

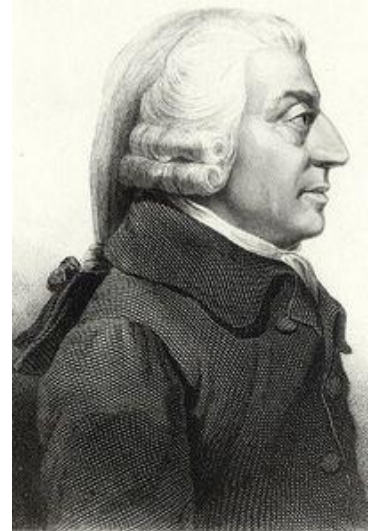
Adam Smith

1723-1790

With [*The Wealth of Nations*](#) Adam Smith installed himself as the leading expositor of economic thought. Currents of Adam Smith run through the works published by [DAVID RICARDO](#) and [KARL MARX](#) in the nineteenth century, and by [JOHN MAYNARD KEYNES](#) and [MILTON FRIEDMAN](#) in the twentieth.

Adam Smith was born in a small village in Kirkcaldy, Scotland, where his widowed mother raised him. At age fourteen, as was the usual practice, he entered the University of Glasgow on scholarship. He later attended Balliol College at Oxford, graduating with an extensive knowledge of European literature and an enduring contempt for English schools.

He returned home, and after delivering a series of well-received lectures was made first chair of logic (1751), then chair of moral philosophy (1752), at Glasgow University.



He left academia in 1764 to tutor the young duke of Buccleuch. For more than two years they traveled throughout France and into Switzerland, an experience that brought Smith into contact with his contemporaries Voltaire, Jean-Jacques Rousseau, [FRANÇOIS QUESNAY](#), and Anne-Robert-Jacques Turgot. With the life pension he had earned in the service of the duke, Smith retired to his birthplace of Kirkcaldy to write *The Wealth of Nations*. It was published in 1776, the same year the American Declaration of Independence was signed and in which his close friend [DAVID HUME](#) died. In 1778 he was appointed commissioner of customs. In this job he helped enforce laws against smuggling. In *The Wealth of Nations*, he had defended smuggling as a legitimate activity in the face of “unnatural” legislation. Adam Smith never married. He died in Edinburgh on July 19, 1790.

Today Smith’s reputation rests on his explanation of how rational self-interest in a free-market economy leads to economic well-being. It may surprise those who would discount Smith as an advocate of ruthless individualism that his first major work concentrates on ethics and [CHARITY](#). In fact, while chair at the University of Glasgow, Smith’s lecture subjects, in order of preference, were natural theology, ethics, jurisprudence, and economics, according to John Millar, Smith’s pupil at the time. In [*The Theory of Moral Sentiments*](#), Smith wrote: “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.”¹

At the same time, Smith had a benign view of self-interest, denying that self-love “was a principle which could never be virtuous in any degree.”² Smith argued that life would be tough if our “affections, which, by the very nature of our being, ought frequently to influence our

conduct, could upon no occasion appear virtuous, or deserve esteem and commendation from anybody.”[3](#)

Smith did not view sympathy and self-interest as antithetical; they were complementary. “Man has almost constant occasion for the help of his brethren, and it is in vain for him to expect it from their benevolence only,” he explained in *The Wealth of Nations*.[4](#)

Charity, while a virtuous act, cannot alone provide the essentials for living. Self-interest is the mechanism that can remedy this shortcoming. Said Smith: “It is not from the benevolence of the butcher, the brewer, or the baker, that we can expect our dinner, but from their regard to their own interest” (ibid.).

Someone earning money by his own labor benefits himself. Unknowingly, he also benefits society, because to earn income on his labor in a competitive market, he must produce something others value. In Adam Smith’s lasting imagery, “By directing that industry in such a manner as its produce may be of 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.”[5](#)

The Wealth of Nations, published as a five-book series, sought to reveal the nature and cause of a nation’s prosperity. Smith saw the main cause of prosperity as increasing division of labor. Using the famous example of pins, Smith asserted that ten workers could produce 48,000 pins per day if each of eighteen specialized tasks was assigned to particular workers. Average [PRODUCTIVITY](#): 4,800 pins per worker per day. But absent the division of labor, a worker would be lucky to produce even one pin per day.

Just how individuals can best apply their own labor or any other resource is a central subject in the first book of the series. Smith claimed that an individual would invest a resource—for example, land or labor—so as to earn the highest possible return on it. Consequently, all uses of the resource must yield an equal rate of return (adjusted for the relative riskiness of each enterprise). Otherwise reallocation would result. [GEORGE STIGLER](#) called this idea the central proposition of economic theory. Not surprisingly, and consistent with another Stigler claim that the originator of an idea in economics almost never gets the credit, Smith’s idea was not original. The French economist [TURGOT](#) had made the same point in 1766.

Smith used this insight on equality of returns to explain why wage rates differed. Wage rates would be higher, he argued, for trades that were more difficult to learn, because people would not be willing to learn them if they were not compensated by a higher wage. His thought gave rise to the modern notion of [HUMAN CAPITAL](#). Similarly, wage rates would also be higher for those who engaged in dirty or unsafe occupations (see [Job Safety](#)), such as coal mining and butchering; and for those, like the hangman, who performed odious jobs. In short, differences in work were compensated by differences in pay. Modern economists call Smith’s insight the theory of compensating wage differentials.

Smith used numerate economics not just to explain production of pins or differences in pay between butchers and hangmen, but to address some of the most pressing political issues of the day. In the fourth book of *The Wealth of Nations*—published, remember, in 1776—Smith told

Great Britain that its American colonies were not worth the cost of keeping. His reasoning about the excessively high cost of British imperialism is worth repeating, both to show Smith at his numerate best and to show that simple, clear economics can lead to radical conclusions:

A great empire has been established for the sole purpose of raising up a nation of customers who should be obliged to buy from the shops of our different producers all the goods with which these could [SUPPLY](#) them. For the sake of that little enhancement of price which this [MONOPOLY](#) might afford our producers, the home-consumers have been burdened with the whole expense of maintaining and defending that empire. For this purpose, and for this purpose only, in the two last wars, more than a hundred and seventy millions [in pounds] has been contracted over and above all that had been expended for the same purpose in former wars. The interest of this debt alone is not only greater than the whole extraordinary profit, which, it ever could be pretended, was made by the monopoly of the colony trade, but than the whole value of that trade, or than the whole value of the goods, which at an average have been annually exported to the colonies.⁶

Smith vehemently opposed [MERCANTILISM](#)—the practice of artificially maintaining a trade surplus on the erroneous belief that doing so increased wealth. The primary advantage of trade, he argued, was that it opened up new markets for surplus goods and also provided some commodities from abroad at a lower cost than at home. With that, Smith launched a succession of free-trade economists and paved the way for David Ricardo's and [JOHN STUART MILL](#)'s theories of [COMPARATIVE ADVANTAGE](#) a generation later.

Adam Smith has sometimes been caricatured as someone who saw no role for government in economic life. In fact, he believed that government had an important role to play. Like most modern believers in free markets, Smith believed that the government should enforce contracts and grant patents and copyrights to encourage inventions and new ideas. He also thought that the government should provide public works, such as roads and bridges, that, he assumed, would not be worthwhile for individuals to provide. Interestingly, though, he wanted the users of such public works to pay in proportion to their use.

Many people believe that Smith favored retaliatory tariffs. A retaliatory tariff is one levied by, say, the government of country A against imports from country B to retaliate for tariffs levied by the government of country B against imports from country A. It is true that Smith thought they might be justified, but he was fairly skeptical. He argued that causing additional harm to one's own citizens is a high price to pay that tends not to compensate those who were harmed by the foreign tariff while also hurting innocent others who had no role in formulating the tariff policy. He wrote:

There may be good policy in retaliations of this kind, when there is a probability that they will procure the repeal of the high duties or prohibitions complained of. The recovery of a great foreign market will generally more than compensate the transitory inconveniency of paying dearer during a short time for some sorts of goods. To judge whether such retaliations are likely to produce such an effect does not, perhaps, belong so much to the science of a legislator, whose deliberations ought to be governed by general principles which are always the same, as to the skill of that insidious and crafty animal, vulgarly called a statesman or politician, whose councils are directed by the momentary fluctuations of affairs. When there is no probability that any such

repeal can be procured, it seems a bad method of compensating the injury done to certain classes of our people to do another injury ourselves, not only to those classes, but to almost all the other classes of them. When our neighbours prohibit some manufacture of ours, we generally prohibit, not only the same, for that alone would seldom affect them considerably, but some other manufacture of theirs. This may no doubt give encouragement to some particular class of workmen among ourselves, and by excluding some of their rivals, may enable them to raise their price in the home-market. Those workmen, however, who suffered by our neighbors prohibition will not be benefited by ours. On the contrary, they and almost all the other classes of our citizens will thereby be obliged to pay dearer than before for certain goods. Every such law, therefore, imposes a real tax upon the whole country, not in favour of that particular class of workmen who were injured by our neighbours prohibition, but of some other class. ([An Inquiry into the Nature and Causes of the Wealth of Nations, par. IV.2.39](#))

Some of Smith's ideas are testimony to his breadth of imagination. Today, vouchers and school choice programs are touted as the latest reform in public [EDUCATION](#). But Adam Smith addressed the issue more than two hundred years ago:

Were the students upon such charitable foundations left free to choose what college they liked best, such liberty might contribute to excite some emulation among different colleges. A [REGULATION](#), on the contrary, which prohibited even the independent members of every particular college from leaving it, and going to any other, without leave first asked and obtained of that which they meant to abandon, would tend very much to extinguish that emulation.[Z](#)

Smith's own student days at Oxford (1740–1746), whose professors, he complained, had “given up altogether even the pretense of teaching,” left him with lasting disdain for the universities of Cambridge and Oxford.

Smith's writings are both an inquiry into the science of economics and a policy guide for realizing the wealth of nations. Smith believed that economic development was best fostered in an environment of free [COMPETITION](#) that operated in accordance with universal “natural laws.” Because Smith's was the most systematic and comprehensive study of economics up until that time, his economic thinking became the basis for classical economics. And because more of his ideas have lasted than those of any other economist, some regard Adam Smith as the alpha and the omega of economic science.

Selected Works

1759. *The Theory of Moral Sentiments*. Edited by D. D. Raphael and A. L. Macfie. Oxford: Clarendon Press; New York: Oxford University Press, 1976. Available online at: <http://www.econlib.org/library/Smith/smMS.html>

1776. *An Inquiry into the Nature and Causes of the Wealth of Nations*. Edited by Edwin Cannan. Chicago: University of Chicago Press, 1976. Available online at: <http://www.econlib.org/library/Smith/smWN.html>

Footnotes

[1.](#)

Smith 1759, part I, section I, chap. I, para. 1; available online at: <http://oll.libertyfund.org/192/39008/908774>.

[2.](#)

Ibid., part VII, section II, chap. iii, para. 12; available online at: <http://oll.libertyfund.org/192/39125/909478>.

[3.](#)

Ibid., part VII, section II, chap. iii, para. 18; available online at: <http://oll.libertyfund.org/192/39125/909484>.

[4.](#)

Smith 1776, book I, chap. 2, para. 2; available online at: <http://oll.libertyfund.org/220/111839/2312795>.

[5.](#)

Ibid., book IV, chap. 2, para. 9; available online at: <http://oll.libertyfund.org/220/111910/2313856>.

[6.](#)

Ibid., book IV, chap. VIII, para. 53; available online at: <http://oll.libertyfund.org/200/111936/2316261>.

[7.](#)

Ibid., book V, chap. 1, para. 140 [OUP article ii, para. 12]; available online at: <http://oll.libertyfund.org/200/111942/2316475>.