

# Economic Insights

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## Adam Smith Capitalism's Prophet

*No series on the great figures in the history of economics would be complete without Adam Smith, known generally as the father of modern economics. Smith's influence on the development of economic theory and the evolution of modern, market-based societies cannot be overstated. As with all great thinkers, his reputation has had peaks and valleys. Some economists would deny that he was either a great thinker or an influential philosopher. But whether or not his critics will admit it, these controversies reflect Smith's stature in the realm of economic thought.*

*In this Economic Insights, we look at the man, his life and some of his thoughts, with an eye toward offering Smith's persuasive, engaging arguments and observations to a new generation. His magnificent *Wealth of Nations* repays readers today as it always has. His masterpiece should never become, as so many great works do, just another classic that no one bothers to read because they think they already know what it says. A credit to Smith's genius is that this has not yet happened to his works and probably never will. That alone sets him apart from the majority of thinkers and writers, whether economists or not.*

— **Bob McTeer**  
President  
Federal Reserve Bank of Dallas

Adam Smith was born in Kirkcaldy, Scotland, near Edinburgh, in 1723.<sup>1</sup> His father died before Smith was born, but his will provided money for tutors and guardians, so Smith became well educated. At age 14 he enrolled at Glasgow University. After three years, he traveled to England to attend Balliol College, Oxford, for the next six years, returning to Kirkcaldy in 1746.

Smith earned money lecturing and soon gained a reputation that enabled him to live quite comfortably. He was invited in 1751 to join the faculty of Glasgow University as professor of logic. The following year, he moved to the chair in moral philosophy, lecturing until 1763 on natural theology, ethics, jurisprudence and, finally, political economy. Smith's notes on theology are lost to history, but his notes on jurisprudence were published as *Lectures on Jurisprudence* in 1896, more than a century after his death. In 1759 his lectures on ethics became *The Theory of Moral Sentiments*, a work that greatly enhanced

his reputation. Of course, his lectures on political economy are available to us in the form of his masterpiece, *An Inquiry into the Nature and Causes of the Wealth of Nations*, first published in 1776.

Smith was able to leave his teaching position after the success of his 1759 book and his well-paid appointment as tutor to the Duke of Buccleuch. Traveling with his pupil in France and surrounding areas, Smith met a number of important thinkers and writers and came to enjoy his tutorial work, always making observational notes during his travels. The notes would later be used to provide empirical support for his theoretical arguments in *Wealth of Nations*. While visiting Paris, Smith met Francois Quesnay and A. R. J. Turgot, the leading theorists of the Physiocrat school of political economy, which was then at the height of its influence.

Returning to London in 1766, Smith worked on revisions to his *Theory of Moral Sentiments* until the next year. He then returned to Kirkcaldy, where

### The Most Famous Rhetorical Metaphor in Economics

As every individual, therefore, endeavors as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labors to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic [as opposed] to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention....By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it. ■

— *Wealth of Nations*, Vol. 1, 456

he began work on *Wealth of Nations*, completed nine years later. It was an immediate success and went through five editions by 1789. Two years after *Wealth of Nations* was published, Smith actively sought and won an appointment as commissioner of customs for Scotland. Strangely, Smith spent the last 12 years of his life (1778–90) attempting to enforce the very type of protectionist regulations against which he had argued so impressively in *Wealth of Nations*.<sup>2</sup>

Since the publication of *Wealth of Nations*, Smith's theories and ultimate purpose have been the subject of controversy. Not everyone thinks of him as a great economic philosopher.<sup>3</sup> But no one can deny the impressive influence Smith had on the policies of his time

and even, in the case of Marxism, on the theoretical positions of his most vocal opponents. As Wesley Mitchell put it, Smith sought to convince people that “the wealth of a nation would be promoted with vastly greater effectiveness by the ‘obvious and simple system of natural liberty’ than by national planning of the mercantilist sort.”<sup>4</sup> And like John Maynard Keynes, Smith offered more in his *Wealth of Nations* than economic theory; he proffered policy solutions to what he saw as continuing economic problems. He claimed, as did Keynes, that his solutions would improve macroeconomic performance and national prosperity.

But whatever his motivations, Smith's life demonstrates the incredible power of one individual's efforts to pro-

### Making Visible the Miracle of the Invisible Hand

The woolen coat, for example, which covers the day-laborer, as coarse and rough as it may appear, is the produce of the joint labor of a great multitude of workmen. The shepherd, the sorter of 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. How many merchants and carriers, besides, must have been employed in transporting the materials from some of those workmen to others who often live in a very distant part of the country! How much commerce and navigation in particular, how many ship-builders, sailors, sail-makers, rope-makers, must have been employed in order to bring together the different drugs made use of by the dyer, which often come from the remotest corners of the world! What a variety of labor too is necessary in order to produce the tools of the meanest of those workmen!...The miner, the builder of the furnace for smelting the ore, the feller of the timber, the burner of the charcoal to be made use of in the smelting house, the brick-maker, the brick-layer, the workmen who attend the furnace, the mill-wright, the forger, the smith, must all of them join their different arts in order to produce them. Were we to examine, in the same manner, all the different parts of his dress and household furniture, the coarse linen shirt which he wears next to his skin, the shoes which cover his feet, the bed which he lies on, and all the different parts which compose it, the kitchen grate at which he prepares his victuals, the coals which he makes use of for that purpose, dug from the bowels of the earth, and brought to him perhaps by a long sea and a long land carriage, all the other utensils of his kitchen, all the furniture of his table, the knives and forks, the earthen or pewter plates upon which he serves up and divides his victuals, the different hands employed in preparing his bread and his beer, the glass window which lets in the heat and the light, and keeps out the wind and the rain, with all the knowledge and art requisite for preparing that beautiful and happy invention, without which these northern parts of the world could scarce have afforded a very comfortable habitation, together with the tools of all the different workmen employed in producing those different conveniences; if we examine, I say, all these things, and consider what a variety of labor is employed about each of them, we shall be sensible that without the assistance and cooperation of many thousands, the very meanest person in a civilized country could not be provided, even according to, what we very falsely imagine, the easy and simple manner in which he is commonly accommodated. ■

— *Wealth of Nations*, Vol. 1, 22–23

### The Origin of the Division of Labor

This division of work is not however the effect of any human policy, but is the necessary consequence of a natural disposition altogether peculiar to men, viz the disposition to truck, barter, and exchange; and as this disposition is peculiar to man, so is the consequence of it, the division of work betwixt different persons acting in concert....Man continually standing in need of the assistance of others, must fall upon some means to procure their help. This he does not merely by coaxing and courting; he does not expect it unless he can turn it to your advantage or make it appear to be so. Mere love is not sufficient for it, till he applies in some way to your self-love. A bargain does this in the easiest manner. When you apply to a brewer or butcher for beer or for beef, you do not explain to him how much you stand in need of these, but how much it would be to your [“his” was meant] interest to allow you to have them for a certain price. You do not address his humanity, but his self-love....This disposition to truck, barter, and exchange does not only give occasion to the diversity of employment, but also makes it useful. ■

— *Lectures on Jurisprudence*, 347–48

foundly change things. An obscure professor writing works that few could—or did—read, he nonetheless successfully impressed his economic model upon a future world that he would not live to see.<sup>5</sup> For in his own time, mercantilism dominated public policy discussions, and the state and its planners directed all economic activities. Smith's theoretical emphasis on individual people as rational utility maximizers whose aggregate efforts brought forth greater overall economic prosperity was an extremely radical proposition in its day and even in the places where Smith propounded his analysis.

Even more radical was Smith's belief that a society composed of individuals acting in pursuit of their own

interests would result in a stable, free and more prosperous society than one regimented and planned by the state. Smith took Isaac Newton's vision of a universe running by itself according to natural laws and applied it to society as a whole and to economic activity in particular. In the recorded history of humanity, no contention has generated more controversy than this simple idea based on faith in the wonders people can achieve when allowed to trade and live in freedom. In fact, the majority of what we today call politics is some proposed, practical application of state power that is tempered by this ongoing debate between Smith's generally *laissez-faire* approach and the approach of planning proponents who claim they can create superior outcomes through coercion.

For Smith, economic growth is good and is achieved by the ever-widening application of the division of labor, which is organized within markets and driven by rational self-interest. Those nations that allow market forces to generate such growth will become wealthier, in Smith's view, than those that follow the mercantile model of managed trade.<sup>6</sup> In his writings on policy issues in *Wealth of Nations*, Smith lays out the proper role for state activity. He maintains that there are three areas for legitimate governmental activity in society: defense against external and internal security threats, the formation of laws that prevent individuals from oppressing one another and the provision of public goods that the market would not supply.

There is, of course, room for disagreement about the scope of state activities within that third governmental task. To Smith, it meant certain high-risk, large efforts such as canal building. In our day, almost every good and service has found advocates who wish it to be made public and, hence, into a long-term taxpayer liability. Although Smith would disagree with the vast expansion of public undertakings, it is unlikely that he would be surprised at the drift of policy since his death.

Regardless of our own predilections to agree or disagree with Smith, his influence on all of us today is probably greater than it was on his contemporaries or those who lived immediately after *Wealth of Nations* was published. He is regarded as not merely the father of modern political economy or just a starting point for a history of thought class but a system builder who sought to integrate ethics, morality, political economy and jurisprudence into a coherent whole. We will endlessly debate the extent to which he succeeded in this task—that, in itself, is testimony to his continuing influence and importance. We have, to a large extent, abandoned his system of natural liberty by expanding state interventions into our daily affairs, but his metaphor of the invisible hand remains not just immortal but never improved upon as a description of the market's ongoing process.

In George Stigler's judgment, Smith's greatest achievement was to “put into the center of economics the systematic analysis of the behavior of individuals pursuing their self-interest under conditions of competition. This theory was the crown jewel of [*Wealth of Nations*], and it became, and remains to this day, the foundation of the theory of the allo-



Dallas Fed President Bob McTeer salutes the father of modern economics on a visit to Adam Smith's grave in Edinburgh, Scotland.

cation of resources. The proposition that resources seek their most profitable uses, so that in equilibrium the rates of return to a resource in various uses will be equal, is still the most important substantive proposition in all economics.”<sup>7</sup>

Smith was a true scholar, a masterful observer and chronicler of real events, a persuasive and insightful author and, not least important, a beloved, dedicated and extremely effective pedagogue. To paraphrase Sir Thomas More: Not a bad life, that.

### Use of Taxation Power Can Generate Poverty

When, by different taxes upon the necessities and conveniences of life, the owners and employers of capital stock find, that whatever revenue they derive from it, will not, in a particular country, purchase the same quantity of those necessities and conveniences, which an equal revenue would in almost any other; they will be disposed to remove to some other. And when, in order to raise those taxes, all or the greater part of merchants and manufacturers; that is, all or the greater part of the employers of great capitals, come to be continually exposed to the mortifying and vexatious visits of the tax-gatherers; this disposition to remove will soon be changed into an actual removal. The industry of the country will necessarily fall with the removal of the capital which supported it, and the ruin of trade and manufactures will follow the declension of agriculture. To transfer from the owners of those two great sources of revenue, land and capital stock, . . . to another set of persons (the creditors of the public, who have no such particular interest) the greater part of the revenue arising from either, must, in the long run, occasion both the neglect of land, and the waste or removal of capital stock. . . . But a creditor of the public, considered merely as such, has no interest in the good condition of any particular portion of land, or in the good management of any particular portion of capital stock. As a creditor of the public he has no knowledge of any such particular portion. He has no inspection of it. He can have no care about it. Its ruin may in some cases be unknown to him, and cannot directly affect him. ■

— *Wealth of Nations*, Vol. 2, 927–28

Smith died in July 1790 after more than a decade of opulent, agreeable living supported by his tutor's pension, his royalties and his salary from the government of Scotland. He died with these words to his companions: "I love your company, gentlemen, but I believe I must leave you to go to another world."<sup>8</sup> Just before he died, he implored close acquaintances to burn all his unpublished works, which came to 16 volumes. Unfortunately, his friends did as he requested, leaving us but a fraction of his output. But what a fraction! Smith is buried in Edinburgh, Scotland, in a large if not especially well-visited or well-maintained grave. ■

— **Robert L. Formaini**  
Senior Economist

## Notes

- <sup>1</sup> Ross (1995, 1). The exact date of Smith's birth is not known, but he was baptized on June 5, 1723.
- <sup>2</sup> Upon securing the customs appointment, Smith burned his clothes because they were not in compliance with England's complex trade restrictions and suggested to friends that they do likewise. See Skousen (2001, 30).
- <sup>3</sup> For an example of outright hostility, see Rothbard (1995).
- <sup>4</sup> Mitchell (1967, 48).
- <sup>5</sup> Blaug (1997, 33–34) reprints an amusing paragraph by Glenn Morrow to the effect that no one has ever read *Wealth of Nations* cover to cover. As for changing the world, in Smith's case, Keynes' famous description of "academic scribblers" was never more on target. See Keynes (1964, 383).
- <sup>6</sup> Robbins (1998, 128–29).
- <sup>7</sup> Stigler (1982, 147–48).
- <sup>8</sup> Skousen (2001, 31).

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## Why People Have Such a Weakness for the 'Spirit of System'

This spirit of system commonly takes the direction of that more gentle public spirit; always animates it, and often inflames it, even to the madness of fanaticism....The great body of the party are commonly intoxicated with the imaginary beauty of this ideal system, of which they have no experience, but which has been represented to them in all the most dazzling colours in which the eloquence of their leaders could paint it. Those leaders themselves, though they originally may have meant nothing but their own aggrandisement, become, many of them in time, the dupes of their own sophistry, and are as eager for this great reformation as the weakest and foolishlest of their followers. Even though the leaders should have preserved their own heads, as, indeed, they commonly do, free from this fanaticism, yet they dare not always disappoint the expectation of their followers, but are often obliged, though contrary to their principle and their conscience, to act as if they were under the common delusion. ■

—*The Theory of Moral Sentiments*, 232–33

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