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978-1-107-04337-4 - Adam Smith's *Wealth of Nations*: A Reader's Guide

Jerry Evensky

Excerpt

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## Prologue

### *The Purpose of This Work*

My subject is Adam Smith's economics as he presents it in his *Inquiry into the Nature and Causes of the Wealth of Nations* (sometimes abbreviated *WN* in what follows).<sup>1</sup>

Smith's rhetorical strategy in *The Wealth of Nations* is to lay out his narrative in a stepwise process of analytical presentation, empirical persuasion, and policy implications.

There are five "Books" in *WN*. Smith begins his analytical presentation in Book I, defining his terms and arranging them into statements about economic processes. In Book II he turns to the dynamics of economics systems, analyzing how and why the wealth of a nation grows, stagnates, or declines. In Book III he offers an empirical case for his model by demonstrating the power of his analysis to explain both the twists and turns and the long view of humankind's history.

Having presented his model and made his empirical case for it, in Book IV Smith examines two alternative models, Mercantilism and Physiocracy, highlighting their weaknesses and the perverse consequences of their application as policy. Finally, in Book V Smith turns to the policy implications of his own analysis, offering his perspective on the role of government in a liberal society with a special emphasis on the importance of establishing security and justice, providing public goods, optimal revenue generation, and properly aligning incentives.

*The Wealth of Nations* (first edition published in 1776) is one piece of Smith's planned body of work that was to offer a moral philosophical (a

<sup>1</sup> Smith writes that inquiries into what is "properly called Political Economy ... [are inquiries into] the nature and causes of the wealth of nations" (*WN*, 678–9).

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holistic) analysis of the human condition. He makes this agenda clear in the original "Advertisement" to the first published piece in this analysis, the first edition (1759) of his *Theory of Moral Sentiments*. Therein he tells us that there are more dimensions of his analysis yet to be written concerning law and government (never written, but his *Lectures on Jurisprudence* reflect his thinking on this dimension<sup>2</sup>) and economics (realized in WN).<sup>3</sup>

What I offer here is an analysis of the economics of Adam Smith as presented in *The Wealth of Nations* that weaves those other dimensions of his moral philosophy into his economics so that the integrated character of his moral philosophy becomes clear. To that end, I highlight the central role of the ethical standards and legal institutions in Smith's understanding of how and why the wealth of a nation grows, stagnates, or declines. This integrated analysis of WN has not been done before.<sup>4</sup>

<sup>2</sup> "The first of the two reports relates to Smith's Jurisprudence lectures in the 1762–3 [Glasgow University] session [LJ(A)], and the second, in all probability, to the lectures given in the 1763–4 session [LJ(B)].... [Clearly] what really matters ... is the *reliability* of the document [(referring to LJ(B))], does it or does it not give a reasonably accurate report of what was actually said in the lectures at which the original notes were taken? Now that we have another set of notes [LJ(A)] to compare it with, we can answer this question with a fairly unqualified affirmative" (Meek, Raphael, and Stein, 1978, 5, 7 emphasis in original).

<sup>3</sup> Even at the end of his life as he publishes the last revision of TMS in the year he dies (1790) Smith harkens back to this agenda in the "Advertisement":

"In the last paragraph of the first Edition of the present work, I said, that I should in another discourse endeavour to give an account of the general principles of law and government, and of the different revolutions which they had undergone in the different ages and periods of society; not only in what concerns justice, but in what concerns police, revenue, and arms, and whatever else is the object of law. In the Enquiry concerning the Nature and Causes of the Wealth of Nations, I have partly executed this promise; at least so far as concerns police, revenue, and arms. What remains, the theory of jurisprudence, which I have long projected, I have hitherto been hindered from executing, by the same occupations which had till now prevented me from revising the present work. Though my very advanced age leaves me, I acknowledge, very little expectation of ever being able to execute this great work to my own satisfaction; yet, as I have not altogether abandoned the design, and as I wish still to continue under the obligation of doing what I can, I have allowed the paragraph to remain as it was published more than thirty years ago, when I entertained no doubt of being able to execute every thing which it announced." (TMS, 3)

<sup>4</sup> In the course of my analysis I also examine several elements of Smith's WN that I do not believe have been developed in the literature. These include:

- In Book I, Smith's take-off theory of growth.
- In Book II, Smith's analysis of circuits of growth as self-expanding cycles driven by capital deepening and spilling over into ever widening circuits of trade.

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Ethics and law, as the keys to a “well-governed society” (WN, 22), are a constant theme in what follows because the progressive maturation of “government” is the *sine qua non* of Smith’s moral philosophical vision of humankind’s material progress. For Smith it is the content of and balance between individual ethics and institutional laws that “govern” a nation. And, it is the character of this *enlarged conception of “government”* that determines the prospect for a nation’s progress. In my “Epilogue: Adam Smith and Laissez-Faire,” I explore Smith’s complex view on the relationship between the citizen and the state. Smith’s is a nuanced view informed by what he clearly believes to be the messy business of the human condition.

It is not my purpose to offer a meticulous tome that addresses every issue that has ever been raised about Smith’s WN. WN has been dissected page by page by very thoughtful scholars for well over 200 years. A work written to address all the issues that have been examined with regard to every element of Smith’s WN would require multiple volumes.

My goal is at once less ambitious, and at the same time more so. It is to offer a persuasive analysis<sup>5</sup> of Smith’s *Inquiry into the Nature and Causes of the Wealth of Nations* as a unified theory of the evolution of humankind’s growing capacity for material production. And, to demonstrate how Smith’s economics is integrated into his larger moral philosophical vision of humankind’s progress from past to present to prospect.<sup>6</sup>

- In Book III, Smith’s analysis of the twists and turns of history in the short and mid-term to complement his understanding of the longer-term trajectory of the human condition.
- In Book IV, an analysis of the evolution of Smith’s views on the Mercantile system.
- In Book V, Smith’s focus on the role of government as an instrument for aligning incentives.

<sup>5</sup> If this is to be a persuasive representation of Adam Smith’s economics, I must at least meet the standards Smith would set for me:

- My interpretations of the individual elements of his analysis must efficiently and effectively represent a persuasive reading of his text, and
- I must weave a thread through these individual elements that “makes the sense of the author flow naturally upon our mind” (LRBL, 6) so that his *Inquiry into the Nature and Causes of the Wealth of Nations* makes sense as a narrative.

<sup>6</sup> Smith was a professor of Moral Philosophy at Glasgow. “Adam Smith did not think of himself as an economist, and so limited to familiar subject matter disciplinary boundaries. He was, instead, a moral philosopher, whose intellectual curiosity extended to the origins of the explanatory structure being applied” (Buchanan, 2008, 23).

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## 4 Adam Smith's Wealth of Nations: A Reader's Guide

To date, the most significant book-length analysis of the entire *Wealth of Nations* is Samuel Hollander's *The Economics of Adam Smith* (1973). Hollander's is a very valuable contribution to Smith scholarship, but it approaches Smith from a perspective that differs from the one I offer here. As Hollander himself notes, his purpose is to analyze Smith through a modern lens, applying modern techniques<sup>7</sup> to assess Smith's contributions.<sup>8</sup> The chapter headings in Hollander's work make clear that he is deconstructing Smith's analysis and exploring its elements one by one (Ch. 1 Automatic Equilibrating Processes, Ch. 2 Economic Development, Ch. 3 Industry Structure, Ch. 4 Theory of Value, and so on).

My purpose is different. It is to represent what Adam Smith *as moral philosopher* is doing in his *Inquiry into the Nature and Causes of the Wealth of Nations* as a part of his "grand vision" (Buchanan, 2008, 27).<sup>9</sup>

How do I *know* what Smith is "doing"? I don't. But, while it is impossible to know Smith's intentions with certainty, it is possible, by presenting an analysis that efficiently and effectively weaves together the threads of his *Inquiry* into a unified, coherent narrative, to offer a persuasive account of what he seems to be trying to communicate.<sup>10</sup>

<sup>7</sup> This is certainly a legitimate approach if, as Paul Samuelson writes: "Inside every classical economist is a modern economist trying to get out" (Samuelson, 1977, 42). But as the next footnote makes clear, Hollander has a more restrained view of the retrofitting of modern concepts on our predecessors.

<sup>8</sup> "[W]e adopt the position that the use of modern analytical tools, concepts, and procedures may be of considerable aid in an analysis of the work of an earlier writer, *provided that he was operating within the general frame of reference for which these devices are appropriate*. In particular, we believe that there is justification for the utilization of the current state of knowledge regarding the general equilibrium process in a study of the economics of Adam Smith insofar as he adopted the position that the price mechanism can be relied upon to clear product and factor markets.... The historian must, however, be alive to the danger that, in following this procedure, he will end up with an account of 'Smithian' ... economics rather than the economics of Adam Smith ..., it cannot be too strongly emphasized that it is with the latter that we are concerned" (Hollander, 13–14, emphasis in original).

<sup>9</sup> "How absurd to think of the author of the *Wealth of Nations* as interested only in the wealth of nations! Adam Smith's great work is more than a treatise on economics; it is a philosophical work, in that sense of the word 'philosophy' which has almost passed out of usage in the last hundred years" (Morrow, 322).

<sup>10</sup> "At the heart of Smith's thinking, his doctrine, and his method of presentation (the three are always related) is the notion of the chain (see ii. 133 and cf. Astronomy II. 8–9) – articulated continuity, sequence of relations leading to illumination. Leave no chasm or gap in the *thread*: 'the very notion of a gap makes us uneasy' (ii. 36)" (Bryce, 13, emphasis added). I follow Griswold's standard: that the "plausibility of my reconstruction of his basic framework rests primarily on its fit with his work" (Griswold, 170).

Smith asserts in his *Lectures on Rhetoric and Belles Lettres* that the point of good writing is to communicate with one's reader: "[T]he perfection of stile consists in Express<ing> in the most concise, proper and precise manner the thought of the author ... which he designs to communicate to his reader" (*LRBL*, 55).<sup>11</sup>

Adam Smith had something to say that he believed could contribute to humankind's progress.<sup>12</sup> My focus has been on listening carefully in order to understand as clearly and to relate as effectively as possible what Smith is trying to communicate. James Buchanan writes: "Perhaps, only perhaps, by concentrating carefully on Adam Smith's grand vision, paying heed both to what he actually wrote and to what he must have had in mind, we can, finally, come to a consensus understanding of his inclusive message as well as its current implications" (Buchanan, 2008, 27). I agree.

This work is offered as a scholarly contribution to the Smith literature, the domain of Smith specialists. That said, I have endeavored to write a piece that an interested nonspecialist will find a worthy read. There are, after all, very few Smith specialists, but there are many folks who reference Smith.

For well over 200 years Smith's work has been a constant reference, cited for authority in the thoughtful, and sometimes not so thoughtful,<sup>13</sup> public discourse about the nature of markets and the role of government in a market system.<sup>14</sup> If Smith is going to be called upon to "participate"

<sup>11</sup> "Smith's range of interests includes rhetoric and belles-lettres, in the pursuit of which he developed theories as to the best literary form for getting your message over to your audience" (Campbell, 574).

<sup>12</sup> "The Historians again made it their aim not only to amuse but by narrating the more important facts and those which were most concerned in the bringing about great revolutions, and unfolding their causes, to instruct their readers in what manner such events might be brought about or avoided" (*LRBL*, 111).

<sup>13</sup> See Amartya Sen's "Uses and Abuses of Adam Smith" (Sen, 2011). Smith is often treated like the Soviet Central Committee of the Communist Party treated Marx, as a deep well of expressions (taken out of context) that one can dip into in order to justify the next Five Year Plan. Another classic example of this selective citation process is that enlisted by Mrs. B. J. Gaillot to "prove," using the Bible as the textual resource (the "well"), that segregation is the will of God. See "God Gave the Law of Segregation (as well as the 10 Commandments) to Moses on Mount Sinai" (Gaillot, 1960). Mrs. Gaillot was doing her thing in New Orleans when I was growing up there. She was "effective" enough to get herself excommunicated from the Catholic Church.

<sup>14</sup> "One of the consequences of becoming a celebrated authority and father of a discipline like Adam Smith is that one inevitably becomes subject to recruitment drives on the part of a variety of one's successors. Appealing to the authority of a great thinker or seeking

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in this discourse, those who cite him should at least do him the courtesy of trying to understand his ideas in his own terms.

Herein I offer my understanding of Smith's ideas in his own terms.

inspiration in their work are regular occurrences in political and academic life, so fighting over Smith's legacy is no new sport" (Smith, Craig, 539). "[A]n economist must have peculiar theories indeed who cannot quote from *The Wealth of Nations* to support his special purposes" (Coats, 219).

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## I

## Adam Smith's Moral Philosophical Vision

*The Context of His Economic Analysis*

## ADAM SMITH AS MORAL PHILOSOPHER

Philosophy, by representing the invisible chains which bind together all these disjointed objects, endeavours to introduce order into this chaos of jarring and discordant appearances, to allay the tumult of the imagination, and to restore it, when it surveys the great revolutions of the universe, to that tone of tranquility and composure, which is both most agreeable in itself, and most suitable to its nature. Philosophy, therefore, may be regarded as one of those arts which addresses themselves to the imagination. Adam Smith's *History of Astronomy* (hereafter *HA*) (45–6)

Adam Smith was a philosopher,<sup>1</sup> one who believed that there is an order underlying what we observe in our universe and that to imagine and represent those “concealed connections<sup>2</sup> that unite the various appearances of nature” (*HA*, 51) is an intellectual joy,<sup>3</sup> an emotional balm,<sup>4</sup> and a social benefit.<sup>5</sup>

<sup>1</sup> See *Adam Smith's Moral Philosophy* (Evensky, 2005) chapters 1–4 for a more detailed presentation of what is covered here.

<sup>2</sup> Smith alludes to this concept of a natural system to be revealed in various ways. See Raphael and Skinner (p. 6) for examples.

<sup>3</sup> “[P]hilosophical effort involved not only an escape from the contemplation of ‘jarring and discordant appearances’ but also a source of pleasure in its own right” (Raphael and Skinner, 6). “It gives us a pleasure to see the phenomena which we reckoned the most unaccountable all deduced from some principle (commonly a wellknown one) and all united in one chain, far superior to what we feel from the unconnected method where everything is accounted for by itself without any reference to the others” (*LRBL*, 146).

<sup>4</sup> “Philosophy, by representing the invisible chains which bind together all these disjointed objects, endeavours to introduce order into this chaos of jarring and discordant appearances, to allay the tumult of the imagination, and to restore it, when it surveys the great revolutions of the universe, to that tone of tranquility and composure, which is both most agreeable in itself, and most suitable to its nature” (*HA*, 45–6).

<sup>5</sup> “Science is the great antidote to the poison of enthusiasm and superstition, and where the superior ranks of the people were secure from it, the inferior ranks could not be much exposed to it” (*WN*, 796).

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In his day philosophy was divided into two domains: Natural and Moral Philosophy.

Natural Philosophy focused on the physical universe. Natural philosophers carefully observed the universe and imagined what invisible connecting principles would be consistent with the “jarring and discordant appearances” we observe. Why, for example, do a few stars appear to wander through the heavens among the multitude of fixed stars?<sup>6</sup>

For centuries successively more complex epicycles of explanation seemed to offer ever more accurate explanations of these wandering stars. Each “success” encouraged even more careful observation. But keen observation brought not more understanding – just more epicycles. Then the earth was moved by Copernicus from the center of the “universe” and, with the benefit of Kepler’s elliptical orbits, a much simpler and more coherent explanation of the motion of these “wandering stars,” the planets,<sup>7</sup> was achieved.

But if the earth is indeed spinning on its axis and orbiting around the sun, why don’t we feel a brutal wind?<sup>8</sup> If we speed along in a carriage the wind is in our face, and yet as we hurtle around the sun – no wind. This and other questions remained unanswered. Enter Newton.

Newton’s analysis seemed to explain all that we could see, and to correctly predict things that were as yet unseen when he wrote (e.g., the return of Halley’s comet<sup>9</sup>). His laws of physics seemed *as if* they were the actual laws that ruled the physical universe.

This “as if” is not my phrase; it is Adam Smith’s. In his *History of Astronomy* Smith concludes his analysis of this history with glowing praise for Newton’s work, qualified by “as if”:

And even we, while we have been endeavouring to represent all philosophical systems as mere inventions of the imagination, to connect together the otherwise disjointed and discordant phaenomena of nature, have insensibly been drawn in, to

<sup>6</sup> My never to be forgotten high school teacher Mr. Herbert Behrend introduced me to this question.

<sup>7</sup> “The Stars, when more attentively surveyed, were some of them observed to be less constant and uniform in their motions than the rest, and to change their situations with regard to the other heavenly bodies; moving generally eastwards, yet appearing sometimes to stand still, and sometimes even to move westwards. These, to the number of five, were distinguished by the name of Planets, or wandering Stars” (*HA*, 55).

<sup>8</sup> “How, therefore, could the imagination ever conceive so ponderous a body to be naturally endowed with so dreadful a movement?” (*HA*, 78). “If the Earth, it was said, revolved so rapidly from west to east, a perpetual wind would set in from east to west, more violent than what blows in the greatest hurricanes” (*HA*, 79).

<sup>9</sup> See Smith’s *HA* (p. 103).

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make use of language expressing the connecting principles of this one [Newton's], *as if* they were the real chains which Nature makes use of to bind together her several operations. (HA, 105, emphasis added)

"As if" reflects Smith's philosophical humility.<sup>10</sup> The chains of causation that connect the natural events we observe are invisible. All we can know is what we observe, the events as they appear on the face of nature.<sup>11</sup> We can only imagine the invisible links based on what we can observe. We can never "know" nature, but with keen observation and building on the analysis of our predecessors, we can imagine and represent ever more persuasively what may lie behind the face of nature.<sup>12</sup> Smith "fully realized that science was a succession of approximations" (Bittermann, 733).

Newton was a Natural philosopher. Smith was a Moral philosopher.

Natural philosophers sought to represent the invisible connecting principles that underlie the order around us. Moral philosophers did the same for the order among us – the order of humankind.

Following Newton, observation and imagination are the keys to Smith's moral philosophical method. As a Moral philosopher, Smith observed all things human. His data included histories of past societies, stories of contemporary societies, and observations of his own society. His goal, based on these data, was to present a persuasive analysis<sup>13</sup> of the nature and causes of humankind's past and present course with an

<sup>10</sup> For a lovely example of Smith's admiration for philosophical humility, see his letter written as a eulogy for David Hume and in particular his description of Hume's imagined conversation with Charon as he tries to negotiate a delay in crossing the River Styx (*Correspondence*, 217).

<sup>11</sup> "Who wonders at the machinery of the opera-house who has once been admitted behind the scenes? In the Wonders of nature, however, it rarely happens that we can discover so clearly this connecting chain. With regard to a few even of them, indeed, we seem to have been really admitted behind the scenes, and our Wonder accordingly is entirely at an end" (HA, 42–3).

<sup>12</sup> So too, I can't know Smith's mind. I can only imagine and offer what I hope will be a persuasive analysis based on what is observable ... his works.

<sup>13</sup> "The desire of being believed, the desire of persuading, of leading and directing other people, seems to be one of the strongest of all our natural desires. It is, perhaps, the instinct upon which is founded the faculty of speech, the characteristic faculty of human nature. No other animal possesses this faculty, and we cannot discover in any other animal any desire to lead and direct the judgment and conduct of its fellows. Great ambition, the desire of real superiority, of leading and directing, seems to be altogether peculiar to man, and speech is the great instrument of ambition, of real superiority, of leading and directing the judgments and conduct of other people" (TMS, 336).

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eye toward contributing to the realization of its prospect,<sup>14</sup> which, he believed based on the patterns he observed from the past to the present, is progress.<sup>15</sup>

Smith's *Inquiry into the Nature and Causes of the Wealth of Nations* is one dimension of his larger moral philosophical inquiry into humankind's past, present, and prospect.

#### SMITH'S MORAL PHILOSOPHY AND THE WEALTH OF NATIONS

Adam Smith comes to his *Inquiry into the Nature and Causes of the Wealth of Nations* with some principles of his analysis of humankind already well developed.

In his first book, *The Theory of Moral Sentiments* (1759), he lays the foundation for his analysis of humankind by examining human nature, the attributes we share as the individuals who collectively make up humankind.

Our nature is, according to Smith, like a "coarse clay" (TMS, 162),<sup>16</sup> very malleable but with some universal characteristics:

- We all act on the same set of basic sentiments (self-love, justice, and beneficence) – individuals' different actions in similar circumstances are explained by the differing balance of these sentiments among us.
- We all desire to enjoy the approbation (praise) and avoid the disapprobation (blame) of those with whom we share our social world.
- We each have the capacity to transcend the societal pressures that derive from our desire for praise or abhorrence of blame, and in pursuit of

<sup>14</sup> For Smith "the historian's aim as an author consisted, not in seeking to entertain the reader ... but rather in offering him instruction, so that mankind, by coming to know the more interesting and important events of human life and by coming to understand what caused them, could learn the means by which good effects might be produced and evil effects avoided in human affairs" (Howell, 27–8).

<sup>15</sup> "Smith along with his contemporaries expected the world to become more intelligent, more tolerant, and more humane with the decline of superstition and the advance of knowledge.... Smith was undeniably a 'progressivist' ... Yet progress was not automatic. He did not look to Providence for direct aid in the economic and moral improvement of mankind. Man had to act on his own behalf ... Smith's own work as economist and philosopher were [*sic*] intended, most probably, as contributions toward this progress (Bittermann, 733–4).

<sup>16</sup> "Man [as individual] is perpetually changing ... [b]ut humanity, or human nature, is always existent, is always the same.... This, therefore, is the object of science, reason, and understanding" (EPS, 121). See Meek for more on this malleable conception of being as pervading "Enlightenment thought" (Meek, 1976, 20).