

THE FALLACIOUS PANACEA OF CAPITAL

Where Adam Smith and Karl Marx Agree They Are Both Wrong

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Summary:

Adam Smith, the "father of Capitalism", Karl Marx, the "father of Communism", and Henry George, the originator of natural-resources economics, are arguably the most influential economists of all times. Surprisingly, and as much as they may differ otherwise, they are all firmly based on the main tenets of Classical Economics, namely its key elements, the three factors of production: land, labor, and capital and the three corresponding avenues of distribution: rent, wages, and interest. While Smith and Marx pay lip service to the concept of land they end up with a two-factor model, ignoring land or natural resources as a necessary basis of all wealth-begetting powers for all practical purposes. Not only are thus both communist and capitalist systems beset by systemic bust periods, their theoretical flaws are at the roots of an unparalleled environmental destruction on a global scale. This paper explores the areas where both Smith and Marx fail due to their faulty structural analyses and it argues that Henry George with his reality-consistent, integral model manages to put economics on a sound financial and fiscal basis in line with social justice and adequate to meet the local, global, and ecological challenges of our 3rd millennium.

Introduction:

The all-pervasive, all-encompassing, all-critical, and all-decisive question of our time is an obvious one: How could we have gone so very wrong economically on a global scale for such a very long time, given the collective genius of all the eminent economists of all ages?

The answer leads to another question: Since economics and the world economies have been so very mismanaged to all of our detriment for all this time the only possible solution to this dismal economic conundrum is the following: The great economists haven't done their homework properly! Rephrase this as another question and you get: Which of the great economists haven't done their homework?

And for the answer I would like to single out all but two the most eminent: Adam Smith on the right, and Karl Marx on the left. Both are arguably with Henry George the most globally influential economists of all times.

Strangely enough they all firmly stand on the irrefutable and well-established grounds of the School of Classical Economics. And with equal and unexpected strangeness they all do agree on the fundamentals:

Land, Labor, and Capital are the principal basic factors of production; rent, wages, and interest are the avenues of [re-] distribution. While Smith and Marx pay ample, initial lip service to that trichotomy, they quickly forget the factor land or nature for all practical purposes and henceforth work with an equation of two elements, leaving the third, most basic, and most importantly nourishing and balancing element out and unheeded. So George alone did his homework and he never for one second forgot to include land/nature as the basic factor of the economic equation.

For that reason he alone of all the great economic thinkers is still with us and we have to go back to the future to redress the global balance and reestablish the lost balance between ecology and economics according to his theorems.

I. What Smith Didn't Learn from David Hume

To understand the proper relation of land, labor, and capital, and the correlative all-determining question of money and finance we have to go back and retrace its inception at the origin of the Classical School. David Hume's insights into economic theory are generally considered to have been both seminal and way ahead of its day. His influence upon Smith and thus the embarkation of classical economics cannot be possibly exaggerated. To describe this influence a popular proverb of the time was altered to fit the purpose: "If Hume had told Smith the moon were a green cheese there would have been no objection."

Hume's main axioms can be summarized as follows:

- ξ Wealth is made up of commodities not money
- ξ His quantity theory of money stipulates that the amount of goods in circulation in a given economy should determine the amount of money in circulation
- ξ In an early anti-Mercantilist slant, he denies that an economy can be kept running by exporting for gold returns
- ξ In anticipation of the “law of comparative advantage” Hume saw that the given special features of a nation's domestic economy, such as natural resources, geography, climate peculiarities, and skill in crafts make exchange mutually desirable
- ξ In applying the adage that it is bad to “throw good money after bad” to international trade Hume stipulated that industry-wise poor nations would drag down richer ones in not being able to partake in the minimum trade necessary to sustain and increase wealth on an international scale
- ξ In his analysis low interest rates are the beneficial results of a booming trade rather than the disadvantageous backlash of a monetary glut

Now what did Adam Smith “the so-called father of Modern Economics” do with Hume's teachings and insights? Regarded in the sober daylight of the 21st Century, he is rather the forgotten stepchild of the Age of Enlightenment who tried to translate the great philosopher's work into the realm of economics. He actually did his homework or his job none too well. But pioneers at the dawn of economic time may be forgiven their weaknesses. After all Columbus died with the certain erroneous belief of having discovered the West Indies! The point here isn't that he was wrong regarding the label he attached to his discovery. The point is that he indeed didn't fall off the face of the earth as held by the prejudice of his age and that he had the courage and drive to make his discovery after all! And the point is not that Hume was spilling the baby of higher truths with the bathwater of extra-sensory perception or that Smith turned Hume's moon back into a green cheese, or at least was trying his best to do so. The point is that both were there at a decisive stage of human history to usher in a New Age: the Age of Enlightened Economics.

Smith thus managed to encapsulate Hume's philosophy into a set of fallacies and prejudices that are still haunting us to this very day! Hume did not treat Political Economy in the systematic manner of Smith but in an essayistic manner more in line with his own temperament. Where he treats the same subjects he never the less manages to avoid most of Smith's errors.

It may be remarked that both Smith's grave fallacies as well as his genuine insights have been religiously followed and slavishly reflected in our post-modern times:

- § After separating them neatly at the outset of the *Wealth of Nations* Smith is hopelessly discombobulating the factors of productions. He is at times indiscriminately classifying land, labor, and money as capital
- § The invisible hand stands in symbolically for the self-regulatory mechanisms of nature. It presupposes an invisible being who in turn is burdened with the most blatant incongruities and injustices
- § In maintaining that the "government governs best which governs least" he overreacts to the preceding night of despotism of the Feudal and Mercantile Ages
- § In positing that competition is a cure-all he disregards social justice as a necessary ultima ratio of the economic equation
- § He contrives an actually rather charming kind of economic theodicy, which derives from the sum of ignorant striving self-interests a magical enlightened common wealth for all. Whether it works is another question. At the latest since Black Thursday, October 24, 1929 we definitely know it doesn't
- § He holds that growth is an economic goal that needs to be pursued at any expense
- § On the one hand he sounds the alarm bell stating that the employer of capital, unlike the landlord and the laborer, has no interest in conformity with the general interest but stands in conflict to it. Here Smith is presaging like concerns of Karl Marx by about a century
- § On the other hand he finds princes and royalty inept and only the entrepreneur to be able really to manage the economy for the good of all!

- ξ He confuses money hopelessly with capital and hence with real wealth, an error in which he is later joined in by the Monetarists
- ξ In criticizing the Mercantilists for their export-over-import obsession and their confusing precious metal too closely with wealth he is nevertheless doing the same in worrying about the gold and silver standards of money
- ξ Smith is an early proponent of the Wage Fund Theory: If this theory which holds that laborers are paid by the entrepreneurs out of their capital were practically adhered to those capitalists following it would rapidly stop just being what they are!

II. The 'Social Fiction' of the *Economic Man*

There is a popular anecdote relating that for Smith, albeit not for Hume, there is a Scotsman in every man, alluding to the proverbial, if possibly legendary frugality of the Scotch national character much in line with those fabled in the same vein of the Swiss and the Swabians.¹ What comes out of this curious piece of alleged national psychology in Economics is nothing less than the Dr. Frankenstein monster conception of the "economic man" or homo economicus. There is here a tacit agreement between Smith, Ricardo, and even reaching down to Stuart Mill including most classical economists, that man is solely engaged in the acquisition of wealth.

Economic man fallaciously standing in for the integral human being as a whole is hence supposed to be guided mainly if not exclusively by the following:

- ξ Compulsory self-interested action
- ξ The maximizing of his returns under all circumstances
- ξ Always taking the greater to the lesser profits
- ξ Seeking with no exception the lowest price
- ξ Lowering costs by all means possible

¹ . Quoting Bagehot after Eugene Rotwein in *Introduction to David Hume's Writings on Economics*, Madison 1970, p. CVII

ξ The limitless acquisition of material wealth

Nature is factored into the Smithian equation as land, but then it is – as mentioned - soon forgotten and becomes a negligible quantity. In a curious and quite hypocritical duplicity, mimicking Hume's denial of knowledge in all things non-economic, Smith maintains "economic man" to be motivated exclusively by self-interest while conceding that "moral man" – another species from other celestial spheres apparently – is motivated mainly by altruism. If 'moral man' be from heaven 'economic man' must surely come straightaway from hell.

Unless we take this to be an early version of our postmodern psychological truism that 'man be from mars' while 'woman be from Venus' it is not difficult to see that this monster is not only heading for a full-frontal crash but that it would take the world with it in its destructiveness. Environmental disasters happily condoned by the heirs of classical economics are preprogrammed in this very misconception beyond a shred of reasonable doubt. It would take an economic gadfly like Thorstein Veblen with his 'conspicuous consumption' to explode the myth of the economic man never to be revived here ever after.

III. What Adam Smith Did Learn from the Physiocrats

On the upside of things, Smith did correctly take over the Physiocrats macroeconomic perspective: You can't set a coherent set of policies unless you understand the parts as well as the whole [synthesis – analysis / the engine taken apart by the 'analyst' needs to be put back together by the 'synthesist' otherwise it doesn't run] and he did correctly add the upcoming industry to trade [Mercantilists] and land [Physiocrats] as the sources of wealth. Smith's forte lies in anticipating intuitively the industrial age, recognizing and analyzing correctly the importance of the division of labor – today we would say economy of scales – for that upcoming age, and over long stretches handsomely criticizing the Mercantilist or Protectionist system: Foreign trade does not have the function to increase the gold reserves of a given country but to carry out the surplus produce to foreign markets and import those goods that the home market can't satisfy.

Prosperity does not derive from a “positive balance of payment or trade” but from an even balance of production and consumption. He here picks up the clues from his mentor Hume: Watch the flow of goods not the flow of money! He correctly exploded Mercantilism as the ‘spirit of monopolism’ which is ultimately not wealth begetting but poverty-begetting and as “the sneaking art of underling tradesmen erected into political maxims and commerce” having “become a source of discord instead of unity”.

IV. Where Marx Shouldn't Have Followed Adam Smith

The missing link between Smith, Ricardo, the Enlightenment aspect of the New Frontier economists and Lassalle, Proudhon, and Marx that really sustains the transition is hence not Utilitarianism – as can often be read in Histories of Economics – but Hegel.

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As we have seen Marx took over uncritically the confusion and fudging of the term “capital” from Smith and it is no wonder that he carried it on into this new debate. Rather than learning from others Marx had to be always right, even if he wasn't.

One of the more profound criticisms of Karl Marx came from the Italian writer Alberto Moravia. Moravia looked at the inquisitorial commissar in Dostoyevsky's *Rodion Raskolnikow* aka *Crime and Punishment* or *Guilt and Atonement* and detected in him and the Social Darwinist killer who gave the book its title the future of the Soviet Commissars and Orwell's Big Brother who is so absolutely right as opposed to every one else, so that killing even on a mass scale is but little more than a handmaid's service for the Higher Truth – never mind the corpses piling up.

V. The Best of Karl Marx?

How can a system that promised a classless society and a veritable paradise on earth for all and ended after the bloodiest purges in the history of mankind and the worst prison system after the Nazis with way over 20.000.000 dead, a greater number deported, not

counting the dead of WW II, how can such a system be taken on its high side. Well, as paradox and terrifying as it sounds, it can, albeit, with great caution. Not all its initial ideas were wrong or bad. Trying to establish social and economic justice was and is a necessary and true goal. Today more than ever!

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So it is a necessary and true goal to root for and champion the insulted and the injured, the salt of the earth, in other words the underdog, those who are always left out and never find an adequate representation – throughout world history most of us, that is. Marx, whatever his other considerable flaws were, here has the moral high ground over practically the entire field of classical and neoclassical economics, because a half-starving world population does not even enter into their hedonistic calculus of the rich. Like Malthus Marx identified the right problems of the future and he managed to ask the right questions: Economic justice and a more equitable distribution. Like Malthus, albeit, he did not give the right answers! Had they both been right we – not just you and me but the entire world population meaning truly all of us - would long be dead.

VI. Now Were Did Marx Go Off?

Why did his justified wrath akin to the Pentateuch prophet not smash the fiends of social justice and ‘the all-round developed personality’ of man, but got shipwrecked on the shores of that very selfsame world history he felt he had so well deciphered with his dialectical materialism?

Marx prided himself of standing Hegel on his head. Who he really stood on his head was not Hegel but Adam Smith and since there are serious flaws, confusions and mix-ups in the pioneer’s groundbreaking work – as we have seen above - standing it on its head really doesn’t help any, or does it? And the consequences of mistaking the basic principles of Political Economy are far worse than mistaking the moon for a green cheese that after all might just be excused as the foibles of two splenetic and mild-mannered Scotch country gents.

To distinguish between the three factors of production land, labor, and stock - as Smith initially called capital - as Smith does and as Marx follows him in doing and then to forget all about it and call land capital, labor, capital, and capital capital, and to confuse everything else under and above the sun together and subsume it under this generic term, and then to throw in the kitchen sink for good measure – which by an irony of the history of the mundane thinkers for once indeed under certain conditions actually does constitute real capital – does not help terribly in establishing a new science and clarifying precisely those matters that lead to the social injustice in the first place! Smith does all this and Marx follows him with painstaking Teutonic accuracy in this confusion. Stood on its head some coins may fall out of the pockets of Smith's figurative effigy, but at this point, coins, "specie" as they were called in Hume's days, or currency – as money is not wealth - do not help matters either.

As we know money is not wealth but only represents wealth and in analyzing money first and foremost - without heeding the other factors in their separation, and the same goes for analyzing capital for that matter - does not lead us one iota closer to the understanding of the true causes of maldistribution of wealth or towards the redressing of social and economic justice. It is no accident that George spoke of Marx's "vicious terminology" really inherited in all its inaccuracy and laxness from Smith and it does not help towards Marx's declared goal.

One "mystery" of Marxism that needs to be addressed at this point because it so badly puzzled and puzzles even the best minds is the concept of surplus value. After Engels brought out the 2nd and 3rd drawer of posthumous Marxian scrap-paper under the decidedly high-sounding but certainly no less digestible title "*Das Kapital II & III*", Kautsky brought out the remaining boxes of unreadable marginal notes and scribbles as "*Theories of Surplus Value I – IV*". What all this simply boils down to is the following. Marx denied the legitimacy of interest or return on capital. This is being subsumed under the term surplus value and it is declared the capitalist's theft and expropriation of the worker's legitimate earnings. This further is related to the illegitimacy of competition.

Because competition is denied as a productive drive under any circumstances any legitimate gain deriving thereof consequently has to be denied as well.

In de facto excluding land from the analysis and focusing on a much overstrained one-size-fits-all rubber-term “capital” the ecological catastrophe in the states behind the former Iron Curtain was actually pre-programmed with near certainty and perfection. The capitalist states were only less environmentally damaging and polluting to the extent to which they had not suspended human rights and freedom of expression as the totalitarian states had. Thus a measured resistance against environmental destruction could be organized.

VII. The Ultimate Litmus Test: the “Cold War”

The Cold War, which according to Professor Nibaldo Aguilera lasted from 1849 – 1989, was a Trench Warfare not just of conflicting social utopias, it was a trench warfare of terms! Whenever you opened your mouth to pronounce yourself on any given economic issue you immediately had to give away the side you were on. Did you use terms like ‘factors of production’ that meant you were an apologist of classical economics and capitalism. Did you use ‘means of production’ and ‘productive forces’ automatically you were classified as a subversive Marxist revolutionary. There was no sitting on the fence!

If there is any single one practical and incontrovertible argument against the Marxist brand of Communism that came to define the Cold War it was not even the fall of the Wall 1989. It was life under Communism behind the Iron Curtain itself, or rather the undeniably oppressive nature of it! Nobody who had the chance or misfortune to live or spent any length of time behind the Curtain after Stalin’s ascension to power and prior to November 1989 would in his right mind want to deny that this system was spiteful of human rights and human dignity to the highest and most intolerable degree and that it was what in French is called *irrespirable*. Unless your name were Bernard Shaw, of course, and you were given special red carpet treatment by the Stalinists. Then you could regularly embarrass your progressive and Fabian friends in proposing Stalin for the Nobel

Peace Prize, which Shaw was never bashful of doing. Great men may have great flaws, but that does not necessarily detract from their overall greatness otherwise.

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Marx distrusted competition and hence advocated the appropriation of “the means of production” by what he envisioned to be the worker’s representatives who in reality turned out to be Big-Brother-style Polit Commissars. His system in which the state unfortunately never “withered away” because those on top would not give up their extraordinary totalitarian power came down to an old-style command economy practiced throughout history by any run-of-the-mill tyrant. Litmus test for all social and economic change has to be human rights and the political framework given by the enlightenment philosophers. In this sense Marx is pre-enlightenment Middle Age barbarism not definitely removed from Captains Kidd or Blackbeard or Sheik Osama. Why bother with water under the bridge in other words?

VIII. Natural Wealth Creation for All & the Greater Leviathan

George in discovering the economic subconsciousness or what he called the “Greater Leviathan” of the body economic knew that unlike political processes economic processes – provided the communally generated land value accretions was collected as societal rent-tax! – knew that a command economy could only wreak havoc! He also saw that competition need not be evil but can be turned to advantage again if the necessary social adjustments are made.

As Marx does not understand the true nature of capital and factures land or natural resources out of the equation following Smith he cannot find the proper solution of the “Iron law of wages” which is based on land monopolies. He cannot understand that the “tendencial fall of the rate of profits” is really based on the same constriction which upsetting the apple-cart of his class struggle brings “laborer” and “capital-user” onto the same side as producers and which annuls his class warfare further hypostasized into the sky “as the antagonistic [read: unsolvable] contradiction between matter and spirit”.

IX. The First Nations & the Land where Women Counted

If you have a two-factor economy *without* nature you might as well have an economy without factoring women into the equation as the economist Marilyn Waring ironically suggested in her work *If Women counted*. Based on her research, studies, and work with women in the Pacific rim area she came to the conclusion that mothers in the so-called lesser-developed nations have an 18 hours work day, 7 days a week, 365 days a year. They are not even getting paid for their services. Would they go on a global general strike or boycott the entire economy would simply break down. An economy without women does not work; neither does an economy without nature! The immediate result of either equation, practically speaking, would be death on a worldwide scale.

We erroneously think that our dealing with land and natural resources as exploitable private concerns – based on Roman law – is the standard of all economic behavior and the inevitable epitome of all economic wisdom. Anthropology and the History of Ancient Cultures and Civilizations teach us, on the contrary, that that is not in the least the case. Most high cultures like the Ancient Egyptian or the Ancient Meso-American ones had a relation to land and nature like the First Nations. Henry George is one of the first and only economists at the threshold between classical and modern economics who took sufficient account of that fact!

Women and Nature, given the respect due to them, would entail a recognition based on human dignity for all humankind, as indeed it would not be able to exist even for a moment without either. “Heaven is thy Father, Earth is thy Mother. Honor them” is a native American wisdom which strangely summarizes the implicit or explicit knowledge of most ancient cultures. George built a coherent economic theory on that basis. That is one reason why the issues he raises are still relevant for us where all the rest seemed to have failed.