

# 2.2 — Smith & The Classical System

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# Outline



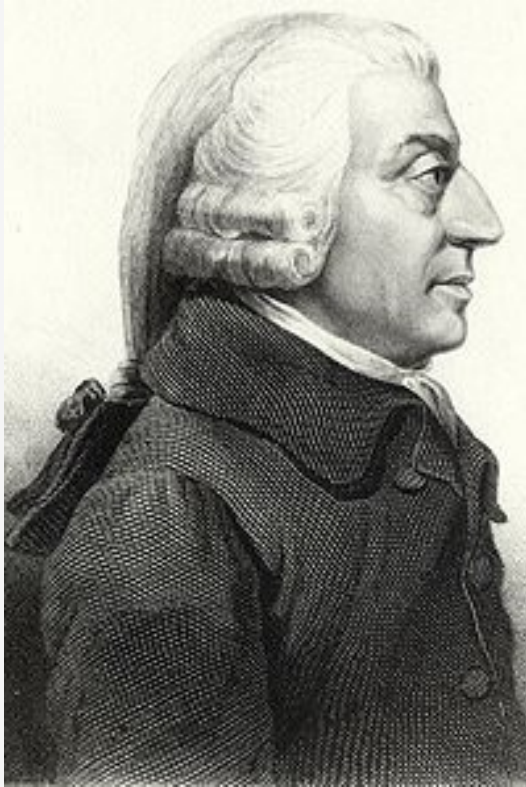
The Classical System

The Life of Adam Smith

Smith's (and Classical's) Rejection of Mercantilism

Escaping Feudalism: Smith's Explanation

# The Breadth of the Smithean Vision



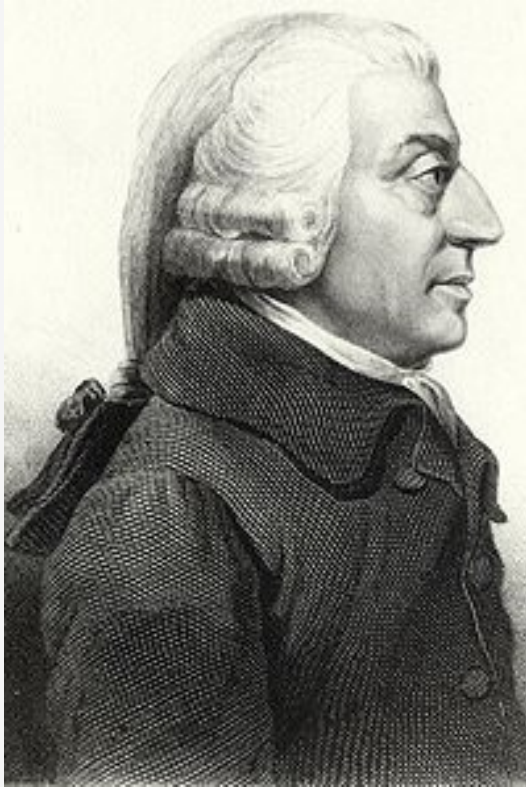
Adam Smith

1723-1790

- The breadth and influence of Smith's *Wealth of Nations (WON)* is incredible
  - theory + history + analogies + policy recommendations
  - borrows concepts from others, but unique in systematization, style, & vision
- Everyone should read Smith, those with an interest in economics should read all the Smith you can get your hands on
  - readable, entertaining, insightful, even when he's wrong

[Wealth of Nations \(Online\)](#)

# The Breadth of the Smithean Vision



Adam Smith

1723-1790

- **Today:** overview of what ties the Classical Economists together
  - Smith's (and others) attack on the mercantilist system
  - **Book IV** of *Wealth of Nations (Of the Systems of Political Oeconomy)*
  - Smith's arguments about the emergence of commercial society out of feudalism
  - **Book III** of *Wealth of Nations (Of the different Progress of Opulence in different Nations)*
- **Next class:** Smith's analysis of markets, prices, and growth
  - **Books I-II** of the *Wealth of Nations (Of the Causes of Improvement in the productive Powers of Labour)* and (*Of the Nature, Accumulation, and Employment of Stock*)
  - **Book V** (*Of the Revenue of the Sovereign or Commonwealth*)



# The Classical System

# The Classical Economists



- “Classical School” of economics 1776-c.1870
- Dominant form of economics in English-speaking world
- Leaders based on their great works:
  - Smith 1776-c.1820
  - Ricardo c.1820-c.1850
  - J.S. Mill c.1850-c.1870
- Famous critics (considered classical)
  - Malthus & Marx



# Common Themes of Classical Writers: Harmony & Laws



- Believe in a **natural harmony of interests**
  - markets channel self-interest into social benefit
- Like physiocrats, belief in **discoverable natural laws**
- Project to **describe the analytical principles** that create & distribute wealth
  - In extremis: “the Ricardian vice”
  - Smith & Mill: blend theory, history, anecdotes & analogies



# Common Themes of Classical Writers: Dynamics



- Big picture focus (macroeconomics)
- Focus on **dynamics: economic growth**
  - determinants of “wealth of nations”
- Stability of economic growth
  - Ricardian steady state equilibrium
- Dealing with 19<sup>th</sup> century crises: “general gluts”, depressions & business cycles
  - especially correspondence between Ricardo & Malthus; Say's Law





# Common Themes of Classical Writers: Prices



- Focus on changes in *real variables* that affect economic activity
  - money essentially neutral
- Explain the **determination & change of relative prices**
- Market price reflects **cost of production**
  - price = wages + profits + rent
  - labor theory of value (?)
- “Supply side” focused
  - especially in the long run **“natural price”**
  - did not ignore demand (esp. short run)



# Common Themes of Classical Writers: Distribution



- Focus on **determination of distribution of income**
- Analytical classes: **laborers, capitalists, landowners**
  - How was income divided among them?
  - Who gained & who lost in the long run?
- Productive vs. unproductive labor



# Common Themes of Classical Writers: Policy



- Focus on **competitive markets** in **full-employment**
  - suspicious of monopolies, mercantilist restrictions & privileges
- Advocate **free trade**, **lassiez-faire**, minimal government interference
- Malthus & Marx reject full-employment & policy recommendations
  - force a (convincing?) response



# Common Themes of Classical Writers: Liberalism



- **(Classical) liberalism:** individual liberty & autonomy is the highest value, good in and of itself, but empirically, also brings prosperity

Smith: “the simple and obvious system of natural liberty”

- political freedom and economic freedom
- Equality, pluralism, and toleration
  - against class & privilege (remnants of feudal tyranny)
  - A society of “contract” rather than a society of “status”
- “Liberal” in U.S. politics today is correlated with, but quite different from, “classical liberalism”
  - U.S. left-wing politics today: 20<sup>th</sup> Century Progressivism + some elements of socialism



# Common Themes of Classical Writers: Liberalism



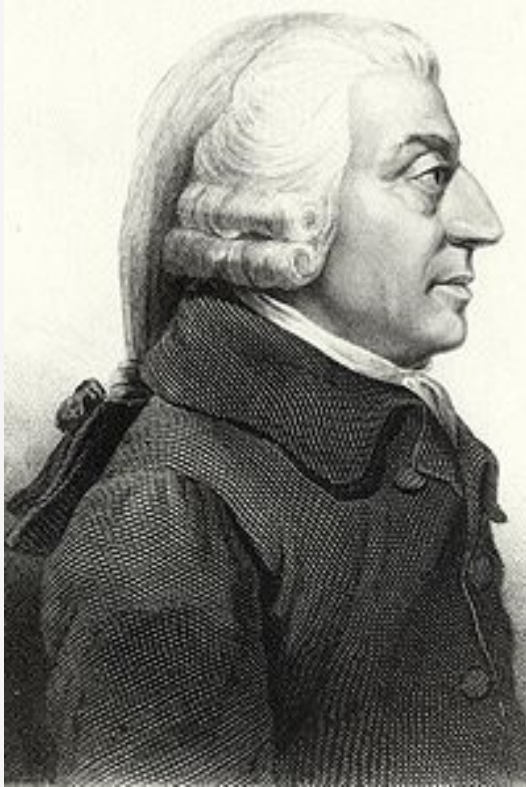
- Classicals were **analytic egalitarians**: view all members of humanity as equals, all can participate in exchange and flourish
  - economics is universally applicable to all
  - class, race, other social divisions are distractions
- Read [How the Dismal Science Got its Name](#) (believe me, it's not at all what you think!)
  - [Part II](#); [Part III](#); [Part IV](#); [Part V](#); [Part VI](#)





# The Life of Adam Smith

# The Life of Adam Smith

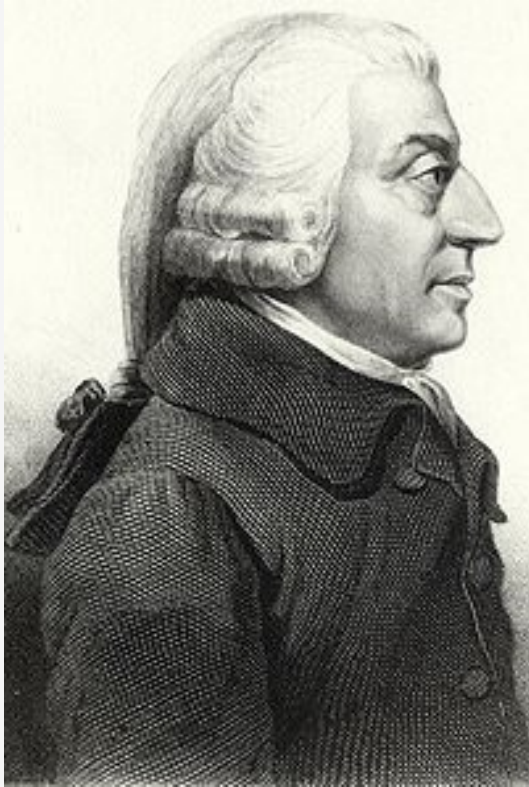


Adam Smith

1723-1790

- Born in Kirkcaldy in 1723, studied at Glasgow University under Francis Hutcheson, later Oxford
- Gave lectures at Edinburgh U. 1748-1750
- Chair of Moral Philosophy at Glasgow U (Hutcheson's chair) in 1752
  - 1759: *Theory of Moral Sentiments*
- Travelled to France as tutor to (English) Duke of Buccleuch (1764-1766)
  - met Quesnay & Turgot
  - earned a pension to live off of later
- Travelled & wrote *Wealth of Nations* published in 1776
- Made a Commissioner of Customs (1778) and died in 1790

# The Life of Adam Smith



Adam Smith

1723-1790

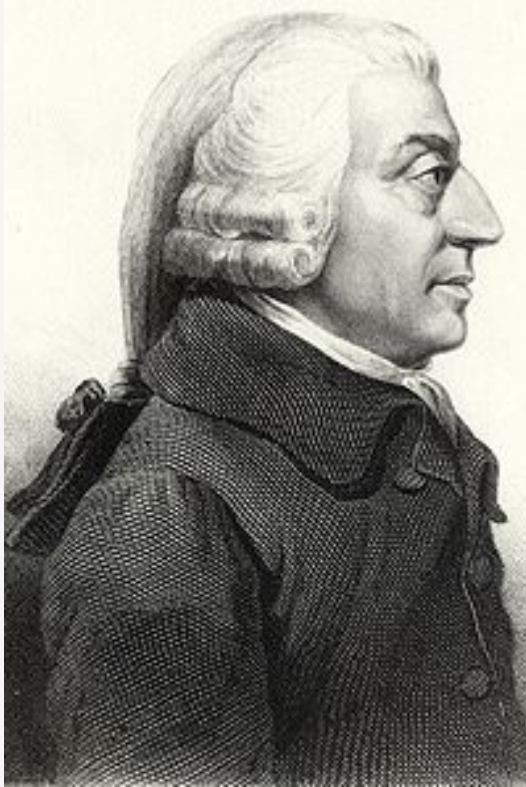
- Famously an absent-minded professor
- Smith had all of his papers burned at his death
- Students loved him and took copious notes
  - We have has *Lectures on Justice, Police, Revenue, and Arms* (1763) and other works via student notes
- Never married





# Smith's [and Classical's] Rejection of Mercantilism

# Adam Smith on Political Oeconomy



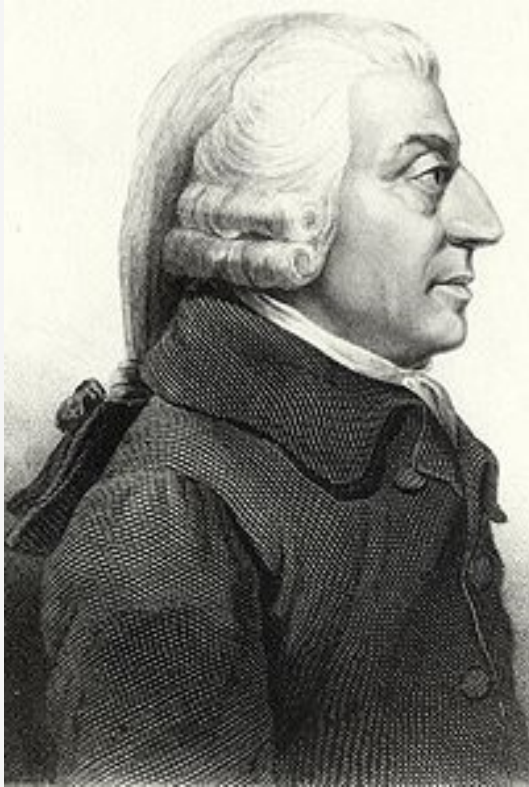
Adam Smith

1723-1790

- We begin with *Book IV*, Adam Smith's exploration of systems of political economy
  - End today in *Book III* on the economic history of Europe
- This is Smith at his most **normative & polemical**
- Next class we will see the objective, dispassionate, and analytical Smith

Smith, Adam, 1776, *An Enquiry into the Nature and Causes of the Wealth of Nations*

# Adam Smith on Political Oeconomy



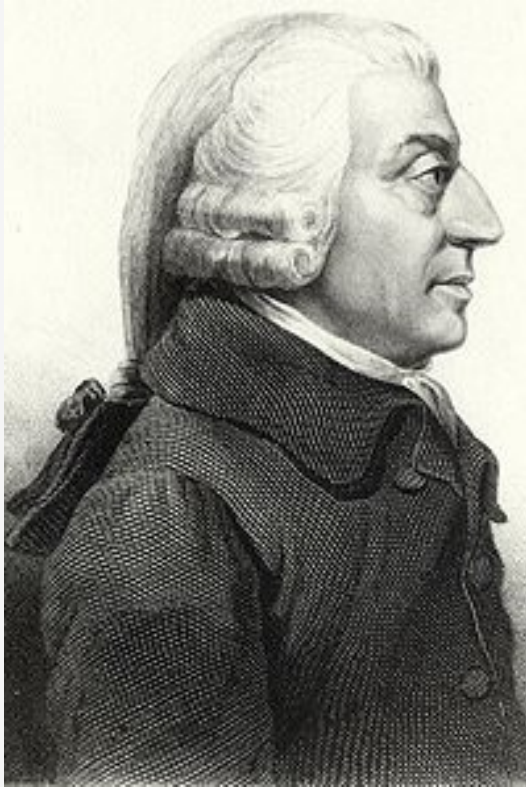
Adam Smith

1723-1790

“**Political œconomy**, considered as a branch of **the science of a statesman or legislator**, proposes two distinct objects: first, to provide a plentiful revenue or subsistence for the people, or more properly to enable them to provide such a revenue or subsistence for themselves; and secondly, to supply the state or commonwealth with a revenue sufficient for the public services. It proposes to enrich both the people and the sovereign.

“The different progress of opulence in different ages and nations, has given occasion to **two different systems of political œconomy**, with regard to enriching the people. The one may be called the **system of commerce**, the other that of **agriculture**.”

# Mercantilism: Wrong on the Wealth of Nations I

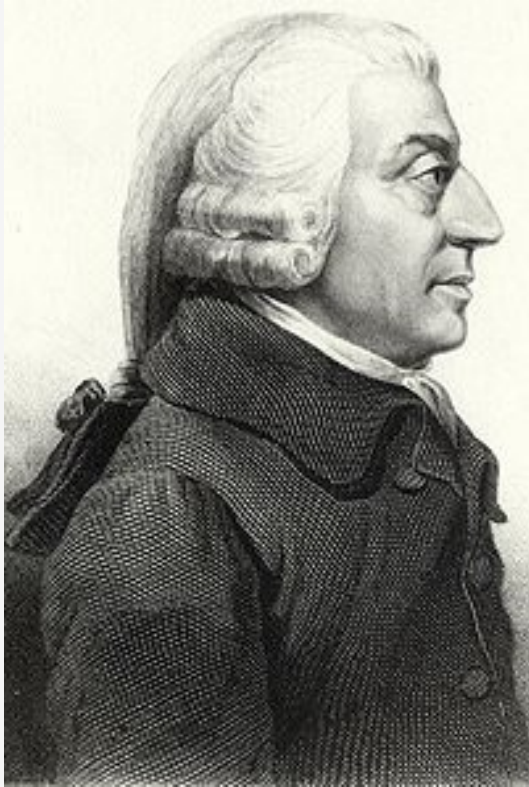


Adam Smith

1723-1790

“We trust with perfect security that the freedom of trade, without any attention of government, will always supply us with the wine which we have occasion for: and we trust with equal security that it will always supply us with all the gold and silver which we can afford to purchase or to employ,”

# Mercantilism: Wrong on Trade

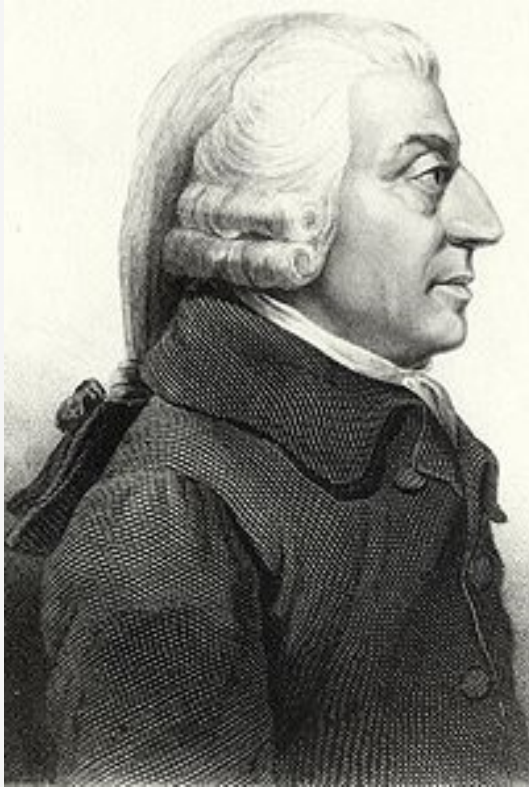


Adam Smith

1723-1790

“As every individual, therefore, endeavours as much as he can...to employ his capital [in] that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry...and by directing that industry in such a manner as its produce may be of the greatest value, **he intends only his own gain**, and he is in this, as in many other cases, **led by an invisible hand to promote an end which was no part of his intention...By pursuing his own interest he frequently promotes that of the society** more effectually than when he really intends to promote it.”

# Mercantilism: Wrong on *Managing* Trade

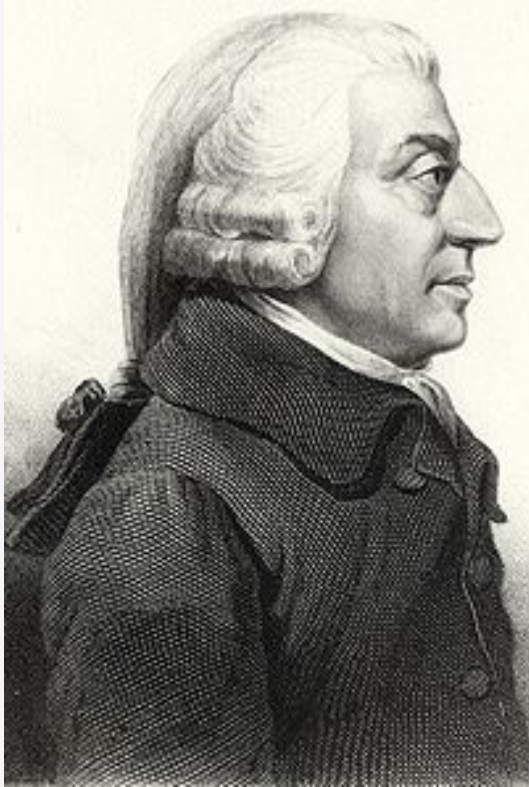


Adam Smith

1723-1790

“The statesman, who should attempt to direct private people in what manner they ought to employ their capitals, would not only load himself with a most unnecessary attention, but assume an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it.”

# Mercantilism: Wrong on the *Balance of Trade* I



Adam Smith

1723-1790

“Nothing, however, can be more absurd than this whole doctrine of the balance of trade, upon which, not only these restraints, but almost all the other regulations of commerce are founded. When two places trade with one another, this doctrine supposes that, if the balance be even, neither of them either loses or gains; but if it leans in any degree to one side, that one of them loses and the other gains in proportion to its declension from the exact equilibrium. Both suppositions are false. A trade which is forced by means of bounties and monopolies may be and commonly is disadvantageous to the country in whose favour it is meant to be established, as I shall endeavour to show hereafter. But that trade which, without force or constraint, is naturally and regularly carried on between any two places is always advantageous, though not always equally so, to both.”

# Mercantilism: Wrong on The *Balance of Trade* II



Frederic Bastiat

1801-1850

“[A]ccording to the theory of the balance of trade, France has a quite simple means of doubling her capital at any moment. It suffices merely to pass its products through the customhouse, and then throw them into the sea. In that case the exports will equal the amount of her capital; imports will be nonexistent and even impossible, and we shall gain all that the ocean has swallowed up,” ([The Balance of Trade](#) 1848).



# Mercantilism: Wrong on The *Balance of Trade* III



Frederic Bastiat

1801-1850

“The truth is we should reverse the principle...and calculate the national profit from foreign trade in terms of the excess of imports over exports...But this theory, which is the correct one, leads directly to the principle of free trade...Assume, if it amuses you, that foreigners flood our shores with all kinds of useful goods, without asking anything from us; even if our imports are *infinite* and our exports *nothing*, I defy you to prove to me that we should be the poorer for it,” ([The Balance of Trade](#) 1848).

# Aside: Frederic Bastiat

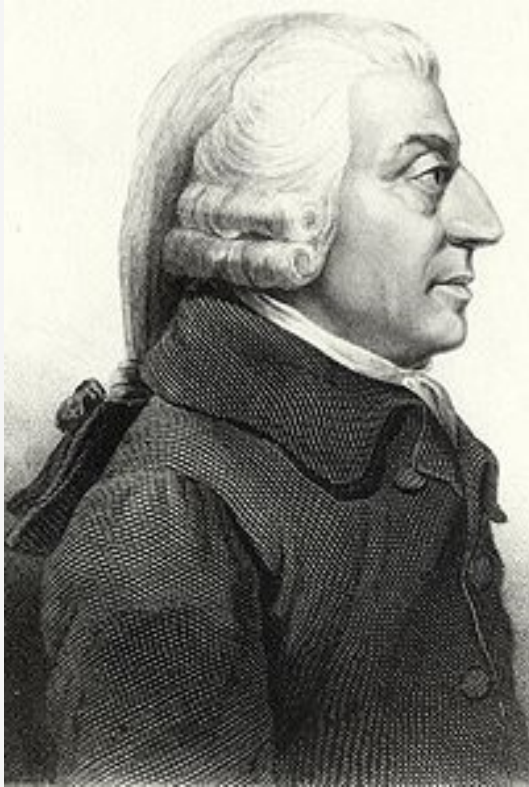


Frederic Bastiat

1801-1850

- A 19<sup>th</sup> Century French economist after the French Revolution
- Member of French National Assembly (1848-1850)
- Advocate and popularizer of Adam Smith in France
- One of the greatest economic writers: wrote parables, satires, and essays to explain Classical economic principles and ridicule mercantilism
  - “What is Seen and What is Not Seen” (“Parable of the Broken Window”)
  - “A Negative Railroad”
  - “The Balance of Trade”
  - “The Candlemakers Petition”

# Mercantilism: Wrong on The Point of Production



Adam Smith

1723-1790

“**Consumption is the sole end and purpose of all production**; and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident that it would be absurd to attempt to prove it. But in **the mercantile system** the interest of the **consumer is almost constantly sacrificed to that of the producer**; and it seems to consider production, and not consumption, as the ultimate end and object of all industry and commerce.”

# Mercantilism: A Corporate Welfare Scheme I



Adam Smith

1723-1790

“It cannot be very difficult to determine who have been the contrivers of this whole mercantile system; not the consumers, we may believe, whose interest has been entirely neglected; but the producers, whose interest has been so carefully attended to; and among this latter class our merchants and manufacturers have been by far the principal architects.”

# Mercantilism: A Corporate Welfare Scheme II



Frederic Bastiat

1801-1850

From the Manufacturers of Candles, Tapers, Lanterns, Candlesticks, Street Lamps, Snuffers and Extinguishers, and from the Producers of Tallow, Oil, Resin, Alcohol, and Generally of Everything Connected with Lighting.

To the Honorable Members of the Chamber of Deputies. We are suffering from the ruinous competition of a foreign rival who apparently works under conditions far superior to our own for the production of light that he is *flooding* the *domestic market* with it at an incredibly low price; for the moment he appears, our sales cease, all the consumers turn to him, and a branch of French industry whose ramifications are innumerable is all at once reduced to complete stagnation.

# Mercantilism: A Corporate Welfare Scheme III



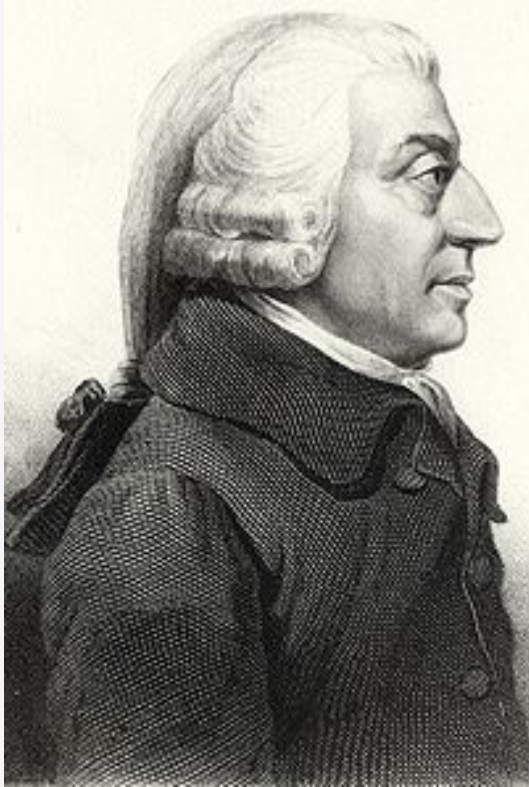
Frederic Bastiat

1801-1850

We ask you to be so good as to pass a law requiring the closing of all windows, dormers, skylights, inside and outside shutters, curtains, casements, bulls'-eyes, deadlights, and blinds - in short, all openings, holes, chinks, and fissures through which the light of the sun is wont to enter houses, to the detriment of the fair industries with which, we are proud to say, we have endowed the country, a country that cannot, without betraying ingratitude, abandon us today to so unequal a combat.

[This will] encourage industry and increase employment...If you grant us a monopoly over the production of lighting during the day...we shall buy large amounts of tallow, charcoal, oil, resin, wax...and moreover, we and our numerous suppliers, having become rich, will consume a great deal and spread prosperity into all areas of domestic industry.

# Mercantilism: End the Artificial Restrictions I

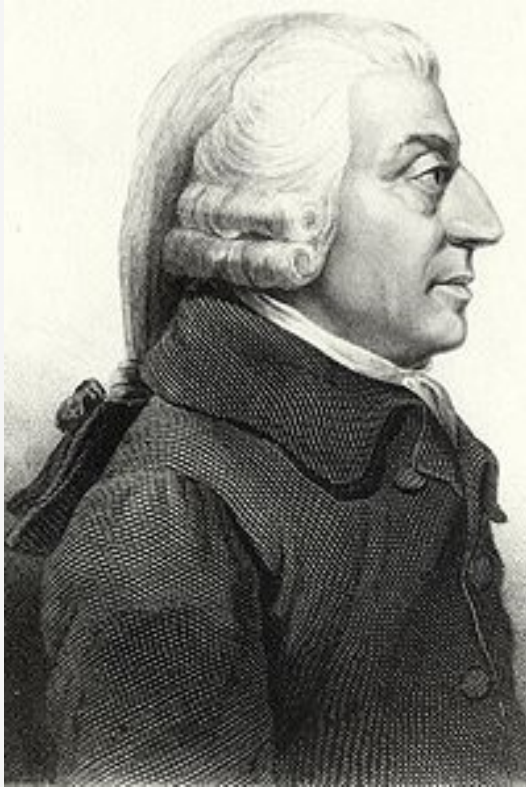


Adam Smith

1723-1790

“Let the same natural liberty of exercising what species of industry they please, be restored to all his Majesty's subjects...break down the exclusive privileges of corporations, and repeal the statute of apprenticeship, both which are real encroachments upon natural liberty, and add to these the repeal of the [anti-migration laws] so that a poor workman, when thrown out of employment either in one trade or in one place, may seek for it in another trade or in another place without the fear either of a prosecution or of a removal.”

# Mercantilism: End the Artificial Restrictions II



“The natural effort of every individual to better his own condition...is so powerful, that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often encumbers its operations.”

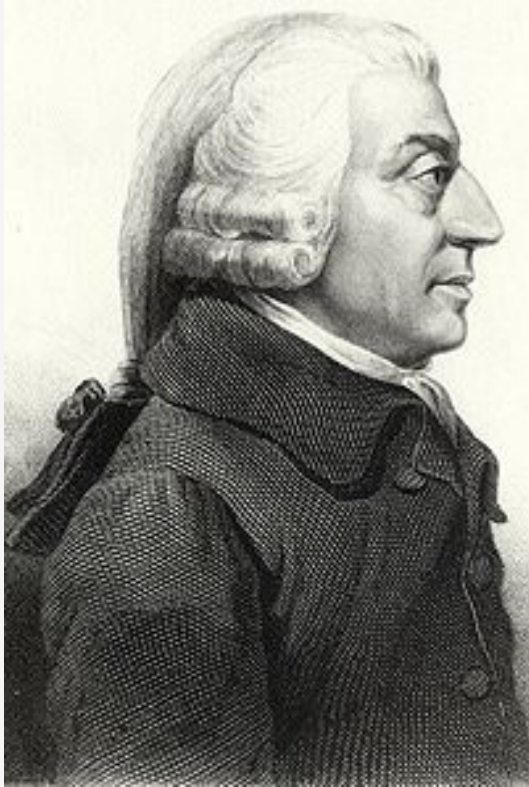
Smith, Adam, 1776, *An Enquiry into the Nature and Causes of the Wealth of Nations*, Book IV, Chapter V

Adam Smith

1723-1790



# Mercantilism: Wrong on Colonies I

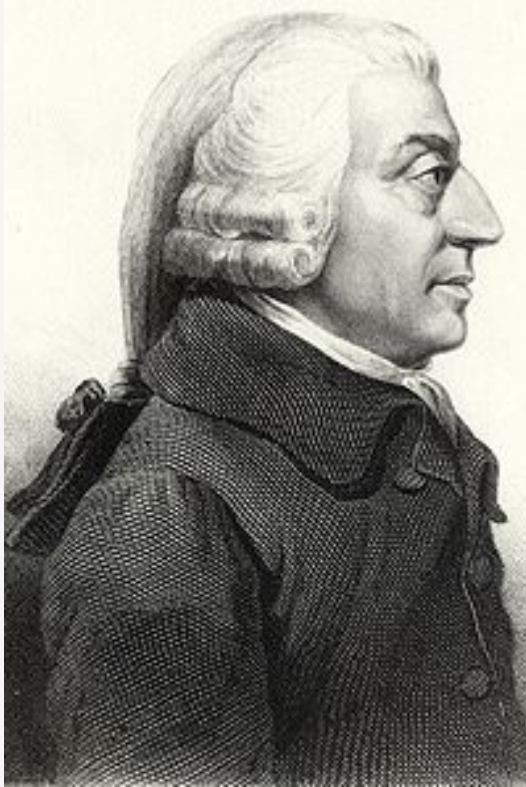


Adam Smith

1723-1790

“Of all those expensive and uncertain projects, however, which bring bankruptcy upon the greater part of the people who engage in them, there is none perhaps more ruinous than the search after new silver and gold mines. It is perhaps the most disadvantageous lottery in the world, or the one in which the gain of those who draw the prizes bears the least proportion to the loss of those who draw the blanks: for though the prizes are few and the blanks many, the common price of a ticket is the whole fortune of a very rich man.”

# Mercantilism: Wrong on Colonies II

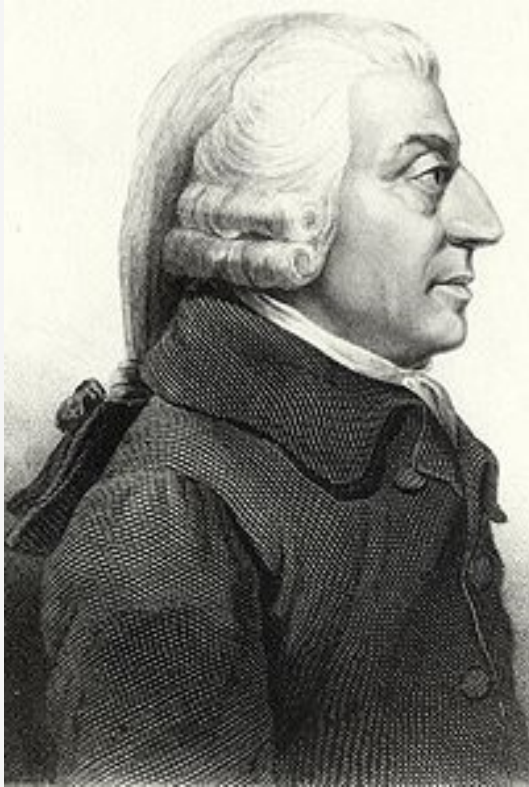


Adam Smith

1723-1790

”Folly and injustice seem to have been the principles which presided over and directed the first project of establishing those colonies; the folly of hunting after gold and silver mines, and the injustice of coveting the possession of a country whose harmless natives, far from having ever injured the people of Europe, had received the first adventurers with every mark of kindness and hospitality.”

# Mercantilism: Wrong on Colonies III



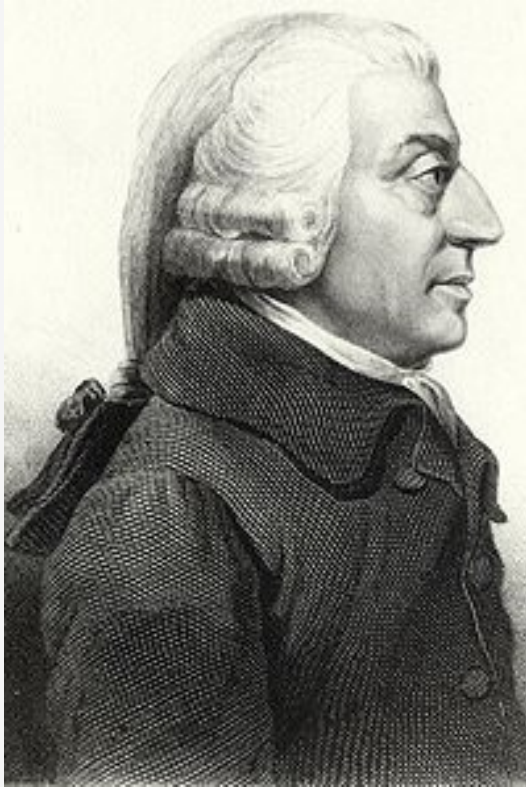
Adam Smith

1723-1790

“To prohibit a great people, however, from making all that they can of every part of their own produce...is a manifest violation of the most sacred rights of mankind. Unjust, however, as such prohibitions may be, they have not hitherto been very hurtful to the colonies...

“We must carefully distinguish between the effects of the colony trade and those of the monopoly of that trade. The former are always and necessarily beneficial; the latter always and necessarily hurtful. But the former are so beneficial that the colony trade, though subject to a monopoly, and notwithstanding the hurtful effects of that monopoly, is still upon the whole beneficial, and greatly beneficial; though a good deal less so than it otherwise would be...Under the present system of management, therefore, Great Britain derives nothing but loss from the dominion which she assumes over her colonies.”

# Mercantilism: Wrong on Slavery



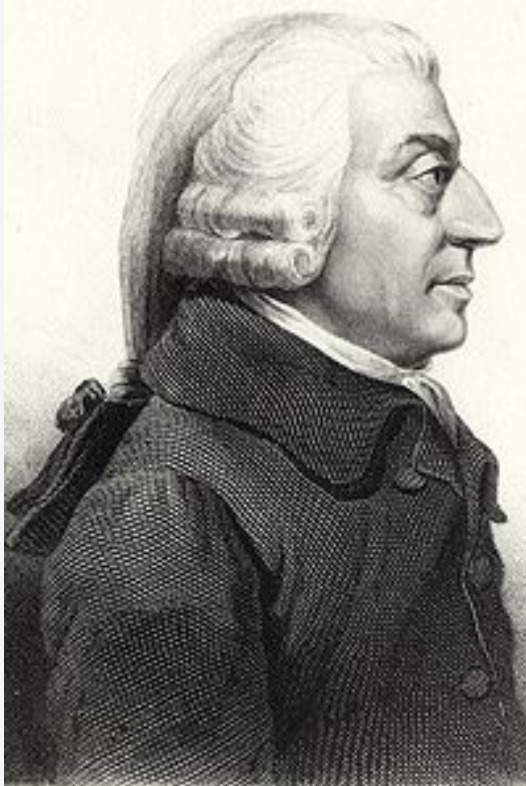
Adam Smith

1723-1790

“Fortune never exerted more cruelly her empire over mankind, than when she subjected those nations of heroes to the refuse of the jails of Europe, to wretches who possess the virtues neither of the countries which they come from, nor of those which they go to, and whose levity, brutality, and baseness, so justly expose them to the contempt of the vanquished.”

Smith, Adam, 1749, *Theory of Moral Sentiments*, Part V, Chapter 2: Of the Influence of Custom and Fashion upon Moral Sentiments

# Adam Smith on the Physiocrats I



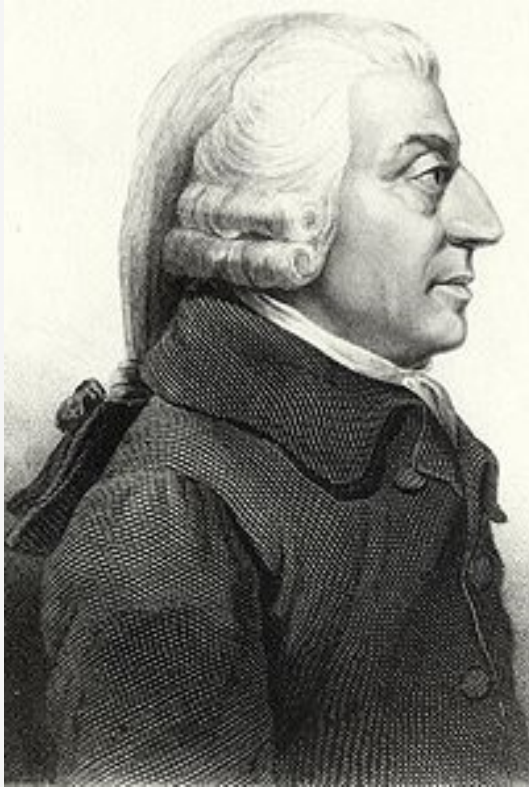
Adam Smith

1723-1790

“The French philosophers, who have proposed the system which represents agriculture as the sole source of the revenue and wealth of every country, seem to have adopted this proverbial maxim; and as in the plan of Mr. Colbert the industry of the towns was certainly over-valued in comparison with that of the country; so in their system it seems to be as certainly undervalued.”

Smith, Adam, 1776, *An Enquiry into the Nature and Causes of the Wealth of Nations*, Book IV, Chapter IX: Of the Agricultural Systems, or of those Systems of Political Œconomy which Represent the Produce of Land as either the Sole or the Principal Source of the Revenue and Wealth Every Country

# Adam Smith on the Physiocrats II



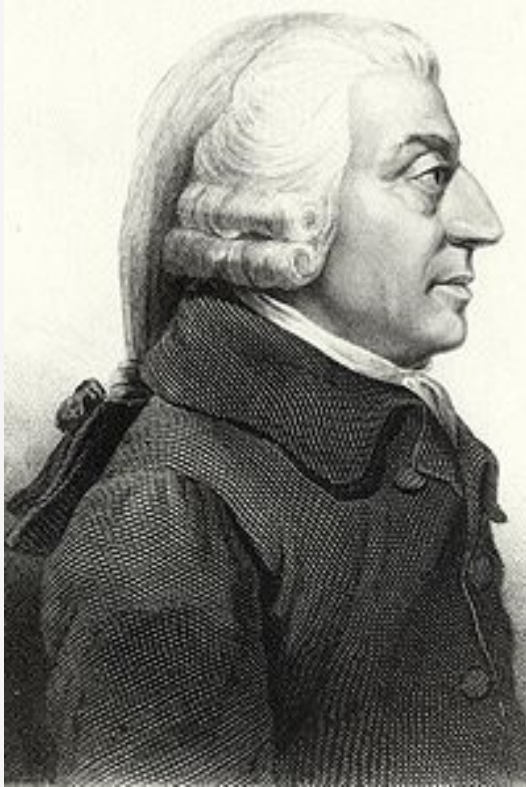
Adam Smith

1723-1790

“The capital error of this system...seems to lie in its representing the class of artificers, manufacturers and merchants, as altogether barren and unproductive,”

Mr. Quesnai, who was himself a physician, and a very speculative physician, seems to have entertained a notion of the same kind concerning the political body, and to have imagined that it would thrive and prosper only under a certain precise regimen, the exact regimen of perfect liberty and perfect justice...In the political body, however, the wisdom of nature has fortunately made ample provision for remedying many of the bad effects of the folly and injustice of man; in the same manner as it has done in the natural body, for remedying those of his sloth and intemperance.”

# Adam Smith on the Physiocrats III



Adam Smith

1723-1790

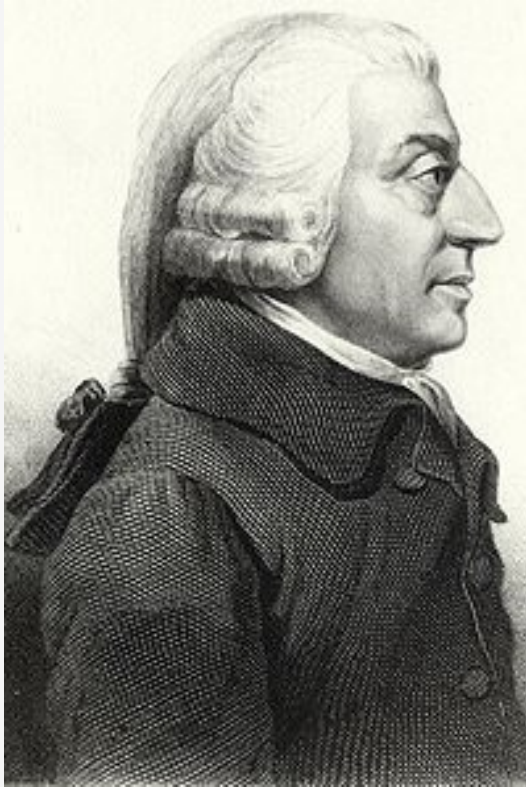
“This system [the physiocrats'], however, with all its imperfections, is, **perhaps, the nearest approximation to the truth that has yet been published upon the subject of political œconomy**, and is upon that account well worth the consideration of every man who wishes to examine with attention the principles of that very important science," (Book IV, Chapter IX: Of the Agricultural Systems, or of those Systems of Political Œconomy which Represent the Produce of Land as either the Sole or the Principal Source of the Revenue and Wealth Every Country)



# Escaping Feudalism: Smith's Explanation



# Adam Smith's Explanation I



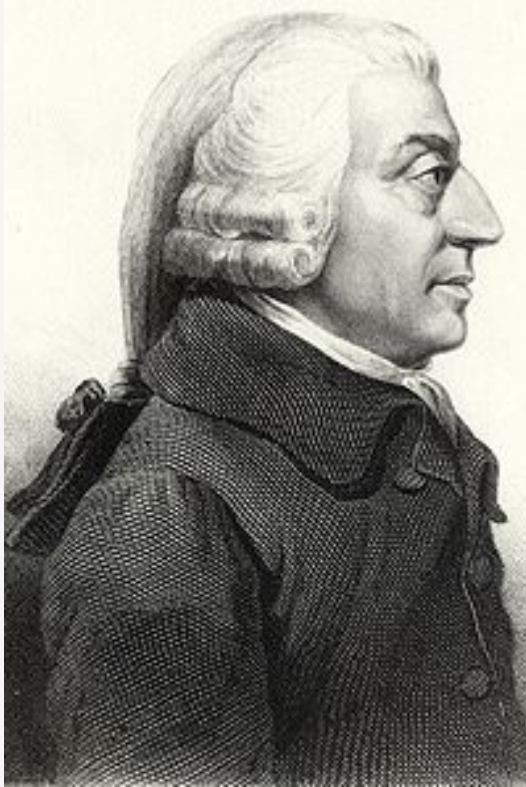
Adam Smith

1723-1790

"In order to understand [the kings' grant of independence to the towns], it must be remembered, that in those days the sovereign of perhaps no country in Europe, was able to protect, through the whole extent of his dominions, the weaker part of his subjects from the oppression of the great lords.

"The inhabitants of cities and burghs, considered as single individuals, had no power to defend themselves: but by entering into a league of mutual defence with their neighbours, they were capable of making no contemptible resistance."

# Adam Smith's Explanation II



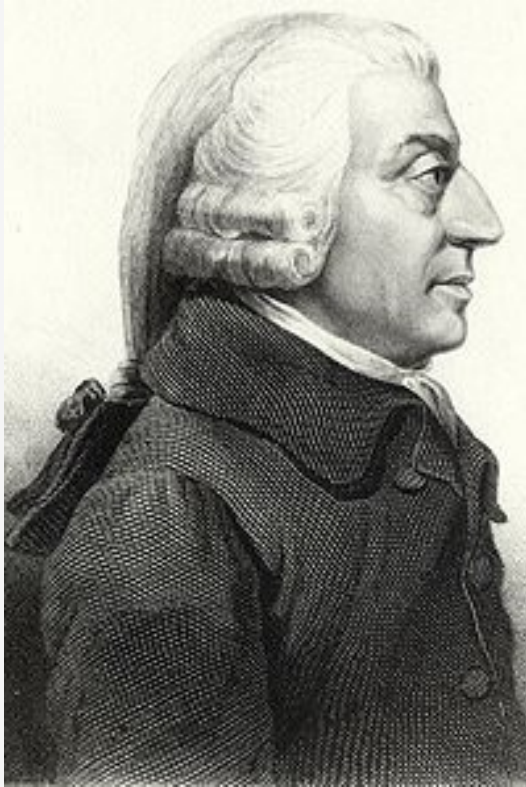
“The lords despised the burghers [townspeople]..The wealth of the burghers never failed to provoke their envy and indignation, and [the lords] plundered them upon every occasion without mercy or remorse. The burghers naturally hated and feared the lords. The king hated and feared them too; but though perhaps he might despise, he had no reason either to hate or fear the burgher.”

Smith, Adam, 1776, *An Enquiry into the Nature and Causes of the Wealth of Nations*, Book III, Chapter III

Adam Smith

1723-1790

# Adam Smith's Explanation III

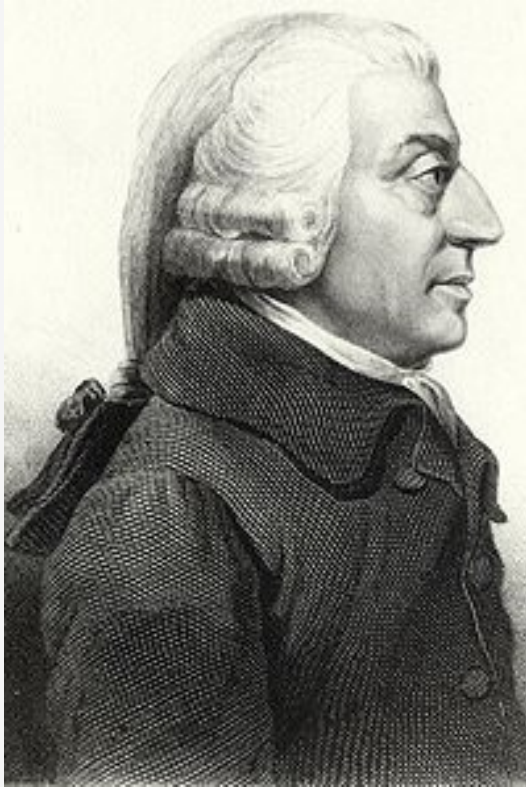


Adam Smith

1723-1790

“Mutual interest, therefore, disposed [the burghers] to support the king, and the king to support them against the lords. They were the enemies of his enemies, and it was his interest to render them as secure and independent of those enemies as he could. By granting them magistrates of their own, the privilege of making bye-laws for their own government, that of building walls for their own defence, and that of reducing all their inhabitants under a sort of military discipline, he gave them all the means of security and independency of the barons which it was in his power to bestow. Without the establishment of some regular government of this kind, without some authority to compel their inhabitants to act according to some certain plan or system, no voluntary league of mutual defence could either have afforded

# Adam Smith's Explanation IV



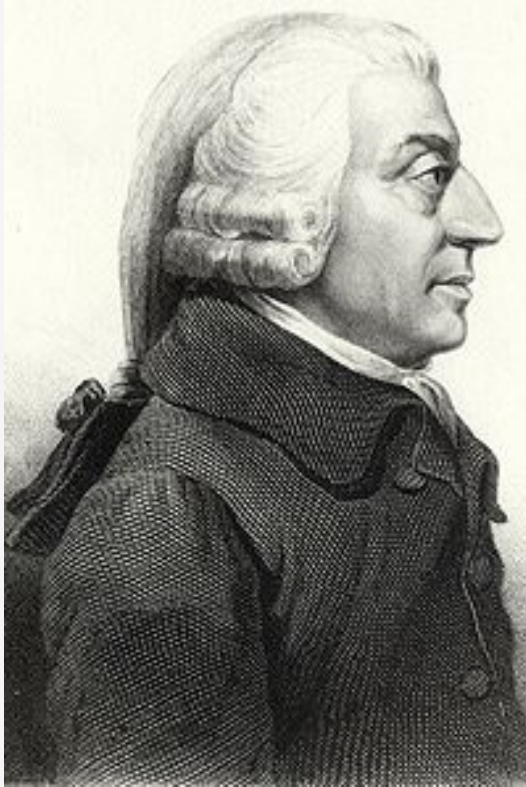
"In countries such as France or England, where the authority of the sovereign, though frequently very low, never was destroyed altogether, the cities had no opportunity of becoming entirely independent. They became, however, so considerable that the sovereign could impose no tax upon them, besides the stated farm-rent of the town, without their own consent. They were, therefore, called upon to send deputies to the general assembly of the states of the kingdom, where they might join with the clergy and the barons in granting, upon urgent occasions, some extraordinary aid to the king. Being generally, too, more favourable to his power, their deputies seem, sometimes, to have been employed by him as a counter-balance in those assemblies to the authority of the great lords. Hence the origin of the representation of burghs in the states-general of all the great monarchies in Europe."

Smith, Adam, 1776, *An Enquiry into the Nature and Causes of the Wealth of Nations*, Book III, Chapter III

Adam Smith

1723-1790

# Adam Smith's Explanation V



Adam Smith

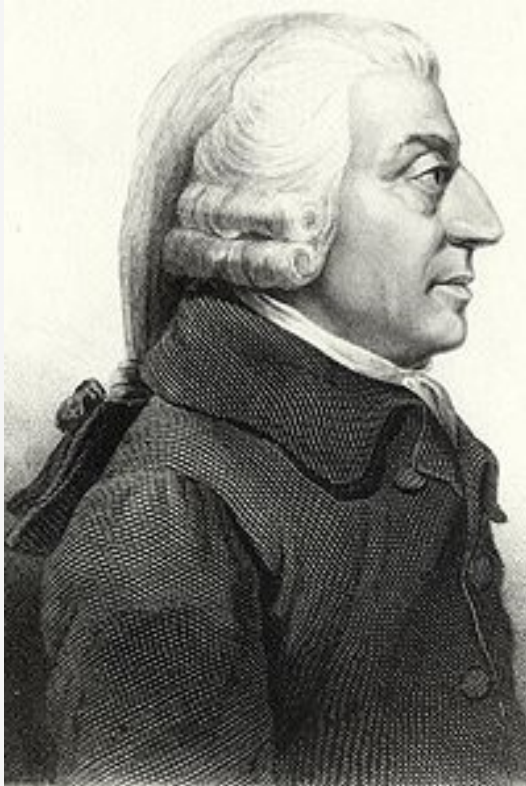
1723-1790

- Three players:
  1. king
  2. nobility (lords)
  3. towns
- Nobles control vast manors and estates in the countryside
- Towns are full of freemen (with no lords), grow wealthy from trade
- Lords hate towns, towns hate lords

Smith, Adam, 1776, *An Enquiry into the Nature and Causes of the Wealth of Nations*

Weingast, Barry R, 2017, "Adam Smith's Theory of Violence and the Political-Economics of Development," Manuscript

# Adam Smith's Explanation VI



Adam Smith

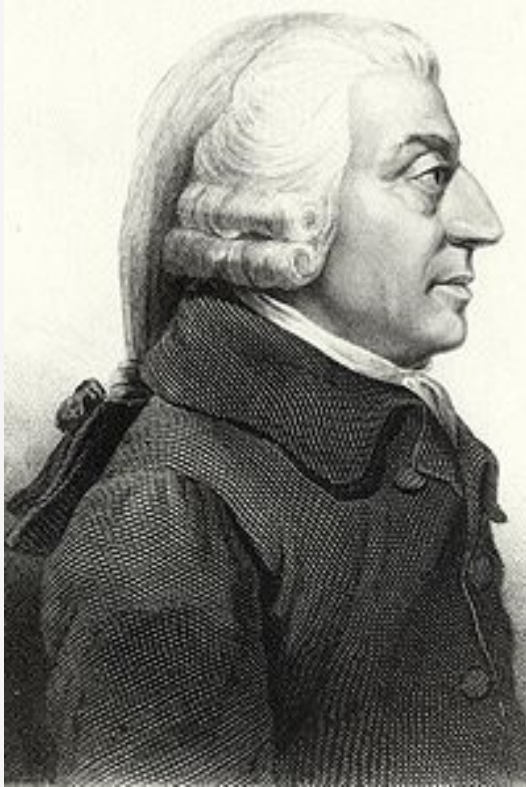
1723-1790

- King and towns find a mutually-beneficial exchange against common enemy: the lords:
  - King exempts towns from feudal ties to lords (effectively grants independence)
  - Allows towns to govern themselves, and pledges mutual protection against lords, in exchange for regular taxes to the King
- Towns choose governance that benefits themselves: stronger property rights, rule of law, justice, military defense against lords
  - Don't get too excited: they are a clear oligarchy, not a democracy!

Smith, Adam, 1776, *An Enquiry into the Nature and Causes of the Wealth of Nations*

Weingast, Barry R, 2017, "Adam Smith's Theory of Violence and the Political-Economics of Development," Manuscript

# Adam Smith's Explanation VII

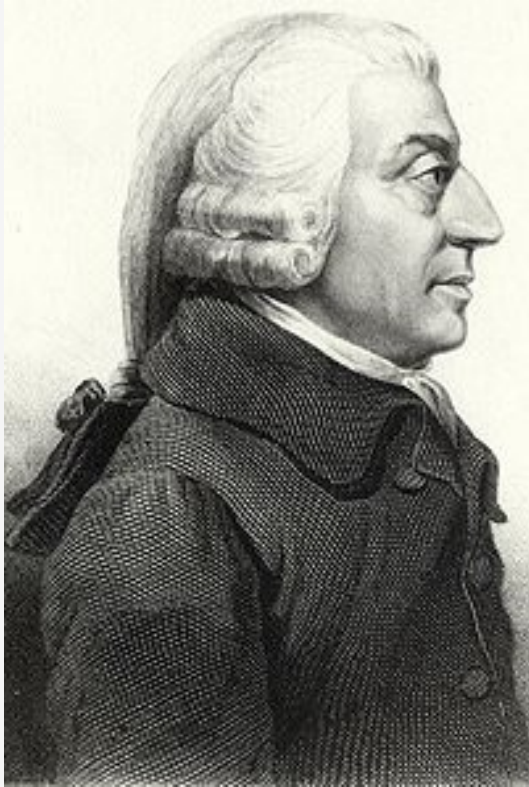


Adam Smith

1723-1790

- King gained increased fiscal capacity (regular tax revenue from towns) and military capacity to weaken the lords
- a lot more wealth, people start buying their way out of feudal dues
  - "bastard feudalism"
- Merchants and townspeople have enough wealth and power to have a seat at the table
- King requires consent of Parliaments, not just of landowning Lords, but also of towns and merchants

# Adam Smith on The System of Natural Liberty



Adam Smith

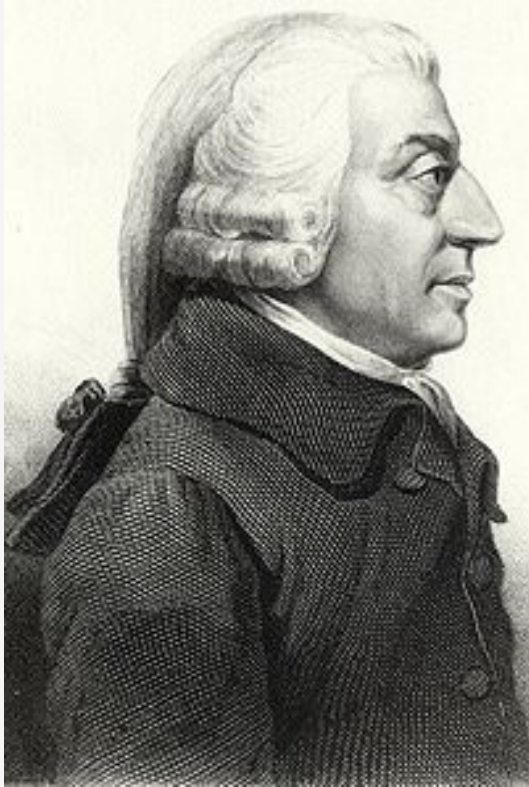
1723-1790

“It is thus that **every system which endeavours, either by extraordinary encouragements** to draw towards a particular species of industry a greater share of the capital of the society than what would naturally go to it, **or, by extraordinary restraints, force from a particular species of industry some share of the capital which would otherwise be employed in it**, is in reality **subversive of the great purpose which it means to promote. It retards, instead of accelerating, the progress of the society** towards real wealth and greatness; and diminishes, instead of increasing, the real value of the annual produce of its land and labour.”

Smith, Adam, 1776, *An Enquiry into the Nature and Causes of the Wealth of Nations*, Book IV, Chapter IX: Of the Agricultural Systems, or of those Systems of Political Œconomy which Represent the Produce of Land as either the Sole or the Principal Source of the Revenue and Wealth Every Country



# Adam Smith on The System of Natural Liberty

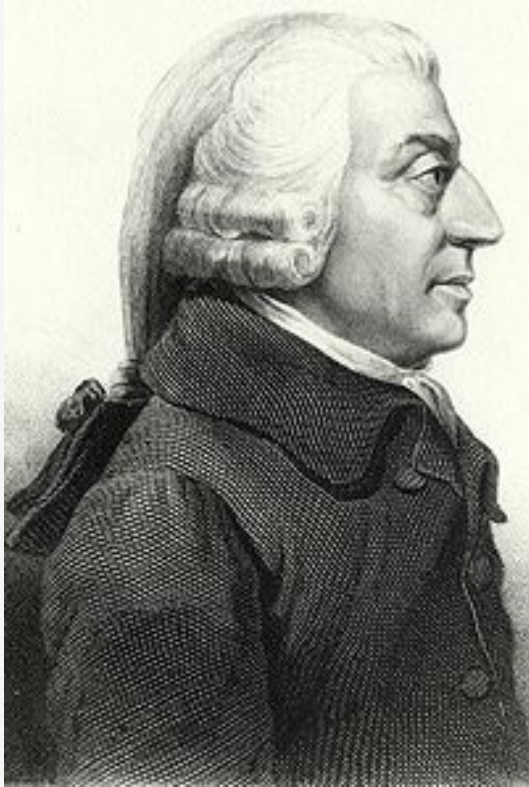


Adam Smith

1723-1790

“All systems either of preference or of restraint, therefore, being thus completely taken away, **the obvious and simple system of natural liberty** establishes itself of its own accord. **Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man**, or order of men. The sovereign is completely discharged from a duty, in attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society,”

# Adam Smith on The System of Natural Liberty



Adam Smith

1723-1790

“According to the system of natural liberty, **the sovereign has only three duties** to attend to; three duties of great importance, indeed, but plain and intelligible to common understandings: **first, the duty of protecting the society from violence and invasion** of other independent societies; **second**, the duty of protecting, as far as possible, **every member of the society from the injustice or oppression of every other member** of it, or the duty of **establishing an exact administration of justice**; and, **third**, the duty of **erecting and maintaining certain public works and certain public institutions** which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because the profit could never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society.”