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## Adam Smith as an Economist<sup>1</sup>

By EDWIN CANNAN.

I HAVE no responsibility for this choice of subject. I would not have chosen it myself, because I was acutely conscious of the difficulty of saying, one hundred and fifty years after the publication of the *Wealth of Nations*, anything which is both new and true about it. I do not profess to have solved the difficulty now. I hope what I shall say is true; but as for newness, I can only be like the candidates for Ph.D. degrees, who when their supervisor says, "I can't see that you are discovering any new facts," plead "But don't you think I might be held to have 'exercised independent critical power'?" (Ph.D. Regulations, section 5 b).

Very little of Adam Smith's scheme of economics has been left standing by subsequent inquirers. No one now holds his theory of value, his account of capital is seen to be hopelessly confused, and his theory of distribution is explained as an ill-assorted union between his own theory of prices and the physiocrats' fanciful Economic Table. His classification of incomes is found to involve a misguided attempt to alter the ordinary useful and well-recognised meaning of words, and a mixing up of classification according to source with classification according to method or manner of receipt. His opinions about taxation and its incidence are extremely crude, and his history is based on insufficient information and disfigured by bias.

But three great things he did accomplish.

The first was the definite substitution of income—"produce" as he called it—for the older idea of a capital aggregation of "treasure" or something akin to "treasure." He was quite aware of what he was doing here. The Introduction and Plan which he prefixed to the *Wealth of Nations* begins with two paragraphs in which the continuous attainment of a large quantity of the necessaries and conveniences of life is treated as the end of economic endeavour, and it ends with a sentence in which

<sup>1</sup> The first of a series of seven lectures delivered by various lecturers at the London School of Economics in Lent Term, 1926, to commemorate the completion of a hundred and fifty years since the publication of the *Wealth of Nations*.

the "real wealth" of a nation is taken to be "the annual produce of the land and labour of the society."

Of course this idea was not new in the sense of springing from Adam Smith's head like Athene from that of Zeus. The seed for it had been sown by the calculations of the English political arithmeticians in the end of the seventeenth century, and its germination had been assisted by the physiocrats' discussion of what they called "the annual reproduction" and its "distribution." But Smith must be given the credit of getting in the harvest.

Right down to his time the reigning school of economic thought was open to the reproach which he levels against it when he says that it represented the great object of the industry and commerce of a nation to be the multiplication of gold and silver within it. It is no use to pretend that this was confined to the small fry of less reputable writers. With the possible exception of Sir William Petty, Cantillon was the acutest economist of the period before Adam Smith, and in some directions anticipated doctrine which did not come into fashion till a century and a half after his own time; but what does he say? At the beginning of his *Essai* he says "*la richesse en elle-même n'est autre chose que la nourriture. les commodités et les agréments de la vie,*" and he heads chapter xvi of Part I "*plus il y a de travail dans un Etat, et plus l'Etat est censé riche naturellement.*" This raises great hopes, but they are rudely shattered by what follows. Calculating that only 25 per cent. of the population can be regarded as available for any labour other than that required for the production of the absolute necessities of life, Cantillon says that if some of these persons are employed in beautifying the people's apparel and refining their food, their country "will be considered rich according to the amount of this labour, though it adds nothing to the quantity of things necessary for the subsistence and maintenance of men." But, he thinks, if the same persons are employed in getting metals out of the earth and fashioning them into tools and plate, the country will not only appear richer but "will really be so."

"It will be so especially," he proceeds, "if these persons are employed in drawing from the bosom of the earth gold and silver, metals which are not only durable, but so to speak permanent, which cannot be consumed even by fire, which are generally received as the measure of value, and which can at all times be exchanged for everything necessary for life: and if these persons work so as to bring gold and silver into the country

in exchange for manufactures and wares which they have made there and which are exported to foreign countries, their labour will be equally useful and will really benefit the country.

“For the point which really seems to determine the comparative grandeur of States is the body of reserve which they have over and above the annual consumption, like stores of cloth, linen, corn, etc., to serve for lean years in case of need or in case of war. And inasmuch as gold and silver can always buy all these things even from the enemies of the State, the true body of reserve for a State is gold and silver, of which the greater or less actual quantity necessarily determines the comparative grandeur of Kingdoms and States.” (*Essai*, pp. 117 ff.)

Sir James Steuart brought out his book—the first in English with the title of *Political Economy*—in 1767, and its 1,300 quarto pages quite fail to make clear what he thought constituted the wealth of society. Even the great Turgot, though he is sound enough about money and bullion, does not adopt the idea of produce or income being the wealth of society, but says the riches of a country are to be found by multiplying the annual value of land by the number of years' purchase and adding the value of moveable goods. (*Réflexions*, xci.)

The statesmen or politicians were, as usual, worse than the economists. Necker, in 1776, the year which we are now commemorating, included in the riches of the State “neither the land which supports the people nor the advances in tools, in animals, in buildings, in things necessary for sowing and cultivation;” because “all this is absolutely a part of the population since it is impossible to separate man from his subsistence.”

“So,” he continued, “the only riches which form a power distinct from the population are the surplus of goods of all kinds which are gradually amassed in a society, and which, being susceptible of exchange against the services of foreigners, can increase the public power.

“These goods consist to-day chiefly in treasures (*matières précieuses*) such as gold and silver; because these metals have become the common measure of exchanges, and the sure means of acquiring everywhere all the productions of the land and the labour of men.” (*Sur la législation et le commerce des grains*, chap iv.)

To change all this, to recognise that not a hoard of gold and silver, nor even a store of all kinds of valuable and useful things, is the end of economic endeavour, but instead, a large continuous produce or supply of consumable necessities and conveniences—

that, in short, as Smith himself put it (vol. ii, p. 159), "Consumption is the sole end and purpose of all production," was a great service. It marks the transition from the state of mind of the savage who can only think of what he has in hand, to the state of the civilised man who looks before, and considers himself well off when he is assured of having adequate supplies of food and other necessities and conveniences in the future.

The second great change which Adam Smith made in general theory was to substitute wealth per head for wealth in the aggregate, whatever that may be. He does this in the second sentence of the *Wealth of Nations* in his stride, so to speak, apparently without noticing that anything important was happening: "The nation," he says, "will be better or worse supplied with all the necessities and conveniences for which it has occasion" according as the produce "bears a greater or smaller proportion to the number of those who are to consume it." That is, he will consider the nation wealthy or not wealthy according as its average worker is wealthy or not wealthy, and not according as the sum of all its members' wealth is great or small.

By this he threw over the old idea of an entity called the state or the nation existing outside the individuals who constitute its subjects or members, and flourishing or languishing irrespective of their prosperity. To us that may seem a small thing. We are accustomed to think of Switzerland or of Denmark as a rich nation compared with Russia. But it was a great break with tradition in 1776, so great that Smith himself often fails to live up to it, and drops back into speaking of China as rich, while at the same moment insisting on the extreme poverty of the Chinese. Cantillon had had a glimmering of it in 1730, when he wondered whether it might not be better to have a smaller well-to-do population than a larger poor one, but he dismissed consideration of the matter as outside his subject.

It was a change in accordance with the humaner spirit of the age. The "nation" was henceforth to be the whole people and not merely the King or the ruling classes, who, being themselves above the reach of want, could afford to pursue national glory and power and despise the sordid considerations which invade the homes of the people. No longer were the people to be regarded as mere pawns to be used as required in the queer game of accumulating a hoard of treasure of which the only conceivable use was to be sent abroad again in time of war. They were to be a body of persons whose individual necessities

and conveniences of life were to be the objects to be pursued. "Political Economy," Smith says himself in the Introduction to Book IV, had to teach the Statesman how to get revenue for the State, but also, and firstly, to "provide a plentiful revenue or subsistence for the people, or more properly to enable them to provide such a revenue or subsistence for themselves."

There are difficulties, of course, about accepting the average wealth as conclusive. Those which concern the validity of the average (whatever average is taken) as a measure of general individual wealth we may dismiss as matters of detail, but it is otherwise with the difficulty which confronts us when we are asked whether indefinite diminution of numbers, provided it is accompanied by increasing wealth, is good from an economic point of view. Smith himself evaded this difficulty by his firm belief that prosperity and population move together, but we know that they often do not. Yet at any rate Smith's view was better than the one which it displaced. Within certain limits, at any rate, we may be satisfied to prefer the high average to the high aggregate.

The substitution of the average for the aggregate involved that approval of high wages which marks off the economists from the more ill-disposed employers whom the socialists persist in supposing them to represent. Nowadays even, there are some persons who will tell you that low wages are a great "advantage" to Japan and Germany. In Smith's day they were probably more predominant. With them he reasons gently but persuasively: "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" (vol. i, p. 80). Wage-earners are the most numerous income-receiving class, so that an increase of wealth per head is not likely to take place without an increase of wages.

Smith's sympathies, indeed, seem to have been wholly with the industrious wage-earner, and especially with the poorest. In the *Lectures* we find him telling his Glasgow students:

"The division of opulence is not according to the work. The opulence of the merchant is greater than that of all his clerks, though he works less; and they again have six times more than an equal number of artisans. . . . The artisan who works within doors has far more than the poor labourer who trudges up and down without intermission. Thus he who as it were bears the burden of society has the fewest advantages" (p. 163).

The employers of his time and their spokesmen were always complaining that high wages ruined their workmen by making them drunken and disinclined to work more than half the week. In his lectures Smith speaks as if he accepted the fact so far at least as the "commercial parts of England" and especially Birmingham were concerned, summing up the result in a Ruskinian phrase, "So it may very justly be said that the people who clothe the whole world are in rags themselves" (p. 257). He does not, however, suggest reduction of wages as a remedy, but elementary education and a consequent abolition of early employment of children. In the *Wealth of Nations* he pooh-poohs the whole theory of high wages ruining workmen. Industry, he thinks, is improved by encouragement :

"A plentiful subsistence increases the bodily strength of the labourer, and the comfortable hope of bettering his condition, and of ending his days perhaps in ease and plenty, animates him to exert that strength to the utmost. Where wages are high, accordingly, we shall always find the workmen more active, diligent, and expeditious than where they are low; in England, for example, than in Scotland" (vol. i, p. 83). It is said, he observes, that "in cheap years workmen are generally more idle and in dear ones more industrious than ordinary," but this, he believes, is merely the result of masters being able to make better bargains with their men in dear years, which they then naturally commend as more favourable to industry.

"Some workmen, indeed," he admits, "when they can earn in four days what will maintain them through the week, will be idle the other three. This, however, is by no means the case with the greater part." The majority, he thinks, are more likely to overwork themselves when paid liberally by the piece; "excessive application during four days of the week is frequently the real cause of the idleness of the other three, so much and so loudly complained of" (vol. i, pp. 83, 84). "If masters would always listen to the dictates of reason and humanity they would have frequently occasion rather to moderate than to animate the application of many of their workmen."

Smith thus started the line of thought which was continued by what are called the classical economists. A recent writer has actually said that those economists "defended subsistence wages." Of all the libels upon them invented by socialist and semi-socialist writers this is about the worst. They may have been, they certainly frequently were, wrong about the causes of high wages, but they were always in favour of them. Malthus

devoted years to his propaganda for raising wages by reducing the supply of labour. Ricardo certainly reckoned himself among those "friends of humanity," who, he says, should wish the labourer to have expensive tastes so as to keep the supply of labour down and wages up. McCulloch, who is so often a very present source of comfort to the enemies of the classical economists, is never tired of insisting on the advantage of high wages, as a glance at the heading of Wages in the index to his *Principles* will show.

Thirdly, Adam Smith may fairly claim to be the father, not of economics generally—that would be absurd, but of what in modern times has been called, with opprobrious intention, "bourgeois economics," that is the economics of those economists who look with favour on working and trading and investing for personal gain. We are apt to forget that the idea that a wage-earner, a trader, or an investor may be, and indeed generally is, a very respectable person is very modern. From Homer we learn that the people whom Odysseus visited on his travels thought it all the same whether he was a trader or a piratical murderous marauder. Primitive people are said to have regarded exchange as a kind of robbery rather than as a mutual giving. Greek philosophers thought wage-earners incapable of virtue, and money-lenders have been objects of antipathy throughout the ages. In Smith's own time Dr. Johnson and Postlethwayt very seriously considered whether a trader could be a gentleman.

Smith came forward as the admirer and champion of the man who wants to get on. Probably, like many another Scotch boy, he had learnt that gospel on his mother's knee. He did not get it from his master, Hutcheson, for he complained that Hutcheson did not sufficiently explain "from whence arises our approbation of the inferior virtues of prudence, circumspection, temperance, constancy, firmness." Regard, he said, for "our own private happiness and interest" is often a laudable principle of action. "The habits of economy, industry, discretion, attention and application of thought are generally supposed to be cultivated from self-interested motives, and at the same time are apprehended to be very praiseworthy qualities which deserve the esteem and approbation of everybody. . . . Carelessness and want of economy are universally disapproved of, not, however, as proceeding from a want of benevolence, but from a want of the proper attention to the objects of self-interest" (*Moral Sentiments*, pp. 464-6). Far from making people inclined to cheat, he held, commerce made them honest and desirous of



fulfilling their contracts. He told his Glasgow students, according to the report of one of them :

“ Whenever commerce is introduced into any country, probity and punctuality always accompany it. These virtues in a rude and barbarous country are almost unknown. Of all the nations in Europe, the Dutch, the most commercial, are the most faithful to their word. The English are more so than the Scotch, but much inferior to the Dutch, and in the remote parts of this country they are far less so than in the commercial parts of it. This is not at all to be imputed to national character, as some pretend ; there is no natural reason why an Englishman or a Scotchman should not be as punctual in performing agreements as a Dutchman. It is far more reducible to self-interest, that general principle which regulates the actions of every man, and which leads men to act in a certain manner from views of advantage, and is as deeply implanted in an Englishman as a Dutchman. A dealer is afraid of losing his character, and is scrupulous in observing every engagement. When a person makes perhaps twenty contracts in a day, he cannot gain so much by endeavouring to impose on his neighbours as the very appearance of a cheat would make him lose. When people seldom deal with one another we find that they are somewhat disposed to cheat, because they can gain more by a smart trick than they can lose by the injury which it does their character.

“ They whom we call politicians are not the most remarkable people in the world for probity and punctuality. Ambassadors from different nations are still less so. . . . The reason of this is that nations treat with one another not above twice or thrice in a century, and they may gain more by one piece of fraud than lose by having a bad character. . . . But if states were obliged to treat once or twice a day, as merchants do, it would be necessary to be more precise . . . a prudent dealer, who is sensible of his real interest, would rather choose to lose what he has a right to, than give any ground for suspicion ” (*Lectures*, pp. 253-5).

In the *Wealth of Nations* Smith says, like a true bourgeois : “ Bankruptcy is perhaps the greatest and most humiliating calamity which can befall an innocent man.” Throughout the book he treats prodigality with bourgeois contempt ; it is a kind of mental aberration : sane men save :

“ With regard to profusion, the principle which prompts to expense is the passion for present enjoyment ; which though sometimes violent and very difficult to be restrained, is in

general only momentary and occasional. But the principle which prompts to save is the desire of bettering our condition, a desire which, though generally calm and dispassionate, comes with us from the womb and never leaves us till we go into the grave. In the whole interval which separates those two moments, there is scarce perhaps a single instant in which any man is so completely satisfied with his situation as to be without any wish of alteration or improvement of any kind. An augmentation of fortune is the means by which the greater part of men propose and wish to better their condition. It is the means the most vulgar and the most obvious; and the most likely way of augmenting their fortune is to save and accumulate some part of what they acquire, either regularly and annually or upon some extraordinary occasions" (vol. i, pp. 323-4).

All this approval of the man who wants to get on in life, succeed in business, or whatever you like to call it, would have been a very poor gospel if such success were only purchased at the cost of depressing other people. But in Adam Smith's view it was not. On the contrary, he held that commerce and investment having been introduced, each man by trying to help himself, in fact, not only helped himself, but all others.

So, in his opinion, when "the butcher, the brewer, and the baker" provide us with our dinner, not because they love us, but because they wish to benefit themselves, they need not be ashamed of the fact. Let them go on doing their best to serve their own interest, and they will serve us and society generally better than "if they affect to trade for the public good," and better than if the State tries to regulate their prices.

He pictured the vast multitude of persons in various parts of the world co-operating in the production of the modest coat of the labourer; he showed how their specialising in their respective occupations increased their product; he described this division of labour as the greatest cause of the superior opulence of civilised mankind over their primitive ancestors and their uncivilised contemporaries. And he pointed out that the co-operation was not due to any effort of collective wisdom, but to men's natural propensity to serve their own interest by "truck, barter, and exchange of one thing for another." He described the increase of capital as another great cause of prosperity, and said very truly that it was not the result of Government foresight, for Governments were generally prodigal and profuse, but of the frugality and good conduct of individuals desirous of bettering their own condition.

It is easy to object to the confidence in "Nature" which he displays, in accordance with the fashion of the time, when he assumes that the coincidence between self-interest and the general good establishes itself "naturally," in the absence, that is, of all human institutions except a few which were regarded as being themselves natural. In our day, with the law of property just put into an Act of several hundred pages in length, and the relations between husband and wife, and between parents and children in a state of flux, we are not likely to believe in an orderly and harmonious state of "natural liberty" in which society does not presume to "interfere" with individual action. We see that self-interest, which might lead many of us to snatch jewellery from shop windows in the Strand, is made to flow in quite unnatural directions by the existence of those very artificial institutions, the Metropolitan Police and the Bow Street Police Court and Dartmoor Prison. Throughout history society has been fashioning and modifying its institutions so as to make it the interest of its members to do the right thing.

It is just the incompleteness of those institutions which have been the great obstacle to the acceptance of Smith's view in the realm of international trade. International trade is still looked on with quite primitive suspicion: each country imagines that it must be very careful not to allow its subjects to buy and sell across the national boundary as freely as they do inside it. There is no confidence that the fact that they find it profitable indicates that the country as a whole will benefit by it.

Adam Smith could see no sense in a country's refusing to let its inhabitants buy from abroad what they could buy cheaper than at home. No prudent head of a household, he said, has anything made at home when he can buy it at less expense outside, and what is prudence on the part of the householder can scarcely be folly on the part of a nation. Why, then, this persistence of fear of cheap imported goods, rising almost to panic when the price falls to zero, as when a defeated enemy consents to pay reparations and it is realised that the reparations will be paid not in paper money or gold but in goods?

The simplest explanation that may be proposed is that nations, trying to think collectively, are stupider than ordinary householders thinking individually, so that they do by mere stupidity what the householder will not do. But there is probably more in it than that, and I am inclined to think that the true explanation is to be looked for in the very fact which Smith ignored, namely, that such harmony as is found between the pursuit of

self-interest and the general good is dependent on the existence of suitable human institutions.

As between country and country "natural liberty" in the completest sense still very largely prevails. Any sovereign state may declare war upon another except in so far as it is hindered by some very recent arrangements, the strength of which has yet to be tested. Hence a prudent nation has some excuse for considering whether the immediate advantage to itself of a particular branch of foreign trade may not be outweighed by the greater strength which that trade may cause the other country to possess in some future conflict of arms. The nation, in fact, in contemplating its foreign trade, is always asking, "What if there is war?"

The existence of protection in British overseas dominions and even in the Irish Free State may be brought up against this suggestion that want of institutions giving security against foreign attack is the chief root of the general refusal to regard international trade as favourably as internal domestic trade. The Dominions, it may be said, protect themselves against the metropolitan country and each other as well as against foreign countries, and it cannot be that they suppose that there is danger to be apprehended from either. But it is doubtful if there is much strength in the objection. Tradition has enormous force in these matters. The Dominion which feels itself a separate entity is likely to behave from mere force of imitation in the way which the nations which have complete independence and sovereignty ordinarily do.

Adam Smith himself never really faced the difficulty. He was too much in the thrall of old ways of thinking which have come down from the ancient very partial civilisation when the barbarians were regarded as just as much outside society as the wolves and other wild beasts. His followers have scarcely improved on him to this day, and still get themselves into inextricable difficulties by at one moment treating "the nation" as if it were synonymous with human society, and at another recognising that it is only a section which may be doing its level best to harry, kill, and erase the memory of some other section or sections.

But though Smith was wrong in supposing that the desire for individual gain would pull the industrial chariot safely along in the absence of harness, and though this error vitiated his doctrine and accounts for its ill-success in the international sphere, so far as internal trade and specialisation of persons

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and places to particular occupations were concerned, he was on firm ground, because the institutions which are required for making self-interest take the beneficent road were actually there—not, of course, in a perfect form—they never will be that, but sufficiently developed to justify his view. When he describes the co-operation necessary for making the labourer's rough coat and contrasts the situation of the humblest member of a civilised and thriving nation very favourably with that of many an African king, the absolute master of the lives and liberties of ten thousand naked savages, he was in fact taking things as they were in his time. That he failed to see that self-interest had been put in the shafts and harnessed by law and order, products of collective wisdom, detracts little from the value of his exposition that it was a very good horse.

By that exposition he elevated the conception of gainful occupation and investment from a system of beggar-my-neighbour to one of mutual service. The new conception has steadily gained ground in the more advanced countries of the world. It is true that there is a numerous sect which tries to convince the wage-earners that they are working not for the public and not for the consumers of the things or the services which they produce, but for the capitalist employer who gets what is left after wages and other expenses have been met; but their sour propaganda loses force as the old theory of the iron law of wages drops into oblivion in face of obvious facts, and the nature and necessity of interest becomes more clear.

So we do not now think of work being done as by a slave for a master, and of business being engaged in as by a gambler to win gain at the expense of other players. We work for our wages and our salaries, and even for those residues which are called profits: we save and invest for our interest and our dividends: knowing full well that the more successful we are, the better not only for ourselves but for the consumers of our products.

I hope that no teacher in the School will ever give any countenance to the pernicious belief that steady and honest service in satisfying the demand of the people for the necessaries and conveniences of life is something to be ashamed of because it is profitable. The modern workman and the modern trader can practise virtue as well as a Greek philosopher, a mediæval begging friar, or a twentieth century social reformer.