

ADAM SMITH AND ALL THAT

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This paper tells you everything you need to know in order to impress your friends with your knowledge of the most famous people and the useful past of the subject of economics. However, it is recommended that this paper should not be read in the company of anyone who reads dusty old books, and who therefore has a tendency to sneeze.

I. INTRODUCTION

Students of economics no longer study the history of economic thought for the simple reason that it is much too difficult. It requires a lot of reading of books that do not have convenient introductions and summaries, and so it takes up far too much time. As a consequence, most economists are not familiar with the great names of the past and are unable to place modern analyses in historical, or any other, perspective.

This paper is designed to overcome this deficiency in one simple lesson. It collects all the useful past possessed by the subject into one convenient, and therefore easy to plagiarize, source.

This aim is possible because economics is a relatively young subject, though it has attracted the attention of many interesting characters. Many of these people were polymaths, though they did not actually learn their subject parrot-fashion, and were often ignorant of maths. Many were frequently highly innovative, and some were totally confused.

It will be seen that economists have always been very keen on building models. Unfortunately, they must have used poor glue because their models have a tendency to fall apart as soon as any weight is placed on them. Also, many economists are rather belligerent and jump up and down on each other's models. Furthermore, many of the models involve flows of water, and consequently end

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up going down the drain. Too often the baby gets thrown out with the bath water.

Importantly, the general public does not like being treated as subjects of models and has the quite irrational fear that model-makers will start to believe that their models are more important than the real world. Hence, as soon as they learn that they are being modeled, ordinary people have developed the clever knack of fighting back by changing their behavior. This is part of the general phenomenon, understood by producers of television programs, that if a lens is pointed at people, they immediately behave in peculiar and antisocial ways.

Many economic analyses have been illustrated using hypothetical factories, sometimes making unusual commodities. For example, there is one famous pin factory; these pins were urgently needed to burst lots of South Sea bubbles, as well as to deflate opponents. Although there are also examples of wig makers, this paper is relatively free of wig history. It also positively avoids discussion of abstruse methodological arguments, as most economists have not cared what scientific status their pronouncements may or may not possess. However, in view of the importance of taxes, there is quite a lot of taxonomy. Similarly, the importance of trade and exchange, combined with the fact that some economists were also trained as lawyers, means that tortologies often appear.

Some historians see the history of economics in terms of a series of revolutions. This may have something to do with the observation that many economists have spent their professional lives going round in circles, and some of them were indeed quite revolting.

This paper is accompanied by a number of self-testing questions, which are designed to boost the confidence of readers, confirming what they knew all along—that they know more than the writer. The answers can be found on the world wide web, at the address: www.andallthat.edu.au. To view these answers, which are supplemented by dramatic reconstructions of debates, by out-of-work actors wearing silly wigs and using strange voices, you may need to download the free easy-to-use text-and-image-handling innovative software, *crib.zip*. This takes just over three hours to download and install, is not necessarily virus-free, and is quite likely to wreck your hard disk.

II. BEFORE ADAM SMITH

Surprising as it may seem in view of his name, economics did not begin with Adam Smith. Classical scholars wrote about economic issues. However, they did not use the word “economics” and they wrote in Greek and Latin, so they can safely be ignored here.

Medieval scholars also wrote on economic subjects. They were highly interested in low interest rates on loans. But as they were monks, they can be dismissed as having worked in monasteries in isolation from the real world, unlike modern academic economists.

Later there were the mercantilists, in the seventeenth century, made up of a group of war-mongering and monopoly-seeking merchants. Their aim was to

accumulate more gold than any other country, by cutting imports and increasing exports. But it was later realized that this would lead to an imbalance by changing the center of gravity of the earth.

In order to finance wars, the mercantilists wanted to assess the taxable capacity of the country, and so began the important task of constructing the first measures of National Income and population. This involved a highly esoteric procedure, which has been copied many times since, of making up the numbers. This was called Political Arithmetic and has never been out of fashion.

In their obsession for adding up their assets, the mercantilists were strongly influenced by the contemporary flowering of the natural sciences, exemplified by the work of Isaac Newton, built on years of careful observation of the planets (by other people). Newton was rewarded by being allowed to take over the Royal Mint, where he used his skills to have forgers put to death. As every one knows, Newton was influenced, like Adam and Eve before him, and the Beatles after him, and even the builders of New York, by an apple. It is shown below that a discarded apple later had an important influence on the origins of a fundamental economic theorem.

The earlier scientific work of Galileo did not have a comparable influence on economic analysis. This was because economists believed they had a rather imperfect telescope and anyway they were impatient to get on with other things.

The mercantilist period also saw the passing of the first economic law, and this was by royal decree. King Davenant passed a law saying that when corn crops are lower than normal as a result of crop failures, the price of corn should be raised so high that farmers actually make more money than in normal times. Strangely, later generations of historians have found it hard to identify this king, or his law.

After the mercantilists, the physiocrats began to think about economics, but they were French and had unfortunate connections with the French Revolution. They realized the folly of the mercantilists' idea that a country could endlessly accumulate gold from a trade surplus, and thereby invented the circular flow. This stressed the fact that money goes round and round the economy. It probably also explains why coins were usually round and why misers clipped the edge of their coins to stop them rolling away.

The physiocrats also recognized the important principle that what goes in must come out, but they were not able to invert a matrix, so further development of this insight had to wait another 150 years when it was later reinvented as input–output analysis.

III. ADAM SMITH AND CLASSICAL ECONOMICS

Adam Smith is the most famous economist ever, as well as being a Good Man (in fact he was so good, he was said by his friends to be overflowing with moral sentiments). He was the leading economist of the British school of classical economists. However, they had the good sense to write in English rather than Latin, and not to wear togas.

His most famous book is called *The Wealth of Nations*, of which every literate

person has heard. However, no one reads this book any longer: it therefore can be said to have acquired the status of a true classic. One reason it is not read these days is that, like Shakespeare's plays and the King James Bible, modern readers realize immediately that it is made up entirely of famous quotations. It is not quite clear why his contemporaries failed to realize this obvious point.

Adam Smith was born, educated, taught, and lived in Scotland most of his life. However, he travelled on horseback to Balliol College to find out if education in Oxford was really as bad as he had been told—it was. Like many students at that university ever since, he simply spent a few years getting on with his own private studies in the library. The fact that we have all indirectly benefited by Oxford being so appallingly bad eventually led to the important idea of external effects from higher education.

Shortly before his death, Adam Smith had a large number of cheap medallions of himself made. Indeed, there were so many that they are still given away as consolation prizes to students of economics in British universities who have to become merchant bankers because they cannot find anything useful to do with their degrees.

Smith objected to unproductive labor, so he opened a famous pin factory, mentioned above, to keep the people busy. In doing this, he invented the idea of the division of labor: this states that the poor work while the rich supervise.

He had many skills. He even tried to be the first person to invent the invisible man, but he only got as far as the invisible hand. However, this hand was very powerful, and managed to imbue markets and prices with the ability to coordinate economic activity, even though people could not see the hand signals. Many later governments, by failing to see this hand although it was in front of their faces, have thought they could do better, with disastrous results.

Adam Smith was concerned by the question of the legitimate role of government. He developed a number of maxims for taxation, but this turned out to be a very bad name for them, as it has led to the idea that taxation should be maximized.

Smith managed to confuse later writers by appearing to argue that economic values were determined by the labor content of the goods in the production process. As will be seen below, this was the center of much controversy and resulted in the expenditure of much labor, to little value.

A contemporary of Smith was a French economist called Say. Instead of adopting a labor theory of value, Say tried to work out a theory of value based on demand. This involved piles of cannon balls, in a complex illustration of the problem of aggregation. This theory had little influence because no one could see what cannon balls had to do with the demand for goods. Many years later, an economist called Samuelson built a canonical classical model, but by then Say was dead so it didn't matter.

Say also found that supplying things was very demanding, so he invented the law that "supply creates its own demand." This was quite often misunderstood, probably because it was in French and was hard to translate. He was later heavily criticized by Keynes, who thought it was safe to criticize someone who was both dead and French.

IV. T. R. MALTHUS

Malthus was another important classical economist. He was also a vicar and therefore a Good Man, at least until he became a professor of economics.

Malthus was very worried about population growth. He thought the poor would be crushed under the weight of childbearing, and this led to the subsistence theory of wages. This became a cornerstone, or impediment, of the classical theory.

He became worried about over-population after being terrified by the horror story written by the daughter of William Godwin, in which an attempt to create a perfect man resulted in the creation of a perfect monster. Malthus tried to persuade the poor not to have too many children, by drawing diagrams for them; but the ignorant poor thought that they were meant to multiply geometrically. This all added up to a rather dismal story.

Malthus's theory of population eventually evolved into Charles Darwin. To show his gratitude, Darwin had ten children and persuaded one of them, a mathematician, to defend the theories of an economist called Jevons (see below).

Malthus had a very good friend called David Ricardo. They were such good friends that each one disagreed with virtually everything that the other one said.

V. DAVID RICARDO

Ricardo made a fortune from speculating, particularly during the Napoleonic Wars, so he was able to retire to the country at a relatively young age. After he died, a member of the royal family used his house and grounds to go horse riding on weekends; it is not known what she did with Ricardo's collected works, a housewarming present from the Royal Economic Society.

Even though Ricardo had lent the government a large amount of money so that it could beat the French, he was worried by the burden of the National Debt. The Bank of England was built in 1694 to store the initial debt, which had itself been created to finance a war. Ricardo thought the Bank was in danger of bursting at the seams. He thought it was becoming such a huge pile, it got confused with a Sinking Fund.

He also thought that people would be indifferent about borrowing in order to pay their taxes, so long as they could force their children to pay the interest charges, and anyway they would have a long time to think about it: this was called Ricardian Equivocation.

Ricardo had lots of spare time in retirement, so he began to construct a corn model, in which corn was made into corn, except for the bits that he kept eating to keep up his strength. He found it so laborious that he started, under Adam Smith's influence, to work out a labor theory of value, but he only got ninety-three percent of the way through it.

Years later, Sraffa gave this effort much higher marks (but a typographical error led this to be printed as Marx, a source of much confusion). After spending many years editing Ricardo's works, Sraffa tried to complete the model. However, he only managed to write the introduction. He was so ashamed that he called it a prologomena instead, so that no one would realize. Other economists have

followed this example and have written what they called propaedeutic essays, relying on the narrow vocabulary of most of their colleagues.

On becoming a landlord, Ricardo worked out an analysis of rent. He devised this theory while reading the works of his friend Malthus, and wrote copious notes in the margins of Malthus's books. This gave rise to the concept of the extensive margin.

Ricardo was a supporter of the Poor Law, which was drafted by a senior member of a committee. This argued that the poor should be kept poor, and was based on an application of the law that supply creates its own demand; that is, giving too much to the poor would only result in more of them. This problem has still not been solved.

Ricardo was bullied into writing his book, *The Theory of Political Economy and Taxation*, by his friend James Mill, who could not stand to see anyone idle for long. James Mill argued that Ricardo had a comparative advantage in writing economic analysis. This had the double advantage that he could also use the manuscript to keep his son, John Stuart Mill, busy by forcing him to make summaries of it at the breakfast table. He was given small sections at a time, somewhat like a breakfast serial.

His book was considered to be very important, even though it was published before Ricardo got around to writing the sections on taxation. For some years afterwards Ricardo had a very strong grip on the economics profession in Britain. This gave rise to the expression, "Ricardian vice-like grip." It was later used to describe the way people cling to models that are in danger of falling down.

VI. J. S. MILL

John Stuart Mill was, as already mentioned, the son of James Mill. He was a leading figure in the utilitarian movement, which believed that all actions should aim to maximize the total happiness of the greatest number of people. His strenuous work program from early childhood led to a nervous breakdown, until he realized that you become happy only by not trying to be happy, but by doing something interesting, like economics.

Some people found it hard to accept that one man could have so many original insights over such a wide range of learning, so they started to accuse him of being eclectic. This is the worst insult that can be thrown at an economist, and is even worse than being called scholarly. Both of these sins are far, far worse than being completely wrong, which can actually be an advantage if it is done cleverly enough.

Mill reciprocated by building a model of international trade. This explained relative prices on the grounds that when one hand gives, the other takes. This is a good example of the principle that good ideas often seem platitudinous in retrospect. However, many other economists, misunderstanding this principle, have started from platitudes that they have then attempted to dress in fancy clothes.

He also discussed the wages fund, which was put to one side in order to pay

the subsistence wages of workers. Later economists have found it hard to find such a wages fund, and have argued about whether Mill might have decanted it into a large sack.

VII. W. S. JEVONS

William Stanley Jevons was in the middle of a science degree when his father lost all his money. So Jevons went to Sydney, in Australia, where he made a mint. This enabled him to return to England. We have it on good authority that Jevons had little respect for authorities, especially J. S. Mill. He also criticized Ricardo, who he said had gone off the rails.

After hearing a lecture by the Vice Chancellor of Melbourne University, Jevons had a revelation that a utility theory of exchange could provide the basis for a complete model of the economy. This shifted the emphasis from growth, the preoccupation of the classical economists, to exchange as the central problem. Later generations called this the marginal revelation, but this led to much confusion about its nature, especially as the margin had already been invented.

Jevons was worried about coal reserves running out. This attracted the attention of the Prime Minister, Gladstone, who became worried about the effect this might have on the amount of hot air in the House of Commons, so he started a debate about income taxation.

Jevons was interested in, and made original contributions to, many subjects, including the history of economic thought. However, later generations of economists appear to have forgiven him for this latter aberration, and have politely ignored it.

Jevons had a strong influence on Edgeworth, who produced many original papers. However, he was indifferent to success and instead of making his discoveries known, he placed the papers in a box, called the Edgeworth Box, where they remained for many years before their secrets became widely known. Unlike some other economic boxes that had been built to scale, this one was certainly not empty.

It turned out that one of his findings followed in the long tradition established by Newton. Edgeworth found that if a half-eaten apple is left in the sun for long, the core shrinks. Some economists found it hard to appreciate the relevance of this finding for economics, and suggested that he was simply playing games.

VIII. L. WALRAS

Walras, a Frenchman, was the son of an economist and the father of general equilibrium theory, according to which everything is connected to everything else. This was a Good Idea, but unfortunately he did not have the equipment needed to get his model working. He was inspired to extend the partial equilibrium model of his countryman Cournot, who owned a mineral water spring and was also a mathematician. Due to failing eyesight, Cournot could not see how to extend his own model, or to correct his own proofs properly.

Walras's attempt to persuade people that mathematics could be useful in

economics consisted of filling his huge book, published in 1874, with “an exuberance of algebraic foliage,” consisting of endless symbols and unreadable diagrams. It did not become as well known as Walras hoped, largely because it has to be read with a wet towel over the head, and there simply were not enough towels to go around. Also, his strategy for promoting the book consisted of falling out with all the economists he could find. This method has been widely adopted since, with varying success.

Walras invented a *tâtonnement* process. This enabled him to discover the general principle that if the analysis is mixed with vague foreign words and curious metaphors, other economists will argue for many years about what the author might have had in mind, and end up using the interpretation that fits their own ends. He also tried to auction off the unsold copies of his book, but forgot to pay the auctioneer, who ran off with the takings.

The Swedish economist Cassell wrote a simplified version of Walras’s general equilibrium model and stated the analytical problems clearly. He had his own version immediately translated into English—always a good idea—but accidentally forgot to mention Walras’s name and so for a while became more famous than Walras.

Walras’s successor was Pareto, who had earlier been employed by the Italian railways to try to help the trains run on time. This gave rise to the expression, “Pareto efficiency.” He also thought it was a cardinal sin to compare the utilities of different individuals.

IX. ALFRED MARSHALL

Alfred Marshall was the father of the Cambridge School. He had a library named after him, and this was the origin of the saying, “it’s all in Marshall.” He was responsible for establishing the economics tripod in Cambridge. Despite having three legs, it had only a partial equilibrium and kept falling over.

Marshall did not like Jevons’s emphasis on the demand side, to the neglect of supply, so he cut up Jevons’s book with a pair of scissors.

By a great stretch of the imagination, Marshall invented the concept of elasticity. Like Archimedes, he was in the bath when his discovery was made. He also examined the representative firm in great detail, but the complexity meant that his colleagues were unable to see the wood for the trees.

Marshall’s early love was mathematics, and he began economics by translating J. S. Mill’s models into maths. But he was so ashamed by the pleasure it gave him, that he translated the maths into diagrams. However, this still gave too much pleasure, so he buried them all. Economists are now encouraged to reverse this process.

Marshall has the distinction of having written the last Treatise in economics. Thus, he treated his readers as serious adults concerned with the fundamental nature of the subject and interested in appreciating the special vision of economics, with its strengths and limitations, which the author has allowed to mature over some years and labored hard to explain. Modern, and therefore obviously superior, writers instead produce textbooks in which they talk down

to readers who are regarded as having the sole aim of being able to tick the right boxes in multiple-choice exams. Alternatively, they write introductory papers like the present one.

X. CONCLUSIONS

This paper has presented a succinct summary of much of the history of economics in one easy lesson. It is entirely descriptive and therefore fully objective and uncontroversial. It has been seen that economics is a very serious, though far from dismal, subject. It is, therefore, surprising that a number of famous fiction writers have poked fun at it in the past. However, these writers can easily be dismissed as merely having made swift attempts to display, like peacocks, their satirical skills.

This paper has closed with discussion of Alfred Marshall who, like many other important economists, died in the 1920s. A sequel is planned but, since this deals with people who may still be alive, or whose relatives may still be alive, or whose look-alike has been spotted somewhere in the southeast of England, a first draft is currently in the hands of a team of solicitors.

XI. SOME QUESTIONS

Here are some questions to test your knowledge of the useful history of economic thought. Some of them are only slightly impossible. While answering these questions, keep the following simple points in mind:

- (1) If you don't know the answers, just make them up, but only if they are outrageous and difficult to check.
- (2) It is all right to cheat flagrantly, but do not on any account repeat yourself. If you are caught doing either of these things, become aggressive and threaten legal action, while claiming that no one told you that stupidity is stupid.
- (3) Your answers may be allusive, but certainly not affected (well, only slightly).
- (4) Above all, remember at all times the economist's motto: don't allow facts to get in the way of a good story.

Attempt as many questions as possible until you fall asleep, indicating the time and place.

1. Was Say closer to Malthus than Ricardo was to Marshall? You may prevaricate noisily, but remain seated at all times.
2. Was Adam Smith as important as is generally thought? Feel no obligation to stick to the subject.
3. Could William Petty have counted on the support of Adam Smith? And if not, how often?
4. How many Irish economists does it take to change Galbraith's mind? You are allowed to scoff knowingly.

5. Who invented Pareto optimality? If not, who did? And was it the best he could come up with?
6. Can economic laws be effectively policed? If so, what is the opportunity cost? (Carefully avoid mention of Robert Peel).
7. Why didn't Ricardo invent Political Arithmetic? Was he constructing one of his many numerical examples at the time?
8. Are there any economic subjects you regard as too boring to mention? Yawn loudly, but politely, as you think of them.
9. Is it true that Mirabeau was a handsome but narcissistic Frenchman who kept looking at his own reflection? How does this reflect on the Physiocrats?
10. Discuss vaguely, paying special attention to rumors to the contrary, the suggestion that economists don't know any better.
11. Cantillon was baked by his cook after an argument. What has this got to do with Economics?
12. Deplore the failure of effective demand. You may place an order for more paper at this point in the exam.
13. Stigmatize Malthus's theory of population growth. How did he conceive it? And who put him up to it?
14. Why did J. S. Mill find so many questions unsettling? Did he neglect to revise before his final exams, or did he just have a nervous disposition?
15. Economics is full of stylized facts without theories and theories without facts. Is this a fact or a theory? If so, how would a linguistic philosopher answer this question? (You are only allowed to use "it all depends on what you mean" fifty three times).
16. Who was right, Malthus or Ricardo? If so, does it matter? And what if it did?
17. Expatiate briefly on the idea that the utility of the calculus to utilitarians is decreasing at the margin. What does it all add up to? And what is the greatest number? (Does it exceed x^y ?)
18. Can apples give rise to theories that bear fruit? Did Edgeworth say "cor blimey" when he stumbled across the core of an economy? And did it drive Marshall nuts?
19. Is Ricardo's theory of rent any use to landlords? Restrict your answer to illegible scribble in the right hand margin of the exam script.
20. Be mercifully brief about the labor theory of value. Do adherents invariably measure prices properly?
21. Comment abrasively on the suggestion that you don't know what you are talking about in your answers to questions 3(b) and 7(c).
22. Complain loudly that economics was ever invented. What should take its place?
23. If all economists were placed end-to-end, would it be an unstable equilibrium? Would there be multiple equilibria?
24. Why are Smith and Marshall generally referred to as Adam Smith and Alfred Marshall, while Jevons and Edgeworth are know merely by their last names? Only deep philosophical and politically correct answers are permitted to this question.
25. What does it mean in the end to say that ends can't be distinguished from means, and would Robbins agree or even care?

26. Did Mill and Cairnes form a non-competing group, and if so, against whom?
27. Is it realistic to assume that economists don't care about the realism of assumptions? And is this an example?
28. Comment elliptically on the suggestion that if Keynes was a post-Keynesian then Ricardo was a Sraffian and Smith was a general equilibrium theorist, and pigs really can fly.
29. Are economists subject to diminishing returns? Be careful, as this might be a trick question.