economy is important as such a system.

Throughout history, no country has been able to maintain prosperity for an extended period of time without maintaining markets and trade. However, a market economy requires some form of regulation and institutions, and care for those who have fallen out of the market is not automatically achieved. In this regard, both regulation and redistribution are necessary.

The humankind has achieved a remarkable progress. But that progress has not been automatically achieved. Rather it has been achieved through the history of people struggling to work on challenges and problems at hand. Against this backdrop, I shall focus five aspects of the insights of Adam Smith which could teach us about the future of capitalism: the desirability of growth, the drivers of growth, the role of exchange, trade and markets, the importance of institutions, and the history dependency of institutions.¹⁸

Smith's Human Nature Assumptions

At the heart of Smith's work is his egalitarian human nature assumptions. First, Smith focuses on human beings as an exchanging animal distinct from other animals: the “propensity to truck, barter, and exchange one thing for another” is “common to all men, and to be found in no other race of animals” (WN I.ii.1).¹⁹ His life-long interest in communication is well-known (Berry 2018, Chapter 2). Exchange requires language and notion of contract: Smith suggested this propensity to be “the necessary consequence of the faculties of reason and speech” (WN I.ii.2).²⁰

¹⁸ This section is partly drawn from Wakatabe (2015a).

¹⁹ There are controversies regarding this Smithian assumption.

²⁰ “It is one thing to think *for* yourself, another to think *by* yourself, and the enlightened ones were not much given to thinking by themselves. On the contrary, thinking was regarded as essentially a social activity. People thought with each other, that is, they *shared* their thoughts” (Broadie 2010, 20).

Second, he stresses the difference in natural abilities with his famous reference to the difference between “a philosopher and a common street porter”²¹:

difference of natural talents in different men is, in reality, much less than we are aware of; and the very different genius which appears to distinguish men of different professions, when grown up to maturity, is not upon many occasions so much the cause, as the effect of the division of labour. The difference between the most dissimilar characters, between a philosopher and a common street porter, for example, seems to arise not so much from nature, as from habit, custom, and education (WN I.ii.4).

Thirdly, Smith admits a wide variety of human motives other than self-interest. Although Smith assigns the “desire to bettering our condition” (WN II.iii.28) a dominant role among human motives, arguing it to be “uniform, constant, and uninterrupted” (WN II.iii.31), he juxtaposes it with “passions,” a wide variety of motives such as overconfidence, pride, vanity, love for dominance and control, envy, and rapacity. Indeed, the running theme of Smith and most of his contemporaries is the consideration of the circumstances in which “passions” do not coincide with real “interests”.²²

First, economic growth is good, desirable, and just, as long as it contributes to the happiness of the majority of the people.

Provided that economic growth benefits the lower ranks of the people by raising their living standard through the increased natural rate of wage, Smith asks himself the question:

Is this improvement in the circumstances of the lower ranks of the people to be regarded as an advantage or as an inconvenience to the society? The answer seems at first sight abundantly plain. Servants, labourers and workmen of different kinds,

²¹ Smith does not ignore any difference in abilities. On the contrary, he does admit that “[t]o excel in any profession, in which but few arrive at mediocrity, is the most decisive mark of what is called genius or superior talents” (I.x.b.24).

²² Here Smith can be interpreted as a precursor of behavioral economics (Ashraf, Camerer and Loewenstein 2005), but it is more accurate to say that behavioral economics has been an attempt to resurrect the insights of Smith and other 18th century thinkers.

make up the far greater part of every great political society. But what improves the circumstances of the greater part can never be regarded as an inconveniency to the whole. No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable. It is but equity, besides, that they who feed, cloath and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves tolerably well fed, cloathed and lodged (WN I.viii.36).

It is important that Smith accounts for distributional concerns when he argues for the desirability of economic growth. It is not only the majority (the “far greater part of the members) but also the lower-income group (the “lower ranks of the people”) to which policymakers should pay attention. Also, Smith believes focusing on those group of people is just. In this regard, policies which benefit the majority of the people should be preferred (Levy 1995).²³

Economic growth contributes to happiness of the people, especially for the “labouring poor, although he thinks growth will raise the happiness of “all the different orders of the society”.

It deserves to be remarked, perhaps, that it is in the progressive state, while the society is advancing to the further acquisition, rather than when it has acquired its full complement of riches, that the condition of the labouring poor, of the great body of the people, seems to be the happiest and the most comfortable. It is hard in the stationary, and miserable in the declining state. The progressive state is in reality the cheerful and the hearty state to all the different orders of the society. The stationary is dull; the declining melancholy (WN I.viii.43).

The relationship between economic growth and happiness is contentious. It is possible that economic and material wealth does not bring happiness, although loss of income through unemployment and poverty does affect the wellbeing of the people. According to Kahneman and Deaton (2010), subjective well-being has two aspects: emotional well-being (the frequency and intensity of stress, anger, and sadness felt in daily life) and evaluation of life (the evaluation of one's life). The former increases with

²³ Although Smith did not conceive macroeconomics as Henry Thornton, David Ricardo, Knut Wicksell, Irving Fisher, Ralph Hawtrey and John Maynard Keynes developed, the objectives of macroeconomic policy would fit the Smithian policy making principle.

income up to a certain income level, but does not change beyond a certain income level, while the latter continues to increase with income. They conclude that money can buy an evaluation of life and a certain level of satisfaction, but it cannot buy emotional well-being. However, the most recent study (Killingsworth, Kahneman, and Mellers 2023) shows that “Happiness increases steadily with $\log(\text{income})$ among happier people, and even accelerates in the happiest group,” but there is the flattening pattern among the least happy 20% of the population. So, the positive relationship between economic growth and happiness still holds for the “majority of the people”.

Secondly, knowledge and technology drive economic growth, but they are endogenously and socially created.

As is discussed in Challenge 3, productivity is technologically *and socially* determined. (Gordon 2016, Acemoglu and Johnson 2023). It follows from Smith’s human nature assumptions; human beings are learners for Smith. Smith locates the division of labor at the center of endogenous generation of knowledge. The division of labor is the connecting principle of Smith’s work, and it is the foundation of a society. When we work in one occupation, we work in the occupation which the division of labor has created. Also, the division of labor creates new occupation: “The division of labour, however, so far as it can be introduced, occasions, in every art, a proportionable increase of the productive powers of labour. The separation of different trades and employments from one another, seems to have taken place, in consequence of this advantage” (WN I.i.4). The division of labor presupposes the mutual yet unconscious cooperation among people:

if we examine, I say, all these things, and consider what a variety of labour is employed about each of them, we shall be sensible that without the assistance and co-operation of many thousands, the very meanest person in a civilized country could not be provided, even according to, what we very falsely imagine, the easy and simple manner in which he is commonly accommodated (WN I.i.11).

The egalitarian assumption in human capacity entails the significance of knowledge acquired through “habit, custom, and education” (WN I.ii.4). More specifically, Smith comprehends the sources of knowledge in five ways: skill formation of the working population, human capital accumulation, the rise of invention/innovation at workplace, the progress of science, and technology transfer.

The division of labor entailed both the division of labor within firms and that within society (Rosenberg 1965; Elmslie 1994; Smith 2006), which allows Smith to recognize the ever-growing types of new occupations in growth. Smith refers to the skill formation among the workers (the “improvement of the dexterity in every particular workman”) as the first benefit of the division of labor (WN I.i.5-6). Human capital also accumulates through it (Kiker 1966). Technology transfer is also endogenized through capital accumulation: “A nation is not always in a condition to imitate and copy the inventions and improvements of its more wealthy neighbors; the application of these frequently requiring a stock with which it is not furnished” (ED, 579).

The progress of science is also endogenized in that security and material foundation of a society allows people to be curious. According to Smith, the rule of law is crucial for the development of knowledge. It is a continuation of the Humean theme, yet, while David Hume considered the steps from security through curiosity to knowledge was subject to uncertainty, Smith goes further than Hume in relating security to knowledge more firmly: “when law has established order and security, and subsistence ceases to be precarious, the curiosity of mankind is increased, and their fears are diminished. The leisure which they then enjoy renders them more attentive to the appearances of nature, more observant of her smallest irregularities, and more desirous to know what is the chain which links them all together” (EPS, ‘History of Astronomy’, III.3).

The key to inclusive capitalism lies in the fact that natural wage would increase during economic growth, a feature of Smith’s growth model as distinct from the post-1815 growth model based on diminishing returns (Negishi 1989; Waterman 2009). Inclusiveness is closely related to the sense of fairness. After all, there is a growing sense among the public that “[c]urrent competition seems unfair to those who are affected” (Baldwin 2019, 7) in which people feel their wages are stagnation. From the Smithian point of view, it is crucial that inclusiveness should be accompanied with growth in wages.

Potentially, this knowledge-based growth has no limit since there is no diminishing returns to knowledge. Richard Baldwin notes that “human and physical capital face diminishing returns, while knowledge capital does not”. He further speculates that “The reason is unclear, but one guess that it reflects the fact that human ignorance is infinite despite millenniums of knowledge creation” (Baldwin 2019, 28). Despite the prevalent pessimism on the productivity growth in the future, Smith clearly sides with optimists.

Thirdly, the expansion of exchange and trade is good. But we should be aware of its distributional consequences.

This follows directly from Smith's human nature assumption of human beings as exchanging animals which have "the propensity to truck, barter, and exchange one thing for another" (WN I.ii.1). Markets also serve as knowledge-enhancing and disciplinary institutions. As the Smithian dictum that the "division of labor is limited by the extent of the market" suggests, markets enlarge the scale and scope of the division of labor, which in turn facilitates knowledge of the economy.

Globalization has been associated with economic growth not only in correlation but also in causation.²⁴ Smith thinks that globalization in terms of a "more extensive foreign trade," relating it to the improvement in the productivity of its industry:

A more extensive foreign trade, however, which to this great home market added the foreign market of all the rest of the world; especially if any considerable part of this trade was carried on in Chinese ships; could scarce fail to increase very much the manufactures of China, and to improve very much the productive powers of its manufacturing industry. By a more extensive navigation, the Chinese would naturally learn the art of using and constructing themselves all the different machines made use of in other countries, as well as the other improvements of art and industry which are practiced in all the different parts of the world. Upon their present plan they have little opportunity.....except that of the Japanese (WN IV.ix.41).

His argument is based on technology transfer induced by foreign trade, which resembles David Hume's.

Smith is also aware of distributional consequences of trade :

The undertaker of a great manufacture, who, by the home-markets being suddenly laid open to the competition of foreigners, should be obliged to abandon his trade, would no doubt suffer very considerably. That part of his capital which had usually

²⁴ For studies showing causality from trade to growth, see a classic paper of Frankel and Romer (1999).

been employed in purchasing materials and in paying his workmen might, without much difficulty, perhaps, find another employment. But that part of it which was fixed in workhouses, and in the instruments of trade, could scarce be disposed of without considerable loss (WN IV.ii.44).

Ultimately, or in the longer-run, there may be an equilibrium in which capital can be reallocated to other area, but Smith stresses that the “adjustment costs” due to trade could be significant. Therefore, he proposes a gradual transition for opening up the domestic market.

The equitable regard, therefore, to his interest requires that changes of this kind should never be introduced suddenly, but slowly, gradually, and after a very long warning. The legislature, were it possible that its deliberations could be always directed, not by the clamorous importunity of partial interests, but by an extensive view of the general good, ought upon this very account, perhaps, to be particularly careful neither to establish any new monopolies of this kind, nor to extend further those which are already established. Every such regulation introduces some degree of real disorder into the constitution of the state, which it will be difficult afterwards to cure without occasioning another disorder” (WN IV.ii.44).

It should be also noted that Smith is concerned with the equity or fairness of such a policy, whereas he is also concerned with the competence of the policymakers to make an appropriate decision, a feature we shall discuss later.

Fourthly, institutions matter. Markets are the most fundamental institutions, but it is imperative to preserve competition in markets, especially free entry.

Given Smith’s assumptions of humans as exchanging animals, the “opulence,” or economic development depends on how people organize themselves, i.e., institutions. Markets are the fundamental institutions to Smith; they are knowledge-enhancing and disciplinary institutions. Smithian says that the “division of labour is limited by the extent of the market”; Markets enlarge the scale and scope of the division of labor, which in turn facilitates the knowledge of the economy as we have discussed; it is also disciplinary because Smith thinks what we would call corporate governance in terms of the interaction between corporations and markets.

The case in point is his analysis of joint-stock companies, exemplified by the East India Company. Smith stresses that joint-stock companies are inherently inefficient due to the principal-agent problems and its status as monopoly (Anderson and Tollison (1982)): “The directors of such companies, however, being the managers rather of other people’s money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private co-partnery frequently watch over their own” (WN V.i.e.18). Since “Negligence and profusion...must always prevail, more or less, in the management of the affairs of such a company,” joint-stock companies for foreign trade “have seldom been able to maintain the competition against private adventurers” without an “exclusive privilege”.

The above example shows that Smith is not a defender of capitalists, but that of the competitive market capitalism. Smith’s objective is to “save capitalism from the capitalists” (Rajan and Zingales 2003) and he is decidedly pro-market, but not pro-business. After all, Smith attacks the system of commerce which is supported by merchants and manufacturers.

To widen the market and to narrow the competition, is always the interest of the dealers. To widen the market may frequently be agreeable enough to the interest of the public; but to narrow the competition must always be against it, and can serve only to enable the dealers, by raising their profits above what they naturally would be, to levy, for their own benefit, an absurd tax upon the rest of their fellow-citizens. The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it (WN I.xi.p.10).

Fifthly, proper law and institutions are essential to the well-functioning market economy, the “system of natural liberty”. However, the “system of natural liberty” is not automatically achieved. History matters. Policy and institutions are history dependent.

Smith states clearly that his ideal is to establish the “simple system of natural liberty.”

All systems either of preference or of restraint, therefore, being thus completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men. The sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society (WN IV.ix.51).

However, the system of natural liberty is not a system without regulations or the government: “those exertions of the natural liberty of a few individuals, which might endanger the security of the whole, are, and ought to be, restrained by the laws of all governments; of the most free, as well as of the most despotical” (WN II.ii.94). For example, Smith supports regulation of banking (West 1997) saying that “[t]he obligation of building party walls, in order to prevent the communication of fire, is a violation of natural liberty, exactly of the same kind with the regulations of the banking trade which are here proposed.” Also, he justifies patents on the public good nature of knowledge (WN V.i.e.30). In light of the 1763 financial crisis, Smith does describe what is now considered as the lender of last resort function of central bank conducted by the Bank of England without any judgement. He regards the Bank of England which “acts, not only as an ordinary bank, but as a great engine of state” (WN II.ii.85) (Rockoff 2013, 319-321). A free and competitive market system works best when they are supported by a proper legal and institutional structure. Therefore, Smith is not an advocate for “laissez faire” (Viner 1928; Samuels and Medema 2005; Samuels 2011: 190-8; Hollander 2013).

It is well known that Smith argues for the limited government under the system of natural liberty: “According to the system of natural liberty, the sovereign has only three duties to attend to; three duties of great importance, indeed, but plain and intelligible to common understandings” (WN IV.ix.51). These three duties are (1) the defence of the country, (2) the administration of justice, and (3) the maintenance of certain public work. They have three characteristics in common. First, they are focused on the effective establishment of property rights. Famously, Smith says that “defence, however, is of much more importance than opulence” (WN IV. ii.30), underlying the

importance of national security, the most fundamental foundation for securing property rights. Second, they are for the benefits of the public and not for the individual interests. By focusing on three duties, “The sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society” (WN IV. ix. 51). Thirdly, they are communication-and-knowledge-enhancing policies with their emphasis on public infrastructure and elementary education, which is closely related to Smith’s conception of human beings (Rothchild and Sen 2006).

A bigger question is how a proper legal and institutional would emerge. Smith’s answer is that it is not automatic. Examples are plentiful. First, the most fundamental problem is the violation of property rights whose prime example is slavery. Secondly, there is persistence of inefficient property rights, such as primogeniture and entails. Thirdly, there are a wide variety of inefficient government regulations such as protection and monopoly.

This leads to the Smithian comparative and historical analysis. It is based on three assumptions: First, following the Smithian human assumptions, he conceives a race among human motives; secondly, he also highlights the race between knowledge, technology, trade, institutions, policy, and politics; thirdly, as such, historical contingencies matter in deciding the course of development of a society.

Two prime examples of the Smithian comparative and historical analysis are slavery and free trade. Smith writes on slavery on several occasions. For him, slavery poses a puzzle: he believes that free labor is more efficient than forced labor, therefore slavery is an inefficient,²⁵ but it persists throughout the history: “We are apt to imagine

²⁵ It should be noted that it is Smith’s belief that “[i]t appears, accordingly, from the experience of all ages and nations, *I believe*, that the work done by freemen comes cheaper in the end than that performed by slaves” (WN I.viii.41; emphasis added). His belief is further elaborated later: “Slaves, however, are very seldom inventive; and all the most important improvements, either in machinery, or in the arrangement and distribution of work which facilitate and abridge labor, have been the discoveries of freemen. Should a slave propose any improvement of this kind, his master would be very apt to consider the proposal as the suggestion of laziness, and a desire to save his own labor at the master’s expense. The poor slave, instead of reward, would probably meet with much abuse, perhaps with some punishment. In the manufactures carried on

that slavery is entirely abolished at this time, without considering that this is the case in only a small part of Europe; not remembering that all over Moscovy and all the eastern parts of Europe, and the whole of Asia, that is, from Bohemia to the Indian Ocean, all over Africa, and the greatest part of America, it is still in use" (LJ (A) iii.101). He answers this puzzle with recourse to one set of human motives, the love of domination: "The pride of man makes him love to domineer, and nothing mortifies him so much as to be obliged to condescend to persuade his inferiors. Wherever the law allows it, and the nature of the work can afford it, therefore, he will generally prefer the service of slaves to that of freemen" (WN III.ii.10).²⁶ But there is a further question as to why slavery was abolished in "some part of Europe". For him, the answer lies in politics with collision of interested groups. Slavery was abolished since the king and the church wanted to reduce the power base of the large slaveholders: "it was absolutely necessary both that the authority of the king and of the clergy should be great. Where ever any one of these was wanting, slavery still continues" (LJ (A) iii.121).

From this perspective, it follows that progress in the sense of the abolition of inefficient and unjust institution is possible but not guaranteed. Moreover, Smith is pessimistic about the prospect of the abolition of slavery in the future:

It is indeed almost [sic] impossible that it should ever be totally or generally abolished. In a republican government it will scarcely ever happen that it should be abolished. The persons who make all the laws in that country are persons who have slaves themselves. These will never make any laws mitigating their usage; whatever laws are made with regard to slaves are intended to strengthen the authority of the masters and reduce the slaves to a more absolute subjection. The profit of the masters was increased when they got greater power over their slaves. The authority of the masters over the slaves is therefore unbounded in all republican governments (LJ (A) iii.101-2).

It is noteworthy that Smith predicts conflicts of vested interests become stronger as the polity becomes more democratized.

by slaves, therefore, more labor must generally have been employed to execute the same quantity of work, than in those carried on by freemen" (WN IV.ix.47). This contrasts with the division of labor among "freemen" which Smith emphasizes as a promoter of opulence. See Drescher 2002.

²⁶ For a different, more rational-agent based view, see Weingast (2021).

Smith is also pessimistic about the prospects of achieving free trade. Using the word Utopia, he declares: “To expect, indeed, that the freedom of trade should ever be entirely restored in Great Britain is as absurd as to expect that an Oceana or Utopia should ever be established in it.” The reason is, again, politics motivated by self-interests.

Not only the prejudices of the public, but what is much more unconquerable, the private interests of many individuals, irresistibly oppose it. Were the officers of the army to oppose with the same zeal and unanimity any reduction in the numbers of forces with which master manufacturers set themselves against every law that is likely to increase the number of their rivals in the home-market; were the former to animate their soldiers in the same manner as the latter enflame their workmen to attack with violence and outrage the proposers of any such regulation, to attempt to reduce the army would be as dangerous as it has now become to attempt to diminish in any respect the monopoly which our manufacturers have obtained against us. This monopoly has so much increased the number of some particular tribes of them that, like an overgrown standing army, they have become formidable to the government, and upon many occasions intimidate the legislature. The Member of Parliament who supports every proposal for strengthening this monopoly is sure to acquire not only the reputation of understanding trade, but great popularity and influence with an order of men whose numbers and wealth render them of great importance. If he opposes them, on the contrary, and still more if he has authority enough to be able to thwart them, neither the most acknowledged probity, nor the highest rank, nor the greatest public services can protect him from the most infamous abuse and detraction, from personal insults, nor sometimes from real danger, arising from the insolent outrage of furious and disappointed monopolists (WN IV.ii.43).

Other example involves his discussion of the interaction between cities and country in British development. Two forces operate in shaping the development of institutions: the “extent of the market”, and politics. The former is assumed to be a positive, progressive, and beneficial force such as the discovery of America (WN I.xi.g.25). In comparison, the latter could be either progressive or retrogressive depending on the particular policies which the political process takes: it could secure property rights, lift regulations, or open up markets; or it could maintain inefficient

institutions, close or limit trade with foreign countries, establish monopoly companies, or set regulations.²⁷

Therefore, Smith argues that the path to “opulence” is not automatic. His comparative and historical analysis of the path to “opulence” can be summarized in the following figure. There are three types of failures in the path: failed transition from the feudal system; halted development; and slow development. Reasons for these three types vary depending on specific situations. For failed transition, slavery or its equivalent remain; for halted development, monopoly of trade and closed trade; and for slow development, “preferences and restraints,” and remnants of inefficient institutions.²⁸

²⁷ A similar dynamics can be found in the discussion of the effects of colonial trade on the development of home country. The beginning of colonial trade opened an enormous opportunity for the home country, since it would expand the extent of the market, thus potentially initiating the causes of virtuous development. However, it was also tempting for the political elites to exploit the situation for their own benefits, by monopolizing the trade. Once the latter effects overwhelmed the former, development came to a halt (WN IV.vii.c).

²⁸ According to Acemoglu and Robinson (2006), there are four views of how institutions evolve, function, and differ: efficient, ideology, incidental, and social-conflict views. The efficient view considers institutions as the efficient outcome of deliberate choices by the members of society. The ideology view stresses the importance of beliefs, ideas, and ideology at a particular time in explaining institutions. The incidental view emphasizes historical accidents and their persistent influence. The social-conflict view one envisions institutions as the equilibrating outcome of complex political and social conflicts. Smith’s comparative and historical analysis clearly rejects the first view, since inefficient institutions such as primogeniture, entails, and slavery could survive and persist in many places and throughout history. His analysis contains some elements of the remaining three views, but the social conflict view is at the core. What stands out for Smith’s analysis is the strong emphasis on the contingent nature of institutional development: historical incidents could change the course of development for a long time: “The difference between the genius of the British constitution which protects and governs North America, and that of the mercantile company which oppresses and domineers in the East Indies, cannot perhaps be better illustrated than by the different state of those countries” (WN I.viii.26; WN IV. b.17-21; WN IV.vii.b.51).

Nature of Failures	Cases	Reasons
Failed Transition from the Feudal System	Russia, Poland, Hungary, Bohemia, Moravia, Germany	Remaining slavery, one sort or another
Halted development	Spain, Portugal, China	Monopoly of trade, Closed trade
Slow development	Britain, France	“Preferences and restraints”, remnants of inefficient institutions (primogeniture, entails)

Figure 30: Smith’s analysis of failures to “opulence”

IV. Concluding Remarks

Capitalism, or a “commercial society” in Smith’s parlance, has delivered a great deal of achievements. Yet, it now faces several serious challenges. I have argued that Adam Smith could still offer answers to those challenges: First, capitalism should be a knowledge-based growing, market-oriented, and inclusive one. Smith’s is a broader endogenous economic growth, with pro-market but not pro-business orientation, and with concerns with distributional outcomes for most of the people. Secondly, although Smith believes that progress is possible, history, institutions and policy would determine the course of progress: in this sense, he takes a view that institutions are not always efficient and historical incidents and social conflict shape them (Acemoglu and Robinson 2006, 2012, 2019; Greif 2006; North, Weingast and Wallis 2009). Therefore, thirdly, progress is not automatically achieved. Smith has “relatively cautious sense of progress” of the Scottish enlightenment thinkers (Berry 2018, 14).

We tend to forget the historical context against which he wrote his work including the *Wealth of Nations*. That was the time when the infant mortality rate was high, universal basic education was nonexistent, the free expression of ideas was severely limited, competition was restricted, internal and external trade was distorted, and the mega corporations dominated the larger part of the subcontinent. Smith’s problems are still our own problems.

In his excellent *The Crisis of Democratic Capitalism*, Martin Wolf stresses four key objectives which a renewed capitalism should satisfy: security, opportunities, prosperity, and dignity. His more specific five goals are the following (Wolf 2023, 231):

1. A rising, widely shared, and sustainable standard of living
2. Good jobs for those who can work and are prepared to do so
3. Equality of opportunity
4. Security for those who need it
5. Ending special privileges for the few.

These five goals can be legitimately called Smith's goals as well.

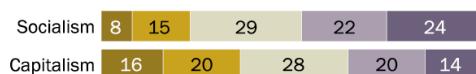
I would like to conclude this paper with three parting thoughts. The first concerns exactly what people understand by the words “capitalism” and “socialism”.

More say capitalism ‘gives all people an equal opportunity to be successful’ than say this about socialism

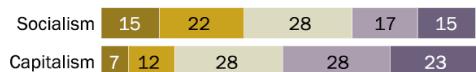
How well do the following phrases describe ____? (%)

■ Extremely ■ Very ■ Somewhat ■ Not too ■ Not at all

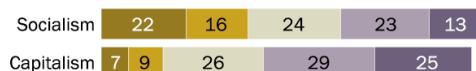
Gives all people an equal opportunity to be successful



Makes sure everyone’s basic needs, such as food, health care, and housing, are met



Restricts people’s individual freedoms



Note: No answer responses not shown.

Source: Survey of U.S. adults conducted Aug. 1-14, 2022.

PEW RESEARCH CENTER

Source: Pew Research Center (2022)

Figure 31: People appreciate capitalism giving all people an equal opportunity

The millennials are perceived to be in favor of “socialism,” but what they understand by that name may be different from the socialism as we know it (Ekins and Pullmann 2016). For those who do not know the Cold War era, their model socialism is

that of Nordic countries. The Nordic countries are advanced capitalist welfare states combined with high degree of globalization and the market economy. In the meanwhile, the millennials are perceived to be in favor of income redistribution, but they tend to trust the government less, and are skeptical about the government intervention in general. Also, they tend to favor free market economy and free enterprise over big business as other generations do. Furthermore, they understand “socialism” not in a traditional sense, but in providing more social services and guaranteed income. They may be critical toward the current form of capitalism, but they do not really wish to go back to the old-style socialism.

Millennials Favor Free Market Economy Over Govt Managed Economy, Capitalism Over Socialism by Smaller Margin

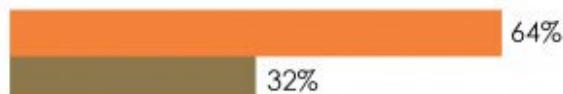
Which is the better system: capitalism or socialism?

■ Capitalism ■ Socialism



Which is the better system: free market economy or an economy managed by the government?

■ Free Market Economy ■ Govt Managed Economy

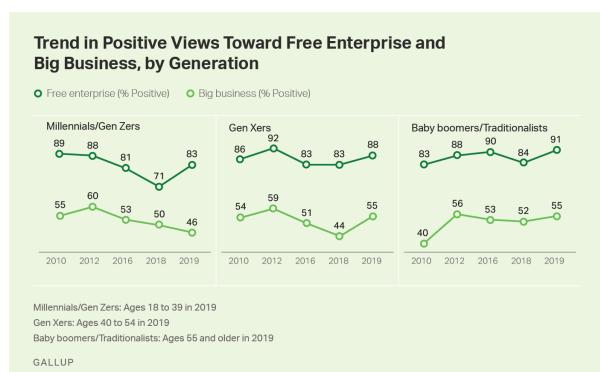


Reason - Rupe Spring 2014 Millennial Poll

Don't know/refused responses not shown

Source: Ekins and Pullmann 2016

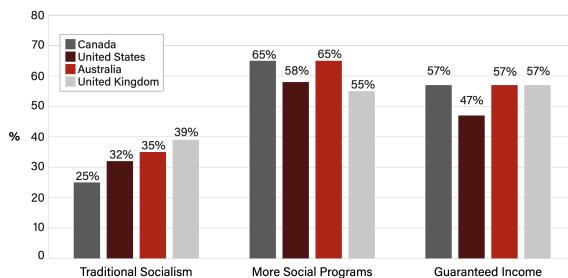
Figure 32 Millennials favor free market economy over government managed economy



Source: Gallup

Figure 33: Younger people prefer free enterprise

Figure 17: Comparing Total Agreement (Strongly Agree and Agree) for Definitions of Socialism Across Countries, All Ages



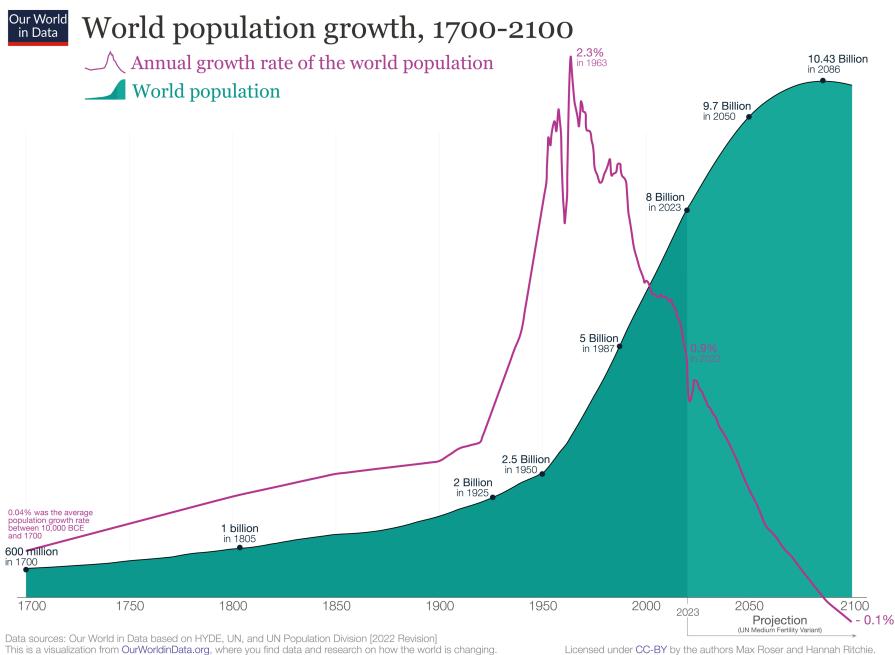
Source: <https://www.fraserinstitute.org/studies/perspectives-on-capitalism-and-socialism>

Figure 34: People want more social programs and guaranteed income than traditional socialism

Arguably, they are the generation surrounded by new technology, and practitioners of gig and sharing economy. Their lifestyle tends to dematerialize, as they show strong interest in environmental issues. Most of all, they cherish freedom and democracy. It is quite possible that they are already living in the future capitalism.²⁹

Secondly, even though one feels confident about dealing with the current challenges, there may be a genuine fear for the future of capitalism from a Smithian perspective, that is depopulation. The world population growth rate is already declining, and it would be estimated to decrease from the peak of 10.43 billion in 2086 onward.

²⁹ Social anthropologist Yasushi Watanabe characterizes the millennials as follows: “Grown up in an age when family and work have become more diverse and individualized, they, backed by the internet society, are leaning toward new forms of relationship between the public and the private including social entrepreneurship and sharing economy. They prefer freedom economically and socially, are highly interested in social justice including human rights and the environment, are tolerant toward diversity, and want changes. They are dissatisfied with the existing political parties, two party system or the old-fashioned either-or-division such as conservative vs. liberal ... Those characteristics have strong affinity with libertarian” (Watanabe 2019, 193).



Source: One World in Data

Figure 35: World population will decrease in the future

If this happens, one may have to worry about the implications on the world from the Smithian dictum that the “division of labor is limited by the market”. The Smithian growth process entails a virtuous interdependence between increased population and increased prosperity through the knowledge generation supported by the abovementioned Smithian dictum. Charles Jones (2022) argues for this linkage from modern theoretical perspective and voices concerns for the prospects for economic growth: today’s declining fertility rate would slow down and eventually halt economic growth in the future. To counter this possibility, one could argue that we need all people, regardless of gender, ethnicity, and regions, to come on board to contribute to the growth process. Beyond that, would AI and Robots sustain economic growth in the future?

Lastly, I would like to touch upon the motivation behind Smith’s writings, i.e., why he wrote what he wrote. Who is the impartial spectator, by the way? It should be Adam Smith himself, not the Adam Smith who lived a real life but the ideal person whom Adam Smith thought he should be. He is the person who does not take side with special interests and the privileged, but with the general interests of the people. After all, that is the ideal political economist. And this should also apply to the ideal elites about whom Martin Wolf characterizes as follows:

it is not enough for members of elites to be clever, well trained, and ambitious if they are also self-satisfied, narrowly educated, and selfish, possibly even amoral.

Members of a functioning elite, which includes the business elite, need wisdom as well as knowledge. Above all, they need to feel responsible for the welfare of their republic and its citizens. Indeed, if there are to be citizens at all, members of the elite must be exemplars. It is not hard: instead of lies, honesty; instead of greed, restraint; instead of fear and hatred, appeals to what Abraham Lincoln called “the better angels of our nature (Wolf 2023, 377).

Moreover, in the *Theory of Moral Sentiments*, he asks how one can persuade the legislator “who seems almost dead to ambition” to think more about the public affairs. Smith’s tactic is to appeal to the “same love of system, the same regard to the beauty of order, of art and contrivance.”

If you would hope to succeed, you must describe to him the conveniency and arrangement of the different apartments in their palaces; you must explain to him the propriety of their equipages, and point out to him the number, the order, and the different offices of all their attendants. If any thing is capable of making impression upon him, this will (TMS IV.i.11).

The Smithian tactic is the application of the famous “invisible hand” argument which relies on the unintended consequences. Given this, there is a hope that social scientific inquiry may promote public spirit, and therefore action toward better public policy.

Nothing tends so much to promote public spirit as the study of politics, of the several systems of civil government, their advantages and disadvantages, of the constitution of our own country, its situation, and interest with regard to foreign nations, its commerce, its defence, the disadvantages it labours under, the dangers to which it may be exposed, how to remove the one, and how to guard against the other. Upon this account political disquisitions, if just, and reasonable, and practicable, are of all the works of speculation the most useful. Even the weakest and the worst of them are not altogether without their utility (TMS, IV.i.11)

I believe that this gathering of the International Adam Smith Society would eventually offer “the most useful” speculation to promote public spirit.

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