

Lecture Notes: Adam Smith

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1. Smith's Starting Point: Human Nature

Adam Smith starts with the observation that humans are largely but not exclusively self-interested creatures: we are, largely but not exclusively greedy. Yet we have a complex and sophisticated societal division of labor. And that division of labor is essential to our prosperity. Indeed, it is essential to our survival: drop one or two of us into the Sierra Nevada, even in summer, and we will quite likely die. Drop 100 of us, and we will quite likely survive, and even flourish.

How can animals that are by nature greedy nevertheless cooperate on a large scale? That is the deep moral-philosophical question that we can see

both of Smith's big books—his *The Theory of Moral Sentiments* and *An Inquiry into the Nature and Causes of the Wealth of Nations*—as aimed at. As Robert Heilbroner puts it in his *The Worldly Philosophers*, Smith:

is interested in laying bare the mechanism by which society hangs together. How is it possible for a community in which everyone is busily following his self-interest not to fly apart from sheer centrifugal force? What is it which guides each individual's private business so that it conforms to the needs of the group? With no central planning authority and no steady influence of age old tradition, how does society manage to get those tasks done which are necessary for survival?...

Adam Smith says that our ability to create and maintain a complicated societal division of labor that is so productive rests on three facets of human nature:

1. **language**, in that we are an anthology intelligence—what one of us knows or learns, pretty quickly all of us within and many of us without earshot will quickly learn;
2. **hierarchy**, in that we tend to form and respect weak dominance hierarchies in which we can command and obey;
3. **gift exchange**: in that we bind ourselves together by forming gift-exchange relationships—what Adam Smith called our “natural propensity to truck and barter”: we firmly expect to be and are very happy when we trade favors with each other, and we are uneasy when we feel as though we are always giving or always receiving, for we want the exchange of gifts and favors to be reciprocal, and roughly balanced.

Back in our environment of evolutionary adaptation, we could form gift-exchange relationships only with a few: our close neighbors, our good friends, and our near kin. Trust, you see, is necessary for a long-term gift-

exchange relationship, and short-term such relationships are rare because each has to have and be willing to give up something the other wants or needs right now. And since we are largely self interested, trust is hard to generate and maintain without other binding social ties.

2. From Human Nature to Human Society

Hence the key importance of the human cultural invention of money in forming our large-scale human society: money means that any one of us can make a short-term one-shot exchange relationship with any other one of us, someone who we may well never see again. Money, you see, is manufactured trust, and it allows us to extend our societal division of labor to encompass, indirectly, nearly everybody else in the world.

For example, consider the 30-foot bronze statue of Athene Promakhos—Athena Fighting-in-Front—that the council and people of Athens had cast and installed on the Acropolis around -450. The Greek geographer Pausanias wrote that anyone approaching Athens by sea by day could see her gleaming helmet and the tip of her spear as soon as they had rounded Sounion Head at the southern tip of Attika. 70 tons of bronze supposedly went into the statue, which survived until 1204—63 tons of copper, 7 tons of tin. Copper was abundant. But where in the -5th century were the artisans of Athens to find 7 tons of tin? The historian Herodotos states that he could find nobody in Athens who knew where the tin was coming from: all anyone could say was that the ships had picked up the tin, already mined, in Sicily, and that they thought it came from “tin islands” in the ocean on the other side of Europe. But he could find nobody who would claim to have actually seen these tin islands, or this ocean on the other side of Europe. So he doubted the stories.

The answer, of course, was that the tin was in Cornwall, at the southwestern tip of the island of Britain. The societal division of labor, as

governed by the market, was a mechanism that “knew” that 7 tons of tin needed to be mined in Cornwall and then shipped, probably via the English Channel-Seine-portage-Rhone-Mediterranean route, to Athens via Sicily. And so it happened. But, apparently, nobody anywhere in the value chain knew its entire extent. The market knew things that no human individual knew. And this was almost 2.5 millennia ago: the market knows much, much, much more now.

Language, weak dominance, gift exchange, and money have enabled us to progress from perhaps 10,000 of us 70,000 years ago living at a global average living standard of perhaps three 3.5 dollars a day to today’s world-girdling societal division of labor now 7.5 billion strong, with a global average standard of living no about \$35 a day. We are now, collectively, on average, at least 10 times as well-off and 750,000 times as numerous as we were 70,000 years ago back in the environment of evolutionary adaptation when we last passed through a Darwinian bottleneck.

3. The “System of Natural Liberty”

Adam Smith was a genius because he had a truly game-changing insight into how our societal division of labor should be organized. As far as the production and distribution of our collective material wealth is concerned, you see, most of what we need and want is both excludible and rival.

If something is “excludible”, that means we can assign it an owner—some one of us can be designated to control it, and to decide on its use, or decide to transfer “ownership” of it to something else. If something is excludible, we can push the decisions about how it is to be used out to the periphery of society, to the people on the ground who know what is going on, rather than have the decision made by some centralized bureaucracy clueless because of its inability to reliably judge information conveyed to it at third- or fourth-hand. Having ownership makes sense if information about

what is going on is dispersed and hard to assemble: giving control to people on the spot is then a very good idea.

If something is “rival”, that means that one person's use of it forecloses the opportunities of others: if I am using this iPhone, you cannot be using the same iPhone. If a good is rival, that one of us is using it diminishes the opportunities and possibilities available to others. That makes them poorer. Thus it makes sense to charge a price for somebody using a rival commodity. That makes them feel in their gut the effects of their decisions on the opportunities open to others. Charging prices is a way to align individuals’ incentives about whether it is worth it for them to make use of a commodity with the effects of their decision on the overall well-being of the society.

Hence, Adam Smith argued in his *Inquiry into the Nature and Causes of the Wealth of Nations*, the wealth of nations is most greatly enhanced by following the dictates of what he named the System of Natural Liberty —“liberty” because it leaves people free to do what they wanted with their labor and their possessions, “natural” because it conforms with human nature, "system" because it can be and is extended to the status of a general principle. Let people decide what they want to do with their things and their labor, and they arrange themselves in a large highly-productive societal division of labor. Self-interest focuses people on creating value. Competition curbs any distracting focus of self-interest on accomplishing exploitation.

This “System of Natural Liberty” is, Smith argues, good. As Heilbroner summarizes:

Self-interest... drives men to action.... [But] a community activated only by self-interest would be a community of ruthless profiteers. This regulator is competition, the socially beneficial consequence of the conflicting self-interests of all the members of society. For each man, out to do his best for himself with no thought of social cost, is faced with a flock of similarly

motivated individuals who are in exactly the same boat.... A man who permits his self-interest to run away with him will find that competitors have slipped in... will find himself without buyers in the one case and without employees in the other. Thus very much as in the *Theory of Moral Sentiments*, the selfish motives of men are transmuted by interaction to yield the most unexpected of results: social harmony.... The... market is that it is its own guardian. If output or prices or certain kinds of remuneration stray away from their socially ordained levels, forces are set into motion to bring them back to the fold. It is a curious paradox which thus ensues: the market, which is the acme of individual economic freedom, is the strictest task master of all...

This leads to a fraught question: Is this a *theological* point? Is the fact that acting “naturally” in the sense of giving market exchange free rein produces good results evidence that there is a benevolent Providence out there? Is this a *teleological* point? Are, in some sense, money and gift-exchange aimed at creating prosperity? How is it that processes that are not human—that lead to consequences not desired directly by any human—have a mind of their own, and lead to good ends? It is indeed a marvel that, as Smith puts it, in his theory at least:

[While] every individual... endeavours... to direct that industry that its produce may be of the greatest value... labours to render the annual revenue of the society as great as he can.... He... neither intends to promote the public interest, nor knows how much he is promoting it.... He intends only his own security.... He intends only his own gain.... In this, as in many other cases, [he is] led by an invisible hand to promote an end which was no part of his intention...”

It is a marvel. But what kind of a marvel is it?

It is not that Smith is opposed to government. Government is necessary to protect property, and to enforce contracts: people—most people—will respect others’ property and keep their own contracts, most of the time. But for the non-most people and at the non-most times we need the police, hence we need government. We need public works. We need public

education. We need national defense. Adam Smith is very clear on all of these. In fact, Book V of the *Wealth of Nations* on what the government should do and how it should do it is the largest of the five parts of the book. But, Smith is certain, attempts of some centralized bureaucrat to undermine the System of Natural Liberty in its proper sphere—to direct who should do what when and where—were likely to produce not wealth and prosperity but poverty and misery.

4. Adam Smith & Poverty

Adam Smith loathes poverty.

Adam Smith is eager to create a society in which there is no poverty.

Adam Smith spends a substantial amount of time investigating the course of poverty over time. For example, he takes time and care to write:

During the course of the last century, taking one year with another, grain was dearer in both parts of the united kingdom than during that of the present.... It is equally certain that labour was much cheaper. If the labouring poor, therefore, could bring up their families then, they must be much more at their ease now. In the last century, the most usual day-wages of common labour through the greater part of Scotland were sixpence in summer, and fivepence in winter.... Through the greater part of the Low country, the most usual wages of common labour are now eight pence a-day; tenpence, sometimes a shilling, about Edinburgh.... In England, the improvements of agriculture, manufactures, and commerce, began much earlier than in Scotland. The demand for labour, and consequently its price, must necessarily have increased with those improvements. In the last century, accordingly, as well as in the present, the wages of labour were higher in England than in Scotland. They have risen, too, considerably since that time, though, on account of the greater variety of wages paid there in different places, it is more difficult to ascertain how much.... Not only grain has become somewhat cheaper, but many other things from which the

industrious poor derive an agreeable and wholesome variety of food have become a great deal cheaper. Potatoes... cost half the price which they used to do thirty or forty years ago. The same thing may be said of turnips, carrots, cabbages; things which were formerly never raised but by the spade, but which are now commonly raised by the plough. All sort of garden stuff, too, has become cheaper.... The great improvements in the coarser manufactories of both linen and woollen cloth furnish the labourers with cheaper and better clothing; and those in the manufactories of the coarser metals, with cheaper and better instruments of trade, as well as with many agreeable and convenient pieces of household furniture...

Which he then cross-checks with elite gossip:

The common complaint that luxury extends itself even to the lowest ranks of the people, and that the labouring poor will not now be contented with the same food, clothing, and lodging which satisfied them in former times, may convince us that it is not the money price of labour only, but its real recompense, which has augmented...

Having established that poverty has diminished, he next launches a full-bore attack on all those who claim this is a bad thing:

Is this... to be regarded as an advantage or as an inconveniency?... Servants, labourers, and workmen... make up the far greater part.... 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...

And then he makes a strong appeal to human solidarity, and to the reciprocal obligations humans undertake by entering into the gift-exchange relationships that knit society together:

It is but equity, besides, that they who feed, clothe, 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, clothed, and lodged...

“It is but equity, besides...” This is a very strong appeal to human solidarity. It is coming from someone often seen as and sometimes dismissed as an apostle of human self-interest.

5. Adam Smith & Inequality

5.1. Inequality Generated Outside the Market

Smith’s first way of minimizing the importance of inequality—or at least minimizing the responsibility of the market and of the economy for fighting inequality—is to argue that inequality springs from politics and sociology rather than from market economics. Inequality arises from the role that hierarchy and command-and-control play in the mixed-up processes that are human society. The society of England becomes more unequal because William the Bastard from Normandy and his thugs with spears—300 families, plus their retainers—kill King Harold Godwinson, and declare that everyone in England owes him and his retainers 1/3 of their crop. The society of England becomes more unequal because Queen Elizabeth I Tudor grants a monopoly over trade with America to Sir Walter Raleigh. Why? Because he had successfully flirted with her. These are not *economic* processes. These are not closely connected with the “system of natural liberty” than is the market economy.

Indeed, the system of natural liberty is only one way you can organize society. Societies can be organized as ones of feudal lords and peasants, as priests and worshippers, robbers bands and their victims. But these ways of organizing society are impoverishing and, Smith claims in his very naming of his system the “System of Natural Liberty”—unnatural. Dugald Stewart quotes from one of Smith’s lectures that, at least in the lecture hall at Glasgow in 1749, Smith was blunt:

Little else is required to carry a state to the highest degree of affluence from the lowest barbarism but peace, easy taxes, and a tolerable administration of justice; all the rest being brought about by the natural course of things...

I believe that the later Adam Smith would note that “tolerable administration of justice” covers a lot of ground: the later books of *An Inquiry into the Nature and Causes of the Wealth of Nations* are very long indeed: Book III on how the historical development of Europe has let it to deviate from the System of Natural Liberty is 43 pages, Book IV on errors being made in 1776 by the governments of Europe is 273 pages, and Book V on what governments should and should not do is 276 pages—a total of 592 pages on what governments should, should not, and have unfortunately done, with only a total of 346 pages laying out Smith’s analytical system and its conclusions, among them that:

All governments which thwart this natural course, which force things into another channel, or which endeavor to arrest the progress of society at a particular point, are unnatural, and, to support themselves, are obliged to be oppressive and tyrannical...

As Heilbroner puts it:

The great enemy to Adam Smith's system is not so much government per se as monopoly—in any form. “People... meet[ing] together... [and] the conversation ends in... some diversion to raise prices.”... If the working of the market is trusted... anything that interferes... lowers social welfare. If, as in Smith’s time, no master hatter anywhere in England could employ more than two apprentices or no master cutler in Sheffield more than one, the market system cannot possibly yield its full benefits.... If, as in Smith's time, great companies are given monopolies of foreign trade, the public cannot realize the full benefits of cheaper foreign produce. Hence, says Smith, all these impediments must go...

5.2. Wealth Inequality Prevents Worse Damage

Adam Smith's second way of minimizing the importance of economic inequality is to claim that it is a relatively gentle alternative to other forms of inequality that will emerge if economic inequality is reduced. Smith argues in Book III of the *Wealth of Nations* that the rise in inequality in market income and consumption went along with reduced inequality in social status and hierarchy—and in reduced societal violence as well. Great landlords who cannot earn and spend their wealth in the city will focus on arming and maintaining retainers, and the result will be that they will “make war according to their own discretion, almost continually upon one another, and very frequently upon the king; and the open country still continued to be a scene of violence, rapine, and disorder”. But once there are luxuries to be purchased by wealth earned by selling produce to the growing cities, “it was impossible that the number of their retainers should not as gradually diminish, till they were at last dismissed altogether”, and so peace came to the countryside.

As John Maynard Keynes was to write a century and a half later: “It is far better for a man to tyrannize over his bank balance than over his fellow citizens...”

5.3. Smith Gets Snarky, Stoic, and Cynical

5.3.1. Snarkism

Adam Smith's next way of minimizing the importance of economic inequality is to snark. The aim of wealth is to make you happy. Smith thinks that what wealthy women wish they could buy is beauty, and what wealthy men wish they could buy is strength. But who are the beautiful and strong in England? Adam Smith tells us in an aside on nutrition on the good qualities of the potato:

The chairmen, porters, and coal-heavers in London, and those unfortunate women who live by prostitution, the strongest men and the most beautiful

women perhaps in the British dominions, are said to be, the greater part of them, from the lowest rank of people in Ireland, who are generally fed with this root [the potato]...

The rich aren't doing a terribly good job of using their wealth to promote human flourishing, are they? And there is the implication that the rich are none too happy. We see Smith, and what he is doing here, I think.

5.3.2. Stoicism

But Adam Smith's main way of minimizing the importance of economic inequality is to assume the philosophical pose of the stoic. You work hard. You sacrifice your peace and leisure in order to get rich. And what does that get you as you age?

Adam Smith writes that to the aging, looking back at a life in which they have sacrificed their ease and their happiness in order to gain wealth:

Power and riches appear then to be, what they are, enormous and operose machines contrived to produce a few trifling conveniencies to the body, consisting of springs the most nice and delicate, which must be kept in order with the most anxious attention, and which in spite of all our care are ready every moment to burst into pieces, and to crush in their ruins their unfortunate possessor. They are immense fabrics, which it requires the labour of a life to raise, which threaten every moment to overwhelm the person that dwells in them, and which while they stand, though they may save him from some smaller inconveniencies, can protect him from none of the severer inclemencies of the season. They keep off the summer shower, not the winter storm, but leave him always as much, and sometimes more, exposed than before, to anxiety, to fear, and to sorrow; to diseases, to danger, and to death...

Who then benefits from all the industry and toil of the upwardly-mobile? Adam Smith argues that it was, somewhat paradoxically, the poor. The rich sacrifice their true happiness to set in motion enterprises. And the

commodities produced by those enterprises are principally consumed by the poor:

The earth by these labours of mankind has been obliged to redouble her natural fertility, and to maintain a greater multitude of inhabitants.... The proud and unfeeling landlord.... The capacity of his stomach bears no proportion to the immensity of his desires, and will receive no more than that of the meanest peasant. The rest he is obliged to distribute among those, who prepare, in the nicest manner, that little which he himself makes use of... all of whom thus derive from his luxury and caprice, that share of the necessaries of life, which they would in vain have expected from his humanity or his justice...

5.3.3. Cynicism

Last, Adam Smith minimizes the importance of economic inequality by claiming that there is little or nothing to be done about it. Human nature is such that people will seek to create, and then to obey, those whom they will call their superiors. It is the view expressed by Calvera in the movie *The Magnificent Seven*. Chico asks Calvera:

And the people of the village? What about them?

Calvera responds:

I leave that to you. Can men of our profession worry about that? If God did not want them to be sheared, he would not have made them sheep!

As Adam Smith puts it in his *Theory of Moral Sentiments*:

A stranger to human nature, who saw the indifference of men about the misery of their inferiors, and the regret and indignation which they feel for the misfortunes and sufferings of those above them, would be apt to imagine, that pain must be more agonizing, and the convulsions of death

more terrible to persons of higher rank, than they are to those of meaner stations.

Upon this disposition... is founded the distinction of ranks, and the order of society. Our obsequiousness to our superiors more frequently arises from our admiration for the advantages of their situation, than from any private expectations of benefit from their goodwill.... We desire to serve them for their own sake, without any recompense but the vanity or the honour of obliging them...

To attempt to eliminate inequality is, for Smith in his cynical mode, like trying to bail out the sea: make society equal, and people will find somebody to look up to, and then figure out a way to give their money away to the rich.

So that is Adam Smith: worry about prosperity and wealth, yes; trust the (properly managed) “system of natural liberty”, yes; worry about poverty and want, yes; worry about inequality, not so much.

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