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The Condensed Wealth of Nations

AND THE INCREDIBLY CONDENSED THEORY OF MORAL SENTIMENTS

EAMONN BUTLER

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1 Introduction

Adam Smith's pioneering book on economics, *The Wealth of Nations* (1776), is around 950 pages long. Modern readers find it almost impenetrable: its language is flowery, its terminology is outmoded, it wanders into digressions, including one seventy pages in length, and its numerous eighteenth-century examples often puzzle rather than enlighten us today.

And yet, *The Wealth of Nations* is one of the world's most important books. It did for economics what Newton did for physics and Darwin did for biology. It took the outdated, received wisdom about trade, commerce, and public policy, and re-stated them according to completely new principles that we still use fruitfully today. Smith outlined the concept of gross domestic product as the measurement of national wealth; he identified the huge productivity gains made possible by specialisation; he recognised that both sides benefited from trade, not just the seller; he realised that the market was an automatic mechanism that allocated resources with great efficiency; he understood the wide and fertile collaboration between different producers that this mechanism made possible. All these ideas remain part of the basic fabric of economic science, over two centuries later.

So *The Wealth of Nations* is worth reading, but nearly impossible to read. What we need today is a much shorter version: one that presents Smith's ideas, not filtered through some modern commentator, but in modern language. This book aims to do precisely that, updating the language and the technical terms, with just enough of Smith's examples and quotations to provide a sense of colour, and with marginal notes to explain how today's economic concepts have developed from Smith's early ideas.

The same treatment is given to *The Theory of Moral Sentiments* (1759) – Smith's other great book, and the one that made him famous. A product of the philosophy course that Smith taught at Glasgow University, it explained morality in terms of our nature as social creatures. It so impressed the young Duke of Buccleuch's stepfather that he promptly hired Smith (on a handsome lifetime salary) to tutor the boy, and escort him on an educational journey through Europe.

With time on his hands, and new insights gleaned on these travels, Smith began sketching out the book that would become *The Wealth of Nations*. He spent another decade writing and polishing the text at his home in Scotland, and debating his ideas with the leading intellectuals of the age in London. The finished book was another huge commercial success, rapidly going into several editions and translations.

It was revolutionary stuff. It hit squarely at the prevailing idea that nations had to protect their trade from other countries. It showed that free trade between nations, and between individuals at home too, left both sides better off. It argued that when governments interfered with that freedom with controls, tariffs or taxes, they made their people poorer rather than richer.

Smith's ideas influenced the politicians and changed events. They led to trade treaties, tax reform, and an unwinding of tariffs and subsidies that in turn unleashed the great nineteenth-century era of free trade and growing world prosperity.

How this book is laid out

In what follows, the material in normal text is the author's condensation of Adam Smith's arguments. The indented paragraphs are Smith's own words. The material in *italics* is the author's own explanation of what Smith is saying and why it is important.

2 The Condensed Wealth of Nations

A nation's wealth is its per capita national product – the amount that the average person actually produces. For any given mix of natural resources that a country might possess, the size of this per capita product will depend on the proportion of the population who are in productive work. But it also depends, much more importantly, on the skill and efficiency with which this productive labour is employed.

At the time, this idea was a huge innovation. The prevailing wisdom was that wealth consisted in money – in precious metals like gold and silver. Smith insists that real wealth is in fact what money buys – namely, the 'annual produce of the land and labour of the society'. It is what we know today as gross national product or GNP, and is used as the measure of different countries' prosperity.

Book I[1] examines the mechanism by which this productive efficiency comes to be improved. Productive employment depends (it will be shown) on how and how much capital2 is in use, and

1 The *Wealth of Nations* is divided into five 'books' which are in turn divided into chapters.

2 Where Smith writes 'stock' we would normally use 'capital' today.

Book II explores this. National product is also greatly influenced by public policy, which Book III considers. Book IV appraises different theories of economics in the light of all these considerations. Book V then identifies the proper role of government, the principles of taxation, and the impact of government on the economy.

Book I: Economic efficiency and the factors of production

Specialisation and productivity

The key to economic efficiency is specialisation – the division of labour. Take even the trifling manufacture of pin making, for example. Most of us would be hard pressed to make even one pin in a day, even if the metal were already mined and smelted for us. We could certainly not make twenty. And yet ten people in a pin factory can make 48,000 pins a day. That is because they each specialise in different parts of the operation. One draws out the wire, another straightens it, a third cuts it, a fourth points it, a fifth grinds the top to receive the head. Making and applying the head require further specialist operations; whitening the pins and packaging them still more. Specialisation has made the process thousands of times more productive.

This enormous gain in productivity has led to specialisation being introduced, not just within trades, but between them. Farming, for instance, becomes much more efficient if farmers can spend all their time tending their land, their crops and their livestock, rather than pausing to tool up and make their own household items too. Likewise, ironmongers and furniture-makers can produce far more of these household goods if they do not have to dissipate their effort on growing their own food too. Even whole countries specialise, exporting the goods they make best and importing the other commodities that they need.

> The greatest improvement in the productive power of labour, and the greater part of the skill, dexterity, and judgment with which it is anywhere directed, or applied, seems to have been the effects of the division of labour.[3]

3 *The Wealth of Nations*, Book I, Chapter I, p. 13, para. 1.

Three factors explain the enormous rise in efficiency which specialisation makes possible.

- First is the increased skill which people gain when they do the same task over and over again. The rapidity with which skilled workers can do a task is sometimes amazing.
- Second, less time is wasted in moving from one task to the next. A weaver who cultivates a smallholding has to break off weaving, fetch the farming tools, and walk out to the field. It takes time for people to get in the right frame of mind when they turn from one task to another, and back again. The importance of such disruptions should not be underestimated.
- Third, specialisation allows the use of dedicated machinery, which dramatically cuts the time and effort needed in manufactures. Often, workers themselves have invented labour-saving devices, while other improvements have come from the machine-makers, who are now a specialist set of trades themselves.

The division of labour clearly requires an advanced degree of cooperation between all those who are involved in the manufactures concerned. Indeed, the production of even the simplest object harnesses the cooperation of many thousands of people. A woollen coat, for example, requires the work of shepherds, sorters, carders, dyers, spinners, weavers, and many more. Even the shears needed to cut the wool will have required the work of miners and ironworkers. And the transportation of the wool will have required sailors, shipwrights, and sail-makers. The list is endless.

> The woollen coat, for example, which covers the day-labourer, as coarse and rough as it may appear, is the produce of the joint

> labour of a great multitude of workmen. The shepherd, the sorter of the wool, the wool-comber or carder, the dyer, the scribbler, the spinner, the weaver, the fuller, the dresser, with many others, must all join their different arts in order to complete even this homely production.[4]

This collaboration of thousands of highly efficient specialists is a very advanced economic system: and it is, in fact, the source of the developed countries' great wealth. It means that things are produced far more efficiently, making them cheaper. Even the poorest members of society thereby gain access to a wide variety of products and services that would be completely unaffordable in the absence of specialisation.[5]

The mutual gains from exchange

Specialisation developed out of the natural human tendency to barter and exchange. When we see people who have things that we want, we know that they are unlikely to give them to us out of the goodness of their hearts. But then we might have something which they want, and which we would be prepared to give them in return.

> It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.[6]

By 'self-love' or 'self-interest', Smith does not imply 'greed' or 'selfishness'. He has in mind a concern for our own welfare that is entirely natural and

4 *The Wealth of Nations*, Book I, Chapter I, p. 22, para. 11.

5 *The Wealth of Nations*, Book I, Chapter I, p. 22, para. 10.

6 *The Wealth of Nations*, Book I, Chapter II, pp. 26–7, para. 12.

proper indeed, in The Theory of Moral Sentiments *he calls it 'prudence'.*[7] *And he stresses that 'justice' – not harming others – is fundamental to a healthy human society.*

And this in fact is how we acquire most of the things we need – through exchange, rather than trying to make everything ourselves. And the trade has made both of us better off. We have each sacrificed something we value less for something we value more.

This is another crucial insight. In Smith's world, like ours, most goods were exchanged for money rather than bartered for other goods. Since money was regarded as wealth, it seemed that only the seller could benefit from the process. It is a notion that led to the creation of a vast web of restrictions on trade, in the attempt to prevent money leaking out of a country, a town, or even a profession. But Smith shows that the benefit of exchange is mutual, so no such restrictions are needed.

These gains from exchange, and our natural willingness to do it, stimulate the division of labour. It is worth us building up a surplus of what we personally make well in order to have something to trade with other people. To take it at its simplest, imagine a primitive society where, through some particular mental or physical talents, one person is better than others at making arrows, or building houses, or dressing skins, or working metal. If, through that specialist skill, they make more of these things than they have personal need for, it gives them something they can exchange with others. So each can then focus on their efficient specialist production, and get the other things they need from exchange with other efficient producers. The smith trades surplus knives for the fletcher's surplus arrows, the tanner trades clothing for the builder's shelter. Each ends up with the mix of things they want, all of them expertly and efficiently produced.

7 *The Theory of Moral Sentiments*, Part VI, Section I.

Even the most dissimilar people can thus cooperate – though they do not do so from any great feelings of benevolence, but because both sides see a personal benefit from the exchanges that they make.

Wider markets bring bigger gains

The benefit that we get from exchange is what drives us to specialise, and so increase the surplus that we maintain to exchange with others. Just how far that specialisation can go depends on the extent to which exchange is possible – that is, on the extent of the *market*.[8]

Some trades – the profession of a porter, for example – are possible only in large towns, where there are enough customers to provide constant work. At the other end of the scale, though, each family in the remote Highlands of Scotland must be its own farmer, butcher, baker, brewer and carpenter. In between, a country smith must deal in every sort of ironwork, and a country carpenter must be a joiner, a cabinetmaker, carver, wheelwright and wagon-maker all at once.

Money and value

One thing that definitely does extend the market is *money.*[9] In a commercial society, where specialisation is strong, we make few of our own needs, and rely on our exchanges with others to supply our wants. But exchange would be difficult if, for example, hungry brewers always had to search out thirsty bakers. Rather than everyone having to rely on finding some person with exactly the inverse of their own needs, ancient human societies therefore strove to find some medium of exchange – some third commodity

8 *The Wealth of Nations*, Book I, Chapter III.

9 *The Wealth of Nations,* Book I, Chapter IV.

that most people would be happy to trade for their own product, and could then trade with others.

In Homer's time it was cattle; in Abyssinia it is salt; shells serve the purpose in India, dried cod in Newfoundland, tobacco in Virginia, and sugar in the West Indies. But over time, metal became the standard currency. It is durable, and (unlike cattle) can be divided without loss into small amounts, then reassembled into larger amounts again, according to the need. Originally, simple bars of copper served as money in ancient Rome; but these were variable, and the quantity had to be weighed each time they were used. So eventually, stamps were devised, showing the standard of weight and fineness of the metal – the first coins.

But, whether exchange is mediated through money or not, what is it that determines the rate at which different products are exchanged? The word *value* has two meanings – one is value in use, the other is *value in exchange*. Water is extremely useful, but has almost no exchange value, while a diamond is largely useless but has enormous exchange value.

Explaining the principles that determine exchange value, the components of this price, and the factors that cause it to fluctuate, is no easy matter.

Indeed it is not. It takes Smith several chapters of The Wealth of Nations *to do it, specifically Book I, Chapters V–XI. Today we might solve the diamonds and water problem with marginal utility theory: since diamonds are so rare, an additional one is a great prize, but since water is so plentiful, an extra cupful is actually of little use to us. Or we might use demand analysis. But such tools did not exist in Smith's time.*

The real measure of the exchangeable value of all commodities is the labour put into their production.[10] The reason why we put effort into creating the product we sell is precisely to spare ourselves the effort of creating the things we buy. When we trade, what we are buying is the labour of others. Ultimately, wealth is not money – it is the amount of other people's labour that we can command, or purchase. (Of course, some sorts of labour might be more difficult, or require more ingenuity than others. But these things will be adjusted by the bargaining in the marketplace.)

For many commentators, this looks uncomfortably like a crude labour theory of value, which focuses on production costs and overlooks demand. Some argue that it led Karl Marx into his appalling errors about labour. One could defend Smith as just trying to simplify things by talking about an age before land or capital ownership, where labour was the sole production cost, and temporarily ignoring other factors such as land and capital, and also ignoring demand, all of which he goes into later. At best his words are misleading, at worst they are mistaken: but then he was breaking new ground.

Usually, of course, we estimate exchange value in terms of money, because money is far more tangible and easy to measure than labour. But it is not a perfect measure. The metals we use for coinage, such as gold and silver, fluctuate in value over the long term, depending, say, on the productivity of the mines and the cost of transportation. Labour remains the real price: money prices are just nominal prices. We buy in from others things that it would cost us more toil and trouble to do for ourselves. The real wealth that we obtain from exchanging with others is their labour, not their money.

10 *The Wealth of Nations*, Book I, Chapter V.

Labour, capital, and land

In a primitive, hunting society where there is no stock and land is free, labour is the only factor of production. Since there is no point in anyone buying something they could make with less effort themselves, prices should always reflect the labour involved. If it costs twice the labour to kill a beaver than it does to kill a deer, one beaver should exchange for two deer[11] (though the difficulty or dexterity of the required labour will be reflected in market prices).[12]

In the hunting society, the whole product of labour belongs to the labourer. It is different, though, when people acquire capital and employ others to work with it. Then, the product must be shared between them – in the wages of the labourer and the profit of the employer. Profits, though, are different from wages: they reflect not the work of the employer, but the value of the capital that is employed in the production.

In the earlier chapters of The Wealth of Nations*, Smith uses the word 'stock' rather than 'capital'. He later explains that 'stock' includes fixed and circulating capital, as well as materials being used in the process of manufacture, finished goods that are still unsold, and goods being held for later consumption. And then he starts talking more about 'capital'. Normally today we would call all these things 'capital', including any 'stock' of semi-finished, unsold or unconsumed goods; it seems easier to use this term.*

When land is taken into private ownership, a third group shares in the national product, namely the landlords. Food, fuel, and minerals are now no longer available merely for the labour of collecting them. The landlords demand that part of the product must now be remitted to them as rent.

11 *The Wealth of Nations*, Book I, Chapter VI, p. 65, para. 1.

12 *The Wealth of Nations*, Book I, Chapter V, p. 49, para. 4.

Thus there are three factors of production, remunerated by different principles. The price of wheat comprises partly the rent of the landlord, partly the wages of the labourers, and partly the profit of the farmer who provides the money and the equipment to run the business. In the price of flour, the profits of the miller and the wages of the miller's workers must be added; and in the price of bread, similarly, the profits of the baker and the wages of the baker's staff. However many people are involved in a productive process, the costs always resolve themselves into some or other of these three elements.[13]

Of course, it is possible for two or more of these revenue streams to belong to the same person. A planter may combine the roles of landlord and farmer, and a farmer may combine the roles of farmer and labourer: so some mixture of rent, profit and wages then comes to the same person.

Production costs and market prices

The wages and profits in any production process tend to an average rate that depends on the market. When the price of a commodity exactly matches the cost (rent, profit, wages) of producing it and bringing it to market, we might call it the natural price.[14] If it sells at more than that, the seller makes a profit. If it sells at less, the seller makes a loss.

The language is antiquated, but by 'natural price' Smith means no more than the cost of production, including a 'normal' rate of profit under competition. This is in line with his view that value has more to do with what goes into a product, whereas today we would talk about supply and demand. This makes the term 'natural price' difficult to render in modern language, but it seems sensible to use simply 'cost of production'.

13 *The Wealth of Nations*, Book I, Chapter VI.

14 *The Wealth of Nations*, Book I, Chapter VII.

The price at which products are actually sold is called the *market price*. This depends on supply and demand – the quantity of the product that sellers bring to market, and the size of the demand from potential buyers.[15] When supply falls short of demand, there is competition between buyers, and the price is bid up. If a town is blockaded, for example, the prices of essential goods rise enormously. By contrast, when there is a glut and supply exceeds demand, sellers have to drop their price – particularly if the product is perishable, like fruit, and cannot be brought back to market later. When supply and demand match exactly, however, the natural and market price are equal, and the market exactly clears.

If a market is overstocked and prices are below the cost of production, landlords will withdraw their land, employers their stock, and workers their labour, rather than suffer continued losses in this line of production. So the quantity supplied will fall, and market prices will be bid up again to the natural price, at which the market is cleared. If, by contrast, a market is understocked and prices are high, producers will commit more resources to this profitable line of production. So the quantity supplied will rise, and market prices will be bid down again to the natural, market-clearing price.

The market is therefore self-regulating. Prices are always gravitating towards the cost of production under competition, and producers are always aiming to supply the amount of their product that exactly matches customers' demand.

Here is yet another hugely important insight from Smith. The market is a completely inevitable system. In their natural pursuit of profit, sellers steer their resources to where the demand, and therefore price, is highest, thereby

15 Smith calls this *effectual demand*, pointing out that some people who would like a product cannot actually afford it. Today this is understood, and we would say simply *demand*.

helping to satisfy that demand. Resources are drawn to their most valued application, without the need for any central direction.

Specific price factors

Of course, market prices still fluctuate above or below the cost of production. Because harvests are variable, for example, the same labour may produce more wheat, wine, oil or hops in one year than in another, and the market price will fall or rise accordingly. The production of other goods, such as linen and woollen cloth, suffers less variation of this sort, and prices are more stable. But a public mourning will raise the price of black cloth, for example, along with the wages of journeymen tailors.

When demand increases and the market price of a commodity rises above its cost of production, suppliers naturally try to conceal the fact that they are making extraordinary profits. They do not want to alert their competitors. So prices may remain high for a while. But such secrets cannot be kept for long.

Manufacturing secrets may last longer. A dyer, for example, who finds a way of producing a particular colour at half the usual cost, might enjoy extraordinary profits for many years before competitors also discover it. So here the market price may diverge from the natural price for a long time.

Other special circumstances can have the same effect. The favourable soil and situation of particular French vineyards, for example, may raise their rent well above others in the same neighbourhood. Or again, a supplier who is granted a monopoly can keep prices up, simply by restricting supply. Likewise, laws that limit apprenticeships, or restrict the number of people who can enter a trade, enable particular professions to keep their prices high.

As a result of such accidents, natural causes, and regulations, the market price of a product may remain above the production cost for some time. But it cannot long remain below it. In that case, suppliers would simply withdraw, rather than face continued losses (assuming they are free to do so – unlike ancient Egypt, for example, where boys were forced to follow their father's trade).

Wages depend on economic growth

As we have seen, in an age before land is appropriated by owners, and capital is accumulated by employers, the whole produce of labour belongs to the labourer. But as soon as land is appropriated, landlords demand a share of any production that uses their land, and as soon as capital is accumulated, employers demand the same.

There are a few workers who own all the stock needed for their own production activities, but this is uncommon. Usually, workers are employees of other people, who own productive assets. How the product is shared, then, is a matter of contract between workers and employers: but the employers usually have the upper hand. Since there are fewer of them, they can combine more easily to rig the labour market and keep down wages. They have greater resources with which to sit out a trade dispute. And while the law forbids combinations of workers, the collusion of employers is everywhere.[16]

Throughout his writings, Smith shows great sympathy for the ordinary working people of the time, and little for the merchants and employers, whom he sees as trying to rig markets in their own favour. This often comes as a shock to people who assume that Smith, as a believer in markets and free trade, must be on the side of the bosses. Smith believes that free and

16 *The Wealth of Nations*, Book I, Chapter VIII, p. 84, para. 13.

competitive markets are the best way to spread wealth, and in particular, to spread it to the poor – and that the efforts of politicians and businesspeople to diminish competition and freedom should therefore be resisted.

When the demand for labour is rising, however, the workers have the advantage, and competition between employers bids up wages. But the demand for labour can rise only when gross national product rises, since wages can only be paid out of income or capital. When wealthy landlords have spare revenue, for example, they hire more servants; when weavers or shoemakers have surplus stock, they hire more journeymen. Wages cannot rise if the national product is static or falling.

China has long been a rich, fertile, industrious and populous country; but there seems to have been little or no development there since Marco Polo visited it five hundred years ago. The land is still cultivated and not neglected, but China's economy is not growing. That is why the poverty of the poorest labourers in China is greater than in even the poorest nations of Europe.

Bengal is also a fertile country, but poverty is so rife that hundreds of thousands of people die of hunger each year. Clearly, the national product that is needed to maintain the labouring poor is in fact shrinking (for which we can blame the oppression of the East India Company).

Factors affecting wage rates

In growing economies such as that of Great Britain, however, wages are above subsistence, though they do vary. Summer wages, for example, are higher, because workers need to save for the winter, when wages are lower but costs are higher. Wages also vary from place to place. The usual price of labour in London is about eighteen pence a day; in Edinburgh it is ten pence; in rural Scotland it is eight pence. And yet, grain – the food of the common people – is dearer in Scotland than in England, where it grows better. If working people in Scotland can sustain themselves on these low wages and with high grain prices, it suggests that the working people in England must be living in some affluence.

Though wages are rising in Great Britain, prices are generally falling as a result of the rising productivity brought on by specialisation. Potatoes, turnips, carrots and cabbages, for example, cost half of what they did forty years ago. Linen and woollen cloth is cheaper, as is ironmongery and furniture. We should welcome the fact that the working poor are becoming better off: a country where most people live in poverty can hardly be called rich and happy. (It is true that soap, salt, candles, leather and alcohol have become more expensive – though mainly because of the taxes on them. But these are luxuries which do not feature in the budgets of most working people.)

> No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable.[17]

Decent wages are essential for the well-being of labourers and their families. But to pay decent wages is in the interests of employers, too. When wages are high, workers are better fed and stronger. They also have the prospect of saving and improving their condition, which makes them more inclined to work diligently. And when workers are given sufficient rest, they are likely to be healthier and more productive.

17 *The Wealth of Nations*, Book I, Chapter VIII, p. 96, para. 36.

Capital and profits

The profit which employers derive from capital is even more variable and hard to measure than the wages of labour. It depends on market prices, on how competitors are faring, and on the many problems that can occur in the production, transportation and storage of goods.[18] Interest rates, however, provide a rough index of profitability: if people can make a good profit from the use of money, they will be prepared to pay well to borrow it.

As we have seen, an increase in capital allows more business to take place, and so tends to raise wages. But it also tends to reduce profits. The greater supply of capital increases the competition between its owners, and bids down the rate of return that it can generate, and the interest rates that borrowers will be prepared to pay for its use.

However, there are exceptions in particular circumstances. In the North American and West Indian colonies, for example, wages are high, and so are interest rates. So those are indicators that profits are high too. The reason is that there is plenty of fertile land in these territories, but as yet there aren't enough people or capital to cultivate it. Workers and equipment are in great demand, and therefore they command high prices. This, of course, does not last forever: as new colonies grow, they have to bring more marginal land into production, and profits gradually fall.

Another special case might be where a country has become as rich as its soil and situation can sustain, and could grow no further. Being fully populated, there would be great competition and wages would be low; and being fully capitalised, the competition between employers would be great, and profits would be low as well. But no country has yet reached this degree of wealth.

18 *The Wealth of Nations*, Book I, Chapter IX, p. 105, para. 3.

Today we see no limit to economic growth. Our capital and technology give rise to all kinds of new business sectors and opportunities for employment. In Smith's time, however, the economy was dominated by agriculture, and he mistakenly sees the impossibility of developing land beyond its fertility as a limit to economic growth.

Market wage rates

In any locality, the net benefits of employing labour or capital should tend to equalise across all uses. If they did not, and there were higher wages or profits to be made in some particular industry, workers or employers would flood into that employment – whereupon wages or profits would be bid back down towards the norm. In reality, however, it is obvious that the financial rewards that are actually achieved in different lines of work and industry vary widely. But in saying that the rewards of employment tend to equality, the non-pecuniary costs and benefits of different industries must be considered too, along with the purely financial returns. There are several such factors:

- First, some professions may be easier, cleaner, or more respectable than others. A weaver earns more than a tailor because the work is harder, a smith more than a weaver because the work is dirtier. A collier earns still more because that work is dark, dirty and dangerous. Butchers are well paid because the work is brutal and odious; and in the case of public executioners, even more so.
- Second, some professions are difficult or expensive to learn. The time and effort spent in learning them has to be recovered through the price of the work done. Hence a skilled labourer is better paid than an unskilled one.
- Third, some trades are seasonal. A builder cannot work in frost or hard weather, and has to earn enough in good seasons to

provide for the dearth of work in the bad. Common labourers earn four or five shillings a week, but, for this reason, builders earn seven or eight shillings a week during the seasons when they can work.

- Fourth, earnings are higher in trades that require a large degree of trust, such as goldsmiths, lawyers or doctors. Their honesty and competence commands a premium from their customers.
- Fifth, earnings reflect the probability of success in any profession. Lawyers are well paid because very few of those who go into the law actually succeed in it. Their customers are paying the costs of those who fail, along with those who succeed. The exorbitant rewards of actors, singers, dancers and so on reflect not only this, but the rarity and beauty of their talents – and the discredit of employing them in such professions.

Other special circumstances can also make a difference to wage and profit rates. For example:

- First, it depends on how established the trade is. Entrepreneurs will have to pay more to attract workers from established trades into new ones. Employment in the new trade may be seen as less secure, or more dependent on the fickleness of fashion.
- Second, there might be a particular shift in supply or demand. In time of war, for example, merchant sailors' wages rise from twenty-one or twenty-seven shillings a month to more like forty or sixty shillings. And in different years, harvests of wheat, wine, hops, sugar, tobacco and other crops can vary greatly, and the profits made by the dealers will necessarily vary too.
- Third, pay can vary when people have more than one job: cottagers in Scotland commonly receive an acre or two of land,

> and two pecks of oatmeal a week in return for their occasional labour to the farmer. This they consider as their salary: and they are willing to work for others in their spare time for very little.

Wages and politics

It is not just the economic character of different employments that can lead to discrepancies in wages and profits. Political factors can be critical too.

First, there are regulations that restrict entry into certain professions. The fewer people who are allowed to practise in a particular trade, the more they can charge for their services. And the professions have exploited this by promoting various rules governing apprenticeships. Bye-laws forbid master cutlers in Sheffield, for example, from having more than one apprentice at a time, while Norfolk weavers, English hatters and London silk weavers are not allowed more than two. Apprenticeships are also very long, usually seven years. This is supposed to protect the public from shoddy work. In fact it does no such thing, but like the limit on apprentice numbers, it again serves to keep up the wages of the relevant professions. Unfortunately, this gain for the producers is achieved only by forcing the public to pay more, and by denying others the right to use the sacred property of their own labour as they choose.

It is perfectly natural that the professional guilds should try to expand their markets and limit the competition – and thereby promote their own interest against that of the general public. Unfortunately, they have been aided in this by the law, which grants them special privileges. The establishment of a public register of a profession's members, for example, makes it easier for them to come together (and, of course, talk about how to raise their prices or restrict the market still further). Laws that allow professions to levy compulsory welfare funds for the benefit of their own members make it inevitable that they have to come together. And allowing trades to decide policy by a majority vote will limit competition more effectively and durably than any voluntary collusion whatever.[19]

> People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.[20]

The only truly effective discipline over businesses is their fear of losing customers.[21] A competitive market in which customers are sovereign is a surer way to regulate their behaviour than any number of official rules – which so often produce the opposite of their avowed intention.

Secondly, public policy can sometimes depress the earnings of a trade by over-encouraging entry into them. Public pensions, scholarships, bursaries and so on may have this effect.

Third, the law obstructs the circulation of labour and capital from trade to trade and from place to place. For example, the arts of weaving linen, silk and wool are not very different. If one of these industries faced hard times, its members could quickly re-train and move into another. But the other trades have secured legal powers, such as rules on apprenticeships, that enable them to exclude these workers. Similarly, the poor laws, which made each parish responsible for the support its own poor, made parishes unwilling to allow poor people to move in from other areas, even if they were willing to look for new work.

19 *The Wealth of Nations*, Book I, Chapter X, Part II, p. 145, para. 30.

20 *The Wealth of Nations*, Book I, Chapter X, Part II, p. 145, para. 27.

21 *The Wealth of Nations*, Book I, Chapter X, Part II, p. 146, para. 31.

Land and rents

The third factor of production is land, and rent is what is paid for its contribution to the national product.[22] Rent is different from wages, which must be laboured for, or the profits of capital, which must be carefully accumulated and managed. It is derived merely on account of ownership, rather than any care and effort of the landlord. Indeed, rent is charged even on unimproved land. Scottish landlords whose estates are bounded by kelp shores charge a rent to those who harvest this useful seaweed that washes up naturally – just as surely as they charge a rent for their wheat fields.

In his discussions of landlords, Smith has principally in mind the Scottish chiefs and nobles who dominated huge tracts of land there. Much of it was being enclosed; and forfeited Jacobite estates were being handed over to new owners. Hence, perhaps, Smith's scornful view of landlords as an avaricious class who 'love to reap where they never sowed'.

Landlords take as much rent as they can get; when wages or profits are high, rents naturally follow. Fortunately for them, almost any land can produce more food than is required for the subsistence of those who work it. Even the deserted moors of Norway and Scotland produce pasture for cattle, which provide more than ample milk and meat for the few people who are needed to tend them. In other words, land always produces some surplus that can provide a rent to the landlord. Land that is very fertile, or well situated (close to a town and its markets, for example) will produce an even higher rent.

As well as food, of course, land provides clothing and living space. Once again, land can always provide a surplus of clothing, from

22 *The Wealth of Nations*, Chapter XI.

the skins of animals, for example. The natives of North America probably had so many pelts that they would be thrown away as being of no value – until the Europeans arrived, eager to trade these things for blankets, guns and brandy.

A rich family consumes no more food than a poor one – though it may be of better quality. But the landowners who have command of more food than they can eat – either through growing it themselves or in the form of rent from tenants – nevertheless seem to have a boundless appetite for clothing, housing and showy equipage. Compare the spacious palaces and great wardrobes of the rich with the hovels and the few rags of the poor.

The rich are always willing to exchange their surplus for luxuries of this kind, and the poor are equally willing to supply this demand in order to get the basics that they need by way of exchange. The poor compete and specialise to supply the rich, which boosts the efficiency of production, raises incomes, and creates a growing demand for buildings, dress, furniture, fuel, minerals, precious stones – every convenience that the land can produce. But still the landlords take their share, of course, because all those farms, forests and mines produce a rent for them.

On the basis of his principle that every part of a nation's production reflects rent, wages and profits, Smith has shown that all the various actors in an economy – landowners, workers and employers – are in fact interdependent. Indeed, their interdependence goes beyond production: since goods are produced to be exchanged, they are all crucially involved in the valuation and distribution of that product too. In other words, they are parts of a seamless system of flows in which goods are created, valued, exchanged, used and replaced – and resources are pulled to their best use – all quite automatically, within a functioning economic system. *This is, essentially, the* *modern understanding that we call the market economy. It was a huge theoretical innovation.*

Nevertheless, this interdependence does not prevent some economic agents from trying to take advantage of others, as Smith now goes on to explain.

Self-interest of the different factors

Laws and regulations, as we have seen, can promote or damage the interests of particular groups, and indeed, of the public. But it is the employers of capital who do best out of this. Landlords are unlikely to understand the consequences of such measures: the fact that income derives from mere ownership, rather than the application of physical or mental effort, leaves them too idle and ignorant to think about such things.

As far as those who live by wages are concerned, the general interest of society is crucial. Labourers suffer most cruelly when business is in decline. They benefit when society prospers. But as a result of poor education and their lack of access to information, they are incapable of understanding how society's interests affect their own. Struggling merely to survive, they have no time or energy to spend thinking about public policy. And the voice of the common people does not carry far in the public debate.

Those whose income derives from capital, however, are quite different. Their interests do not coincide with those of other people, because their profits are squeezed when the economy flourishes. Their interest lies in widening the market and narrowing the competition, and they are skilled at achieving this end. Since planning and management is fundamental to their business, they have the knowledge, contacts and mental acuity to promote measures that they know will benefit them.

But this private benefit comes at the expense of the public, who suffer when markets are distorted and competition is reduced. When the owners of capital propose a new regulation, therefore, it should be given the utmost scrutiny. It comes from a group whose interest does not coincide with that of the public, and who can and do gain by deceiving them.

> 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 oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it.[23]

23 *The Wealth of Nations*, Book I, Chapter XI, Conclusion of the Chapter, p. 267, para. 10.

Book II: The accumulation of capital

In an advanced economy, most of our needs are supplied not through what we make ourselves, but through our voluntary exchange with others. But this means that we have to produce, and sell, our own surplus before we can acquire the products we need in return. Weavers, for example, need sufficient capital to buy or rent their weaving frame, for tools and materials, and to have enough to live on until their cloth is finished, transported to market and sold.

Capital has to be accumulated, in other words, before people can embark on specialist trades – and capture the large gains in productivity that result from it. And the greater the specialisation in the economy, the more capital is required to maintain it. The accumulation of capital thus feeds economic growth. It is a virtuous circle: the growth of capital promotes specialisation, which creates even larger surpluses, and these in turn can be reinvested into new equipment that makes yet further specialisation and growth possible.[24]

Division of capital

Capital has two parts to it. One is that part which is expected to produce future income. This can be fixed capital, which stays with the owner, or circulating capital, which does not. The other part is that which supplies immediate consumption: this includes stocks of goods that are intended for consumption, income from whatever source, and stocks of goods such as clothes or furniture, which are not yet completely consumed.

24 *The Wealth of Nations*, Book II, Introduction, pp. 276–7, paras 2–4.

Smith in fact says 'stock' is divided into 'capital' and the other 'stocks'. It is not easy to render this in modern terminology; 'capital' seems the best general term. Also, Smith's definition includes revenue, which modern economists would not, though cash in hand, work in progress and fixed and moveable assets are regarded as capital items today.

Money

Though we commonly express a person's income in money terms, as a particular quantity of gold or silver pieces, money itself has no intrinsic value.[25] Money is only a tool of exchange, a highway that helps get the nation's product to market, but produces none itself. Real wealth resides in what that money can buy, not in the coins themselves.

The fact that wealth and money are separate things can be shown quite easily. After all, a person who receives a guinea of income today may spend that same guinea tomorrow, thus providing the income of a second; and that person may spend the same guinea on the next day, providing the income of a third. So the amount of money in circulation is clearly much less than the total income of the nation. National income is the quantity of goods bought and sold, not the metal pieces that happen to be used to facilitate the exchange of that product.

Smith is again taking on the mercantilists here, and trying to dispel the myth that money is wealth. This, he believes, causes many policy errors as nations try to limit the outflow of money by restricting trade, while in fact wealth is increased when trade is vibrant and free.

Yet money does have some important effects. It renders capital active and productive. The cash which dealers are obliged to

25 *The Wealth of Nations*, Book II, Chapter II.

keep aside for occasional needs is dead capital, which produces nothing. But efficient banking can make it move faster and work harder. Where banks substitute paper banknotes for gold and silver, it allows this dead capital to be brought back to life and into use more easily than before – speeding up the commercial highway and increasing the productivity of the country's industry.

There may be a temptation among banks to over-issue their notes beyond what their stocks of gold and silver will bear. This risk can be reduced if banks are not allowed to issue small notes. Otherwise, competition between banks safeguards the public, forcing banks to be careful about the scale of their note issue, limiting the possibility of a run on any one bank doing widespread damage, and focusing them on the needs of their customers to avoid them defecting to others.

Smith was writing in an age before fiat currency – notes and coin that governments simply declare to be legal tender and (somehow) get the public to accept as such. In his day, banks could issue notes as receipts for customers' gold, and using those in transactions was far more efficient than having to move around the real metals. The banks could even issue more notes than they had gold in their vaults, relying on the probability that not all the note holders would demand their bit of gold all at once. If a bank over-issued notes beyond this comfortable level, however, it could lead to a run on the bank as note holders rushed to cash in their notes before the bank's reserves ran out. There was a major Scottish banking crisis of this sort shortly before Smith wrote: hence his sensitivities on the matter. He believes that competition will generally keep banks prudent, but that there still needs to be regulation to protect the public. He has no problem with a general regulation in the public interest: it is just regulations that favour special interest that he objects to.

Productive and unproductive labour

Some labour adds to the value of what is worked on – the labour of a manufacturer, for example, works to add value to an item which can then be sold at a profit. This we can call productive labour. It produces something marketable that lasts for some time afterwards. Other labour – such as the labour of a menial servant – does not add value to anything. It is consumed immediately, and leaves nothing vendible behind. This we can call unproductive labour.

> A man grows rich by employing a multitude of manufacturers: he grows poor by maintaining a multitude of menial servants.[26]

This kind of labour still has value, which is rewarded accordingly. The army and judiciary, for example, serve the public, and their professions are honourable, but their labour of today purchases nothing tomorrow. This year, the army may maintain security in some hostile region; but next year they still have to be there to continue the same task. In the same category of unproductive workers are churchmen, lawyers, physicians, actors, buffoons, musicians and dancers. What they do expires as soon as they do it, leaving nothing saleable behind. Unproductive labour is supported mostly from the rent of land and the profits of stock. Common workmen have scant wage, and little time to spend on them.

The realisation that services have value, as well as manufactures or agricultural products, is another Smith innovation, and one we recognise today, when service industries have grown enormously important. But the fact that they add value makes it rather misleading to call them 'unproductive'. It might be that the menial servants of the rich landowner are a pure consumption. But the services of teachers, writers, composers,

26 *The Wealth of Nations*, Book II, Chapter III, p. 330, para. 1.

doctors, and even lawyers can last and be enjoyed for some time after the service is performed. It may be that the knowledge, ideas, music, health and laws they produce are intangible and cannot be sold, but today we would hardly call that 'unproductive'. Once again, Smith is breaking new ground, so the fact that he struggles to pin down these concepts is understandable.

The more such services are consumed, the less income and capital are we left with for future investment. And therefore, the lower will be the next year's national product. Future income depends on the extent of our capital, and the only way to accumulate capital is by saving. Indeed, just to maintain capital we need to save, because materials and equipment must be repaired and replaced all the time. If instead of saving, we consume our current revenues on unproductive hands, then we are eating into our capital for the purpose of current consumption. This is prodigality, and if it persists, must lead to ruin.

The mercantilist view is that such dis-saving does not matter provided all the spending is done at home in the domestic economy, and that no gold or silver is therefore sent abroad. If the quantity of money in the country has not fallen, they say, then no wealth has been lost. But in fact, even though the quantity of money in the country does not change, real damage is being done. Capital is being consumed instead of maintained. Since future income growth depends on the accumulation of capital, future income will necessarily be lower.

Capital can also be wasted through bad investment decisions. Again, this does not affect the nation's gold and silver deposits, but it certainly reduces its future productive capacity. Every failed project in agriculture, mining, fisheries, trade or manufactures uses up some of the country's productive funds.

However, nations are never ruined by the prodigality or injudicious investment of private individuals: only by that of public institutions.[27] Ordinary people know that they must save and invest if they are to improve their condition and boost their future incomes. But most of government's income is spent on maintaining unproductive hands – a numerous and splendid court, the religious establishment, great fleets and armies – all of which subsist on the product of taxpayers' labour. Governments see little reason to save and invest for themselves. Unfortunately, when such public spending becomes so large that taxpayers have to eat into their capital in order to continue to pay for it, then future incomes are necessarily diminished.

Even so, the free economy is remarkably robust. People's constant effort to better themselves, the mainspring of progress, is often enough to keep the economy growing, despite the extravagance and errors of government.[28]

> It is the highest impertinence and presumption…in kings and ministers, to pretend to watch over the economy of private people…. They are themselves always, and without any exception, the greatest spendthrifts in the society…. If their own extravagance does not ruin the state, that of their subjects never will.[29]

The total national product can grow only through a growth in the number of productive workers, or through a rise in their productivity. Productivity can be increased only through better management of labour and capital resources, or through the use of more or better machines and equipment – each of which usually

27 *The Wealth of Nations*, Book II, Chapter III. p. 342, para. 30.

28 *The Wealth of Nations*, Book II, Chapter III. p. 343, para. 31.

29 *The Wealth of Nations*, Book II, Chapter III. p. 346, para. 36.

requires new capital investment. Greater production, therefore, usually indicates that a greater quantity of capital has been invested. If we see a country's lands becoming better cultivated, its manufactures more numerous, and its trade more extensive, we can be sure that its capital has increased. And that increased capital accumulation can be attributed to the private saving and investment of individuals, together with the legal security that enables them to accumulate their capitals without fear of them being stolen, and the liberty that encourages them to save, invest, and so better their own condition.

Interest

People lend to others in the expectation that the capital they advance to the borrower will eventually be returned to them, and that the borrower will pay a kind of rent for the use of it. Borrowers expect that they can use this capital for productive uses that will be so profitable that they can more than repay both capital and interest. Again, though, we should remember that what the borrower wants is not the money, but what the money will buy. The loan, in other words, represents some small part of the national product being assigned over from the lender to the borrower.[30]

When there is more capital available in any country, there is more competition between its holders, and borrowers can offer a lower price for it. In other words, the more capital there is, the lower the rate of interest that can be charged. The growth of capital, and its lower cost, will boost productive industry: more labour will be hired, and wages will be bid up. So employers will be paying less for their borrowed capital – though they will see their profit rates being eroded too.

30 *The Wealth of Nations*, Book II, Chapter IV.

Some people argue that it is the increase in the quantity of gold and silver, which resulted from mining discoveries in the Spanish West Indies, that has lowered interest rates. But this cannot be true. If everything else stays the same, then an increase in the quantity of silver has no effect other than to diminish the value of that particular metal – like every other commodity that is in plentiful supply. The effect of this is that money prices would appear to rise. But this rise in prices is purely nominal, rather than real. Prices would rise, but nothing, including interest rates, would really have changed.

Here, Smith is countering the mercantilist view with a quantity theory view of money – that the more money there is in circulation, the less it is worth. In other words, inflation. His intuitive view is that all prices are affected, and that nothing real changes. Today we recognise that inflation does have some distorting effects because the new money enters the economy in particular places and that price rises spread out from there, with the differences causing real misallocations on the way.

Some countries have attempted to outlaw the lending of money at interest. But this has simply increased the evil of usury, rather than preventing it. People still want to borrow money, but now they have to pay not just the interest, but a premium for the risk that the creditor runs in lending illegally. Government efforts to peg interest rates below their market price have the same effects. Creditors will not lend their money for less than the use of it is worth: so borrowers have to offer them a risk premium in order to get it at its full value.

This is a classic example of price controls leading to a black market. Where prices are artificially held down below market rates, suppliers may simply turn to other markets where they can make more money, creating shortages. Or they may continue to deal illegally: but in this case, customers will have *to pay even more than the market price to compensate sellers for their risk. The same arguments apply to rent controls, wage controls and other price restrictions.*

Further reflections on capital

Capital can be used in four different ways.[31] Some assets (such farms or fisheries) yield raw produce for immediate consumption or for processing. Some (such as machinery and equipment) are used to prepare raw materials for consumption. Some (such as carts and ships) are used to transport raw or manufactured products to market.

Lastly, capital is used in retailing – to divide raw or manufactured goods into smaller amounts that match consumers' needs. If there were no butchers, for example, people would be obliged to purchase a whole ox or sheep at a time, which would be an inconvenience to the rich and an impossibility to the poor.

Smith here is taking on a view common in his time that retailers contributed nothing, and that they required regulation because competition was cutthroat, causing some to fail as others pushed customers into buying what they did not need.

The current political prejudice against shopkeepers is therefore misplaced. They do add value, and they serve the public. The competition between them might force some out of business, but it can never hurt the consumer. Competition pressurises them to keep down their prices – a pressure which monopolists do not experience. The argument that, without regulation, some retailers might dupe customers into buying things they do not need is a specious one. For example, it is not the widespread prevalence of alehouses that causes people to drink to excess. Rather, it is the

31 *The Wealth of Nations*, Book II, Chapter V.

disposition to drink that gives employment to the alehouses.[32] Retail trades, like any other, follow the demand.

The capital that is employed in agriculture seems to be the most productive. That is because nature works alongside the human labour, bringing the crop to fruition. The American colonies have grown rapidly largely because their capital is focused on this highly productive sector. They let others provide the capital for the (less profitable) trading and manufacturing sectors they need. America's manufactures are almost entirely imported, in a trade financed by the capital of merchants in Great Britain. Even the Virginia and Maryland stores and warehouses employed in this transatlantic trade are British owned. If, as a result of the present disagreements, the Americans were to call a halt to this trade and divert their capital into domestic manufacture, the effective monopoly that would be given to their domestic producers, and the increased costs they faced, would make them worse off.

Economic progress stems only from countries producing a surplus that they can then exchange with others. Countries are better off if they do not try to remain self-sufficient and raise trade barriers against others.

32 *The Wealth of Nations*, Book II, Chapter V, p. 360, para. 7.

Book III: The progress of economic growth

The principal commerce of an advanced society is that which takes place between the country and the towns. In a sense, the towns acquire their whole wealth from the country. But that does not mean that their wealth comes at the expense of the country. Both sides benefit. Farmers need town artisans to make their tools and household goods, and towns need markets for their produce. The greater the wealth and population of a town, the bigger is the market, and the more the country benefits.

Priority of agriculture

Since subsistence is prior to convenience and luxury, the cultivation and improvement of the country must have taken place prior to the growth of towns; and towns could only grow insofar as the country produced surpluses.

If the profits were equal, people would generally prefer to live from land, rather than manufactures or foreign trade. Land, and rent, seems much more secure than manufactures or trade, which are liable to many accidents and uncertainties, and landowners enjoy the beauty and peace of the countryside. Yet farmers still need artificers such as smiths, carpenters, wheelwrights and ploughwrights, masons and bricklayers, tanners, shoemakers and tailors. These people in return need food and raw materials. The inhabitants of the town and the country are mutually dependent; nevertheless, the towns could only grow in proportion to the prosperity of and the demand from the countryside.

When people are allocating their capital, therefore, they prefer to put it first into land, then into manufactures, and only then into foreign trade, with its many risks. Where land is extensive and fertile, such as the North American colonies, capital goes predominantly into agricultural improvement. In countries where the land is fully improved, more capital is diverted into manufacturing. In either case, the import-export business is generally left to other countries, where manufacturing is advanced. In fact, North America has grown fast precisely because its capital has gone into agriculture, while its trade has been financed by British merchants. The wealth of ancient Egypt, and of China and Indostan, demonstrate that nations can prosper even though their trade is financed mostly by foreigners.

The rise of the towns

The towns may depend on the country, but they also help to improve it. First, they provide large markets for the produce of the country. Second, rich people in the towns buy and improve land in the country. Wealthy merchants fancy themselves as country gentlemen – though they are also businesslike improvers of agriculture. Thirdly, the commerce of the towns promotes order and good government – principles which spread out to the country.

Townspeople achieved their freedom and independence before those in the country. Gradually they won privileges and self-government – helped in part by the desire of weak kings to make them allies against the rich landowning barons, who despised both kings and merchants. Order and government, security and liberty thus arose in the towns, and manufacturing and trade expanded.[33]

In the age before manufactures, however, great landowners had nothing for which they could exchange their surplus. All they could do was use their wealth to maintain a large following of retainers and dependants. This gave them a vast authority, and they – rather than any distant king – naturally became the chief

33 *The Wealth of Nations*, Book III, Chapter III.

lawgivers and administrators. But such power can be arbitrary, and the introduction of the feudal law was an attempt to restrain it by creating a comprehensive system of rights and duties, from the king down to the smallest landholder.

The feudal law still could not curb the arbitrary power of the great lords. But the rise of manufacturing and commerce did.[34] Once manufactured goods became available, the lords at last had something for which they could exchange their surplus. They started to spend their wealth on comforts and impressive luxuries, rather than on maintaining thousands of retainers.

As a result, however, the great landlords lost the source of their whole power and authority. For merchants are not as dependent on their customers as retainers are on their lord. They have other customers too: their loyalty is more divided.

> 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.[35]

As the number of retainers diminished, farms were enlarged and became more efficient and productive. This prompted landlords to raise their rents, but in return the tenants demanded more security. Tenants became more independent, landlords lost their arbitrary power, and an orderly system of justice developed. The commerce and manufactures of the cities had been the cause of the improvement and cultivation of the country.

34 *The Wealth of Nations*, Book III, Chapter IV.

35 *The Wealth of Nations*, Book III, Chapter IV, pp. 418–9, para. 10.

This history is speculative, and yet the breakdown of the traditional feudal power of the great Scottish chiefs may have given Smith real examples from his own time.

Tenancy law and agricultural efficiency

In England, the considerable security that is given to tenants has contributed to the agricultural success and grandeur of the nation. In other parts of Europe, leases have been too short to encourage improvements, or entailed unspecified services to be delivered to the landlord, or invited taxes (French farmers who produce a surplus find it almost all confiscated in the taille).

Small proprietors have a much more direct interest in managing their land than large ones, and so are more successful and productive. But in Europe, the persistence of primogeniture has still prevented the division of great estates. Land was considered, not just as a source of income and enjoyment, but as the basis of power, patronage, and protection: so in the dangerous times that followed the fall of Rome, it was thought better for land to be kept intact.[36] This tradition has persisted, and as a result, land rarely comes to market – perhaps a third of the land area of Scotland is entailed under this system – and where it does come to market, it is sold only at a high, monopoly price. The system makes land use inefficient: cost-effective improvement of land takes the same close attention to detail and to profit as any other business, but the grand proprietors of large estates have much less interest in these things than those who cultivate their own small landholdings. Such is the inefficiency of this system that in Europe it takes over five hundred years for the population to double.

36 *The Wealth of Nations*, Book III, Chapter II.

In North America, where primogeniture does not prevail, the population doubles every twenty-five years. There is an open market in land, and fifty or sixty pounds is enough to begin a plantation. If European landholdings were divided equally among the children on the death of the proprietor, the estate would generally be sold, more land would come onto the market, prices would moderate and the productivity of the land would rise.

Slavery, however, is another factor that limits agricultural efficiency. In Russia, Poland, Hungary, Bohemia, Moravia and other parts of Germany, serfs are tied to the land and can be bought and sold with it. But a serf or slave who can acquire no personal property has no interest other than to eat as much, and to labour as little as possible: productive work has to be forced out of them. Though slave labour looks cheap it is therefore the least cost-effective sort of labour. Slavery is common in the sugar and tobacco plantations of the British colonies, but only because the extent and fertility of the land makes the expense of slavery affordable.

Book IV: Economic theory and policy

Economics is about how to generate income for the people and to supply a revenue for the state. There are presently two principal theories, the mercantile system and the agricultural system.

The mercantile system

The mercantile system holds that wealth consists in money – gold and silver. A rich person, or a rich country, is one with plenty of money. Under this view, therefore, policy should focus on heaping up large quantities of money, seeking it out from colonies, welcoming it into the country, but preventing it from leaving.[37]

As an illustration of this attitude, when the Spaniards discovered America, their first question was whether gold or silver could be found locally, such was the prevalence of this view and the assumed importance of these metals. For the same reasons, Spain and Portugal have severe prohibitions, or heavy taxes, on the exportation of gold and silver. Even some old Scottish laws prevented their exportation.

Traders, of course, found these restrictions very inconvenient. So they argued that by allowing them to pay for some imports with gold and silver, they could actually make more money for the country by processing the imports and exporting them elsewhere, getting back even more gold and silver. This led to some easing of the rules: the prohibition on gold and silver exports from France and England was confined to coin, not bullion. Holland even dropped the coin restriction.

37 *The Wealth of Nations*, Book IV, Chapter I.

So attention then fixed on the balance of foreign trade, since this is what would determine the net inflows and outflows of gold and silver if they could be moved freely across borders. By contrast, domestic trade – though far more important – was ignored, on the grounds that no money came into or left the country as a result of it, so it could never make the country richer or poorer. But in fact the preoccupation with international trade is inappropriate. Very little of a country's trade comprises foreign trade, with gold or silver being imported or exported: most wealth is created and consumed domestically. Cross-border movements of gold and silver are hardly likely to ruin a great nation.

And it is a mistake to imagine that wealth resides only in money. Money is just a medium of exchange. It is useful, because everyone accepts it. Yet what people actually want when they do accept it is not the money, but the things that they can buy with the money. Certainly, gold and silver have the merit of being more durable than some other commodities, and this adds to their usefulness as a store of value. But durability is not everything: we are perfectly happy to import wine from France and send them hardware in exchange. Nevertheless, the French are not so stupid as to amass more pots and pans than they need to cook their food, just because they are more durable. It would be a complete waste of resources. By the same token, neither we, nor any country, should seek to amass more gold and silver than is needed to facilitate trade. It would be a waste too – dead capital that would come out of the available resources we need to feed, clothe, maintain and employ the people. Money is a utensil, just like pots and pans.

Having thus shown the error of the mercantilist belief that money equals wealth, Smith now moves on to attacking the trade restrictions that the mercantilists have erected, in the name of preventing money from leaking abroad.

Trade restrictions

Prohibitions or high duties against imports – motivated by the mercantilist confusion about money – mean that the country's domestic producers are given an effective monopoly of the home market. Bans on the importation of live cattle, for example, give domestic graziers a monopoly on the supply of butcher's meat; woollen manufacturers benefit from bans on woollen imports, and silk manufacture has recently secured the same advantage, as have many other trades.[38]

But, as explained earlier, the number of people who can be employed in a developed country is proportional to the capital that is mobilised there. Regulations such as these cannot possibly increase employment beyond what the available capital can maintain. All they do is to divert industry from one employment to another. But businesspeople naturally invest their capitals where they believe they can generate most value. Indeed, they are likely to be much better judges of this, understanding more about the local situation, than some distant regulator; and giving regulators such great economic power is dangerous in itself.[39]

The only mention of the Invisible Hand in **The Wealth of Nations** *occurs at this point above. However, while the invisible hand idea – a functioning social order produced by the private and indeed self-interested action of individuals – pervades Smith's work, this particular reference to it is rather elliptical.*

If foreign goods are no cheaper than domestic ones, then giving a monopoly of the home market to domestic producers is evidently pointless. If, on the contrary, foreign goods are in fact cheaper, then

38 *The Wealth of Nations*, Book IV, Chapter II.

39 *The Wealth of Nations*, Book IV, Chapter II, p. 456, para. 10.

the regulation is harmful, because it is wasteful to make at home what you can buy cheaper elsewhere. The tailor does not attempt to make his own shoes, nor the shoemaker his own clothes: and countries too should make what they can make cheaper, and buy in what would cost them more to produce.

> By means of glasses, hotbeds, and hotwalls, very good grapes can be raised in Scotland, and very good wine too can be made of them at about thirty times the expense for which at least equally good can be brought from foreign countries. Would it be a reasonable law to prohibit the importation of all foreign wines, merely to encourage the making of claret and burgundy in Scotland? [40]

Trade restrictions are also defended as a tool to prevent an adverse balance of trade. But as we have seen, foreign trade is relatively insignificant. And as long as a country is producing more than it consumes, it is saving and adding to its capital. Such a country could still import more than it exports – an adverse trade balance – and nevertheless continue to produce surpluses and grow richer.

Justified and unjustified trade barriers

Trade restrictions are a tax on the whole country. But they are often defended as being necessary to deal with 'special cases'. British tariffs on foreign wine and beer, for example, are justified on the grounds that they reduce drunkenness. It is a remarkable claim, since the wine producing countries such as France, Italy and Spain are among the soberest peoples in Europe. Certainly, alcohol may sometimes be abused, but it is still better if we can buy it – like anything else – more cheaply than we can brew it ourselves. And in any case, the fact that the tariffs favour Portugal, which British merchants say is a better customer for their manufactures, over

40 *The Wealth of Nations*, Book IV, Chapter II, p. 458, para. 15.

France, gives the lie to their supposed justification. It is an example of how interest groups can pervert the policy of a great country.[41]

In any event, we cannot prosper by trying to impoverish our neighbours. A nation is more likely to grow rich from trade if its neighbours are also rich, industrious, commercial nations, than if they are poor.

Here, Smith is attacking the common assumption that in any exchange there must be a winner and a loser. In terms of international trade policy, this led to the idea that a country could become rich only by taking money off others and making them poorer. Smith, of course, champions the modern view, that both sides benefit from voluntary trade, so the assumption is wrong and the policy is counterproductive. But Smith concedes that there can be some justification for at least temporary restrictions on foreign trade in limited circumstances, which he now enumerates.

A case can be made for tariffs when some particular industry is vital for the defence of the country, of course. The Navigation Acts, which aimed at reducing the naval power of Holland, are an example. But there is a cost; if foreigners are hindered from coming to sell into our markets, they may not come to buy, either. The embargo may make them less wealthy, or they may form trading alliances with other nations, and buy in their markets instead.

There is, too, a case for imposing a tax on imported articles if the same articles produced at home are taxed for some reason – as are soap, salt, leather and candles. This levels the competition between domestic and foreign producers. However, we should not let this policy be expanded, as domestic producers would like it to be, into imposing taxes on all foreign imports that might happen to compete

41 *The Wealth of Nations*, Book IV, Chapter III, Part II, p. 493, para. c8.

with home industries. Taxes raise the prices of things, imposing a burden on consumers; and taxes on necessities are a particular evil.

There might be a case for retaliatory import tariffs or prohibitions as a way of forcing other countries to drop their trade restrictions against us. It is up to those insidious and crafty animals, the politicians, to negotiate and decide if such a policy is likely to work. But if there is no chance of it working, why add further injury to ourselves by imposing tariffs?

Some people argue that if trade has been interrupted by tariffs or prohibitions, it should be restored only slowly; that a sudden restoration of free trade would be disruptive. In fact, though, foreign trade is a small part of a country's industry, and any disruption would be small. Most of the people affected would easily find other employments – especially if labour-market restrictions were eased. And in the process, the whole country would be the gainer.

Drawbacks, bounties, price controls and trade preferences

Drawbacks – where an exporter can claim back tax paid at home, or where import duties can be reclaimed upon re-export – cannot boost industry beyond its natural level. In principle, they merely restore activity to where it would have been in the absence of the tax. However, the specific rules on these tax concessions are so complicated that they do distort things, and often invite fraud.[42]

Bounties – subsidies on exports – are designed to boost our foreign trade in lines of industry that could not profitably be exported without them. But again, if merchants did not receive the bounty, they would employ their capital in other, more profitable, industries. Subsidies of any sort merely force the country's trade into a

42 *The Wealth of Nations*, Book IV, Chapter IV.

different, less advantageous direction. They are a double tax on the public: the public have to pay tax to finance the subsidy, then they have to pay more than they need for a commodity that could be bought cheaper from another source.[43]

Subsidies are also open to fraud. The subsidy to the white herring industry, for example, is set according to the tonnage of the ship, rather than its crew's diligence or success in fishing. Not surprisingly, ships equip themselves for the purpose of maximising their subsidy, rather than maximising their catch. In the process, the subsidy has ruined the local coastal fisheries and driven up the price of essential equipment (barrels, for example, have doubled in price from three shillings to six shillings).

> 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.[44]

Another form of intervention is price controls. The production of grain is an industry that has been subject to such controls. When harvests are poor, the price naturally rises. But when governments then try to help consumers by imposing price limits, it discourages the producers from bringing grain to market, or encourages consumers to buy it up so fast, that the season will surely end in shortages and famine. Bad harvests cannot be prevented: but the best way to temper them is to maintain the unlimited and unrestrained freedom of the farmers and merchants.

43 *The Wealth of Nations*, Book IV, Chapter IV and Chapter V.

44 *The Wealth of Nations*, Book IV, Chapter V, p. 520, para. 32.

Another intervention in markets is import preferences, where particular countries are given the sole right to bring in particular goods, or the right to bring them in at a lower rate of tariff than faced by others. An example is the treaty that allows Portugal to import wines to England at two-thirds of the normal tariff. But while import preferences are obviously advantageous to the merchants and manufacturers of the exporting country, they are inevitably disadvantageous to the receiving country – which thereby denies itself access to world competition and ends up paying more to the monopoly importer.

Colonial trade restrictions

Countries even impose trade restrictions on their own colonies. In line with the mercantilist view, the usual motivation for founding colonies is the prospect of finding gold and silver. Since Columbus, the pious purpose of converting native peoples to Christianity might have sanctified the project, but the real motive was the hope of treasure. That is what carried Ojeda, Nicuesa, and Vasco Nuñes de Balboa to Darien, Cortez to Mexico, and Almagro and Pizarro to Chile and Peru. But the search of treasure is an uncertain and ruinous exercise. It was over a hundred years after the Brazils were first settled, before any silver, gold or diamond deposits were discovered there.[45]

But there are compensations. Colonies that are planted on waste or thinly inhabited land advance more rapidly to wealth and greatness than any other society. The colonists bring with them agricultural and other useful skills. They have the habits of regular government, with the legal system and administration to support it. They have no rent to pay, and few taxes. But the land is so extensive, that even with every available hand, it is unlikely that any owner could

45 *The Wealth of Nations*, Book IV, Chapter VII.

make it produce even a tenth of what it is capable of producing. Owners are eager, therefore, to collect more labourers, and are prepared to reward them liberally for their work. But these high wages, combined with the cheapness of the land, soon enable the labourers to set themselves up as landlords, who will seek to attract workers of their own, paying them equally liberally; and so the cycle continues.

For a new colony to prosper, the key seems to be plenty of good land, and the liberty to manage their own affairs. The English colonies in North America have grown faster than any: land is so cheap, and labour consequently so dear, that they can import from Britain almost all of the manufactures they need. The fact that Britain prohibits them from making certain manufactures in order to maintain a monopoly for its own producers therefore does them little practical harm. As their economy develops, however, such prohibitions could become really oppressive and insupportable.

The policy of forcing the North American colonies to trade only with the home country poses dangers to Britain too. It has drawn Britain's capital away from other markets and concentrated it in the colony trade. An unnaturally large proportion of Britain's industry is therefore at risk in this overgrown market. The threat of the trade being disrupted has accordingly filled the people of Britain with more terror than they ever felt for a Spanish armada or a French invasion.

The only solution to this is to relax the laws that give Britain the monopoly on trade with the colonies, and let other countries trade with them. Capital would then return to the many other uses that the monopoly has starved of it. To avoid doing permanent damage, this trade liberalisation would have to be gradual: for example, the sudden loss of trade to the ships which carry the 82,000 hogsheads of tobacco that Britain then re-exports to other countries, would in itself be a major economic shock.

But such is the mercantile system: it produces large distortions that are then very hard to remedy. The colonial trade monopoly has not boosted industry: indeed, by diverting industry into a market where the returns are slow and distant rather than frequent and near, it has made Britain's capital work less productively and has actually depressed incomes.

Since capital can only come out of income or savings, this means that Britain's capital is accumulated more slowly, and future incomes are lower than they would otherwise have been. Rents too are depressed by the monopoly, since by raising manufacturing profits, it discourages capital from going into land improvement. And since it also depresses capital accumulation, in the long run, the amount of income earned as profits is smaller as well. In other words, wages, rent and profits are all damaged by the monopoly – just for the benefit of a few manufacturers.

Unnaturally high rates of profit, like those that come from monopoly, seem to destroy merchants' natural thrift. Instead of saving and reinvesting, they spend instead on expensive luxuries, and the capital of the country is consumed rather than accumulated. The exorbitant profits of the merchants in Cadiz or Lisbon, for example, have not augmented the capital of Spain or Portugal, nor promoted the industry or alleviated the poverty of those two beggarly countries. London merchants enjoy lower rates of profit, but still seem better off. Profit rates in Amsterdam are even slimmer, but its attentive and parsimonious burghers are even wealthier than those in London.

Smith's interest in colonial policy is not entirely academic. He is writing just before the American colonists declared independence from Britain. He wants to advise the British authorities that only greater freedom of trade and more proportionate political representation can head off the crisis. Unfortunately, his advice came too late.

Ancient Rome's refusal to grant the privileges of citizenship to allies who had borne the cost of defending her precipitated the social war. Now, Britain insists on taxing its American colonists, but refuses them parliamentary representation. This has precipitated discontent, and turned the Americans from peaceful tradesmen into militant politicians. The only solution is for Britain to grant representation to the colonies, in proportion to what they contribute to the public finances.

As the colonies grow stronger, it becomes harder for home nations to unjustly usurp the whole benefit of the trade with them. All they end up with is the expense of maintaining their authority. In the mercantilist system, producer interests come to dominate. But the whole purpose of production is actually consumption, and it is consumer interests that should rightly prevail.

> Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer.[46]

The agricultural system

The second theoretical system of economics suggests that the product of land is the sole source of national wealth and income. It divides society into three groups: first, the proprietors of land; second, the farmers and farm workers; and third, the

46 *The Wealth of Nations*, Book IV, Chapter VIII, p. 660, para. 49.

artificers, manufacturers and merchants – whom they see as an unproductive class.

Proprietors, they argue, contribute to national income through the expense that they lay out on land improvement, such as buildings, drains and enclosures. Farmers too contribute to national income through their expenditures on husbandry, seed, livestock and the maintenance of farm workers. But in this system, the overall contribution of manufacturers is zero. The benefit of their labour is precisely offset by the cost of their wages, materials, and tools. They may indeed be useful, adding value to particular parts of what the landowners and farmers produce, but they consume the same amount from elsewhere. They provide the equipment needed to grow wheat or raise cattle, for example, but they consume wheat and cattle products too.

Though unproductive, in the sense that they merely rearrange wealth, this class is still nevertheless very useful to the producers, providing them with markets, equipment and manufactures. The producers have no reason to oppress them: quite the opposite, in fact, since the more liberty they enjoy, the more competition there is between them, and the lower the cost of what they supply. Likewise, the more liberty enjoyed by the other two classes, the greater the surplus that their land produces, and the more there is available for the unproductive class. The best policy for promoting prosperity, according to this system, is one of perfect liberty.

This view probably overstates the need for liberty to be perfect. By way of analogy, it seems that the human body can remain perfectly healthy despite a variable and sometimes unwholesome diet. Similarly, the economy seems capable of surviving, despite illiberal public policies. It may be slowed, but it is hard to stop.

Turgot, the leading advocate of this view, was not only a pioneering economist but also physician to Marie Antoinette. Smith's comparison of the economic system to the human body therefore rebuts Turgot's philosophy in terms he could well understand.

However, the main error of the agricultural system is to see the artificers, manufacturers and merchants as a barren or unproductive class. First, the theory accepts that this class covers its own cost. This is hardly barren. Second, they do actually attach value to things that endure and which can later be sold: this is clearly productive labour.

Despite these imperfections, this theoretical system is among the better ones. It recognises that wealth consists not in money, but in a country's production; and it sees perfect liberty as the best way to maximise this. In the absence of trade restraints or preferences, people are left free to pursue their own interests, and to bring their capital and labour into competition with others, subject only to the rules of justice. Capital and labour flow into their most advantageous uses, and the state is spared any need to supervise and direct economic life. Indeed, the system of perfect liberty leaves the state only three duties to attend to: defence, justice and certain public works.

> The sovereign is completely discharged from a duty [for which] no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society.[47]

47 *The Wealth of Nations*, Book IV, Chapter IX, p. 687, para. 51.

Book V: The role of government

Defence expenditure

The first duty, and necessary expense, of the state is defence: protecting the society from the violence or invasion of others.

Among nations of hunters, such as the native tribes of North America, people have to be warriors as well as hunters. They must live off their own labour, even when they are at war. There is no king or commonwealth with the resources to maintain them.

Nations of nomadic shepherds, such as the Tartars and Arabs, all have chiefs, but warriors must still live off their flocks. These, and the whole nation, go along with them. But then there is the prospect of capturing booty from vanquished enemies.

In an agricultural age, people are settled. Farms cannot simply be abandoned, so the men of military age go to war, and others stay behind. As long as the seeds are in the ground, they can be spared; nature will do most of the work.

In the manufacturing age, things are different. When people quit their work as smiths, carpenters, or weavers, their income immediately dries up; when they take to the field to defend their nation, they cannot maintain themselves, and must necessarily be maintained from the public purse – all the more so because modern military campaigns can last for months on end. Also, military equipment has become more complex and more frightening, which requires a specialist and disciplined force. For all these reasons, the defence of advanced countries must be financed by the state.

Justice

Just as the state must protect people from foreign enemies, so must it protect them against domestic ones.

Among nations of hunters, there is hardly any property. People usually have nothing to gain from injuring others, and there is little need for any formal administration of justice. But where property exists, things are otherwise. There are potential gains from theft. The avarice and ambition of the rich, or the desire for ease and enjoyment among the poor, can lead to private property being invaded. The acquisition of valuable property – which may take years to build up – necessarily requires the establishment of a civil government and a magistracy to preserve order and justice.

> The affluence of the rich excites the indignation of the poor, who are often both driven by want, and prompted by envy, to invade his possessions. It is only under the shelter of the civil magistrate that the owner of that valuable property, which is acquired by the labour of many years, or perhaps of many successive generations, can sleep a single night in security.[48]

It is obviously useful if, as a rational matter, everyone accepts the authority of independent judges. But there is also a natural respect for authority among humans that makes this acceptance more likely. People respect personal qualities such as strength, wisdom, prudence and virtue; and they respect maturity and age. Wealth is another factor which promotes deference, particularly so in the age of shepherds, where great proprietors have nothing else to spend their fortunes on other than maintaining thousands of retainers. That is why the authority of an Arabian sharif is very great, and that of a Tartar khan altogether despotic.

48 *The Wealth of Nations*, Book V, Chapter I, Part II, p. 710, para. c2.

A fourth cause of human deference is the inequality of birth: though this is the result of an inequality of wealth. In the age of hunters, there are no major wealth inequalities; the son of a wise or brave man may be more respected than most, but the differences are unlikely to be great. In nations of shepherds, by contrast, wealth can stay within families for generations, and birth is greatly revered. It is in this age that great inequalities of wealth start to emerge. Alongside this wealth emerges civil government – an institution designed to protect those who have property against those who do not.

> Civil government, so far as it is instituted for the security of property, is in reality instituted for the defence of the rich against the poor, or of those who have some property against those who have none at all.[49]

Smith's argument that law and government are institutions devised by the rich to prevent them being robbed by the poor does not mean that it is a bad system. He has already remarked earlier that for people to accumulate capital, they must have confidence that their property, which may take years of effort to acquire, will not be stolen from them. And this capital accumulation is essential for economic growth.

Public works

The third role for the state is to build and maintain public works that could never yield a profit to individuals: institutions to facilitate commerce, the education of the young and the instruction of people of all ages.

As the commerce of a country increases, so does its need for public works such as roads, bridges, canals and harbours. Most such facilities can be financed out of tolls or charges, without any

49 *The Wealth of Nations*, Book V, Chapter I, Part II, p. 715, para. 12.

burden being imposed on the public finances. The coinage, which also facilitates commerce, generally defrays its own expense and indeed provides a small seignorage to the state; the post office generates a very large profit.

> The greater part of such public works may easily be so managed, as to afford a particular revenue sufficient for defraying their own expense, without bringing any burden upon the general revenue of the society.[50]

Public works which cannot produce such revenues, but which benefit some particular locality, are better maintained by a locally raised and administered tax. London streets, for example, would not be so well lit and paved if the cost of the lighting and paving fell upon the Treasury; and instead of being a tax on the particular street, parish, or district of London, the expense would be a tax on all citizens, most of whom would gain no benefit at all.

Some supporters of greater public expenditure take comfort from Smith's remarks on public works and education (below), but it is a false comfort. First, Smith limits his remarks to projects that are essential for commerce, such as infrastructure and education. He does not support public projects as a substitute for private commerce. There is an unbridgeable distance between this limited support for public works and the numerous and large undertakings of the modern state. Second, even where Smith accepts that public expenditure may be necessary to get infrastructure projects built, he thinks that this cost should be repaid by charges on the users, rather than direct taxation. If charges are impossible, it should be the local beneficiaries who should pay the tax. Third, in Smith's time there were few companies large enough to finance large-scale infrastructure projects (except a few joint-stock companies, of which he was very

50 *The Wealth of Nations*, Book V, Chapter I, Part III, Article I, p. 724, para. d2.

suspicious for other reasons): this has changed. And ways of collecting tolls and charges are much more sophisticated today. Private build and operation of public infrastructure projects is therefore more practical than in Smith's time.

The object of these public works is to facilitate commerce generally. But some particular branches of commerce, such as that carried on with barbarous and uncivilised nations, require extraordinary protection. An ordinary store or counting-house could give little security to the goods of the merchants who trade with West Africa, or Indostan. The interests of commerce have often made it necessary to post ambassadors to foreign countries: the commerce of the Turkey Company prompted the establishment of an ambassador in Constantinople; the first English embassies to Russia were entirely for commercial interests.

It seems reasonable that such extraordinary expense should be paid by a moderate tax on those in the particular trades affected. It also seems reasonable that, when merchants undertake to establish a new trade with some remote and barbarous nation, they might be granted a temporary monopoly. Like the patents on new machines, this is the easiest way for the state to recompense them for a risk that should afterwards deliver benefit to the general public.

National policy has been inconsistent, however, and sometimes this protection of trade has been contracted out to private companies, but these companies have either mismanaged or restricted the trade. They include regulated companies like the Hamburgh, Russia, Eastland, Turkey and African Companies, which any qualified person can join on payment of a fee; in other words, they are rather like the trade guilds, and behave like them too. They also include joint stock companies established by government, such as the South Sea, Hudson's Bay, and Royal African Companies, which have been granted exclusive privileges in foreign trade. But such privileges have not prevented such companies from failing, and perpetual monopolies to them are an absurd tax on the public.

Joint stock companies may succeed, without special privileges, in repetitive trades like banking or insurance, or in building utilities such as canals. Other forms of business, however, move too quickly and require risk-taking and attention to changing details. A company governed by a board of directors moves too slowly to succeed in such industries.

Smith is commonly construed as being opposed to joint stock companies – the kind of arrangement that dominates big business today. But in fact he is principally against the special privileges that had been granted to particular companies; and he believes that companies governed by a large board of director-shareholders could not move quickly enough to succeed in most lines of business. Today, however, shareholders elect a small board of directors who in turn rely on a small executive group to run things, making it possible for large companies to operate quite nimbly.

Education of the young

Despite the clear benefit of economic efficiency that it delivers to society, specialisation can have harmful effects on the individual. The person who spends years performing the same simple operation has no opportunity for innovative thinking. Unless the government takes steps to prevent it, the labouring poor will fall into mental torpor, narrow-mindedness, and a fear of change and the unknown.

Smith here anticipates Karl Marx's idea of 'alienation' among workers who do repetitive tasks with little interest in their final product.

In barbarous countries, of hunters or shepherds, the variety of people's occupations and the everyday problems they have to overcome keeps their minds and their judgement sharp.

> The man whose whole life is spent in performing a few simple operations, of which the effects too are, perhaps, always the same, or very nearly the same, has no occasion to exert his understanding, or to exercise his invention in finding out expedients for removing difficulties which never occur.[51]

In civilised countries, however, the education of the common people requires particular attention. Wealthier people are more willing and able to pay for their children's education; and they tend to have more varied jobs, so their minds are less likely to grow torpid through want of exercise. The common people, however, have little money for education – and little time, too, since in order to eke out a living for the family, their children have to start work as soon as they are able to do so.

But the essential elements of education can be acquired very young. And for a very small cost, the public can encourage, or even impose, the requirement to acquire this basic learning on almost everyone. It could do this by establishing local schools where children can be taught for such moderate fees that even a common labourer could afford them. The masters could be paid partly from the public purse (though they should not be paid wholly, nor even mainly, from this source, because they would then soon neglect their students). In Scotland, the establishment of such parish schools has taught almost all the common people to read, and many of them to write and account. In England, charity schools have had something of the same effect.

51 *The Wealth of Nations*, Book V, p. 782, para. f50.

> The endowments of schools and colleges have necessarily diminished more or less the necessity of application in the teachers. Their subsistence [is] altogether independent of their success and reputation in their particular professions.[52]

Smith himself was educated at one of these local, publicly supported schools in Scotland. But his policy recommendations, while generously motivated, are not wholly consistent. He argues for some state finance for school buildings, but only partial state support for teachers; and at the same time he praises the private schools that teach dancing and other arts. Certainly, he was not contemplating comprehensive state education as is common in many countries today.

Schoolbooks could of course be more instructive: and instead of Latin, elementary geometry and mechanics would be more useful to the common people. Public awards for educational achievement could help too. And there could be an examination before anyone was allowed to join a trade.

This is how the Greek and Roman republics maintained the martial spirit of their citizens. They instituted gymnasia for their practice, appointed teachers (who were paid by their students) and awarded badges of distinction to those who excelled in these exercises. Today, only a few people are trained in this martial spirit, except perhaps in Switzerland, and the spread of cowardice and the lack of a sense of self-worth, is as big a danger as ignorance and stupidity.[53] Fostering self-worth and promoting knowledge are a benefit to society, promoting decency and good order.

52 *The Wealth of Nations*, Book V, Chapter I, Part III, Article II, p. 760, para. f5.

53 *The Wealth of Nations*, Book V, Chapter I, Part III, Article II, pp. 787–8, para. f60.

Religious education

The institutions for the instruction of all ages are chiefly those for religious instruction. The ministers of established religions, being supported by estates or tithes, grow complacent, and are often eclipsed by the zeal and industry of new ones. They fall back on the law to protect their position: the Roman Catholic clergy, for example, used the law to persecute the heretics, and were in turn persecuted by the Church of England.

Moral systems can be austere or liberal. People of fashion veer to the liberal system, and indulge luxury, disorderly mirth, and within reason, intemperance. But then they can afford such laxity. The wiser folk among the common people, by contrast, abhor such excesses, which they know are potentially ruinous to them. Their moral problem is particularly acute in the cities, where anonymity allows people to fall more easily into self-neglect and profligacy, unless they are picked up by one of the small, austere, often unsocial religious sects.

The first remedy for this problem is the study of science and philosophy, which the state could spread, not by giving salaries to teachers (which would make them negligent and idle), but by requiring people to learn them before going into a trade. The second is to amuse and divert people by promoting the arts.

Funding state expenditures

Some expense is needed to support the dignity of the monarch, who as the chief magistrate must command general respect. The cost of the criminal justice system is likewise an expense that the whole society should bear. The expense of civil proceedings, however, is better defrayed by those who benefit from it – that is, its users. Indeed, as a general principle, public servants should be paid by results.

> Public services are never better performed than when their reward comes in consequence of their being performed, and is proportioned to the diligence employed in performing them.[54]

Local or provincial expenditures which have a local or provincial benefit should be paid out of local or provincial taxes, rather than a tax on the whole society. The cost of good roads and communications, however, may justly be financed out of general taxation. But much of the cost can be recovered by user fees, such as the turnpike tolls in Engand or the peages in other countries.

The expense of education may also fall legitimately on general taxation; but again it is equally proper and perhaps advantageous if it is paid for by those who receive the immediate benefit.

In other cases, where public works benefit the entire society but cannot be paid for by specific users, the shortfall must usually be found from general taxation.

Governments may try to raise money from commercial projects, but they are generally unsuccessful traders. Public servants regard the public purse as almost inexhaustible, spend unnecessarily and pay themselves well, while successful businesspeople are careful and parsimonious at managing their limited resources. Some governments, likewise, raise revenue from their land holdings, but these are generally insufficient to pay for all the demands on the public purse, and moreover, state assets are generally less well managed than private holdings.

54 *The Wealth of Nations*, Book V, Chapter I, Part II, p. 719, para. 20.

> When the crown lands had become private property, they would, in the course of a few years, become well-improved and well-cultivated...the revenue which the crown derives from the duties of customs and excise, would necessarily increase with the revenue and consumption of the people.[55]

The principles of taxation

There are four principles that should guide legislators in the design of taxation.

> There is no art which one government sooner learns of another than that of draining money from the pockets of the people.[56]

First, people ought to contribute, as far as possible, in proportion to the income that they derive under the protection of the state.

Second, taxes ought to be certain, and not arbitrary. The time and manner of payment should be clear to everyone. Otherwise, it gives excessive and arbitrary power to tax gatherers, and can lead to corruption and intimidation.

Third, taxes should be levied at a convenient time. Taxes on rents or houses, for example, should be payable when rents are paid. Taxes on consumable goods are convenient too, because they are paid little by little, as goods are bought.

Fourth, taxes should cost no more than necessary. They should not require a great number of expensive officers to collect. They should not discourage industry nor destroy capital. They should not encourage evasion (as high excise taxes encourage smuggling) nor

55 *The Wealth of Nations*, Book V, Chapter II, Part I, p. 824, para. a18.

56 *The Wealth of Nations*, Book V, Chapter II, Part II, Appendix to Articles I & II, p. 861, para. h12.

should the penalties ruin those who are driven to evasion. And they should not require frequent, odious and vexatious visits from tax gatherers in order to collect them.[57]

These principles of taxation would seem entirely natural today. The fact that he has to state them indicates how arbitrary and unjust were the taxes of his day. However, there are inconsistencies in Smith's other tax proposals. He opposes taxes on consumption, but supports a tax on luxuries (including things that we would think rather basic today, like poultry). He says that people should pay tax in proportion to their income, but wants the rich to pay 'something more than in that proportion'.

Taxes on land

If taxes are levied on the rent of land, it requires periodic re-assessment, since rents do vary from time to time, and the tax would otherwise become unequal and unfair. This of course requires a certain bureaucracy – rent agreements would have to be declared and registered (and indeed, policed) to prevent any fraudulent collusion between landlord and tenant to evade the tax.[58]

Taxes on the produce of land, such as tithes, are very unfair. They fall harder on those who own and farm less productive land. And they discourage landlords from improving their land, or farmers from investing in better cultivation, when the church or state shares none of the expense but takes part of the profit.[59]

House rents can be divided into building rent – the profit on the capital used to build the house – and ground rent – the rent derived from the ownership of the land it is built on. Taxes on

57 *The Wealth of Nations*, Book V, Chapter II, Pt II, p. 827, para. b6.

58 *The Wealth of Nations*, Book V, Chapter II, Part II, pp. 832–3, para. c17.

59 *The Wealth of Nations*, Book V, Chapter II, Part II, pp. 837–8, para. d6.

house rents would fall most heavily on the rich, which is perhaps not unreasonable, and rents would be very easy to ascertain. Taxes on ground rent would have the advantage of being a tax on land ownership and not discouraging improvement and building, but then it is harder to ascertain what part of the total rent should be considered as ground rent.[60]

Such difficulties have led legislators to adopt easier ways of estimating the rent. Now, for example, taxes are levied in proportion to the number of windows in each house. Unfortunately, the low-rent house of a poor family in the country can have more windows than the high-rent house of a rich family in town, and this tax is accordingly very unfair and unequal in its impact.[61]

Taxes on capital and profits

There are two kinds of income generated by capital, namely interest and profit. Profit is not a good object of taxation, because it is the compensation for the risk and trouble of employing capital, and if it were taxed, employers would have to increase their profit margins (making their products dearer for consumers), or reduce the interest they pay to lenders (making those with savings worse off).[62]

Interest would appear to be as easily taxed as rents, but this is not so. First, loans and repayments are much easier to conceal than land and rents; monitoring them would require an intrusive bureaucracy. Second, capital is very mobile, and owners can avoid the tax (and the vexations of the tax-gatherers) simply by moving their capital abroad. And that robs domestic industry of the capital it needs to grow.

60 *The Wealth of Nations*, Book V, Chapter II, Part II, pp. 843–4, paras e7–e11.

61 *The Wealth of Nations*, Book V, Chapter II, Part II, pp. 845–6, paras e16–e20.

62 *The Wealth of Nations*, Book V, Chapter II, Part II, Article II, p. 847, paras f1–f2.

> The proprietor of stock is properly a citizen of the world, and is not necessarily attached to any particular country. He would be apt to abandon the country in which he was exposed to a vexatious inquisition, in order to be assessed to a burdensome tax, and would remove his stock to some other country where he could either carry on his business, or enjoy his fortune more at his ease.[63]

Some countries have taxed the profits of particular trades – such as hawkers and pedlars, and hackney coaches and sedan-chairs. The licence to sell alcohol is another form of taxation. However, such taxes always fall ultimately on the consumers, rather than the dealers, who simply raise their profit margins to compensate for the tax.[64]

Tax can also be levied when property is transferred – such as death duties or stamp taxes. But such taxes eat into the nation's capital. They transfer it into the current consumption of public expenditure, and leave less to be invested in productive enterprises.[65]

Taxes on wages, individuals and goods

Just as producers, in order to maintain their margins, pass on taxes to consumers, so are taxes on wages ultimately paid by the employers – and therefore, once again, by the consumers. Absurd and destructive as such taxes are, they still occur in many countries.[66]

63 *The Wealth of Nations*, Book V, Chapter II, Part II, Article II, pp. 848–9. para. f8.

64 *The Wealth of Nations*, Book V, Chapter II, Part II, Article II, pp.852–3, paras g1–g4.

65 *The Wealth of Nations*, Book V, Chapter II, Part II, Appendix to Articles I & II, p. 862, para. h14.

66 *The Wealth of Nations*, Book V, Chapter II, Part I, Appendix to Articles I and II, pp. 864–6, para. 2.

Wealth taxes are arbitrary and unfair, given that a person's wealth varies from moment to moment.[67] Capitation taxes are unfair because they fall most heavily on the poor: like income taxes, they simply push up wages and therefore, ultimately, consumer prices.[68] Taxes on the necessities of life (such as salt, leather, soap and candles) do the same.[69]

Taxes on luxuries raise only the price of those luxuries,[70] but like customs duties, they are very expensive to collect. They discourage particular industries, and heavy taxes of this sort prompt people into evading them, requiring an intrusive bureaucracy to police them.[71]

Public debts

When the costs of running the public sector are financed through borrowing, it consumes some of the capital that has been built up within the country. Private capital that is intended for the maintenance of productive labour is diverted into the support of unproductive labour.[72]

Smith is not exactly arguing that public servants are 'unproductive' in the sense we would understand the word today (though he does think that public services tend to be less efficient and well-managed than private businesses): rather, he is saying that most public services are a form of consumption. If they are financed by debt, this amounts to consuming the capital of the nation.

67 *The Wealth of Nations*, Book V, Chapter II, Part II, Article IV, p. 867, paras j2–j4.

68 *The Wealth of Nations*, Book V, Chapter II, Part II, Article IV, p. 869, para. j8.

69 *The Wealth of Nations*, Book V, Chapter II, Part II, Article IV, pp. 874–5, paras k10–k13.

70 *The Wealth of Nations*, Book V, Chapter II, Part II, Article IV, p. 873, para. k9.

71 *The Wealth of Nations*, Book V, Chapter II, Part II, Article IV, pp. 896–9, paras k60–65.

72 *The Wealth of Nations*, Book V, Chapter III.

On the other hand, the more that is borrowed, the less has to be raised in taxation, and borrowing can be a rational way to finance a large, lengthy and costly expenditure, such as a war. Private capitals would certainly suffer greatly if all the costs of a war had to be raised through tax rises at the time (though it might make wars shorter, less popular, and less likely to happen).

And yet, when the principle of government borrowing has become entrenched, the number of taxes that come with it still put a burden on the public that makes it hard for them to maintain their capitals. As a result of the debt, Britain's peacetime public budget is now more than £10m – which would be enough to fight a war, under conventional tax-based financing.

People argue that the public debt is simply a transfer from one set of pockets to another; no money goes abroad, and the country is not a farthing poorer. But this is not true. The Dutch, for example, own a very large part of our public debt. Furthermore, the debt diverts capital from landowners and employers, towards the government's creditors. With less capital, land is less improved, and agriculture declines; the same is true of manufactures. They face the further vexation and cost of the necessary visits from the tax gatherers. So capital is being transferred from people who have a keen interest in using it productively to those, mere creditors, who have no interest in the condition of land or the good management of the capital stock at all.

Borrowing has enfeebled every state that has done it. Genoa and Venice are the only Italian republics that remain independent. Spain seems to have learnt the practice from Italy, and was deeply in debt by the end of the sixteenth century, before England owed a shilling. France too suffers a large debt burden. It may be that England's military expenditure, and tax burden, have been light enough that private capital has been strong enough to repair all the breaches which the waste and extravagance of government has made in it, but another war may yet compromise it.

And we should remember than when public debts have been run up, there is scarcely any example of their being fairly and completely repaid.

The cost to Britain of maintaining its colonies has been large. The last war cost upwards of £90m. The Spanish war of 1739, undertaken mainly on account of the colonies, cost above £40m. Had it not been for these wars, the public debt might well have been completely extinguished by now.

It is argued that the colonies must be protected, as they are provinces of the British empire. But they contribute neither revenue nor military force to the empire, they are merely showy appendages of the empire. And if the empire can no longer support the expense of maintaining these appendages, it should let them go, save the expense, and live within its modest means.

3 The Incredibly Condensed Theory of Moral Sentiments

Natural empathy as the basis of virtue

Human beings all have a natural feeling for others. Even the worst of us feels some pity when others suffer. We flinch when we see someone about to be struck, and writhe when we watch the slack-rope artist. And we share the happiness of others too. Let us call it sympathy.[73]

> How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it.[74]

Yet there are limits. We sympathise only when the actions and emotions of others seem appropriate to their circumstance. When we see someone consumed with grief, we want to know what has befallen them: it is not their emotions that excite our sympathy, so

73 Smith says *sympathy*, so we will stick with that, but *empathy* might be a more accurately descriptive word today.

74 *The Theory of Moral Sentiments*, Part I, Section I, Chapter I, p. 9, para.1.

much as the circumstances that gave rise to them. Similarly, people with dementia may be perfectly happy, and the dead may be past caring, but we still feel for them because we can imagine ourselves in such dreadful conditions. But we do not sympathise with excessive grief, or anger, or infatuation that we regard as damaging to the person, or to others.

On the other hand, we do feel a genuine pleasure when someone else exactly shares our emotions and opinions.[75] We unburden ourselves onto friends, and their sympathy makes us feel better. We consider the views of those who agree with us as just, proper and appropriate. But when we do not share the emotions of others, or disapprove of their actions and opinions, we think them at fault, and it distresses both of us.

Even so, as mere spectators, we cannot really share the full ferocity of another person's emotions – the fierce anger of someone who has been wronged, say, or the profound grief of someone recently bereaved. Our sympathetic feelings, though genuine, are inevitably weaker.

But these other people are spectators of our emotions too. They will see that we feel less strongly than they. This discord will distress them, and prompt them to restrain their emotions in order to bring themselves more into line with our view of their predicament. Gradually we learn what emotions and actions seem proper to others. We try to temper them to the point where an impartial spectator would fully share our sentiments and regard them as appropriate. Indeed, we are prompted to go further and show real concern for others, because we know that an impartial spectator would approve, and we take pleasure from that.

75 *The Theory of Moral Sentiments*, Part I, Section I, Chapter II.

> And hence it is, that to feel much for others and little for ourselves, that to restrain our selfish, and to indulge our benevolent affections, constitutes the perfection of human nature; and can alone produce among mankind that harmony of sentiments and passions in which consists their whole grace and propriety.[76]

Smith's explanation of the source of human morality is completely novel. Many philosophers, from the ancients such as Zeno to the moderns such as David Hume, had sought to explain moral action as something beneficial, either to the individual or to society. Smith makes the case that moral action is indeed beneficial, but it is not a matter of calculation. Rather, human beings have a natural empathy with each other, and we quickly learn what others will tolerate and what they will not.

Passions such as pain, hunger or love are very specific to the individual. But there are social passions (such as fellow-feeling) and unsocial passions (such as hatred) too, and these are where sympathy has a key role.[77]

We are also more disposed to sympathise with a person's joy than with their sorrow. This explains why poor people conceal their poverty and rich people parade their wealth. Money does not really buy happiness, but we suppose that it does; and all our attention, sympathy and admiration is worth far more to the rich than the baubles and minor conveniences that money actually delivers.

Reward, punishment and society

Rewards are important for encouraging the social passions, and punishments for discouraging the unsocial. Hence it is the intention, more than the outcome, which excites our approval

76 *The Theory of Moral Sentiments*, Part I, Section I, Chapter V, p. 25, para. 5.

77 *The Theory of Moral Sentiments*, Part I, Section II.

or disapproval[78] Only when a helpful action stems from a positive motive do we believe it merits reward; and only when a harmful action stems from a negative motive do we believe it merits punishment.[79]

Indeed, as social creatures, our very existence requires that unmerited and unprovoked malice should be restrained through punishment, and nature has given us strong instincts to guide us in this[80] (though we may conceitedly put it down to our own reason).[81]

We cannot look into people's hearts, of course, so rather than punish everyone we suspect of having bad *motives*, we punish people only when their *actions* are intended to cause harm.[82] Even robbers and murderers can live peacefully together, provided they restrain their urges to rob and murder each other.[83] The rules we have to prevent people harming others, we call justice. Without justice, society could not possibly survive – which is why our instinct to preserve it is so strong.[84]

Conscience

But nature has given us something far more effective for this purpose than our laws and punishments, namely conscience. We judge other people's actions, but we also judge our own too.[85] That internal judge is a harsh critic. Never mind if others praise us: we need to feel *worthy* of that praise.[86]

78 *The Theory of Moral Sentiments*, Part II, Section I, Chapters III and IV.

79 *The Theory of Moral Sentiments*, Part II, Section I, Chapter IV.

80 *The Theory of Moral Sentiments*, Part II, Section I, Chapter V, p. 77, para. 10.

81 *The Theory of Moral Sentiments*, Part II, Section II, Chapter III.

82 *The Theory of Moral Sentiments*, Part II, Section III, Chapters I and II.

83 *The Theory of Moral Sentiments*, Part II, Section II, Chapter III, p. 86, para. 3.

84 *The Theory of Moral Sentiments*, Part II, Section II, Chapter I.

85 *The Theory of Moral Sentiments*, Part III, Chapter I.

86 *The Theory of Moral Sentiments*, Part III, Chapter II.

Conscience has a powerful social function. It stops us from becoming too absorbed in ourselves and too forgetful of others. The loss of a little finger may be more immediate to us than an earthquake that consumes the whole of China. But conscience would never let us permit the loss of so many distant lives, if by sacrificing our little finger we knew we would prevent it. To nature, all people are important, and conscience gives us some of that perspective. It makes us unwilling to harm others merely for our personal gain.[87]

Another useful instinct is our disposition to make and follow rules. We see how our actions affect others and how theirs affect us, and gradually we develop ideas of what sorts or actions are appropriate or inappropriate. These moral rules give us a quick indication of how to behave, without having to think out each situation afresh. Different societies may have slightly different norms, but if each system did not promote social welfare, it would soon cease to exist. Even though we observe the rules only to spare ourselves a guilty conscience, we end up helping to promote the well-being of society.[88]

To Smith, morality is a matter of social psychology. Certain rules of action generate a well-functioning society. When they are followed, society prospers, and when they are not, it is destroyed. Smith was writing a century before Darwin, but he is trying to express an evolutionary view: nature has endowed us with conscience and morality because it helps us to survive.

Morality and money

The rich, too, benefit the rest of us without meaning to. They give employment to all those people who make the luxuries and status

87 *The Theory of Moral Sentiments*, Part III, Chapter III.

88 *The Theory of Moral Sentiments*, Part III, Chapter IV, p. 159, paras 7–8.

symbols they demand; it is a great equalizer. The supposed benefits of wealth may be a delusion, but the pursuit of riches drives people to enormous exertions, which improve not just manufactures, but science, the arts and intellectual life along the way. [89]

> [The rich] are led by an invisible hand to make nearly the same distribution of the necessaries of life, which would have been made, had the earth been divided into equal portions among its inhabitants.[90]

Virtue and the good society

A truly virtuous person has *prudence*, *justice* and *beneficence*. Prudence helps moderate the individual's excesses and therefore benefits society.[91] The rules of justice prevent us harming others. *Beneficence* promotes the happiness of others, so helps society too.

Self-command over our violent passions can be virtuous too: but it can be double-sided, turning into the cold steel of the zealot. Normally we are most concerned for ourselves, then our family, and only then for others.[92] But since humanity is more important than the individual, self-sacrifice is sometimes needed.[93] Nature does give some individuals the self-command to make such sacrifices, which we admire – insofar it is used for beneficial purposes rather than destructive ones.

89 *The Theory of Moral Sentiment*s, Part IV, Chapter I.

90 *The Theory of Moral Sentiments*, Part IV, Chapter I, pp. 184–5, para. 10.

91 *The Theory of Moral Sentiments*, Part VI, Section I, Chapter I.

92 *The Theory of Moral Sentiments*, Part VI, Section I, Chapter I.

93 *The Theory of Moral Sentiments*, Part VI, Section III, Chapter III, p. 235, para. 3.

Affection for our country implies respect for its institutions, and is not the same as sympathy for other people. In times of turmoil, the institutions of a country can collide against the happiness of its citizens.[94] Politicians then start proposing to overthrow existing institutions and replace them with 'rational' alternatives. But we should remember that old institutions may deliver real benefits that are not obvious to reformers, and that all individuals have motivations of their own that may submit so easily to the politicians' great plans. Freedom and human nature are a surer guide to the creation of a harmonious, functioning society than the supposed reason of visionaries, or fanatics.

> The man of system… seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chess-board. He does not consider that in the great chess-board of human society, every single piece has a principle of motion of its own, altogether different from that which the legislature might choose to impress upon it.[95]

Smith's ethical analysis here is much like his economic analysis. Morality and the market are both functional systems. They work on instinctive principles, and left to themselves, they work reasonably well to promote human welfare. If we had other, destructive instincts, we would not be here to discuss the matter. We should therefore be cautious of trying to re-shape these systems in ways that might appear sensible to us but could in fact destabilise the whole mechanism.

94 *The Theory of Moral Sentiment*s, Part VI, Section II, Chapter II, p. 229, para. 4.

95 *The Theory of Moral Sentiments*, Part VI, Section II, Chapter II, pp. 233–4, para. 17.

4 Further reading

Butler, Eamonn (2007) Adam Smith – *A Primer*, Institute of Economic Affairs, London. A brief, simple introduction to Smith's life and writings.

Haggarty, J. (1976) *The Wisdom of Adam Smith*, Liberty Fund Indianapolis, IN, USA. If you are just after Smith quotations, this is the book for you.

O'Rourke, P. J. (2006) *On The Wealth of Nations*, Atlantic Monthly Press, New York, USA. A witty but perceptive summary of Smith's main ideas.

West, E. G. (1976) *Adam Smith: The Man and His Works*, Liberty Fund Indianapolis, IN, USA. A short biographical overview of Smith's life, work and influence.

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Eamonn Butler is the Director of the Adam Smith Institute, an influential think tank he co-founded in 1977. For more than 30 years, the institute has been at the leading edge of the UK debate on privatisation, including the sale of state enterprises, the commercialisation of government agencies, contracting-out of local services, and the introduction of internal markets in health and education.

Dr Butler has degrees in philosophy, economics and psychology. He is the author of volumes on Hayek, Friedman and Mises and *The Best Book on the Market: How to Stop Worrying and Love the Free Economy*.

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