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Jonathan B. Wight

University of Richmond, jwight@richmond.edu

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Adam Smith and Poverty



JONATHAN B. WIGHT
University of Richmond

Jonathan B. Wight teaches at the University of Richmond. He is the author of the economics novel, Saving Adam Smith: A Tale of Wealth, Transformation, and Virtue, and co-author of Teaching the Ethical Foundations of Economics (NCEE, 2007), a set of lessons for high school teachers.

INTRODUCTION

Can we end poverty in America? Does economic theory offer a solution? Humility would be a good starting place, because systemic problems like generational poverty rarely stem from single causes. Putting the broken pieces together is difficult when some edges are sharp, some are shattered, and others missing. This essay draws on insights from Adam Smith in order to examine the problem of poverty. It focuses on a case study involving Serena Robins (the real names have been altered).

Serena Robins is a 36-year-old single mother. She is raising her 9-year-old daughter, Amber, in a dangerous neighborhood of Richmond, Virginia. Amber's father dealt drugs; he has been absent since before Amber's birth. Serena works as a nurse's aid, earning \$9.50/hour. That's more than minimum wage, but

Serena's bi-weekly paycheck disappears quickly as she makes payments on a car loan, credit card bills, and a mortgage she took out to finance the small Habitat-for-Humanity home she helped build.

By world standards, Serena has it made: she has a job, a house, and modern electronic amenities like television sets. She even has an exercise treadmill. Yet she's in a high risk category—one illness or job displacement away from bankruptcy. She has built up no savings and she owes \$12,000 in credit card debt (on which she pays 18 percent interest). This sounds bad, but many of Serena's friends aren't so lucky. They have no collateral, and in desperation they often turn to "payday" lenders who charge interest rates of 300 percent or more, annually. At that rate, someone who takes out a \$100 loan to make it through the month can wind up paying \$400 to the lender before the loan is paid off.

One "easy" approach to alleviating poverty is through *economic education*: teaching at-risk people about compound interest, for example, and the importance of not buying on credit. Instruction of this sort would seek to restore an old notion of "virtue ethics"—if you don't have the cash, don't buy the TV set or game box. Adam Smith noted that a healthy *self-interest* is good for the economy, but so is a healthy *self-command*: learning to say "no" to one's impulses. Smith asks (1982, p. 186): "How many people ruin themselves by laying out money on trinkets of frivolous utility?" In Serena's case, the exercise treadmill lies unassembled in her living room, six months after she purchased it. A computer she bought is still in its plastic wrap.

Poverty in America, as illustrated by Serena's case, is not so much a matter of absolute deprivation of basic necessities. It is more a matter of *relative deprivation*.

Smith, the Enlightenment philosopher who founded modern economics, was sympathetic to the plight of the poor, and argued that poverty must be understood within a cultural setting:

By necessities I understand not only the commodities which are indispensably necessary for the support of life, but whatever the custom of the country renders it indecent for creditable people, even of the lowest order, to be without (1981, pp. 869-870).

In Smith's time, a linen shirt and leather shoes were necessities because "The poorest creditable person of either sex would be ashamed to appear in public without them" (Ibid.). Today, extravagant sneakers costing a small fortune may be the equivalent of Smith's linen shirt. While we might question the merit of purchasing such items, it is not irrational for individuals to seek social acceptance by living according to "the custom of the country."

Through education and policy measures, we should encourage people to break out of poverty through hard work and frugal living. By themselves, however, exhortations rarely work: *role models* are needed as well. In America there are many examples of people who make it from the bottom into the middle- and upper-income brackets. Unfortunately, these role models often break out of the inner city, too, and move to the suburbs. Self-selection means that a disproportionate number of bad role models remain.

Even good role models have a hard time convincing young people to focus on a ten- or twenty-year life plan. Why do young people not give more thought to the future? According to behavioral economics, it is because they often adopt *hyperbolic discounting*: they prefer smaller immediate gratifications

to larger future rewards. This preference affects the life choices young people make: staying in school or dropping out, using drugs or staying clean, avoiding or risking early pregnancy. Teenagers may view sexual intercourse and child bearing, for example, as marks of adulthood—part of a necessary rite of passage. The disastrous effects of early parenthood on education, and on future earnings, may not be consciously calculated by those who take this view.

In such a context, changing lifestyle is important, but enhancing human capital is even more critical. *Human capital* refers to mental functioning, experiences, language ability (written and oral), social networks, reputation, physical health, mental health, motivation, personality, and other factors. Adam Smith thought that education was a key factor explaining human capital and thus economic status: "The difference between ... a philosopher and a common street porter, for example, seems to arise not so much from nature, as from habit, custom, and education..." (1981, 28-29).

Serena is a caring mother, eager to support her daughter's education. Yet she suffers from a number of physical and psychological ailments; she is often too tired after a 12-hour shift to interact much with Amber, or to meet with Amber's teachers, or to attend meetings of the PTA. There are no bedtime books for Amber because Serena herself is a rudimentary reader. She does not know how to help Amber with math or science homework. So, although she tries hard and believes strongly in her daughter's education, Serena relies heavily on the school system to deliver educational results.

The public school Amber attends is overcrowded, and her teachers spend too many hours addressing problems of discipline and absenteeism. There is

a rudimentary PTA, but it languishes without support from engaged parents. Amber is an eager learner. She tries to please and she doesn't complain; but she has quiet needs that go unaddressed—a condition she accepts stoically. Low expectations can be self fulfilling.

Among adults and children in Amber's world, business communication skills are particularly weak. Many inner-city residents speak a dialect that inverts noun and verb agreements and uses a rich slang vocabulary. This provides for fertile interpersonal dialogue and expression. Amber is a sponge, picking up the speaking rhythms and grammar of her mother and peers. Studies of brain physiology show that language develops quite early, and language actually forms the brain.

Adam Smith believed that language arises primarily from the social need to persuade. This implies that persuasive idioms may persist even when they fail to optimize the speaker's economic value. If a colloquial dialect is the only language a child masters, this creates a lifelong limitation on career opportunities. There are exceptions, of course, exemplified by rappers, artists, and sports heroes; language subcultures can also thrive in big cities where there are sufficient customers, suppliers, and workers to achieve economies of scale.

But most children will not grow up to be rappers or sports stars. So what chance does Amber have to shine at English, math, and the other subjects she will need to graduate from high school and continue her education? The statistics are grim: while high school graduation rates nationally are about 82 percent, 14 of the 50 largest urban school districts have on-time graduation rates lower than 50 percent. In Detroit, fewer than 1 in 4 students graduate on time (Toppo, 2006). In reaction to this dismal record, many

economists endorse *school choice*. Adam Smith emphasized the *accountability* of the marketplace: competition forces participants in market activity to not "neglect their business" (1982, 785). The same would be true for teachers and administrators, presumably, if schools were subject to market forces. While there are risks associated with school choice—namely, that public schools might end up serving only the severely needy—it is possible that experimentation with market forces and accountability could breathe life into the educational experience. Technical training and trade apprenticeships might also be preferable alternatives for some students.

Smith promoted the practical and moral obligation of government to finance—but not necessarily to produce—educational services for the young. A meritocratic society requires an even playing field, which today implies more than simply classroom education. Neuroscience has shown that fetal brain developments provide the building blocks of intellectual and emotional capacities. Equal opportunity begins in the womb.

Adam Smith put forward a standard formula for economic success: the rule of law, property rights, competitive markets, and limited government (which would include investments in human capital). In a setting shaped by these institutions, one can step back and let the invisible hand work. Yet even in a great country where these institutions are established, pockets of relative poverty stubbornly remain.

The factors limiting human development in Richmond (and other cities) have not appeared through immaculate conception. Policies supported, historically, by most Americans have created and perpetuated many of these difficulties.

The policies include those that shaped the long period of slavery and the Jim Crow segregation laws; those that permitted the bulldozing of thriving black business districts to clear the way for construction of interstate highways; the assassination of key leaders; those banning city buses from going to suburban malls (where the jobs are); and myriad other actions that leave many poor residents with the impression that the political economy is rigged against them. Indeed, welfare programs of the 1960s likely exacerbated the cycle of poverty that they sought to end. The folly of unintended consequences is an important theme in Smith's work.

Our quick review of generational poverty suggests layers of complexity, not easily addressed by theory or policy. One solution is to boost human capital (especially through economics education) in poor communities, but succeeding at this is devilishly complex. Hope, self-confidence, and self-respect are scarce resources for many poor people—not intrinsically, but as a consequence of history, culture, institutions, and failed policies. Adam Smith suggests that compassion—and accountability—are needed on both sides of this debate.

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