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SOME INSTITUTIONAL ASPECTS OF THE *WEALTH OF NATIONS*

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PERHAPS as a result of the increasingly formal nature of economics as an academic discipline, the institutional content and preoccupations of Adam Smith's *Wealth of Nations* have suffered prolonged neglect. The following syllogistic restatement, by Wesley Mitchell, may be taken as representative of contemporary formulations of Smith's central argument:

First, every individual desires to increase his own wealth; second, every individual in his local situation can judge better than a distant statesman what use of his labor and capital is most profitable; third, the wealth of the nation is the aggregate of the wealth of its citizens; therefore, the wealth of the nation will increase most rapidly if every individual is left free to conduct his own affairs as he sees fit.¹

The view which will be presented here is not that this syllogism is wrong, as an interpretation of Smith's views, but that it is uninteresting. By jumping directly from the conception of man as a rational creature to the policy recommendation of laissez faire and all that, it completely short-circuits much of the real substance of Smith's work. By visualizing the human agent as engaged in the effort to maximize a single, unambiguous magnitude, two aspects of Smith's book and the crucial importance of the interplay between them are ignored: (1) his much more elaborate conception of the *conflicting* forces which impel the human agent to action and, as a direct result, (2)

his sustained inquiry into the ultimate impact, in terms of human action and its welfare consequences, of different kinds of institutional arrangements. It is the purpose of the present paper to examine the interrelationships between these two sets of forces.

We begin, then, by adding what Smith regarded as certain essential components of human behavior to the traditional image of the relentless pursuit of material gain.

In addition to the well-known "constant, uniform and uninterrupted effort of every man to better his condition," Smith attached great importance to the belief that the generality of mankind is intractably slothful and prone to indolence. A major counterbalance to the desire for and the pursuit of wealth, therefore, is a love of ease and inactivity. "It is the interest of every man to live as much at his ease as he can. . . ."²

A critical corollary of this position is that, although it is the desire for wealth which prods and lures mankind to put forth his greatest efforts, the *attainment* and possession of wealth are regarded by Smith as almost universally corrupting. For, once such wealth has been acquired, man naturally gives vent to his desire for ease. "The indolence and vanity of the rich"³ is fully as important a force in Smith's system as is the desire for riches

¹ Wesley Mitchell, *The Backward Art of Spending Money*, Augustus M. Kelley, Inc., New York, 1950, p. 85; see also his *Lecture Notes on Types of Economic Theory*, Augustus M. Kelley, Inc., New York, 1949, Vol. 1, chap. 5.

² Adam Smith, *The Wealth of Nations*, p. 718. Subsequently referred to as "*Wealth*." All references are to the Cannan edition which was reissued in the Modern Library Series (New York: Random House, 1937).

³ *Wealth*, p. 683.

itself. For "a man of a large revenue, whatever may be his profession, thinks he ought to live like other men of large revenues; and to spend a great part of his time in festivity, in vanity, and in dissipation."⁴

Thus the considerable wealth of the large landlord virtually disqualifies him from supervising the efficient operation of his estate. His background and opulence render him incapable of devoting unremitting attention to details, of making those marginal calculations which are so essential to efficiency.⁵ Elsewhere, in speaking of landlords, Smith refers to "that indolence, which is the natural effect of the ease and security of their situation."⁶

Perhaps even more disastrous, because of its effects on capital accumulation, is the effect of high profits upon the business class:

The high rate of profit seems every where to destroy that parsimony which in other circumstances is natural to the character of the merchant. When profits are high, that sober virtue seems to be superfluous, and expensive luxury to suit better the affluence of his situation.⁷

Although he does not spell it out, there seems to be some rate of profits which may be regarded as optimum from the point of view of achieving the maximum rate of economic growth. Higher profits are clearly regarded as desirable up to some level, since they constitute both the major source and the major incentive for the accumulation of capital. Beyond this unspecified optimum, however, "parsimony . . . that sober virtue seems to be superfluous." Thus Smith opposes monopoly not only because it results in resource misallocation. Monopoly has the equally insidious effect of retarding capital accumulation, since

easily earned profits result in prodigality.⁸ Indeed, as will be seen below, the conflicting forces which motivate man to act really establish an optimum level of income in all economic activities.

Finally, and most important, Smith regards it as a strategic component of the human personality that man is naturally deceitful and unscrupulous and will quite willingly employ predatory practices so long as such practices are available to him. "Such, it seems, is the natural insolence of man, that he almost always disdains to use the good instrument, except when he cannot or dare not use the bad one."⁹

Given these human characteristics, it is plain that the mere absence of external restraints and the freedom to pursue self-interest do not suffice, in Smith's view, to establish social harmony or to protect society from "the passionate confidence of interested falsehood."¹⁰ What are required, above all, are institutional mechanisms which *compel* man, in his "natural insolence," "to use the good instrument."

What the usual emphasis on self-interest and individual freedom overlooks is that such self-interest can be pursued in innumerable antisocial ways. It is not sufficient to answer that Smith assumed a competitive framework in his analysis and policy recommendations, because such a framework is not sufficiently specific. Atomistic competition, absence of collusion, and mobility of resources are not nearly sufficient to establish the linkage between unhampered pursuit of self-interest and social well-

⁸ *Ibid.*, pp. 578-79.

⁹ *Ibid.*, p. 751. Smith's generally low estimate of humanity is subjected to an entertaining, tongue-in-cheek, treatment in a recent article by Arthur H. Cole, "Puzzles of the 'Wealth of Nations,'" *Canadian Journal of Economics and Political Science*, XXIV (February, 1958), 1-8.

¹⁰ *Wealth*, p. 463.

⁴ *Ibid.*, p. 766.

⁶ *Ibid.*, p. 249.

⁵ *Ibid.*, pp. 363-64.

⁷ *Ibid.*, p. 578.

being. Smith himself clearly realized this. Indeed, large portions of his *Wealth of Nations* are specifically devoted to analyzing the nature of the appropriate institutional framework.

Failure to stress the relationship between Smith's broader conception of human nature and the institutional order with which he was so much preoccupied leads to the creation of unnecessary problems of interpretation and "reconciliation." Thus we have recently been told that

Smith's reliance on moral sentiments as prerequisites of any workable system of competition has often been lost sight of and even denied by later generations of economists who preferred to popularize Smith's reference to the invisible hand as evidence of his glorification of selfishness. Nothing could be further from the truth. It is unthinkable that a moral philosopher of the stature of Adam Smith, who published *The Theory of Moral Sentiments* in 1759, would have abandoned his conceptions of the moral laws governing human behavior in 1776 when he published *The Wealth of Nations*, without making such a change of view explicit. It is, therefore, imperative that *The Wealth of Nations* be read in conjunction with the earlier *Theory of Moral Sentiments* in order to understand that Smith presupposes the existence of a natural moral law as a result of which the prudent man was believed to be anxious to improve himself only in fair ways, i.e., without doing injustice to others.¹¹

It will be shown below that such an interpretation is not only totally incorrect but does a considerable injustice to the subtlety and sophistication of Smith's argument.

¹¹ K. William Kapp, *The Social Costs of Private Enterprise* (Cambridge, Mass.: Harvard University Press, 1950), pp. 28-29. Smith's general skepticism and reluctance to attach too much force to the unalloyed operation of humanitarian motives, even where it might appear most appropriate, is neatly conveyed in the following quotation: "The late resolution of the Quakers in Pennsylvania to set at liberty all their negro slaves, may satisfy us that their number cannot be very great. Had they made any considerable part of their property, such a resolution could never have been agreed to" (*Wealth*, p. 366).

A neglected theme running through virtually all of the *Wealth of Nations* is Smith's attempt to define, in very specific terms, the details of the institutional structure which will best harmonize the individual's pursuit of his selfish interests with the broader interests of society. Far from assuming a "spontaneous" identity of interests (in the mere absence of government restrictions) or of being "blind to social conflicts,"¹² Smith was obsessed with the urge to go beyond the ordinary market-structure definition of competition and to evaluate the effectiveness of different institutional forms in *enforcing* this identity.

The ideal institutional order for Smith is one which places the individual under just the proper amount of psychic tension. The individual applies himself with maximum industry and efficiency when the reward for effort is neither too low (slaves, apprentices) nor too great (monopolists, large landowners).¹³ However, more complicated than the *intensity*

¹² "A sunny optimism radiates from Smith's writing. He had no keen sense for social disharmonies, for interest conflicts. . . . On the whole, it is true to say that he was blind to social conflicts. The world is for him harmonious. Enlightened self-interest ultimately increases social happiness" (Gunnar Myrdal, *The Political Element in the Development of Economic Theory* [London: Routledge & Kegan Paul, Ltd., 1953], p. 107).

¹³ The manifest impossibility of acquiring and enjoying wealth is, of course, completely stultifying to economic efficiency: "The experience of all ages and nations, I believe, demonstrates that the work done by slaves, though it appears to cost only their maintenance, is in the end the dearest of any. A person who can acquire no property, can have no other interest but to eat as much, and to labour as little as possible. Whatever work he does beyond what is sufficient to purchase his own maintenance, can be squeezed out of him by violence only, and not by any interest of his own" (*Wealth*, p. 365).

On the other hand, as already cited: "A man of a large revenue, whatever may be his profession, thinks he ought to live like other men of large revenues; and to spend a great part of his time in festivity, in vanity, and in dissipation" (*ibid.*, p. 766).

dimension of individual effort is the matter of the *direction* into which this effort is channeled. Smith is, in effect, searching for the appropriate definition of an institutional order which will eliminate zero-sum (or even negative-sum) games. It is the function of institutional arrangements to cut off all avenues (and they are many) along which wealth may be pursued without contributing to the welfare of society. Such a goal in practice requires a careful balancing of incentive, of provision of opportunity to enlarge one's income, against the need to minimize the opportunities for abuse, i.e., possibilities for increasing one's income in an antisocial fashion.

A central, unifying theme in Smith's *Wealth of Nations*, then, is his critique of human institutions on the basis of whether or not they are so contrived as to frustrate man's baser impulses ("natural insolence") and antisocial proclivities and to make possible the pursuit of self-interest *only* in a socially beneficial fashion. Indeed, it will become apparent below that Smith's basic argument applies to the whole spectrum of social contrivances and is not restricted to economic affairs. The question is, in each case, whether institutions do, or do not, harness man's selfish interests to the general welfare. This is, of course, the basis of Smith's critique of mercantilism.

The violence of Smith's polemic against mercantilism lay in the fact that it enabled merchants to better their condition in a manner which did not contribute to the nation's economic welfare. As a result of the dispensation of monopoly grants, of the arbitrary bestowal of "extraordinary privileges" and "extraordinary restraints" upon different sectors of industry by the government, the individual merchant was able to enrich himself without at the same time en-

riching the nation. For, as Smith clearly recognizes, the pursuit of one's economic self-interest is not necessarily confined to the economic arena. When it spills over into the political arena, it leads to actions which detract from, rather than add to, the economic welfare of society. By contrast, the competitive order which Smith advocated was an institutional arrangement which was characterized, negatively, by the absence of all special privilege and sources of market influence and, positively, by the all-pervasive and uninhibited pressures of the market place. The price system, as Smith saw it, was an intensely coercive mechanism. Its decisive superiority as a way of organizing economic life lay in the fact that, *when it was surrounded by the appropriate institutions*, it tied the dynamic and powerful motive force of self-interest to the general welfare. Its free operation would, in most cases, leave the individual producer no alternative but to pursue his economic interests in a manner conducive to the national welfare.¹⁴

The secondary literature on Adam Smith has devoted considerable attention to the ways in which the establishment of a free-market network will promote economic efficiency. But the emphasis has been primarily on the allocative efficiency of the free market and too little on the ways in which appropriate institutions contribute to the productivity of the human agent as a factor of production—a matter of supreme importance to Smith. Appropriate institutions increase both the *motivation* and the

¹⁴ For Smith's own qualifications of this proposition see Jacob Viner, "Adam Smith and Laissez-Faire," chap. v of J. M. Clark *et al.*, *Adam Smith, 1776-1926: Lectures To Commemorate the Sesquicentennial of the Publication of "The Wealth of Nations"* (Chicago: University of Chicago Press, 1928). I wish to acknowledge my intellectual indebtedness to Viner's masterly analysis of Smith.

capacity of the human agent, whereas inappropriate institutions detract from these things.

Thus Smith opposes apprenticeship laws not only because they impede the mobility of labor between industries but also because they constitute institutional arrangements which pervert the incentive to industry and hard work. During his apprenticeship the young man perceives (correctly) that there is no connection between his effort and his reward (as would exist, e.g., under piecework), and habits of slothfulness and laziness are therefore encouraged:

The institution of long apprenticeships has no tendency to form young people to industry. A journeyman who works by the piece is likely to be industrious, because he derives a benefit from every exertion of his industry. An apprentice is likely to be idle, and almost always is so, because he has no immediate interest to be otherwise. . . . A young man naturally conceives an aversion to labour, when for a long time he receives no benefit from it. . . . But a young man would practise with much more diligence and attention, if from the beginning he wrought as a journeyman, being paid in proportion to the little work which he could execute, and paying in his turn for the materials which he might sometimes spoil through awkwardness and inexperience.¹⁵

Smith had much to say, of course, about the whole complex of institutions surrounding the ownership and cultivation of the land. His condemnation of such feudal relics as the laws of entail and primogeniture, which impeded the free marketability and therefore the optimum employment of land, is well known. Here, too, however, his search is for the most appropriate institutional scheme. Indeed, all of Smith's historical discussion of systems of land tenure (especially Book III, chap. 2) constitutes a highly interesting account of how specific legal and traditional arrangements in

Europe have impeded economic progress by failing to provide proper and necessary incentives to landlord and tenant.¹⁶

The excessive wealth of the great landlord renders him incapable of efficient operation of his estate.¹⁷ However, so long as large estates continue to exist, their most efficient mode of operation poses a serious problem. To place the operation of the land in the hands of a hired agent would be to sever completely the linkage between self-interest and social welfare which the union of property ownership and self-management ordinarily provides. Under such an arrangement,

the country . . . would be filled with idle and profligate bailiffs, whose abusive management would soon degrade the cultivation, and reduce the annual produce of the land, to the diminution, not only of the revenue of their masters, but of the most important part of that of the whole society.¹⁸

The larger the unit of ownership under a single proprietor, the greater the abuses we may expect from the "negligent, expensive, and oppressive management of his factors and agents."¹⁹ As a logical extension of this argument, Smith observes that

the crown lands of Great Britain do not at present afford the fourth part of the rent, which could probably be drawn from them if they were the property of private persons. If the crown lands were more extensive, it is probable they would be still worse managed.²⁰

¹⁶ For a recent treatment of the same problem, bearing numerous parallels to Smith's argument, see United Nations, *Land Reform: Defects in Agrarian Structure as Obstacles to Economic Development* (New York: United Nations, Department of Economic Affairs, 1951).

¹⁷ *Wealth*, pp. 363-64.

¹⁸ *Ibid.*, p. 784.

¹⁹ *Ibid.*, p. 775.

²⁰ *Loc. cit.* So strongly did Smith feel about the importance of maintaining the union between ownership and management that he actually suggested a

¹⁵ *Wealth*, pp. 122-23.

Where lands were tenant-operated, Smith attached great importance to all arrangements, either legal or customary, which assured a close relationship between personal diligence and reward. Thus Smith regards long leases and security against arbitrary eviction as decisive in accounting for English achievements, which he felt contrasted so favorably with those of her Continental neighbors:

There is, I believe, no-where in Europe, except in England, any instance of the tenant building upon the land of which he had no lease, and trusting that the honour of his landlord would take no advantage of so important an improvement. Those laws and customs so favourable to the yeomanry, have perhaps contributed more to the present grandeur of England, than all their boasted regulations of commerce taken together.²¹

The ideal unit of agricultural organization, of course, is the small proprietorship, which represents a fusion of all the Smithian virtues:

A small proprietor . . . who knows every part of his little territory, who views it all with the affection which property, especially small property, naturally inspires, and who upon that account takes pleasure not only in cultivating but in adorning it, is generally of all improves the most industrious, the most intelligent, and the most successful.²²

Within this context, Smith's well-known opposition to the joint-stock company should occasion no surprise, nor should it be treated, as it occasionally is, as a quaint ("pre-industrial") archaism

form of discriminatory taxation, contrived in such a manner "that the landlord should be encouraged to cultivate a part of his own land" (*ibid.*, pp. 783-84).

²¹ *Ibid.*, pp. 368-69. Elsewhere, Smith observes: "Some leases prescribe to the tenant a certain mode of cultivation, and a certain succession of crops during the whole continuance of the lease." With typical sarcasm he attributes this arrangement to "the landlord's conceit of his own superior knowledge (a conceit in most cases very ill founded)" (p. 783).

on his part. Whatever advantages the corporate form of organization might bring, Smith regarded the offsetting disadvantages as decisive. The divorce of ownership and management and the consequent loss of incentive to diligence and efficiency are precisely the same objections that he raises to the management of large estates by persons other than the owners:

The trade of a joint stock company is always managed by a court of directors. This court, indeed, is frequently subject, in many respects, to the controul of a general court of proprietors. But the greater part of those proprietors seldom pretend to understand any thing of the business of the company; and when the spirit of faction happens not to prevail among them, give themselves no trouble about it, but receive contentedly such half yearly or yearly dividend, as the directors think proper to make to them.²³

Moreover, all the ordinary incentives to economize, naturally existing in the owner-operated firm, are lost upon the managers of a joint-stock company. Smith makes it perfectly clear that he would object to the adequacy of recent attempts to measure the effectiveness of competitive forces by the use of industry (or product) concentration ratios. For he regards bigness itself, in the *absolute* and not only the relative sense, as objectionable. Joint-stock companies destroy the incentive to efficiency *within* the individual firm:

The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be ex-

²² *Ibid.*, p. 392. Notice, however, that Smith regards it as an important virtue of the cultivating landlord that he can afford to bear the costs of experimentation. "The landlord can afford to try experiments, and is generally disposed to do so. His unsuccessful experiments occasion only a moderate loss to himself. His successful ones contribute to the improvement and better cultivation of the whole country" (*ibid.*, p. 784).

²³ *Ibid.*, p. 699.

pected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.²⁴

If an "unremitting exertion of vigilance and attention . . . cannot long be expected from the directors of a joint stock company,"²⁵ the mercantile projects of princes hold out even smaller prospects of success. Such projects

have scarce ever succeeded. The profusion with which the affairs of princes are always managed, renders it almost impossible that they should. The agents of a prince regard the wealth of their master as inexhaustible; are careless at which price they buy; are careless at what price they sell; are careless at what expence they transport his goods from one place to another. Those agents frequently live with the profusion of princes, and sometimes too, in spite of that profusion, and by a proper method of making up their accounts, acquire the fortunes of princes.²⁶

Thus Smith is constantly searching out the impact of specific institutional forms upon the human actor. Given his basic conception of human motivations and propensities, the specific kinds of behavior which we may expect of any individual will depend on the way the institutions surrounding him are structured, for these determine the alternatives open to him and establish the system of rewards and penalties within which he is compelled to operate. Indeed, Smith not only directs some very harsh remarks at human hypocrisy but clearly implies that, once the institutional framework is specified, human behavior becomes highly predictable. After

²⁴ *Ibid.*, p. 700.

²⁵ *Ibid.*, p. 713.

²⁶ *Ibid.*, p. 771.

an extensive criticism of the self-seeking behavior of the servants of the East India Company, he states:

I mean not, however, by any thing which I have here said, to throw any odious imputation upon the general character of the servants of the East India Company, and much less upon that of any particular persons. It is the *system of government, the situation in which they are placed*, that I mean to censure; not the character of those who have acted in it. *They acted as their situation naturally directed*, and they who have clamoured the loudest against them would, probably, not have acted better themselves.²⁷

Although it would occur to few people to look to Smith for guidance in the conduct of government business, there is much useful instruction in such matters in the *Wealth of Nations* (Book V). The general lesson which has always been drawn from Smith—especially by those who have clearly neglected to read him (or Viner²⁸)—has concerned the very limited number of functions which a government can "appropriately" perform. Of much greater interest for our present purposes are the rules laid down or implied by Smith as to how the government ought to organize the conduct of its affairs, for here Smith touches, at great length, upon the subject matter of this paper.

The guiding principle in the organization of public affairs may be stated briefly: "Public services are never better performed than when their reward comes only in consequence of their being performed, and is proportioned to the diligence employed in performing them."²⁹ But this statement is neither so obvious

²⁷ *Ibid.*, pp. 605–6 (italics mine). The importance of institutional determinants of human behavior is reinforced, in Smith's view, by his belief that natural, inborn differences among men are not very significant and are typically exaggerated (see *ibid.*, pp. 15–16).

²⁸ Viner, *op. cit.*

²⁹ *Wealth*, p. 678.

nor so platitudinous as it may sound, for the establishment of the optimum arrangements in accordance with this principle is an extraordinarily difficult task and even today (perhaps one should say "especially today") is seriously neglected. Although reward should be "proportioned to the diligence employed," care must be taken that such diligence can be exerted only in socially beneficial directions. Here again it is the direction, rather than the mere intensity, of human effort that is crucially important. For, as Smith points out, in legal proceedings the income of attorneys and clerks of court had indeed been proportioned to their diligence. But, unfortunately, this diligence had been defined and measured for remunerative purposes in a too strictly quantitative sense, i.e., in terms of the number of pages of their written output. As a result,

in order to increase their payment, the attorneys and clerks have contrived to multiply words beyond all necessity, to the corruption of the law language of, I believe, every court of justice in Europe. A like temptation might perhaps occasion a like corruption in the form of law proceedings.³⁰

The administration of justice is, indeed, rife with examples of the difficulties involved in devising techniques which effectively link the pursuit of self-interest with the public welfare. Although present arrangements leave much to be desired, anything which tends to reduce the financial interest of the lawyer in the case of his client is studiously to be avoided. "Lawyers and attorneys, at least, must always be paid by the parties; and, if they were not, they would perform their duty still worse than they actually perform it."³¹

Yet the administration of justice in the broader sense ought *never* to be conducted primarily with respect to financial

considerations, most especially where the sovereign himself exercises judicial authority. For this establishes a highly improper liaison with self-interest which leads to the flagrant abuse of justice, rather than its promotion:

This scheme of making the administration of justice subservient to the purposes of revenue, could scarce fail to be productive of several very gross abuses. The person, who applied for justice with a large present in his hand, was likely to get something more than justice; while he, who applied for it with a small one, was likely to get something less. Justice too might frequently be delayed, in order that this present might be repeated. The amercement, besides, of the person complained of, might frequently suggest a very strong reason for finding him in the wrong, even when he had not really been so.³²

The exact methods devised for the remuneration of judges are, therefore, of considerable importance. Fixed salaries, while limiting possibilities for corruption, are likely to lead to indolence and neglect, whereas allowing the judges to

³⁰ *Ibid.*, p. 680. Had the Russians read their Smith with nearly the same diligence as they did their Marx, they might not now be so plagued with problems perfectly analogous to, but far more serious than, "the conveyances of a verbose attorney."

"Orders from above have an entirely different effect from that desired by the planners themselves. Thus they plan output in tons in many ministries (including heavy machine-building and iron and steel) so that the factories concentrate on the heavier goods within each item of the assortment (product-mix) specified in the plan. They plan output of textiles by length and not area, so that factories produce narrower cloths than their looms will take in order to boost their output figures. They plan geological surveys in metres drilled and not in tons of minerals discovered, so that you can fulfil the plan by doing unnecessary drilling. The output of each factory is planned in wholesale prices as well as in physical terms; and as wholesale prices include the cost of raw materials, factories concentrate on those items which use more raw materials and less labour, again in order to boost their output figures" (R. W. Davies, "Industrial Planning Reconsidered," *Soviet Studies*, April, 1957, p. 428).

³¹ *Wealth*, p. 677.

³² *Ibid.*, p. 675.

establish and to collect fees, out of which they are to derive their incomes, increases the possibility that the pursuit of self-interest will lead to corrupt practices. Since, at the same time, it is desirable that the law courts should defray the expenses of their operation and that the judiciary should be completely independent of the executive branch, Smith proposes a carefully contrived system whereby fees are independently determined and standardized, means of payment precisely defined and publicly recorded, and payment to the judges withheld until proceedings are completed. Under these circumstances, Smith is hopeful, judges will have practically no alternative but to mete out justice in a fair and expeditious manner.³³

The strong feelings which Smith harbored against "that insidious and crafty animal, vulgarly called a statesman or politician," are too well known to require elaboration. They represented the *fons et origo* of the many perversions and extravagances which Smith identified with "the Mercantile System." More important, however, is the fact that Smith regards politicians and government officials as a class of men peculiarly insu-

lated not only from the ordinary pressures of the market but from any other institutionalized compulsion which engages the pursuit of their selfish interests with the public welfare. At the same time, the opportunities and devices typically available for enriching themselves directly at the expense of the public he regards as myriad. Just as in the case of the servants of the East India Company, however, it must be emphasized that Smith condemns not politicians per se but the institutional framework within which politicians typically find themselves.

On the question of the functions which may appropriately be undertaken by governments, Smith makes several highly interesting observations, indicating that his antigovernment bias was, in substantial measure, a reflection of the currently limited possibilities for engaging the "interested diligence" of public officials upon the efficient operation of government undertakings. For example, Smith cites approvingly the mercantile projects carried out by small European governments. His invidious comparisons with the government of England turn, not on a matter of principle, but upon the almost certain incapacity of the British government to engage successfully in similar undertakings, in contrast with the established efficiency of the (small) governments of Venice and Amsterdam:

The orderly, vigilant, and parsimonious administration of such aristocracies as those of Venice and Amsterdam, is extremely proper, it appears from experience, for the management of a mercantile project of this kind. But whether such a government as that of England; which, whatever may be its virtues, has never been famous for good oeconomy; which, in time of peace, has generally conducted itself with the slothful and negligent profusion that is perhaps natural to monarchies; and in time of war has

³³ *Ibid.*, pp. 677-81. The system of paying fees to courts of law, Smith argues, has led in the past to competition among different courts of justice which had highly beneficial consequences. The competition for litigation led not only to an expansion in the jurisdiction of courts originally set up for specific purposes, such as the court of exchequer, but also, as a direct consequence, to a swift and impartial justice. Even more interesting is his suggestion that such intercourt competition was a dynamic force in changing the law itself and in leading to the emergence of new legal concepts, such as the highly important writ of ejectment. Smith reports that "the artificial and fictitious writ of ejectment, the most effectual remedy for an unjust ouster or dispossession of land," was invented by the courts of law to regain a considerable amount of litigation which had been temporarily lost, in this competitive process, to the court of chancery (*ibid.*, p. 679).

constantly acted with all the thoughtless extravagance that democracies are apt to fall into; could be safely trusted with the management of such a project, must at least be a good deal more doubtful.³⁴

Similarly, although cautioning that much of the information available concerning events in Asia was derived from such unreliable sources as the accounts of "stupid and lying missionaries," Smith concedes that roads and canals may be operated by Asian governments with a high degree of efficiency. This is because, in such places as China and Indostan, the primary source of revenue to the sovereign is derived from a land-tax or land-rent. Under these circumstances, it is in the direct interest of the sovereign to provide and maintain the most efficient possible network of transportation facilities.³⁵ It is highly improbable, however, "during the present state of things," that any European government could provide such transport facilities with any degree of efficiency because their self-interests are not similarly engaged by their sources of revenue:

The revenue of the sovereign does not, in any part of Europe, arise chiefly from a land-tax or land-rent. In all the great kingdoms of Europe, perhaps, the greater part of it may ultimately depend upon the produce of the land: But that dependency is neither so immediate, nor so evident. In Europe, therefore, the sovereign does not feel himself so directly called upon to promote the increase, both in quantity and value, of the produce of the land, or, by maintaining good roads and canals, to provide the most extensive market for that produce.³⁶

What is involved here, therefore, is not only the matter of administrative

³⁴ *Ibid.*, p. 770. Of course, Smith insists that, wherever possible and appropriate, the administration of smaller (local) units of government is to be preferred to that of larger, national units (*ibid.*, p. 689).

³⁵ *Ibid.*, p. 688; see also pp. 789-90.

³⁶ *Ibid.*, pp. 688-89.

competence or efficiency but also the absence of institutional arrangements so structured as to engage the motive and interests of those concerned.

Smith's shrewd perception of the impact of different organizational arrangements upon the individual pursuit of wealth appears in the distinction that he draws between the operation of roads and canals. Canals, he argues, may more properly be left in private hands than roads. This is because the interested diligence of the canal-owner requires the canal to be maintained, or it will become impassable through neglect and therefore cease entirely to be a source of revenue. Highways, on the other hand, deteriorate by degrees and, although entirely neglected, may still remain passable. If private persons are allowed to collect such tolls, the roads will therefore suffer considerable neglect, since such persons will lack the personal incentive to maintain them.³⁷

³⁷ *Ibid.*, p. 684. In a discussion of the appropriate investment criteria for underdeveloped countries, Albert Hirschman recently made a proposal whose inner logic was strikingly similar to that underlying Smith's distinction between the operation of roads and canals: "Priority should be given to investments, industries, and technical processes which either hardly require maintenance or *must* have maintenance because its absence carries with it a very high penalty, i.e., leads to accidents or immediate breakdown rather than to slow deterioration in the quantity and quality of output. The fact that the performance of the airlines in Columbia is excellent, that of the railroads mediocre, and that of the roads outright poor can be explained in terms of this criterion: nonmaintenance would lead to certain disaster in the case of airplanes, but roads can be left to deteriorate for a long time before they finally disappear, and railroads occupy a somewhat intermediate position from this viewpoint." (Albert Hirschman, "Economics and Investment Planning: Reflections Based on Experience in Columbia," in *Investment Criteria and Economic Growth* (Cambridge, Mass.: Center for International Studies, Massachusetts Institute of Technology), p. 48; see also Albert Hirschman, *The Strategy of Economic Development* (New Haven, Conn.: Yale University Press, 1958), pp. 139-43.

Smith's search for an institutional scheme which will establish and enforce an identity of interests between the public and private spheres even carries over into his discussion of the nation's military establishment. After an extended discussion of the changing technology of warfare and its consequences for the organization of a nation's military establishment, he concludes: "It is only by means of a standing army . . . that the civilization of any country can be perpetuated, or even preserved for any considerable time."³⁸ The obvious threat which such a standing army poses to republican principles, "wherever the interest of the general and that of the principal officers are not necessarily connected with the support of the constitution of the state,"³⁹ is to be remedied by insuring that military leadership is recruited only from among those classes whose self-interest is indissolubly linked with the support of the existing government. Thus,

where the sovereign is himself the general, and the principal nobility and gentry of the country the chief officers of the army; where the military force is placed under the command of those who have the greatest interest in the support of the civil authority, because they have themselves the greatest share of that authority, a standing army can never be dangerous to liberty.⁴⁰

Smith's further exploration of this general theme is richly developed in his discussion of religious and educational institutions (Book V, chap. 1, Arts. 2d and 3d). Although Smith raises strong social and political objections to the accumulation of wealth and power by ecclesiastical institutions, he argues that such accumulation almost certainly de-

stroys their effectiveness as "institutions for the instruction of people of all ages" as well. For members of the clergy are likely to be most zealous and industrious as teachers of religious doctrine if they "depend altogether for their subsistence upon the voluntary contributions of their hearers."⁴¹ If they are independently endowed, if their interested diligence, in other words, is not made dependent on public assessment of the effectiveness of their performance, they are likely to become negligent and slothful in the fulfillment of their duties. It is this situation which prompted Smith to make such frequent disparaging references to clergy of "ancient and established systems . . . reposing themselves upon their benefices" and to the "contemptuous and arrogant airs" displayed by "the proud dignitaries of opulent and well-endowed churches," etc.⁴²

But, although Smith is opposed to the "independent provision" of the clergy, he does not advocate the alternative of leaving them to the free pursuit of their interested diligence. For the extreme tensions under which the clergy would then be placed would tempt them to adopt reprehensible practices which they might otherwise not choose, were the compulsions less great. Such a policy would lead to deceitful appeals to a naïve, credulous, and superstitious public and wholesale exploitation of the gullibility of the latter—in effect, unfair ecclesiastical

⁴¹ *Ibid.*, p. 740.

⁴² *Ibid.*, pp. 741 and 762. A further consequence of large endowments and benefices, to which Smith attached considerable importance, is that, by their competitive attractions, they draw superior talents out of universities and into the church. "After the church of Rome, that of England is by far the richest and best endowed church in Christendom. In England, accordingly, the church is continually draining the universities of all their best and ablest members" (*ibid.*, p. 763; see also pp. 762-64).

³⁸ *Wealth*, p. 667.

³⁹ *Ibid.*, p. 667.

⁴⁰ *Ibid.*, pp. 667-68.

practices.⁴³ Thus the special circumstances surrounding the usual functions of the clergy lead Smith to amend somewhat his general maxim: "In every profession, the exertion of the greater part of those who exercise it, is always in proportion to the necessity they are under of making that exertion."⁴⁴ The difficulty here is that extreme necessity is not only likely to maximize effort and to overcome the natural indolence of the clergy but to influence the direction of that effort in socially disagreeable ways. Here again Smith's concern is not only with the maximization of effort but with the more subtle dimensions of human behavior.

It is of considerable interest to the argument of this paper to note that, although Smith is highly critical of almost every religious order with which he deals, he does single out at least one important exception. Reference is made to the very high praise indeed which Smith accords to the Presbyterian clergy:

There is scarce perhaps to be found any where 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.⁴⁵

And, further:

The most opulent church in Christendom does not maintain better the uniformity of faith, the fervour of devotion, the spirit of order, regularity, and austere morals in the great body of the people, than this very poorly endowed church of Scotland.⁴⁶

One may, if one wishes, dismiss this major exception as originating in a source of bias too obvious to be worth recording.

⁴³ See *ibid.*, pp. 742-43, for the extended quotation from Hume's *History of England* which Smith approvingly inserts.

⁴⁴ *Wealth*, p. 717.

⁴⁵ *Ibid.*, p. 762.

⁴⁶ *Ibid.*, p. 765.

But this would be doing much less than justice to the scope of Smith's argument and to the fact that this judgment is consistent, at least in Smith's eyes, with criteria which he develops and employs elsewhere. Smith seems to feel that the mode of payment devised for the Presbyterian clergy struck just that optimum balance between underpayment, which drove the mendicant orders to that excessive and misplaced zeal which Smith likened to a plundering army,⁴⁷ and overpayment from large independent endowments, which was so often responsible for indolence, negligence, and "contemptuous and arrogant airs." The consistency of Smith's judgment and the generality of his argument are perfectly clear in the closing paragraph of the section devoted to the clergy:

The proper performance of every service seems to require that its pay or recompence should be, as exactly as possible, proportioned to the nature of the service. If any service is very much under-paid, it is very apt to suffer by the meanness and incapacity of the greater part of those who are employed in it. If it is very much over-paid, it is apt to suffer, perhaps, still more by their negligence and idleness. A man of a large revenue, whatever may be his profession, thinks he ought to live like other men of large revenues: and to spend a great part of his time in festivity, in vanity, and in dissipation. But in a clergyman this train of life not only consumes the time which ought to be employed in the duties of his function, but in the eyes of the common people destroys almost entirely that sanctity of character which can alone enable him to perform those duties with proper weight and authority.⁴⁸

Smith's devastating remarks respecting the state of education are often treated as a mere *curiosum*. In fact, however, Smith's critique of educational in-

⁴⁷ *Ibid.*, p. 742: "The mendicant orders derive their whole subsistence from (voluntary) oblations. It is with them, as with the hussars and light infantry of some armies: no plunder, no pay."

⁴⁸ *Ibid.*, p. 766.

stitutions—especially universities—is entirely consistent with the general principles which have been referred to in this paper. Because of special privileges and independent endowments, England's great universities in particular lack the appropriate institutional mechanisms which link the pursuit of self-interest on the part of the faculty to the need to perform satisfactorily their professional duties. This is especially the case where the colleges are not only heavily endowed⁴⁹ but where also (*mirabile dictu!*) the teachers themselves constitute the governing body.⁵⁰ Under such a self-perpetuating arrangement the incomes of teachers bear virtually no relation to their proficiency as either scholars or pedagogues. This sham is intensified in those cases where class attendance is made obligatory and students are unable to exercise their consumer sovereignty by awarding their fees to instructors of greatest competence. In those cases where the instructor derives his entire income from endowments, the connection between effort and reward is completely ruptured, and the situation is hopeless. For even if the teacher is naturally energetic and constitutionally incapable of a life of total quiescence, his energies will be channeled into directions *other* than that of scholarship, since the marginal private gains in such pursuits have been effectively set at zero.⁵¹

⁴⁹ "The endowments of schools and colleges have necessarily diminished more or less the necessity of application in the teachers. Their subsistence, so far as it arises from their salaries, is evidently derived from a fund altogether independent of their success and reputation in their particular professions" (*ibid.*, p. 717).

⁵⁰ Perhaps it should be added that, in Smith's opinion, the control of a university by some "extraneous jurisdiction" (bishop, governor, minister of state) was likely to be ignorant and capricious in nature—as in the French universities (*ibid.*, pp. 718–19).

The result is, inevitably, a total and shameful neglect of learning.⁵²

The situation, mercifully, is not so bad in the public schools, which "are much less corrupted than the universities." The principal reason for the difference, as might be expected, is that "the reward of the schoolmaster in most cases depends principally, in some cases almost entirely, upon the fees or honoraries of his scholars."⁵³

The central argument of this paper may be restated as follows: Smith's *Wealth of Nations* provided the first systematic guide to the manner in which the price mechanism allocated resources in a free-market economy, and the book has been justly celebrated for this unique achievement.⁵⁴ At the same time, however, Smith was very much preoccupied with establishing the conditions under which this market mechanism would operate most effectively. His conception of human behavior allowed for the free operation of certain impulses, motivations, and behavior patterns which were calculated to thwart, rather

⁵¹ "If he is naturally active and a lover of labour, it is his interest to employ that activity in any way, from which he can derive some advantage, rather than in the performance of his duty, from which he can derive none" (*ibid.*, p. 718).

⁵² "In the university of Oxford, the greater part of the public professors have, for these many years, given up altogether even the pretence of teaching" (*ibid.*, p. 718). And, more generally: "The discipline of colleges and universities is in general contrived, not for the benefit of the students, but for the interest, or more properly speaking, for the ease of the masters. Its object is, in all cases, to maintain the authority of the master, and whether he neglects or performs his duty, to oblige the students in all cases to behave to him as if he performed it with the greatest diligence and ability" (*ibid.*, p. 720).

⁵³ *Ibid.*, p. 721.

⁵⁴ Cf., however, the reservations expressed by Schumpeter, to whom nothing, except Walras' *Elements*, appears to have been sacred (J. A. Schumpeter, *History of Economic Analysis* [New York: Oxford University Press, 1954], pp. 184–86).

than to reinforce, the beneficent operation of market forces, and Smith was therefore very much concerned with providing an exact, detailed specification of an optimal institutional structure. Later generations of economists have virtually ignored this aspect of Smith's analysis both by oversimplifying his conception of human behavior and by merely invoking, without examination, a competitive economy. The result has been a neglect of some of the most fruitful and suggestive aspects of Smith's analysis and a distortion of the broader implications of his argument. The present paper represents a partial attempt to restore this balance.

Recent concern among economists

with problems of economic development and with specific areas of government policy formulation suggests a resurgence of interest in the incidence of different institutional forms upon economic behavior.⁵⁵ Although the *Wealth of Nations* is certainly not the last word on this subject, its analytical framework still constitutes a most useful point of departure.

⁵⁵ Cf., for example, W. A. Lewis, *The Theory of Economic Growth* (Homewood, Ill.: Richard D. Irwin, Inc., 1955), esp. chap. iii, and the masterly analysis of the American patent system in Fritz Machlup, *An Economic Review of the Patent System* (Study No. 15 of the Subcommittee on Patents, Trademarks and Copyrights of the Committee on the Judiciary, U.S. Senate [Washington: Government Printing Office, 1958]).