

between interest rates and profit rates (i.e. the fundamental rates of return on investment). Here he points out correctly that 'no man will accept of low profits, where he can have high interest; and no man will accept of low interest where he can have high profits'. In short, interest and profit rates tend to be equal on the market. Very true, but which causes which, or what is the underlying cause of both? Hume characteristically abandons the search for cause, and says that 'both arise from an extensive commerce, and mutually forward each other'. Böhm-Bawerk is surely right when he says that this view is 'somewhat superficial'.⁹ But more than that: it is incorrect and reverses cause and effect by stating that 'extensive commerce, by producing large stocks (capital), diminishes both interest and profits'. For there is no reason why larger stocks of capital should lower interest or profit rates; what they *do* lower is the prices of capital goods and consumer goods. The casual chain is the other way round: lower time-preference rates, which usually but not always attend higher standards of living and greater prosperity, will cause both capital to accumulate *and* profit and interest rates to fall. The two, as the Austrian School would later point out, are different sides of the same coin.¹⁰

Turning to the other areas of economics, it is possible that some of the deep flaws in Adam Smith's value theory were the result of David Hume's influence. For Hume had no systematic theory of value, and had no idea whatever of utility as a determinant of value. If anything, he kept stressing that labour was the source of all value.

On political economy, David Hume may be considered a free trader and opponent of mercantilism. A friend and mentor of Adam Smith from their first meeting in 1752, Hume came to know the French *laissez-fairists* during his years in that country, and Turgot himself translated Hume's *Political Discourses* into French.

15.5 Notes

1. In the same year, 1718, Carmichael published a *System of Natural Theology*, and two years later produced an introduction to logic. In the year of his death he wrote a *Synopsis of Natural Theology*.
2. A more concise but less effective version, an *Introduction to Moral Philosophy*, had been published immediately after his death in 1747.
3. Mandeville was a Dutch physician who spent much of his life in England. The *Fable of the Bees* was itself an expanded version of a satirical essay, *The Grumbling Hive, or Knaves Turned Honest* (1705).
4. *Fable of the Bees* (1924), p. 359. Cited in the excellent article by Salim Rashid, 'Mandeville's *Fable*: Laissez-faire or Libertinism?', *Eighteenth-Century Studies*, 18 (Spring 1985), p. 322.
5. So bitter were the Anglican priests in Scotland at the governmental establishment of Presbyterianism that they, as well as the Roman Catholics, formed the backbone of the Jacobite rebels dedicated to the restoration of the Stuart monarchy in Great Britain.
6. Professor Salerno attempts to justify Hume's curious assumption of a permanent tendency to unemployed resources by applying the Alchian-Allen information cost analysis. But this approach only explains the maintenance of any business inventory, inventory which, as Salerno shows, is not truly 'idle' but performs an important function to the businessman of

dealing with uncertainty. But such inventory hardly explains the unemployment of labour and other resources, which is presumably unwanted (since inflation supposedly eliminates this idleness) and hence involuntary. Of course if, as we would maintain, unemployment results from excessively high asking prices for resources, then this unemployment is brought upon the resource-owners by their own actions, although as an undesired consequence. In a deep sense, then, this unemployment is really 'voluntary'. See Joseph T. Salerno, 'The Doctrinal Antecedents of the Monetary Approach to the Balance of Payments' (doctoral dissertation, Rutgers University, 1980), pp. 160-2, and W.H. Hutt, *The Theory of Idle Resources*, (2nd ed., Indianapolis: Liberty Press, 1977).

7. Unfortunately for the development of the British classical school and of economics itself, Hume failed to heed the criticism of his friend, and Adam Smith's childhood friend, James Oswald of Dunnikier (1715-69). Oswald, an important MP who might have become Chancellor of the Exchequer, and whose advice on economics was sought by Hume and Smith, wrote to Hume that 'the increased quantity of money would not necessarily increase the price of all labour and commoditis; because the increased quantity, not being confined to the home labour and commoditis, might, and certainly would, be sent to purchase both from foreign countries...'. Though Hume answered by conceding this cash balance effect in the balance of payments adjusting mechanism, he failed to incorporate it into his fuller presentation of the price-specie-flow process. See Salerno, *op. cit.*, note 6, pp. 252-3.
8. Salerno, *op. cit.*, note 6, pp. 165-6.
9. Eugen von Böhm-Bawerk, *Capital and Interest* (South Holland, Ill.: Libertarian Press, 1959), I, p. 30.
10. Spiegel hails Hume's analysis as presaging 'modern economic theory, with its functional approach' that replaces old-fashioned concern with cause and effect. Hume, he says, foreshadows 'the later concern of economic science with functional rather than casual relationships, which... did not become common before the twentieth century'. So much the worse for both Hume and twentieth century theory! For the functional, non-casual relations of mathematics are scarcely appropriate for an analysis of human action, where human preferences and choices are the *cause*, and have specifically traceable *effects*. Ironically, moreover, the great destroyer of cause and effect did *not* lack a causal theory of interest; instead, he picked the wrong end of the causal chain by claiming that low interest and profits were both caused by the accumulation of capital goods. Cf. Henry W. Spiegel, *The Growth of Economic Thought* (Englewood Cliffs, NJ: Prentice-Hall, 1971), pp. 211-2.

16 The celebrated Adam Smith

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16.1 The mystery of Adam Smith

Adam Smith (1723–90) is a mystery in a puzzle wrapped in an enigma. The mystery is the enormous and unprecedented gap between Smith's exalted reputation and the reality of his dubious contribution to economic thought.

Smith's reputation almost blinds the sun. From shortly after his own day until very recently, he was thought to have created the science of economics virtually *de novo*. He was universally hailed as the Founding Father. Books on the history of economic thought, after a few well-deserved sneers at the mercantilists and a nod to the physiocrats, would invariably start with Smith as the creator of the discipline of economics. Any errors he made were understandably excused as the inevitable flaws of any great pioneer. Innumerable words have been written about him. At the bicentennial of his *magnum opus*, *An Inquiry into the Nature and the Causes of the Wealth of Nations* (1776), a veritable flood of books, essays, and memorabilia poured forth about the quiet Scottish professor. His profile sculpted on a medallion by Tassie is known throughout the world. A hagiographic movie was even made about Smith during the bicentennial by a free market foundation, and businessmen and free market advocates have long hailed Adam Smith as their patron saint. 'Adam Smith ties' were worn as a badge of honour in the upper echelons of the Reagan Administration. On the other hand, Marxists, with somewhat more justice, hail Smith as the ultimate inspiration of their own Founding Father, Karl Marx. Indeed, if the average person were asked to name two economists in history whom he has heard of, Smith and Marx would probably be the runaway winners of the poll.

As we have already seen, Smith was scarcely the founder of economic science, a science which existed since the medieval scholastics and, in its modern form, since Richard Cantillon. But what the German economists used to call, in a narrower connection, *Das AdamSmithProblem*,¹ is much more severe than that. For the problem is not simply that Smith was not the founder of economics. The problem is that he originated nothing that was true, and that whatever he originated was wrong; that, even in an age that had fewer citations or footnotes than our own, Adam Smith was a shameless plagiarist, acknowledging little or nothing and stealing large chunks, for example, from Cantillon. Far worse was Smith's complete failure to cite or acknowledge his beloved mentor Francis Hutcheson, from whom he derived most of his ideas as well as the organization of his economic and moral philosophy lectures. Smith indeed wrote in a private letter to the University of Glasgow of the 'never-to-be-forgotten Dr. Hutcheson', but apparently amnesia conveniently struck Adam Smith when it came time to writing the *Wealth of Nations* for the general public.²

Even though an inveterate plagiarist, Smith had a Columbus complex, accusing close friends incorrectly of plagiarizing *him*. And even though a

plagiarist, he plagiarized badly, adding new fallacies to the truths he lifted. In castigating Adam Smith for errors, therefore, we are not being anachronistic, absurdly punishing past thinkers for not being as wise as we who come later. For Smith not only contributed nothing of value to economic thought; his economics was a grave deterioration from his predecessors: from Cantillon, from Turgot, from his teacher Hutcheson, from the Spanish scholastics, even – oddly enough – from his *own* previous works, such as the *Lectures on Jurisprudence* (unpublished, 1762–63, 1766) and the *Theory of Moral Sentiments* (1759).

The mystery of Adam Smith, then, is the immense gap between a monstrously overinflated reputation and the dismal reality. But the problem is worse than that; for it is not just that Smith's *Wealth of Nations* has had a terribly overblown reputation from his day to ours. The problem is that the *Wealth of Nations* was somehow able to blind all men, economists and laymen alike, to the very knowledge that other economists, let alone better ones, had existed and written before 1776. The *Wealth of Nations* exerted such a colossal impact on the world that all knowledge of previous economists was blotted out, hence Smith's reputation as Founding Father. The historical problem is this: how could this phenomenon have taken place with a book so derivative, so deeply flawed, so much less worthy than its predecessors?

The answer is surely not any lucidity or clarity of style or thought. For the much revered *Wealth of Nations* is a huge, sprawling, inchoate, confused tome, rife with vagueness, ambiguity and deep inner contradictions. There is of course an advantage, in the history of social thought, to a work being huge, sprawling, ambivalent and confused. There is sociological advantage to vagueness and obscurity. The bemused German Smithian, Christian J. Kraus, once referred to the *Wealth of Nations* as the 'Bible' of political economy. In a sense, Professor Kraus spoke wiser than he knew. For, in one way, the *Wealth of Nations* is like the Bible; it is possible to derive varying and contradictory interpretations from various – or even the same – parts of the book. Furthermore, the very vagueness and obscurity of a work can provide a happy hunting ground for intellectuals, students and followers. To make one's way through an obscure and difficult tract, to weave dimly perceived threads of a book into a coherent pattern – these are rewarding tasks in themselves for intellectuals. And such a book also provides a welcome built-in exclusion process, so that only a relatively small number of adepts can bask in their expertise about a work or a system of thought. In that way they increase their relative income and prestige, and leave other admirers behind to form a cheering section for the leading disciples of the Master.

Adam Smith did not found the science of economics, but he did indeed create the paradigm of the British classical school, and it is often useful for

the creator of a paradigm to be inchoate and confused, thereby leaving room for disciples who will attempt to clarify and systematize the contributions of the Master. Until the 1950s, economists, at least those in the Anglo-American tradition, revered Smith as the founder, and saw the later development of economics as a movement linearly upward into the light, with Smith succeeded by Ricardo and Mill, and then, after a bit of diversion created by the Austrians in the 1870s, Alfred Marshall establishing neoclassical economics as a neo-Ricardian and hence neo-Smithian discipline. In a sense, John Maynard Keynes, Marshall's student at Cambridge, thought that he was only filling in the gaps in the Ricardian-Marshallian heritage.

Into this complacent miasma of Smith-worship, Joseph A. Schumpeter's *History of Economic Analysis* (1954) came as a veritable blockbuster. Coming from the continental Walrasian and Austrian traditions rather than from British classicism, Schumpeter was able, for virtually the first time, to cast a cold and realistic eye upon the celebrated Scot. Writing with thinly veiled contempt, Schumpeter generally denigrated Smith's contribution, and essentially held that Smith had shunted economics off on a wrong road, a road unfortunately different from that of his continental forbears.³

Since Schumpeter, historians of economic thought have largely retreated to a fallback position. Smith, it is conceded, created nothing, but he *was* the great synthesizer and systematizer, the first one to take up all the threads of his predecessors and weave them together into a coherent and systematic framework. But Smith's work was the reverse of coherent and systematic, and Ricardo and Say, his two major disciples, each set themselves the task of forging such a coherent system out of the Smithian muddle. And, furthermore, while it is true that pre-Smithian writings were incisive but sparse (Turgot) or embedded in moral philosophy (Hutcheson), it is also true that there were two general treatises on economics *per se* before the *Wealth of Nations*. One was Cantillon's great *Essai* which, after Smith, fell into grievous neglect, to be rescued a century later by Jevons; the other, and the first book to use political economy in its title, was Sir James Steuart's (1712–80) outdated two-volume work, *Principles of Political Oeconomy* (1767). Steuart, a Jacobite who had been involved in Bonnie Prince Charlie's rebellion, was for much of his life an exile in Germany, where he became imbued with the methodology and ideals of German 'cameralism'. Cameralism was a virulent form of absolutist mercantilism that flourished in Germany in the seventeenth and eighteenth centuries. Cameralists, even more than western European mercantilists, were not economists at all – that is, they did not analyse the processes of the market – but were technical advisers to rulers on how and in what way to build up state power over the economy. Steuart's *Principles* was in that tradition, scarcely economics but rather a call for massive government intervention and totalitarian planning, from detailed regulation of trade to a

system of compulsory cartels to inflationary monetary policy. His only 'contribution' was to refine and expand previously fleeting and inchoate notions of a labour theory of value, and to elaborate a proto-Marxian theory of inherent class conflict in society. Furthermore, Steuart had written an ultra-mercantilist tome just at the time when classical liberal and *laissez-faire* thought was rising and becoming dominant at least in Britain and France.

Even though Steuart's *Principles* was out of step with the emerging classical liberal *Zeitgeist*, it was no foregone conclusion that the work would have little or no influence. The book was well received, highly respected, and sold very well, and five years after its publication, in 1772, Steuart won out over Adam Smith in acquiring a post as monetary consultant to the East India Company.

One reason that the Schumpeter view of Smith shocked the economics profession is that historians of economic thought, similar to historians of other disciplines, have habitually treated the development of science as a linear and upward march into the truth. Each scientist patiently formulates, tests and discards hypotheses, and thereby each succeeding one stands on the shoulders of the one who came before. What might be called this 'Whig theory of the history of science' has now been largely discarded for the far more realistic Kuhnian theory of paradigms. For our purposes the important point of the Kuhn theory is that a very few people patiently test anything, particularly the fundamental assumptions, or basic 'paradigm', of their theory: and shifts in paradigms can take place even when the new theory is worse than the old. In short, knowledge can be and is lost as well as gained, and science often proceeds in a zig-zag rather than linear manner. We might add that this would be particularly true in the social or humane sciences. As a result, paradigms and basic truths get lost, and economists (as well as people in other disciplines) can get worse, and not better, over time. The years may well bring retrogression as well as progress. Schumpeter had heaved a bomb-shell into the temple of the Whig historians of economic thought, specifically of the partisans of the Smith–Ricardo–Marshall tradition.⁴

We have thus posed our own version of the *Das AdamSmithProblem*: how did so badly flawed a work as the *Wealth of Nations* rapidly become so dominant as to blot out all other alternatives? But before considering this question, we must examine the various aspects of Smithian thought in more detail.

16.2 The life of Smith

Adam Smith was born in 1723 in the small town of Kirkcaldy, near Edinburgh. His father, also Adam Smith (1679–1723), who died shortly before he was born, was a distinguished judge advocate for Scotland and later comptroller of customs at Kirkcaldy, who had married into a well-to-do local

landowning family. Young Smith was therefore raised by his mother. The town of Kirkcaldy was militantly Presbyterian, and in the Burgh School in the town he met many young Scottish Presbyterians, one of whom, John Drysdale, was to become twice moderator of the general assembly of the Church of Scotland.

Smith, indeed, came from a customs official family. In addition to his father, his cousin Hercules Scott Smith, served as collector of customs at Kirkcaldy, and his guardian, again named Adam Smith, was to become customs collector at Kirkcaldy as well as inspector of customs for the Scottish outports. Finally, still another cousin named Adam Smith later served as customs collector at Alloa.

From 1737 to 1740, Adam Smith studied at Glasgow College, where he fell under the spell of Francis Hutcheson, and imbibed the excitement of the ideas of classical liberalism, natural law and political economy. In 1740, Smith earned an MA with great distinction at the University of Glasgow. His mother had baptized Adam in the Episcopalian faith, and she was eager for her son to become an Episcopalian minister. Smith was sent to Balliol College, Oxford, on a scholarship designed to nurture future Episcopalian clerics, but he was unhappy at the wretched instruction in the Oxford of his day, and returned after six years, at the age of 23, without having taken holy orders. Despite his baptism and his mother's pressure, Smith remained an ardent Presbyterian, and returning to Edinburgh in 1746, he remained unemployed for two years.

Finally, in 1748, Henry Home, Lord Kames, a judge and a leader of the liberal Scottish Enlightenment and a cousin of David Hume, decided to promote a series of public lectures in Edinburgh to educate lawyers. Along with Smith's childhood friend, James Oswald of Dunnikier, Kames got the Philosophical Society of Edinburgh to sponsor Smith in several years of lectures on natural law, literature, liberty and commercial freedom. In 1750, Adam Smith obtained the chair in logic at his *alma mater*, the University of Glasgow, and he found no difficulty in the requisite signing of the Westminster Confession before the Presbytery of Glasgow. Finally, in 1752, Smith had the satisfaction of ascending to his beloved teacher Hutcheson's chair of moral philosophy at Glasgow, where he was to remain for 12 years.

Smith's Edinburgh and Glasgow lectures were very popular, and his major stress was on the 'system of natural liberty', on the system of natural law and *laissez-faire* which he was then advocating with far less qualification than later in his more cautious *Wealth of Nations*. He also managed to covert many of the leading merchants of Glasgow to this exciting new creed. Smith also plunged into the social and educational associations that were beginning to be formed by the moderate Presbyterian clergy, university professors, literati, and attorneys in both Glasgow and Edinburgh. It is likely that David Hume

attended Smith's Edinburgh lectures in 1752, for the two became fast friends shortly thereafter.

Smith was a founding member of the Glasgow Literary Society the following year; the society engaged in high-level discussions and debates, and met diligently every Thursday evening from November to May. Hume and Smith were both members, and at one of the first sessions, Smith read an account of some of Hume's recently printed *Political Discourses*. Oddly enough, the two friends, clearly the brightest members of the Society, were extremely diffident, and never said a word in any of the discussions.

Despite his diffidence, Smith was a busy and inveterate clubman, becoming a leading member of the Philosophical Society of Edinburgh and of the Select Society (Edinburgh), which flourished in the 1750s, and met weekly, bringing together the moderate power élite from the clergy, university men, and the legal profession. Smith was also an active member of the Political Economy Club of Glasgow, the Oyster Club (Edinburgh); Simson's Club of Glasgow; and the Poker Club (Edinburgh), founded by his friend Adam Ferguson, professor of moral philosophy at the University of Edinburgh, specifically to promote the 'martial spirit'. As if this were not enough, Adam Smith was one of the leading contributors and editors of the abortive *Edinburgh Review* (1755–56), dedicated largely to the defence of their friends Hume and Kames against the hard-core evangelical Calvinist clergy of Scotland. The *Edinburgh Review* was founded by the brilliant young lawyer, Alexander Wedderburn (1733–1805), who was to become a judge, an MP in England, and finally Lord Chancellor (1793–1801). Wedderburn was so latitudinarian as to favour the licensing of brothels. Other luminaries on the *Edinburgh Review* were top moderate leaders: the politician John Jardine (1715–60), whose daughter married Lord Kames's son; the powerful Rev. William Robertson, and the Rev. Hugh Blair (1718–1800), professor of rhetoric at the University of Edinburgh.

The intensity of Adam Smith's Presbyterianism, even though not fundamentalist, may be seen in his relationship to Hugh Blair. Blair, the minister at the High Kirk, Greyfriars, was in constant hot water with the orthodox Calvinist clergy, who repeatedly denounced him to the Glasgow and Edinburgh Presbyteries. In the *Wealth of Nations*, Adam Smith delivered the following encomium to the Presbyterian clergy: 'There is scarce, perhaps, to be found anywhere in Europe, a more learned, decent, independent, and respectable set of men than the greater part of the Presbyterian clergy of Holland, Geneva, Switzerland, and Scotland'. To which his old friend Blair, though himself a leading if embattled Presbyterian clergyman, commented in a letter to Smith: 'You are, I think, by much too favourable to Presbytery'.

After Smith published his moral philosophy in his *Theory of Moral Sentiments* (1759), his increasing fame won him a highly lucrative position in

1764 as tutor to the young duke of Buccleuch. For three years of tutoring, which he spent with the young duke in France, Smith was awarded a lifetime annual salary of £300, twice his annual salary at Glasgow. In three pleasant years in France, he made the acquaintance of Turgot and the physiocrats. His tutorial task accomplished, Smith returned to his home town of Kirkcaldy, where, secure in his lifetime stipend, he worked for ten years to complete the *Wealth of Nations*, which he had started at the beginning of his stay in France. The fame of the *Wealth of Nations* led his proud erstwhile pupil, the Duke of Buccleuch, to help secure for Smith in 1778 the highly paid post of commissioner of Scottish customs at Edinburgh. With a pay of £600 per annum from his government post, which he kept until the day of his death in 1790, added to his handsome lifetime pension, Adam Smith was making close to a £1 000 a year, a 'princely revenue', as one of his biographers has described it. Even Smith himself wrote in this period that he was 'fully as affluent as I could wish'. He regretted only that he had to attend to his customs post, which took time away from his 'literary pursuits'.

And yet his regrets were scarcely profound. In contrast to most historians, who have treated Smith's customs post embarrassedly as virtually a no-show sinecure in reward for intellectual achievements, recent research has shown that Smith worked full-time at his post, often chairing the daily meetings of the board of customs commissioners. Moreover, Smith sought the appointment and apparently found the position enjoyable and relaxing. It is true that Smith spent little time or energy on scholarship and writing after his appointment; but there were leaves of absence available which Smith showed no interest in pursuing. Furthermore the groundwork for Smith's quest for the appointment was not so much his intellectual attainments as a reward for his advice as consultant on taxes and the budget to the British government since the mid-1760s.⁵

16.3 The division of labour

It is appropriate to begin a discussion of Smith's *Wealth of Nations* with the division of labour, since Smith himself begins there and since for Smith this division had crucial and decisive importance. His teacher Hutcheson had also analysed the importance of the division of labour in the developing economy, as had Hume, Turgot, Mandeville, James Harris and other economists. But for Smith the division of labour took on swollen and gigantic importance, putting into the shade such crucial matters as capital accumulation and the growth of technological knowledge. As Schumpeter has pointed out, never for any economist before or since did the division of labour assume such a position of commanding importance.

But there are more troubles in the Smithian division of labour than his exaggerating its importance. The older and truer perception of the motive

power for specialization and exchange was simply that each party to an exchange (which is necessarily two-party and two-commodity) benefits (or at least expects to benefit) from the exchange; otherwise the trade would not take place. But Smith unfortunately shifts the main focus from mutual benefit to an alleged irrational and innate 'propensity to truck, barter and exchange', as if human beings were lemmings determined by forces external to their own chosen purposes. As Edwin Cannan pointed out, Smith took this tack because he rejected the idea of innate differences in natural talents and abilities, which would naturally seek out different specialized occupations. Smith instead took the egalitarian–environmentalist position, still dominant today in neoclassical economics, that all labourers are equal, and therefore that differences between them can only be the *result* rather than a cause of the system of the division of labour.

In addition, Smith failed to apply his analysis of the division of labour to international trade, where it would have provided powerful ammunition for his own free trade policies. It was to be left to James Mill to make such an application in his excellent theory of comparative advantage. Furthermore, domestically, Smith placed far too much importance on the division of labour *within* a factory or industry, while neglecting the more significant division of labour *among* industries.

But if Smith had an undue appreciation of the importance of the division of labour, he paradoxically sowed great problems for the future by introducing the chronic modern sociological complaint about specialization that was picked up quickly by Karl Marx and has been advanced to a high art by socialist grippers about 'alienation'. There is no gainsaying the fact that Smith totally contradicted himself between Book I and Book V of the *Wealth of Nations*. In the former, the division of labour *alone* accounts for the affluence of civilized society, and indeed the division of labour is repeatedly equated with 'civilization' throughout the book. And yet, while in Book I the division of labour is hailed as expanding the alertness and intelligence of the population, in Book V it is condemned as leading to their intellectual as well as moral degeneration, to the loss of their 'intellectual, social and martial virtues'. There is no way that this contradiction can be plausibly reconciled.⁶

Adam Smith, though himself a plagiarist of considerable dimensions, also had a Columbus complex, often accusing other people unfairly of plagiarizing him. In 1755 he actually laid claim to having invented the concept of *laissez-faire*, or the system of natural liberty, asserting that he had taught these principles since his Edinburgh lectures in 1749. That may be: but the claim ignores previous such expressions by his own teachers as well as by Grotius and Pufendorf, to say nothing of Boisguilbert and the other French *laissez-faire* thinkers of the late seventeenth century.

In 1769, the contentious Smith levied a plagiarism charge against Principal William Robertson, upon the occasion of the publication of the latter's *History of the Reign of Charles V*. It is not known what the topic of the literary theft was supposed to be, and it is difficult to guess, considering the remoteness from Smith's work of the theme of the Robertson book.

The most famous plagiarism charge hurled by Smith was against his friend Adam Ferguson on the question of the division of labour. Professor Hamowy has shown that Smith did *not* break with his old friend, as had previously been thought, because of Ferguson's use of the concept of the division of labour in his *Essay on the History of Civil Society* in 1767. In view of all the writers who had employed the concept earlier, this behaviour would have been ludicrous, even for Adam Smith. Hamowy conjectures that the break came in the early 1780s, because of Ferguson's discussion at their club of what would later be published as part of his *Principles of Moral and Political Science* in 1792. For in the *Principles*, Ferguson summed up the pin-factory example that constituted the single most famous passage in the *Wealth of Nations*. Smith had pointed to a small pin-factory where ten workers, each specializing in a different aspect of the work, could produce over 48 000 pins a day, whereas if each of these ten had made the entire pin on his own, they might not have made even one pin a day, and certainly not more than 20. In that way the division of labour enormously multiplied the productivity of each worker. In his *Principles*, Ferguson wrote: 'A fit assortment of persons, of whom each performs but a part in the manufacture of a *pin*, may produce much more in a given time, than perhaps double the number, of which each was to produce the whole, or to perform every part in the construction of that diminutive article'.

When Smith upbraided Ferguson for not acknowledging Smith's precedence in the pin-factory example, Ferguson replied that he had borrowed nothing from Smith, but indeed that *both* had taken the example from a French source 'where Smith had been before him'. There is strong evidence that the 'French source' for both writers was the article on *Epingles* (pins) in the *Encyclopédie* (1755), since that article mentions 18 distinct operations in making a pin, the same number repeated by Smith in the *Wealth of Nations*, although in English pin factories 25 was the more common number of operations.

Thus Adam Smith broke up a long-standing friendship by unjustly accusing Adam Ferguson of plagiarizing an example which, in truth, both men had taken without acknowledgement from the French *Encyclopédie*. The Rev. Carlyle's comment that Smith had 'some little jealousy in his temper' seems a vast understatement, and we are informed by his obituary notice in the 1790 *Monthly Review* that 'Smith lived in such constant apprehension of being robbed of his ideas that, if he saw any of his students take notes of his

lectures, he would instantly stop him and say, 'I hate scribblers'.⁷ While there is also evidence that Smith allowed students to take notes, the point about his crabbed temper and Columbus complex is well made.

Smith's use of an example of a small French pin-factory rather than a larger British one highlights a curious fact about his celebrated *Wealth of Nations*: the renowned economist seems to have had no inkling of the Industrial Revolution going on all about him. Although he was a friend of Dr John Roebuck, the owner of the Carron iron works, whose opening in 1760 marked the beginning of the Industrial Revolution in Scotland, Smith showed no indication that he knew of its existence. Although he was at least an acquaintance of the great inventor James Watt, Smith displayed no knowledge whatever of some of Watt's leading inventions. He made no mention in his famous book of the canal boom which had begun in the early 1760s, of the very existence of the burgeoning cotton textile industry, or of pottery or of the new methods of making beer. There is no reference to the enormous drop in travel costs that the new turnpikes were bringing about.

In contrast, then, to those historians who praise Smith for his empirical grasp of contemporary economic and industrial affairs, Adam Smith was oblivious to the important economic events around him. Much of his analysis was wrong, and many of the facts he did include in the *Wealth of Nations* were obsolete and gathered from books 30 years old.

16.4 Productive vs unproductive labour

One of the physiocrats' more dubious contributions to economic thought was their view that only agriculture was productive, that only agriculture contributed a surplus, a *produit net*, to the economy. Smith, heavily influenced by the physiocrats, retained the unfortunate concept of 'productive' labour, but expanded it from agriculture to material goods in general. For Smith, then, labour on material objects was 'productive'; but labour on, say, consumer services, on immaterial production, was 'unproductive'.

Smith's bias in favour of material objects amounted to a bias in favour of investment in capital goods, since a stock of capital goods by definition has to be embodied in material objects. Consumer goods, on the other hand, either consist of immaterial services, or they get used up – consumed – in the process of consumption. Smith's imprimatur on *material* production, therefore, was an indirect way of advocating investment in an accumulation of capital goods as against the very *goal* of producing capital goods: increased consumption. When discussing exports and imports, Smith realized full well that there was no point to amassing intermediate objects except that they eventually be consumed – that the only goal of production is consumption. But as Professor Roger Garrison has pointed out, and as we shall see further on the question of usury laws, Adam Smith's Presbyterian conscience led him

to value the expenditure of labour *per se*, for its own sake, and led him to balk at free market time-preferences between consumption and saving. Clearly, Smith wanted far more investment towards future production and less present consumption than the market was willing to choose. One of the contradictions of this position, of course, is that accumulating more capital goods at the expense of present consumption will eventually result in a higher standard of living – unless Smith prepared to counsel a perpetual and accelerated shift toward more and more never-to-be-consumed means of production.

In Book II of the *Wealth of Nations*, Smith opines that labour on material objects is productive, while other labour is not because it does not ‘fix or realize itself in any particular subject...which endures after that labour is past and for which an equal quantity of labour could afterward be purchased’. Included in immaterial and hence unproductive labour are servants, ‘churchmen, lawyers, physicians, men of letters of all kinds; players, buffoons, musicians, opera-singers, opera-dancers, etc.’ To Smith the important point was that the ‘work of all’ unproductive labourers ‘perishes in the very instant of its production’. Or, as he put it, ‘Like the declamation of the actor, the harangue of the orator, or the tune of the musician, the work of all of them perishes in the very instant of its production’. Smith also writes that ‘productive’ labour ‘adds to the value of the subject on which it is bestowed’, whereas ‘unproductive labour does not’ – another way of putting the fact that labour on services is not embodied in ‘any particular subject’. ‘Productive’ labour, moreover, allegedly creates a ‘surplus’ for profit in manufacturing. Adam Smith’s lingering physiocratic bias was also shown in his preposterous assertion that agriculture is a far more productive industry than manufacturing, because in agriculture nature works alongside man and provides extra rent for landlords as well as profit for capitalists. In addition to other fallacies, Smith here failed to realize that nature in the form of ground land collaborates in *all* activities of man, not just agriculture, and that all activities, including manufacturing, will therefore yield ground rent to landowners.

In his thorough and searching critique of Adam Smith, Edwin Cannan speculated that Smith, if pressed, ‘would probably have admitted...that the declamation, harangues, and tunes, have a value’. Smith oddly identified the build-up of material capital goods with annual production. On the latter, as Cannan points out, ‘the durability of the things produced by labour is in reality of no significance. The declamations, harangues, and tunes are just as much a part of the annual produce as champagne or boots...’. Yet Smith, in Book II, excludes all production of immaterial services from the annual product, which is allegedly produced entirely by the ‘productive labourers’, who in turn ‘maintain’ not only themselves but all the unproductive classes of labour as well.

In a witty and charming passage, Cannan then comments:

People have always been rather apt to imagine that the class which they happen to think the most important 'maintains' all the other classes with which it exchanges commodities. The landowner, for instance, considers, or used to consider, his tenants as his 'dependants'. All consumers easily fall into the idea that they are doing a charitable act in maintaining a multitude of shopkeepers. Employers of all kinds everywhere believe that the employed ought to be grateful for their wages, while the employed firmly hold that the employer is maintained entirely at their expense. So the physiocrats alleged that the husbandman maintained himself and all other classes; and Adam Smith alleged that the husbandman, the manufacturer, and the merchant maintained themselves and all other classes. The physiocrats did not see that the husbandman was maintained by the manufacturing industries of thrashing, milling, and baking, just as much as the millers or the tailors are maintained by the agricultural industries of ploughing and reaping. Adam Smith did not see that the manufacturer and merchant are maintained by the menial services of cooking and washing just as much as the cooks and laundresses are maintained by the manufacturer of bonnets and the import of tea.⁸

It is not just durable objects, however, that Adam Smith was interested in; it was durable *capital* goods. Durable consumer goods, like houses, were again, for Smith, 'unproductive', although he grudgingly conceded that a house 'is no doubt extremely useful' to the person who lives in it. But it is not 'productive', wrote Smith, because 'If it is to be let to a tenant for rent, as the house itself can produce nothing, the tenant must always pay the rent out of some other revenue which he derives either from labour, or stock [capital], or land'. Again, Cannan provides the proper riposte: 'It did not occur to Adam Smith to reflect that if a plough is let for rent, as a plough itself can produce nothing the tenant must always pay the rent out of some other revenue'.⁹

Adam Smith's bias against consumption and in favour of saving and investment is summed up in Professor Rima's analysis:

It is clear from his third chapter in Book II, 'On the Accumulation of Capital or of Productive and Unproductive Labour', that he is concerned with the effect of using savings to satisfy the desire for luxuries by those who are prodigal instead of channelling them into uses that will enhance the supply of fixed or circulating capital. He is, in effect, arguing that savings should be used in such a way that they will create a flow of income and new equipment, and that failure to use savings in this manner is an impediment to economic growth.¹⁰

Perhaps – but it *also* means that Smith was not content to abide by free market choices between growth on the one hand, and consumption on the other.

Professor Edwin West, a modern admirer of Smith who generally portrays the Scotsman as an advocate of *laissez-faire*, admits Smith's bias: 'Yet Smith, like a prudent steward of a Scottish aristocrat's estate, could hardly disguise a strong personal preference for much private frugality, and therefore for "productive labor", in the interests of the nation's future accumulation'. He then