The Trouble with Adam Smith

Author(s): THOMAS K. McCRAW
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THOMAS K. McCRAW

THE BATTLE between Adam Smith and Karl Marx is over. By a late-round technical knockout, Smith and capitalism have won. But now a second championship fight is under way, a contest between different kinds of capitalism. In one corner stands a relatively laissez-faire consumer variety represented by the United States. In the other corner is a more nationalistic, producer-oriented capitalism epitomized by Germany, Japan, and the "Little Dragons" of East Asia (Korea and Taiwan).

The theoretical split that underlies this competition is best exemplified by Adam Smith on the one hand, and on the other by the two great prophets of activist national developmental policy. These are the American Alexander Hamilton (1757–1804) and the German Friedrich List (1789–1846). So far, in the realms of ideology and academic theory, Smith is ahead on points. But there is reason to believe he will fade in the middle and late rounds, and in this essay I want to explain why. I will do this not through an extended comparison of Smith with Hamilton and List, but by looking mostly at Smith alone—at his intellectual strengths and weaknesses, his preferred units of analysis, and especially his hostile attitude toward organizations.

I

Ever since its publication in 1776, *The Wealth of Nations* has been regarded as the most influential book on economics ever written. Ronald Coase, the 1991 Nobel laureate in economics, called it "a work that one contemplates with awe. In keenness of analysis and in its range it surpasses any other book on economics. Its preeminence is, however, disturbing. What have we been doing in the last 200? years?" Joseph Schumpeter, though no particular admirer of Adam Smith, described it

✪ THOMAS K. McCRAW is the Straus Professor of Business History at Harvard University. He is the author of several books, including the Pulitzer Prize-winning *Prophets of Regulation*, and editor of several others, including *America Versus Japan*.

as "the most successful not only of all books on economics but, with the possible exception of Darwin's *Origin of Species,* of all scientific books that have appeared to this day."

The influence of *The Wealth of Nations* has always been high, but of course higher at some moments than others. When it was first published, it received a fair amount of attention but did not have a sensational success. In the first two or three decades after publication, its powerful messages about free trade and minimal government seeped slowly into the consciousness and everyday vocabularies of British and American citizens. Soon its translation into French, German, Spanish, and other languages spread Smith's influence to Europe and Latin America. In the late nineteenth and early twentieth centuries, its message penetrated Japanese, Chinese, and other Asian circles.

Every fifty years since 1776, as the economist R. D. Collison Black has noted, *The Wealth of Nations* has been memorialized in formal ceremony. In 1826, the author had been dead for only thirty-six years and had not yet attained the status of sainthood. Accordingly, David Ricardo and others of that generation threw reverence to the winds and criticized some of Smith's technical errors. On the other hand, both they and numerous politicians had long since embraced Smith's system of "natural liberty" and its free-trade implications. By 1846, the Corn Laws had been repealed and the era of free trade and international British economic hegemony had begun.

Thirty years later, in the centennial celebrations of 1876, the policy side of Adam Smith, as distinct from the analytical, received even greater emphasis in both Britain and America. Having witnessed Britain's rise to unmatched prosperity under its free-trade regime, celebrants were ready to proclaim Smith *the* prophet of political economy. Economic theory, however, was now in turmoil. The classical system was being challenged by Marx and the socialists and also by Léon Walras and the marginalists. By the late nineteenth century it had come under relentless attack by popular critics of industrialism—writers such as Carlyle and Dickens in Britain, Victor Hugo in France, Henry George and Henry Demarest Lloyd in America. Adam Smith's laissez-faire system seemed linked to an ominous polarization of wealth and to the horrifying industrial squalor that plagued European cities.

By the 150th anniversary of *The Wealth of Nations* in 1926, enlightened capitalism and the emerging welfare state had eliminated some of the squalor, though little of the maldistribution of wealth. On the theory side, the neoclassical reconstruction was nearly complete, and the economics of Alfred Marshall ruled the academy alongside marginalism, to which it was tied. Yet doubts about Adam Smith had again become rife. For a world trying to recover from the Great War, the merits of free trade and laissez-faire were far from self-evident. Perhaps in consequence, 1926 was the least joyous, though most intellectually interesting, of all the anniversaries.

Fifty years later, in 1976, conditions had become uniquely propitious for celebration of Smithian policy as well as theory. With the triumph of capitalism over its rivals finally in sight, with deregulation and privatization on the lips of economists and politicians all over the world, and with American bicentennial hoopla at full throttle, Adam Smith had reached the highest pedestal. The Chicago economist Milton Friedman had just won the Nobel Prize. His colleague George J. Stigler, an equally ardent Smithian, was about to win one of his own. *The Wealth of Nations* had become more fashionable than at any other time in its history. Inexpensive paperback editions proliferated. A huge project to edit and republish all of Smith's works was under way, sponsored by the University of Glasgow and Oxford University Press. By 1981, the young Washington commandos of the Reagan Revolution were sporting neckties decorated with Smith's profile. (Their identification of *The Wealth of Nations* with Reaganite principles had a certain logic, but they should also have known that Smith despised conspicuous consumption and favoritism toward the wealthy.) By 1989, with the collapse of socialist regimes in the Soviet Union and eastern Europe, Smith reigned as intellectual king of the economic hill.

II

In person, Adam Smith seemed the unlikeliest of guides to the practical world. He was, hands down, the most absentminded economist in the history of the discipline. Once he put bread and butter into boiling water and complained that he had never tasted a worse cup of tea. Bumbling and ungainly, he was forever talking to himself, sometimes in a loud voice. "His absence of mind was amazing," wrote Walter Bagehot. "On one occasion, having to sign his own name to an official document, he produced not his own signature, but an elaborate imitation of the signature of the person who signed before him; on another, a sentinel on duty having saluted him in military fashion" [doing the "Present Arms" movement with his rifle], Smith "astounded and offended the man by acknowledging it with a copy—a very clumsy copy no doubt—of the same gestures."

Altogether, he represented an easy target for future critics. Schumpeter liked to ridicule Smith's "sheltered and uneventful life" as "a professor born and bred." He noted with relish that Smith's understanding of human nature was circumscribed by the fact "that no woman, excepting his mother, ever played a role in his existence: in this as in other respects the glamours and passions of life were just literature to him." This comment reveals less about Smith than about Schumpeter, the self-styled world's leading economist and greatest lover; and it is not quite accurate. Smith did lead the quiet life of a scholar, but his cousin Jane Douglas kept house for him over many years, and during a sojourn to France in the 1760s he made lasting friendships with several women who presided over Paris salons.

Smith (1723–1790) was born and raised in Kirkcaldy, a town of about fifteen hundred on the North Sea side of Scotland, just across the Firth of Forth from Edinburgh. His father, several other relatives, and eventually he himself were employed by the Scottish civil service, an ironic circumstance given his future reputation as an anti-government man. As a child, he was delicate and dreamy, subject, as his biographer John Rae puts it, to "those fits of absence and that habit of speaking to himself which he carried all through life." Kidnapped by gypsies at the age of three, he was returned to his mother in short order. "He would have made, I fear, a poor gipsy," Rae avers. As an adult, Smith once went out for a nocturnal stroll wearing his dressing gown and, deep in thought, walked all the way to Dunfermline, fifteen miles west of Kirkcaldy.

After a local elementary education, Smith entered the University of Glasgow at the age of fourteen. In his three years there, he earned an M.A. and became excited by the philosophic teachings of Francis Hutcheson, the likely source of Smith's powerful economic ideas about the division of labor. He then spent six years at Oxford on a scholarship, one of a tiny number of Scots among the total of one hundred students enrolled at Balliol College. Little is known of his years at Oxford except that, judging from the evidence of his later writings, he detested it. He found no new Hutchesons to inspire him, and he came to regard the English university system as generally corrupt and inferior to that of Scotland.

Smith returned to his mother's home in Kirkcaldy in 1746. Now twenty-three years old, still studious and unprepossessing, he felt no attraction to either the ministry or the law. For a couple of years he did nothing, at least nothing that was recorded. Then came a sudden opportunity. He was invited by some prominent men of Edinburgh to give a series of public lectures on rhetoric, belles lettres, and jurisprudence. In the presentations that followed, he proved such an able scholar and speaker that in 1751 he was elected to the chair of logic at the University of Glasgow. Later in that same year he moved up to the more prestigious chair of moral philosophy, once held by his own teacher, the "never to be forgotten" Hutcheson.

Smith remained at Glasgow for twelve years, lecturing and writing. In 1759, at the age of thirty-six, he brought out the first of his two great books. This was *The Theory of Moral Sentiments,* which soon made him moderately famous in Britain and throughout Europe. Six English editions were published during his lifetime. Three French and two German translations appeared before the end of the eighteenth century.

The Theory of Moral Sentiments is a long, engaging treatise on human nature and ethical systems. Written in the "plain style" Smith cultivated, it flows so easily that one suspects it originated as a series of oral presentations to undergraduates. "It is rather painting than writing," waxed Edmund Burke in his review. The book combines in approximately equal parts what today would be taught in departments of ethics, psychology, and sociology. The unit of analysis is the individual. The theme is the evolution of moral structures and the mixture of motivations that govern human behavior. There is much criticism of the pursuit of wealth and of undue admiration for "the rich and powerful," which Smith finds "the great and most universal cause of the corruption of our moral sentiments." The analytical emphasis is on "sympathy" (what we would call empathy), "self-love" (self-interest), and the "impartial spectator" (one's conscience, reinforced by a desire to be well regarded by others and to deserve their high regard). The opening sentence of the book suggests both its concentration on human nature and its appealing tone: "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." The book is much less preoccupied with "the invisible hand" of beneficent market forces than is *The Wealth of Nations,* which appeared seventeen years later.

Among contemporary admirers of *The Theory of Moral Sentiments* was the English statesman Charles Townshend, stepfather of the young Duke of Buccleuch. Townshend had visited Glasgow not long after reading the book. (The ever-distracted Smith, conducting him on a visit to a local tannery, fell into a vat of evil-smelling liquid and had to excuse himself.) In 1763, when the duke reached the age of seventeen, Townshend proposed that Smith become his tutor during a projected three-year tour of the Continent. This sort of arrangement, which was regarded as an elite alternative to university education, was not uncommon in the eighteenth century. For Smith, then forty years of age, Townshend's offer was too lucrative to refuse. It provided for £300 annually plus traveling expenses, and, afterward, £300 per year for life. This was about twice his salary at the University of Glasgow, which included no provision for his retirement years. Altogether, it represented a very handsome sum; the average yearly wage of laboring persons in 1760s Britain was £25–£30.

Although he had never before visited the Continent, Adam Smith was by this time no mere provincial. Despite his clumsiness and notorious absentmindedness, he moved in the highest intellectual circles of England and Scotland. Glasgow was still a two-week stagecoach ride from London, but Smith was already (or soon to be) acquainted with Lord Shelburne, Edward Gibbon, Edmund Burke, Joshua Reynolds, Oliver Goldsmith, and the American Benjamin Franklin. (It is worth noting that, in 1755, Smith's native Scotland contained only about one and a quarter million inhabitants. The population of England and Wales was just over six million, of the North American colonies that became the United States about one and a half million. The grand total was about nine million, as compared to more than three hundred million today.) Smith's closest friend was David Hume, who, some scholars believe, was the source of his obsession for free trade.

As Bagehot remarked, there was about Adam Smith "a sort of lumbering bonhomie which amused and endeared him to those around him." Alexander Carlyle, a prominent Presbyterian minister from Edinburgh, said:

> [Smith's] voice was harsh and enunciation thick, approaching to stammering. . . . He was the most absent man in company that I ever saw, moving his lips, and talking to himself, and smiling, in the midst of large companies. If you awaked him from his reverie and made him attend to the subject of conversation, he immediately began a harangue, and never stopped till he told you all he knew about it, with the utmost philosophical ingenuity . . . but when you checked him or doubted, he retracted with the utmost ease, and contradicted all he had been saying.

According to James Boswell, who had been Smith's pupil at the University of Glasgow, Dr. Johnson considered him "as dull a dog as ever he met with." Smith, returning the favor, "said that he imputed Johnson's roughness to a certain degree of insanity which he thought he had."

By early 1764, Smith and the young Duke of Buccleuch had made their way to Toulouse. For several weeks things remained dull, and Smith, as he reported to Hume, began "to write a book in order to pass away the time." The book turned out to be *The Wealth of Nations,* over which he labored for the next dozen years. Soon the social pace picked up, with periodic whirls of dinner parties and attendance at Paris salons.

More to Smith's reflective tastes, the Buccleuch party began to enjoy unlimited entrée to French intellectual life. He met A. R. J. Turgot, the future finance minister who was then writing his own influential treatise, *Reflections on the Importance and Distribution of Riches.* Smith spent a lot of time talking with François Quesnay and other leading Physiocrats, who were then at the height of their prominence. He met Helvetius. He visited Voltaire in Geneva. Most important, he began to study the economic policies of the French state, which he, like some of the Physiocrats, found irrational. The French tax system, for example, required that peasants remit about four-fifths of their income to the government. As Bagehot later commented, "On all economic matters the France of that time was a sort of museum stocked with the most important errors."

After almost three years in France, the Buccleuch group returned to London in late 1766. For a few months Smith gave advice (almost certainly not followed) to Charles Townshend, who as chancellor of the exchequer was in the process of framing his unfortunate policies for the American colonies.

In 1767, Smith went home to his mother's house in Kirkcaldy. There, for six uninterrupted years, he worked relentlessly on the manuscript of *The Wealth of Nations*—day after day, week after week, without stint and with intense pleasure. A self-styled "solitary philosopher," he spent this entire period working alone, "in great tranquility, and almost in complete retirement" from other diversions. A close student of rhetoric and an uncompromising devotee of revision, Smith rewrote the text again and again, and yet again. Many times he brought his book to the verge of completion, only to decide on still another revision or the inclusion of even more material. He remained an obsessive reviser throughout his life. "I am a slow a very slow workman," he later wrote his publisher, "who do and undo everything I write at least half a dozen times before I can be tolerably pleased with it." In 1773, he returned to London to consider a second tutorial trip abroad, which he did not take, and to arrange at last for the publication of his manuscript.

Yet the book did not see print for three more years still. The reason, in addition to Smith's procrastinations and his torturous redrafts, was the development of new material on two subjects: the management of universities, on which he held strong views; and British policy toward the deteriorating situation in the American colonies. Finally, in 1776, the year in which the colonies declared their independence and also the year in which Bentham completed his *Theory of Legislation* and Gibbon brought out his first volume of *The Decline and Fall of the Roman Empire*, Smith's great book appeared. He was the same age—fifty-two years, nine months—as John Maynard Keynes was when *The General Theory of Employment, Interest and Money* was published in 1936.

An Enquiry into the Nature and Causes of The Wealth of Nations was offered for sale in two volumes at a combined price of one pound sixteen shillings, the equivalent of about $120 today. The length of the first print run is not known, but it sold out in six months. Smith's friends were elated. "I am much pleas'd with your Performance," wrote Hume, "and the Perusal of it has taken me from a State of great Anxiety. It was a Work of so much Expectation, by yourself, by your Friends, and by the Public, that I troubled for its Appearance; but am now much relieved." Gibbon exclaimed, "What an excellent work is that with which . . . Mr. Adam Smith has enriched the public! An extensive science in a single book, and the most profound ideas expressed in the most perspicuous language." Hugh Blair, an Edinburgh cleric who had long used Smith's ideas in his sermons, wrote him that *The Wealth of Nations* "exceeded my expectations. One writer after another on these Subjects did nothing but puzzle me. I despaired at ever arriving at clear Ideas. . . . I do think the Age is highly indebted to you, and I wish they may be duly Sensible of the Obligation. . . . Your work ought to be, and I am perswaded will in some degree become, the Commercial Code of Nations." Blair was persuaded correctly. It did.

Adam Smith lived for fourteen years after 1776, long enough for his fame to spread into the New World. He spent most of these years quietly in Edinburgh, serving as a Commissioner of Customs and Salt Duties, an appointment he probably won through the influence of the Duke of Buccleuch. In this post he earned the handsome salary of £600 per year in addition to the £300 he still received from Buccleuch. His "present situation," as he wrote in 1780, "is therefore as fully affluent as I could wish it to be."

Smith's routine during this period was dominated by meetings of the Board of Commissioners, but in his free time he worked on new editions of *The Wealth of Nations* and, even more thoroughly, of *The Theory of Moral Sentiments*. Despite worsening health, he completed very extensive revisions of the latter book in 1789. The new edition was published in the spring of 1790. By then Smith's health was declining rapidly. On a Sunday evening in mid-June of the same year, he spent a pleasant few hours with a group of friends, as was his custom. When he left the room to retire, he said, "I love your company, gentlemen, but I believe I must leave you—to go to another world." He died a few days later.

III

The Wealth of Nations is a very substantial tome. Its half a million words are organized into five "books": three of nearly three hundred pages each, one just over one hundred, one about fifty. The analytical core appears in the first two books, which total about four hundred pages. The rest is concerned with the history, description, and analysis of the mercantile system, colonial administration, jurisprudence, education, and tax policy.

Smith's prose adhered to his preferred "plain style," with copious and vivid illustrations from everyday life. Although the book was written more than two centuries ago, it remains strikingly easy to read, and one finds it difficult not to feel grateful for Smith's assiduous redrafts and revisions. Woodrow Wilson once said that Smith "was a great thinker,—and that was much; but he also made men recognize him as a great thinker, because he was a great master of style—which was more." Ronald Coase has written that Smith's prose is "very different from that of most modern economists who are either incapable of writing simple English or have decided that they have more to gain by concealment." John Kenneth Galbraith, who knows something about prose style himself, said of Smith, "Few writers ever, and certainly no economist since, have been as amusing, lucid, or resourceful—or on occasion as devastating."

Over the last two centuries, many commentators on *The Wealth of Nations* have emphasized the *systematic* nature of Adam Smith's contribution. The salient virtue of his book is its demonstration—argued with conviction and often presented in very precise terms—of how everything in economic life is related to everything else, and how every relationship can be understood on the basis of a few general principles. Smith was one of the first to take the crucial step of isolating economic problems from politics and making them independent subjects for study.

Beyond his systematic approach, Smith caused at least two other basic reorientations of economic thought. First, he elevated concern for national income ("produce") over that for accumulated wealth ("treasure"). Second, he implicitly added the idea of per capita wealth and income to that of aggregate. As the English economist Edwin Cannan once put it, "We are accustomed to think of Switzerland or of Denmark as a rich nation compared with Russia. But it was a great break with tradition in 1776."

The organizing principle of Smith's analytical economics is, of course, self-interest: "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." Today self-interest remains the chief assumption employed in mainstream analysis, the most frequently used tool in the economist's toolbox, perhaps even the toolbox itself. As George Stigler observes, Smith's "construct of the self-interest-seeking individual in a competitive environment is Newtonian in its universality."

Beyond self-interest, the modern reader is struck by how many other key analytical ideas are presented in *The Wealth of Nations*. Without being comprehensive, one can enumerate the following: the circular flow of economic life, equilibrium theory, opportunity cost, the division of labor, differential compensation, rent-seeking behavior, agency theory, the concept of public goods, and the theory of second-best. To this day, these ideas remain the stock-in-trade of economic analysis.

Few if any of them were wholly original with Adam Smith. Most had appeared in one form or other no later than the seventeenth century and early eighteenth, a fertile period of analysis by dozens of innovative writers. Schumpeter goes so far as to say that *The Wealth of Nations* "does not contain a single *analytic* idea, principle, or method that was entirely new in 1776." Whether or not this is accurate, it seems clear that Adam Smith was primarily a systematizer and synthesizer—a developer rather than a pioneer. Schumpeter himself, who regarded the difficult Léon Walras (1834–1910) as the greatest of all economists, makes the interesting comment that, given the infancy of the discipline in Adam Smith's time, his defects amounted to virtues. "Had he been more brilliant, he would not have been taken so seriously. Had he dug more deeply, had he unearthed more recondite truths, had he used difficult and ingenious methods, he would not have been understood. . . . He never moved above the heads of even the dullest readers." Smith's writing, Schumpeter goes on to say, is memorable because of its incomparable richness of illustration. "The facts overflow and stumble upon one another," with the author "heating" them "till they glow."

Of course, *The Wealth of Nations* is very far from an unblemished performance. It contains plenty of major conceptual errors: the notion that capital employed in agriculture yields the highest returns, the ascription of superior usefulness to domestic trade over foreign trade or shipping, the implicit labor theory of value. "The last of Smith's regrettable failures," Stigler adds, "is one for which he is overwhelmingly famous—the division of labor. . . . [A]lmost no one used or now uses the theory of division of labor, for the excellent reason that there is scarcely such a theory. . . . [T]here is no standard, operable theory to describe what Smith argued to be the mainspring of economic progress."

Without quarreling in the slightest with the greatness of *The Wealth of Nations,* I want to underscore two interrelated characteristics of Adam Smith's approach: his units of analysis and his attitude toward organizations. Together, these tend to limit his usefulness for the study of business enterprise and of national economic systems as they have evolved in our own time. It is here that he is most vulnerable to the intellectual challenges represented by Hamilton, List, and other economic nationalists.

In modern writing on business and economics, the researcher might reasonably choose among numerous potential units of analysis: the individual, the firm, the industry, the market, the policy, the macroeconomy, the transaction, the event, the locational cluster, the innovation, the externality, economic growth, or any of several others. All are legitimate objects of study, though perhaps not equally esteemed in present-day mainstream economics.

Adam Smith is decidedly more interested in three of these units than in the others. First, he exhibits a lively concern with supply and demand in markets. The primacy of market competition in his system derives from the fact that transactions among distant buyers and sellers cannot be affected by sympathy, one of the bases of his ethical system set forth in *The Theory of Moral Sentiments*. As Coase remarks, in the absence of sympathy, the competitive discipline of markets uses "the strength of self-interest to offset the weakness and partiality of benevolence, so that those who are unknown, unattractive, or unimportant, will have their wants served."

Smith's second distinctive unit of analysis is policy, as in his prolonged passages attacking mercantilism. Eli Heckscher, the leading scholar of mercantilism, once called this part of *The Wealth of Nations* "an emphatic piece of free trade propaganda." But much more than mercantilist policy is analyzed. About two-thirds of the book's total of one thousand pages are concerned with detailed investigations of economic policies in different countries at different epochs.

Third, and most conspicuously, Adam Smith is committed to the study of the individual. The word *individual*, like *natural* and its cognates, occurs hundreds of times in the text of *The Wealth of Nations*. Yet here Smith's construct is not the individual with a unique soul, that favorite subject of philosophy and literature. Smith's individual is less a shaper of society than an isolated unit reacting predictably to external stimuli. Little autonomy is ascribed to the individual, and no uniqueness. To Adam Smith, people are fungible. All are governed by their "human nature," which was for him, as for many other eighteenth-century writers, a foreordained, immutable, and scientifically discoverable congeries of attitudes and propensities. There is almost no notice of behavioral diversity deriving from nationality, ethnicity, gender, stage of life, or endowment with talent and intelligence. Instead, the conduct of the individual is governed solely by "human nature," and human nature is the same in every human being.

This is not to say that Smith posited an abstraction called *homo oeconomicus* for the purpose of model building. The concept of economic man was a creation of the nineteenth century, not the eighteenth. It was certainly not the conceit of Adam Smith, who, unlike Ricardo, was no builder of abstract models. His own fullest statement about human nature, which appears in *The Theory of Moral Sentiments*, does not privilege self-interest over sympathy or the impartial spectator as a determinant of human action. Yet Smith *is* interested, to the point of obsession, in human nature, and in discovering (and celebrating) the "natural order." As is evident in many passages, he is acutely offended when "institutions" distort "the natural course of things."

IV

Adam Smith does not just *prefer* to focus on individuals and human nature. He goes much further than this. He exhibits a powerful aesthetic aversion to any type of collective action, a visceral distaste bordering on revulsion. For him, "human institutions" so invariably produce "absurd" results that they have no presumptive legitimacy.

Many writers have commented on Smith's dislike of "merchants and manufacturers," who are routinely castigated throughout *The Wealth of Nations*. Here I am arguing a broader point: that he not only despised the "monopolistic" spirit of businessmen, but that he also had a profound hostility to any type of organized activity. He denounced politicians, professors, craftspeople, and churchmen just as vehemently as he did businessmen. When operating in concert, all are depicted as incorrigible rent seekers, scheming to extract more than a fair market price for their services. All are infected with the same "corporation spirit" subversive of the "natural order of things" and hostile to "the system of perfect liberty."

It is true that in the opening pages of *The Wealth of Nations*, Smith extols the division of labor as the prime mover in economic growth. He speaks in glowing terms of "the assistance and co-operation of many thousands." Yet in a book of one thousand pages and half a million words, he says nothing about how this cooperation is to be encouraged, let alone organized. Jacob Viner observes that for Smith the only effective voluntary associations were those "of merchants and manufacturers to exploit the consumer and of masters to exploit the worker."

When Smith does concentrate on organizations—whether guilds, business corporations, universities, political groups, or religious orders—his verdict is uniformly and passionately negative. Most organized groups were, in his view, rent-seeking "corporations." In a discussion of methods used by such groups to extract more than their proper share, he writes, "It is to prevent this reduction of price, and consequently of wages and profit, by restraining that free competition which would most certainly occasion it, that all corporations, and the greater part of corporation laws, have been established."

In Smith's world, something rotten is likely afoot wherever two or more individuals are gathered together, except as family members or in the unambiguous roles of buyer and seller. Even when people meet for "merriment and diversion," if they happen to be of the same trade a "conspiracy against the public" is in the offing. And when merchants and manufacturers cannot accomplish their nefarious purposes alone, they turn to government for help. "This [mercantilist] monopoly," Smith writes, "has so much increased the number of some particular tribes of [manufacturers], that, like an overgrown standing army, they have become formidable to the government, and upon many occasions intimidate the legislature." When this happens, the public interest is compromised and politics itself becomes sullied: "The sneaking arts of underling tradesmen are thus erected into political maxims for the conduct of a great empire."

As James F. Becker once wrote in *The Journal of the History of Ideas,* Smith viewed "all clubs, cliques, cabals, joint stock companies, trading companies, and other social guilds as corporations having in common certain properties that render them positively harmful, or, at best, of dubious social utility. . . . There is the implication that the mixture of authority and corporation is somehow dangerous but not a clue as to why this is so." Smith's "organizational solution" to these problems, Becker writes, is for "free, individual competition and a limited governmental agenda," a solution almost identical with that of John Locke a century before and one plainly insufficient to an effective engagement of modern industrial problems.

V

Why did Adam Smith see things this way? Galbraith facetiously suggests that, "handicapped by his environment," he "judged all races by the Scotch (as we are correctly called) and their much celebrated tendency to self-seeking recalcitrance." More likely, Galbraith speculates, he simply "failed to see the pride people could have in their organization." Yet his prejudice was so pronounced that it must go deeper than this.

Aside from his social clubs, Adam Smith had no significant first-hand experience with any substantial organizations except universities. As a student, he had unhappy encounters with the Oxford faculty, and this left an indelible impression: "In the university of Oxford," he wrote in *The Wealth of Nations,* "the greater part of the public professors have, for these many years, given up altogether even the pretence of teaching." Smith himself had been a professor at the University of Glasgow for twelve years. He had also served as Dean of the Faculty (1760–62) and Vice-Rector (1762–64) during a period of tangled administrative problems at the university.

In the eighteenth century, as now, few universities were paragons of organizational virtue. Then as now, many professors essentially got away with murder. They often exploited the system, working only when they felt like it. They behaved like a privileged caste, blithely living off the university's endowment. Small wonder that any close student of such a system, especially one like Smith prone to skepticism, would not readily give other organizations the benefit of the doubt.

A second and more telling reason for Smith's anti-organizational bias is his curious and perhaps willful obliviousness to the industrial revolution. It is true that the age of machine production was just beginning, and perhaps we might excuse him, as we cannot excuse classical economists of the nineteenth century, for failing to grasp its significance. Yet two additional circumstances underscore Smith's culpability here. First, he was such an acute and up-to-date observer of other phenomena, such as the protean situation in the American colonies, that his relative ignorance of technology seems more than a little strange. Second, numerous other writers, especially in the 1750s and 1760s, did detail the wonders of technological innovation. These include Josiah Tucker, Arthur Young, Sir James Steuart, Malachy Postlethwayt, and sometimes even Samuel Johnson.

By contrast, there are only a couple of pages on machinery in *The Wealth of Nations*. Smith makes extended references to the division of labor in his illustrative pin factory. But he makes no mention at all of such crucial inventions as Hargreaves's spinning jenny (1767), Arkwright's water frame (1769), or James Watt's steam engine. Watt, who worked as an instrument maker at Smith's own University of Glasgow, first began to tinker with the Newcomen steam engine in 1763, and the Newcomen engine itself already had been in use for two generations. Watt made his breakthrough improvements in 1765, patented them in 1769, and entered his famous partnership with Matthew Boulton in 1775. By the late 1770s, water pumps powered by Boulton and Watt engines were in common use in the tin and copper mines of Cornwall.

By the time Smith's third and much expanded edition of *The Wealth of Nations* appeared in 1784, mechanized textile mills had sprung up and steam engines were no longer a novelty item. In revising his book for the third edition, Smith took pains to add, as he put it in a letter to his publisher, "a full exposition of the Absurdity and hurtfulness of almost all our chartered trading companies." Yet there is still little mention, here or in the fourth edition (1786) or fifth (1789), of the technological innovations that were working a radical change in economic life—and nowhere more than before his very eyes in Great Britain. "There is virtually no mention of cotton textiles," Charles Kindleberger observes, "only one reference to Manchester in a list of cities, nothing on pottery, nothing on new methods of producing beer. . . . [Nor does Smith] discuss the spread of coal in industrial use." Another economist, R. Koebner, makes a similar argument. He sees Smith as "strikingly grudging" toward the one or two leaps in productivity noted in *The Wealth of Nations*. He speculates that the reason why Smith missed the point of the industrial revolution derived from his low opinion of businessmen's motives. Whatever the reason, the industrial revolution was the most important of all the things Smith was absentminded about, and the robustness of his analysis suffers grievously as a result.

VI

For Adam Smith, only agriculture was fully "natural." This was why he was so offended by mercantilism, which was based on a very different premise. In mercantilist thought, not only are trade and manufacturing just as "natural" as agriculture, but they are also more productive of wealth and power. For Smith the trouble is that they require careful organization and the intrusion of his despised "human institutions." His bias for agriculture, which he seems to have developed at an early age, could only have been reinforced by his conversations with Quesnay and other Physiocrats during his sojourn in France in 1764–67. (Acknowledging Smith's "unequivocal" error in preferring agriculture to industry, Stigler quips that "there is no such thing as a free trip to Paris.")

Of many examples in *The Wealth of Nations* showing Smith's preference, the following is representative: "Country gentlemen and farmers are, to their great honor, of all people, the least subject to the wretched spirit of monopoly. The undertaker of a great manufactory is sometimes alarmed if another work of the same kind is established within twenty miles of him. . . . Farmers and country gentlemen, on the contrary, are generally disposed rather to promote than to obstruct the cultivation and improvement of their neighbours' farms and estates." Smith's line of thinking here mixed economic analysis with political and ethical considerations, and even with aesthetic preferences.

His reasoning led him to reduce the industrial revolution to nothing more than the division of labor. This meant no key roles for such elements as machine production, fuel and water power, human entrepreneurship, state promotion of manufacturing, and, most important of all, technology. As Hiram Caton recently wrote in the *Journal of Economic History*, "To admit that technology harnessed natural forces—the critical insight of industrial production—would have established the primacy of manufacture to agriculture and destroyed the whole fabric of the 'natural order' by the machinery of art." This Adam Smith could not accept.

Smith's laissez-faire, based as it was on agriculture's exclusive title to "naturalness," represented nothing less than a system directed against the central thrust of industrial capitalism. With a few exceptions, the classical economists who followed him in the next two generations of English economic thought did little to correct his myopia. Continuing to focus on static analysis and to promote free trade and minimal government, they forbore to study entrepreneurship, manufacturing technology, the factory system, or the anatomy of economic growth. This way of thinking became so entrenched that it may not be too much to say that it remains the preferred stance of mainstream neoclassical economists down to the present day, some two centuries after the death of Adam Smith.

Of course, alternative approaches did appear soon after Smith's death. Caton points out that scholars have focused on one of these alternatives, socialism, to the unfortunate exclusion of the other, the "industrial critiques" of Alexander Hamilton, Friedrich List, and a few others:

> Hamilton blazed the trail that List was subsequently to follow. He reaffirmed mercantilism, aware of the classical alternative and critical of it. . . . Hamilton wrote three years after Smith issued the last edition of *The Wealth of Nations*. Smith never remarked the novelty of industrial production nor considered the new factor of exponential economic growth that it introduced. Hamilton underscored its potential in remarking the "prodigious effects" obtained by bringing "artificial force . . . in aid of the natural force of man."

Of all the early "industrial" critics of Smith, the most systematic was List, the German nationalist who lived in the United States during the 1830s and absorbed Hamiltonian principles of positive government for the promotion of manufactures. Returning to Europe and seeing state intervention as the only way to unify the dozens of independent German principalities, List evangelized in favor of a customs union, protective tariffs for infant industries, and public development of a national railway network. List's long treatise, *The National System of Political Economy*, though it contains important errors of both theory and fact, is an uncommonly effective engagement and critique of the Smithian system. As Caton writes, "List was the first economist to base all his doctrine on the proposition that manufacture differs 'fundamentally' from agriculture or trade because it stood essentially in a positive feedback relation to science." The enormous gains in per capita income from manufacturing as opposed to agriculture would produce "not only a fundamentally different orientation on the economies of modern nations, but also an espousal of capitalism with good conscience."

If this line of analysis is correct, and I believe it is, then Adam Smith's intellectual relevance to modern industrial capitalism becomes problematical and in need of reconsideration.

VII

A third reason why Smith suppressed any inquiry into the morphology of organizations had to do with his fear of organized power, which might distort or even destroy his "system of natural liberty." Of course, he conceded the need for a legal framework to protect property rights and individual freedoms. Little in his system of natural liberty could operate in the absence of civil authority. But he did not go much beyond this. He remained a passionate advocate of minimal regulation for either the promotion or restriction of economic activity. Innumerable passages in both *The Wealth of Nations* and Smith's surviving letters practically scream out his exasperation with the "absurd" policies of activist governments throughout Europe.

Nothing in Smith's writings suggests any basic dissatisfaction with the stratified nature of society or with the British constitution, which he praised as the world's best. Himself the beneficiary of lucrative patronage from Shelburne and Townshend, he endorsed his age's habits of deference. He was no democrat, and seems not to have minded that, like the great majority of his fellow citizens, he could not vote. (Fewer than 5 percent of adult males then had the franchise.) Smith believed that poverty will always be with us, and he defined "the poor" and "the common people" as 99 percent of the population. As for the presumed effects of the laissez-faire policies Smith advocated, the economist Harvey Chisick notes "that he was thinking in terms of an improvement which might be represented as a movement from six to eight on a scale of ten. Now there is a real and significant measure of improvement in its own terms. But it is nothing like the impact of the Industrial Revolution, which cannot be represented on such a scale at all."

Smith accepted existing social rankings. He saw no need for, and some danger in, rival hierarchies based on new money of commercial and industrial origin. His abundant commentary in *The Wealth of Nations* on the superiority of agriculture to trade and industry, his obsessive preoccupation with "the mean rapacity, the monopolizing spirit of merchants and manufacturers," suggests that he spoke more for the old order than the new. To the extent that this preference had implications for his analytical framework, it meant that he must favor agriculture over industry, exchange over development, and getting prices right over actively promoting economic growth.

Most important of all, it meant that his entire system of proscribing "monopoly" by insuring the maximum number of competitors had the serendipitous and remarkable result of finessing the issue of power altogether. Smith's "system of natural liberty," refined by later classical and neoclassical economists into the formal, easily mathematicized system of "perfect competition," implicitly denies the reality of power. In a system of perfect competition, which includes perfect resource mobility, numberless buyers and sellers in frictionless markets, and possession by all participants of perfect information and perfect rationality, the issue of power cannot arise.

For the intellectual historian, this aspect of the Smithian system and of the perfect competition model represents an arresting phenomenon. The tenacious strength and resilience of the model, in both its primitive Smithian articulation and its twentieth-century refinement as the foundation of static equilibrium analysis, are evidence of a commanding paradigm, but also of the predilections of that paradigm's adherents. Since buyers and sellers are unable to affect the market under perfect competition, they are by definition bereft of economic power. To the extent that economic power underlies political power—and that, of course, is to a very great extent indeed—then the Smithian marketplace solves, all by itself, the eternal problem of the distribution of power. It thereby excludes from consideration such problems as exploitation, abuse, and the entire agenda of man's inhumanity to man. Like all utopian schemes for the elimination of power from the list of human problems, this exclusion has an almost irresistible appeal. If only it can be implemented, if only "market imperfections" can be eliminated, then psychic relief waits just around the corner.

Smith's own acute discomfort with power could hardly be more apparent. *The Wealth of Nations* brims over with relentless, sweeping denunciations of the "stupid" and "absurd" results of the actual exercise of power. Again and again Smith asserts that harmful consequences ensue whenever power is used to alter the "natural" course of economic life. As the economist Nathan Rosenberg writes, Smith is convinced that "the possession of power inevitably leads to the playing of zero-sum games" in which the application of power will help its user but hurt others. All of this implies that, for Smith, organizations represented both sources of power and manifestations of its reality. It says that for him, individuals and markets are "natural," but institutions and organizational hierarchies are not.

For many of his professional descendants, as well as for Smith himself, this kind of preference was not merely a choice of technique. Instead, it was a full-blown exhibition of an aesthetic preference, and perhaps of naïveté as well. It expressed a visceral feeling that agriculture is good, industry is bad, small is beautiful, big is bad, individuals and markets are good, organizations and hierarchies are bad. And it derived more from simple prejudice than from scientific analysis.

Even today, after several industrial revolutions, long after it has become obvious that complex organizations lie at the heart of the fantastic economic growth that has occurred since Smith's time, ample evidence of pervasive dislike for organizations persists. Contempt for bureaucracies runs so deep in the popular consciousness that denouncing them is like shooting fish in a barrel. Even in modern economics, the animating force of most models remains the individual's utility function. Mainstream neoclassicism has very great difficulty coping with organizations, including business firms. It addresses the issue by assuming a profit-maximizing entity indistinguishable from Adam Smith's self-interested individual. It ignores a vast literature in history, sociology, and other disciplines that shows beyond doubt that organizations do not usually behave as individuals do and that groups of varying sizes have different patterns of behavior.

In this sense as in so many others, Adam Smith emerges as the bender of the twig that became the tree of modern economic analysis. To a surprising extent his prejudices and propensities remain those of modern economists in the mainstream neoclassical tradition. Just as Christopher Columbus's geographical misconception survives today in our five-century-long conceit that native Americans are "Indians," just as the fallacious identification of the womb as the source of nervous collapse survives in the word *hysteria,* so the anti-organizational bias of the founder continues to shape economic analysis.

VIII

As the bedrock assumptions of economic analysis are reconsidered in our own time, it is appropriate to begin by rethinking Adam Smith and *The Wealth of Nations.* For all Smith's unquestionable greatness, his feet were of clay when it came to the study of organizations. For us, with two hundred years of experience he himself lacked, it is not permissible to be as absentminded about the industrial system as he was, nor as reflexively hostile to organizations.

Aside from its intrinsic intellectual interest, a rethinking of Smith is timely today because economic nationalism is on the rise. The commercial and industrial competitors of the United States, notably Japan and Germany, often act from a premise that the key unit of analysis is not the individual but the nation-state. Conscious of the indispensable roles in national growth played by firms, industry groups, and elite public-sector ministries—in a word, *organizations*—Japanese and German bureaucrats and business managers have been able to deploy resources so as to achieve stronger economic performance.

In doing this, they have concentrated less on the individual as consumer than on the organization as producer. They have typically allocated a greater percentage of GNP to investment and less to consumption than have their counterparts in the United States, where during the 1980s Adam Smith's influence reached its two-hundred-year peak. For Smith himself, writing in the eighteenth century, there was no good way to anticipate this divergence across countries. The industrial revolution was just starting, and his own preferred unit of analysis was the individual. As he wrote in *The Wealth of Nations*:

> 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. The maxim is so perfectly self-evident, that it would be absurd to attempt to prove it. But in the mercantile system [of deliberate national economic development], the interest of the consumer is almost constantly sacrificed to that of the producer; and it seems to consider production, and not consumption, as the ultimate end and object of all industry and commerce.

Historically, Smith's logic held up so long as the individual remained both the consuming and the producing unit. But in the modern world, the great majority of production is done not by individuals but by complex organizations. In this kind of system, the simplicity of automatic exchange between individual producers and consumers—the premise that underlies Smith's entire system—almost disappears.

In all countries today, the major actors in the production sector must plan their investments on the basis of lengthy (five- to ten-year) time horizons. Even for enormous Japanese and German manufacturing firms, "time-to-market" for new products is usually measured not in weeks or months but years. Consequently, large investments must be made long before there is any return from sales to the consumer. This in turn means that *investment* by the producers, because it is so far removed in time from ultimate consumption, must be attended to in careful, deliberate fashion. It cannot be left to the whims of individuals, who will usually act in their own short-term self-interest, as Smith correctly argued. It must be done through organizations; and it is best done with the positive assistance of wise public policy.

Over the last two decades, the consumption-investment trade-off has become strikingly polarized across countries. The United States at one extreme favors consumption. Japan at the other puts relatively greater emphasis on investment. This remarkable national divergence provides the clearest statistical index of what is happening in the competition between different types of capitalism, even more than do the widely publicized statistics on fiscal and trade deficits.

As Keynes demonstrated long ago, investment does not occur as automatically as Adam Smith believed, and as his neoclassical descendants in government and the academy continue to believe. The trouble now, somewhat as in the 1930s, is not primarily with the economy itself but with what Keynes then called "the immaterial devices of the mind." For the modern neoclassical theorist or the slavish devotee of the "free market," it is uncommonly difficult to tune out the siren song of Adam Smith. It is hard to look beyond ideology and elegant models to see the world as it really is, a world in which capitalism of the Smithian variety is being consistently out-performed.

The German and Japanese economic systems today are just as market-oriented, just as "capitalistic," as is the American. But they are far less centered on the individual. Their architects, less fearful of deliberate applications of national economic strategies, less convinced that "human institutions" inevitably produce "absurd" results, are intellectual legatees not of Smith but of Hamilton and List. In consequence, they are ideologically better prepared to compete in the modern world economy. That economy is dominated by phenomena that Hamilton and List analyzed and embraced but that Adam Smith either ignored or abhorred: nationalism, technology, organization, and power.