Adam Smith: The Beginning of Mature Classicism

I shall always remain with the impression of having lost a friend whom I loved and respected, not only for his great talents, but for every private virtue.

THE DUKE OF BUCCLEUCH TO DUGALD STEWART

The writer, in combating received opinions, has found it necessary to advert more particularly to those passages in the writings of Adam Smith from which he sees reason to differ; but he hopes it will not, on that account, be suspected that he does not, in common with all those who acknowledge the importance of the science of Political Economy, participate in the admiration which the profound work of this celebrated author so justly excites.

DAVID RICARDO

The main credit for putting economic development on the map as a subject for general analysis belongs undoubtedly to Adam Smith.

LORD ROBBINS OF CLAREMARKET

The early classical economists from Petty to Turgot clarified the concepts of viability, surplus, and the distinction between luxury consumption and the accumulation of capital. But, in effect, they did so only for the case of capitalist agriculture. Adam Smith (1723-1790) changed all this. In his early works he made quite clear the concept of surplus arising throughout industry, capitalist agriculture being only one special case of a capitalist industrial undertaking. Then, in his great mature work, the Wealth of Nations, he set out in detail what would nowadays be called the fundamental duality of surplus (in the quantity relations) and profit (in the price relations) obtained at a uniform rate throughout industry. The structure of classical theory had now been laid bare—mature classicism had begun.

Adam Smith and the Scottish Enlightenment

The scene to which we now turn seems at first sight utterly different from the France of Quesnay and Mirabeau. Yet appearances prove deceptive, for Scot-
tish society in the late eighteenth century was in an intellectual ferment, and her universities (unlike the Oxford and Cambridge of the period) were coming to brilliant life. The Scottish Enlightenment does not sparkle with diamonds and champagne, but it does with wit and ideas. It was run on oatmeal porridge and high aspirations.

Adam Smith was, on his father’s side, “descended from a family of Aberdeenshire lairds at one time identified with Rothiebirsben and later with Inveramsay.”4 His mother was a Douglas of Strathenry, a great-great-granddaughter of Sir William Douglas of Lochleven, later Earl of Morton, the sinister laird who held Mary Queen of Scots prisoner in his castle on an island in Loch Leven.5 But there were gallant Douglases too: the laird’s brother, dashing young George (“pretty Geordie”) Douglas, and a little orphan cousin, young Willie Douglas (“the little Douglas”) together engineered the Queen’s escape, and served her faithfully until her death.6 For all Adam Smith’s vision of the historically liberating forces of industry under his new system of natural liberty, one can hear a hint of the tones and assumptions of an eighteenth century country gentleman throughout his many comments on the qualities of capitalists.

It has recently been remarked that “Adam Smith for the most part was a perfunctory, dilatory correspondent.”7 It is not simply that Smith was averse to writing letters, although this was notoriously the case. The matter goes deeper than that. Smith’s whole social and intellectual circle was one in which self-revelation was neither indulged in nor thought to be good form. In the case of two great founders of neoclassical theory, Jevons and Walras, we shall later have reason to be grateful for the intimate revelations about the development of their thought to be derived from private journals and letters. They breathed the heavily scented air of the later years of the Romantic Rebellion, and it shows in their writings.

Such exotic flowers did not flourish in the cool crisp northern climate of the Scottish Enlightenment. Those sober Augustans admired the eighteenth century English poets, and Smith appears to have agreed with the view that Shakespeare had written good scenes but no good play, and to have “thought Racine’s Phaedrus [sic] the finest tragedy extant in any language in the world.”8 Not a view which would cut Smith off, it may be noted, from the French Enlightenment which he was later to know intimately. In any case, as Jacob Viner remarked of Smith:

In the circle in which he lived, a high value was set both on the privacy of one’s own affairs and on the protection of the privacy of those with whom one had had intimate personal relations. It was then quite common, therefore, for men in their old age to carry
out, or to leave instructions for carrying out after their death, a massive destruction of their private papers. Adam Smith did this. . . .

Nevertheless, certain biographical questions simply cannot be avoided if one is to give the barest sketch of Smith’s role in the development of mature classical political economy. One of the most celebrated of these questions concerns his relations with the French economists, and therefore makes it important to know how early in his work he was acquainted with French economic writings, and, on the other hand, how early he developed certain characteristic ideas.

**Adam Smith as Student**

The question as to how much Adam Smith owed the French economists of his period has long been in dispute among historians of economic analysis. Indeed the issue had already been raised by Smith’s close friend and first biographer, Dugald Stewart, only five years after Smith died. After spending the years from 1737 to 1740 as a student at the University of Glasgow, Smith had been sent as an exhibitioner to Balliol College, Oxford. Of the seven years he spent there, Dugald Stewart wrote, “I have heard him say, that he employed himself frequently in the practise of translation, (particularly from the French), with a view to the improvement of his own style. . . .” So we know that Smith was reading French literature more than fifteen years before Quesnay began to publish on economic subjects. Dugald Stewart goes on to remark:

> It was probably also at this period of his life, that he cultivated with the greatest care the study of languages. The knowledge he possessed of these, both ancient and modern, was uncommonly extensive and accurate. . . . How intimately he had once been conversant with the more ornamental branches of learning; in particular, with the works of the Roman, Greek, French, and Italian poets, appeared sufficiently from the hold which they kept on his memory. . . .

The modern reader can see the justice of Stewart’s opinion if he samples the elegant prose of Smith’s posthumously published essays on the “History of the Ancient Logic and Metaphysics,” on the “Imitative Arts,” on “Music, Dancing and Poetry,” and on “English and Italian Verses.” It should be recalled that an intensely scholarly youth like Smith, coming from Glasgow when the University there was in the ferment of the Scottish Enlightenment, would, in the decadent Oxford of the eighteenth century, be thrown
back largely on his inner intellectual resources. The Scottish Enlightenment, it must again be remembered, had influenced, and been influenced by, the French. The Scottish philosopher, historian, economist, and *belle lettrist*, David Hume, for example, was revered in French intellectual society. And Hume was to become a lifelong friend and admirer of Smith. It has been recognized that Smith shared with other members of the Scottish Historical School a certain conception of the importance of economic forces in history which has striking similarities to that of Turgot.*

After coming down from Oxford in 1746, Smith spent two years of quiet study at his birthplace, Kirkaldy, with his mother, to whom he remained devoted throughout his life. In 1748 he moved to Edinburgh, and in these years entered a crucial phase of his development. From this period date the first of his speculations on economic theory of which we have any report.

*The Edinburgh Lectures*

It has been remarked that a certain mystery surrounds both the circumstances and the subject matter of the lectures which Adam Smith gave at Edinburgh during the three years, 1748 to 1751. Public lectures, not sponsored by or given at the university, were fashionable in Edinburgh just then. And Smith could offer lectures on a newly modish topic: English Literature. It has been suggested that there were probably two courses on Literature and Literary Criticism, and then a final course on Jurisprudence. Fragments of the lectures on jurisprudence, discovered in the present century, suggest that here "Adam Smith had already laid the foundation of a great part of his economic work."  

Dugald Stewart published in 1795 an extract from a paper drawn up by Smith in 1755 (now lost) in which Smith describes his early economic views:

Man is generally considered by statesmen and projectors as the materials of a sort of political mechanics. Projectors disturb nature in the course of her operations in human affairs; and it requires no more than to let her alone, and give her fair play in the pursuit of her ends, that she may establish her own designs.  

And, in another passage:

Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice; all the rest being brought about by the natural course of things.  

* For a summary of the case for and against French influence on Smith before he went to France, see the section below, "Smith in France."
The significance of these passages, and of other less direct evidence concerning Smith's early work, is brought out in a hypothesis which was advanced by William Robert Scott:

One conclusion that can be stated with a fair degree of certainty is that Book III of the *Wealth of Nations* entitled "The different progress of Opulence in different nations" is traceable back through the early draft . . . .[1] and the *Glasgow Lectures* to this final course at Edinburgh. It . . . is confirmed by the quotation Adam Smith himself gave in 1755, which in effect contrasts the slow progress of opulence with what would happen if the natural course of things were allowed free play.[10]

We shall take the position in this book that the fundamental concern of Smith's economic thought is with the allocation of surplus output so as to attain the greatest possible growth of the economy. It seems plain to us that early in his economic writings Smith shows a clear understanding of the notions of viability and surplus, and of the bearing on growth of the allocation of surplus as between luxury consumption and accumulation; and that his concern with natural liberty derives from his observation of the way in which feudal survivals and mercantilist restrictions diverted capital stock from the uses in which it would lead to maximal growth. If, as Scott suggested, "The different progress of Opulence in different nations" is one of the oldest parts of Smith's corpus of work on economics, we believe it also to be one of the most central. A consideration of the development of this core into a whole system and the influences to which it was or was not subject, and a glance at the leading analytical features of the developed system, will show us Smith's place as the founder of mature classical political economy.

*The Two Reports of Smith's Lectures on Jurisprudence*

In 1751 Smith was elected professor of logic in the University of Glasgow, and then, in 1752, he became professor of moral philosophy and remained so with the greatest distinction—on the testimony of his contemporaries—fortirteen years. During these years the acquaintance between Smith and the Scottish philosopher, David Hume, had grown into friendship, as is amply testified by about fifteen friendly letters from Hume. Smith's replies are (predictably) few and far between, but no less warm in tone: "Tho you have resisted all my Solicitations, I hope you will not resist this. I hope, I need not tell you that it will give me the greatest pleasure to see you."[19]

Meanwhile, Smith had published his brilliant essay on the foundations of

moral judgment, *The Theory of Moral Sentiments* (1759),\textsuperscript{20} to Hume's enthusiastic admiration. So Smith now had a direct link with the French Enlightenment: he was author of a book admired by French intellectual society, and the close friend of its darling, David Hume.

Then, during the academic years of 1762–63 and (probably) 1763–64, Smith gave at Glasgow the lectures on Jurisprudence of which two reports, one for each (academic) year, have come down to us. As is well known, the first of these, written by a student, was discovered by Edwin Cannan and published in 1896 under the title *Lectures on Justice, Police, Revenue and Arms*.\textsuperscript{21} This report was dated 1766, but is thought to be of lectures given during 1763–64. We shall follow the notation of the Glasgow Edition's editors and refer to it for brevity as LJ(B). The earlier report, that for the session 1762–63, which is referred to in the Glasgow Edition as LJ(A), was discovered by the late John M. Lothian in 1958, and is published for the first time in The Glasgow Edition of the Works and Correspondence of Adam Smith.

Ever since a report, LJ(B), of Smith's lectures at Glasgow upon Jurisprudence first became available in Cannan's edition, the tendency of critical opinion has been to stress the gap between these lectures and Smith's mature work in the *Wealth of Nations* (1776).\textsuperscript{22} This was already to be seen in the position taken by Cannan in the introduction to his edition of the Lectures published in 1896. Of course, Cannan was quick to point out that the discovery of the lectures disposed of the crude myth, which had surfaced here and there throughout the nineteenth century, to the effect that Smith had borrowed everything that seemed original in the *Wealth of Nations* from the French economists. And the Lectures indeed contain many of the doctrines traditionally thought of as Smithian: the analysis of the advantages of the division of labor, the advocacy of the removal of mercantilist restrictions, the establishment of a regime of economic liberty, the attack on monopolies, the theory of natural and market prices, and so on. Cannan (and subsequent scholars), however, have been more concerned with those respects in which the Lectures fall short of Smith's later work. Writing of the development of Smith's thought on economics, Cannan remarked that the manuscript of the Lectures "enables us to follow the gradual construction of the work almost from its very foundation, and to distinguish positively between what the original genius of its author created out of British materials on the one hand and French materials on the other."\textsuperscript{23}

Cannan found the main ideas of the mature work, which are missing in the lectures, to be the scheme of distribution of the total product of a year's industry into wages, profits, and rent; and the theory of capital:
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There is no trace whatever in the lectures of the scheme of distribution which the Wealth of Nations sets forth. The main body of Book II, “Of the Nature, Accumulation and Employment of Stock,” is also entirely unaccounted for. There is nothing at all about capital in the lectures, and stock is not given an important place.24

Yet, despite Cannan’s view, there are a number of places in the version of the lectures which he had before him, where Smith shows a clear awareness of the role of the accumulation of capital stock in the emergence of capitalist production. He is well aware of the consequences of administrative measures which prevent prices from reaching their natural (long run) level:

If the price of one commodity is sunk below its natural price, while another is above it, there is a smaller quantity of the stored stock left to support the whole. On account of the natural connection of all trades in the stock, by allowing bounties to one you take away the stock from the rest. This has been the real consequence of the corn bounty.25

Smith’s whole argument implies an understanding of the way in which a government policy (such as a bounty on the export of corn) diverts capital stock from what would otherwise be the most productive uses, thus making the growth of the economy less than what it could have been. Similarly, Smith believed that the necessity to tie up a proportion of the country’s stock in precious metals so as to have money for circulation forces one to have so much dead stock so that “the poverty of any country increases as the money increases, money being a dead stock in itself, supplying no convenience of life. . . .”26

Viability is tersely stated: “an industrious people will always produce more than they consume.”27 And he argues quite clearly that luxury at home can destroy a country’s accumulation of capital—to the contrary of mercantilist prejudices.28 Similarly, luxury consumption by the country’s rentier creditors (payments on the national debt to idle people) means that “industry is taxed to support idleness,”29 and the accumulation of capital impeded. Likewise, his discussion of lending at interest is much concerned with the relations between interest and stock.30 But perhaps the most telling passages of all come where Smith is discussing the slow progress of opulence. The division of labor, Smith’s famous principle, is seen entirely in terms of its tendency to promote accumulation. Given its effects, why has every nation remained poor for so long? It all turns on the accumulation of capital:

Before labour can be divided some accumulation of stock is necessary. A poor man with no stock can never begin a manufacture. Before a man can commence farmer, he must at least have laid in a years provision, because he does not receive the fruits of his labour till the end of the season.31
THE TWO REPORTS OF SMITH’S LECTURES ON JURISPRUDENCE

The other cause of the slow progress of growth is the weakness of government: when people expect to be robbed they have no motive to be industrious, and therefore there can be little accumulation of stock. When the power of government grows, wars endanger growth, and it becomes next to impossible that any accumulation of stock can be made. Finally, governmental policies oppress agriculture which Smith regards as being of all arts the most beneficent to society, and early stages of land tenure, such as the feudal, are highly inefficient in maximizing accumulation. The whole study of the impediments to the growth of agricultural surplus is dazzling.32

Having summed up the causes which hinder the growth of surplus in agriculture, which he describes as the most important branch of industry, Smith proceeds to show that the slow growth of manufacturing has similar causes. Slave labor postponed the development of machinery, and contempt for trade prevented the investment of talent and capital in manufactures. Thus, merchants “could never amass that degree of stock which is necessary for making the division of labour, and improving manufactures.”33

Finally, when he turns to the discussion of revenue, Smith is concerned to show that the use of land to raise revenue is a cause of the slow progress of opulence. Were the British government supported by the rent of land, the land in its hands would be much worse cultivated: “By this therefore the stock of the country would be greatly diminished and fewer people maintained.”34 One of his principal concerns about taxes is that they increase the stock needed to carry on a business. It is typical of this whole discussion that his primary objection to taxes on imports is that they divert stock from its optimal allocation for growth: “The more stock there is employed in one way, there is the less to be employed in another. . . .”35

Thus we have shown that a reading of the report of Smith’s Lectures, LJB(B), which was available to Cannan demonstrates that between 1751 and 1764 Smith had in fact powerfully developed one great theme of all of his work: the allocation of surplus throughout industry so to ensure its maximal growth. If we may be excused for putting our point in modern terminology, the quantity relations of a viable economy, and of an economy using surplus generated throughout industry so as to promote overall growth, are surely to be found clearly expressed in Cannan’s version of the Lectures. On the other hand, if the role of surplus was clear in that version, the nature and role of its dual, profit, was not. The concept of profit as a return earned on stock by its owner simply in proportion to the amount of stock invested in a given enterprise, which, as we shall see, is treated in detail in the Wealth of Nations, is not made explicit in the only report of Smith’s Lectures, LJB(B), which was
available until recently. Now, it happens that the newly published version of the Lectures, LJ(A), offers possible light on these matters, and to this we therefore turn.

**Profit in the Newly Discovered Lectures**

The editors of The Glasgow Edition suggest that:

A number of scholars, basing themselves on LJ(B) have argued that in Smith’s Glasgow lectures capital and the accumulation of capital did not yet play anything like the central role which they were later to do in [the Wealth of Nations]; that the concept of profit on capital as a basic category of class income was still missing; and that the concept of a normal rate of profit on capital was also missing. Now . . . it is possible that these judgements may require some—although perhaps not very much—modification.38

As far as the accumulation of capital is concerned, we have already shown that it indeed played a major role, even in the Cannan version—on this our case rests. With regard to profit and the normal rate of profit, however, there are significant differences between the two reports of Smith’s Lectures. On this question, three passages singled out for comment by Meek, Raphael, and Stein will bear examination. In the first of these, Smith describes how:

... each branch of trade will afford enough both to support the opulence and give considerable profit of the great men, and sufficiently reward the industry of the labourer. Every trade can afford something* for those who do not work, and give enough to the industrious. Thus . . . if we should suppose that the pin makers can furnish 1000 pins in the day, that these (including the price of the metall which is about 20^e per pound, out of which many thousand pins can be made) can be sold at the rate of 3 half-pence per 100. The whole thousand will then be worth 13^e, of which the artizan can afford 3 to his master and have 12 as the price of his labour, or may give him 200 and retain 800 to himself, for it is the same thing whether we suppose each one to have the commodity he works in or the value of his share.37

It would be hard to find a more precise statement of the relation between physical surplus and profit, short of the use of matrix algebra. We leave the detailed discussion of the duality of profit to surplus for our treatment of the Wealth of Nations below, where Smith repeatedly invokes it. But it must surely be granted that the idea was clear to him when he lectured in Glasgow.

Now, as regards the concept of a tendency toward a uniform rate of profit throughout industry in the long run, the editors of The Glasgow Edition note a passage where Smith states that the price of a good must be enough to repay

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1 Replaces an illegible word. Glasgow Editors’ reference.
the costs of education and the apprentice fee "not only in principall but with
the interest and profit which I might have made of it." Admittedly, appren-
tices become master craftsmen, not capitalists, but the point is that Smith is
arguing that one would not lay out the capital for an apprentice fee if one ex-
pected less yield in the long run than the same capital would have yielded as
profit if used as stock anywhere in industry.

Finally, there is a passage where Smith describes, as the Glasgow Editors
note, what may be expected to take place in a competitive market in the long
run when a trade is overprofitable:

For if any trade is overprofitable all through into it till they bring it to the naturall price,
that is, the maintenance of the person and the recompence of the risque he runs; that is,
what is sufficient to maintain the person according to his rank and station.

If Smith had stopped after the phrase "naturall price," one might be willing to
grant his having his complete theory of profit by this time. The remainder of
the passage, however, shows an obvious uncertainty of touch, if compared
with the perfectly clear understanding of the nature of capitalist profit as a re-
turn paid exactly in proportion to the value of the stock invested (not to the in-
vestor's "station"!) which we shall see in due course in the Wealth of Na-
tions. For all that, a reading of the newly published report must surely
convince one that Smith's theory of profit was already well advanced (and
vastly ahead of its time) by his lectures of the academic year, 1762–63.

The "Early Draft"

One further manuscript of Smith's work before he went to France has been
known for some time through the efforts of W. R. Scott and the help of the
then Duke of Buccleuch. The manuscript was found among papers at Dalkeith
House, a seat of the Dukes of Buccleuch. As Scott remarks, "There is a cer-
tain appropriateness in its home, since Dalkeith at one time belonged to the
head of the branch of the Douglas family from which Adam Smith's mother
descended till it was sold in 1642 by William, eighth Earl of Morton, to
Francis Scott, second Earl of Buccleuch."

Cannan had claimed that, "It is plain that Adam Smith acquired the idea of
the necessity of a scheme of distribution from the Physiocrats, and that he
tacked his own scheme (very different from theirs) on to his already existing
tory of prices." We have seen that the discovery of the new report of
Smith's Lectures shows that he had quite developed ideas about the distribu-
tion of the product between wages and profit by the academic year 1762–63.
About rent, he was always to remain somewhat unclear. Scott's publication of
the "Early Draft" in 1937, however, in itself was quite an effective answer to Cannan’s hypothesis.

The manuscript at issue begins with "Chapter 2" which is entitled "Of the nature and causes of public opulence." 42 In this, Smith addresses the question of the accumulation of stock specifically in relation to the question of how the total product is distributed. For instance, he asks how it comes about that in a civilized society the poor are better provided than in a savage state where each retains the whole product of his own labor:

In a civilized society the poor provide both for themselves and for the enormous luxury of their superiors. The rent, which goes to support the vanity of the slothful landlord, is all earned* by the industry of the peasant. The monied man indulges himself in every sort of ignoble and sordid sensuality, at the expense of the merchant and the tradesman to whom he lends out his stock at interest. All the indolent and frivolous retainers upon a court are, in the same manner, fed, clothed, and lodged by the labour of those who pay the taxes which support them. Among savages, on the contrary, every individual enjoys the whole produce of his own industry. . . . We might naturally expect, therefore, if experience did not demonstrate the contrary, that every individual among them should have a much greater affluence of the necessaries and conveniences of life, than can be possessed by the inferior ranks of people in a civilized society. 43

Smith’s answer, of course, is that the division of labor "can alone account for that superior opulence which takes place in civilized societies, and which, notwithstanding the inequality of property, extends itself to the lowest member of the community." 44 And again: "So great a quantity of every thing is produced, that there is enough both to gratify the slothful and oppressive profusion of the great, and at the same time abundantly to supply the wants of the artizan and the peasant." 45

One comes away from the "Early Draft" with the feeling that Adam Smith had now fully filled out his picture in quantity terms of the role played by the extraction of surplus, and the allocation of surplus output to growth or luxury consumption. What was missing from this manuscript, however, was an explicit treatment of the dual of surplus—profit. The full-dress development of the theory of the uniform rate of profit in the price relations of a mature classical model would be found only in the Wealth of Nations.

Smith in France

Smith was now about to leave for France, and we may conveniently ask how much, up to this point, he could have owed to physiocratic influence. We

have seen that, at least from his Oxford years, he was well read in French literature. The issue as to how much specific physiocratic work Smith could have read has long been debated, and each new piece of information about the contents of Smith's library has rekindled the fire. We must content ourselves here with a few general points. First of all, as will be recalled, Quesnay's *Tableau Économique*, in its three "editions" during the 1750's, was shown to only a few of Quesnay's friends at Versailles. The *Tableau* was not made available to the reading public until it appeared in Mirabeau's *Rural Philosophy*. As we know, Quesnay's early article, "Corn," had appeared in the *Encyclopedia* in 1757, and Mirabeau's work (to which Quesnay certainly contributed), the *Theory of Taxation*, came out in 1760, while Mirabeau's *Rural Philosophy* was first printed in 1763. Scott argues that the "balance of probability" is that Smith acquired these books, which were in his library, while in France, and not while still in Glasgow. In any case, most of this work was published too late to have deeply influenced Smith's early thought. And, above all, as we have been at pains to show, Smith was already concerned in his early writings with the surplus which is yielded by the employment of capital stock throughout industry, not just in agriculture, and with the profit that results from this. These ideas, however, he could not have learned from any physiocratic literature. More suggestive is the fact that Cantillon's *Essay* was in Smith's library. From Cantillon, as we have seen, one could develop a picture of surplus not being confined to the agricultural sector, and possibly even some notion of profit. Perhaps Smith and Quesnay were both inspired by that brilliant and mysterious figure, each taking from Cantillon what he, in the circumstances of his country and experience, could use.

It was late in the year 1763 that Smith made the momentous decision to accept the offer to travel on the continent with the young Duke of Buccleuch. Remarking that the system of political economy, of which the principles had already been delivered in the *Glasgow Lectures*, was now the leading object of Smith's studies, Dugald Stewart wrote:

The coincidence between some of these principles and the distinguishing tenets of the French economists, who were at that very time in the height of their reputation, and the intimacy in which he lived with some of the leaders of that sect, could not fail to assist him in methodizing [sic] and digesting his speculations. . . .

In this passage Dugald Stewart launched the tradition of looking for a French influence on Smith. Now, it is indeed true that Smith moved in a French society imbued with physiocratic ideas and was intimately acquainted with the leading physiocrats. This began slowly. The first visit to Paris of Smith and
the young duke lasted only ten days, after which they stayed eighteen months at Toulouse; and then traveled extensively in the south of France, after which they spent two months in Geneva. They returned to Paris around Christmas of 1765, where they remained till the next October. Of their life there, Stewart wrote:

The society in which Mr. Smith spent these ten months, may be conceived from the advantages he enjoyed, in consequence of the recommendations of Mr. Hume. Turgot, Quesnai, [sic] Necker, d’Alembert, Helvétius, Marmontel, Madame Riccoboni, were among his acquaintances; and some of them he continued ever afterwards to reckon as friends.48

These people were all to be seen about town in the salons which, as the financier and statesman Jacque Necker put it, formed “the invisible power which, without finances, without troops, without an army, imposes its laws upon the town, on the Court, and even on the King himself.”49 Jean le Rond d’Alembert, for instance, a close friend of David Hume and one of the greatest of the contributors to the Encyclopedia, held a salon with Julie de Lespinasse which was frequented by Turgot and Smith. Most of them wrote for the Encyclopedia; Claude-Adrien Helvétius was a noted philosopher. Marie-Jeanne Laboras de Mézières, Mme. Riccoboni, the novelist, was a friend of Hume’s and a great admirer of Smith. Smith, evidently, was in the thick of it: he was meeting all intellectual Paris.

Nor did they forget him when he left France—he was no nine-days wonder. Writing on March 3, 1778, Louis-Alexandre, Duc de la Rochefoucauld,50 sent Smith a copy of a new edition of his grandfather’s Maxims, and informed Smith that he had nearly finished a translation of The Theory of Moral Sentiments when he found that another translation had been published. La Rochefoucauld, who was a close friend of Turgot and a disciple of Quesnay,51 continued to be a friend of Smith all his life. La Rochefoucauld’s enthusiasm for Smith’s work was quite unimpaired by the fact that Smith had been unkind to the author of the Maxims (François VI, Duc de La Rochefoucauld, grandfather of Smith’s friend) in early editions of his Theory of Moral Sentiments.52

Smith, for his part, sent word to the duke in 1789 that future editions of the Moral Sentiments would no longer contain the unfavorable reference to the Maxims, and this change was indeed made in the sixth edition, which appeared in 1790. Thus the Scotsman was no less generous in his gestures than the French. Stewart tells us that, “If he had not been prevented by Quesnai’s [sic] death, Mr. Smith had once an intention (as he told me himself) to have inscribed to him his ‘Wealth of Nations’.”53
So it is hardly surprising that the issue of Adam Smith’s relation to the Physiocrats was already being raised by Stewart in 1795, five years after Smith’s death. For us, however, one great theme of all Smith’s work, the analysis of the allocation of surplus generated throughout industry, had been developed long before Smith went to France—by its very nature, it could not have been derived from physiocratic writings. And the treatment of the dual problem, the uniform rate of profit, which plays a minor role in Smith’s early work and which is for us the outstanding originality of the Wealth of Nations, is utterly at variance with physiocratic thinking. Turgot alone could have been sympathetic to it, and, as we know, he had the benefit of Smith’s close friendship before he wrote his Reflections.

The Wealth of Nations

On July 5, 1764, at Toulouse, when Smith and the duke had not yet begun to go much into society, Smith had written to his friend, Hume, “I have begun to write a book in order to pass away the time. You may believe I have very little to do.”54 In October of 1766, Smith and his pupil returned to London, and we are told by Dugald Stewart that during the next ten years Smith “remained with his mother at Kirkaldy, occupied habitually in intense study. . . .”55 Finally, in 1776, there appeared the masterpiece to which we now turn. Classical political economy had come of age.

When one reads the Wealth of Nations, it is to find the great theme of the allocation of surplus output to the maximum possible accumulation of capital, developed continually through endless variations, as Smith ranges over the whole of economic life as he knew it. Indeed, some of the most vivid expressions of the theme come in contexts where one would least expect to find them. Yet, strangely enough, in discussions of the Wealth of Nations, “allocation” has been assumed to mean “allocation of given resources,” and it has been seriously debated whether Smith’s basic concern was with “growth” or with “allocation” (of given resources).

Commenting on this issue, Samuel Hollander has recently contrasted two views of the Wealth of Nations: Smith’s basic concern, according to one view, “is with the increasing of material wealth rather than the efficient allocation of scarce resources among alternative uses.” . . . But we must refer at this point to an alternative well known view according to which the very essence of Smithian economics lies precisely in the statement of the role of relative product and factor prices in making an optimum allocation of scarce
resources." He cites Lord Robbins, who has written that "from the point of view of theoretical economics, the central achievement of [Smith's] book was his demonstration of the mode in which the division of labour tended to be kept in equilibrium by the mechanics of relative prices—a demonstration which . . . is in harmony, with the most refined apparatus of the modern School of Lausanne." 

However, we must note with Hollander that "a more recent statement by Lord Robbins of the main purpose of the Wealth of Nations suggests a change of emphasis." He goes on to cite Robbins as saying recently that, "The main credit for putting economic development on the map as a subject for general analysis belongs undoubtedly to Adam Smith. . . . [As] political economy its coverage [of the Wealth of Nations] is wide, ranging from an exhibition of the essential structural relationships of an exchange economy practicing the division of labour, to the economic functions of the state and the claims of taxation. But, as the title itself implies, the central focus is on development—what makes the Wealth of Nations greater or less." 

Agreeing with this latter view, Hollander sums up his findings on the Wealth of Nations: "The object of the work was ultimately to define the necessary conditions for rapid economic development in contemporary circumstances and Smith’s treatment of the price mechanism must accordingly in the final resort, be considered with this end in view." This, of necessity, implies that in Adam Smith the theory of allocation has a special role connected with the accumulation of surplus. Hollander adds weight to this suggestion when he goes on to say, "It is, in brief, not merely the elaboration of the mechanisms of resource allocation which requires attention, but also the particular uses to which the analysis was put. . . ." 

It has recently been noted by R. D. Collison Black that economists today are finding "more of value in [Smith’s] contribution than did their predecessors of fifty and even a hundred years ago." Black suggests that this remarkable revival of interest can be partly explained by the change in perspective which has occurred:

. . . for the standpoint from which the majority of economists today are accustomed to view Smith’s contribution is that of the economics of growth and development. Seen from there, it naturally appears more sensible and significant than when it is viewed from the angle of a static theory of value and distribution of the neo-classical type. 

* The School of Lausanne, referred to by Lord Robbins, was founded by Léon Walras. "School of Lausanne" is thus a term for Walrasian allocation theory. See chapter 6.
In appraising this characteristic of Smith's work it is crucial to stress our distinction between two sorts of general equilibrium model (and, therefore, two sorts of allocation): (1) a model in which resources are given, i.e., parametric, and the object of the analysis is to show how these given resources are allocated; and (2) a model in which (variable) amounts of commodities are being produced and allocated as inputs to yield more of the same commodities, in order to maximize surplus. Observe that in both types of model a concept of allocation would play a role. However, it will become increasingly evident as we proceed that the role played by allocation is very different in each case. The first model, where resources are simply given, and the whole economic problem is seen as that of allocating them among alternative uses, is, in effect, the model developed by Walras and the neoclassics (as we show in chapters 5 and 6). But this is not what "allocating" means for Smith. In the Wealth of Nations the problem is to produce the right quantities of the various input commodities, and to allocate them in such a way as to encourage growth.

Hollander summarizes his view of the nature and role of capital in Smith by saying that, "Capital is primarily subsistence goods whereas machinery, tools, raw materials (and skills) are simply more complicated forms." On this view, the rate of accumulation of surplus depends on the choice of the right input mix, and on the allocation of these produced inputs (wage goods, tools, machinery) in the employment of productive labor (engaged upon the production of commodities which can be used to produce more commodities so as to maximize the accumulation of capital). This is a model in which allocation plays the second of the two roles which we have been at pains to distinguish.

Thus, we recognize the just claims of those who stress Smith's contribution to the development of "allocation" theory, but nevertheless point out that it was in the allocation of surplus output and not of "given resources" that Smith was interested: a dynamic theory in which the role of the freely operating market is to allocate the surplus available as capital stock so as to put in motion the greatest quantity of productive labor. The reader will recall that the discussions of allocation theory by Richard Cantillon, by Quesnay, and by Turgot, all concerned the allocation of surplus output. This is, above all, true of Smith who is concerned throughout the Wealth of Nations with that allocation of surplus output which will generate the maximum accumulation of capital.

As early as chapter VI of Book I, the distinction between the use of the
surplus for growth and its use for luxury consumption is clearly made, and the concept of the trade-off between accumulation and consumption is set out:

But there is no country in which the whole annual produce is employed in maintaining the industrious. The idle everywhere consume a great part of it, and according to the different proportions in which it is annually divided between those two different orders of people, its ordinary or average value must either annually increase, or diminish, or continue the same from one year to another.\(^65\)

It is fundamental to Smith's view about the behavior of wages over time that "as capital accumulates, most workers will become better off, and they will continue to become better off for so long as accumulation is able to continue."\(^66\) The importance of capital accumulation in keeping wages above bare subsistence through continual increases in the demand for labor is vividly described in chapter VIII of Book I: "It is not the actual greatness of national wealth, but its continual increase, which occasions a rise in the wages of labour."\(^67\) And, again, "The liberal reward of labour, therefore, as it is the necessary effect, so it is the natural symptom of increasing national wealth."\(^68\) It should be borne in mind that, for Smith, even "subsistence" does not mean bare biological survival:

In Great Britain the wages of labour seem, in the present times, to be evidently more than what is precisely necessary to enable the labourer to bring up a family. In order to satisfy ourselves upon this point it will not be necessary to enter into any tedious or doubtful calculation of what may be the lowest sum upon which it is possible to do this.\(^69\)

Furthermore, Smith, and later Ricardo, look to capital accumulation, as it proceeds, to occasion short-run changes in demand which will tend to keep pushing wages something above even the customary long-run subsistence level.\(^70\)

In chapter XI of Book I, we find a clear statement of the concept of surplus in agriculture:

But land, in almost any situation, produces a greater quantity of food than what is sufficient to maintain all the labour necessary for bringing it to market, in the most liberal way in which that labour is ever maintained. The surplus too, is always more than sufficient to replace the stock which employed that labour, together with its profits. Something, therefore, always remains for a rent to the landlord.\(^71\)

Here Smith's way of using the concept of subsistence is vividly illustrated, and the role of the agricultural surplus in making capital accumulation possible is precisely stated:
But when by the improvement and cultivation of land the labour of one family can provide food for two, the labour of half the society becomes sufficient to provide food for the whole. The other half, therefore, or at least the greater part of them, can be employed in providing other things. 72

Thus, Smith accepted and emphatically carried on the deeply sound insight of physiocracy to the effect that capital accumulation is impossible without an agricultural surplus.

In Book II, entitled, "Of the Nature, Accumulation, and Employment of Stock," the theme of capital accumulation positively thunders out. The division of labor, we are told, is intimately related to the accumulation of stock:

In that rude state of society in which there is no division of labour, in which exchanges are seldom made, and in which every man provides everything for himself, it is not necessary that any stock should be accumulated or stored up beforehand. 73

And so:

As the accumulation of stock must, in the nature of things, be previous to the division of labour, so labour can be more and more subdivided in proportion only as stock is previously more and more accumulated. 74

This fundamental characteristic of Smith's concept of capital accumulation has been tellingly analyzed in the recent paper by W. A. Eltis, already cited. 75

In chapter I of Book II, Smith distinguishes capital stock into fixed and circulating, making it plain that he fully understands the need for both kinds of capital in agriculture as well as in manufacturing industry, treating both kinds of enterprises as identical capitalist undertakings. We are far from physiocracy:

In a great iron-works, for example, the furnace for melting the ore, the forge, the slitting-mill, are instruments of trade which cannot be created without a very great expense. . . . That part of the capital of the farmer which is employed in the instruments of agriculture is a fixed; that which is employed in the wages and maintenance of his labouring servants, is a circulating capital. 76

The notion, sometimes put forward, that capital in Smith can be treated simply as a quantity of corn for wages and seed is totally refuted by a perusal of this section. 77 Yet, curiously enough, the view that Adam Smith in the Wealth of Nations was dealing with capitalist industry has been denied. Samuel Hollander notes, in his recent work on Smith, that "There is to be found in the secondary literature the widely-held view that Smith's preoccupation in
discussing the industrial sector was with domestic handicrafts, where workers were often self-employed, and in any event not maintained by a master from another class but rather from another generation.” 78 Hollander marshalls a mass of detailed evidence to disprove this. He shows that “Smith entered into a highly sophisticated analysis of the effect of scale of industry upon the degree of division of labor practiced at the plant. This in itself is eloquent testimonial to the fact that factory organization was to Smith’s mind well established and calling for detailed analysis.” 79 He adds that, “Further evidence that Smith’s analytical structure was largely designed for factory, rather than domestic, organization may be drawn from the discussion of ‘profits’.” 80 New support for this view of Smith has been offered in a recent contribution by R. M. Hartwell, who argues that “Adam Smith was aware of the economic changes occurring during his lifetime, which coincided with the background and beginnings of the industrial revolution.” 81

Again, in chapter II of Book II, Smith stresses the importance of fixed capital for both agriculture and manufacturers. 82 It is typical that though the chapter is called “Money,” it should be used to discuss the relations of money to capital stock and its accumulation. A paper currency would not require the diversion to the purchase of gold or silver of stock which could be used for capital accumulation. Then, in chapter III of this book, we find the great treatment of productive and unproductive labor: “Thus the labour of a manufacturer adds, generally, to the value of the materials which he works upon, that of his own maintenance, and of his master’s profit. The labour of a menial servant, on the contrary, adds to the value of nothing. . . . A man grows rich by employing a multitude of manufacturers: He grows poor by maintaining a multitude of menial servants.” 83 Manufacturer, as the reader will have noted, is used here in its original sense of a worker in industry. Cannan, in a footnote in his edition, points out that one will only get rich by employing manufacturers if the latter are employed to produce commodities for sale, and not luxuries for the rich man’s own consumption. Likewise, one will only grow poor by employing menial servants when they are for one’s own comfort, not if one is, for example, an innkeeper. And, indeed, it must be admitted that Smith does not quite capture the distinction he needs in all cases. But it is fairly clear that Smith intends labor to be thought of as productive if and only if it is devoted to the maintenance and growth of capital, as distinct from turning out luxuries:

Both productive and unproductive labourers, and those who do not labour at all, are all equally maintained by the annual produce of the land and labour of the country. . . . According, therefore, as a smaller or greater proportion of it is in any one year employed
in maintaining unproductive hands, the more in the one case and the less in the other will remain for the productive, and the next year’s produce will be greater or smaller accordingly; the whole annual produce, if we except the spontaneous productions of the earth, being the effect of productive labour.\textsuperscript{84}

Elits has commented on Smith’s distinction between productive and unproductive labor that, “There are obviously difficult borderline cases (as there are in the modern distinction between investment and consumption) and the distinction has lapsed, but it may have force in distinguishing activities which contribute to growth from those that do not.”\textsuperscript{85} He adds that, “The sole echo of Smith’s distinction in modern theory is in Piero Sraffa’s classically based \textit{Production of Commodities by Means of Commodities} (1960) where goods (and presumably services) that are used as factors of production and those that are bought by workers influence the prices of other goods, the wage, the rate of profit, etc., while goods (and presumably services) that are solely consumed by non-workers do not.”\textsuperscript{86}

Of course, the fact is that some related notion is to be found in any modern classical reproduction system. An examination of the mathematics of any such system will reveal that there is a technology whose outputs are necessary to the reproduction of the system—to its viability. Labor devoted to producing this output is “productive”—in fact, it is “reproductive”, i.e., necessary for reproduction. Labor devoted to producing, for example, carriages, which do not enter into the reproducibility of the system, is not, in this sense, productive. Intellectual historians whose historiography took for granted a general equilibrium system of the post-Walrasian, neoclassical type where, as we shall see, these ideas are without meaning, necessarily misunderstood Smith’s analysis of the accumulation of capital.

Smith’s concern for the accumulation of subsistence goods, of the subsistence of laborers, shows very clearly in his discussion of agricultural surplus:

As subsistence is, in the nature of things, prior to conveniency and luxury, so the industry which produces the former, ministers to the latter. The cultivation and improvement of the country, therefore, which affords subsistence, must, necessarily, be prior to the increase of the town, which furnishes only the means of conveniency and luxury. It is the surplus produce of the country only, or what is over and above the maintenance of the cultivators, that constitutes the subsistence of the town, which can therefore increase only with the increase of this surplus produce.\textsuperscript{87}

As always, the emphasis is on allocation of surplus so as to maximize growth. Thus he contrasts the primitive use of the agricultural surplus during feudal times to feed retainers, with its later use to buy manufactures, which leads to growth:
In a country which has neither foreign commerce, nor any of the finer manufactures, a
great proprietor, having nothing for which he can exchange the greater part of the
produce of his lands which is over and above the maintenance of the cultivators, con-
sumes the whole in rustic hospitality at home. If this surplus produce is sufficient to
maintain a hundred or a thousand men, he can make use of it in no other way than by
maintaining a hundred or a thousand men. 88

Smith's grasp of the surplus in manufacturing comes out vividly in his analy-
sis of the way in which the latter is used to pay for foreign wars:

No foreign war of great expense or duration could conveniently be carried on by the
exportation of the rude produce of the soil. . . . It is otherwise with the exportation of
manufactures. The maintenance of the people employed in them is left at home, and
only the surplus part of their work is exported. 89

Thus, the theme of surplus and accumulation pervades Smith's discussion
of colonies, of foreign wars, of everything pertaining to the wealth of a
ation. He speaks of a balance:

. . . very different from the balance of trade, and which, according as it happens to
be either favourable or unfavourable, necessarily occasions the prosperity or decay of
every nation. This is the balance of the annual produce and consumption. If the
exchangeable value of the annual produce . . . exceeds that of the annual consump-
tion, the capital of the society must annually increase in proportion to this excess. 90

And, in discussing America and the East Indies, he writes:

The most advantageous employment of any capital to the country to which it belongs,
is that which maintains there the greatest quantity of productive labour, and increases
the most the annual produce of the land and labour of that country. 91

Thus he attacks the monopoly of the colony trade on the grounds that it
diverts stock from uses in which growth would be greater. The monopoly arti-
ficially raises the rate of profit, and merchants gain. "But as it obstructs the
natural increase of capital, it tends rather to diminish than to increase the sum
total of the revenue which the inhabitants of the country derive from the
profits of stock. . . ." 92

Summing up his case against mercantilist restrictions, Smith argues: ""The
mercantile stock of every country . . . naturally seeks, if one may say so, the
employment most advantageous to that country." 93 And so, "'All the dif-
ferent regulations of the mercantile system, necessarily derange more or less
this natural and most advantageous distribution of stock." 94 Thus, his whole
attack on mercantilism can be seen in terms of the misallocation of surplus to
which the policy leads, thereby reducing the accumulation of capital.

In his treatment of physiocracy, which he describes as "'this liberal and
generous system," and which "with all its imperfections, is, perhaps, the nearest approximation to the truth that has yet been published upon the subject of political economy..." Smith's main criticism centers on the physiocratic mistake about the role of manufactures in the accumulation process: "The capital error of this system, however, seems to lie in its representing the class of artificers, manufacturers and merchants, as altogether barren and unproductive." So, in his eyes, the cardinal sin of the physiocrats is to favor agriculture in a way which leads to the misallocation of surplus, thus defeating their own ends:

These systems, therefore, which preferring agriculture to all other employments, in order to promote it, impose restraints upon manufactures and foreign trade, act contrary to the very end which they propose, and indirectly discourage that very species of industry which they mean to promote.

It is the same with his discussion of the physiocratic policy proposal of a single tax on land—his whole concern is that the progress of agriculture and the accumulation of capital not be hindered. And, indeed, this is true of his discussion of taxation in general. Thus, taxes on ground-rents are approved of, since they do not interfere with production and output: "The annual produce of the land and labour of the society, the real wealth and revenue of the great body of the people, might be the same after such a tax as before," And this point of view shows especially clearly throughout his discussion of "Taxes upon Profit or upon the Revenue arising from Stock." Finally, when he comes to discuss taxes on wages, we find that these are ordinarily shifted to the consumer, since wages are supposed to be at the then appropriate subsistence level:

The demand for labour, according as it happens to be either increasing, stationary, or declining; or to require an increasing, stationary, or declining population, regulates the subsistence of the labourer, and determines in what degree it shall be, either liberal, moderate, or scanty... while the demand for labour and the price of provisions, therefore, remain the same, a direct tax upon the wages of labour can have no other effect than to raise them somewhat higher than the tax.

With splendid consistency, he concludes:

If direct taxes upon the wages of labour have not always occasioned a proportionable rise in their wages, it is because they have generally occasioned a considerable fall in the demand for labour. The declension of industry, the decrease of employment for the poor, the diminution of the annual produce of the land and labour of the country, have generally been the effects of such taxes.

* Recall that this does not mean bare physical survival.
How to increase, not diminish, the annual produce—that is always the question for Smith. Thus, it is again with a tax upon the necessities of life: he believes this operates “exactly in the same manner as a direct tax upon the wages of labour.” And it is the fact that they cannot be shifted which enables Smith to distinguish taxes on luxuries, even the luxuries of the poor.

As the book draws to a close, Smith reiterates the unique consequences of the use of surplus for capital accumulation: a complete departure from the characteristic earlier practice of using it to feed retainers. He recalls that “Land and Capital Stock are the two original sources of all revenue both private and publick,” and goes on to remind us that land is largely a produced capital good. Thus, the allocation of surplus to capital accumulation lies at the heart of Smith’s whole account of the emergence of capitalism out of the previous phase of history. Deep concern with human progress illuminates all of Smith’s writings, from beginning to end, and as has been recently remarked, “It is known for example that he lectured on the ‘progress of society’ while in Edinburgh between 1748 and 1751...” Dugald Stewart reported that Smith:

followed the plan that seems to be suggested by Montesquieu; endeavouring to trace the gradual progress of jurisprudence, both public and private, from the rudest to the most refined ages, and to point out the effect of those arts which contribute to subsistence, and to the accumulation of property, in producing correspondent improvements or alterations in law and government.

It is perhaps unnecessary to add, for anyone acquainted with the breadth and humanity of Smith’s mind, that for all his correct insistence on the crucial importance of the accumulation of capital in the period in which he lived, he never fell into the vulgar error of imagining that economic growth was costless in human terms. As has recently been well said:

Smith believed that, to a large extent, nature speaks to history in the language of economics, and that the broad course of history so instructed is probably toward an easier, more cultivated, more rational and secure life for the generality of mankind. At the same time, he imagined that the advance of civilization was synchronous with the generation of a tremendous industrial mob, deprived of nearly every admirable human quality. Civilization is not an unqualified good, or more accurately, it comes at a price.

The Uniform Rate of Profit

As we have now seen, the Wealth of Nations masterfully develops and brings to a climax Smith’s earliest theme: the allocation of surplus to capital ac-
cumulation. With respect to the dual of physical surplus—namely, profit—however, the *Wealth of Nations* breaks quite new ground, both for Smith, and for the history of economic analysis. In the report of the *Lectures on Jurisprudence*, published by Cannan, LJ(B), and in the “Early Draft” of the *Wealth of Nations*, the term profit does occur. But it was possible for Ronald Meek to observe of these manuscripts:

The amount of ‘profit’ received is variously visualized as being dependent upon the degree of risk involved, the amount of good luck experienced, the strength of the monopoly position enjoyed, or the quantity and quality of labour performed—nowhere is it clearly visualized as varying according to the amount of stock employed.¹¹²

Thus, the view of profit in Cannan’s version of the *Lectures* and in the “Early Draft” does not differ substantially from that of Turgot in the *Reflections*. Turgot’s capitalists were “industrious,” and, while they were described as receiving “profits,” these profits were not clearly distinguished from the wages of management, or from the interest on the finance they provided. Smith, as we know, had finished his lecturing in Glasgow long before Turgot’s *Reflections* appeared in print, and had reached the view of profits which we have seen reported in LJ(A). Clearly, when they met, Smith had already gone further than Turgot on the issue of profits, before going to France. Indeed, it is possible that Smith’s early thoughts on profits influenced Turgot’s position as presented in the *Reflections*. Our interest, however, is in Smith’s fully mature theory of profits, which is set out in detail for the first time in the first edition of the *Wealth of Nations*.

In Smith’s mature theory, it is not the least the point that capitalists should be “industrious.” What is at issue is that the capitalists use their stock in setting to work industrious people. In return, Smith’s capitalists “receive, over and above the return of their paid-out costs and interest on their capital at the normal rate, a net income, profit, which is, as it were, exuded by the capital-labour relationship, and which bears a regular proportion not to the effort, if any, which they expend, but, to the value of the capital they have invested.”¹¹³

For Smith, profit is the reflection in prices of the physical surplus which can be generated in each sector. Given that capitalists are free to invest their stock where they please, Smith expects profit to be extracted at a normal or usual rate throughout the economy, in proportion to the amount of stock invested. To show this duality between surplus and profit a little notation is very helpful, but a warning must be issued first. We cannot give any adequate formalization of Smith’s rich picture of capital accumulation. To mention
only the most obvious point, accumulation is being accelerated, in the *Wealth of Nations*, by continual extensions of the division of labour. As the scale of output increases in a sector, certainly a sector devoted to manufacturing, returns are increasing more than proportionately. This feature of Smith cannot be captured by our simple models which assume *constant* returns to scale in production.

We can, however, adapt the corn and iron model first introduced in chapter 2 so that it will exhibit the *single feature* of Smith’s theory with which we are at the moment concerned: the duality between surplus in the quantity relations and a uniform rate of profit in the price relations. Let us then consider an alternative way of closing the model introduced in chapter 2, in a somewhat Smithian spirit. We do this through a specification of how the surplus is used in accumulating larger stocks of corn and iron in each sector of the economy. This particular allocation of surplus can be represented by introducing, in each sector, a *rate of growth*: a percentage, written $g_C$ in the corn sector and $g_I$ in the iron sector, by which the allocations of corn and iron increase through time. On the assumption that this growth in the means of production absorbs the entire surplus, we write:* 

\begin{align*}
  a_{CC} Y_C(1 + g_C) + a_{CT} Y_I(1 + g_I) & = Y_C \quad (1) \\
  a_{IC} Y_C(1 + g_C) + a_{II} Y_I(1 + g_I) & = Y_I \quad (2)
\end{align*}

Of course, Smith was aware that there was luxury consumption which, as we have seen, was the point of his famous distinction between productive and unproductive labor. His disapproval of unproductive labor shows that he wished to see the economy approximate as closely as possible to a condition of maximum growth. Assuming, however, that luxury goods absorb some of the output of both sectors in their production (but not for present purposes specifying these production processes in detail) we may write down the case where there is some growth but also some consumption of surplus in each sector as follows:

\begin{align*}
  a_{CC} Y_C(1 + g_C) + a_{CT} Y_I(1 + g_I) & = (1 - \lambda_C) Y_C \quad (3) \\
  a_{IC} Y_C(1 + g_C) + a_{II} Y_I(1 + g_I) & = (1 - \lambda_I) Y_I \quad (4)
\end{align*}

Luxury consumption of corn and iron is measured, respectively, by $\lambda_C Y_C$ and $\lambda_I Y_I$. The values of $g_C$ and $g_I$ in these equations will, of course, be less than in equations (1) and (2).

*In long run equilibrium a state of unbalanced growth such that $g_C \neq g_I$ is inconsistent with a linear (constant returns to scale) technology. In our more complete discussion in chapter 11 we therefore assume balanced growth.
THE UNIFORM RATE OF PROFIT

In the Wealth of Nations, Smith is quite explicit in stating that industrial profits are a reflection of surplus and arise, not from any labor of management, but out of a social relation between propertyless labor and the capitalist class:

As soon as stock has accumulated in the hands of particular persons, some of them will naturally employ it in setting to work industrious people, whom they will supply with materials and subsistence, in order to make a profit by the sale of their work, or by what their labour adds to the value of the materials.114

Indeed, Smith is perfectly clear about what he means by profit:

The Profits of stock, it may perhaps be thought, are only a different name for the wages of a particular sort of labour, the labour of inspection and direction. They are, however, altogether different, are regulated by quite different principles, and bear no proportion to the quantity, the hardship, or the ingenuity of this supposed labour of inspection and direction. They are regulated altogether by the value of the stock employed, and are greater or smaller in proportion to the extent of this stock.115

Thus, not only did Smith recognize the generation of surplus throughout industry, but he clearly saw its relation to a uniform rate of profit on stock. As has been remarked by Samuel Hollander, a characteristic element of Smith’s work “is his extension of physiocratic doctrine to allow for the generation of surplus value in all sectors.”116 Seeing physical surplus as possible only in the agricultural sector, the physiocrats had naturally conceived of a disposable “revenue” only in the form of rent. For Smith all sectors were capable of yielding a physical surplus and all sectors must offer the capitalist, if he is to commit his stock to them, a uniform rate of profit on that stock.

We can represent this fundamental feature of Smith’s theory in our little model as follows. Writing $P_c$ and $P_l$ for the price of a unit of corn and the price of a unit of iron, respectively, then, if the rate of profit were zero—if corn and iron were sold at cost—the price equations would be:

\[ P_c a_{cc} + P_l a_{lc} = P_c \]  
(5)
\[ P_c a_{ci} + P_l a_{li} = P_l \]  
(6)

It is shown in chapter 12 that for these equations to hold, surplus would have to be zero. Thus, it follows that if surplus exists, prices must exceed cost, giving rise to profit. Equations (5) and (6) must therefore be written as inequalities:

\[ P_c a_{cc} + P_l a_{lc} < P_c \]  
(7)
\[ P_c a_{ci} + P_l a_{li} < P_l \]  
(8)
The price relations for a simple classical model with surplus become equations again when we introduce a rate of profit, \( r \). Formally, \( r \) measures the ratio of profit to the value of capital stock in each sector—which was exactly Smith’s concept. In per-unit terms, the value of capital stock is the value of the commodities used up in producing a unit of output (in sustaining the productive laborers and providing them with the materials and equipment they need to produce a unit of output). This value is measured by the sums on the left-hand sides of inequalities (7) and (8). Profit per unit of output is the excess of price over capital value (per unit of output). The price relations of the model are thus written:

\[
(P_C a_{CC} + P_I a_{IC})(1 + r) = P_C
\]

\[
(P_C a_{CI} + P_I a_{II})(1 + r) = P_I
\]

so that:

\[
r = \frac{P_C - P_C a_{CC} - P_I a_{IC}}{P_C a_{CC} + P_I a_{IC}} = \frac{P_I - P_C a_{CI} - P_I a_{II}}{P_C a_{CI} + P_I a_{II}}
\]

which is the ratio of profit to capital in each sector.

When we turn to Smith’s many discussions of profit in the Wealth of Nations, we see again and again the clarity and force with which he held the theory we have just formalized in our simple model. Thus, speaking of the natural and market price of commodities, he tells us that if anyone sells a commodity:

at a price which does not allow him the ordinary rate of profit in his neighbourhood, he is evidently a loser by the trade; since by employing his stock in some other way he might have made that profit.\(^{117}\)

That a price will normally include, in addition to cost, profit at some normal rate,\(^*\) is made quite explicit:

Though the price, therefore, which leaves him this profit, is not always the lowest at which a dealer may sometimes sell his goods, it is the lowest at which he is likely to sell them for any considerable time; at least where there is perfect liberty, or where he may change his trade as often as he pleases.\(^{118}\)

In chapter X of Book I, speaking of wages and profits in the different employments of labor and stock, he tells us that:

\(^*\) Smith made it quite clear in the Wealth of Nations that profit would tend to be equalized among trades in the long run. He had no theory, however, of the determination of what this rate would be. Providing a theory of how the rate of profit is determined was to be one of Ricardo’s great contributions. See chapter 4.
THE UNIFORM RATE OF PROFIT

The whole of the advantages and disadvantages of the different employments of labour and stock must, in the same neighbourhood, be either perfectly equal or continually tending to equality. If in the same neighbourhood, there was any employment evidently either more or less advantageous than the rest so many people would crowd into it in the one case, and so many would desert it in the other, that its advantages would soon return to the level of other employments.119

Smith shows a clear understanding of the circumstances which can make profits diverge, in the short run, from the uniform rate. These divergences have no bearing, he in effect argues, in a model of long-run equilibrium:

The establishment of any new manufacture, of any new branch of commerce, or of any new practise in agriculture, is always a speculation, from which the projector promises himself extraordinary profits. These profits sometimes are very great, and sometimes, more frequently, perhaps, they are quite otherwise; but in general they bear no regular proportion to those of other trades in the neighbourhood. If the project succeeds they are commonly at first very high. When the trade or practise becomes thoroughly established and well known, the competition reduces them to the level of other trades.120

Thus, the short-run gains due to uncertainty have nothing to do with what Smith means by the rate of profit, which is a phenomenon of long-run equilibrium. Aside from these short-run phenomena, profits may differ even in the long run owing to differences in the "agreeableness or disagreeableness of the business..."121 However, Smith remarks, "In point of agreeableness or disagreeableness, there is little or no difference in the far greater part of the different employments of stock."122 So, profits differ little on this account, and, furthermore:

The apparent differences, besides, in the profits of different trades, is generally a deception arising from our not always distinguishing what ought to be considered as wages, from what ought to be considered as profit.123

Thus, specially skilled management, or entrepreneurship is appropriately seen as getting a wage, which is not a part of the rate of profit.

Smith is perfectly aware that government policies can cause profits to diverge from the normal rate. He is always at pains to point out that the uniform rate of profit will be approximated only in so far as an economy approaches to his concept of the system of natural liberty.124

The role of the uniform rate of profit in Smith's analysis of the allocation of surplus output is perhaps most clearly shown in his attack on bounties:

Bounties, it is allowed, ought to be given to those branches of trade only which cannot be carried on without them. But every branch of trade in which the merchant can sell his goods for a price which replaces to him, with the ordinary profits of stock, the whole capital employed in preparing and sending them to market, can be carried on
without a bounty. . . . Those trades only require bounties in which the merchant is obliged to sell his goods for a price which does not replace to him his capital, together with the ordinary profit; or in which he is obliged to sell them for less than it really costs him to send them to market. The bounty is given in order to make up this loss, and to encourage him to continue, or perhaps begin, a trade of which the expense is supposed to be greater than the returns, of which every operation eats up a part of the capital employed in it, and which is of such a nature, that if all other trades resembled it, there would soon be no capital left in the country.123

These trenchant phrases are echoed in a letter of January 3, 1780, published for the first time in The Glasgow Edition of the Correspondence. Smith advocates measures for increasing the public revenue without laying new burdens on the people: “The first is a repeal of all bounties upon exportation . . . our merchants ought not to complain if we refuse to tax ourselves any longer in order to support a few feeble and languishing branches of their commerce.”126 Thus, in equilibrium, where inputs and outputs have the composition that maximizes the desired growth of output, each sector earns the ordinary profits of stock (without the need for bounties). The duality between surplus and profit could hardly be more clearly expressed.

The Last Years

About two years after the publication of the Wealth of Nations, Smith was offered the preferment of being a commissioner of his Majesty’s Customs in Scotland. This brought ease and affluence, but it probably hindered his finishing his projected tasks. He moved to Edinburgh in 1778, to take up office, and there remained for the rest of his life with his mother, and his beloved cousin, Jane Douglas, who now took charge. Then, in 1784, his mother died, and Jane Douglas followed her to the grave in 1788. Stewart, who knew whereof he wrote, tells us that:

They had been the objects of his affection for more than sixty years; and in their society he had enjoyed, from his infancy, all that he ever knew of the endearments of a family. He was now alone, and helpless. . . . 127

Smith now declined rapidly. He had been in poor health, though still eager for the society of his remaining friends, as we see from a letter of February 8, 1788, published for the first time in the Correspondence:

Though nothing can be more tempting than the company you propose I should dine with to-morrow; yet the state of my health, the coldness of the weather, and my fear of bringing back some of my old complaints; by venturing to dine at so great a distance,
oblige me to beg you would excuse me. It is a great mortification to me; but necessity must be submitted to.\textsuperscript{128}

Smith died on July 17, 1790. A few days before his death, he gave orders that all his manuscripts, except the few posthumously published as essays, be destroyed.

The quantity and price relations of the classical system, as we would say today, were now set forth. Profit appeared as the dual of surplus, and long-run equilibrium would require that it be earned at a uniform rate throughout industry. The fundamental importance of agricultural surplus to all economic development had been given due credit, while the errors of physiocracy in attributing the creation of surplus wholly to agriculture had been removed.

Smith had replaced the archaic classes of the physiocrats—peasant and self-employed artisan (who owned his tools and his working capital)—by the significant classes of modern capitalism: propertyless wage earners and capitalists who owned and controlled the means of production. Smith, however, had provided no theory as to what determined the level of the profits which were earned at a uniform rate throughout industry. This was to be the great task of Ricardo.

\textbf{Notes}


For the present quotation, see Vol. I, p. 6.


10. Stewart, "‘Account of the Life of Smith,’” p. xiii.
25. Smith, *Lectures on Jurisprudence*, p. 498. In references to LJ(B), we shall first cite the page numbers of The Glasgow Edition, Vol. V, and then, in parentheses, the page numbers of Cannan, ed., *Lectures on Justice and Arms*, which in this case is (181).
36. Smith, Lectures on Jurisprudence, p. 34; editors’ italics. This is a reference to
LJ(A).
37. Ibid., p. 343; our italics.
38. Ibid., p. 357.
39. Ibid., p. 363.
40. Scott, Adam Smith, p. 317.
42. Smith, “Early Draft,” p. 562. In references to the “early Draft” we shall give
first the page reference to The Glasgow Edition, Vol. V, and then the page of
Scott, Adam Smith, in parentheses which in this case is (322).
43. Ibid., p. 563 (326–7).
44. Ibid., p. 564 (328).
45. Ibid., p. 566 (331).
46. Scott, Adam Smith, p. 173.
48. Ibid., p. lii.
51. Rae, Life of Smith, p. 192.
52. Smith, Letter 194, Correspondence, pp. 233–4.
54. Smith, Letter 82, Correspondence, pp. 101–2.
56. Samuel Hollander, The Economics of Adam Smith, University of Toronto Press,
57. Robbins, An Essay on the Nature and Significance of Economic Science, Mac-
20.
58. Hollander, The Economics of Smith, p. 20, n. 53.
Thought, cited by Hollander, The Economics of Smith, p. 20, n. 64.
61. Ibid.
62. R. D. Collison Black, “Smith’s Contribution in Historical Perspective,” in
Thomas Wilson and Andrew S. Skinner, eds., The Market and the State, Essays
63. Ibid.
64. Hollander, The Economics of Smith, p. 155; Hollander’s italics.
66. W. A. Eltis, “Adam Smith’s Theory of Economic Growth,” in Andrew S.
Skinner and Thomas Wilson, eds., Essays on Adam Smith, Oxford at the Claren-
68. Ibid., I vii.27 (73). See the whole passage, I vii.15–I vii.31 (68–74).
69. Ibid., I vii.28 (74).
71. *Ibid.*, l.xi.6.2 (146). See also l.xi.6.34–l.xi.6.41 (159–60).
72. *Ibid.*, l.xi.e.7 (163).
77. *Ibid.*, II.i.8–II.i.28 (263–7).
78. Hollander, *The Economics of Smith*, p. 95, n. 1; Hollander’s italics. See, further, the literature cited there.
82. Smith, *Wealth of Nations*, II.ii.1–II.ii.7 (270–1).
84. *Ibid.*, II.iii.3 (315). The whole of chapter iii is relevant.
89. *Ibid.*, IV.i.30 (413).
100. *Ibid.*, V.ii.e.10 (795–6).
NOTES

120. *Ibid.*, I.x.b.43 (115).
122. *Ibid*.
123. *Ibid*.
126. Smith, Letter 203, *Correspondence*, p. 245.