UNBRIDLED CAPITALISM / Angus Deaton
STORYTELLING ECONOMISTS / Mary Morgan
MARKET, STATE AND SOCIETY / Jesse Norman
ECONOMIC SENTIMENTS / Emma Rothschild
WHITHER PRODUCTIVITY / Linda Yueh
Throughout 2023, our friends at the University of Glasgow are hosting a series of events to mark the tercentenary of Adam Smith—300 years since the birth of the man widely considered to be the father of economics. Here, we’ve brought together some of the top scholars who’ll be speaking at those celebratory occasions, alongside other experts in economic history, the history of economic thought and the contemporary relevance of Smith’s ideas.

The Economics Observatory was originally conceived in 2020 as a way for the UK’s economic research community to answer questions from policy-makers and the public about the economics of the pandemic. But we always planned to go on to explore further global challenges: they’ve turned out to include climate change, the cost of living crisis and the effects of Russia’s invasion of Ukraine. And we’ve frequently looked back to evidence from past upheavals to see what lessons can be drawn for current policy responses.

In this issue, we seek to learn not just from a key period of economic and social change—the early days of the Industrial Revolution, which Smith witnessed—but also from analysis of what was happening by the foremost minds of the age. As Benjamin Friedman explains, Smith was part of the vibrant intellectual milieu of the Scottish Enlightenment, drawing on insights from science, philosophy and religion. And as Smith biographer Jesse Norman emphasises, his thinking was highly influential on leading political figures of the day.

We also examine the longer-term impact of Smith’s writings on how economics is done. Mary Morgan notes how storytelling is central to the exposition of his arguments, a practice that continues to play a key role in economic analysis. Other contributors focus on the most famous of Smith’s vignettes: the specialised activities of pin factory workers exemplifying the division of labour; people of the same trade conspiring against the public; and the butcher, baker and brewer pursuing their own interests.

Each of these resonates today. The hollow corporations of modern supply chains reflect specialisation taken to extremes. Corporate collusion, to raise prices is still widespread, often now facilitated by online algorithms. And although commonly misinterpreted as advocacy for pure laissez-faire capitalism, Smith’s metaphor of the invisible hand coordinating individual pursuits for wider social benefit remains foundational to economic theory.

Adam Smith was a thinker of his times—but he can inspire us to a better understanding of ours.

Romesh Vaitilingam
Editor-in-Chief, Economics Observatory

300 celebrations.

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300 YEARS: IN NUMBERS

The central task for the global economy since Adam Smith’s times has been to provide for an exploding population. Life expectancy has doubled; the global headcount has risen more than ten-fold; yet economic output has increased far faster—growing by 16,700%.

At the time of Smith’s death in 1790, there were one billion people on earth. There are now eight billion, an increase mainly driven by improvements in healthcare and sanitation. Bacterial diseases that were major killers, including cholera and tuberculosis, have been almost eradicated, and there are many fewer deaths during childbirth. By 2100, the world’s population could reach 11 billion, with much of the growth in Africa and South Asia. The populations of East Asia, Europe and Latin America are likely to level off and then shrink.

Life expectancy has more than doubled from around 35 in Smith’s day to 72 today. But a larger population living longer is a burden on essential resources such as energy, water and food. Today, over 700 million people live in poverty. For them, life expectancy remains much lower than elsewhere: someone born in the UK today is expected to reach the age of 82; in Burundi, the figure is just 63.

In 1700, total GDP was around $2 trillion. By 2022, this had grown to $100 trillion. Launching this explosion in economic activity were the Agricultural and Industrial Revolutions. Man and beast were replaced by new technology, as threshing machines and seed drills drove up crop yields, and steam engines and spinning jennies fuelled a boom in industrial output. But slavery also played a big role in driving growth. Slavery was only abolished in Britain in 1833, and in the United States in 1865, 75 years after Smith’s death.

The factories that Smith knew often used clean forms of energy: water wheels that drove milling machinery left little in the way of pollution. But growth since has relied on energy from fossil fuels. As the frontrunners of the Industrial Revolution, Europe and the United States have been the world’s greatest polluters. Today, China, India and other emerging economies are catching up. In 2022 alone, China emitted an estimated 12 gigatonnes of carbon, over 25% of the global total.

Smith wrote extensively about industry, and he would have been fascinated by the exponential rise in computing speed over recent decades. Over the past 60 years, computers have gone from machines the size of warehouses to the advanced portable systems we carry in our smartphones. The speed of this increase, known as Moore’s Law, shows little sign of abating. Today, you can store a full of The Wealth of Nations on your phone and use YouTube to stream a video on the invisible hand, all before joining an online economics lecture remotely from almost anywhere on earth.

In the mid-1800s, the average person in Britain worked 60-70 hours a week. The weekend was Saturday lunchtime only. A big change came in 1847, when Parliament capped hours and regulated working conditions. Today, the average working week is 36 hours, and many firms are trialling four-day weeks. The workforce has also grown as a share of the population: in 1800, around 50% of the workforce were women; that figure now is 47%. The UK’s political franchise has expanded too. In 1770, just 5% of the population could vote, and they were only men. Today, every citizen over 18 can cast their ballot.

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/ Dénes Csala / Richard Davies / Charlie Mayrick /
Adam Smith was an extraordinary thinker, who was shaped by and informed the extraordinary era of the Scottish Enlightenment.

Adam Smith (1723-1790) is widely considered the father of modern economics with the publication of *The Wealth of Nations*. The success of this book, published in 1776, is related not only to its contents but also to the existence of a literate reading public at that time. Smith was fortunate to be part of the Scottish Enlightenment.

He was born in the Fife town of Kirkcaldy, not far from Edinburgh, the capital city. Both Edinburgh and Glasgow were seats of learning and had a vibrant social and intellectual scene. There were publishing houses and important periodicals, such as the Edinburgh Review. Although Smith was no extrovert, it was relatively easy for him to meet other well known thinkers, such as the philosopher David Hume.

Smith was also able to travel abroad as he became the tutor to a wealthy young aristocrat who was doing a grand tour. During this period, he met influential people such as Benjamin Franklin and Voltaire. He also encountered an important group of economic thinkers—the French Physiocrats—who were opposed to some of the policies of the ancien régime, which, they argued, had impoverished France.

During Smith's time, European nations pursued mercantilist policies, through which they attempted to limit imports by protectionism. This ignored the gains from trade, and tended to lead to trade wars or even actual warfare. Smith later argued against mercantilism from trade, and tended to lead to trade wars or even limit imports by protectionism. This ignored the gains 

The *Wealth of Nations* became a publishing phenomenon. Some of its ideas—such as the role of self-interest and the invisible hand of the market—are taken as foundational concepts in economics. Earlier thinkers argued that self-interest was a sin, and that society was created and managed by God. Smith's own public image went some way to making problematic ideas acceptable. He was a religious man and his companion work, *The Theory of Moral Sentiments*, reflects his deep faith.

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Smith was also influenced by the systematic approach to economic ideas used by the Physiocrats, such as Quesnay's *Tableau Économique*, even if he did not agree with the specifics of their arguments. It is also from the Physiocrats that Smith adopted the attitude of *laissez-faire* for which he is famous, even if the nuances of his views have often since been misunderstood.

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He came to the view that there was an understanding of Smith in the academic world, which wasn’t being translated into a modern public understanding of him. It was all too easy to put him in a box marked ‘neoliberal’, ‘market fundamentalist’ or ‘materialist’, which was completely at variance with what he actually thought. It was incredibly easy for people with different political goals to grind an axe one way or another. Yet at the same time, there was this vast undiscovered continent of interesting ideas, which needs to be brought back into the picture.

That was the intellectual stimulus and excitement, and then there was a practical application, which was that it’s only when you start to understand Smith more widely that you think about issues that translate directly into how we think now—not just economic issues: competition policy, trade, and the like—but also really important social issues. Smith is astoundingly good on virtue signalling, on materialism and its discontents, on the way in which societies evolve, and on empire—all issues that we’re thinking hard about now.

Adam Smith, scholar and public servant.

Jesse Norman MP, author of *Adam Smith: What He Thought, and Why It Matters*, talks to Romesh Vaitilingam.

RV: Why is Adam Smith so important to you that you invested a huge amount of time in writing a book about him? And why do you think he matters for today such that we should be celebrating his 300th birthday?

JN: I’ve always been a bit obsessive about Smith, and for several reasons. He has an extraordinary and continuing intellectual prestige, but he also exercises a kind of intellectual influence. When you think about the citation index of Smith, there is a staggering gap between him and other economists, even those as prominent as Karl Marx and John Maynard Keynes.

He’s also an unbelievably interesting thinker. I came to the view that there was an understanding of Smith in the academic world, which wasn’t being translated into a modern public understanding of him. It was all too easy to put him in a box marked ‘neoliberal’, ‘market fundamentalist’ or ‘materialist’, which was completely at variance with what he actually thought. It was incredibly easy for people with different political goals to grind an axe one way or another. Yet at the same time, there was this vast undiscovered continent of interesting ideas, which needs to be brought back into the picture.

RV: On the misunderstanding of Smith, how much of that is a result of cherry-picking from his work? Or do you think the fact that much of his other work was destroyed upon his death (at his request) has contributed?

JN: One cannot count the intellectual loss of the 18 notebooks that were destroyed. But yes, Smith’s writing is so luminous and so wide-ranging. He has an ability to think on both sides of different topics before he comes to a conclusion. This means that to have a detailed and sympathetic understanding of him, you really have to immerse yourself in it, and then weigh up a series of texts that you might think are conflicting.

Actually, I don’t think they are conflicting—he is a remarkably systematic and careful thinker. But there is certainly a lot of material to support some of these divergent readings. If you want to believe Smith is red in tooth and claw about markets, then there are certainly passages that would support that. And if you want to think he’s a bleeding heart liberal who wandered around worrying about other people’s feelings, then there are passages that will support that as well.
It's worth saying that where that leads to historically is this idea that somehow that there are two Smiths: one of The Theory of Moral Sentiments and one of The Wealth of Nations. That idea flourished when we didn't have any other materials. It was wrong then and I think it can be shown to be wrong by sympathetic reading of both the books and understanding how they fit together. But discovering the various lectures and sets of notes on jurisprudence and some of the earlier writings explains that whole view. It became much clearer what systematic project Smith was engaged in, and then what the linking theory of government and law is that sits between the two big published works.

RV: Smith lived in incredibly interesting times, but your book about him suggests that his personal life was not that interesting.
JN: That's true, but Smith's correspondence is absolutely worth reading: it's fascinating. There are many individual correspondences, and notably, the one with Hume, which is running on both sides. And there's an excruciating teasing letter from Hume, after the publication of The Theory of Moral Sentiments, that is laugh-out-loud funny, which I describe in the book as a masterpiece of tantric epistolation, because it leads the reader on so much. But otherwise, Smith's life is a featureless Sahara. We don't have any sense of the people he loved apart from his mother and one or two friends. We have no sense of any girlfriends or secret amours, and we have no sense of him in any of the wider colour that is mandatory to the current understanding of human achievement, which is always to tell the back story and try and show how the ideas came about. We've kind of gone full circle—in the old days, we didn't mind at all what the back story was when we had the ideas; now, no one can think of an idea without trying to give it a psychological and historical origin.

RV: How were Smith's ideas initially taken up? I understand the books sold well, and he got copies into the hands of key influencers of the time—for example, Robert Burns' copy of The Wealth of Nations, which is now in the library at the University of Glasgow.
JN: Yes, the books did sell well. But a lot was happening in 1776 with the American colonies in the War of Independence. You've also got the publication of Gibbons' Decline and Fall, which is a smash hit, and so the publishers are doing great business in London. The Wealth of Nations does well. It's a big, fat book that first folio, so it's very much priced at the top end of the market. It's picked up by a few people who realise its intellectual significance. It goes into politics, through Pitt, who proclaims himself something of an apostle of Smith, and there's an attempt that Pitt makes to get a genuinely free trade agreement with the French in the 1780s, which seems to bear both a Smithian and Josiah Tucker influence—it's hard to be completely clear about the influences. And of course, Charles James Fox famously talks about it at the despatch box, and how marvellous it is, as well as, confessing privately that he never read a word, which was entirely in character for him.

Then very broadly speaking, it all gets swamped by the French Revolution. And the French revolutionaries love the book, because they think Smith is essentially a man of revolutionary temperament, who wants to sweep away all in his equalising commercial society. And this is economically analogous to what they're proposing to do to the hierarchies and privileges of revolutionary France. I don't think that's what it's supposed to be about at all—it's pretty clear in the late revisions to The Theory of Moral Sentiments that Smith was extremely dismissive of revolutionaries.

RV: Let's come to the present and imagine that we could bring Smith back to modern Glasgow or London. What do you think his take would be on some of the big challenges we're facing now?
JN: That's such an interesting question. Let's choose the issue of productivity. The first thing to realise about Smith is that he's not hostile to the state. So, he recognises not only that markets need an encasing framework of law, which is set and enforced by the state, but also that the state can make very important interventions in its own right. In the 18th century, the biggest intervention is the Navigation Acts and Smith is ok with them. He thinks that security trumps economics if that's what is required to protect trade.
So, in that sense, he's prepared to take very strong interventions. We mustn't think of him in a purely laissez-faire way. He's looking for unified treatments, but I think he might well say that we shouldn't expect a single unified answer to why productivity has been as bad as it is. There are lots of different things going on. These days, we might think in terms of zombie companies, withdrawal of labour from the workforce, marginal incentives or the financialisation of the economy. I'm not sure what a Smithian theory would be—this is just a parlour game—but I think he would warn against a single, one-size-fits-all engagement with it.

RV: Let's reflect on your own personal engagement. You've worked in academia, in the private sector and now in government. Smith is all about the intersections of different parts of society—the market, the state, civil society—so it would be good to hear your take on that and how he might have influenced your own career.
JN: When you think about Smith, he is an astoundingly interdisciplinary thinker. The linking idea of exchange that brings together The Wealth of Nations, as the exchange of goods and services, and The Theory of Moral Sentiments, as the exchange of regard or esteem, is also the idea of exchange that underlies his thoughts on how language develops. So, we're exchanging ideas through language with each other. That composite theory shows how he was intellectually able to devise a single unified set of ideas and then to apply it to different circumstances.

It’s the same when I write books. That target is to try to change people's minds when they're thinking about the origins of representative government and the duties of an MP, whether it's Burke and political parties, or markets, political economy and society with Smith, or in my new book—The Winding Stair—the rule of law and Edward Coke, or the origins of science and technology and Francis Bacon. Hopefully, by reading my work, it does cohere into a view of what matters in life and how we should understand the world.

RV: To return to Smith, he was an intellectual, but also very much engaged in society and worked in government. I wonder if you can reflect on his take on the interaction between ideas and action, between what academics do and what gets done in the real world?
JN: Smith is one of the very first people who was able to make his life as an academic and also simultaneously in public life. The Enlightenment is an enlightenment of academics; it is not one of salon flâneurs or wits. Smith, as an academic, puts in the hard yards. He does the thinking, does the teaching, which he enjoys, and comes out of a very academic milieu. That gives an intellectual integrity and character to his work. But he was much more engaged in public affairs than people sometimes reflect.

The idea that Smith is just an ivory tower intellectual is quite wrong. I've written an article about him as an adviser, which goes through all the different ways in which he was involved in advising on political, economic and tax matters. It's a very substantial list—and his advice was clearly taken very seriously, as you might expect, given the respect in which he was held.

In my case, the thing that has been interesting in my own life has been how everything I have done in different ways recapitulates itself in my political activity. I spent some time working on Wall Street and in the City of London, and then I ended up on the HM Treasury committee. I spent some time running arts organisations and being on the board of the Camden Roundhouse in London and the Hay Festival, and then I ended up running the culture, media and sport committee. I've been a devout cyclist all my life, and now I run decarbonisation and technology within the Department for Transport. So, all the different parts of your life become part of the same thing.

Scan to read the full interview.
ONCE UPON A TIME...

Vignettes scattered through Adam Smith’s writing illuminate his arguments. Such thought experiments continue to play a key role in economic analysis today.

Economists are great storytellers. Their tales might be anecdotes of economic events that they have observed and which seem significant. More often, they are small, thoughtfully imagined stories about how the economic world works. Economists use these narratives to reason about why things happen in the way that they do—and perhaps what might happen next.

Where did this style of doing economic science come from? Well, maybe from Adam Smith, who is often seen as the father of the discipline.

When economists think back to his book *The Wealth of Nations*, they typically remember his narrative of the pin factory, which appears as the first step in his argument. He tells us how by dividing the process of pin-making into a set of 18 individual tasks (drawing out the wire, straightening it, cutting it, creating and fixing the head, and so on)—with each worker specialising and becoming highly efficient in one task—the workshop could produce thousands of pins a day. This contrasts with the few that would be made if each worker made whole pins.

The reasoning and the moral: the division of labour leads to huge productivity gains through specialisation of tasks. Economists often recall another of Smith’s stories, one of innovation: a little boy who figured out that if he tied a piece of string onto a steam engine at a particular point, it would automate his task, freeing him to play with his friends.

They may even recall his vignette of an individual who sought to exchange a small amount of salt for meat, but finds that all that is available in the market is a whole oxen. This creates a small story explaining how money must have emerged to solve such difficulties of exchange.

These stories occur in the first four chapters of his monumental work, which laid out an account of the whole economic system, and how and why it came to develop the features it has. Even though economists no longer build their accounts on labour being the source of value and the driver of wealth creation, Smith’s stories have remained memorable. Why is this so?

Perhaps the answer is that modern economists share his dependence on small stories—not as descriptions of things they have seen nor as illustrations of their ideas, but as something more important, namely as tools for reasoning through their ideas.

Smith’s stories sometimes captured an essential point in a nutshell format—as in the example of the little boy’s innovation. Sometimes the stories were puzzle- framers, designed to explore a difficult question—such as why and how money developed to solve the salt/oxen-exchange problem. And sometimes they were illuminators, clarifying difficult questions and explaining complicated answers—not least why the division of labour opens up such productive powers.

Certainly, Smith’s telling of small stories resonates with the way that modern economists use such accounts: as nutshells, puzzle- framers and illuminators. These are not descriptions of what happens but imaginative thought experiments to explore hidden economic ways and to reason about economic activities and outcomes. Small stories are an everyday practice for modern economists, just as they were for Smith.
Three centuries of economic history from Adam Smith’s birth to today.

1723-2023

Adam Smith is born in Kirkcaldy, Scotland.

1764
James Hargreaves invents the spinning jenny in the early days of the Industrial Revolution.

1776
Adam Smith’s book *The Wealth of Nations* is published.

1779
Adam Smith dies at Panmure House.

1789
The Congress of Vienna establishes a new political and economic order in Europe after the Napoleonic Wars.

1815
The German Chancellor Otto von Bismarck introduces the first old-age pension scheme.

1847
The Great Irish Famine reaches its devastating peak.

1879
James Clark Ross discovers the Ross Ice Shelf in Antarctica.

1889
James Hare, a Canadian senator, becomes the first person of Chinese origin to sit in the British Parliament.

1891
The Maastricht Treaty creates the European Union (EU) and the framework for the euro as a common currency.

1913
The US Federal Reserve System is created.

1936
John Maynard Keynes publishes *The General Theory of Employment, Interest and Money*.

1978
Deng Xiaoping launches China’s official process of opening-up and reform.

1995
The World Trade Organization is established.

2004
EU enlargement adds ten new countries, including several formerly communist countries of Eastern Europe.

2007-09
The global financial crisis.

2007
Adam Smith’s portrait appears on the Bank of England’s £10 note.

1913
The US Federal Reserve System is created.

1991
The emergence of new market economies in Eastern Europe and Asia follows the collapse of the Soviet Union.

2015
The Paris Agreement provides a framework for limiting global warming to below 2°C to combat climate change.

2016
The UK leaves the European Union.

2022
Russia launches an invasion of Ukraine.

2023
Adam Smith tercentenary celebrations.

2020
The Covid-19 pandemic causes widespread economic disruption and job losses around the world; the Economics Observatory is launched.

2020
The Treaty of Rome creates the European Economic Community (EEC), promoting economic integration among its six founding member states.

1973
OPEC’s oil embargo crisis leads to a global economic slowdown; the first enlargement of the EEC brings in Denmark, Ireland and the UK.

1957
The Treaty of Rome creates the European Economic Community (EEC), promoting economic integration among its six founding member states.

1991
The emergence of new market economies in Eastern Europe and Asia follows the collapse of the Soviet Union.

1978
Deng Xiaoping launches China’s official process of opening-up and reform.

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The World Trade Organization is established.

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Adam Smith’s portrait appears on the Bank of England’s £10 note.
Key influences on Smith’s thought.

Newtonian principles, Stoic philosophy and post-Calvinist religious thinking all shaped the ideas of Adam Smith—and through him, they underpin modern economics.

Smith gave early editions of his groundbreaking books to influencers of the time. This copy of The Wealth of Nations—now in the University of Glasgow library—belonged to poet Robert Burns.

Ideas rarely come out of nowhere. Prior thinking matters. So too do the surroundings in which the people doing the new thinking live. Even when this influence is subconscious, what people think normally reflects what is happening around them. This applies not just to the physical circumstances governing their everyday lives, but also to the significant historical forces, and even the major attention-arresting events, of their time. Economic thinking is no exception.

Adam Smith laid the foundations for what became modern Western economics in the third quarter of the 18th century. The centrepiece of his thinking was the idea that ordinary individuals, acting merely in their own self-interest, can—and under conditions of well-regulated competitive markets will—take actions that make not only themselves better off, but others too.

Against the background of centuries of concern over the consequences of self-interested behaviour, especially in the economic sphere, the idea was not just novel but startling. And it has been the centrepiece of Western economics ever since. But where did Smith’s thinking come from?

Some of the chief influences are well understood, and widely discussed in scholarly research. Smith and his generation of intellectuals were all educated in Newtonian principles of system and mechanism. Newton’s great Principia Mathematica was first published in 1687, and by the time Smith was an undergraduate at the University of Glasgow, the book was part of the standard curriculum in all Scottish universities, as well as at Cambridge in England.

What made Smith’s contribution in The Wealth of Nations special was that he offered not only the central proposition about self-interested economic behaviour making others better off, but also a systematic explanation for it together with the mechanism—market competition—that made it work. Some of his intellectual predecessors, both British and French, had intuited the proposition, but none had offered a systematic explanation or a believable mechanism.

Several other influences are also familiar. Smith was well educated in Stoic philosophy (his favourites were Epictetus and Marcus Aurelius), with its concept of natural harmony in the universe. He was a highly observant man, and he lived in an increasingly commercial society and spent time in major mercantile centres like Edinburgh, Glasgow, London and Paris. He was also an insightful philosopher, whose penetrating introspections had earlier formed the basis of The Theory of Moral Sentiments.

I believe that there was something else at work too: the new and hotly contended religious thinking in the English-speaking Protestant world at that time, associated with the movement away from Calvinist notions of depravity and predestination. In place of Calvin’s belief that all men are ‘totally depraved’ and ‘unable to do good’, the new thinking emphasised the inherent goodness of all men. In John Locke’s memorable metaphor, all men are given the ‘candle of the Lord’ with which to understand what is right.

The new thinking set out that all men are able to be saved, and that—in the words of John Tillotson, the first Archbishop of Canterbury appointed after the Glorious Revolution of 1688—each person must ‘cooperate’ with God in achieving their salvation. This stood in contrast to earlier beliefs that who was saved was a matter determined before the world was even created, leaving no room for influence from an individual’s decisions or acts. Further, instead of the Calvinist idea that the sole purpose of human existence is to glorify God, now human happiness was a divinely intended end, perhaps the most important.

The contention over this change in religious thought was a rolling process, developing first in England, then in Scotland and later still in America. Importantly, it was at its height in Scotland just when Smith and his contemporaries were coming to young adulthood and therefore forming what Einstein called their ‘world view’ (Weltbild) and what Joseph Schumpeter called the economist’s ‘preanalytic vision’. Especially in light of the close integration of intellectual life in Edinburgh and Glasgow at the time, it was highly likely to have affected their thinking about the world, even though Smith, and even more so David Hume, were not outwardly religious men.

In effect, Smith and his contemporaries were secularising the religious thought of their day, with its optimistic assessment of human character and expansive sense of the possibilities for human agency. Those principles were essential to the creation of modern Western economics and they have remained so ever since. Today economics is still about human choices and their possibilities. Smith’s proposition about the effect of self-interested actions taken under conditions of market competition is still the heart of our analytical apparatus. And the more expansive and optimistic view of human agency held by Smith and Hume remains ours as well.
Over the past 300 years, economic nationalism has ebbed and flowed: from the mercantile system that Adam Smith described through waves of globalisation, backlash and battles for supremacy.

Adam Smith coined the term ‘mercantile system’ to describe the way that international trade was managed during much of his lifetime. As he explained in *The Wealth of Nations*, it was dominated by government regulation. Trade was organised by chartered businesses such as the East India Company, which operated within competing empires, and commodity production was largely based on a plantation economy dependent on slavery.

This all changed rapidly in the late 18th century. With the onset of industrialisation, Britain adopted policies of free labour and free trade, most notably repealing the protectionist Corn Laws in 1846. It abandoned centuries of imperial regulation in favour of a global free market, with competing private companies, exporting industrial goods and importing food and raw materials in a worldwide pattern of trade.

This first age of globalisation provoked its own reaction. The Long Depression of 1873-96 sparked a widespread return to tariffs and imperial expansion. At the same time, the United States, protected by its own tariff wall, emerged as the most productive power in the world economy.

For some, the rise of competing autarkic economic blocs—mirroring growing geopolitical rivalries—accelerated the drift towards war in 1914. For others, the period was a new highpoint in globalisation, bringing intensified economic and financial interdependence of nations.

The First World War fundamentally reshaped global trade. The United States replaced Britain as the most powerful trading nation. The market struggled to recover from global economic warfare and a post-war collapse in world trade. The United States resorted to high tariffs, as did most nations across the world as they gained tariff autonomy. Britain gradually abandoned free trade too in favour of reliance on imperial trade.

A real turning-point came with the Reciprocal Trade Agreement Act of 1934, which foreshadowed the emergence of the United States as the world’s leading liberal trading power. This was confirmed by its readiness to promote multilateral world trade after the Second World War, not least through the emergence of the General Agreement on Tariffs and Trade, the predecessor of the World Trade Organization (WTO). This ensured an important check on the resort to trade barriers seen after 1918.

The onset of the Cold War accelerated the creation of a regional trading bloc in Europe, which meant that the goal of universal free trade remained distant. At the same time, Japan emerged as a global rival in trade to Europe and the United States.

As decolonisation increased the number of less economically developed states, after 1964, the United Nations Conference on Trade and Development (UNCTAD) began to voice the concerns of primary commodity-producing nations that were trading on unfavourable terms with the industrialised West. Despite fears of a resurgence of mercantilist rivalry in the 1970s, the end of that decade saw a global reaction against the Keynesian post-war order of managed trade.

World trade was increasingly deregulated, with barriers removed not only on trade in goods but also the increasingly important areas of services, investment and intellectual property. The formation of the WTO in 1995 symbolised this new world of global free trade, although many feared that it was dominant multinational corporations and their shareholders who benefitted most.

More recently, widespread backlash has challenged what some call the ‘neoliberal’ vision of the free market, with the rapid emergence of China threatening US economic supremacy. There has also been a seeming return to the fragmentation of markets, exacerbated by Russia’s invasion of Ukraine. The state, not the consumer, seems to be returning as the driver of economic growth.

Global shipping routes in 2021

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SMITH AND SELF-INTEREST.

Both Adam Smith’s work and modern behavioural economics show us how our decisions are influenced by perceptions of the motivations and moral judgements of others.

When I ask people what’s the first thing that comes to mind about Adam Smith, self-interest is the most common answer. Some of the most well-read responders even dare citing that

“…It is not from the benevolence of the butcher, the baker, or the brewer that we expect our dinner, but from their regard to their own interest.”

It seems to be widely thought that Smith is all about self-interest. But is he really?

If we search for self-interest in The Wealth of Nations, we might be surprised. We find all sorts of interests: public interest, private interest, own interest, interest in something. We find several mentions of rates of interest. But self-interest is mentioned only once.

It is not the famous butcher, baker or brewer who are self-interested: we expect our dinner from their regard to their own interest, not from their self-interest. The self-interested are the inferior clergy of the Church of Rome, which subsists on voluntary oblations of the people.

And yet, for Smith, people are very much interested. We may not be self-interested, but we are definitely interested in others: in others’ opinion, in others’ judgement, in how others see us. We are interested in others’ motivation, and in how others perceive our motivations.

In Smith’s view, we always and almost automatically put ourselves in the shoes of another and imagine how we would react in similar circumstances. If we would react the same, we agree with them and approve of their reaction. Conversely, we disagree and disapprove if we would respond differently.

This implies that we have to understand the context in which the other person is acting. Their reaction by itself is not enough. Context is what makes the difference.

For example, would you accept money from me knowing that I won it in the lottery? Would you accept the same amount knowing that I had attacked an innocent person to get it? It is the same amount of money. In both cases, it comes from me. But your evaluation is different—and probably your willingness to accept the money may be altered.

Modern behavioural economics is full of experiments of this kind. The payoff is the same, but the context differs. For example, experimental studies show that people are less insulted by a computer offering them a small share of a pot of money than if another person does it. We are interested in the intentions of the other, not just our self-interest.

A commonly understood self-interested individual would care only about the payoff. Context is irrelevant. But Smith teaches us that we are interested in the motivations of others and in how others morally judge us. It is not self-interest, but interest in the approval of others that we find in Smith, if we care to read his work with interest.

Some of the most recurrent subjects for public debate are wages, profits, taxes and inequality. What’s more, perhaps because of the recent series of economic crises, ideas about policies in these areas that were once marginal are now increasingly mainstream.

Raising the minimum wage is no longer assumed to have the distorting effects on the labour market that it was assumed to. High profits are coming to be seen as symptoms of economic pathology, not a robust business model. Demands for redistributive taxation have found new defenders (though more pragmatic perspectives propose a new trade-off between fairness and efficiency). And inequality has prevailed as an overriding concern among developed economies as much as developing economies.

These positions were in fact central tenets in the thinking of the original market theorist, Adam Smith. Readers long confused the points in The Wealth of Nations that explained how society originally emerged or how it currently operated with the economy that Smith was prescribing. To reconstruct what the ideal economic system was for Smith, one needs instead to assemble all the economic prescriptions he proposed.

Smith thought that high profits were a symptom of serious market disequilibrium: they were ‘always highest in the countries which are going fastest to ruin.’ This is because ‘the rate of profit does not, like rent and wages, rise with the prosperity, and fall with the declension of the society.’ The current record-breaking corporate profits would not have surprised him.

Accordingly, Smith believed wages should be sufficient to provide the ‘necessary’, defined as middle-class comforts. This was a call for a generous minimum wage, which he expected to occur naturally, following economic growth. It’s only low wages that resulted from concerted action—either government intervention, as when the ‘sophistry’ of merchants and manufacturers manipulated legislatures to pass favourable laws; or when employers used their bargaining advantage to coerce workers. Unsurprisingly, Karl Marx was an admirer of this view.

Smith also praised the British tax system. It featured per capita taxes that were twice as high as those imposed on the French, yet the ‘people of France…are much more oppressed by taxes than the people of Great Britain.’ Why? Because French taxes fell disproportionately on the poor. ‘The inequality of the worst kind’ was when taxes must ‘fall much heavier upon the poor than upon the rich.’ The reasons were not moral. Bad taxes were simply bad economics.

Smith also thought regulation in favour of the worker was ‘always just and equitable,’ that inheritances should be partitioned, even royal land should be redistributed. Once all these building blocks are assembled, it is hard to see how steep inequality could even arise.
Where Smith wrote.

Ashley Lait talks to Caroline Howitt, programme director at Panmure House, Adam Smith’s home in Edinburgh.

**AL:** Can you tell us about the 18th century history of Panmure House and that’s time there?
**CH:** Panmure House is an ancient building, right in the centre of Edinburgh. Today, it sits very near the Scottish Parliament. It was originally built in 1691 and was the town seat of the Earl of Panmure.

But the house was made famous by arguably its greatest resident, Adam Smith, who moved here in 1778 to become commissioner of customs. He lived here until his death in 1790. Across that period—at the height of the Scottish Enlightenment—Smith was already very famous. He worked on the final editions of both The Theory of Moral Sentiments and The Wealth of Nations while he lived in the house.

He also used Panmure House as a convening space for many of the other finest minds of that generation. They would come here every Sunday to dine and debate the big issues of their day, and to discuss ideas that went on to have a significant influence on our modern society as it is in the West.

It is easy for us to forget just how groundbreaking and radical these people were at the cusp of the first Industrial Revolution. James Hutton, for example, was the father of modern geology. He was the first person to drill down into the radical concept of ‘deep time’—the idea that the earth was a lot older than stated in the Bible. Joseph Black, the founder of modern chemistry and known for discovering carbon dioxide, often visited the house too. It really was a hub for incredible thinkers.

**AL:** What happened to the house following Smith’s death in 1790—and how did it become the research and education centre it is today?
**CH:** In the 19th century, it became a foundry. But it fell into disrepair and the north wing—the residential part of the building where Smith lived—even fell down. Luckily in the 1950s, the owner of The Scotsman newspaper, Roy Thomson, rescued and restored it.

He gave it to Edinburgh City Council and it was then used as the Canongate Boys’ Club. For some time, it was used for this educational purpose but it later became dilapidated again.

Then in 2008, Edinburgh Business School and Heriot-Watt University rescued the building from dereliction and spent ten years and £6.6 million restoring it to the beautiful 18th-century standard now on display. The view was to not just restore the building physically, but also intellectually to what it was in Smith’s time: a beacon for brilliant minds to come together across disciplines and solve the biggest challenges that we face today.

**AL:** What were the priorities for the restoration?
**CH:** There were obviously a series of archaeological digs and architectural surveys that informed the process. For example, they found an industrial site from the medieval period in what is now the entrance in the basement. This would have been outside Edinburgh’s city walls, but it was an important find so this halted the restoration for a time.

Within the house, we wanted to marry the tradition and heritage of the 18th century with the modernity and accessibility that we need to be able to bring Smith’s ideas and methods into the 21st century. So, we have a painstakingly handcrafted penchek stone staircase, but we also have a disability access lift. We have stunning tulip wood panelling that’s been imported from the United States and painted in pastel colours—because that’s exactly what they would have had in Smith’s time—but behind it are 92-inch TVs so that we can broadcast events and meet people from around the world.

There are other more subtle details too, including translucent quotes from Smith’s works on some of the panels. They could be easily missed but they are intended to highlight that detail and nuance matter, which is central to our mission of reviving a spirit of respectful public discourse.

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**AL:** Can you tell us about Panmure House’s mission and your role within that?
**CH:** A big part of our mission today is to try to redress the balance between Smith’s works and to reconnect the now disparate sides of Smith’s oeuvre. He is sometimes thought of as a proponent of laissez-faire capitalism, but he wasn’t. We are trying to recouple the financial and economic insights of The Wealth of Nations with the philosophical and more humanist insights from The Theory of Moral Sentiments.

I have been the programme director since 2019 and my team’s role is to push forward that intellectual restoration work. Part of that is our Adam Smith Lecture Series, which brings the world’s greatest economic practitioners, thinkers and Nobel laureates here to the birthplace of modern economics.

We also have leadership and research programmes, including the Panmure House Prize, worth £75,000, which is one of the world’s biggest prizes for economics. This is specifically for research on long-term investment, and its impact on innovation.

**AL:** How important is broadening awareness of Smith and his ideas to your work?
**CH:** I personally feel that we’ve not been great at celebrating Adam Smith. We celebrate David Hume and some of the other key figures of the Scottish Enlightenment, but Smith has had less attention. I think that can help to explain how the house was allowed to go to rack and ruin. You can’t imagine that happening to Shakespeare’s house.

But there has been more research in recent times, which has highlighted how central Smith was in bringing together brilliant Enlightenment thinkers who used to convene here to share ideas.

I also think that Smith would have defined himself as an educator first and foremost rather than an economist. He was a brilliant teacher and took pride in his mentoring roles. I’m currently looking at a portrait of the young Duke of Buccleuch, whom Smith took on a grand tour of Europe.

So, part of our work is also education-focused. We have the Smith Schools’ Series, which is designed to give critical thinking and debate skills to the next generation, teaching them to defend their arguments, while also respectfully engaging with others.

The series has been specifically targeted at schools in underprivileged areas that might not otherwise get such opportunities.

**AL:** During the tercentenary, what is the legacy that Panmure House would like to celebrate?
**CH:** Smith set out to create what he called a comprehensive science of man. He was interested in why people do the things they do and how we work together. Unlike how some have interpreted his work, he wasn’t a Gordon Gekko character (from the 1987 film Wall Street) who said ‘greed is good’ and that we should just be out for ourselves.

The famous quote from The Wealth of Nations about the butcher, the brewer and the baker has been taken out of context as a justification for the free market being allowed to run wild. People forget that he was the commissioner of customs. It’s said that he would have done away with taxes and diminished the role of the government, but he worked for the government and helped to define and deliver taxation in his role.

For us, it’s crucial to look holistically at Smith’s work. I wouldn’t say we take a particular position on Smith, rather that we are placing an emphasis on all of his work. This includes The Theory of Moral Sentiments, which was an investigation into the fact that we are social creatures and that we care about one another, which is important for building a society, a judiciary and a successful marketplace.

In terms of legacy, our focus is much more on applying Smith’s methodology practically in the 21st century to try to effect change to inequality—need vision and solutions across long periods of time. Indeed, we have just welcomed Adam Dixon, our inaugural Adam Smith Chair in Sustainable Capitalism, who will lead a research team looking at sustainable finance, sustainable innovation and sustainable leadership.

Overall, the tercentenary offers an opportunity to reflect on the power of Smith’s legacy and how central he was to the Scottish Enlightenment. We have the chance to think about what he has to teach us and how we can apply it to make our own society a better and more joined-up place to live.
Who to read next.

Ten big thinkers from the past who have influenced our understanding of economics.

1. DAVID RICARDO, 1772-1823
Ricardo was an early advocate of free trade as the way to promote global prosperity. His theory of comparative advantage—which explains the benefits of specialisation and the division of labour at the level of countries—continues to underpin arguments against protectionism and economic nationalism. He was a passionate opponent of Britain’s Corn Laws, which restricted imports of food, and was influential in their eventual abolition in 1846.

2. MARY PALEY, 1850-1944
Paley was the first woman to pass finals in political economy at the University of Cambridge, but was barred from receiving a degree because of her gender. She moved to Bristol with her husband Alfred Marshall, where they co-authored The Economics of Industry. Her influence was evident from the book’s discussion of gender pay inequality, arguing that men and women may be equally productive but receive unequal pay because of custom and general opinion.

3. JOHN MAYNARD KEYNES, 1883-1946
Keynes rightly predicted that his 1936 book The General Theory of Employment, Interest and Money would revolutionise the way the world thinks about economic problems. He argued for government spending to promote employment and get the economy out of recessions, even if this resulted in budget deficits.

4. FRIEDRICH HAYEK, 1899-1992
An advocate of the economic benefits of free markets. Hayek countered the views of Keynes. His contributions include the monetary theory of business cycles—that changes in the money supply can interfere with price signals—and analysis of the importance of prices in conveying information for market decisions.

5. JOAN ROBINSON, 1903-1983
Robinson made wide-ranging contributions to economics, notably in thinking about imperfect competition between firms in product markets. She coined the term monopoly to describe a market dominated by a single buyer—for example, Apple in the market for iPhone apps.

A pioneer in the economics of developing countries, Lewis was the first black academic at the London School of Economics. His work included the theory of dual labour markets, in which the shift of workers from agriculture to the manufacturing sector boosts productivity growth. He was also the founding president of the Caribbean Development Bank.

7. ANNA SCHWARTZ, 1921-1993
The first woman to receive a PhD in economics from Yale University. Wallace’s research and policy work focused on race, gender and class discrimination in the workplace. In the 1960s, she was chief of technical studies at the Equal Employment Opportunity Commission, and her work informed anti-workplace-discrimination aspects of the Civil Rights Act of 1964.

8. PHYLLIS WALLACE, 1921-1993
Known for her work on general equilibrium theory, welfare economics and social choice, one of Arrow’s best-known contributions is the ‘impossibility theorem’. This explains why no system of voting can translate the preferences of individuals—when given three or more options—into a community-wide ranking.

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10. ELINOR OSTROM, 1933-2012
Ostrom was the first woman to win the Nobel Prize in Economic Sciences. She studied local communities around the world to understand how they manage resources sustainably. Her insights show how different institutions and systems can provide incentives for sustainable behaviour and avoid the ‘tragedy of the commons’, where shared resources can be depleted in the absence of property rights or government oversight.
For many of us, the word wealth tends to be associated only with financial assets. But this is an overly narrow view of prosperity. For much of history, land was the foundation of wealth: the Domesday Book, for example, was a record of landholding compiled at the order of William the Conqueror in 1085.

Property remained the key asset into Adam Smith’s times. Along with financial assets like pensions and savings, property is still an important component of wealth in the UK, as are physical assets such as factories and warehouses, or machines and lorries.

But even this perspective needs to be broadened. The wealth of nations depends on a wide range of assets, all able to be accumulated (or depleted) over time. These assets also deliver economically valuable services year by year. Those that are often overlooked, partly because they are harder to measure, are sometimes called missing capitals.

Natural capital is one. This refers to the resources provided by nature, such as a liveable climate, water, ecosystems and minerals. While some are part of the monetary economy, many others are only just starting to be more carefully measured, given the new recognition that economic activity has been using nature for free in an unsustainable way. The threat of climate change and biodiversity loss heighten the importance of natural capital in our national accounting.

Another component of wealth is human capital: the skills and know-how everybody invests in acquiring, primarily through education and training. Increasingly, economists are including health in measures of human capital, as healthy people are more productive.

Less tangible are two other missing capitals. One is intangible capital, which consists of accumulated value in intellectual property, designs or organisational know-how. The other is social capital—the ways in which people in local communities or wider societies connect with each other to share resources and activities. An economy with high social capital—typically measured by the levels of trust in others that people express—is likely to be richer than one with low social capital.

Returning to a more holistic view of wealth is essential for sustainable growth. A focus on wealth embeds concerns for the future because the value of any asset today depends on the services that it is expected to provide in future. Specifically, if an asset is depleted too much or not maintained well, it loses value.

Including the whole range of assets ensures that decisions can take account of the links and trade-offs between them. For example, cleaner air will improve human capital as well as natural capital: and investing in upstream tree planting will reduce what needs to be spent on concrete flood defences downstream.

Finances and more conventional economic measures certainly matter—but the long-term prosperity of a nation requires a more comprehensive view of wealth.
WHAT POLICIES MIGHT SMITH ADVOCATE TODAY?

Adam Smith’s legacy supports a more progressive public agenda. Environmental threats and rising inequalities require collective responses and investments with ethics at their heart.

/ Fonna Forman /

Across the world, division and inequality are rife. Both the Covid-19 pandemic and climate change have been met with science denial. Accelerating migration due to war, poverty and natural disasters prompts resurgent nativism and border-building everywhere. Populism is on the rise in many countries; war has returned to Europe with Russia’s invasion of Ukraine; and explosive gun violence in the United States is met with acquiescence to the firearms industry. Undergirding all of this is the dramatic polarisation of public and private interests.

We can only speculate about how Adam Smith would respond to our current crises. What is clear is that his writing has been distorted to validate narratives, policies and practices that undermine public wellbeing in ways that contradict what he actually cared about.

Too much of the nuance in his thought has gone missing since he wrote The Wealth of Nations in 1776. His work has been reduced by the left and right alike to a manifesto for small states, trickle-down economics, privatisation and austerity.

But Smith had a lot to say about ethics, human dignity, public goods, public investment and collective responsibilities to collective interests when there are insufficient incentives in markets. His legacy supports a more progressive public agenda.

In the much-neglected Book V of The Wealth of Nations, Smith foresaw an expanded role for governance, regulation and public investment. He saw that as states grew, society would become more opulent and challenges would become more complex. The statesman played an essential role for Smith, balancing public and private considerations, investing strategically and judiciously in public goods, particularly when the market is ill-suited to do so.

Public wellbeing sometimes needs a helping hand. Smith devoted the longest section of The Wealth of Nations to elaborating public provision (notably public education), as well as progressive taxation and taxes on luxury goods. Future public investment scenarios were underspecified in Smith’s narrative, but his open-endedness is a 21st century invitation for public innovation.

For Smith, our duty of cooperation expands to the natural limits of shared interests and capacities. While he was focused primarily on the local obligations of the 18th century, our planetary interdependence today expands his interest-and-capacity-based duties to people across the world.

Covid-19 exposed the extent to which disease and deprivation in one place can affect us all. Migration has global effects. And climate change is the mother of public goods, the very foundation of collective wellbeing and prosperity.

A Smithian global public agenda would put combating climate change at its centre. It would support regulatory agendas that subordinate the short-term profits of a few to long-term collective investments that would dramatically reduce greenhouse gas emissions. Policy would focus on investments in clean energy technologies and a just labour transition.

Smith had no patience for collusion between politicians and corporations. He was among the 18th century’s most vocal critics of empire, slavery and resource exploitation abroad. Empire corrupted the European soul; and the state had become a puppet for the vile agendas of international trading companies like the East India Company.

What would he think about the agendas of multinational corporations and many governments today? How would he evaluate their resource extraction, land dispossession, labour exploitation, enslavement of the working poor (in industries like mining, textiles and agriculture) and the widespread disdain for our planet and its inhabitants?

At the tercentenary of Smith’s birth, we should reclaim these neglected dimensions of his thought because they reveal humanitarian instincts and palliative resources from within capitalism itself, which can change the narrative and temper some of the most pernicious effects of its unbridled global functioning. That these resources emerge from Smith’s thinking gives them added rhetorical power.

Scan to read the climate crisis issue of ECO magazine.
Unbridled capitalism—an idea often mistakenly attributed to Adam Smith—has flourished in the United States. But it ignores deep inequalities, not just economic but also in health and wellbeing.

Economic systems should help people to prosper and flourish, but today’s capitalism is failing in this basic task. Progress has come to a halt for many—not just material progress, but also in health and wellbeing.

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Growth in per capita gross domestic product (GDP) continues, albeit sluggishly. For those who believe in economic growth as the overriding goal, the United States is seen as a positive exception, an example to other rich countries. Many take this as a cause for celebration, not only for Americans, but also for the relatively unbridled capitalism that the United States has come to represent.

Some might even hark back to Adam Smith and claim that the United States has done so well because it has closely followed the market-centred policies that are seen as Smith’s greatest legacy.

Compared with the UK and the European Union (EU), the United States has been more reluctant to use government to regulate markets. It also uses markets where others do not, most notably in healthcare. And it has not stifled innovation or growth: Amazon, Facebook, Google, Microsoft and Netflix, are all American companies. European successes are in less innovative luxury companies such as LVMH, which owns Christian Dior, Moët & Chandon, and Bulgari, among many other high-end brands.

But growth is worthless to those who do not share it. GDP is blind to who benefits and who loses, and over the last half century, the majority of Americans have not seen the growth in incomes that might seem warranted by the growth in the economy.

Economic failure or failed economics?

Unbridled capitalism—an idea often mistakenly attributed to Adam Smith—has flourished in the United States. But it ignores deep inequalities, not just economic but also in health and wellbeing.

Being rich is no good if you are dead, and individual-based measures of money and health miss the social aspects of wellbeing, relationships with family and loved ones, the sense of accomplishment that comes from work, and positive daily experiences of life. For the two-thirds of Americans without a four-year college degree, these aspects of life are worse now than 50 years ago, notwithstanding some post-Covid-19 improvements, which are likely to be temporary.

Smith understood and celebrated the power of markets, but he did much more. Fewer of his other insights and warnings feature in today’s mainstream economics. The transformation of Smith’s economics into Chicago economics has not only emaciated the subject, but it has done great harm to public policy and is at least partly responsible for what I see as a failure of American society.

Yet it did not have to be this way. Economists such as Tony Atkinson, Jim Mirrlees and Amartya Sen have pursued a broader programme, worrying about poverty and inequality, and about health and its place in wellbeing. Sen traces a key misstep, not to Milton Friedman, but to Lionel Robbins, whose definition of economics as the study of allocating scarce resources among competing ends narrowed the subject, compared with what Hilary Putnam calls the ‘reasoned and humane evaluation of the social wellbeing that Smith saw as essential to the task of the economist’.

Economics should be about understanding the reasons for and doing away with the sordidness and joylessness. But that is not how it worked out in America. •

The Bethlehem Steel Corporation, founded in 1904, became one of the world’s largest steel-producing companies. Its beams and plates were used in many of America’s most iconic architecture, including the Chrysler Building, the Empire State Building and the Golden Gate Bridge. The company filed for bankruptcy in 2001, with its flagship plant in Pennsylvania left to rust.
The hollow corporation.

Adam Smith explained the gains from workers in a pin factory specialising in their tasks. Specialisation today looks very different, with many businesses focused on just a single link in the global supply chain.

Adam Smith famously described the productivity gains from division of labour. The central insight is that specialisation by workers and organisations can promote greater efficiency—with the benefits limited only by the size of the market.

But Smith could not have imagined how by the 21st century, the market would have expanded both geographically and structurally. Rather than being defined by capital and labour—once the core features of firms—markets are now driven by specialist services bought from other businesses.

The idea of the hollow corporation seems to have been first introduced by Norman Jonas writing in BusinessWeek in 1986. He described how firms were outsourcing more and more of their activities to independent, specialist suppliers—a development that he thought would gather pace.

Apple is currently the most valuable company in the world, with a market capitalisation of around $2.75 trillion. Assets on its balance sheet account for around $330 billion. These are mostly cash and investments—property, plant and inventories total about $45 billion. Your Mac and iPhone were designed in California, but they were not made there. Apple has outsourced manufacturing to businesses like Foxconn, a Chinese subsidiary of the Taiwanese Hon Hai group. The Apple-designed processors now used to power Mac computers are manufactured by TSMC, another Taiwanese company.

You have certainly driven past an Amazon warehouse. But it is unlikely that Amazon owns it. Most of their warehouses belong to Prologis, the world’s biggest real estate company. Equinix is one of several large data centre companies that provide server space for large corporations, including Amazon. Phone masts are mostly owned by specialist companies such as American Tower or, in Europe, Connex.

When you fly, it is unlikely that the plane belongs to the airline whose logo is on the fuselage. There are several large aviation leasing companies that own aircraft bodies, the largest being AerCap. But they don’t own the engines. The supply and service of these are contracted from a manufacturer like Rolls-Royce, which in turn has transferred ownership of the engines to a business such as GATX, which also leases railway carriages.

Modern businesses buy parts, buildings and technology (capital) as a service. Increasingly, they also buy routine labour as a service, especially for tasks such as cleaning, security and catering.

Compass and G4S (both British) and ISS (Danish) each have around 500,000 staff. These businesses specialise in low-paid activities—such as catering, security and facilities management—but other firms offer more sophisticated specialisations. IBM, once known for dominance of the mainframe computer business, is today the largest global consultancy company. Not only does it sell software as a service: it also sells labour as a service.

The Speedee Service System devised at McDonald’s and promoted by Ray Kroc was imitated by other fast food chains and in many service businesses—from print shops to pharmacies to hotels. Today, franchising even extends to global accounting firms, with country-specific operations trading under one worldwide brand.

The customers of platforms such as Facebook, Twitter and YouTube are also these companies’ suppliers. And much the same is true of eBay and Google. Airbnb and Uber are both platforms and franchises. As platforms, they link hosts with guests, passengers with taxis; as franchises, they try to monitor the quality of their lodgings and the reliability of their drivers.

The division of labour in today’s hollow corporations pares down the activities undertaken by businesses to a single link in the chain of production at which the corporation enjoys a competitive advantage. We have come a long way from the pin factory.
When countries industrialise, they move out of agriculture and into manufacturing, which has higher productivity or output per worker and thus generates higher wages. Industrialisation is how countries throughout history became middle class and prospered. Deindustrialisation then follows. In advanced economies, manufacturing starts to become less important as a share of output once they become richer. Services in the business, retail and finance sectors begin to dominate the economy, and employment shifts from factories to offices or stores. This is in relative terms, since in absolute terms the UK remains one of the top ten manufacturing nations in the world—with sales worth £400 billion in 2021.

Still, manufacturing has declined from contributing a quarter of national output in the UK in 1980 to a fifth in the 1990s and under an eighth in the 2000s. The 2000s saw a financial crisis that dented productivity growth. But the slowdown in productivity goes back several decades. This raises the question of whether services-based economies can grow well. It is not just a question for advanced economies but also for developing countries, some of which are experiencing premature deindustrialisation. This is when the economy moves from agriculture to services without becoming industrialised first.

The crucial question is whether state intervention can be effective. One area where the UK lags other major economies is investment. When research and development (R&D) and other intangible investments were included, estimates of US GDP increased by 3%. The OECD estimates that intangible investment, including in education (human capital) and software, is as important as investment in tangible machinery and equipment in the UK.

There is a strong argument for the UK government to act to bolster investment in general, and specifically in services, particularly since a great deal of value-added in manufacturing is based on service inputs such as design and R&D.

By targeting investment, which should be feasible, government need not favour certain industries and instead could give businesses incentives to invest efficiently. This would be more aligned to Smith’s famous observation that: ‘It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.’

It’s worth mentioning that Smith didn’t favour the services sector as it was in his day. He believed that it was comprised of ‘buffoons, opera singers, and musicians’, whose output could not be traded. Consequently, it did not add to national output in the same way as manufacturing.

Smith was, of course, a product of his times. On the tercentenary of his birth, the services sector is now vastly different since a digital download of music is as tradable as a widget. If services can produce lasting value and public intervention can avoid distortions, Smith might be persuaded that governments should try to shape the economy to boost growth.

What would the father of economics say about a government that sought to rebalance the economy away from services and towards making things once again? Would Adam Smith, who is widely understood as arguing that the invisible hand of market forces leads to the most efficient outcomes, support government intervention to reshape the economy?

The Industrial Revolution of the late 17th and 18th centuries transformed Britain into the world’s first industrial nation, captured in Smith’s seminal work, *The Wealth of Nations*. By the 20th century, deindustrialisation meant that the UK economy had shifted away from industry and towards services. Today, major economies are predominantly services-based—the sector accounts for around four-fifths of UK national output. On the 300th anniversary of Smith’s birth, the UK economy is struggling with slow productivity growth. And it is not alone, with many countries confronting the same challenge. So, it seems a good time to revisit this question about the role of government in shaping the economy to try to raise productivity and standards of living.

The services-based UK economy continues to struggle with slow productivity growth. Adam Smith might be convinced of the need for government intervention.

Linda Yueh
AI CARTELS.

Adam Smith warned of firms within an industry colluding to charge higher prices. Such concerns are magnified in a time of online algorithms and instantaneous price adjustments.

"People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."

This famous quotation from The Wealth of Nations was written at a time when cartel were organised in physical, usually smoke-filled, rooms between real people. There are good reasons to think that this is no longer the case.

Economists have long worried about the possibility of tacit collusion, whereby firms adjust their pricing without formally agreeing to do so. This was demonstrated by General Electric (GE) six decades ago. Having been convicted in 1960, along with Westinghouse, of explicit collusion in the market for turbine generators—and then having seen prices fall by a half in the following three years—GE began to post prices publicly. It released its algorithms that are able to respond to changes in the prices of rivals and implement an agreed cartel.

In that case, there was an agreement between humans to create the cartel. But now even that may not be necessary. Recent experimental research shows that relatively simple algorithms based on artificial intelligence can lead to prices above what would be sustainable in a competitive market.

In 2017, Margrethe Vestager, the European Union’s commissioner for competition, said: ‘It’s true that the idea of automated systems getting together and reaching a meeting of minds is still science fiction... But we do need to keep a close eye on how algorithms are developing... So that when science fiction becomes reality, we’re ready to deal with it.’

I’m not sure we’re in the realm of science fiction any more.

Equally, the algorithm could experiment by hiking prices and seeing if competitors respond. If they do, great. If not, then the algorithm can bring the price straight back down, all within the blink of an eye.

This possibility is a nightmare for competition authorities. Firms reacting to the decisions of their rivals is the essence of price competition. But how do we know when we have too much of it? And what can we do about it? How might authorities stop firms reacting to their rivals’ price changes?

This is not a far-fetched scenario. The Trod/GB eye cartel case in 2016—in which two online sellers were colluding around the sale of posters and frames on Amazon—was all about using online repricing software to monitor the prices of rivals and implement an agreed cartel.

In that case, there was an agreement between firms to conspire, but now even that may not be necessary. Recent experimental research shows that relatively simple algorithms based on artificial intelligence can lead to prices above what would be sustainable in a competitive market.

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The room where it happens.

Modern competition law makes it illegal to be party to a price-fixing agreement—or even to be in the room when such conspiracies are discussed. Adam Smith would probably approve.

Adam Smith was a strong advocate of competition, and worried about how it could be undermined. But despite his well known observation about the proclivity for firms to conspire against the public, he did not go so far as to propose that cartels should be illegal.

It would be unfair to criticise Smith for this, not least because modern competition laws would have been inconceivable before he had articulated the benefits of a competitive market economy. Nevertheless, a deeper look at the analysis in The Wealth of Nations helps us to understand both why he adopted this position and why he is an enduring influence on competition policy today.

While Smith thought that collusion was endemic, he considered it ‘self-evident’ that: ‘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.‘ His concern with collusion, then, was that it raises profits at the expense of consumers.

But he also believed strongly in personal liberty, and advocated an economic system in which every man ‘is left perfectly free to pursue his own interest in his own way, and to bring both his industry and his capital into competition with every other man.’

Personal liberty limits the acceptability of state intervention, even to prohibit meetings where prices might be fixed. Smith noted: ‘It is impossible, indeed, to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice.’

Nevertheless, he argued, nothing should be done to help firms to identify rivals, put them in the same room or allow them to require any form of joint action: ‘though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies, much less to render them necessary’.

Under modern competition law, it is illegal to be party to an agreement to fix prices, or to allocate markets or share price-sensitive information. Being in the same room when such matters are discussed is also illegal.

This a step further than Smith considered feasible, though it took until the 21st century before enforcement became widespread and reasonably effective. Landmark legislation includes the Sherman Act of 1890 in the United States, the European Union Treaty of 1957 and the UK Competition Act in 1998. But it was not until the 1990s that there was effective implementation of anti-cartel legislation in much of Europe. It was around this time too that most other countries introduced anti-cartel laws.

Smith’s focus on consumers continues in modern competition policy. It has outlasted 19th century utilitarianism and 20th century welfare economics, which would support a policy that balances the interests of consumers and producers.

What’s more, his concern for personal liberty is still met in that rival firms can meet in the same room. Now though, they are advised to be accompanied by a lawyer to ensure that the conversation does not stray into pricing.
Effective policy-making must take account of potential unintended consequences of new measures, rather than presuming that the responses of individuals and organisations will follow a predetermined path like pieces on a chessboard.

Adam Smith's popular reputation is that of the father of economics. But he is often seen as a figure of the political right. Much of this is due to the concerted efforts of the Chicago School of economics—Milton Friedman and George Stigler, in particular—to claim Smith as an inspiration for their brand of free market economics, which came to prominence under Ronald Reagan in the United States and Margaret Thatcher in the UK. That a leading right-wing thinktank is called the Adam Smith Institute adds to this view.

But this picture of Smith was always a simplification. More often than not, it was outright misleading. Modern mantras about ‘rolling back the state’ and advocacy of laissez-faire are hard to square with the glittering complexity of Smith’s writings.

For example, he favoured the rich paying proportionately more in taxes than the poor. He warned that business leaders couldn’t go five minutes in each other’s company without the talk turning to ‘a conspiracy against the public, or in some contrivance to raise prices’.

And he taught his students that ‘Laws and government may be considered in this and indeed every case as a combination of the rich to oppress the poor, and preserve to themselves the inequality of the goods which would otherwise soon be destroyed by the attacks of the poor, who if not hindered by government would soon reduce the others to an equality with themselves by open violence.’

But it would be a mistake to claim Smith as a totem for the political left. In the first place, doing so is anachronistic. Smith died in 1790, just as the French Revolution was getting under way. His socio-political world differs radically from ours, and our categories of contemporary political analysis simply do not map onto his. More importantly, projecting our ideological categories on to him not only distorts his thought, but risks depriving them of their continuing value.

It is better to read Smith as an exemplary guide to how to think responsibly about politics whatever one’s ideological persuasions. A particularly clear example comes in Smith’s final additions to The Theory of Moral Sentiments, his first great book.

Smith there urges us to remember that a true patriot—somebody who genuinely loves their country and wants the best for it—has to balance two things. On the one hand, a desire to preserve what is good about one’s country and ensure it lasts into the future. On the other, an ability to recognise that sometimes reform is essential and that things must change (maybe even radically) if the state and its people are to prosper.

The trouble is that knowing whether a particular moment requires conservation or reform is typically very difficult. Things are made especially dangerous by what Smith calls ‘the spirit of system’. By this, he means the temptation to think that all one needs is a pre-determined plan, which can be imposed on society to make it function better. From the perspective of ‘the man of system’, society is just a chessboard, and the ‘pieces’ on it (the rest of us) must simply do what they are told.

But as Smith warns, society is not a chessboard. The pieces on it have their own ‘principles of motion’ and cannot simply be controlled according to the whim of political decision-makers. Politicians are apt to forget this, and the results of them doing so can be calamitous: ‘the game will go on miserably, and the society must be at all times in the highest degree of disorder’.

Of course, politicians cannot simply abdicate from judgements and decisions. They need to make policy as best they can. But they should do so with humility, and in full recognition of the complexity characterising any real-world society. They should, in particular, respect the fact that unintended consequences are inevitable, while the mere possession of good intentions is not enough when people’s lives are at stake.

An illustration of what Smith had in mind took place in the UK in the autumn of 2022. When Liz Truss and Kwasi Kwarteng announced their ‘mini-budget’ of unfunded tax cuts and spending, they seemed to think that the rest of the world would follow their plan. Instead, the predictable spectacle of individuals and organisations following their own ‘principles of motion’ unfolded, leaving the plan—and the UK economy—in tatters.

All of that would have been bad enough, but Truss—a woman of system if ever there was one—later illustrated her failure as a politician. Writing in the Daily Telegraph, she insisted that her plan had been correct all along: it had just been implemented a little too fast. It was, she insisted, still a good plan, and it was the fault of other people, not her, that it all went horribly wrong. The plan wasn’t the problem, the problem was that the pieces on the chessboard hadn’t done what they were told.

Smith’s great lesson is that one should avoid being a person of system. Yet the problem with politics is that it often attracts them. This is one reason that politics is such an extremely difficult, but also dangerous, arena of human conduct. No plan or ideology—either from left or right—can ever be the whole story because society is not a chessboard, and never will be.

So, one lesson from Smith is that whenever somebody is trying to sell you a plan, or even just a slogan, and assuring you that if we just do what they say, then everything will improve, proceed with extreme caution. ‘Take back control’; ‘for the many, not the few’; ‘make America great again’? I prefer ‘caveat emptor’.

Smith and the Spirit of System

POLITICS

/ Paul Sagar /
Gender gaps in paid and unpaid work.

Adam Smith’s division of labour was about the efficiency gains from task specialisation in factories. But the gender division—gaps between men and women in pay, prestige, career progression and much more—can also be highly inefficient as well as highly inequitable.

Centuries of economic growth and campaigning have enabled gender parity in legal rights in the developed world. But there remain persistent gaps in the economic standing of women and men across all high-income countries.

Women still make systematically different education choices from men, and they bear most of the earnings penalty that comes from becoming a parent. What’s more, gender gaps in paid work are typically exacerbated by gender gaps in unpaid work, which leads to differences in access to leisure and economic prestige that favour men.

These inequalities naturally raise issues of redistributive justice, related to unequal access to employment opportunities and life satisfaction. Additionally, economists are becoming increasingly concerned about the optimal distribution of goods and services in the economy, what’s known as allocative efficiency.

If we accept the premise that innate talent is equally distributed between men and women, barriers to women’s entry into certain male-dominated occupations imply that the talents of some remain underused. This applies equally to the underuse of men in occupations dominated by women. What’s needed is a rethink of traditional trade-offs between equity and efficiency, and the associated zero-sum fallacy—the idea that one person’s gain must mean another person’s loss.

Drivers of gender inequalities are actively researched in several areas of economics. Recent advances are coalescing around different gender barriers to labour market opportunities.

One key constraint for women is their primary role in raising and caring for children. Evidence from several countries has established that while childbirth is fairly neutral for men’s careers, it causes a large and persistent drop in women’s earnings. On becoming a parent, women are more likely than men to leave employment and, if they remain in work, they tend to favour family-friendly working conditions. These include flexible schedules and shorter hours, which are less conducive to career development and progression.

The resulting motherhood penalty is not substantially mitigated by the availability and generosity of child-care support policies, nor by the introduction of parental leave rights that are exclusively reserved for fathers. As a result, it’s natural to think about the deeper roots of these inequalities, which are related to social norms about appropriate gender roles in the household and the workplace.
Studying Smith.

Emma Rothschild, director of the Center for History and Economics at Harvard University, talks to Craig Smith, senior lecturer in the Scottish Enlightenment at the University of Glasgow.

CS: You have been studying Adam Smith for some time. How did you first come across him?

ER: He wasn’t on the syllabus when I studied economics at Oxford, but I read him when I was an undergraduate and I was fascinated by The Wealth of Nations from then on. I became more and more intrigued by what seemed to me to be a disconnect between the Smith I was reading—and eventually studying as a historian—and the Smith who was a public figure in a very different time, place and world economy.

This disconnect between Smith scholarship and the public discourse about him has been much more enduring than I thought it would be at the time of the bicentenary of his death. Between the bicentenaries of his death and the Smith who was a public figure in a very different time, place, and world economy. I was reading—and eventually studying as a historian seemed to me to be a disconnect between the Smith scholarship and the public discourse about him has been much more enduring than I thought it would be at the time.

The other thing that I’ve been thinking about is the extent to which Smith’s great subject wasn’t really the economy. It wasn’t the factory system or the Industrial Revolution or large-scale coal mining, as these came much later. He clearly saw dynamism in that mid-18th century world, and I think his intuition that something very important was happening, before some obvious manifestations of the Industrial Revolution, has been validated by recent quantitative economic history.

This work shows that there was very rapid growth in this, for example, all with relatively old-fashioned technologies and energy saving technologies. The other thing that I’ve been thinking about is the extent to which all those empirical passages in Smith are not really about what economists now would think of as the economy. They’re not about markets, or even particularly about prices, supply and demand, or technology. They’re actually about government and policies. There are long lists of commodities that have bounties on them, or prohibitions associated with them. These have made me think about the extent to which Smith’s great subject wasn’t really the autonomous sphere of the market. It’s striking how little he says about how markets work. What he’s really interested in is what governments are doing, why they’re doing it, and why merchants and manufacturers want government prohibitions, restrictions and boundaries.

I’m not against drawing on Smith to try and understand the present—everybody else is doing it, so why shouldn’t people who have read Smith. It’s fascinating to follow what companies are doing right now in relation to, for example, electric vehicles and preferences, quotas and inducements for green infrastructure, and ask the Smithian question: why do they want these government interventions?

CS: I’m astounded by the extent of the quasi-popular literature, essentially blaming him for climate change. I think he is a fascinating figure in relation to how we got to the contemporary dilemmas of economic growth and the environment. But potentially in a rather positive way since he was writing at a time, and about an economy, in which there was not large-scale use of fossil fuels. It was also an economy that was flourishing in many ways.

ER: It’s an open question to consider what it was about the mid-18th century British and French economies that Smith found so promising. It wasn’t the factory system or the Industrial Revolution or large-scale coal mining, as these came much later. He clearly saw dynamism in that mid-18th century world, and I think his intuition that something very important was happening, before some obvious manifestations of the Industrial Revolution, has been validated by recent quantitative economic history.

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CS: For the 300th anniversary, we’ve run an online reading group where we’ve worked our way through The Wealth of Nations. I’ve also been asking people for their favourite passages of Smith—what are yours?

ER: I read the passages about the East India Company quite often. An economic history journal asked that question for a symposium and I found something about ‘useless companies’—trying to get at his critique of economic actors, not because he was against free enterprise, but because he saw that what companies wanted was to have regulations that helped them. In terms of the larger issues you’ve raised, this poses a lot of problems because it shows that individuals and companies are playing economic games but are seeking to advance by using political methods. I think that’s a very central idea for Smith.

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CS: I’m struck by what you said about him being empirical. I think that’s something my students are surprised by: how much data and how many everyday examples are in the work. I wonder, what you make of Smith as an economic historian when he goes into that level of detail?

ER: It’s an open question to consider what it was about the mid-18th century British and French economies that Smith found so promising. It wasn’t the factory system or the Industrial Revolution or large-scale coal mining, as these came much later. He clearly saw dynamism in that mid-18th century world, and I think his intuition that something very important was happening, before some obvious manifestations of the Industrial Revolution, has been validated by recent quantitative economic history.

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CS: What do you hope will come out of the renewed attention because of the tercentenary in terms of public perceptions of Smith?

ER: I hope he’s going to be a subject of controversy and serious reading for another 300 years. I don’t know whether he would have hated all the attention… probably! There’s an expression that historians use, which is ‘thinking with history’, and for me, ‘thinking with Adam Smith’ is a very good way to examine his times and our times. If the outcome of the 300th anniversary is that there are more reading groups like the one you’ve just completed, where people actually read what Smith wrote and think about it, that would be a very good outcome.

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Three centuries later, the times and issues are clearly different. But the underlying and interlocking questions of morality and economics are similar.

Smith pushed back against the idea that the wealth of a nation should be measured in how much gold it had, or the riches of a select few merchants. Today, economists ask what is the wealth of a nation if it doesn’t consider environmental sustainability or rising inequalities?

Smith also highlighted the dangers from elites—and big business—in capturing and exerting undue influence over economic policy. In his day, it was the East India Company. Today, it might be the concern that economists have over the influence of multinationals and digital oligarchs, and the continued power of patronage.

As the articles in this edition of ECO highlight, the tercentenary has provided an opportunity for economists to re-engage with Smith’s ideas and to reflect on the underlying moral questions that lie at the heart of the big economic challenges we face today.

Graeme Roy