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A Little Adam Smith is a Dangerous Thing

The 2001 Paxton Paper. The father of modern economics. Widely quoted, but often with the wrong attribution.

by Jonathan B. Wight, Ph.D.



About the Author

Jonathan Wight is an Associate Professor of Economics in the Robins School of Business at the University of Richmond, where he has been since 1982. He received his undergraduate degree from Duke University in 1976 and spent the year after graduation in voluntary service with the Jesuit Volunteer Corps of Portland, Oregon. His doctorate in Economics was received at Vanderbilt University as a Danforth Scholar.

Jonathan has authored numerous articles on health economics in developing countries and is the coauthor of a book on the mind-body connection in medical economics. He has recently completed a joyful novel of intrigue on the moral foundations of capitalism, entitled, *Saving Adam Smith: A Journey Toward Wealth, Virtue, and Business Transformation*. It is due out by Prentice-Hall in Fall 2001.

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“[T]here is scarcely any economic truth now known of which he [Adam Smith] did not get some glimpse.”

--Alfred Marshall
(great 19th century economist)¹

Introduction

Who is Adam Smith? He is a long-dead economist—the most illustrious free-market advocate of all time. Adam Smith is to capitalism as Karl Marx is to communism. Despite his renown, a prominent economics journal published an article in 1971 with the title, “After Samuelson, who *needs* Adam Smith?”²

The question was rhetorical: Nobel

Prize winner Paul Samuelson represented the new guard of 20th century economists, and Adam Smith, the early founder of economics, represented its classical school of the 18th and 19th centuries. Samuelson and other modern economists desired to transform economics into a “hard” science—a new physics—and at its advanced levels, the new economics utilized deep theorizing with the precise language of higher mathematics. One can imagine all the young Albert Einstein’s scribbling with their chalk on blackboards, deducing with perfect logic the inner workings of an economic system, just as one might the inner workings of an

atom.
In order to model any system, however, one has to simplify. In the case of an economic system, one has to simplify human behavior and its motivation. Whether the assumptions used are realistic or not was never a salient issue for modern economists, because another Nobel laureate, Milton Friedman, assured them that the truthfulness of a model’s assumptions was irrelevant so long as the model did its job of prediction. In any event, one of the key assumptions used in modern economic models was that human nature could be summarized by a set of characteristics

known as *Homo economicus*. If he walked our streets, *Homo economicus* would be a relentlessly rational, unfeeling, calculating automaton, a greedy materialist maximizer—in short—he would be that egotistical, selfish bore few of us find agreeable company.

The intellectual foundations for *Homo economicus* go back at least to Mandeville, but it is Adam Smith who is usually quoted: “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love...³”.

In another famous passage Smith elaborates that an entrepreneur:

“...neither intends to promote the publick interest, nor knows how much he is promoting it . . . 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.” (WN p. 456, emphasis added)

Adam Smith was trying to counter medieval church theology, which held that any self-interested behavior was sinful and detrimental. Smith countered that self-interest could yield valuable outcomes for society as people pursued specialization and market trade. Much later these quotes would be used to justify the greedy and grasping personae of *homo economicus*, illustrating how a little Adam Smith can prove to be a dangerous thing. For example, Max Lerner in 1937 would say that Adam Smith “sanctified predatory impulses” and “gave a new dignity to greed.”⁴ By the 1980s the movie *Wall Street* has the financial tycoon Gordon Gekko reciting the mantra, “[G]reed is good . . . Greed works. Greed clarifies, cuts through and captures the essence of the evolutionary spirit. . . It’s all about bucks. The rest is conversation.”

Will the Real Adam Smith Please Stand Up?

Table 1 contains quotations on human nature useful for contrasting with *homo economicus*. While these quotes are a bit obscure, most of you can probably guess who wrote the following: “[S]elf-deceit, this fatal weakness of mankind, is the source of half the disorders of human life.” Was this not Sigmund Freud, waxing on the irrationality of the human psyche? What about this lovely quote on the fallacy of

materialism? “For to what purpose is all the toil and bustle of this world?... Do they imagine that their stomach is better, or their sleep sounder in a palace than in a cottage?” Surely Jesus said this, although it is given here in an obscure translation. And could anyone doubt that the following warning was issued by Pope John Paul? “This disposition to admire, and almost to worship, the rich and the powerful . . . [is] the great and most universal cause of the corruption of our [morals].”

In truth, all these quotes have the same author—Adam Smith.⁵ The simplistic vision of Smith that survives in older textbooks—the reduction to *homo economicus*—is a caricature. Although I cannot do justice to all of these topics, I will argue here that: assumptions do matter; that Smith’s vision of a more complex human nature produces important insights for understanding behavior; and that continuing to use a simplistic view of Smith is, indeed, a dangerous thing.

First, Do Assumptions Matter?

My objection to *homo economicus* is not that it does not accurately identify selfish aspects of human character. My objection is that it dogmatically elevates these motives to a high altar, to the point where many economists cynically scoff at the very notion of altruism or collective responsibility. This dogma blinds economists from seeing other motives that do, in fact, play a part of economic life. For example, the prediction that rational agents always shirk and free board is far from empirical reality, as is readily apparent in observing the tips left by anonymous travelers at highway restaurants. *Homo economicus* would never tip, unless he expected to return to that same restaurant in the near future.

More important, economic models can change the very behavior the model seeks to describe. In a fascinating series of experiments at Cornell, researchers showed that studying *homo economicus* in microeconomics classes actually altered students’ natural tendencies regarding honesty and cooperation in public dealings, leading the authors to question, “Do Economists Make Bad Citizens?”⁶ It appears that human behavior is malleable, and if you repeatedly hold up a model to students that insists that they are greedy and individualistically selfish, they will act to fulfill these expectations. The outcome is

not independent of the assumptions, which would not surprise Adam Smith.

Biographical Details

Smith was born (1723) in a small fishing village north of Edinburgh, Scotland during that tumultuous period known as The Enlightenment. Enlightenment thinkers struggled to reconcile the conflicting views of the Church with the facts and methods of a dawning Scientific Revolution. Smith did his undergraduate work at the University of Glasgow, by some accounts then the finest university in Europe. There he came under the tutelage of Francis Hutchinson, a great Scottish Enlightenment figure. Smith pursued graduate studies at Oxford for six disappointing years. His orthodox tutors caught him reading Hume’s, *Treatise of Human Nature*, and Smith was reprimanded and the book seized. Meanwhile, England was thrown into civil war during the Jacobite uprising (1745), an attempt to put the Scottish “Pretender” James III, on the throne of England and restore the Papacy. Scots became reviled, and Smith no doubt experienced prejudice at Oxford. During this time he suffered a nervous breakdown, and subsequently rejected the church calling.

With doctorate in hand, Smith returned to his hometown of Kirkcaldy, Scotland, where for two years he lived with his widowed mother and was gainfully unemployed; in modern parlance, this would be called a “postdoc.” Smith spent his time reading books and taking long walks by the sea, presumably pondering what to do with his life. Eventually, he moved to Edinburgh and began giving public lectures for a fee. He developed an enthusiastic following, and when a faculty position came open at the University of Glasgow in 1751, Smith was selected over his close friend David Hume. Smith’s senior in age and prominence, Hume was openly atheistic and was blackballed by the church. Smith, a Deist, had been more guarded in his ideas regarding church matters.

Smith stayed at Glasgow fifteen years teaching Moral Philosophy, a subject encompassing religion, ethics, law, and political economy. During this period he published what he considered his most significant book, *The Theory of Moral Sentiments* (1759), which quickly won him fame in Enlightenment circles. In 1764 Smith resigned his university chair to accept a

post as tutor to the stepson of Lord Townshend, a prominent political figure. For the next two years Smith toured Europe, meeting with the great thinkers of his day: Voltaire, Quesnay (founder of the Physiocrats), Rousseau, and others. In 1766 he returned to Britain with a lifetime pension of £300 per annum, a large sum considering Smith's modest habits and bachelor lifestyle.

The pension allowed Smith to return to his mother's side in Kirkcaldy, and for the next eight years he worked on his second book, *The Wealth of Nations*. Issued in 1776, its timing with the American Revolution was no coincidence: Smith hoped, through this treatise on free trade, to sway Parliament to abandon its mercantile policies in North America and thereby avoid bloodshed. Despite Smith's active lobbying, he failed in this endeavor. Smith spent the remainder of his life as Commissioner of Customs in Edinburgh, and his spare time in expanding and editing *The Theory of Moral Sentiments*. He died July 17, 1790.

The Theory of Moral Sentiments

What is significant about Smith's *Moral Sentiments*? In this book Smith outlines the broad psychological foundations for motivation and action, from which he develops a theory of moral conscience. Smith's model starts with the recognition that while we are strongly motivated by the desire to secure our own survival and success, humans are also inherently *social* animals. In contrast to the rugged individualism depicted by *homo economicus*, Smith observed that humans "can subsist only in society," and are "fitted by nature to that situation." No man is an island, but "All the members of a human society stand in need of each other's assistance...." Justice is the pillar upholding the edifice of this society.

As social animals we seek the positive praise and approval of others. But it is not praise alone that we desire: it is praise for which we are truly worthy. According to Smith, humans are innately attuned, using our vivid imaginations, to feel the joys and pains of others and to have our sentiments reciprocated. This interplay of natural empathy with the desire for approbation, provides the preconditions for the development of morality. This arises through an interior dialogue in which we try to see our own actions as others may see

them. We acquire perspective. We listen to an internal judge—an impartial "spectator"—who adjudicates our conduct. In short, we acquire moral conscience.

Enlightenment thinkers like Smith thus pointed society toward the idea that progress here on earth, rather than in an afterlife, was both possible and desirable. While we are not born with a moral conscience, we are born with the innate tools for creating one and with a reason for doing so. This does not guarantee that everyone will succeed. Developing a moral conscience requires diligent practice, heightening our sensitivity to the rights and needs of others. It is a socialization skill that most elementary school teachers and parents would readily applaud. Put simply: education requires attention to the cultivation of moral virtues.

To Adam Smith, not all virtues are equal. Smith distinguishes between some "narrow" prudence-virtuous actions directed to securing one's own fortune and health—and some "superior" prudence-virtuous actions directed toward "nobler purposes" than oneself. By joining the "the best head" to "the best heart," superior prudence constituted the "perfection" of human nature. (TMS 216)

The World of Commerce

It is within this philosophical and psychological context that we must seek to understand Smith's second and more famous treatise, *The Wealth of Nations*. There is little question both books provide a unified philosophical position. In *Moral Sentiments* Smith analyzed the wide range of motives that lead to action, and promoted a progressive standard of virtue in moral life; in *Wealth of Nations* he examined one motive in detail, that of self-interest, and its role through narrow prudence in fomenting progress in economic life. Smith never endorsed "greed" as a dominant motive or as something vital to making the economic system work. This view that "greed is good" actually comes from Mandeville's famous poem, *The Fable of the Bees* (1714), which Smith roundly denounced as "fallacy" (TMS, pp. 312-313). Smith's "invisible hand" works not only because of the power of competition, but also because our selfish natures are held in check by internal, moral restraints. It is this restraint that allows the economic system to flourish with minimum government intervention.

Pursuing one's "self-interest" meant something quite different to Smith than greed. Self-interest means prudently considering your own security when making decisions; self-interest becomes twisted into selfishness when one maintains an egoistic attachment to one's own needs even when they conflict with the legitimate rights of others. While people can and do hold "passive" feelings of selfishness, action arises after a thought process in which one examines one's choices from the vantage of the "impartial" spectator. Our "active" principles of justice often win out over our "passive" feelings of selfishness.

Recently some economists, philosophers, and biologists have argued that all of our behaviors, even those whom we consider to be altruistic, is really just disguised selfishness. This is to some degree an old argument, and Smith addressed it, buying none of it. For one thing, Smith says our sympathies are often felt so innately that no calculating rational actor could have arrived at them as instantaneously as they are felt. Smith states unequivocally, "Sympathy, however, cannot, in any sense, be regarded as a selfish principle." (TMS p. 317)

Let me clarify another misconception. In *The Wealth of Nations* Smith wrote about the innate urge people have to truck and barter and to better themselves in a material way. Nevertheless, Smith had no illusions that material wealth would provide happiness. Smith calls this belief a "deception," saying, "It is this deception which rouses and keeps in continual motion the industry of mankind." (TMS p. 183) Pride, vanity, and power, rather than utility, are cited by Smith as reasons for acquisition. In contrast to the deception of materialism, Smith says that following one's moral conscience is the road to happiness.

Smith's Relevance Today

Moral Sentiments provides a framework for understanding why we should care about moral and civic virtues, and why these virtues may be highly desirable in business settings (and not something about which economics instructors should be cynical). For one thing, cooperation pays: repeated studies have shown that people who are individualistically and selfishly rational actually earn *less* in game theory experiments than those who behave cooperatively. A so-called practical

businessperson who uses rationality and logic to squeeze every penny out of a transaction regardless of what is fair, is hardly likely to engender the qualities of loyalty, esteem, and consideration that will give him a thriving business in a competitive marketplace. Smith says, "To be anxious, or to be laying a plot either to gain or to save a single shilling, would degrade the most vulgar tradesman in the opinion of all his neighbors." (TMS p. 173)

In the world of small business known to Smith, moral values are recognized to have an impact on productivity. Smith writes that businessmen prefer to keep their business local because, "He can know better the character and situation of the persons whom he trusts..." (WN p. 454) Trust arises from shared moral values, and in a business setting enhances efficiency by lowering transaction costs. Anyone who doubts this has only to examine the "cowboy capitalism" of present-day Russia to see a free market bereft of a moral (or legal) compass and floundering badly. So too, the economic "miracle" in Southeast Asian became unhitched in the late 1990s when "crony" capitalism threatened the integrity of asset market values. The marketplace of Adam Smith, by contrast, existed not in some imaginary land of autonomous, amoral individuals, but within an interdependent social fabric in which virtue was extolled and a moral conscience constrained individual actions.

Conclusion

Let us return to the question which began this paper: "Who needs Adam Smith?" By the evidence of who is reading him today, the answer must be "quite a few of us." The surge of academic writing on Smith over the past twenty-five years is astonishing: Annual citations to Adam Smith *quadrupled* over the period 1971-1997, in fields as diverse as economics, sociology, psychology, philosophy, and law. What could possibly explain this surge of interest in a long-dead economist? If the march of scientific advancement were efficient, all new theory would already embody any knowledge from the past worth keeping. Why bother reading Smith's dusty tomes from the 18th century?

There are several scintillating possibilities but I will consider here only two: first, political and economic events create cycles of ideologies being "in" and "out" of favor. The fall of communism and

the shrinking of governments no doubt explains much of Smith's current appeal. Recall, however, that Adam Smith was never a doctrinaire advocate of *laissez-faire*; in this we find, once again, that some authorities for their own purposes use a caricature of Smith that is just plain wrong.

A second explanation for Smith's resurgence is that he posed challenging moral problems that once again are of vital interest. Indeed, Smith's genius lay in exploring the interplay of overlapping worlds—the commercial, the social, the political, and the moral—areas experiencing phenomenal growth in interdisciplinary study over the past three decades. The founder of modern economics appears to lead us today in exploring connections with sister disciplines in social sciences and humanities. One researcher has even boldly predicted that in the not too distant future, *homo economicus* will actually evolve into *homo sapiens*!⁸ All of which means that Adam Smith's holistic views—rather than the caricatures—could play a critical role in reshaping our notions of self responsibility and moral conduct in the 21st century.

Notes

¹. Cited in R.D. Collison Black, "Smith's Contribution in Historical Perspective," in Mark Perlman and Mark Blaug, eds., *Economic Theory and Policy in Context: The Selected Essays of R. D. Collison Black*, Economists of the Twentieth Century Series (Aldershot, UK: Edward Elgar, 1995

1976)):p.76.

² Kenneth E. Boulding, "After Samuelson, Who Needs Adam Smith?" *History of Political Economy* 3(2) (Fall 1971): 225-37.

³ Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations* (abbreviated WN). R.H. Campbell and A. S. Skinner, eds., Glasgow Edition (reprinted by Liberty Press, Indianapolis, IN., 1981 [1776]): I.ii.2, pp. 26-27.

⁴ Max Lerner, Introduction to *The Wealth of Nations*, Edwin Canaan, ed. (New York: Modern Library Edition, 1937): p. ix.

⁵ Sources for the quotes in Table 1 are: 1. TMS, II.ii.3.1, p. 85; 2. TMS III.4.6, p. 158; 3. TMS, I.i.4.5, p. 21. 4. TMS, I.iii.2.1, p. 50; TMS, I.iii.3.1, p. 61; 6. TMS VI.i.14, p. 216.

⁶ Robert H. Frank, "Do Economists Make Bad Citizens?" *Journal of Economic Perspectives*, 10, Winter 1996, 187-192; and Robert H. Frank, Thomas D. Gilovich, and Dennis T. Regan, "Does Studying Economics Inhibit Cooperation?" *Journal of Economic Perspectives*, Spring 1993, 7, 159-171.

⁷ Adam Smith, *The Theory of Moral Sentiments* (abbreviated TMS). D.D. Raphael and A.L. Macfie, eds. Glasgow Edition (reprinted by Liberty Press, Indianapolis, IN., 1982 [1759]): II.ii.3.1, p. 85

⁸ Richard H Thaler, "From Homo Economicus to Homo Sapiens." *Journal of Economic Perspectives*, Vol 14, No. 1 (Winter 2000): 133-141.