The Equalizing Hand: Why Adam Smith Expected the Market to Produce Wealth without Steep Inequality

Forthcoming in Perspectives on Politics, December 2013.

Abstract

That the market economy inevitably leads to inequality is widely accepted today, with disagreement confined to the desirability of redistributive action, its extent, and the role of government in the process. The canonical text of liberal political economy, Adam Smith's *Wealth of Nations*, is assumed even in the most progressive interpretations to accept inequality, rationalized as the inevitable trade-off for increasing prosperity compared to less developed but more equal economies. I argue instead that Smith's system, if fully implemented, would not allow steep inequalities to arise. In Smith, profits should be low and labor wages high, legislation in favor of the worker is "always just and equitable," land should be distributed widely and evenly, inheritance laws liberalized, taxation can be high if it is equitable, and the science of the legislator is necessary to put the system in motion and keep it aligned. Market economies are made in Smith's system. Political theorists and economists have highlighted some of these points, but the counterfactual "what would the distribution of wealth be if all the building blocks were ever in place?" has not been posed. Doing so encourages us to question why steep inequality is accepted as a fact, instead of a pathology that the market economy was not supposed to generate in the first place.

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An intense debate is taking place today about how market economies do and should work, especially given the dramatic inequality observed within the US and globally.[1] A widely influential view, shared by sections of the right, center, and left, sees inequality as a natural, perhaps even a beneficial, outcome of market operations.[2] While this remains a matter of debate, it should be recognized as a radical departure from what some of the free market's original defenders claimed. Indeed, even the canonical text of economic liberalism, Adam Smith's *Wealth of Nations* (hereafter *TWN*),[3] suggests that we should revise this assumption about inequality.

Re-examining Smith's political economy reveals how far contemporary views on inequality diverge from classical assumptions. But it also suggests the widespread belief, that inequality is a necessary feature of the market economy, needs to be seriously reconsidered. Conventional disagreement among elites has long been between those who reject corrective measures for inequality (conservatives and libertarians) and those who debate what the measures should be (liberals and social democrats).[4] Recently, however, attention has turned to how economic design can prevent steep inequality from emerging—what Jacob Hacker has described as "pre-distribution." This is "the way in which the market distributes its rewards in the first place,"[5] before redistributive taxation is applied. However, preventing wealth concentration through "pre-distribution" is today a rallying-call only for progressives,[6] who are cast by conservatives as unfriendly to the market.

Yet, the preclusion of wealth concentration is consistent with the principles of neoclassical economics: with increasing competition, monopolies are eliminated and the profit rate should fall.. Further, as I suggest, Smith's system was also designed to preclude the "hyperconcentration" of wealth.[7] Strong concerns with "welfare" may be absent in the text, as critiqued by progressive interpreters of Smith.[8] But if wealth cannot become concentrated, economic inequality is necessarily lessened. This revision of Smith confirms that, rather than proposing a "correction" of liberal theory, progressives calling for "pre-distributive" measures are simply returning it to its roots.

What prevents a more equalized pre-distribution of income? Here again, Smith's diagnosis is strikingly close to some of the most progressive analyses today. In the US, unequal outcomes have been traced both to special interests actively shaping legislation and to deliberate failure of legislative elites to counteract such pressures, what Hacker and Pierson have called "winner-take-all" politics.[9] Similarly, Smith dissects the "special interests" that distorted economic policy in his time. This is normally glossed as specific to his critique of Mercantilism, but his strictures apply to any system where some groups "live by profit." The persistent theme of *TWN* is how such groups can and do deceive legislatures and the public.

If these pathologies were counteracted, the economic system Smith proposes would prevent inequalities from arising in the first place. Scholars have missed this point because Smith does not emphasize it. However, it can be inferred from passages that reveal his expectations about wealth and income distribution, as I will show.

Such revision is both timely and important, as it questions why inequality has been assumed as inevitable or necessary in the market economy—an assumption that weakens efforts to reverse it. Some economists continue to argue that inequality is necessary for growth, though debate is ongoing.[10] Political scientists, on the other hand, focus on inequality and distributive conflict in accounts of democratization and political stability.[11] But as Margaret Levi astutely notes, the political pathologies generating inequality still afflict the most inclusive regimes—established democracies.[12] In some works, only inequality in law is emphasized, as in recent work by North, Wallis and Weingast.[13] Yet "open access orders" cannot materialize if individuals have wide disparities in resources.[14] Inequality thus remains at the core of central social science concerns.

Smith is also placed at the foundation of the neo-liberal anti-debt perspective that is considered to have devastated recovery prospects after the crisis of 2008. In a recent attack on austerity policies, Mark Blyth shows how Smith failed to understand the dynamics of debt- and consumption-driven growth. But placing Smith at the origin of "neoliberal ideas" and of the desire to "dodge taxes" misses a golden opportunity to take a hallowed icon of conservative thought and turn it against its followers.[15] The systematic treatment of Smith's taxation principles that I present revises the anti-tax assumptions about his work. Fiscal politics are also key for inequality, so the implications extend widely.[16]

In the next section, I present the political theory literature that has radically revised the conservative understanding of Smith and show how my argument furthers this revision. In the remaining sections, I present systematic textual evidence on the building blocks of Smith's theory: his claims regarding profits and wages, legislation, the "invisible hand" and taxation, and how concentrated wealth is gradually minimized in his system.[17] The principles he proposes predict far more equalized outcomes in the market economy and are congruent with some of the most progressive calls for reform today.

Adam Smith, Inequality, and Political Theory

Political theorists and economic historians have radically revised the laissez-faire understanding of Smith in the last decades.[18] Outstanding works have shown that he is skeptical of commercial society, that he advocates the improvement of living standards of the poor, and believes in equality and freedom from personal dependence.[19] Further, they've shown that politics and legislation have a central role in the economy: the "invisible hand" is a minor mechanism, not a guiding economic principle of his theory.[20]

Yet these revisionist works still assume that Smith accepts "oppressive inequality."[21] For Hont and Ignatieff, Smith concedes that commercial societies are "more unequal in their distribution of property" than previous ones—the task being to "explain the compatibility of economic inequality and adequate subsistence for the wage-earner within a free-market system."[22] Donald Winch emphasizes Smith's concern with "what might be called economic democracy," but still sees it limited by the "primacy of the negative," as Smith fails to espouse "any positive programme of redistribution."[23] Samuel Fleischacker, with a strongly progressive interpretation, assumes that Smith holds inequality to be justified due to a Rawlsian bargain, "if the worst off people are better off than they would be under a more equal distribution of goods."[24]

Smith does hold this view.[25] But he does not mean it as the end of the matter. In *TWN* he is analyzing the "commercial system" of his time, which he identifies with the "mercantile" one he attacks.[26] Though a revolutionary improvement over the past, that economy does not actualize the "system of natural liberty" as he conceived it.[27] If the principles of the *TWN* were ever fully applied, the economy would be transformed. Smith is famously pessimistic about such change in his lifetime, dismissing it as an Oceana or Utopia;[28] so he does not speculate about its outcome. Nor, following him, have his interpreters. However, the building blocks of his political economy produce a much more egalitarian edifice than assumed. This follows from his purely economic premises, without any appeal to his normative theory, which I set aside for analytical purposes. The egalitarian case for Smith need not be derived from moral reasoning, though of course it can and has.[29] It also supports arguments resolving the "Adam Smith Problem"—i.e. the apparent inconsistency between the sympathy-based *Theory of Moral Sentiments* and the interest-based *Wealth of Nations*.[30]

Why Profits—and Inequality—Should Be Low in Smith's System

That Smith's system would generate low levels of inequality can be inferred from some of his observations and his critique of high profits. For instance, in his analysis of Holland, which he praises as the most advanced economy of his time, he offers a simple explanation for Dutch prosperity. Holland's condition approximates the ideal, most advanced economies, where "the ordinary rate of clear profit would be very small, so that usual market rate of interest which could be afforded out of it, would be so low as to render it impossible for any but the very wealthiest people to live upon the interest of their money." When profit rates are low, so are returns on capital, and thus only a few can live off revenue alone. As a result, "almost every man" in Holland was "a man of business," engaged in productive economic activity.[31]

The point seems inconspicuous, but it poses two unexplored counterfactuals. First, if profit rates are low and barriers to entry eliminated, how can great fortunes ever accumulate? Both factors prevent capturing high market share, so Smith's principles imply that great fortunes should not normally form. As I show, core aspects of his theory also push in this direction. Second, what would wealth distribution be in an economy where capital concentration was so limited that living off interest alone was impossible? Evidently, the maximum amount held by individuals would be highly delimited—a minute fraction of the vast personal fortunes achievable in market economies today.[32] Accordingly, we should expect a more equalized distribution of wealth.[33] The same implication emerges from other observations. Capital accumulation, he says, among landlords, farmers, master manufacturers, and merchants is usually so limited that it can only last them for "a year or two" whilst out of business.[34]

This is, moreover, an elementary principle of neo-classical economics: in a competitive economy, the profit rate should fall and no single firm can dominate the market such that even low return rates can accumulate high levels of capital. Instead, high return rates should indicate high risk.[35] Yet today, high rates of return and certainly high profits are a measure of stock market performance and the best-performing companies are associated with the least amount of risk. This inconsistency between theory and practice is of crucial importance today, when corporate profits have reached unprecedented heights,[36] exacerbating inequalities. The inconsistency reflects a deeper confusion within economic theory itself, where no theoretical agreement exists about profit.[37]

Smith's views on profits may be far simpler than what contemporary economics accepts, but he is clear about their causes and pernicious effects. High levels of profits are inversely related to the health of the economy.[38] This is laid out in one of the most important sections of the work, the conclusion to Book I. There, Smith divides society into "three great orders," those who live by wages (the workers), those who live by rents (landlords), and those who live by profit (mostly merchants and manufacturers). In this pre-Ricardian system, the first two orders, workers and landlords, have an economic interest that is "strictly and inseparably connected with the general interest of the society."[39]

By contrast, those who live by profit, though they provide work, have interests opposed to the common good due to the peculiar character of profit: "The rate of profit does not, like rent and wages, rise with the prosperity, and fall with the declension of the society. On the contrary, it is naturally low in rich, and high in poor countries, and it is always highest in the countries which are going fastest to ruin."[40] High profit rates are crucially tied to capital availability: the scarcer capital is, the worse off the economy and the higher the interest rate. When capital is abundant, by contrast, it is cheap, so interest rates are low and the economy prospers. In fact, "the diminution of profit is the natural effect of . . . prosperity."[41]

High rates of profit are therefore typical in "ruined countries," like Bengal.[42] There, capital is scarce, lowering wages whilst increasing the price of goods, leaving everyone worse off—except manufacturers. France illustrates the point as strikingly: interest rates were high and so were profits, much higher than in Britain. Yet in France living standards were lower, despite richer natural resources.[43] Further, as in Scotland, trade there was "in disgrace."[44] By contrast, in commercial Holland[45] and in the wealthier parts of England profit rates were low—but, crucially, wages were high.[46]

Smith does not reject profit per se: the seller bringing produce to the market should be rewarded for his effort[47] and the investor should be compensated in proportion to his capital, not his labor.[48] Smith also accepts large profit margins for employments under scarcity, where profit includes wages for labor hidden in the service provided, as with apothecaries or groceries in remote areas.[49]

As a rule, however, high profits indicate pathology. Another factor that may increase profit rates is interference with the natural price, which prevents the market from clearing so that supply can meet demand.[50] Critically, such price distortions often result from coercive relations between capital and labor. When interest in China reached twelve percent, profits had to be high enough to support it.[51] "In every different branch, the oppression of the poor must establish the monopoly of the rich, who, by engrossing the whole trade to themselves, will be able to make very large profits." Thus, high profits are made at the expense of the poor and by lowering wages, as I expand further. But the poor are not the only losers; all consumers also suffer, as products may cost more. Higher profit margins require that prices also be adjusted higher to compensate merchants and manufacturers for the limited capital available and the lower volume of sales. This is why higher prices are observed with declining wages.

However, merchants and manufacturers have convinced the public that high wages, not high profits, are damaging to business health. Yet "in reality high profits tend much more to raise the price of work than high wages." Where wages increase, commodity prices rise in arithmetic proportion, but where profits increase, prices must rise "in geometrical proportion to this rise in profit:"[52] wages are a fixed cost whereas profit is proportional. But this is not broadly understood, because manufacturers "complain much of the bad effects of high wages in raising the price . . . of their goods . . . . They say nothing concerning the bad effects of high profits [and] the pernicious effects of their own gains. They complain only of those of other people."[53]

More than two centuries later, this insight on profit still resonates, despite radical changes to the economy and economic theory. The current crisis confirms that high returns to capital often accompany economic collapse. Rates of corporate profitability today are the highest since records began, just as real worker wages have stagnated for decades.[54] Some contemporary economists might be skeptical, but to Smith the correlation is clear: high profits usually mean the economy is in ruins.

Conversely, however, when profits are low and market entry is unrestricted, wealth concentrations can only be minimal. But Smith not only expects low profits for business. He also claims wages should be high for laborers, in essence offering a defense of a generous minimum wage.

Why High Wages for Labor Are Necessary: A Defense of a "Liberal" Minimum Wage

Real wages for workers in the US have stagnated over the last decades just as corporate profits have soared.[55] The minimum wage debate has regained strength, with new studies suggesting that its adverse effects on unemployment and welfare are questionable.[56] But the concept is still tied to a regulatory approach that interferes with the pricing mechanism.[57] Again, Smith offers a powerful corrective, with important implications on inequality.

The economic logic of high wages is clear: "The liberal reward of labour . . .as it is the necessary effect, so it is the natural symptom of increasing national wealth."[58] A well-maintained, healthy labor force is able to reproduce itself and be more industrious.[59] A multiplying labor force was crucial for prosperity in those pre-Malthusian days, as it is in today's economies with aging populations.[60]

Wage levels are not a simple function of supply and demand in *TWN*. Demand affects the amount of work available, but wages are also a function of the cost of living.[61] Smith often mentions inefficiencies raising the price of labor, including misguided taxes on wages.[62] But he does not believe equilibrium wage levels are low.

Rather, wages should enable the subsistence and reproduction of the laborer—a proposal he admits is "evidently the lowest which is consistent with common humanity."[63] Smith's concern is primarily utilitarian, secondarily moral. Improving wages and labor living standards is tied to the general welfare: "No society can surely 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, cloath 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, cloathed and lodged."[64] To contemporary sensibilities, the claim seems condescending and inadequate.[65]

Two important points, however, qualify this assessment. First, the "necessaries" for subsistence are defined relative to average living standards. "By necessaries 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."[66] This even included the middle class "comforts" of linen shirts and leather shoes, even for the "the lowest species of common labourers."[67] Amartya Sen moves even further and relates Smith's position to his own capacious "capabilities" approach to welfare, where need is tied to the "substantive freedom" to secure widely shared human capabilities.[68]

This position also has important implications for the definition of poverty today. Smith's principles, though historically specific, challenge our baselines. The poverty threshold in the US is based on a basket of subsistence goods determined in 1955. It is simply adjusted for inflation, despite radical changes in the economy[69] and strong demands for revision.[70] Moreover, because it includes consumer "comforts," conservatives claim it is too "generous."[71]

These positions are wide of the mark, from Smith's perspective. Rather, more congruent is the poverty threshold of the Organisation for Economic Co-operation and Development. This is pegged to the purchasing power of an average citizen and set at a little lower than half the median income.[72] Arguably, working-class conditions would be significantly improved if the minimum wage conformed to that standard.[73]

Second, in Smith's time, dominant views asserted that wages *had* to be low so that workers become productive. The view was long-standing.[74] Mandeville asserted starkly in 1714 that "the surest Wealth consists in a Multitude of laborious Poor . . . To make the Society happy . . . it is requisite that great Numbers of [the People] should be Ignorant as well as Poor"—to Marx's later delight.[75] High wages, in this view, encouraged idleness; the less the workers had, the more insecure they were, the more obedient a workforce they constituted.[76] Blatant affirmations of this principle today are hard to find; but current practices often produce the same effect.

Smith rebuts these views not in normative terms, but with empirical evidence: where wages were high, as in England, workers were more industrious, competent, and diligent. Where they were low, as in Scotland, human capital was limited. That is why free labor is always more productive than slavery.[77] These were radical statements for the time. They are also a striking precursor to the core insight of efficiency wage theories and Fordism.[78]

Two exceptions exist to this economic logic of high wages: colonies or new economies, like North America, and economies in the "stationary state." In new economies, profit rates can be high whilst the economy is thriving, but this is due to the wide availability of cheap land and the undersupply of labor[79]—which also means wages are high too. By contrast, economies that "had acquired that full complement of riches" and could "advance no further"[80] allow only low profits due to competition, but also drive wages down to the bare minimum. Smith only devotes a paragraph to this possibility.[81] The conundrum of the "Stationary State" analyzed by John Stuart Mill and others[82] is marginal to him, possibly because "no country has ever yet arrived at this degree of opulence"[83] and few were expected to do so.

In a system where high profits and the powers of the "masters" are constrained, a needs-based approach to wage determination can only create bottom-up pressures that will close large wealth gaps. In the following sections we see that Smith opposes the coercion of the economically weak as well and sought legislative remedies to it.

The Causes of High Profits and Low Wages: Incentive, Information, and Bargaining Asymmetries

So, if high profits and low wages are not just pernicious but inefficient, what causes them? According to conventional wisdom, market inefficiencies stem mainly from mercantilist regulations of "police"—from any regulation restricting freedom of trade and competition, preserving guild secrets, or creating monopolies.[84] This implies that the role of the state should be minimal, aiming simply to block mercantilist policies.[85]

However, in Smith's account these inefficiencies mostly result not from state activism, but from unopposed actions by the rich. High profits result from deceit and the power advantages of those "who live by profit," mostly merchants and manufacturers, but also bankers and stockbrokers. Specifically, they stem from information and bargaining asymmetries favoring these groups, much as they do today. A major goal of *TWN* is to instruct the public and the government how to counteract profit-seekers, through legislation and taxation. Smith attacks such groups with a vehemence he never used against government, which he only criticizes when inept and spendthrift.[86]

The causes of high profits thus need systematic analysis. Rosenberg's classic study showed how high profits affect the social role of the capitalist.[87] But a causal account is also in order and this involves analyzing asymmetries of incentives, of information, and of bargaining.

Incentive Asymmetries

Were high profits caused by Mercantilism? Can we assume that in a "free" market economy the pathologies of profit-seeking would disappear? I argue not. For Smith, these tendencies are inherent in the structure of economic interest and of incentives of those who live by profit. This is concisely articulated in the conclusion of Book I discussed earlier.[88] Mercantilism was only the period-specific result of the pathology of profit, not its cause.

In fact, the interest of those who "live by profit" is "directly opposite to that of the great body of the people," the workers and landlords.[89] Any profit-seeker will exploit their deeper knowledge of economic realities, as did stock-jobbers and bankers.[90] "The mean rapacity, the monopolizing spirit of merchants and manufacturers"[91] are constant characteristics of any capital-holder. This structural fact meant that profit-seekers should always be mistrusted and counterbalanced. The interests of merchants are aligned with those of the public only under specific and rare conditions: only when traders are isolated and merchant collusion is structurally constrained, as in the domestic trade of corn, does merchant self-interest serve the common good.[92]

The pathology of profit-seeking is thus endemic in any economic system—even in a global order based on free trade, as Muthu has shown.[93] The underlying threat to Smith's system remains so long as the pursuit of profit remains unchecked—by government or competition. Monopolies have not disappeared, after all, even after Mercantilism ended. The same pathology, ultimately, afflicts anyone with power: "All for ourselves, and nothing for other people, seems, in every age of the world, to have been the vile maxim of the masters of mankind."[94]

Information Asymmetries.

Those who live by profit prevail by exploiting information asymmetries. Such actors are relentless in surreptitiously influencing Parliament so as to "enrich themselves." They succeed because members of Parliament scarcely understand the basic principles of political economy.[95] Merchants are the "pretended doctors" of the system,[96] who convince "parliaments . . . councils of princes . . . nobles and . . . country gentlemen" to pursue policies that enrich the merchants at the expense of the people, simply because men of politics "knew nothing about the matter."[97] "The interested sophistry of merchants and manufacturers confounded the common sense of mankind."[98] A fundamental asymmetry of information privileges profit-seekers against the rest of society.

Accordingly, Smith is adamant that law and policy should never be entrusted to those who live by profit.

> The proposal of any new law or regulation of commerce which comes from this order ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the publick, who have generally an interest to deceive and even to oppress the publick, and who accordingly have, upon many occasions, both deceived and oppressed it."[99]

As I argue later on, such deception underlies most of the regulation that Smith opposes. What appears as an attack on government regulation is, in Smith, usually an attack on those who exploit such information asymmetries to secure profits the system should not normally generate.

Bargaining Asymmetries

Merchants and manufacturers thus impose their preferences on Parliament through asymmetries of information and of incentives. But, Smith argues, they have similar strategic advantages when bargaining with labor. In wage bargaining, "masters" want to lower wages, workers to raise them. Masters, however, have the advantage, since they can more easily collude. In fact, masters "are always and every where in a sort of tacit, but constant and uniform combination, not to raise the wages of labour above their actual rate…We seldom [however] hear of this combination, because it is the usual, and one may say, the natural state of things which nobody ever hears of."[100]

Just as in today's labor market, where laws punish workers and management asymmetrically,[101] the legal system in Smith's time exacerbated bargaining imbalances. Anti-combination laws only applied to labor. "We have no acts of parliament against combining to lower the price of work; but many against combining to raise it." This is no accident: "Whenever the legislature attempts to regulate the differences between masters and their workmen, its counsellors are always the masters."[102]

Workers are at a systemic disadvantage. Smith rejects the contractual equality that permeates Burke's defense of the market economy,[103] as well as neo-classical theorizing and calls for deregulation.[104] Wages are ultimately set by a "contract usually made between [masters and workers], whose interests are by no means the same."[105] "It is not, however, difficult to foresee which of the two parties must . . . have the advantage in the dispute, and force the other into a compliance with their term": masters can hold out longer.

> A landlord, a farmer, a master manufacturer, or merchant, though they did not employ a single workman, could generally live a year or two upon the stocks which they have already acquired. Many workmen could not subsist a week, few could subsist a month, and scarce any a year without employment. In the long-run the workman may be as necessary to his master as his master is to him; but the necessity is not so immediate.[106]

Protests and violence by the workers don't alter the asymmetry. They are always loud and widely noted, but workers "very seldom derive any advantage" from them,[107] partly because the employer is assisted by the civil magistrate, but partly because of the differential capacity of the two sides to sit out the protest.[108]

That is why, he continues in a startling statement, when the "regulation . . . is in favor of the workmen, it is always just and equitable":[109] it supports the economic actor whose interests coincide with the public good and thwarts the monopolistic or coercive practices of those who live by profit.[110]

Smith does not accept these information, incentive, and bargaining asymmetries as inevitable or minor in importance. Nor does he believe that an "invisible hand" will spontaneously iron them out. Asymmetries should be counteracted, he argues, through legislation and constant vigilance. Such action depends upon and consolidates what we would call today a "strong state." Smith's prescriptions, therefore, aren't far from contemporary arguments for the necessity of state capacity in securing liberal political and economic outcomes.[111]

Wise legislation Against the Powerful, Not the "Invisible Hand," Resolves Asymmetries.

Proactive legislation and regulation are constitutive of Smith's economic system—especially regulation that deliberately targeted the economically powerful so as to serve the public good. Although Smith is widely known for passages that seem to suggest a minimal approach to government,[112] in almost all of them he is in fact targeting the "masters" and even prescribed measures that harm them.

The minimalist interpretation usually starts with Smith's three duties of the sovereign: the provision of defense, of justice, and of public goods and institutions. However, his definition of justice does not imply the "primacy of the negative."[113] It describes a much more capacious understanding of government obligations: it includes "that of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it."[114] Such calls for legislative protection of the weak are not perfunctory in Smith. No less than Spanish economic underdevelopment is attributed chiefly to the "partial administration of justice," for instance by protecting "the rich and powerful debtor from the pursuit of his injured creditor."[115]

Smith castigates the unfair information and bargaining advantages of the rich over workers. He criticizes acts of the English Parliament regulating wages because they systematically set an *upper* limit to wages, not a lower one. He explicitly condemns the partiality of the law, which penalized workers severely for combining to prevent the lowering of wages, whereas "if it dealt impartially, it would treat the masters in the same manner." Instead, the law itself ensured that wages remained depressed.[116]

In almost every case, when he appears to condemn a regulation, he is targeting the unfair advantage of the powerful.[117] For instance, he attacks regulations that limited the freedom and mobility of workers whilst favoring employers.[118] He also castigates market restrictions and monopoly laws because they harmed the public, whilst benefiting "traders and artificers" and monopolists.[119]

Moreover, he supports proactive steps to shape outcomes when the intervention benefits a party being economically harmed.[120] This is usually missed because of decontextualized readings of key passages. For instance, he claims that "to hurt in any degree the interest of any one order of citizens, for no other purpose but to promote that of some other, is evidently contrary to that justice and equality of treatment which the sovereign owes to all . . . his subjects."[121] However, in this passage he defends the party harmed by organized interests: the provincial sheep-owners were being regulated to favor the cloth manufacturers, who influenced the legislature.[122] Further, this statement is no blanket rejection of regulatory harm. The proviso, "for no other purpose," has a clear implication: if the purpose were more than to promote the interest of *one* other order, but served instead the common good, he does not reject harm to a group.

In fact, recommendations to harm the strong so as to protect the weak abound in the text. Regulations on banks, for instance, are advisable in areas such as coinage, where fixing the rate of silver meant "bankers only would suffer by this regulation." Bankers would be prevented from manipulative actions, while offering "considerable security to their creditors."[123] Even upper limits on interest rates are advisable, keeping them just above the lowest market rate. This would help channel money to "sober people" who are likelier to employ capital productively. Only "prodigals and projectors" (i.e., speculators) ever borrow at high rates. They are also the least likely to repay their debts.[124]

Smith's overriding criterion is clear when discussing why paper money should be regulated:

> But those exertions of the natural liberty of a few individuals, which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments; of the most free, as well as of the most despotical. The obligation of building party walls, in order to prevent the communication of fire, is a violation of natural liberty, exactly of the same kind with the regulations of the banking trade which are here proposed.[125]

Just as strikingly, under monopoly conditions, regulating the price of a "first necessary of life" is in the public interest. Price limits are misguided only where competition can respond to change and local conditions more effectively.[126] As with Smith's tax prescriptions, the key criterion between good and bad intervention is securing the most productive use of capital—and not burdening the poor. Regulation of the right kind is thus necessary in his "system of liberty." The institution of the market has to be "made" in Smith—only the practice of barter, as well as collusion and deceit, emerges spontaneously.[127]

The "Invisible Hand:" A Localized Mechanism

So what is the role of the "invisible hand" in Smith's system? Naïve notions of it as a mechanism of laissez-faire in Smith have been rejected by political theorists and historians.[128] Yet vestiges of them remain, as some passages in the *Theory of Moral Sentiments* are invoked to claim that

Smith accepted a natural order guided by an invisible hand, where the wealth of the rich 'trickles down' to the poor just as if "the earth [had] been divided into equal portions among all its inhabitants."[129] Viner long ago emphasized that *TWN* discarded this notion and that the book could "provide ammunition for several socialist orations."[130] But this isn't widely known outside the field of Smith specialists.

Moreover, the "invisible hand" isn't usually treated in the context of the structural asymmetries between economic orders—this alone shows how limited its role was. Those who live by profit have a self-interest that runs counter to the common good. Workers and rentiers face asymmetries necessitating constant corrective action by the legislator and, as argued below, the taxman. No "natural harmony" working through an "invisible hand" exists in Smith's system.

The "invisible hand" is in fact a local, not an overarching, mechanism in his theory. It appears in his description of how domestic industry is naturally more advantageous both individually and collectively,[131] as it carries fewer risks than foreign trade.[132] "By directing that industry in such a manner as its produce may be of the greatest value, [the individual] intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention."[133]

Smith accordingly condemns government efforts to dictate individual economic choice, suggesting implicit support for an "invisible hand" mechanism: "The statesman, who should attempt to direct private people in what manner they ought to employ their capitals . . . would assume an authority which could safely be trusted . . . to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it."[134]

However, Smith's point here is unobjectionable: the government cannot dictate to individuals which industry to choose. The individual can be a better judge of this.[135] The point is only radical because confining people to certain trades was common in Smith's time, though unthinkable today. Moreover, such regulations were initiated by the trades themselves, not the state.

Relatedly, Smith often praises "the desire of bettering our condition" as powerful enough to overcome even counter-productive institutions.[136] After all, the division of labor assumes self-interested actions aggregating to a social good.[137] However, such localized mechanisms do not mean government has no role. Smith certainly does not hold this view, as his views on taxation prove.

Before examining these, however, I will note the implications of Smith's proactive use of legislation for our original hypothesis. If, as Smith recommended, laws protect the weaker party in contractual exchanges, economic oppression and exploitation would be reduced and the concentration of profits would accordingly decline. The steeply unequal outcomes preoccupying market critics today would thus be averted.

Taxation Encourages Economic Rationality Where Self-Interest Fails

Perhaps the clearest evidence that Smith did not conceive of the free market as self-correcting in the face of individual economic irrationality is in his treatment of taxation. Despite many revisionist statements on *TWN*, with only a few exceptions,[138] Smith's system of taxation has not been assessed as a whole. Taxation, however, plays a critical role in studies of inequality.[139] Examining its role in Smith's theory dispels quite a few myths, foremost the one that associates the "free market" with low taxation. Smith praises the English system that imposed *double* the per capita burden of the French. For him, the main criterion is whether taxes undermine productivity.

Clarifying when that happens, however, places him at odds with conventional market wisdom both in scholarly and public discourse. He consistently advises against taxing the working poor and castigates employers for deceiving legislators about whom taxes ultimately impacted. By contrast, taxing the rich more than in proportion to their wealth provides needed revenue to the state. But it can also incentivize the rational use of economic resources by a group least likely to do so spontaneously: the rich. Finally, taxes are necessary as long as their goal is state revenue, rather than monopoly. High taxation is opposed only where it violates one or more of these principles.

Taxes Can Be High, As Long As They Are Equitable and Encourage Productivity

Smith is easily assumed to oppose high taxes. But Smith praises English high taxation even while specifying, correctly, that England raised double amounts per capita compared to France (1.25 pound sterling per capita versus 0.652).[140] Scholars miss this point.[141] Moreover, he continues, the French "are much more oppressed by taxes than the people of Great Britain," where it isn't "possible to say that any particular order is oppressed."[142] What Smith specifies to be lighter in Britain were "the inconveniences" imposed by taxes, not their weight.[143] This was achieved because British taxation followed the four maxims he outlines.

But none of his four "maxims" oppose high taxation. They stipulate, first, that taxes should fall equally on all subjects "in proportion to the revenue which they respectively enjoy under the protection of the state"; that the amount should be certain and not arbitrary; that taxes should be levied at a regular and convenient time; and, finally, that they should be levied in the most efficient manner.[144] The fourth maxim may be mistaken as an injunction against high taxes: "Every tax," he says, "ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible."[145] But the point is about the efficiency of collection, as he continues, "over and above what it brings into the publick treasury." References to "easy taxes" also relate to ease of administration and collection.[146]

The motive in imposing a tax is critical, because it determines its economic impact. Taxes should aim to provide revenue to the state to fulfill its functions, not to create a monopoly.[147] Otherwise, Smith is pragmatic about the *level* of taxes. Duties, for instance, can be "occasionally either heightened or lowered according as it was most likely . . . to afford the greatest revenue to the state."[148] "Moderate" taxes should be preferred when high ones would decrease consumption,[149] thus reducing revenue. But decreasing the overall tax rate is nowhere a concern.[150] Moreover, if an income, such as ground-rent, owes its high value "to the good government of the state," it "should be taxed peculiarly, or should contribute something more than the greater part of other funds, towards the support of that government."[151]

Smith's overriding concern is productivity. Even when echoing an anti-tax, anti-government sentiment, his real concern is with how a tax distorts incentives on the productive use of capital. For instance, he claims, there "is no art which one government sooner learns of another than that of draining money from the pockets of the people." In this passage, he is critiquing the newfangled stamp duties on house sales.[152] But the quote seems anti-tax only when removed from this context. His point is that "so far as they diminish the capital value of that property, [duties] tend to diminish the funds destined for the maintenance of productive labour."[153] Smith's objection isn't that revenue is raised from the people per se; it is doing so in a manner that "drains [their] pockets," instead of encouraging productive activities and ensuring they do not burden the "necessitous person," e.g., the seller, which would be "very cruel and oppressive."[154]

By contrast, he recommends high taxes on expenditures that are non-productive and discretionary. House-rent, for instance, should be taxed highly to discourage profligacy and renting large houses. "If the tax indeed was very high, the greater part of people would endeavour to evade it, as much as they could, by contenting themselves with smaller houses, and by turning the greater part of their expence into some other channel."[155] Smith does not enable any assumption that frivolous consumption by the rich has trickle-down effects; he believes it should be strongly curtailed and sent in more productive directions.

Taxes Should Incentivize Economic Rationality and Counterbalance Wealth Asymmetries

Taxation is thus proposed as a mechanism to correct irrational behavior. Singled out for "correction" through tax incentives are landowners and the rich. The former, for instance, harm their tenants by seeking short-term windfalls. They tend to charge tenants a one-off large fine to renew the lease, rather than raise the monthly rent, which would apportion the increase throughout the year. "This practice is in most cases the expedient of a spend-thrift, who for a sum of ready money sells a future revenue of much greater value."[156] It hurts all parties, but chiefly the tenant who must forego a lump sum that could be invested in his business. As a result productive capacity is diminished—and so is the wealth of the community. Similarly, higher taxes should apply when landlords "foolishly" dictate to farmers how to cultivate land, due to their "conceit" of possessing superior knowledge.[157] Corrections, however, also applied to the poor: taxes on alcohol act as sumptuary laws and discourage consumption. Such frugality enables them to raise better families and be more productive workers.[158] Smith recommends irrational behavior be penalized and taxed at a higher rate: the state should instead incentivize the productive use of capital.

Smith thus does not believe that individuals always know best. The irrationality he critiques foreshadows the pathologies afflicting taxpayers in advanced democracies.[159] Instances of myopia are routinely castigated in the text, as when the "middling" and "superior" ranks demand taxes on necessaries, which they would not "if they understood their own interest."[160] When necessaries are taxed, the rich have to raise wages so that the workers can afford the higher-priced goods, while the rich have to pay the higher tax through their own consumption of necessaries as well.[161] Yet they think they are passing on the burden to the poor. When luxuries are taxed, by contrast, wages don't rise, since luxuries are discretionary and in any case out of the reach of the poor.[162]

The fundamental concern is the incidence of taxation: whom does the tax really affect and how does that impact productivity?[163] Smith repeatedly emphasizes the negative effects of shifting the burden to the poor, again echoing contemporary progressive concerns.[164] He also opposes the taxation of labor for the same reasons: advocates fail to understand that the tax is passed onto the consumer through higher prices, without increasing productivity.[165] Government officials alone could be taxed, as they are not engaged in "productive" labor. In England, the higher-paid officials were even taxed at a higher rate.[166] These were the only direct taxes on wages of labor. This discerning policy demonstrates the superiority of the British tax system. Smith thus clearly opposes regressive taxes both on labor and on necessary consumption.

The other systematic goal of taxation in Smith was to counterbalance asymmetries in wealth. Burdening the rich "more than in proportion" to their wealth and lightening the burden on the poor were criteria he applied repeatedly—not because morality demanded it, but because sound economics did. For instance, luxuries and irrational landlord practices should be taxed more heavily, as discussed above. Similarly, taxes on house rents should fall "heaviest upon the rich," who are prone and able to spend more on luxuries and vanities, rather than productive activities.[167]

His tone is indeed tentative when recommending higher taxes on the rich. He simply asserts that it is "not very unreasonable that the rich should contribute to the publick expense . . . something more than in proportion" to their revenue. And that such inequality would "perhaps" not be "unreasonable."[168] But that might be expected from an eighteenth-century text that never intended to be revolutionary, but which attacks the interests of the most powerful group in society.

Smith is far less qualified when condemning the "inequality of the worst kind": when taxes "fall much heavier upon the poor than upon the rich," an outcome he takes great and explicit pains to avoid at multiple points.[169] For instance, taxes on tolls and roads should burden the rich more than the poor. Carriages should not be taxed by weight, as this would burden the poor who carry bulk goods more than the rich, who carry luxuries and small-volume goods. In this way, "the indolence and vanity of the rich is made to contribute in a very easy manner to the relief of the poor."[170] He objects to government raising revenue from turnpikes for the same reason—rather than for some ideological opposition to government per se.[171]

Overall, the primary criteria for Smith are how taxes affect the productive use of capital, whom they ultimately burden, and how they encourage economic rationality, especially among the rich and spendthrift. As I will show, he also supports the taxation of inheritance. He criticizes taxation only when it minimizes revenue to the state, burdens the poor and the workers, and undermines productivity. His philosophy is thus not far from the principles informing contemporary liberal defenses of taxation and critiques of regressive taxation.[172]

Productive use of resources is thus hardly expected to occur by an "invisible hand." Taxation has to encourage it and so does regulation. These points are less noted because Smith is often critical both of the state and of regulation. But Smith does not reject regulation across the board, as scholars have noted.[173] His approach to regulation consistently implies a more efficient use of the state.

Regulation, The State, and "The Science of Political Œconomy"

Smith often highlights limits to the capacity of government, lending support to the "invisible hand" interpretation of his theory[174] and to the conservative attack on government regulation and labor protection that has been critical to the growth of inequality.[175] For instance, craftsmen, he argues, should not be disciplined by a guild, but by the fear of losing their customers. And he opposes guilds even when their purpose is to provide for the widows, orphans, the poor, and the sick.[176] Moreover, nowhere in *TWN* does he support welfare provisions for the weak.[177]

However, his critique of regulation is highly conditional. As already argued, Smith recommends regulation to constrain abuse by economically powerful actors. And when he condemns a specific regulation, he usually offers a replacement.

Smith indeed condemns guilds for favoring employers and workers at the expense of apprentices and the public. He objects to the long apprenticeships because they allowed masters to profit from apprentice labor, while protecting the wages of the already employed at the expense of apprentices living in penury. But increasing labor competition in his system did not mean a race to the bottom: as shown, he stipulated generous wages for workers. Further, apprenticeships were supposed to protect customers from fraud and bad craftsmanship. However, Smith proposes instead "quite different regulations . . . to prevent this abuse." Marks or stamps on products "give the purchaser much greater security than any statute of apprenticeship."[178] Smith does not reject regulation: he proposes alternatives that are more efficient and which presume public authority.

Smith's attitude towards the state's role in the economy is similarly pragmatic. Regarding public works, at issue is not whether the state could or should manage the resource; rather, it is whether the public utility can be self-sufficient. If it is, the state does not have to devote public revenue to it: it can be locally managed. Some departments, such as the mint or the post office, produce a surplus, part of which could be returned to the state.[179] In some cases, state provision is inefficient, as with turnpikes. But high roads are different: since traffic is guaranteed, they remain profitable even if their private owners neglect maintenance. In such cases, state management would be more efficient.[180]

Even when the management of resources becomes problematic, Smith does not turn to market forces. He expects Parliament to intervene. He acknowledges, for instance, that corruption is "very justly complained of" in the case of roads. But it isn't inevitable in his view. Road management is a recent practice and maybe "mean and improper persons" are in control. The practice "has not yet been brought to that degree of perfection of which it seems capable." Notably, state action is clearly necessary for improved management: the "greater part [of its defects] may in due time be gradually remedied . . . *by the wisdom of parliament*."[181]

Further, crucial sectors, such as tax farming, are categorically entrusted to the state, since the dangers of private corruption are overwhelming. Only state commissioners have both the incentives and the knowledge to collect taxes efficiently and fairly.[182] State management of banks could also be optimal: national banks could be highly profitable, as in Holland and Venice. If he rejected one for Britain, it is because of the profligate history specific to the English monarchy.[183]

The decision itself of whether to allocate the management of public resources to the private or the public sector belongs to the statesman or legislator. The legislator practices the science of "political œconomy," which "proposes to enrich both the people and the sovereign."[184] He must understand how the economy works to raise the revenue necessary for government but also to direct individuals to productive activities. He should prevent asymmetries between economic actors. As for "that insidious and crafty animal, vulgarly called a statesman or politician," only more limited policy questions should be entrusted to him.[185]

Legislation should certainly not be entrusted to profit-seekers. Merchants had proven cruel and disastrous as rulers, as the East India Company had shown.[186] But we should not make too much of his equally caustic dismissals of the kings and ministers of his time, "the greatest spendthrifts in the society." They were extravagant, prone to excessive debt,"[187] and were indeed incompetent.[188] Moreover, government interference in foreign trade is counter-productive and under scarcity it can be disastrous, causing famine when intending to help, as in Bengal.[189] But Smith hardly holds that opinion about himself and students of the science of "political economy": their task is to educate Parliament how to resist the sophistry of rent-seeking groups and avoid the errors of incompetent politicians.

In short, the pattern is systemic in Smith's work. Reservations about the state are context and incentive specific. Taxation should be used to micro-manage incentives, to decrease the counter-productive burden of the poor and to encourage the productive use of resources, while generating state revenue to cover the expenses that the "public stock and publick lands" do not.[190] Institutions are perfectible and the "wisdom of parliament," guided by the "science of the legislator," will enable them to reach such perfection.

However, "great property" already existed and even with judicious and pro-active state action in the economy and regulation against unfair practices of the economically powerful, much wealth was inherited and new accumulation would inevitably emerge. Next I consider the fate of the rich and inherited wealth in Smith's system.

Attacking "the Rich," Defending Equality

Smith acknowledges that in "thriving nations" some individuals are so rich they consume the produce "of a hundred times more labour than the greater part of those who work,"[191] and that "the affluence of the few supposes the indigence of the many."[192] However, these are features of societies with "great property."[193] I show that his own system is designed to minimize such concentrations. Further, as with the *Theory of Moral Sentiments*, the *TWN* does not reflect a deferential attitude towards the rich.[194] The word itself almost always has a pejorative or regulatory meaning when applied to individuals in *TWN*.[195] The "rich" live off revenue, which only encourages "idleness."[196]

Most importantly, however, Smith emphasizes two empirical points. First, structural factors prevent the concentration of wealth: either the behavioral patterns of the rich dissipate wealth or low profits prevent its accumulation in the first place. Second, growth requires legislative change, which additionally counters capital concentration.

First, the rich tend to dissipate their fortunes. This is not specific to any period: it occurs in both commercial and agrarian/feudal societies. The medieval nobility, for instance, lost the basis of its power (retained men) when it squandered its wealth for the "trinkets and baubles" newly available through long-distance trade. The irrationality of the rich had thus generated one the major social transformations in the book: the transition from a feudal to a commercial economy.[197]

The same tendency to dissipate wealth is evident in "commercial countries," though the mechanism is different. "Riches, in spite of the most violent regulations of law to prevent their dissipation, very seldom remain long in the same family," mainly due to vanity and self-love, which encourages spending.[198] In France, the problem was even cruder. Bankers and financiers were usually of "mean birth" and could not find socially suitable spouses, so they often remained bachelors and consumed their whole fortunes.[199]

Merchants, on the other hand, who can at least raise and sustain a fortune, are not expected to accumulate much, because profit "in most cases . . . is no more than a very moderate compensation."[200] Even in the corn trade, "great fortunes are as seldom made in this as in any other trade."[201] He assumes *individual* wealth would be low in another unlikely place: when he advises against taxing profits,[202] echoing Montesquieu. His reasons for advising this are not only fear of capital flight and difficulty of assessment; rather, merchants "engaged in the hazardous projects of trade" will "tremble" at disclosing the bad state of their credit which would lead to their ruin.[203] Again, no assumption of great wealth is discernible in these passages.

The second dynamic that would dissipate wealth involved land. Smith is deeply critical of "great property." He castigates the "human institutions" that enabled its inheritance and concentration, primogeniture and entail, and prescribes their abolition. The former allocated all land to the first-born, even though "nothing can be more contrary to the real interest of a numerous family, than a right which, in order to enrich one, beggars all the rest of the children."[204] It also undermined productivity, because large plots could not be efficiently cultivated.[205] Concentration was increased by entails, which constrained the sale of land over successive generations. Entails were "founded upon the most absurd of all suppositions…that every successive generation of men have not an equal right to the earth…; but that the property of the present generation should be restrained and regulated according to the fancy of those who died perhaps five hundred years ago."[206]

These are not simply inefficient practices; they are for Smith the key reasons why Western Europe had dramatically slower growth for centuries compared to countries with a free market of land and greater equality among landowners, such as America.[207] The institutions most responsible for the sluggish growth of Europe were thus ones protecting the property rights of the *rich*. Where lands are concentrated, incentives to improve cultivation are suppressed. "If landed estates . . . were divided equally among all the children, upon the death of any proprietor who left a numerous family, the estate would generally be sold. So much land would come to market, that it could no longer sell at a monopoly price."[208] The property rights crucial for development are those of the yeoman or small farm owner.[209]

Smith unequivocally condemns inheritance laws[210] and, unlike Locke, he rejects property as a "natural, presocial right."[211] Yet, he expresses deep pessimism that inheritance laws would ever be repealed, since they feed family "pride."[212] He was correct: entails were not abolished in England until 1925.[213] But his principles have clear empirical implications. If such institutions were abolished, concentration of land would be drastically reduced. In Britain, where to this day 0.6 percent of the population owns about 70 percent of the land,[214] these were radical propositions. Smith even goes so far as to suggest the redistribution of Crown lands, through the market mechanism: "It would . . . be for the interest of the society to . . . divide the [royal] lands among the people [better perhaps through] publick sale."[215]

Moreover, Smith supports inheritance taxes.[216] Taxing orphans is only "cruel and oppressive" when they are minors, since a father's death deprives them of income. It is "otherwise" when the descendants are adults with independent income. In Holland, he notes without disapproval, such taxes ranged between five and thirty percent.[217] These were "ancient" types of direct taxes that legitimately contributed to sovereign revenue. His critique is focused on the "modern inventions" that replaced such direct taxes, the stamp and sale duties,[218] as discussed earlier.

This may fall short of a heavy estate tax, but Smith's system would in any case block large estates from forming. He predicts that inherited or accumulated wealth will first fall prey to the frivolous consumption patterns of the rich. His own principles on the inheritance of wealth and especially land, even though not expected by him to be instituted, would serve to distribute property even further if applied in any contemporary economy.

In all, the rich are either parasitical, self-destructive, or manipulative. But does natural inequality make economic inequalities inevitable? In fact, unlike half of the American public,[219] Smith does not believe that human inequality is set at birth.[220] Instead, he attributes it to the division of labor. "The difference . . . between a philosopher and a common street porter . . . seems to arise not so much from nature, as from habit, custom, and education." After people become employed, the "difference of talents comes then to be taken notice of, and widens by degrees, till at last the vanity of the philosopher is willing to acknowledge scarce any resemblance."[221]

Nonetheless, even such a revision allows substantial gradations in wealth, social status and in the burdens of labor. There is no return to the idyllic egalitarianism of Smith's primitive "savages,"[222] who were all equal because they were all equally "naked."[223] The division of labor in commercial societies has introduced great variation in professions at the same time as it has improved living standards. This is presumably irreversible. Smith's claim remains valid.[224]

The relevant question in this article, rather, has been whether this necessarily means steep *economic* inequality within commercial societies.[225] The key here is that in a rightly-structured economy, labor wages should be high and profits low, so sharp inequalities should disappear. Executive pay, for instance, would no longer have a ratio of 243:1 to that of the average worker, as is currently the case.[226] The distribution of income, in such a system, would be radically reconfigured. And wealth would not be allowed to accumulate.

Conclusion

As argued, Smith's principles imply that inequality should not prevail in the market economy. Like contemporary progressives, he thinks inequality is normatively and economically undesirable. Smith's theory is often contrasted to more radical calls for revolutionary change or redistribution in the contemporary capitalist economy.[227] Certainly, nothing as radical as, for instance, Paine's demand for a basic income and pension fund in the 1790s can be discerned in Smith.[228]

Nonetheless, if I am right, his political economy constitutes a radical indictment of contemporary inequality. His model assumes limited profits and high labor wages. The legislator must use taxation to incentivize the productive employment of capital, while targeting the rich "something more than in proportion." Legislation and regulation should also prevent those who live by profits from oppressing weaker economic groups. Finally, because laws enabling the hereditary concentration of wealth are damaging, Smith opposes them. In all, such a system should not allow concentrations either of income or of wealth to emerge.

Smith's diagnosis thus resonates with critiques of the neo-classical paradigm, as leveled by Robert Bates against development economics[229] and by social scientists concerned with growing inequality in the US today.[230] Like them, Smith believes inequality is mostly due to rentier practices unopposed by legislation.

Equally troubling to scholars today is another finding: the public lacks consistent and informed positions against inequality-producing policies.[231] As Lisa Martin notes in this journal,[232] this confusion critically enables government inaction. However, confusion exists because opinion is divided on whether inequality is indeed undesirable or inefficient, both at the normative and the empirical level.

Normatively, particularly in the US, inequality is far from universally condemned. Economic freedom is commonly defined "as an equal chance to become unequal."[233] As mentioned, half of the American public believes inequality between persons is set at birth: from such a worldview, economic inequality is inevitable in a meritocracy.[234] As argued here, revising Smith prompts us to reconsider such widespread assumptions.

Even more influential and intractable, however, is the efficiency objection to equality. The trade-off between efficiency and equality is a commonplace in economic thinking, given classic expression by Arthur Okun in 1975: "Any insistence on carving the pie into equal slices would shrink the size of the pie."[235] Acemoglu, Robinson and Verdier recently posited inequality as crucial for innovation: "A greater gap of incomes between successful and unsuccessful entrepreneurs (thus greater inequality) increases entrepreneurial effort and hence a country's contribution to the world technology frontier."[236] If growth is predicated on inequality, efforts to reverse it aren't only misguided, they are counterproductive. But the debate remains open and the logic can be strongly questioned.[237]

An eighteenth-century text of classical political economy cannot decide such complex questions. Moreover, these are long-standing debates in economic theory. Shortly after Smith, David Ricardo tied high profits to "the motive for accumulation" that was the engine of growth and he set profits at odds with high wages.[238] But Smith's text shows that the alternative view advocated by many economists and social scientists today—that steep inequality, high profits, and low wages are inimical to market principles—is by no means a departure from the liberal tradition.

Critically, Smith issues a caution: he suggests that inequalities result from the "persuasive trickery" of those who live by profit. It is perhaps only an irony that the true progenitor of current assumptions about profits and wages, David Ricardo, was a stockbroker and a speculator, who amassed a large fortune. Smith, the customs collector, aims instead to explain in *TWN* how to counterbalance deceitful profit-seekers. He is not optimistic and is also clear of the dangers: anyone who attempts to do so, "and still more if he has authority enough to be able to thwart them, neither the most acknowledged probity, nor the highest rank, nor the greatest public services can protect him from the most infamous abuse and detraction, from personal insults, nor sometimes from real danger, arising from the insolent outrage of furious and disappointed monopolists."[239]

Two centuries later, there is no reason to believe that conditions have changed or that calls for "pre-distribution" will be better received. So the argument that high profits and inequality are a sign that the "free" market economy has failed or at least has deviated from first principles—even while some firms and individuals might be highly successful—remains as timely as ever.

Notes

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[1] The literature is more than extensive; see, for example, Milanovic 2005; Hacker and Pierson 2010.

[2] Rawls 1971; Von Mises 1996, 287; Acemoglu, Robinson, and Verdier 2012.

[3] Smith 1976b.

[4] Among many, McCarty, Poole, and Rosenthal 2006; Gelman 2008; Kenworthy and Pontusson 2005; Hacker and Pierson 2005. The American public mostly wishes to counter inequality; Page and Jacobs 2009.

[5] Hacker 2011, 35.

[6] Hacker 2011, 35; O'Neill 2012.

[7] Hacker and Pierson 2010, 3.

[8] I discuss political theory scholarship in the next section.

[9] Hacker and Pierson 2010; Stiglitz 2012; Galbraith 2000; Stepan and Linz 2011.

[10] Acemoglu, Robinson, and Verdier 2012; Alesina and Rodrik 1994; Persson and Tabellini 1994; Judis 2013.

[11] Acemoglu, and Robinson 2012, 2005; North, Wallis, and Weingast 2009; Bates 2008, 2010; Olson 2000; Boix 2003.

[12] Levi 2013, 190.

[13] North, Wallis, and Weingast 2009, 112.

[14] Hartzell 2010, 290.

[15] Blyth 2013, 101, 114.

[16] Martin, Mehrotra, and Prasad. 2009

[17] I don't offer an economic proof of these predictions, or a defense of their plausibility—a task more appropriate for economists.

[18] Winch 1985; Rothschild 1992; Mehta 2006; Muthu 2008.

[19] Cropsey 1957; Hont and Ignatieff 1983; Rothschild and Sen 2006; Kalyvas and Katznelson 2001; Fleischacker 2004; Forman-Barzilai 2010; Pack 2010; Frazer 2012.

[20] Viner 1927; Skinner and Wilson 1975; Winch 1978, 1996; Haakonssen 1981; Rothschild 1994, 2001.

[21] Smith [1762] 1978a, 5; Rothschild and Sen 2006, 321.

[22] Hont and Ignatieff 1983, 1, 2.

[23] Winch 1996, 101-2.

[24] Fleischacker 2004, 225, also 55, 79; Rothschild and Sen 2006, 321; Cropsey 1957, 72, 95; Winch 1978, 58, 87-92, 96, 99. In Winch 1978, 70-102, "oppressive inequality" is counteracted by the system of justice generated by commercialization. Rothschild mentions in a

footnote "the equitable distribution of goods" is an "objective" in *TMS* and "increased national income" in *TWN;* 2001, 312n144.

[25] Smith [1776] 1976, I.i.11, [1762] 1978a, §3.

[26] The terms "commercial" and "mercantile" appear almost always in tandem *in TWN*; IV.i.45, IV.iii.I, V.iii.a.41, V.ill.c.15, especially IV.v.a.25. Sometimes, passages refer to the "civilized society" that emerged with the accumulation of property.

[27] *TWN,* IV.ix.51.

[28] Smith [1776] 1976, IV.ii.43.

[29] Accordingly, I will not consider Smith's moral philosophy (1976a) and jurisprudence (1978b). Eric Schliesser 2008) showed the merits of this approach in his analysis of equity.

[30] Montes (2004)

[31] I.ix.20. Dutch return rates in the late 1700s were indeed about 3.5 percent for both savings (government bonds) and investments (Dutch East India Company stocks); de Vries and van der Woude 1997, 448. Inflation was not yet theorized but if returns didn't keep up with it, productive activity would be even more pressing.

[32] Determining such an amount is relative to average living standards. In the formula given here, C_0 is initial capital, N is life expectancy in years, f is the average rate of inflation, i is the average interest rate, P_1 is the initial payment and j is the starting year.

$$C_0 = P_1 \sum_{j=1}^{N} \frac{(1+f)^{N-j}}{(1+i)^{N-j}}$$

[33] Equalized outcomes follow logically from Smith's premises, but Dutch inequality was in fact the highest in Europe; van Zanden 1995, 652-3.

[34] I.viii.12.

[35] Except in new economies, discussed later.

[36] Norris 2011; Rampell 2010.

[37] Naples and Aslanbeigui 1996. Economics textbooks elide the inconsistency by analyzing the difference between economic and accounting cost; Krugman and Wells 2009, 227-9, 33-6; Mankiw 2009, 260-2, 282-3.

[38] Smith discussed both high profits and high profit rates. But if competition blocks the accumulation of capital, the distinction is not as consequential.

[39] I.xi.p.7, 8-9.

[40] I.xi.p.10.

[41] I.ix.10.

[42] I.ix.13.

[43] I.ix.9. Smith is correct. Estimates suggest English per capita GDP was 50 percent higher than the French (Maddison 2001) and that worker living standards in London were double compared to Paris (Allen 2001).

[44] I.ix.8; I.viii.44.

[45] I.ix.10

[46] The Dutch had the highest wealth per capita in Europe in the late 1700s. But the "profitless growth" that begun in the early 1700s, with low interest and profit rates, combined with heavy war burdens, led to a large debt, and eventually decline; de Vries and van der Woude 1997, 682-4, 128. Smith excoriated debt, V.iii, but he only condemned some Dutch taxes, on necessaries, for being counter-productive—not the high level of Dutch taxes in general; V.ii.k.79.

[47] I.vii.5.

[48] I.vi.5.

[49] I.x.b.35-36.

[50] I.vii.9-16.

[51] I.ix.15, 10-13.

[52] I.ix.24.

[53] I.ix.24.

[54] Shiller 2000; Norris 2011; Rampell 2010.

[55] Norris 2011.

[56] Schmitt 2013; Card and Krueger 1995; c.f. Neumark and Wascher 2000.

[57] Stigler 1946; Friedman and Friedman 1990, 19.

[58] I.viii.27.

[59] I.viii.42.

[60] World Bank 1994.

[61] V.ii.k.4.

[62] V.ii.i.

[63] I.viii.16.

[64] I.viii.36.

[65] It is also strikingly similar to language of the 1940s; Stigler 1946.

[66] V.ii.k.3.

[67] I.viii.3, 15.

[68] Sen 1999; Rothschild and Sen 2006.

[69] Blank 2008.

[70] Citro and Michael 1995.

[71] Rector and Sheffield 2011.

[72] OECD 2011, 68. This sets the minimum yearly income in the US in 2011 at about $25,000, which is about 170 percent of what the federal minimum wage yields today on an annual basis; Noss 2012.

[73] Smith stops short from condoning the view he extensively analyzes—whereby wage levels should be pegged at least at double the cost of maintenance of labor, so as to support a family, I.viii.15—yet he clearly leaned in a generous direction.

[74] Temple 1673.

[75] [1714] 1924, 287, 288. Marx 1906, VII.XXV.5.

[76] Young 1771.

[77] I.viii.41.

[78] Raff and Summers 1987; Akerlof and Yellen 1986.

[79] I.ix.11.

[80] I.ix.14.

[81] I.ix.14.

[82] Mill 1909, IV.vi; Ricardo 1817; Malthus 1826.

[83] I.ix.15.

[84] I.vii.20-32. Accident and natural causes also lead to price deviations, but Smith devoted little space to them.

[85] Haakonssen 1998.

[86] Smith attacks profit-seekers throughout: IV.i; IV.i.10; IV.iii.c.10; IV.iii.2; IV.viii; IV.ii.43. For his views of government, see the sections on wise legistation and regulation .

[87] Rosenberg 1974.

[88] I.xi.p.

[89] IV.iii.c.10.

[90] V.i.e.22,I.v.37.

[91] IV.iii.c.9; c.f. IV.viii.2.

[92] IV.v.b.3-4, 21.

[93] Muthu 2008.

[94] III.iv.10.

[95] IV.i.10; IV.ii.43.

[96] IV.iii.c.14.

[97] IV.i.10.

[98] IV.iii.c.10.

[99] I.xi.p.10.

[100] I.viii.12-13.

[101] Baker 2013.

[102] I.viii.12,I.x.c.34, I.x.c.61.

[103] Mehta 2006, 257.

[104] Hicks 1932; Heldman, Bennett, and Johnson 1981.

[105] I.viii.11.

[106] I.viii.12.

[107] I.viii.14.

[108] Smith describes the causes of protest (the high cost of provisions or the high profits of employers) with the word "pretence," I.viii.13. But that does not suggest skepticism, since he defines both issues as pathological. The noun meant "putting forth of a claim" in his time; *Oxford English Dictionary*, s.v., "pretence."

[109] I.x.c.61.

[110] Winch 1985, 237.

[111] Holmes 1995; Holmes and Sunstein 1999; Bates 2008, 2005.

[112] V.ii.h.12.

[113] Haakonssen 1981, 85, 89, 97.

[114] V.i.b.1.

[115] IV.vii.c.53.

[116] I.x.c.61.

[117] Winch 1985.

[118] I.x.c.12ff.

[119] I.x.c.18; I.x.c;IV.v.b.43; IV.viii.2.

[120] Winch 1996, 101.

[121] IV.viii.30.

[122] The woolgrowers included landowners and were only *relatively* weak; Thirsk 1990, 190-3.

[123] I.v.37.

[124] II.iv.15, 3.

[125] II.ii.94.

[126] I.x.c.62; Fleischacker 2004, 220.

[127] Polanyi 1944.

[128] Rothschild 1994; Fleischacker 2004; Mehta 2006.

[129] Smith 1976a, IV.i.10; Hont and Ignatieff 1983, 11; Winch 1978, 92, 98; c.f. Fleischacker 2004, 108ff.

[130] Viner 1927, 215.

[131] IV.ii.9.

[132] IV.ii.6,1ff.

[133] II.iii.27.

[134] IV.ii.10ff.

[135] I.x.c.12; IV.v.b.16; IV.ix.51.

[136] II.iii.28-31; IV.v.b.43.

[137] I.i.

[138] Moran 2009.

[139] Hacker and Pierson 2010; but c.f. Pontusson 2011.

[140] V.ii.k.78. England continued to extract more per capita into the twentieth century, Mathias and O'Brien 1976.

[141] Even Viner 1927 and Rothschild and Sen 2006 don't mention this point. Fleischacker 2004 (196-7) states the opposite, though the point would strengthen his progressive reading of the text.

[142] V.ii.k.78.

[143] V.ii.k.66.

[144] V.ii.b.3-6.

[145] V.ii.b.6.

[146] The expression is not in *TWN*; Smith 1976b, 22. Poll-taxes yielded less in England than France due to English "mild government," suggesting a small government approach. However, Smith opposed poll-taxes because they violated his maxims, as they were either arbitrary or uncertain—lower yield was thus expected and desirable; V.ii.j.7. They also harmed the poorest: "so far as they are levied upon the lower ranks of people, [they] are direct taxes upon the wages of labour, and are attended with all the inconveniencies of such taxes;" V.ii.j.8. But he still called them "a badge of liberty;" V.ii.g.11.

[147] V.ii.k.32,38.

[148] V.ii.k.38.

[149] V.ii.k.33-4.

[150] Overall, the fundamental importance of the "uniform system of taxation" in Britain is that it fostered the development of trade, as the whole of the domestic trade was "almost entirely free," V.ii.k.69. This—and not low taxes—was "one of the principal causes of the prosperity of Great Britain" for Smith, ibid.

[151] V.ii.e.11.

[152] V.ii.h.12.

[153] V.ii.h.14.

[154] V.ii.h.13.

[155] V.ii.e.7. Demands for a tax on land value instead of transfer duties prefigure the Georgist ideas on land tax reform that resurfaced with the crisis of the welfare state; Seager 2007.

[156] V.ii.c.12.

[157] V.ii.c.13.

[158] V.ii.k.7.

[159] Bartels 2005.

[160] V.ii.k.9;V.ii.k.7;V.ii.c.18.

[161] V.ii.k.9.

[162] V.ii.k.6. Taxes on luxuries are highly inefficient in administration, producing losses. He concludes that this problem is lightest in England, due to her administrative advantage, V.ii.k.61-66.

[163] Incidence was first emphasized by the Physiocrats.

[164] Newman and O'Brien 2011.

[165] V.ii.i.

[166] V.ii.i.7.

[167] V.ii.e.6.

[168] V.ii.e.6.

[169] V.i.d.5, 13;V.ii.e.6, 19;V.ii.h.13;V.ii.k.45,55.

[170] V.i.d.5.

[171] V.i.d.13.

[172] Holmes and Sunstein 1999; Newman and O'Brien 2011.

[173] Fleischacker 2002, 220.

[174] IV.ix.51; Haakonssen 1998.

[175] Hacker and Pierson 2010; Schlozman and Tierney 1986.

[176] I.x.c.29-31.

[177] Expecting Smith to advocate state welfare is anachronistic, as Fleischacker noted (2004, 201), suggesting instead that Smith enabled the modern concept. I sidestep this debate, since I focus on the prevention of inequality, not its redress; Haakonssen 1998

[178] I.x.c.13.

[179] V.i.d.3, 10; V.ii.a.5.

[180] V.i.d.8.

[181] V.i.d.9; emphasis added.

[182] V.ii.k.73.

[183] V.ii.a.4.

[184] IV.1.

[185] IV.ii.39.

[186] IV.vii.b.11.

[187] II.iii.36; V.iii.3.

[188] V.ii.a.6-7.

[189] Iv.ix.50; IV.v.b.7.

[190] V.i.i.6; V.ii.a.21.

[191] [1776] 1976, 10.

[192] V.i.b.2.

[193] V.i.b.2.

[194] Sometimes such deference is assumed for the TMS; (Winch 1978, 54-5). But Smith treats it as "the great and most universal cause of the corruption of our moral sentiments" (*TMS*, I.iii.3.1). I thank Michael Frazer for bringing the passage to my attention.

[195] C.f. IV.iii.c.11. References to "rich" individuals appear on about sixty pages in Volume I and about forty pages in Volume II. "Wealthy" appears rarely and denotes lower levels of wealth; V.iii.3.

[196] II.iii.12-13.

[197] III.iv.15.

[198] III.iv.16; V.iii.1. That remained true until recently, as intra-family wealth usually lasted three generations, Becker and Tomes 1986, S21. But such limits are now eroding; Bowles and Gintis 2002; Hacker and Pierson 2010, 28-9.

[199] V.iii.36.

[200] V.ii.f.2.

[201] IV.v.b.8.

[202] V.ii.f.6.

[203] V.ii.f.12.

[204] III.ii.4.

[205] III.ii.7.

[206] III.ii.5.

[207] III.iv.19; III.i.1ff.

[208] III.iv.19.

[209] III.iv.20.

[210] Winch 1978, 67.

[211] Fleischacker 2004, 197.

[212] III.ii.4.

[213] Simpson 1986.

[214] Cahill 2001.

[215] V.II.a.19.

[216] Fleischacker 2004, 200.

[217] V.ii.h.4.

[218] V.ii.h.12.

[219] National Election Studies 2002.

[220] Political theorists have long noted this; Levy and Peart 2003; Fleischacker 2004.

[221] I.ii.4; Peart and Levy 2008.

[222] Fleischacker 2004, 224; Hont and Ignatieff 1983.

[223] Smith 1976b, I.i.11.

[224] Milanovic 2005.

[225] This does not minimize the effects of the division of labor on the moral constitution of the worker; Winch 1978, 83. But Smith emphasized this would happen "unless government takes some pains to prevent it" and he made a radical demand for public education, V.i.f.50; Rothschild 2001, 11; Fleischacker 2004, 205.

[226] Stiglitz 2012, 3.

[227] Bates 2005, xvii. C.f. Fleischacker 2004, 201.

[228] Paine 1797.

[229] Bates 2005.

[230] Bartels 2005, 2008; Galbraith 2012; Page and Jacobs 2009; Stiglitz 2012.

[231] Bartels 2005.

[232] Martin 2013, 181.

[233] Hochschild 1981, 278.

[234] National Election Studies 2002.

[235] Okun 1975, 48. See also Kenworthy 2004, ch. 4.

[236] Acemoglu, Robinson, and Verdier 2012, 1.

[237] Kenworthy 2004, 2012; Alesina and Rodrik 1994; Persson and Tabellini 1994; Judis 2013.

[238] Ricardo 1817, 193.

[239] IV.ii.43.