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Nathan Rosenberg

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# Adam Smith on Profits—Paradox Lost and Regained

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Nathan Rosenberg

*Stanford University*

This paper examines the following apparent paradox. Adam Smith's *Wealth of Nations* is universally regarded as a book that powerfully presented the social case for giving the businessman the maximum degree of freedom of action. And yet, although Smith unqualifiedly treats high wages as desirable, he treats high profits as undesirable. Why did so eloquent a spokesman for capitalism and *laissez faire* treat high profits with such unrelieved hostility? The interpretation of Smith presented in answering this question revolves primarily around the belief that easily earned high profits destroy the effectiveness with which the capitalist carries out his social role.

It might be best to begin with a candid admission. This paper is not the paper I had originally set out to write. Adam Smith's treatment of the business community in general and the entrepreneur in particular is a subject that has long fascinated me.<sup>1</sup> It seemed therefore to be both useful and rewarding to ferret out and to examine Smith's treatment of the role of the entrepreneur in the *Wealth of Nations*.<sup>2</sup> After all, in a book that has been regarded as the *locus classicus* of the *laissez faire* ideology for 200 years, a book that shook the world by recommending a maximum degree of freedom for business enterprise—in such a book surely the entrepreneur would play a major role. Although this originally seemed like a reasonable expectation, it was not fulfilled. As I should certainly have realized, Smith's analytical distinctions here were inevitably limited by the modest state of capitalist development itself and the relatively small degree of specialization of function that still prevailed in the middle of the eighteenth century. Indeed, Smith had made a significant contribution to

<sup>1</sup> See Rosenberg (1960).

<sup>2</sup> Smith (1937).

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analytical economics merely by his forceful recognition of profit on capital as constituting a separate and distinct income category.<sup>3</sup>

I have not, I am happy to report, returned from this brief excursion into intellectual history completely empty-handed. Instead of the story I had hoped to tell, I want to report upon a rather unexpected paradox that I encountered. I would like, moreover, to try to unravel this paradox. My determination to do so comes about not only because of a certain taste for intellectual history—although that would be justification enough—but also because the paradox is one that goes to the heart of Adam Smith's Weltanschauung.

Stated in somewhat oversimplified terms, my paradox lies in the fact that Adam Smith treated high wages as being unqualifiedly a good thing, and high profits as being unqualifiedly a bad thing. Why should so eloquent a spokesman for capitalism and laissez faire regard high profits with such a jaundiced eye? Indeed, he closes his chapter on profits with the following devastating barrage: "Our merchants and master-manufacturers complain much of the bad effects of high wages in raising the price and thereby lessening the sale of their goods both at home and abroad. They say nothing concerning the bad effects of high profits. They are silent with regard to the pernicious effects of their own gains. They complain only of those of other people."<sup>4</sup> So fervently did Smith believe these sentiments that the statement actually appears, substantially unchanged, in two different places in *The Wealth of Nations*.<sup>5</sup>

The question of whether high wages were desirable had such an obviously affirmative answer to Smith that he did not even undertake to justify it, but rather asserted it with a rhetorical flourish: "Is this improvement in the circumstances of the lower ranks of the people to be regarded

<sup>3</sup> On this subject, see the perceptive article by Meek (1954). Meek states: "Many of Smith's predecessors had recognized, of course, that those who employed stock in mercantile pursuits generally received a net reward which was proportioned not to the effort, if any, which they had expended, but rather to the value of the stock employed. In Smith's new model it was recognized that net gains similar in this respect to mercantile profit were now also being earned on capital employed in other economic pursuits, such as agriculture and manufacture. But even more important, it was also recognized that the *origin* of these net gains was now very different from what it had formerly been. To Smith's predecessors, generally speaking, profit had appeared as 'profit upon alienation'—i.e., as the gain from buying things cheap and selling them dear. To Smith, on the other hand, profit began to appear as an income uniquely associated with the use of capital in the employment of wage-labor" (pp. 138–39).

<sup>4</sup> Smith (1937, p. 98).

<sup>5</sup> "Our merchants frequently complain of the high wages of British labour as the cause of their manufactures being undersold in foreign markets; but they are silent about the high profits of stock. They complain of the extravagant gain of other people; but they say nothing of their own. The high profits of British stock, however, may contribute towards raising the price of British manufactures in many cases as much, and in some perhaps more, than the high wages of British labour" (Smith 1937, pp. 565–66). This statement appeared in the first edition of the book whereas the one in the text above made its appearance in the second edition.

as an advantage or as an inconveniency to the society? The answer seems at first sight abundantly plain. Servants, labourers and workmen of different kinds make up the far greater part of every great political society. But what improves the circumstances of the greater part can never be regarded as an inconveniency to the whole. No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable.”<sup>6</sup>

If Adam Smith’s views here do not strike our egalitarian sensibilities as particularly startling, that is partly because of a drastic shift in attitudes which Smith himself played some role in bringing about. For earlier in the eighteenth century the dominant view was of the social utility of poverty. Smith’s predecessors were very much exercised—indeed, some were absolutely obsessed—over the socially undesirable consequences of high or rising wages. It had been a firmly accepted part of the conventional wisdom that high wages would reduce effort, that the working class response to higher wages could be described—in the jargon of a later day—in the form of a backward-sloping labor-supply curve. The dominant view was well expressed by Arthur Young, that repository of conventional wisdom, who wrote in his *Farmer’s Tour through the East of England* in 1771 that “every one but an idiot knows that the lower classes must be kept poor or they will never be industrious; I do not mean, that the poor of England are to be kept like the poor of France, but, the state of the country considered, they must (like all mankind) be in poverty or they will not work.”<sup>7</sup>

Similarly, Sir William Temple, in his *Vindication of Commerce and the Arts*, says categorically of laborers that “the only way to make them temperate and industrious, is to lay them under the necessity of labouring all the time they can spare from meals and sleep, in order to procure the necessaries of life.”<sup>8</sup> Such were the dominant views of Smith’s time.<sup>9</sup>

In such a context, Smith’s views were both enlightened and advanced. Moreover, they were novel in a respect that needs to be made quite explicit. Not only did Smith believe that high wages were intrinsically

<sup>6</sup> Smith (1937, pp. 78–79).

<sup>7</sup> Young (1771, 4: 361).

<sup>8</sup> Temple (1786, p. 534).

<sup>9</sup> For an excellent scholarly presentation of the mercantilists’ attitude toward labor, see Furniss (1957). For a careful study of the transition from the old set of views to the later ones, see Coats (1958). Coats states: “Apart from a few isolated advocates of a ‘high wage economy,’ most British economists before 1750 regarded low wages as an essential precondition of the maintenance of a high volume of exports, although the plea that the British workman should enjoy a higher standard of living than that of his continental counterpart represented a tacit admission that successful competition in foreign markets did not require that home wage levels should be equal to or lower than foreign wage levels. By contrast, in the third quarter of the century there was growing support for the view that high wages and rising living standards were not merely compatible with, but were even a necessary concomitant of the prosperity of our domestic and exported manufactures” (p. 46).

desirable because they improved the standard of living of the mass of the population, but he also believed—and here he clashed head-on with the prevailing view—that the working class supply of effort was positively sloped, that higher wages called forth greater effort and not less: “The liberal reward of labour . . . increases the industry of the common people. The wages of labour are the encouragement of industry, which, like every other human quality, improves in proportion to the encouragement it receives. 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.”<sup>10</sup> Although Smith concedes that higher wages are likely to induce some workers to reduce the number of hours worked, he is insistent that such workers constitute only a minority of the labor force. Indeed, Smith appears to be genuinely concerned over the opposite possibility, that a system of incentive wages will cause many workers to suffer the deleterious effects of overwork. In this respect he is the first economist of whom I am aware for whom this was a major concern.

Some workmen, indeed, 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. Workmen, on the contrary, when they are liberally paid by the piece, are very apt to over-work themselves, and to ruin their health and constitution in a few years. A carpenter in London, and in some other places, is not supposed to last in his utmost vigour above eight years. Something of the same kind happens, in many other trades, in which the workmen are paid by the piece, as they generally are in manufactures, and even in country labour, whenever wages are higher than ordinary.<sup>11</sup>

Where workers do, in fact, avail themselves of long intervals of leisure, Smith finds the cause, not in laziness or deficiency of character, but in deeply rooted physiological causes.

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. Great labour, either of mind or body, continued for several days together, is in most men naturally followed by a great desire of relaxation, which, if not restrained by force or by some strong necessity, is almost irresistible. It is the call of nature, which requires to be relieved by some

<sup>10</sup> Smith (1937, p. 81).

<sup>11</sup> Smith (1937, pp. 81–82).

indulgence, sometimes of ease only, but sometimes too of dissipation and diversion. If it is not complied with, the consequences are often dangerous, and sometimes fatal, and such as almost always, sooner or later, bring on the peculiar infirmity of the trade. If masters would always listen to the dictates of reason and humanity, they have frequently occasion rather to moderate, than to animate the application of many of their workmen.<sup>12</sup>

When Smith turns from the examination of the economic behavior of the worker to that of the capitalist, his attitude shifts from that of compassion and understanding to one of compulsive and cantankerous criticism and suspicion. The long-term interests of capitalists, to begin with, do not coincide with those of society: "The rate of profit does not, like rent and wages, rise with the prosperity, and fall with the declension, of the society. On the contrary, it is naturally low in rich, and high in poor countries, and it is always highest in the countries which are going fastest to ruin. The interest of this third order [i.e., capitalists], therefore, has not the same connexion with the general interest of the society as that of the other two [i.e., landlord and worker]."<sup>13</sup> As a result, capitalists as a class are simply not to be trusted: "The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public and who accordingly have, upon many occasions, both deceived and oppressed it."<sup>14</sup>

A businessman who had been taught to regard Adam Smith as a capitalist apologist might well be excused for wondering what sort of strange capitalist apologetics this is, and, if this is what we are likely to get from our friends, just what may we expect from our enemies. Part of the answer may be stated briefly. High profits that persist are often the result of those private conspiracies against which Smith so eloquently inveighed, or of government dispensations of exclusive privileges.<sup>15</sup> In both cases the result is an impediment to resource mobility upon which the effective functioning of a market economy must be predicated. The alacrity with

<sup>12</sup> Smith (1937, p. 82).

<sup>13</sup> Smith (1937, pp. 249–50).

<sup>14</sup> Smith (1937, p. 250).

<sup>15</sup> Profits must also remain relatively high in some areas to compensate for additional risk or for a disagreeable activity (see Smith 1937, chap. 10, pt. 1). "The keeper of an inn or tavern, who is never master of his own house, and who is exposed to the brutality of every drunkard, exercises neither a very agreeable nor a very creditable business. But there is scarce any common trade in which a small stock yields so great a profit" (p. 101).

which businessmen have entered into such arrangements in the past and their persistence and ingenuity in subverting the disciplining effects of the market are the main reason that the text of *The Wealth of Nations* abounds in phraseology extremely critical of the business community: “the sneaking arts of underling tradesmen”; the “mean and malignant expedients” of merchants and manufacturers; the “clamour and sophistry of merchants and manufacturers”; the “interested sophistry of merchants and manufacturers”; “the mean rapacity, the monopolizing spirit of merchants and manufacturers”; and traders who argue with “all the passionate confidence of interested falsehood.”

Smith’s criticisms of mercantilism, which take up such a large portion of his book, also issue from the same cause. Smith sees mercantilism as the successful attempt of rapacious businessmen to exploit the machinery of government for their own self-aggrandizement. Such efforts really had their historical origin in the exclusive corporative spirit of privileged groups, which grew up in medieval towns and cities: “Country gentlemen and farmers, dispersed in different parts of the country, cannot so easily combine as merchants and manufacturers, who being collected into towns, and accustomed to that exclusive corporation spirit which prevails in them, naturally endeavour to obtain against all their countrymen, the same exclusive privilege which they generally possess against the inhabitants of their respective towns.”<sup>16</sup>

The violence of Smith’s polemic against mercantilism lay in the fact that it enabled merchants to better their condition in a manner that 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 provided with innumerable opportunities to enrich himself without enriching the nation. Even when legislation is passed with an ostensibly legitimate social purpose in view, the opportunities for profit making are likely to be restructured in such a way as to lead to private enrichment and not social enrichment. Thus, with respect to the herring bounty, Smith sardonically observes: “The bounty to the white herring fishery is a tonnage bounty; and is proportioned to the burden of the ship, not to her diligence or success in the fishery; and it has, I am afraid, been too common for vessels to fit out for the sole purpose of catching, not the fish, but the bounty.”<sup>17</sup>

The more interesting part of the answer to my question, however, does

<sup>16</sup> Smith (1937, p. 429).

<sup>17</sup> Smith (1937, p. 486). Smith adds the following extraordinary bit of accounting: “In the year 1759, when the bounty was at fifty shillings the ton, the whole buss fishery of Scotland brought in only four barrels of sea sticks. In that year each barrel of sea sticks cost government in bounties alone £113 15s; each barrel of merchantable herrings £159 7s. 6d.”

not lie in monopolistic barriers or other impediments to the achievement of static efficiency with respect to resource use. Rather, it involves the realm of dynamic change over time and broader influences shaping human behavior. For the growth of trade and commerce—and, in their wake, manufactures—is of course associated historically with the rise of the capitalist class. This class gradually displaces the landlord class, which had previously dominated the European economy and polity and had squandered society's social surplus by maintaining a large army of retainers and by what Smith calls "rustic hospitality." The new goods made available by expanding commerce bring in their wake drastic social and political changes.

But what all the violence of the feudal institutions could never have effected, the silent and insensible operation of foreign commerce and manufactures gradually brought about. These gradually furnished the great proprietors with something for which they could exchange the whole surplus produce of their lands, and which they could consume themselves without sharing it either with tenants or retainers. All for ourselves, and nothing for other people, seems, in every age of the world, to have been the vile maxim of the masters of mankind. As soon, therefore, as they could find a method of consuming the whole value of their rents themselves, they had no disposition to share them with any other persons. For a pair of diamond buckles perhaps, or for something as frivolous and useless, they exchanged the maintenance, or what is the same thing, the price of the maintenance of a thousand men for a year, and with it the whole weight and authority which it could give them. The buckles, however, were to be all their own, and no other human creature was to have any share of them; whereas in the more ancient method of expence they must have shared with at least a thousand people. With the judges that were to determine the preference, this difference was perfectly decisive; and thus, for the gratification of the most childish, the meanest and the most sordid of all vanities, they gradually bartered their whole power and authority.<sup>18</sup>

The growth of the commercial sector and the increasing control over income flows by the capitalist class are a critical element in Smith's version of economic growth because, whereas the landlord directed society's surplus resources into frivolous, unproductive activities, the capitalist now directs these resources into productive channels. As Smith

<sup>18</sup> Smith (1937, pp. 388–89; see also p. 385). For further discussion, see Rosenberg (1968).



puts it, "It is the stock that is employed for the sake of profit, which puts into motion the greater part of the useful labour of every society."<sup>19</sup>

Smith's sociological analysis of the rise of capitalism—primarily in book 3 of *The Wealth of Nations*—has been strangely neglected and will, unfortunately, also be neglected here, since it would require a separate paper to treat adequately. A couple of things, however, need to be asserted. By providing a ready market for agricultural products, the growth of commercial and manufacturing towns provides powerful new incentives to the attainment of efficient resource use in agriculture. Furthermore, and for Smith most important, the growth of commerce, by dissolving feudal ties and obligations, makes good government possible for the first time: "Commerce and manufactures gradually introduced order and good government, and with them, the liberty and security of individuals, among the inhabitants of the country, who had before lived almost in a continual state of war with their neighbours, and of servile dependency upon their superiors. This, though it has been the least observed, is by far the most important of their effects."<sup>20</sup>

This good government includes the reduction of crime, which Smith associates with the elimination of the personal ties of dependency of feudalism. He asserts in his *Lectures* that "nothing tends so much to corrupt mankind as dependency, while independency still increases the honesty of the people." And he concludes that "the establishment of commerce and manufactures, which brings about this independency, is the best police for preventing crimes."<sup>21</sup>

Finally, as suggested earlier, the rise of a capitalist class brings an increasing proportion of society's resources—including agriculture itself—under the control of a more efficient class of decision makers.<sup>22</sup> But it is

<sup>19</sup> Smith (1937, p. 249). The structure of feudal society effectively suppressed the possibility of capital accumulation from all classes—albeit in different ways: "Under the feudal constitution there could be very little accumulation of stock, which will appear from considering the situation of those three orders of men, which made up the whole body of the people: the peasants, the landlords, and the merchants. The peasants had leases which depended upon the caprice of their masters; they could never increase in wealth, because the landlord was ready to squeeze it all from them, and therefore they had no motive to acquire it. As little could the landlords increase their wealth, as they lived so indolent a life, and were involved in perpetual wars. The merchants again were oppressed by all ranks, and were not able to secure the product of their industry from rapine and violence. Thus there could be little accumulation of wealth at all; but after the fall of the feudal government these obstacles to industry were removed, and the stock of commodities began gradually to increase" (Smith 1956, p. 220).

<sup>20</sup> Smith (1937, p. 385).

<sup>21</sup> Smith (1956, p. 155).

<sup>22</sup> Smith succinctly lays out the differences in attitude and mentality between the merchant and landowner: "The wealth acquired by the inhabitants of cities was frequently employed in purchasing such lands as were to be sold, of which a great part would frequently be uncultivated. Merchants are commonly ambitious of becoming country gentlemen, and when they do, they are generally the best of all improvers. A merchant is accustomed to employ his money chiefly in profitable projects, whereas a mere country

the dynamic aspect of this point that requires emphasis. The growth of commerce is instrumental in shaping character, in altering tastes, and in providing new and more powerful incentives. The growth of commerce, by increasing the importance of the capitalist class as compared to large landowners, increases the proportion of those in society devoted to parsimony and frugality (“those who are naturally the most disposed to accumulate”),<sup>23</sup> as compared to those who live lives of indolence and prodigality.<sup>24</sup> Commerce inculcates habits of orderliness, reliability, precision, and painstaking attention to detail. Participation in business enterprise inevitably inculcates certain behavior patterns—in particular, those of “order, economy and attention.”<sup>25</sup> Commerce introduces probity and punctuality. But it is important to note that Smith’s argument makes these qualities emerge and spread as a direct response to personal self-interest:

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

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gentleman is accustomed to employ it chiefly in expence. The one often sees his money go from him and return to him again with a profit; the other, when once he parts with it, very seldom expects to see any more of it. Those different habits naturally affect their temper and disposition in every sort of business. A merchant is commonly a bold; a country gentleman, a timid undertaker. The one is not afraid to lay out at once a large capital upon the improvement of his land, when he has a probable prospect of raising the value of it in proportion to the expence. The other, if he has any capital, which is not always the case, seldom ventures to employ it in this manner. If he improves at all, it is commonly not with a capital, but with what he can save out of his annual revenue” (Smith 1937, pp. 384–85).

<sup>23</sup> Smith (1937, p. 578).

<sup>24</sup> Adam Smith’s close friend, David Hume, had said: “(As) the spending of a settled revenue is a way of life entirely without occupation, men have so much need of somewhat to fix and engage them, that pleasures, such as they are, will be the pursuit of the greater part of the landholders, and the prodigals among them will always be more numerous than the misers. In a state, therefore, where there is nothing but a landed interest, as there is little frugality, the borrowers must be very numerous, and the rate of interest must hold proportion to it. The difference depends not on the quantity of money, but on the habits and manners which prevail” (Hume 1955, p. 50).

<sup>25</sup> Smith (1937, p. 385).

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. . . . Wherever dealings are frequent, a man does not expect to gain so much by any one contract, as by probity and punctuality in the whole, and 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. Everything of this kind is odious as it is rare. When the greater part of people are merchants, they always bring probity and punctuality into fashion, and these, therefore, are the principal virtues of a commercial nation.<sup>26</sup>

This discussion of the character-forming aspects of a commercial society now provides the basis for our confrontation with the “paradox of high profits” with which this paper is concerned. A commercial society needs to be perceived as a set of institutions, which, although at one level it may be treated as a collection of legally free individuals engaging in free contractual agreements, at another level is an intensely coercive system. By this I mean that, in order to succeed under a system of competitive capitalism, one needs to develop certain characteristics—the characteristics of order, economy, attention, and probity—with which Smith is concerned and which are the qualities essential for success under the unique pressures imposed upon individual participants in the business arena by capitalist institutions. (The capitalist is haunted by the spectre of bankruptcy. “Bankruptcy is perhaps the greatest and most humiliating calamity which can befall an innocent man. The greater part of men, therefore, are sufficiently careful to avoid it. Some, indeed, do not avoid it; as some do not avoid the gallows.”<sup>27</sup>) These characteristics, it should be clear, do not come naturally to man. Man does not by nature prefer the active and energetic life to the life of indolence and repose. Indeed, Smith asserts that “it is the interest of every man to live as much at his ease as he can.”<sup>28</sup> As a consequence, Smith regards it as axiomatic that “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

<sup>26</sup> Smith (1956, pp. 253–55). For Smith’s characterization of the “inconveniences” of a commercial society, see Smith (1937, pp. 255–59).

<sup>27</sup> Smith (1937, p. 325).

<sup>28</sup> Smith (1937, p. 718).

exertion.”<sup>29</sup> Landlords “are the only one of the three orders whose revenue costs them neither labour nor care, but comes to them, as it were, of its own accord, and independent of any plan or project of their own.”<sup>30</sup> Their characteristic indolence, therefore, is viewed by Smith as “the natural effect of the ease and security of their situation.”<sup>31</sup>

But, while the landed classes live a life of indolence, self-indulgence, and ostentation, they are merely doing what other classes would do if they had the opportunity. 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.”<sup>32</sup> The great virtue of competitive capitalism, from this point of view, is that the intense pressures of the marketplace render such behavior extremely difficult or impossible on the part of the capitalist class. So long as profits are difficult to earn, and so long as competitive pressures keep the rate of profit low, the system itself may be relied upon to force the capitalist to display the traditional virtues of his class. However, high rates of profit, when they persist, constitute evidence that the competitive mechanism is, for whatever reason, not functioning properly. While it is obvious that this has undesirable consequences in terms of resource allocation,<sup>33</sup> it has not been commonly noticed that such easily earned profits had other undesirable consequences, to which Smith attached enormous importance. For

besides all the bad effects to the country in general, which have already been mentioned as necessarily resulting from a high rate of profit; there is one more fatal, perhaps, than all these

<sup>29</sup> Smith (1937, p. 717).

<sup>30</sup> Smith (1937, p. 249).

<sup>31</sup> Smith (1937, p. 249). In speaking of large landed proprietors, Smith remarks: “To improve land with profit, like all other commercial projects, requires an exact attention to small savings and small gains, of which a man born to a great fortune, even though naturally frugal, is very seldom capable. The situation of such a person naturally disposes him to attend rather to ornament which pleases his fancy, than to profit for which he has so little occasion. The elegance of his dress, of his equipage, of his house, and household furniture, are objects which from his infancy he has been accustomed to have some anxiety about. The turn of mind which this habit naturally forms, follows him when he comes to think of the improvement of land. He embellishes perhaps four or five hundred acres in the neighbourhood of his house, at ten times the expence which the land is worth after all his improvements; and finds that if he was to improve his whole estate in the same manner, and he has little taste for any other, he would be bankrupt before he had finished the tenth part of it” (Smith 1937, p. 364).

<sup>32</sup> Smith (1937, p. 766). Similarly, although Smith’s statement about landlords who “love to reap where they never sowed” is frequently cited, it is usually cited minus a critical qualification which Smith attaches. “As soon as the land of any country has all become private property, the landlords, *like all other men*, love to reap where they never sowed, and demand a rent even for its natural produce” (Smith 1937, p. 49; emphasis added).

<sup>33</sup> Smith (1937, pp. 564–66).

put together, but which, if we may judge from experience, is inseparably connected with it. 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. But the owners of the great mercantile capitals are necessarily the leaders and conductors of the whole industry of every nation, and their example has a much greater influence upon the manners of the whole industrious part of it than that of any other order of men. If his employer is attentive and parsimonious, the workman is very likely to be so too; but if the master is dissolute and disorderly, the servant who shapes his work according to the pattern which his master prescribes to him, will shape his life too according to the example which he sets him. Accumulation is thus prevented in the hands of all those who are naturally the most disposed to accumulate; and the funds destined for the maintenance of productive labour receive no augmentation from the revenue of those who ought naturally to augment them the most. The capital of the country, instead of increasing, gradually dwindles away, and the quantity of productive labour maintained in it grows every day less and less. Have the exorbitant profits of the merchants of Cadiz and Lisbon augmented the capital of Spain and Portugal? Have they alleviated the poverty, have they promoted the industry of those two beggarly countries? Such has been the tone of mercantile expence in those two trading cities, that those exorbitant profits, far from augmenting the general capital of the country, seem scarce to have been sufficient to keep up the capitals upon which they were made. . . . Compare the mercantile manners of Cadiz and Lisbon with those of Amsterdam, and you will be sensible how differently the conduct and character of merchants are affected by the high and by the low profits of stock. . . . Light come light go, says the proverb; and the ordinary tone of expence seems every where to be regulated, not so much according to the real ability of spending as to the supposed facility of getting money to spend.<sup>34</sup>

It is only the force of competition, apparently, which can be relied upon to keep the capitalist from behaving like an extravagant landowner. This is so because a major determinant of economic behavior is the ease or difficulty involved in the earning of income. While it may be going too far to suggest that, although Smith did not subscribe to a backward-

<sup>34</sup> Smith (1937, pp. 578–79).

sloping supply curve for labor, he *did* subscribe to it for the capitalist, he does believe that a rise in the rate of profit will reduce the quality, if not the supply, of capitalist effort.

It is true that the barbs which Smith directed at the wealthy usually have large landowners as their target. But there is a good historical reason for this. When Smith wrote, in the middle of the eighteenth century, the landowning classes still thoroughly dominated English society and provided far more conspicuous targets for his attack on great wealth than did the rising class of merchants and manufacturers. But it should be abundantly clear from what has preceded that Smith's sharp invective against the "indolence and vanity of the rich"<sup>35</sup> is not, in principle or intention, confined to any single class in society. Rather, these are characteristics which are attached to the possessors of wealth, from whatever source that wealth is derived, because such possession conditions its owners in highly predictable ways.<sup>36</sup>

This remark brings me to what is both my final point and perhaps a new paradox to replace the one which I have attempted to resolve. I have argued that Smith's hostility to high profits is rooted in his belief that such profits dull the edges of capitalist performance—as in Cadiz and Lisbon—both by dulling his incentive and capacities as an earner of income and by destroying his frugality in disposing of that income. The trouble—and the paradox—of high profits is that the attainment of wealth corrupts the forces leading to the generation of wealth—as is obviously the case with the large landowner. Therefore a recurring theme of the book bearing the title *An Inquiry into the Nature and Causes of the Wealth of Nations* is that, at least on the individual level, the easy attainment of great wealth is likely to destroy the individual's capacity to contribute to the wealth of nations.<sup>37</sup> In this respect, the supreme and essential virtue of competition is that, while it permits the attainment of modest wealth, it places the easy amassing of great wealth virtually beyond reach. It may fairly be said, therefore, that although Adam Smith certainly does not celebrate the social role of the individual capitalist, he does indeed celebrate the role of the capitalist system—or, more precisely, the role of competitive capitalism.

Yet, with all of Smith's preoccupation with the wealth of nations, he

<sup>35</sup> Smith (1937, p. 683).

<sup>36</sup> See Rosenberg (1960).

<sup>37</sup> Smith also noted the inverse correlation between income level and human fertility: "A half-starved Highland woman frequently bears more than twenty children, while a pampered fine lady is often incapable of bearing any, and is generally exhausted by two or three. Barrenness, so frequent among women of fashion, is very rare among those of inferior station. Luxury in the fair sex, while it inflames perhaps the passion for enjoyment, seems always to weaken, and frequently to destroy altogether, the powers of generation" (Smith 1937, p. 79). It is curious that Malthus never examined the important implications of this statement for his theory of population.

also believes that the pursuit of wealth does not take place for the direct gratification or utilitarian purposes provided by an abundance of worldly goods, but rather because the possession of such goods brings their owner the high esteem and approbation of his fellow man.<sup>38</sup> That paradox—and surely the insistence upon the relative unimportance of the wealth of nations by the author of *The Wealth of Nations* deserves to be called a paradox—has to be pursued through Smith's earlier work, *The Theory of Moral Sentiments*. But that is another story.

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<sup>38</sup> "(W)hat are the advantages which we propose by the great purpose of human life which we call bettering our condition? To be observed, to be attended to, to be taken notice of with sympathy, complacency, and approbation, are all the advantages which we can propose to derive from it. It is the vanity, not the ease or the pleasure, which interests us. But vanity is always founded upon the belief of our being the object of attention and approbation. The rich man glories in his riches, because he feels that they naturally draw upon him the attention of the world, and that mankind are disposed to go along with him in all those agreeable emotions with which the advantages of his situation so readily inspire him. At the thought of this, his heart seems to swell and dilate itself within him, and he is fonder of his wealth upon this account, than for all the other advantages it procures him" (Smith 1880, p. 48). Smith makes this point almost aphoristically in the *Wealth of Nations* when he asserts that "with the greater part of rich people, the chief enjoyment of riches consists in the parade of riches" (1937, p. 172); see also Rosenberg (1968, pp. 364–67).