Chapter 6
Adam Smith: Theory and Policy

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Introduction

Adam Smith was appointed to the Chair of Logic in Glasgow University in 1751. He was translated to the Chair of Moral Philosophy in 1752 and held this post until he retired from academic life in 1764. During this period Smith took an active part in the administration of the University and also taught extensively, even by modern standards. On Mondays to Fridays he lectured to the public or graduating class from 7.30 to 8.30 a.m. and met the same class again at 11 o’clock in order to “examine” the students on the topics of the first address. He also lectured on the “private” class at 12 noon, 3 days a week.

According to John Millar, Smith’s most distinguished student and later professor of public law, Smith devoted the bulk of his time in the private class to the delivery of a system of Rhetoric and Belles Lettres which was probably based upon the materials he had worked up when giving a private course in Edinburgh between 1748 and 1751. These lectures were concerned with such topics as the origin of language, style and above all with analysis of a variety of forms of discourse; in effect a general theory of the way in which we communicate ideas, including scientific ideas.

Smith’s teaching from the Chair of Moral Philosophy fell into four parts. Again on the authority of John Millar, it is known that he lectured on natural theology, ethics, jurisprudence and economics in that order and in a style that confirms his debt to his old teacher, Francis Hutcheson. Millar also made it clear that the lectures on ethics formed the basis of the Theory of Moral Sentiments (TMS) (1759) and that the subjects covered in the last part of the course were further to be developed in the Wealth of Nations (WN) (1776).
Adam Smith had a very definite research programme in mind from an early date; a fact which was made clear in the concluding passages of the first edition of the TMS. The point was also repeated in the advertisement to the sixth and last edition of the work (1790) where Smith indicated that the TMS and WN were two parts of a plan which he hoped to complete by giving “an account of the general principles of law and government, and of different revolutions which they had undergone in the different ages and periods of society”.

Sadly, Smith did not live to complete his plan partly at least as a result of his appointment, in 1778, as Commissioner of Customs. But posterity has been fortunate as a result of the discoveries made by Edwin Cannan (1895) and John Lothian (1958) which brought to light two versions of Smith’s lectures on jurisprudence as they were delivered in the sessions 1762–1763 and 1763–1764.

The three parts of Smith’s great plan are highly systematic; each discloses a debt to contemporary scientific work especially in the fields of biology and Newtonian physics; all are interdependent.

The TMS, which builds upon the analyses of Hutcheson and David Hume (Winch 1978), is primarily concerned with the way in which we form moral judgements. It was also designed to explain the emergence, by natural as distinct from artificial means, of those barriers that control our self-regarding and un-social passions. The argument gives prominence to the emergence of general rules of conduct, based upon experience, which include the rules of law. The analysis also confirms that accepted standards of behaviour are related to environment and that they may vary in different societies at the same point in time and in a given society over time; a thesis which owed much to the persuasive influence of Montesquieu.

The lectures on jurisprudence on the other hand help to explain the emergence of government and its changing structure in terms of an analysis which features the use of four distinct types of socio-economic environment the celebrated stages of hunting, pasture, agriculture and commerce.

The ethics and Smith’s historical treatment of jurisprudence were also closely linked with the economic analysis that was to follow. If Smith gave prominence to the role of self-interest in this context, auditors of his lecture course and readers of the TMS would be aware that the basic drive to better our condition was subject to a constant process of moral scrutiny. It would also be appreciated that economic aspirations had a social reference in the sense that it is chiefly from a regard “to the sentiments of mankind, that we pursue riches and avoid poverty” (TMS i.iii.2.1). Later in the book, the position was further clarified when Smith noted that we tend to approve the means as well as the ends of ambition. “Hence … the eminent esteem with which all men naturally regard a steady perseverance in the practice of frugality, industry and application” (TMS IV.2.8).

The lectures on jurisprudence helped Smith to specify the nature of the system of positive law, which might be expected in the stage of commerce and also throws some light on the form of government that might conform to it.

Finally, the treatment of jurisprudence is important because it helps to explain the origins of the modern economy and the emergence of an institutional structure (Rosenberg 1960) where all goods and services command a price. It is in this context that “Every man … lives by exchanging, or becomes in some measure a merchant” (WN I.iv.1); a position which leads to Smith’s famous judgement that:
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. Nobody but a beggar chooses to depend chiefly upon the benevolence of his fellow citizens. Even the beggar does not depend upon it entirely (WN, l.ii.2).

The Workings of the “Invisible Hand”

As far as the purely economic analysis is concerned, it is sufficient to our present purpose to be reminded that in the WN the theory of price and allocation was developed in terms of a model which made due allowance to distinct factors of production (land, labour, capital) and for the appropriate forms of return (rent, wages, profit). This point, now so obvious, struck Smith as novel and permitted him to develop an analysis of the allocative mechanism that ran in terms of inter-related adjustments in both factor and commodity markets. The resulting version of general interdependence also allowed Smith to move from the discussion of “micro” to that of “macro” economic issues, and to develop a model of the “circular flow” which relies heavily on a distinction between fixed and circulating capital.

But these terms, which were applied to the activities of individual undertakers, were transformed in their meaning by their application to society at large. Working in terms of period analysis where all magnitudes are dated, Smith in effect represented the working of the economic process as a series of activities and transactions which linked the main socio-economic groups (proprietors, capitalists and wage-labour) and productive sectors. In Smith’s terms, current purchases in effect withdrew consumption and investment goods from the circulating capital of society; goods which were in turn replaced and income re-generated by virtue of productive activity in a given time period over a series of such periods.

We should note in this context that Smith was greatly influenced by a specific model of the economy which he came across during a visit to Paris in 1766. The model was designed to explain the operation of an economic system treated as an organic system. It was first produced by Francois Quesnay, a medical doctor, and later developed by A.R.J. Turgot, Minister of Finance under Louis XVI (Meek 1962, 1973). The significance of the analogy of the circulation of the blood would not be lost on Smith – and not would the link with William Harvey, a distinguished member of the medical school of Padua.

Looked at from one point of view, the analysis taken as a whole provides one of the most dramatic examples of the doctrine of “unintended social outcomes” or the working of the “invisible hand”. The individual undertaker (entrepreneur), seeking the most efficient allocation of resources, contributes to overall economic efficiency; the merchant’s reaction to price signals helps to ensure that the allocation of resources accurately reflects the structure of consumer preferences; and the drive to better our condition contributes to economic growth. Looked at from another perspective, the work can be seen to have resulted in a great conceptual system linking
together logically separate, yet inter-related, problems such as price, allocation, distribution, macro-statistics and macro-dynamics.

If such a theory enabled Smith to isolate the causes of economic growth, with the emphasis now on the supply side, it was also informed throughout by what Terence Hutchison has described as the “powerfully fascinating idea and assumption of beneficent self-adjustment and self-equilibration” (Hutchison 1988, p. 268).

The argument is also buttressed by a series of judgements as to probable patterns of behaviour and actual trends of events. It was Smith’s firm opinion, for example, that in a situation where there was tolerable security, “the sole use of money is to circulate consumable goods. By means of it, provisions, materials, and finished work are bought and sold, and distributed to their proper consumers” (WN, 11.iii.23). In the same way he contended that savings generated during any (annual) period would always be matched by investment (WN, 11.iii.18); a key assumption of the classical system which was to follow. In the case of Great Britain, Smith also pointed out that real wages had progressively increased during the eighteenth century, and that high wages were to be approved of as a contribution to productivity (WN, l.vii.44). The tone is buoyant with regard to economic growth and this was duly reflected in the policy stance which Smith was to adopt.

Smith’s prescription with regard to economic policy followed the direction of analysis just considered. He called on governments to minimise their “impertinent” obstructions to the pursuit of individuals. In particular, he recommended that the statutes of apprenticeship and the privileges of corporations should be repealed on the grounds that they adversely affect the working of the allocative mechanism. In the same chapter Smith pointed to the barriers of the deployment of labour generated by the Poor Laws and the Laws of Settlement (cf. WN, I.x.c:IV.ii 42). But there is also a moral dimension to the argument in the sense that all of the regulations so far reviewed constitute violations of natural liberty.

Smith objected to positions of privilege, such as monopoly powers, which he regarded as creatures of the civil law. The institution was again represented as impolitic and unjust; unjust in that a position of monopoly is a position of unfair advantage, and impolitic in that the prices of the goods so controlled are “upon every occasion the highest which can be got” (WN, l.vii.27).

In this context we may usefully distinguish Smith’s objection to monopoly in general from his criticism of one manifestation of it namely, the mercantile system, described as the “modern system” of policy, best understood, “in our own country and in our own times” (WN, IV.2). The system is represented as a coherent whole; as a set of policies based on regulation and therefore liable to that “general objection which may be made to all the different expedients of the mercantile system; the objection of forcing some part of the industry of the country into a channel less advantageous than that in which it would run of its own accord” (WN, V.v.a.24).

Professor Winch summarised Smith’s advice to the Legislator (cf. Haakonssen 1981) in these terms:

The system of natural liberty, should it ever come into existence, will produce a fairer distribution of income and fewer injustices in the form of infringements of natural liberties or rights such as those affecting choice of occupation, place of residence, and modes of employing capital and other types of property (1983, p. 529).
Functions of Government

Smith’s view of the government, or rather the functions of government, was positive in other ways. Most obviously, he recognised that the state had an obligation to provide for defence since in the last analysis security is always more important than opulence. He also recognised the need to provide an adequate system of justice, both as a pre-condition of social order and as a basic pre-requisite for economic growth. Both of these essential services were designed to secure a stable environment – and so too were a number of economic policies.

In fact Smith was prepared to justify a wide range of policies, all of which have been carefully catalogued by Jacob Viner in his justifiably famous article on Adam Smith and Laisser-Faire Viner (1927). For example, he was prepared to justify the use of stamps on plate and linen as the most effectual guarantee of quality (WN, l.x.c.13), the compulsory regulation of mortgages (WN, V.ii.h.17), the legal enforcement of contracts (WN, l.ix.16) and government control of the coinage. In addition he defended the granting of temporary monopolies to mercantile groups on particular occasions, to the inventors of new machines and, not surprisingly, to the authors of new books (WN, V.i.e.30).

But four broad areas of intervention are of particular interest, in the sense that they involve issues of general principle. First, Smith advised governments that they were faced with taxes imposed by their competitors in trade retaliation could be in order especially such an action had the effect of ensuring the “repeal of the high duties or prohibitions complained of” (cf. Winch 1983, p. 509). Second, Smith advocated the use of taxation, not simply as a means of raising revenue, but as means of controlling certain activities, and of compensating for what would now be known as a detective telescopic faculty, i.e. a failure to perceive our long-run interest (cf. WN, V.ii.x.4; V.ii.k.50; V.ii.g.12).

Smith was also well aware, to take a third point, that the modern version of the “circular flow” depended on paper money and on credit (Zallio, 1990); in effect a system of “dual circulation” involving a complex of transactions linking producers and merchants, dealers and consumers (WN, 11.ii.88); transactions that would involve cash (at the level of household and credit) (at the level of the firm). It is in this context that Smith advocated control over the rate of interest, set in such a way as to ensure that “sober people are universally preferred, as borrowers, to prodigals and projectors” (WN, II.iv.15). He was also willing to regulate the small note issue in the interests of a stable banking system. To those who objected to this proposal, he replied that the interests of the community required it, and concluded that “the obligation of building party walls, in order to prevent the communication of fire, is a violation of natural liberty, exactly of the same kind with the regulations of the banking trade which are here proposed” (WN, 11.ii.94).

Although Smith’s monetary analysis is not regarded as among the strongest of his contributions, it should be remembered that the witness of the collapse of the major banks in the 1770s was acutely aware of the problems generated by a sophisticated credit structure. It was in this context that Smith articulated a very general principle, namely, that “those exertions of the natural liberty of a few individuals,
which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments, of the most free, as well as of the most despotical” (WN, il.ii.94).

Emphasis should be given finally to Smith’s contention that a major responsibility of government must be the provision of certain public works and institutions for facilitating the commerce of the society which were “of such a nature, that the profit could never repay the expense to any individual or small number of individuals, and which it, therefore, cannot be expected that any individual or small number of individuals should erect or maintain” (WN, V.i.c.1). In short, he was concerned to point out that the state would have to organise services or public works, which the profits motive alone could not guarantee.

The examples of public works which Smith provided include such items as roads, bridges, canals and harbours – all thoroughly in keeping with the conditions of the time and with Smith’s emphasis on the importance of transport as a contribution to the effective operation of the market and the process of economic growth. But although the list is short by modern standards, the discussion of what may be called the “principles of provision” is of interest for the emphasis which is given to situations where market forces alone will not generate services or facilities which are necessary to the economic well-being of the whole.

The theme is continued in Smith’s treatment of another important service, namely education; a subject which was developed in the course of Smith’s discussion of the social and psychological costs of economic growth; costs which he attributed to the division of labour. There are three applications. First, Smith suggested that economic development could lead to a decline in martial spirit; a problem which he likened to leprosy or any other loathsome disease – moving Jacob Viner to add public health to Smith’s list of governmental functions (Viner 1927; Wood 1984, i. 162). In this connection Smith advocated a kind of military education akin perhaps to that of the territorial but not inconsistent with National Service.

Second, he drew attention to the problem of the relatively poor who lack the leisure, means and inclination to provide education for their children (WN, V.i.f.53). Smith’s programme is limited but he did advocate the setting up of local schools of the Scottish model and suggest that the poor could be taught “the most essential parts of education … to read, write and account” together with the “elementary parts of geometry and mechanics” (WN, V.i.f.54, 55). Smith was prepared to go so far as to infringe the natural liberty of the subject, where this is narrowly defined, in recommending that the “public can impose almost the whole body of the people the necessity of acquiring those most essential parts of education by obliging every man to undergo an examination or probation in them before he can obtain the freedom in any corporation, or be allowed to set up any trade either in a village or a town corporate” (WN, V.i.f.57).

Finally, Smith advocated training in the higher sciences, such as were taught in the universities and went so far as to suggest that government should act “by instituting some sort of probation even in the higher and more difficult sciences, to be undergone by every person before he was permitted to exercise any liberal profession, or before he could be received as a candidate for any honourable office or trust of profit” (WN, V.i.g.14). It will be noted that Smith did not regard education as a matter of choice but of compulsion.
Adam Smith on Equitable and Efficient Government

Smith not only identified the various services which the state was expected to provide but also gave a great deal of attention to the forms of organisation which would be needed to ensure and to induce efficient delivery thus returning the reader to the role of self-interest. For example, in the case of justice, treated as a public service, Smith contended that effective provision of so central a service depended crucially on a clear separation of the judicial from the executive power (WN, V.i.b.23).

But as Alan Peacock (1975) has pointed out, Smith’s efficiency criteria are distinguished from this basic issue of organisation, the argument being, in effect, that the services provided by attorneys, clerks or judges should be paid for in such a way as to encourage productivity. Smith also ascribed the “present admirable constitution of the courts of justice in England” to the use of a system of court fees which had served to encourage competition between the courts of King’s bench chancery, and exchequer (WN, V.i.b.20, 21). A further interesting and typical feature of the discussion is found in Smith’s argument that although justice is a service to the whole community, nonetheless, the costs of handling specific causes should be borne by those who give occasion to, or benefit from them. He therefore concluded that the “expense of the administration of justice … may very properly be defrayed by the particular contribution of one or other, or both of those two different sets of persons, according as different occasions may require, that is, by fees of court” (WN, V.i.i.2), rather than by a charge on general funds.

The theme was continued in the discussion of public works where Smith suggested that the main problems to be addressed were those of equity and efficiency.

With regard to equity, Smith argued that public works such as highways, bridges and canals should be paid for by those who use them in proportion to the wear and tear occasioned. At the same time, he argued that the consumer who pays the charges generally gains more from the cheapness of carriage than he loses in the charges incurred (WN, V.i.d.4).

Smith also defended the principle of direct payment on the grounds of efficiency. Only by this means, he argued, would it be possible to ensure that services are provided where there is a recognisable need; only in this way would it be possible to avoid building roads through a desert for the sake of some private interest; or a great bridge “thrown over a river at a place where nobody passes, or merely to embellish the view from the windows of a neighbouring palace; things which sometimes happen, in countries where works of this kind are carried on by any other revenue than that which they themselves are capable of affording” (WN, V.i.d.6).

Smith also tirelessly emphasised the point, already noticed in the discussion of justice, namely, that in every trade and profession “the exertion of the greater part of those who exercise it, is always in proportion to the necessity they are under of making that exertion” (WN, V.i.f.4). On this ground, for example, he approved of the expedient used in France, whereby a construction engineer was made a present of tolls on a canal for which he had been responsible, thus ensuring that it was in his interest to keep the canal in good repair.
The “incentive” argument is eloquently developed in Smith’s treatment of universities where he argued, notably in correspondence with William Cullen, an old friend and colleague, that degrees can be likened to the statutes of apprenticeship (Corr, 177) which offered no guarantee of quality, and protested against the idea of universities having a monopoly of higher education (Corr, 174) on the ground that this would inhibit private teachers, notably of medicine.

In particular Smith objected to a situation where professors enjoyed a stable and high income irrespective of competence or industry (WN, V.i.f.7): the Oxford, rather than the Glasgow model. In the same context, he argued in favour of free movement of students between teachers and institutions (WN, V.i.f.12, 13) as a means of inducing teachers to provide appropriate services. Smith concluded:

The expense of the institutions for education and religious instruction is ... beneficial to the whole society, and may, therefore, without injustice, be defrayed by the general contribution of the whole society. This expense however, might perhaps with equal propriety, and even with some advantage, be defrayed altogether by those who receive the immediate benefit of such education and instruction, or by the voluntary contribution of those who think they have occasion for either the one of the other (WN, V.i.i.5).

While the modern reader has to make a considerable effort to understand Smith’s intentions, students of his course in Glasgow and perhaps contemporary readers of his work would quite readily perceive that the different parts were important of themselves and also that they display a certain pattern of inter-dependence. As we have seen, the ethical argument indicates the manner in which general rules of conduct emerge, and postulates the need for a system of force-backed law, appropriately administered if social order is to be possible. The treatment of jurisprudence showed the manner in which government emerged and developed through time, and threw some light on the actual content of rules of behaviour, which are likely to prevail in the four different socio-economic states.

It would also be evident to Smith’s students that the treatment of economics was based upon psychological judgements (such as the desire for status) which are only explained in the ethics, and that this branch of Smith’s argument takes as given that particular socio-economic structure which is appropriate to the fourth economic stage, that of commerce. The lesson that he taught was that economic phenomena should not be seen in isolation.

**Conclusion**

The modern reader too will find much instruction in Smith’s work, especially if the separate parts are seen, as Smith intended they should be seen, as making the parts a greater whole; an achievement which invites us to consider that economics, ethics and jurisprudence should be seen as the essential components of a system of social science.

There are further dimensions of Smith’s thought which are also of continuing relevance and which reflect aspects of his teaching in jurisprudence and ethics, seen now from a different perspective.
It will be recalled that for Smith the fourth economic stage could be seen to be associated with a particular form of social and political structure which influences the outline of government and the context within which it must function.

Smith drew attention in this connection to the fact that modern government of the British type was a complex instrument; that politics was a competitive game with as its object the attainment of “the great prizes which sometimes come from the wheel of the great state lottery of British politics” (WN, IV, vii, c, 75). Smith added in a passage that reflects the psychological assumptions of the TMS (I, iii.2, “Of the origin of Ambition”) that:

Men desire to have some share in the management of public affairs chiefly on account of the importance which it gives them (WN, IV.vii.c.74).

This point leads on to another which was emphasised by Smith, namely that the same economic forces which had served to elevate the House of Commons to a superior degree of influence had also served to make it an important focal point for sectional interests – a development which could seriously affect the legislation which was passed and thus affect that extensive view of the common good which ought ideally to direct the activities of Parliament in fulfilling the functions of government outlined above.

If Smith was alive to the dangers of collective interests he also commented upon the “insolence of office” and warned against the man of system who “is apt to be very wise in his own conceit” and who “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” (TMS, IV, ii.2.17).

At the same time, Smith noted that governments on the English model were likely to be particularly sensitive to public opinion – and as frequently constrained by it. Smith made much of the point and in a variety of ways. He noted, for example, that even if the British Government of the 1770s had thought it possible voluntarily to withdraw from the current conflict with America, it could not pursue this eminently rational course for fear of public discredit (Corr, 383).

Smith also gave a great deal of attention to the general problems presented by the confirmed habits and prejudices of a people and to the need to adjust legislation accordingly. For example, he likened the fear of engrossing and forestalling in discussing the corn trade “to the popular terrors and suspicions of witchcraft” (WN, IV.v.b.26), and described the law dealing with the exportation of wheat as one which “thought not the best in itself, is the best which the interests, prejudices, and temper of the Times would admit of” (WN, IV.v.b.53). The reference to the Wisdom of Solon in the context of the previous discussion finds an echo in the Moral Sentiments (VI.ii.2, 16).

We are reminded that governments as well as markets may have failings (cf. West 1976); failings which may reflect imperfect knowledge, and the problem of structure as well as the role of public opinion – ironically, one of the most important pillars of political freedom.

Smith recognised the point that in the modern state it is critically important that the citizen be vigilant, informed, above all else educated, in the broad sense of that
term, if an adequate standard of moral and political behaviour is to be sustained. Or, as he put it:

An instructed and intelligent people … are always more decent and orderly than an ignorant and stupid one. They feel themselves, each individually, more respectable, and more likely to obtain the respect of their lawful superiors. They are more disposed to examine, and more capable of seeing thought, the interested complaints of faction and sedition … in tree countries, where the safety of government depends very much on the favourable judgement which the people may form of its conduct, it must surely be of the highest importance that they should not be disposed to judge rashly or capriciously concerning it (WN, V.i.t.61).

The reference to the role of government reminds us that Smith regarded the study of political economy, in the old sense of that term, as a “branch of the science of a statesman or legislator;” of the contrast which he drew between the statesman and that “insidious and crafty animal” vulgarly called the politician and of his conviction that it was the duty of philosophers such as himself to encourage “the development of the public spirited attitudes of the legislator” (Winch 1983, p. 503). Professor Winch concluded that “the strategy of persuasion that lies behind the WN … provides the basis of Smith’s case for bringing science to bear on the conduct of legislators” (op cit, p. 503; cf. Haakonssen 1981) and makes the point that “much of Smith’s advice … depends on considerations that do not flow from economic reasoning alone” (op cit, p. 502).

“The argumentation of this chapter is drawn from A System of Social Science (OUP, 2nd ed., 1996)”.

Works of Adam Smith

Corr    Correspondence, ed. E.C. Mossner and I.S. Ross (OUP, 1977)
LRBL    Lectures on Rhetoric and Belles Lettres, ed. J.C. Bryce (OUP, 1983)
Stewart Dugald Stewart, Account of the Life and Writings of Adam Smith, included in EPS

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