



# George Stigler's Adam Smith: Successes and Failures

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Elsewhere in this volume David Levy and Sandra Peart have discussed Stigler as a reader of Adam Smith. I propose in this chapter to examine Stigler as an interpreter and user of Adam Smith. In a letter dated August 17, 2001, David Raphael wrote to Andrew Skinner:

The first suggestion of a Glasgow edition of the works came from Laurie Hunter in October 1961, when he was a graduate student at Chicago. He wrote to Macfie saying that Professor Stigler thought there should be a collected works edition to celebrate the bicentenary in 1976, and that he (Stigler) would not want to intrude if Glasgow were to do it. (Raphael 2001: 1; see also 2007: 3)

Ronald Meek was the “prime mover” at Glasgow. In a memorandum dated, October 31, 1961, he set out two arguments in favor of a collected works:

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(a) because others [one such “other” would have been the University of Chicago] would do it if we didn’t, and (b) because there was scope for going beyond Cannan in considering Smith’s thought in the light of modern interest in economic growth and development. ... Following upon Meek’s memorandum, a committee was set up (with Meek in the key position of secretary) and a meeting was held on 30 November 1961. (Raphael 2001: 2)

Thus was born the committee to oversee the project, with Ronald Meek in the lead. (He was later replaced by Andrew Skinner.) I relate this anecdote here for two reasons. First, we may observe the ecumenical appeal of Adam Smith. As economists, Stigler and Meek would be strange bedfellows. Stigler was a founding member of the modern Chicago School and Meek was a self-proclaimed Marxist. Yet as scholars they had great professional respect, and shared a deep and abiding appreciation of Smith’s work. Second, it brings to light Stigler’s role in bringing about the *Glasgow Edition of the Works and Correspondence of Adam Smith*, the single most important publishing event for the advancement of Smith scholarship.

As an interpreter of Adam Smith, Stigler published two major articles, “Adam Smith’s Travels on the Ship of State” (1971), and “The Successes and Failures of Professor Smith” (1976). He also edited a reissue of Cannan’s edition of the *Wealth of Nations* (WN) (Smith 1976b), and he produced an abridged version of the book.<sup>1</sup> As what I would call a user, Smith was part of Stigler’s “extended present” (Boulding 1971). As such we find frequent references to Smith throughout Stigler’s writings. These are more than just passing references or textbook sound bites. Stigler is interacting with Smith as if he (Smith) was a contemporary colleague.

Before turning to these we might first briefly note Stigler’s general approach to the history of economic thought. Beginning with his doctoral dissertation, published as, *Production and Distribution Theories* (Stigler [1941] 2013), written under the mentoring of Frank Knight, he produced major historical studies during his career. As a historical scholar one should not be surprised that Knight’s approach to historical texts instilled in him a highly critical approach. Knight opened his famous two-part article on Ricardian economics with the following observation:

On the assumption that the primary interest in the “ancients” in such a field as economics is to learn from their mistakes, the principal theme of this discussion will be the contrast between the “classical” system and “correct” views. (Knight 1935: 3)

In fact, Stigler and Knight pioneered this sort of critical history, which Mark Blaug has called the “absolutist” approach to the history of thought (Blaug 1996: 1–2). Modern theory, Knight’s “‘correct’ views,” are the standard of judgment. It is the standard Stigler employs. Indeed, his dissertation was a seminal work in the advent of absolutist history.

I should also mention that Stigler developed a criterion for scientific exegesis to help determine which interpretation of an author’s words is the correct one when the historian is faced with contradictory passages. He concluded:

The test of an interpretation is its consistency with the main analytical conclusions of the system of thought under consideration. If the main conclusions of a man’s thought do not survive under one interpretation, and do under another, the latter interpretation must be preferred. (Stigler 1965a: 448)

This is of course consistent with absolutist history of thought. Both privilege scientific analysis as the basis of judgment on the grounds that correct and incorrect views can be successfully distinguished. However, I will not be using it in what follows as establishing consistency in the face of contradictory statements by the same author does not arise in his interpretations of Smith.

## “Adam Smith’s Travels on the Ship of State”

The article begins by announcing Stigler’s essential interpretive stance vis-à-vis Smith: “The *Wealth of Nations* is a stupendous palace erected upon the granite of self-interest” (Stigler 1971: 265). Having stated the maximizing principle, which modern economists trace back to Smith’s “palace,” Stigler detects a significant paradox in Smith’s thought: “If

self-interest dominates the majority of men in all commercial undertakings, why not also in all their political undertakings?” (Stigler 1971: 265). In other words, why would a legislator obstruct the system of commercial self-improvement?

Yet Smith did acknowledge the self-interest of particular economic groups in obtaining favorable legislation, and Stigler assembles an impressive table of 26 specific instances (Stigler 1971: 267). There follows another list where the supposed beneficiaries obtained a policy, but they were mistaken, the policy actually hurt them. Stigler states two propositions:

- A. Sometimes (often) economic legislation is passed at the request of economic groups who hope to benefit by the legislation.
- B. On occasion a group is mistaken in the consequences of the legislation and receives no benefit or even positive harm from its legislative program (Stigler 1971: 268).

But, these are immediately dismissed as either platitude, once corrected for Smith’s errors, or as insignificant. Stigler would replace Smith’s “sometimes” with “all,” and

- C. All legislation with important economic effects is the calculated achievement of interested economic classes (Stigler 1971: 268).

Appropriate or not, Smith implicitly rejected the use of self-interest as a general explanation of legislation (Stigler 1971: 268). What evidence is presented in the article, having just stated 26 seemingly counterexamples? “The most important evidence is that for most legislation no group is identified which could have fostered the law and would benefit from it. The most important area of neglect is the discussion of taxation” (Stigler 1971: 269). The second piece of evidence relates to laws requiring that wages be paid in money, not in kind. Stigler claims that Smith is posing a nonexistent legislative puzzle. I find this point baffling. First, I do not detect a puzzling attitude in Smith’s text (which I will examine again below). Second, Stigler, of all people, should know that payment in the medium of exchange puts a utility maximizer on a

higher indifference curve than payment in kind. Thirdly, as I will argue at length, the issue, for Smith, was a matter of justice, and Stigler seems to be blind (dismissive) of any justice claims or ethical underpinnings to the self-interest model.

Stigler's third, and last, piece of evidence is the role Smith grants to pure emotion in politics. Here it is the ignorance and stupidity of the landlords that proves the point.

Stigler goes on to suggest that Smith paid too little attention to the political process itself, as opposed to the legislation it produced. Stigler quotes approvingly Smith's handling of the motives of the American revolutionaries, and how this might be taken advantage of to motivate Smith's proposed peaceful solution of union with Great Britain. However,

In general, ... Smith's attitude toward political behavior was not dissimilar to that of a parent toward a child: the child was often mistaken and sometimes perverse, but normally it would improve in conduct if properly instructed. (Stigler 1971: 272)

I shall not discuss Stigler's objections to Smith's analysis of taxation. Rather Stigler discusses Smith's treatment of the Oxford professors as evidence for his naïve treatment of the agents of the public sector. Smith's unhappy 6 years at Oxford taught him that

In every profession, the exertion of the greater part of those who exercise it is always in proportion to the necessity they are under of making that exertion. (WN V.i.f.4, p. 759)

Consequently, "In the University of Oxford, the greater part of the public professors have, for these many years, given up altogether even the pretence of teaching" (WN V.i.f.8, p. 761). Simply, their salaries were not tied in any way to their performance. For Stigler, this demonstrates his point. If Smith was so astute about human nature as to not even let professors off the self-interest hook, why should he not apply the same logic to legislators?

In fact, he does apply it to law enforcement. Amid a lengthy, Smithian story of unintended consequences Smith observes that, “Public services are never better performed than when their reward comes only in consequence of their being performed, and is proportioned to the diligence employed in performing them” (WN, 241). The story is how an independent judiciary emerged in England, which is a prerequisite for that impartiality which is itself a prerequisite for judges to rule justly. Since Smith is here talking about the public services, it may be that Stigler has overlooked the fact that Smith does apply the model of self-interest to the agents of the government, if not to the political process and lawmakers themselves.

The article ends with a discussion of market failures that we find in Smith. Stigler is not impressed with Smith’s catalogue of failures of self-interest, which he categorizes as being rooted in ignorance, agency problems, and public goods provision. Stigler’s major contributions have centered on his theory of search and information acquisition, and his analyses of the economics of regulatory action and its efficacy in achieving its stated goals. In this light his dismissal of all market failure claims is understandable.

## “The Successes and Failures of Professor Smith”

This essay was published in the bicentennial year, 1976. It is Stigler’s mature assessment of Smith’s great book. His criterion of judgment is historical: were Smith’s theories taken up and used by subsequent practitioners of the science or were they discarded as wrong-headed? “In any event, it is the judgment of the science that is decisive in judging a scholar’s achievements” (Stigler 1976: 1200). To this Stigler attaches his own judgment and further subdivides successes and failures into “proper” and “improper.” We might note here in using science as the criterion of judgment, Stigler is not using the principle of scientific exegesis of texts. He is not trying to reconcile real or apparent cases of inconsistency. Here, while still approaching an historical text as a scientific treatise, he is engaged in assessing the text’s scientific value. As such,

the judges are the economists, including Stigler, who either accepted, rejected, and/or built upon Smith's analytical system.

Smith had one overwhelmingly important triumph: he put into the center of economics the systematic analysis of the behavior of individuals pursuing their self-interest under conditions of competition. This theory was the crown jewel of *The Wealth of Nations*, and it became, and remains to this day, the foundation of the theory of the allocation of resources. The proposition that resources seek their most profitable uses, so that in equilibrium the rates of return to a resource in various uses will be equal, is still the most important substantive proposition in all of economics. ...

I do not know whether to list as a second triumph one enormously successful application of this theory of competitive prices, namely, Smith's theory of the differentials in wage rates and profit rates among occupations. ...

The third and final major success of Smith was his attack on mercantilism. (Stigler 1976: 1201)

But,

There is a fourth considerable success to be credited to Smith: the formulation of the wages-fund theory. ... there is no doubt that it dominated the next 100 years of English economics. (Stigler 1976: 1203)

Thus, the allocative, optimizing properties of the competitive economy, the sources of equalizing wage differentials to explain wage inequality, and free trade have all become "permanent parts of economics" (Stigler 1976: 1204). I concur that these are indeed proper successes.

Stigler proposes one main category for an improper success, an influential doctrine which should have been discarded. This is the idea that Smith got from the Physiocrats: the distinction between productive and unproductive labor. It is "improper" because it is an "error or infertile ... subject or method of analysis" (Stigler 1976: 1204). Certainly, Smith has been widely and frequently criticized for this. As is well known he

advances two definitions: a value definition (productive labor adds value to materials) and a physical definition (productive labor leaves behind some tangible good) (WN II.iii. 1, p. 330). Consequently, Smith and the classical economists, including Marx, have been criticized for ignoring the role of services.

First, Stigler recognizes the kernel of truth in Smith's text. "The purpose of the distinction is clear: if we identify productive labor by the characteristic that its product can be accumulated, then capital formation can take place only out of the product of productive labor" (Stigler 1976: 1204). His critique, then, ignores the definitional problems, but, second, he points out two other issues.

The difficulties with the distinction are two. Even if Smith is correct, the extensive employment of productive labor merely *permits* the accumulation of capital, and the actual formation of new capital requires a wholly independent act of saving. ...

There is a second difficulty: there are investment acts which are not the result of productive labor. Investments in what we now call human capital do not become incorporated in a tangible, saleable commodity as commonly understood. (Stigler 1976: 1204)

We see, then, that human capital, which Smith did recognize as part of the capital of a nation, presents a particular problem. Producers of education should be productive laborers. However, since they produce only services they run afoul of the physical definition of productive labor. In fact, Smith lists teachers explicitly as useful, but unproductive workers. Again I tend to concur with Stigler's judgment here.

"A proper failure contains analytical error" (Stigler 1976: 1205). Here the award goes to Smith's hierarchy of capital investment. Based on the criterion of employing productive labor, Smith argued that from most productive to least productive was agriculture, manufacturing, transport, and retail.

That Smith was in error is unequivocal. He allowed a system of financing to conceal the facts of economic life. If the consumer, instead of paying



the retailer for the corn, had paid the farmer for raising it, the millwright for grinding it, the ship's captain for transporting it, and the retailer for stocking it, then everyone's capital would have gone exclusively to the direct support of production. But nothing essential would have changed. (Stigler 1976: 1206)

Closely related to the hierarchy is the hierarchy of social usefulness of different forms of trade: domestic, foreign, and carrying. There is no doubt that history has passed a negative judgment on Smith's hierarchies. The famous invisible hand comes into play to help private owners of capital choose the socially correct place in the second hierarchy by preferring to invest in domestic trade over foreign or carrying trades. History threw out the theory behind the invisible hand, but not the principle of beneficial unintended consequences.

While the historical verdict may be true, Samuel Hollander in his book on Smith's economics has attempted at least a partial vindication of Smith (Hollander 1973; see also Young 2001). Briefly, Hollander argues that Smith's true position can be discerned by looking at his applications of the principle. Here we find the hierarchy of investments, which in the natural progress of opulence govern the process of economic development, couched in terms of the principles of resource allocation based on factor price equalization, operating in the context of changing relative scarcity. The dynamic model of development is built on the model of static resource allocation and is fully consistent with it. The natural advantage of agriculture, for example, depends on the relative abundance of land compared to labor, thus generating a relatively high profit rate in agriculture (pp. 280ff.). The free play of self-interest is sufficient to direct the first investments of capital into agriculture, and it is only when land becomes scarcer relative to labor that the first investments in manufacturing will come forth. This process generates Smith's "natural balance of industry" which plays a leading role in his critique of mercantilism (WN IV.vii. c. 43, p. 604). Hollander concludes:

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, and it is in the course of Smith's treatment of the historical sequence of investment priorities according to the principle of profit-rate equalization, that a fundamental equilibrating mechanism is utilized, namely resource allocation governed by the differential pattern of factor endowments between economies. (Hollander 1973: 307)

Moving along, Stigler, then raises Smith's labor commanded theory of real price. Smith proposed an hour of labor as the proper unit to correct money prices in the face of long-run inflation and/or deflation. In my view Stigler, again, shows sound judgment not to get involved in Marxian metaphysics about value and labor as the sole "creator" of value. "A very different error, and possibly not an error at all, is Smith's measure of value—which came from the same source as that which may have led him to overvalue agriculture" (Stigler 1976: 1206). Modern price indexes fix a bundle of commodities which yield equal utility as the unit of value, while Smith proposed "the disutility of 1 hour of ordinary labor" (Stigler 1976: 1207). Stigler lists at least three reasons why economists might legitimately object to Smith's standard, and much work has also gone into measuring and correcting sources of error in the modern approach as well. The economics of price indices is beyond the scope of this entry, but I will point out that Smith's labor standard has been fruitfully applied in some modern research. William Nordhaus's celebrated work on the price of light, for example, develops a Smithian index of labor commanded (Nordhaus 1996). His research suggests that the labor measure may perform better than conventional index numbers, especially when measuring price over extremely long periods of time. The upshot is that I concur with Stigler's judgment on labor commanded. It may not have been an error even though history has largely selected against it.

Stigler's final candidate for a proper failure is Smith's monetary theory. I will simply defer to Stigler's conclusion that Hume's theory was better, because it was more "general" and had more "predictive power" (Stigler 1976: 1208).

The last section of the paper takes up the one remaining category of improper failures. Here he asks the question, "Where has the scientific judgment of future economists been wrong about Smith?" Malthus, for example, is charged with taking up the subsistence wage theory, which

Stigler claims Smith rejected. Smith did, in fact, argue that British wages were above subsistence. Moreover, in the progressive state real wages would rise continually, depending on the rate of accumulation of capital. Malthus, then, is charged with perpetrating the error by implicitly assuming that the accumulation parameter in the wage equation was zero (Stigler 1976: 1208).

We might note, that a considerable body of recent scholarship absolves Malthus of this charge, but Stigler's point with regard to Smith is well-taken.<sup>2</sup>

The theory of rent, Stigler suggests, is another failure that should have been a success. It did eventually find its niche in contemporary economics once neoclassical economists came to understand that rent was a surplus in the aggregate, but an opportunity cost in each specific land use:

He consistently treated the rent of land as it should be treated: any one use of land had to pay a rent, which was a cost of production, to draw the land away from other uses; whereas for all uses combined, rent was a residual. (Stigler 1976: 1209)

Lastly, Stigler regrets that no theory emerged to explain the division of labor, but more on this below. Stigler's conclusion is that

Smith was successful where he deserved to be successful—above all in providing a theorem of almost unlimited power on the behavior of man. His construct of the self-interest-seeking individual in a competitive environment is Newtonian in its universality. That we are today busily extending this construct into areas of economic and social behavior to which Smith himself gave only unsystematic study is tribute to both the grandeur and the durability of his achievement. (Stigler 1976: 1212)

Having surveyed Stigler's main contributions as an interpreter of Smith, I offer a brief discussion of his uses of Adam Smith. Having just noted Stigler's dissatisfaction with the way Smith failed to develop a theory of the division of labor, Stigler offered a theory of Smith's famous theorem that the division of labor is limited by the extent of the market. Smith's

theorem suggests a positive feedback loop which generates increasing returns to scale. The theoretical problem, of course, is that increasing returns to scale is not compatible with the competitive organization of industry. This vexed Marshall who developed the concept of external economies. Stigler's contribution toward a solution of the problem was to propose a theory of vertical integration.

But, with the expansion of the industry, the magnitude of the function subject to increasing returns may become sufficient to permit a firm to specialize in performing it. The firms will then abandon the process ( $Y_i$ ), and a new firm will take it over. (Stigler 1951: 188)

Increasing returns lead to the development of specialist firms, which can operate at different points along the supply chain. Thus,

Smith's theorem suggests that vertical disintegration is the typical development in growing industries, vertical integration in declining industries. The significance of the theorem can therefore be tested by an appeal to the facts on vertical integration. (Stigler 1951: 189)

Not surprisingly, Smith's theorem is also invoked in Stigler's celebrated *Price Theory* text (revised edition, 1966).

Then a famous theorem of Adam Smith comes to our rescue: the division of labor is limited by the extent of the market. Smith pointed out that small villages could not support highly specialized occupations, but that large cities could. (Stigler 1966: 168)

This reference is accompanied by the following footnote: "*Wealth of Nations* (New York: Modern Library ed., 1937: 17–21). I earnestly recommend that all of this book except p. 720 be read" (Stigler 1966: 168n). In fairness to Stigler, I could not avoid at least one reference to his famous sense of humor. So, of course, I looked up page 720 in the Modern Library edition, and this is what I found: "If the teacher happens to be a man of sense, it must be an unpleasant thing to him to be conscious, while he is lecturing his students, that he is either speaking

or reading nonsense, or what is very little better than nonsense [and so on]" (Smith 1937: 720).

Smith also gets significant space in the text on the topic of speculation, and there are numerous passing references throughout Stigler's work, which do not need comment. Stigler interacts with Smith as a scientific colleague, which in a nutshell captures Stigler's sympathetic, critical approach to Smith.

## Stigler's Adam Smith: Successes and Failures

As a consummate neoclassical economist Stigler's absolutist approach to Smith has significant merit. As a writer of a somewhat broader approach to historical texts, I nonetheless have a great deal of respect for well-done rational reconstructions, and the use of modern theory as a judge of older theory. There is an analytical core which can be rationally understood and criticized from the perspective of a search for the truth. There are analytical mistakes in the history of economics, and it is worthwhile to point them out even after they have been eradicated from the discipline. (Chances are they have found refuge somewhere else, and are in need of continual refutation.) Smith, after all, was trying to correct what he perceived as the incorrect analytical underpinnings of mercantile commercial policy. His assessment of the Physiocrats was also absolutist in nature: "The capital error of the system ... seems to lie in its representing the class of artificers, manufacturers, and merchants as altogether barren and unproductive" (WN IV.ix. 29, p. 674).

I have already rendered judgments concerning Stigler's catalogue of successes and failures with respect to Smith's analytical economics, and his failure to extend the model of self-interest to the analysis of the public sector. Certainly Smith's vision of the automatic functioning of the competitive economy, analysis of wage differentials, and the demolishing of mercantilist fallacies are success for Smith. Stigler's negative judgment on productive vs. unproductive labor is also well-taken, and I have offered a somewhat more sympathetic view of the hierarchy of capital investments. It was not until well into the twentieth century, with Stigler as once again a pioneer, that economists began to develop

a theory of the state and the economic functions it was taking upon itself. Thus Stigler's negative assessment of Smith's handling of the public sector would seem to have merit. Although, as I argued above Smith would counsel the legislature that the public servants who are employed by the state will behave according to whatever incentive structure the law constructs for them. I also appreciate Stigler's positive use of Smith's analyses in developing his own theory of the dynamics of the division of labor, and his incorporation of significant references to Smith in his *Price Theory*.

However, these successes also form the basis of what I think is the single most significant failure of Stigler as an interpreter of Smith: namely his almost complete neglect of any other aspect of Smith's thought in general and of the *Theory of Moral Sentiments* (TMS) in particular. Amartya Sen, for example, in referring to the same set of Stigler's papers has recently commented that

There is no room in the beliefs of this "as if Smith" for moral values of various kinds, from altruism to social commitment-values the reasonableness of which Smith discussed in considerable detail in *The Theory of Moral Sentiments*. (Sen 2016: 294–295)

Stigler's mentor, Frank Knight, argued repeatedly over a long period of time that economics as a set of analytical propositions was limited both in its ability to explain social phenomena and in its role as guide to policy making. Social questions required economics and ethics. Economics was a science of means, and we need to look to ethics via free and open discussion to discover a set of values to serve as worthwhile ends.

Indeed, Stigler once shared Knight's perspective in his 1943 critique of the "New Welfare Economics." Arguing that new welfare economics was consistent with paying thieves not to rob, Stigler noted that, "surely the primary requisite of a working social system is a consensus on ends" (Stigler 1943: 357). Sandra Peart and David Levy refer to this essay as part of a "Knightian moment" in recent history of economic thought (Levy and Peart 2017: 47ff.). Indeed, at the time Stigler went so far as to suggest that economics was a form of applied ethics (Stigler 1943: 358). As with the discipline, so with Stigler, this moment passed.

The absolutist approach to history similarly narrows the focus of historical inquiry to this analytical core and its evolution. It is potentially valid in its own sphere, but good history requires a broader approach. Like Knight, and briefly Stigler, Smith also was keenly aware of the ethical dimension, but unlike Knight he actually produced a significant treatise.

Stigler once remarked

If an economist is to be a moral philosopher, however-and I have no doubt that we would do this well too-he should develop his philosophy to a level where its implications for policy become a matter of logic rather than a vehicle for expressing personal tastes. (Stigler 1975: 44)

The Knightian period is now long gone, and the irony of this statement should be obvious. Smith, Stigler's longtime "good friend" (Stigler 1976: 1200) was a moral philosopher who became an economist, and he did economics better than any of his contemporaries. (Witness history's judgment of Sir James Steuart's book.) The neglect of TMS of course, is part and parcel of the modern Chicago School's ambiguous Knightian legacy (see Emmett 2009). While eager developers of Knight's price theory they systematically relegated ethics to the realm of personal tastes, which were simply assumed as given, and not open to rational discussion. Consequently, in his Tanner Lectures at Harvard University in 1980 Stigler noted that:

Economists have no special professional knowledge of that which is virtuous or just, and the question naturally arises as to how they are able to deliver confident and distinctive advice to a society that is already well supplied with that commodity. (Stigler 1980: 145)

Thus, it is not surprising that Stigler's attitude toward TMS is highly dismissive:

In fact, Smith's professional work on psychology (in the *Theory of Moral Sentiments*) bears scarcely any relationship to his economics, and this tradition of independence of economics from psychology has persisted despite continued efforts from Jennings [in 1855] to Herbert Simon and George Katona to destroy it. (Stigler 1965b: 28)

Stigler did acknowledge one connection between Smith's economics and TMS. In explaining why Smith might have rejected a bundle of consumption goods as his measure of real value, Stigler noted that

Smith's rejection of consumption in fixing on a measure of value is attributable to his belief that luxuries are frivolous and yield illusory pleasures that vanish in the act of realization. This view is extensively argued in his *Theory of Moral Sentiments* ... and receives adequate expression in the *Wealth of Nations*. That Smith should attribute to almost all economic actors an illusion that greater wealth yields greater satisfactions, an illusion that is perhaps never pierced, is one of his greatest idiosyncrasies. (Stigler 1976: 1207)

In what follows I shall take issue with two central points in Stigler's view of Smith, both rooted in Stigler's neglect of TMS. First, I would like to shed somewhat different light on Stigler's negative assessment of Smith's treatment of politics. While not specifically disagreeing with any of Stigler's specific points, I think Smith's whole treatment of the state and the political process needs to be set against some illuminating remarks found in TMS. Second, I wish to take issue with the foundational principle of Stigler's interpretation: that self-interest is the bedrock upon which the WN is erected.

Consider, first Smith's view of the state and the political agents that make its laws. In Part IV of TMS, Smith develops an original and complex view of the role of utility in the way humans make moral judgments:

But this fitness, this happy contrivance of any production of art, should often be more valued, than the very end for which it was intended; and that the exact adjustment of the means for attaining any conveniency, or pleasure, in the attainment of which their whole merit would seem to consist, has not, so far as I know, been yet taken notice of by any body. (TMS IV. 1. 3)

Smith claims that utility as means (as opposed to ends) and their fitness for accomplishing their intended ends is frequently more valued than the ends themselves. Having applied the principle to the desire for material wealth, Smith notes that



The same principle, the same love of system, the same regard to the beauty of order, of art and contrivance, frequently serves to recommend those institutions which tend to promote the public welfare. (TMS IV.1.11)

Specifically, he has in mind constitutions of government, which, “are valued only in proportion as they tend to promote the happiness of those who live under them” (TMS IV.1.11). Thus, the purpose of the government is to promote the general welfare, but Smith goes on

From a certain spirit of system ... from a certain love of art and contrivance, we sometimes seem to value the means more than the end, and to be eager to promote the happiness of our fellow-creatures, rather from a view to perfect and improve a certain beautiful and orderly system, than from any immediate sense or feeling of what they either suffer or enjoy. (TMS IV.1.11)

In the same manner, if you would implant public virtue in the breast of him who seems heedless of the interest of the country, it will often be to no purpose to tell him, what superior advantages the subjects of a well-governed state enjoy; that they are better lodged, that they are better clothed, that they are better fed. (TMS IV.1.11)

In this case we value the beauty of the system of policy more than we do the material comforts of the majority of the people. Going on Smith notes that

You will be more likely to persuade, if you describe the great system of public policy which procures these advantages, if you explain the connexions and dependencies of its several parts, their mutual subordination to one another, and their general subserviency to the happiness of society .... (TMS IV.1.11)

Upon this account political disquisitions, if just, and reasonable, and practicable, are of all the works of speculation the most useful. (TMS IV.1.11)

This, I take it, is a self-description of Smith's own *Inquiry into the Nature and Causes of the Wealth of Nations*. Now we have already seen

Stigler's sneering attitude toward the idea of using moral suasion in achieving policy reform, where he would prefer that moral advice could be made a matter of logic instead of personal taste. Yet surely Smith and Stigler share a similar view of current policy: that it is the result of special interests being able to capture the political process. Merely explaining that is not going to solve the problem. What appeal could there be other than to rise above the faction and self-interest in politics to appeal to something greater? This would be Smith's public virtue. I would suggest that the systematic, analytical structure of WN is Smith's conscious application of his original insight about the beauty of means. Smith has erected a "stupendous palace" in order to arouse public spirit. Indeed, the automaticity and the efficiency of the system of natural liberty, which virtually all of Smith's readers have admired, is an appeal to this same principle in the way humans make value judgments.

Does this absolve Smith of his failure to apply the self-interest principle to the state? Perhaps not, but it does suggest that such a theory might not have served the purpose of arousing public spirit. I might also point out before moving on that Smith intended to write a treatise on law and government, but never finished it:

I shall in another discourse endeavour to give an account of the general principles of law and government, and of the different revolutions they have undergone in the different ages and periods of society, not only in what concerns justice, but in what concerns police, revenue, and arms, and whatever else is the object of law. (TMS VII.iv.37)

This comment was allowed to stand when Smith revised TMS in the last year of his life. The 1790 edition was prefaced with this: "In the *Enquiry concerning [sic] the Nature and Causes of the Wealth of Nations*, I have partly executed this promise; at least so far as concerns police, revenue, and arms" (TMS Advertisement.2). Whatever would have been in the law and government treatise has been lost save for the two sets of student notes published as the *Lectures on Jurisprudence* (Smith 1978, hereinafter (LJ)). However, I doubt that Smith's treatise would have satisfied Stigler's objections.

Having argued that the "stupendous palace" was a conscious rhetorical strategy that Smith believed would be the most effective way

of arousing public spirit to bring about the reforms necessary to establish the system of natural liberty, I turn to the “bedrock” of the palace. Consider the following two quotations:

But *man has almost constant occasion for the help of his brethren*, and it is in vain for him to expect it from their benevolence only. He will be more likely to prevail if he can interest their self-love in his favour, and show them that it is for their own advantage to do for him what he requires of them. ... It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from a regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages. (WN I.ii.2; emphasis added)

It is thus that man, who can subsist only in society, was fitted by nature to that situation for which he was made. *All members of human society stand in need of each other's assistance*, and are likewise exposed to mutual injuries. Where the necessary assistance is reciprocally afforded from love, from gratitude, from friendship, and esteem, the society flourishes and is happy. ... But though the necessary assistance should not be afforded from such generous and disinterested motives, though among the different members of the society there should be mutual love and affection, the society, though less happy and agreeable, will not necessarily be dissolved. Society may subsist among different men, as among different merchants, from a sense of its utility, without any mutual love or affection; and though no man in it should owe any obligation, or be bound in gratitude to any other, it may still be upheld by a mercenary exchange of good offices according to an agreed valuation. ... Society may subsist ... without beneficence; but the prevalence of injustice must utterly destroy it. (TMS II.ii.3.1–3; emphasis added)

The first quote is, of course, the locus classicus, of the self-interest bedrock of WN. The second, from TMS, is Smith's statement of justice as the necessary virtue for society to exist. In the first Smith is contrasting benevolence (the will to do good) with self-interest as motives to action. In the second, he is contrasting the virtues of justice and beneficence (the act of doing good). The point being that justice and self-interest

seem to occupy the same position in the two passages. If self-interest is the bedrock, then justice is a substratum. If the division of labor is limited by the extent of the market, then the market is limited by the extent of justice; no justice, no market. Smith the moral philosopher turned economist does have special knowledge about what is just.

I have explored Smith's theory of justice and its relevance for WN in other works, so I will offer a very condensed treatment here (Young 1997, 2008, 2018). First, we may note that Smith's discussions of justice are set within the natural jurisprudence tradition, associated with Grotius, Pufendorf, and Hutcheson, extending back to the medieval Scholastics and to Aristotle (Hont and Ignatieff 1983; Young and Gordon 1992; Young 2008). As Smith was aware, the word "justice" had several meanings in the writings of his predecessors, and accordingly, he was always careful to distinguish distributive from commutative justice (see Haakonssen 1981: 99). Hence, when he comes to define justice in *The Theory of Moral Sentiments*, he first notes that the word "justice" has different connotations in the languages with which he is acquainted. "In one sense we are said to do justice to our neighbour when we abstain from doing him any positive harm, and do not directly hurt him, either in his person, or in his estate, or in his reputation" (TMS, VII.ii.1.10). This is commutative justice, and it is the sense in which Smith normally uses the word. The laws of justice deal exclusively with commutative justice.

Continuing, Smith notes another meaning of justice which coincides with certain earlier writers' concepts of distributive justice, and it "consists in proper beneficence, in the becoming use of what is our own, and in the applying it to the purposes, either of charity or generosity, to which it is most suitable...that it should be applied" (TMS, VII.ii.1.11).

These passages suggest that Smith has relegated distributive justice to the category of a personal moral virtue, namely, the duty of charity. Such a classification is in accord with the Protestant natural law tradition (Hont and Ignatieff 1983). Indeed, Smith followed this tradition closely in the *Lectures on Jurisprudence*, the student notes of Smith's moral philosophy course, which have survived and been published, where the distinction between commutative and distributive justice is explained in terms of perfect and imperfect rights:

The common way in which we understand the word right, is the same as what we have called a perfect right, and is that which relates to commutative justice. Imperfect rights, again, refer to distributive justice. The former are the rights which we are to consider, the latter not belonging properly to jurisprudence, but rather to a system of morals as they do not fall under the jurisdiction of the laws. (LJ (A) i.15)

These passages give rise to a common interpretation, which is being increasingly challenged, that Smith held to a narrow definition of justice as commutative justice, and what we now call “economic justice” or “social justice” or sometimes “justice” Smith called distributive justice, which was the virtue of beneficence. I cannot go into this debate here except to note that I am on record supporting a revisionist view that distributive equity may rightly be seen as part of Smith’s conception of justice (Young and Witztum 2006; Young 2018).

I will simply note a few instances of justice in WN. First,

All systems of preference or of restraint, therefore, being thus completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and his capital into competition with those of any other man, or order of men. (WN IV.ix, 208)

According to the system of natural liberty, the sovereign has only three duties to attend to ... secondly ... the duty of establishing an exact administration of justice. (WN IV.ix, 208–209)

This is, of course, the well known and often quoted end of Book IV of WN. The point is that justice is a constraint on self-interest, and thus the motive of self-interest which is indeed so prominent in WN is circumscribed and underpinned by justice. But justice having codifiable laws and punishments also underpins a system of justice, which transforms the principles into law.

Another instance would be Smith’s defense of the high wage, progressive state:

No society can be flourishing and happy, of which the far greater part of the members are poor and miserable. It is but *equity* besides, that they who feed, clothe, and lodge the whole body of the people, should have such a share of the produce of their own labour as to be tolerably well fed, clothed, and lodged. (WN I.viii, 89; emphasis added)

To my knowledge Smith does not use the word “equity” anywhere in his account of justice in TMS. I have, however, found it in the *Lectures*, where I have concluded that equity would seem to constitute a fairness norm in Smith’s theory of justice. The upshot is that he could have just as easily said that “it is but *justice* besides that they who feed, clothe and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves tolerably well fed, clothed and lodged.”

I suggest that justice underpins Smith’s account of wages and wage inequality at the microeconomic level. The chapter in the *Wealth of Nations* on the wages of labor begins with a seemingly obvious point that, “The produce of labour constitutes the *natural recompence* or wages of labour” (WN I.viii.1; emphasis added). Before going on I wish to establish two points. Wages are not actually paid in produce, because the law requires them to be paid in money:

Whenever the legislature attempts to regulate the differences between masters and their workmen, its counsellors are always the masters. When the regulation, therefore, is in favour of the workmen, it is always *just and equitable*; but it is sometimes otherwise when in favour of the masters. Thus, the law which obliges the masters in several different trades to pay their workmen in money and not in goods is quite *just and equitable*. (WN I.x.c.61; emphasis added)

Hence, payment in money is just, and perhaps it is the moral element of Smith’s argument that explains why Stigler treated this passage so negatively, as discussed above.

Note that the real value of the wage is the natural recompense for labor. Now this is natural law language, which I have argued reflects the natural law roots of Smith’s value and distribution theory (Young

2008). The wage payment is rooted in a just claim on the revenue of the employers. Specifically, it is an instance of retributive justice. As Raphael has pointed out, Smith was one of the few to apply the principle of retributive justice to reward as well as to punishment (Raphael 2001: 118) Given that the liberal reward of labor is just and equitable, what does Smith say about the structure of wages at a point in time?

Smith attributes inequality in the labor market to two broad sources: the nature of the employments and the “policy of Europe.” In other words inequalities may be either natural or artificial. Those which arise from the nature of the employments we may consider just, while those resulting from policy are unjust, although there is one case where the results are nonetheless beneficial. There are five broad categories of natural inequalities in the labor market:

First the agreeableness or disagreeableness of the employments themselves; secondly, the easiness or cheapness, or the difficulty or expence of learning them; thirdly, the constancy or inconstancy of employment in them; fourthly, the small or great trust which must be reposed in those who exercise them; and fifthly [*sic*], the probability or improbability of success in them. (WN I.X.b.1)

It is not necessary to go into these five cases to understand the point: “The five circumstances above mentioned, though they occasion considerable inequalities in the wages of labour ... occasion none in the whole of the advantages and disadvantages, real or imaginary, of the different employments ...” (WN I.x.b.39). And the conditions necessary to achieve this equalization among other things there must be “the most perfect freedom” (WN I.x.b.40). The labor market functioning under conditions of perfect freedom (itself a principle of justice) will establish equality in the whole of the rewards minus costs. For example, the expense of acquiring an education creates a just basis for additional compensation—an instance of retributive justice in practice.

That this does present a picture of a just labor market is evident from Smith’s condemnation of certain practices, such as long apprenticeships, which the policy of Europe enforces.

The property which every man has in his own labour, as it is the original foundation of all other property, so it is the most sacred and inviolable. The patrimony of a poor man lies in the strength and dexterity of his hands; and to hinder him from employing this strength and dexterity in what manner he thinks proper without injury to his neighbour, is a plain violation of this most sacred property. It is a manifest encroachment upon the just liberty both of the workman, and of those who might be disposed to employ him. (WN I.x.ii, 136)

This hardly needs elaboration. Freedom exercised within the rules of justice is just liberty, which all should enjoy. A labor market in which freedom equalizes the whole advantages and disadvantages of all employments is a just labor market. Interferences are violations of natural justice. As matters of policy they are, of course, enjoined by the positive law, reforming which is the point. Thus, a just labor market will create equality at a point in time, not an equality of real wages but one of net advantages.

To recapitulate this rather long excursion into Smith scholarship, to view self-interest as the bedrock of the book is to take a superficial view of the book, its place in Smith's larger project, and the role of moral philosophy in economic analysis. Justice, I have argued, is the true bedrock. It not only makes markets possible, but it also constrains self-interest, and consequently makes it possible for the division of labor to function in commercial society. I cannot appeal to the self-interest of a person who stands ready to harm me. Stigler's superficial view of WN is symptomatic of the separation of economics, viewed as positive analysis, from moral philosophy, viewed minimally as providing a theory of justice. I might also point out that the theory of justice informs both the positive analysis and the normative ethical commitments of WN.

## Conclusion

Stigler was a consummate neoclassical economist, and where neoclassical theory is indeed superior to Smith's classical theory it is right and informative to point this out. Stigler nicely brings Smith



into the conversation when he is teaching material that contains Smith's original insights. As such Smith, the theorist is part of Stigler's "extended present." Stigler, as is true of other of Knight's students, has only taken half of what Knight was teaching. His separation of ethics and economics, while in some sense Knightian, misses the point. It is the ethics arrived at through discussion which has a Smithian antecedent in TMS that is really important. It is foundational for social life. The result is a regrettable neglect of Smith's moral theory in general, and the whole idea of justice and its relation to Stigler's beloved competitive economy. In short, I conclude that Stigler was half a Knightian and Smith was a whole Knightian. Or perhaps more accurately Knight was a better Smithian than was Stigler.

## Notes

1. References to all of Smith's texts will be to the *Glasgow Edition* in the standard scholarly format.
2. The reader could do no better than to consult Anthony Waterman's work on Malthus (1991, 2012).

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