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## The Scottish Enlightenment and the Challenges of Commercial Society: Adam Smith's Wealth of Nations

### *Summary*

**RESEARCH OBJECTIVE:** The aim of this paper is to examine the economic advice that Adam Smith provides for individuals and relate that to the judgments that he makes about national economies. It argues that Smith's interest in unintended consequences leads him to consider both levels of economic activity in a particular way. While these aspects of his thought have been discussed in the literature, they have not been analysed together.

**THE RESEARCH PROBLEM AND METHODS:** As a book the *Wealth of Nations* had two interrelated purposes: it was a scientific attempt to understand political economy, and it was also a critical intervention into British policy based upon the evidence of that inquiry. This paper looks at the connection between these two aspects of the book. In particular it examines how Smith moves from an explanation of the evolution and operation of commercial society that depends on unintended consequences (such as the famous 'invisible hand') to a set of suggestions for macro level policy to be undertaken by the government and micro level advice for individuals. The paper proceeds by close textual analysis of key passages from Smith's work.

**THE PROCESS OF ARGUMENTATION:** the paper traces how Smith's scientific approach generalises from historical evidence to identify and study the core principles of the division of labour and trade. From here he identifies a set of necessary conditions for the successful operation of a commercial society: The rule of law, political stability, and certain public works and regulations.

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But Smith also offers some observations on successful economic strategies that should be adopted by individuals.

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**RESEARCH RESULTS:** The paper shows that Smith communicates his advice to individuals through character sketches of the book's 'hero' the prudent man, and the book's 'villains' the prodigal and the projector. The contrast between these examples serves a didactic purpose for Smith.

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**CONCLUSION, INNOVATION AND RECOMMENDATION:** The paper concludes by taking a look at Smith's advice to individuals for pursuing economic success through character sketches. It contributes to the literature by stressing Smith's interest in the connection between macro-level national economic phenomena and micro-level individual economic strategy, and by showing how his book offers advice to both nations and individuals. This is an underexplored dimension of Smith's account that is examined in detail in a way not present in the scholarly literature.

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**KEYWORDS:**

Adam Smith, Commercial Society, prudence, unintended consequences

## INTRODUCTION

When Adam Smith published the *Wealth of Nations* in 1776 it seems that he had two distinct, but related, objects in mind. The first of these was to provide a systematic survey of the political economy of commercial societies that would place the study of the economy on a secure and scientific basis. The second purpose was to use this systematic enquiry and its conclusions to contribute to the debates about British economic policy. Smith famously described this as "a very violent attack... upon the whole commercial system of Great Britain" (Smith, 1987, p. 251). My aim in this paper is to examine how one of the key theoretical developments of Smith's intellectual enquiry impacts on the advice that he gives. What I have in mind here is not so much Smith's actual policy interventions through direct advice given to politicians, nor is it his general prescription for the role of the government as detailed in Book V of the *Wealth of Nations*.<sup>1</sup> These I take to fall broadly under the

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1 For discussions of Smith's impact on policy making see Bonnyman, 2014; Phillipson, 2010; Stigler, 1971.

heading offered by Tom Campbell of “Contemplative Utilitarianism” (Campbell & Ross, 1981), practical, pragmatic, and evidence based policies that a government can enact to assist economic development. Instead I want to look at how Smith’s adoption of a general theoretical outlook that stresses unintended consequences impacts on his ideas with particular reference to what he says about the behaviour of individuals in a commercial society. This approach reveals how Smith’s character sketches of the virtues, usually discussed in the literature on his moral philosophy (Hanley, 2009), form part of the advice on effective economic behaviour found in his political economy.

In order to do this I want to suggest that Smith’s approach is to divide his policy advice into two levels: a macro level and a micro level. On the macro level the adoption of an unintended consequence approach leads Smith to favour minimal direct economic planning in the place of a secure system of property rights backed by a state that provides key non-market provided goods. But for the purposes of the current essay I want to focus on the micro level. In the existing literature there is a tendency to view the micro level through the macro level. One clear example of this can be found in discussion of the famous idea of the invisible hand where this particular sub set of unintended consequences explanations tends to ignore the purposiveness of the actors involved. As a result this essay will adopt an analytic approach, attempting properly to reconstruct Smith’s micro level discussion to determine the place of purposive individual behaviour within an unintended consequences macro analysis. My aim then is to examine how Smith’s adoption of unintended consequences explanations impacts on the advice he gives to individuals on how they ought to conduct their economic activities (even if they cannot predict the unintended consequences of their chosen actions). In other words my focus is on the individual level actions that come together to form the unintended consequences that Smith sees as characteristic of social change in a commercial society.<sup>2</sup> It is the advice that he develops on this level that is one of the most overlooked parts of Smith’s advice for eighteenth century Britain.

In order to explore this underappreciated aspect of Smith’s thought I will provide an analytical account of its place and operation within

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2 In this sense the paper will contribute to the debate surrounding the nature of the invisible hand (Otteson, 2002; Smith, 2006).

his thinking.<sup>3</sup> Let's clear the ground with a couple of preliminary observations. The first concerns Smith's methodology. Smith's approach is scientific in the sense that its theoretical observations are generalisations drawn from evidence. The book abounds with examples and data, case studies and historical observations. Smith's desired aim was to systematise our thinking about the economy. But the desire to systematise is conducted with an appropriate degree of sceptical caution and with one eye always on the evidence.

Economic thinking, as he observes in the introduction, has given rise to a number of different systems of thought which have in turn sought to account for the development of the economy to its present condition. But here, right at the start of the book, Smith makes a clear distinction between the act of systematic analysis and the motivations of the actors whose unintended consequences have produced the object of study. This observation, of a distinction between the motivations and reasoning of actors involved in actual economic activity and the motivations and reasoning of the detached philosophers observing the system as a whole, becomes central to Smith's thinking about political economy.

Perhaps the clearest statement of the limitations that this puts on policy comes in his own admission that his desired policy of free trade is unlikely ever to be enacted.

To expect, indeed, that the freedom of trade should ever be entirely restored in Great Britain, is as absurd as to expect that an Oceana or Utopia should ever be established in it. Not only the prejudices of the publick, but what is more unconquerable, the private interests of many individuals, irresistibly oppose it (Smith, 1976a, p. 471).

Smith clearly believed that he had provided a convincing argument against mercantilist policy, but at the same time he accepted the political and economic reality that the system which he advocated in its place was unlikely ever to be realised in full. For the purposes of our discussion here it is worth noting that it is the private interests of individuals that oppose it. This points us to the topic that I want to

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3 This analytic account will make the case for the centrality of this to Smith's overall account of commercial society, understanding, of course, that Smith's project is undertaken in the particular context of eighteenth century political economy (Hont, 2005; Rutherford, 2012; Berry, 2015).

explore: what did Smith think individuals should do in a commercial economy? How should they direct their behaviour?

The importance of this issue is underlined by Smith's understanding of the nature of the wealth of a nation. Smith's definition of what the state should seek for the national economy is essentially the same as that which he attributes to the individual: "But the great object of the political oeconomy of every country, is to increase the riches and power of that country" (Smith, 1976a, p. 372).

But what we must also bear in mind is that Smith has a particular understanding of what such wealth and power is. It is an aggregate of the wealth and power of the individuals within a society. Smith's defence of commercial society is based on the idea that the living standards of the great bulk of the population are rising in an advancing economy, "scanty" (Smith, 1976a, p. 91) in a static economy, and precarious in a declining or shrinking economy.<sup>4</sup> The power that comes from wealth is "the power of purchasing; a certain command over all the labour, or over all the produce of labour which is then in the market" (Smith, 1976a, p. 48). The wealth of a nation is the wealth of its people taken as a whole: their ability to acquire the "necessities and conveniencies" (Smith, 1976b, p. 231) of life. It is this that allows Smith to differentiate between the public interest and the specific interests of merchants who are able to persuade the government that their own interests are the interests of the people through arguments about the balance of trade. Smith's point being, of course, that the interests of this specific group are almost always at odds with the interests of society as a whole (Smith, 1976a, p. 264-267).

## UNINTENDED CONSEQUENCES AND FEUDALISM

Unintended consequences are at the heart of Smith's analysis in the *Wealth of Nations*. From the very start he deploys the concept to account for his central principle of the division of labour:

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4 Compare with: "The progressive state is in reality the cheerful and the hearty state to all the different orders of society. The stationary is dull; the declining, melancholy" (Smith, 1976a, p. 99). This leads Smith to observe: "It is not the actual greatness of national wealth, but its continual increase, which occasions a rise in the wages of labour" (Smith, 1976a, p. 87).

The division of labour, from which so many advantages are derived, is not originally the effect of any human wisdom, which foresees and intends that general opulence to which it gives occasion. It is the necessary, though very slow and gradual consequence of a certain propensity in human nature which has in view no such extensive utility; the propensity to truck, barter, and exchange one thing for another (Smith, 1976a, p. 25).

The classic case study of social change in the *Wealth of Nations* is the decline of feudalism and the rise of commercial society.<sup>5</sup> Smith's central discussion of this process dwells on the unintended consequences of the interaction of two groups, lords and merchants, who each have their own self-regarding objectives, but whose interaction issues in a macro level social change that neither intended. In his classic statement:

A revolution of the greatest importance to the publick happiness, was in this manner brought about by two different orders of people, who had not the least intention to serve the publick. To gratify the most childish vanity was the sole motive of the great proprietors. The merchants and artificers, much less ridiculous, acted merely from a view to their own interest, and in pursuit of their own pedlar principle of turning a penny wherever a penny was to be got. Neither of them had either knowledge or foresight of that great revolution which the folly of the one, and the industry of the other, was gradually bringing about (Smith, 1976a, p. 422).

If large scale social change is not the result of deliberate policy, but rather can be retrospectively identified as a pattern emerging from individual behaviour, then we see what Christopher Berry has aptly described as Smith's "demotion of purposive rationality" (Berry, 1997, p. 39) in historical explanation. Both the lords and the merchants have a conception of their own interest, and the interaction of them in its pursuit leads to a socially beneficial outcome neither intended. In a moment we will outline the political lessons that Smith draws from this, but our interest here lies with the advice that Smith provides for individuals.

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<sup>5</sup> Smith offers a parallel analysis of the rise and fall of slavery (Smith, 1976a, p. 99, 390).

Viewed from this perspective Smith is suggesting that the lords and the merchants have a conception of their own interest and they respond to it. In pursuing what they believe to be their interest in the most effective way apparent to them they create social patterns which in one sense reflect the mutual satisfaction of interest – the lords get the goods, the merchants turn a profit. Mutual satisfaction through exchange if focussed on the particular exchange, it is not motivated by a desire to maximise a macro level social output: nonetheless that is what arises as an unintended consequence.

Smith offers a similar model in his discussion of the incentives offered by differential wages:

If in the same neighbourhood, there was any employment evidently either more or less advantageous than the rest, so many people would crowd into it in the one case, and so many would desert it in the other, that its advantages would soon return to the level of other employments. This at least would be the case in a society where things were left to follow their natural course, where there was perfect liberty, and where every man was perfectly free both to chuse what occupation he thought proper, and to change it as often as he thought proper. Every man's interest would prompt him to seek the advantageous, and to shun the disadvantageous employments (Smith, 1976a, p. 116).

The basic observation that individuals will pursue what they believe to be their own advantage in both of these examples assumes that the exchanges take place within a framework of rules. Successful mutual exchange depends upon other options, such as theft or expropriation, being ruled out. Not only must the merchant be assured of retaining his profit, but he must also be assured of punishment if, instead of turning a penny, he decides to pick a pocket. Likewise the lord must be prevented from exercising force in extracting the good from the merchant, an opportunity that the dissipation of wealth in Smith's account of the fall of feudalism assures.

At the root of Smith's argument in favour of allowing the free interaction of individuals in this sort of exchange is an epistemic argument:

But the law ought always to trust people with the care of their own interest, as in their local situations they must generally be able to judge better of it than the legislator can do (Smith, 1976a, p. 531).

Individuals are best placed to know both their own interest and the most effectual way to realise it in their own specific circumstances. As a result of this Smith's micro level advice to individuals will take the form of general suggestions about types of behaviour.

## DUTIES OF THE SOVEREIGN

In Book V of the *Wealth of Nations* Smith famously states what he takes to be the three main roles of the government: defence, administration of justice, and the provision of certain public works that would not be provided by the market (Smith, 1976a, p. 687-688).

As Gavin Kennedy has pointed out the scope for government action that Smith allows under the third heading is far wider than often assumed by some of his more laissez faire contemporary admirers.<sup>6</sup> Smith clearly envisages a role for the government in economic activity beyond defence and property rights. However, as Charles Griswold (1999, p. 295) and Samuel Fleischacker (2003, p. 236) have noted,

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6 Kennedy (2008, p. 182-183) lists 27 examples in *WN* which debunk the view that Smith held a dogmatic 'laissez-faire' view that was always opposed to state action. These include: the Navigation Acts, blessed by Smith under the assertion that "defence, however, is of much more importance than opulence" (Smith, 1976a, p. 464); Sterling marks on plate and stamps on linen and woollen cloth (Smith, 1976a, p. 138-139); enforcement of contracts by a system of justice (Smith, 1976a, p. 720); regulations of paper money in banking (Smith, 1976a, p. 437); obligations to build party walls to prevent the spread of fire (Smith, 1976a, p. 324); erecting and maintaining certain public works and public institutions intended to facilitate commerce (roads, bridges, canals and harbours) (Smith, 1976a, p. 723); coinage and the mint (Smith, 1976a, p. 478); post office (Smith, 1976a, p. 724); regulation of institutions, such as company structures (joint-stock companies, co-partneries, regulated companies and so on) (Smith, 1976a, p. 731-758); temporary monopolies, including copyright and patents, of fixed duration (Smith, 1976a, p. 754); education of youth (village schools, curriculum design and so on) (Smith, 1976a, p. 758-789); education of people of all ages (tythes or land tax) (Smith, 1976a, p. 788); the prevention of "leprosy or any other loathsome and offensive disease" from spreading among the population (Smith, 1976a, p. 787-788); registration of mortgages for land, houses and boats over two tons (Smith, 1976a, p. 861, 863); government restrictions on interest for borrowing (Smith, 1976a, p. 356-357); laws against banks issuing low-denomination promissory notes (Smith, 1976a, p. 324); and moderate export taxes on wool exports for government revenue (Smith, 1976a, p. 879).

this role is pragmatic and based on the likely success of each policy intervention. A point which reminds us that Smith has no settled rule which determines where and when a government should act. What he does have, however, is a clear idea of what is essential for government to provide and where government action is unlikely to succeed.

Smith's analysis of "the progress of improvement" (Smith, 1976a, p. 253) emphasises that it is the provision of a stable legal order that is the key to the development of a commercial society. A stable legal system is one of the consequences of the fall of feudalism. The rule of law evolved through a historical process of unintended consequences in Britain.<sup>7</sup>

Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government (Smith, 1976a, p. 910).

The reason for this is straightforward in Smith's view: without security individuals have no incentive to labour. But more than this, security allows the space for a natural propensity to reveal itself. In response to the incentives of security individuals will exert themselves to improve their situation. Smith identifies a number of measures of the outcome of this process. Two of these are of particular interest and are intimately related in Smith's view. Population (Smith, 1976a, p. 87-88) and the wages of labour (Smith, 1976a, p. 99) are taken as proxies for rising living standards achieved by the successful pursuit of interest by individuals.

The dynamic here is interesting. Smith is arguing that we want to improve our situation and that we do so through the rewards of

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7 "...but above all, that equal and impartial administration of justice which renders the rights of the meanest British subject respectable to the greatest, and which, by securing to every man the fruits of his own industry, gives the greatest and most effectual encouragement to every sort of industry" (Smith, 1976a, p. 610).

labour which in turn act as an incentive to further labour. The observation that this leads to a larger population might on one level be thought to be an unintended consequence of this process. But in reality Smith sees it as part of the incentive process. We want to provide for ourselves, and for our families, and to the extent that we can care for our children and improve their lives to a greater extent if we have more resources, then we have an incentive to pursue our interest in the most effective fashion possible. This in turn extends the population and means that it keeps pace with the level of economic development.

It's worth noting that Smith's example for this phenomenon is a comparison between Europe and China. While, as Malthus would later point out, it would be problematic for a society were its population to outstrip the level of resources available to feed it, Smith seems instead to view a growing population as morally desirable in itself. This is not because of any brute value in having more people, but rather because it is the result of lower infant mortality. Again the macro outcome is not part of the intention of the actors – I'm not working hard to reduce infant mortality in my nation, I'm working hard to feed my family.<sup>8</sup>

## INDIVIDUAL DESIRE TO IMPROVE

So Smith has identified a set of general conditions that create the space for individuals to increase industry. He has also identified a powerful incentive and indicator of this in population growth and rising living standards. But as our focus is on the micro level here we should delve a little more deeply into what Smith has to say about the motivation of individuals in this situation. The key is the identification of a natural propensity: the desire to better our condition.<sup>9</sup>

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8 It is worth noting that it is this sort of self-interest that Smith's believes will be approved by all impartial spectators in *TMS*. A man who neglected his own children in favour of trying to save the children of others would be held in contempt.

9 In *TMS* he talks about admiring the rich and the origin of ambition and ranks as potentially the greatest source of moral corruption using exactly the same term: "that great purpose of human life which we call bettering our

Smith offers three broad definitions of this individual motivation:

The natural effort of every individual to better his own condition, when suffered to exert itself with freedom and security, is so powerful a principle, that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often incumbers its operations... (Smith, 1976a, p. 540).

The uniform, constant, and uninterrupted effort of every man to better his condition, the principle from which publick and national, as well as private opulence is originally derived, is frequently powerful enough to maintain the natural progress of things toward improvement, in spite both of the extravagance of government, and of the greatest errors of administration (Smith, 1976a, p. 343).

But the principle which prompts to save, is the desire of bettering our condition, a desire which, though generally calm and dispassionate, comes with us from the womb, and never leaves us till we go into the grave. In the whole interval which separates those two moments, there is scarce perhaps a single instant in which any man is so perfectly and completely satisfied with his situation, as to be without any wish of alteration or improvement, of any kind. An augmentation of fortune is the means by which the greater part of men propose and wish to better their condition (Smith, 1976a, p. 341).

The first two of these appear in anti-mercantilist passages where he criticises policies which seek to promote industry but end up having the unintended consequence of misdirecting effort and favouring sectional interests rather than the public interest.<sup>10</sup> Even in the face of obstacles the desire to improve our situation drives industry forward to overcome barriers. In conditions of legal security all individuals will attempt to improve their situation. What's interesting from our point of view is that in the third passage above Smith makes an explicit link between the desire to improve and the urge to save.

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condition" (Smith, 1976b, p. 50). For Smith's concept of improvement see the passage in *TMS* where he discusses infanticide (Smith, 1976b, p. 209-210).

10 Again Smith's criticism of the merchant's "mean rapacity" and "monopolizing spirit" (Smith, 1976a, p. 493) accepts that these features cannot be completely removed, though they can be checked.

This passage is interesting because it contrasts two distinct strategies that people might deploy: to spend in order to secure present enjoyment, and to save and invest for future enjoyment. Saving, on a crude level, is only possible under a situation of security, but more significantly Smith regards it as the most obvious strategy to develop on an individual level.

It is the means the most vulgar and the most obvious; and the most likely way of augmenting their fortune, is to save and accumulate some part of what they acquire, either regularly and annually, or upon some extraordinary occasions. Though the principle of expence, therefore, prevails in almost all men upon some occasions, and in some men upon almost all occasions, yet in the greater part of men, taking the whole course of their life at an average, the principle of frugality seems not only to predominate, but to predominate very greatly (Smith, 1976a, p. 341-342).

This is an interesting observation because in both the fall of feudalism passage above and its counterpart in *TMS* Smith suggests that it is expenditure in pursuit of the trappings of wealth that drives industry. The feudal lords lose power because, like Esau, they sell their birthright for a mess of pottage. We pursue wealth not for its utility but for its capacity to make others admire us. For example in the allegory of the poor man's son "whom heaven in its anger has visited with ambition" (Smith, 1976b, p. 181). Smith shows how a desire to enjoy the supposed benefits of the life of the rich leads a young man to hard labour and obsessive work without enjoying life and at the end, when he grows old, he finds that he was deceived. That the goods his wealth has bought him do not make him any happier. Smith refers to this as the "deception...which rouses and keeps in continual motion the industry of mankind" (Smith, 1976b, p. 183).

In the unintended consequences model the poor man's son might be considered a hero, because his labour serves the interest of others and boosts productivity for both himself and society. However the tone of Smith's description is not laudatory; rather it is tragic. As with his contempt for the frivolous lords, Smith seems to be suggesting that the macro benefit of economic growth is bought at the price of a wasted life. Passages like this have led some to read Smith as a Stoic, arguing for a more ascetic notion of virtue than is often believed. Take, for example, the following passage from *TMS*:

What can be added to the happiness of the man who is in health, who is out of debt, and has a clear conscience? To one in this situation, all accessions of fortune may properly be said to be superfluous; and if he is much elevated upon account of them, it must be the effect of the most frivolous levity (Smith, 1976b, p. 45).

One reading of this passage is that it suggests that real happiness does not arise from the possession of wealth. If we have enough to be going along with then any gain is strictly speaking unnecessary. However, this seems hard to square with the passages on the desire to improve our situation. The Stoic rises above his desires by denying that they affect his happiness. But if that were true what becomes of the natural desire to better our condition?

One way of squaring the circle is to distinguish between the desire for wealth incentivised by a desire for display and admiration, and a desire for wealth to improve our material circumstances. That Smith has something like this distinction in mind can be seen in his discussion of the characters of the prodigal and the prudent man. Here he distinguishes between precisely these two motivations:

The desire of becoming the proper objects of this respect, of deserving and obtaining this credit and rank among our equals, is, perhaps, the strongest of all our desires, and our anxiety to obtain the advantages of fortune is accordingly much more excited and irritated by this desire, than by that of supplying all the necessities and conveniencies of the body, which are always very easily supplied (Smith, 1976b, p. 213).

## PRODIGALS

Throughout his work Smith cites a number of character sketches which, like that of the poor man's son, illustrate particular ways in which the desire to better our condition might be pursued. For example, Smith criticises the miser as having a faulty notion of value. Seeing the hoarding and accumulation of wealth as the end of human life is, Smith suggests, misguided and distinct from the motivation of a man of "exact oeconomy and assiduity" (Smith, 1976b, p. 173). Elsewhere he contrasts two alternative character types: the prodigal and the prudent man. The prodigal has his attention focussed on the

short term enjoyment of wealth, while the prudent man is careful with his resources and looks to secure and slowly advance his condition.

One way of viewing this is to take the position we discussed earlier of the macro level outcomes. By this approach we could see the prodigal as akin to the feudal lord whose extravagance unwittingly provides a living for the industrious and changes society's power balance. But this is not the point that Smith wants to make. His discussion of the prodigal refers to behaviour within an already commercial society.

The prodigal perverts it in this manner. By not confining his expence within his income, he encroaches upon his capital. Like him who perverts the revenues of some pious foundation to profane purposes, he pays the wages of idleness with those funds which the frugality of his forefathers had, as it were, consecrated to the maintenance of industry. By diminishing the funds destined for the employment of productive labour, he necessarily diminishes, so far as it depends on him, the quantity of that labour which adds a value to the subject on which it is bestowed, and, consequently, the value of the annual produce of the land and labour of the whole country, the real wealth and revenue of its inhabitants. If the prodigality of some was not compensated by the frugality of others, the conduct of every prodigal, by feeding the idle with the bread of the industrious, tends not only to beggar himself, but to impoverish his country (Smith, 1976a, p. 339).

From this point of view "every prodigal appears to be a publick enemy, and every frugal man a publick benefactor" (Smith, 1976a, p. 340). This might lead us to believe that Smith would then explore policies that sought to discourage prodigal behaviour. But he doesn't pursue this. Instead he takes the view that over the whole of society the prudent outweigh the prodigal, and that in a commercial setting the prodigal in reality harms himself more than others.

It can seldom happen, indeed, that the circumstances of a great nation can be much affected either by the prodigality or misconduct of individuals; the profusion or imprudence of some is always more than compensated by the frugality and good conduct of others (Smith, 1976a, p. 341).

So a prodigal may be admonished on the grounds of his personal behaviour, but is not to be regarded as a danger to national wealth.

A point that Smith returns to when he suggests that government is often the most prodigal part of the nation.

hey are themselves always, and without any exception, the greatest spendthrifts in society. Let them look well after their own expence, and they may safely trust private people with theirs (Smith, 1976a, p. 346).

Now as we saw above the desire to better our condition is strong enough to overcome both the restrictions of merchants and the prodigality of governments. For Smith “publick prodigality and misconduct” (Smith, 1976a, p. 342) and “the publick extravagance of government” (Smith, 1976a, p. 343) are inevitable, but like private prodigality need not concern us too much so long as the efforts of the prudent majority are allowed to unfold. Smith makes this point explicitly when he discusses taxation in Book V:

Under the system of funding, the frugality and industry of private people can more easily repair the breaches which the waste and extravagance of government may occasionally make in the general capital of the society (Smith, 1976a, p. 925).

## THE PRUDENT MAN

Smith’s discussion of the prodigal and the prudent man form part of his analysis of capital. Investment comes from capital, and capital comes from savings.

Whatever a person saves from his revenue he adds to his capital, and either employs it himself in maintaining an additional number of productive hands, or enables some other person to do so. As the capital of an individual can be increased only by what he saves from his annual revenue or his annual gains, so the capital of a society, which is the same with that of all the individuals who compose it, can be increased only in the same manner.

Parsimony, and not industry, is the immediate cause of the increase of capital. Industry, indeed provides the subject which parsimony accumulates. But whatever industry might acquire, if parsimony did not save and store up, the capital would never be the greater.

Parsimony, by increasing the fund which is destined for the maintenance of productive hands, tends to increase the number of those hands whose labour adds to the value of the subject upon which it is bestowed. It tends therefore to increase the exchangeable value of the annual produce of the land and labour of the country (Smith, 1976a, p. 337).<sup>11</sup>

Parsimony and careful investment are strategies which are motivated by the desire of improving our situation. As we noted above they are the most frequently chosen strategy, as the prudent outnumber the prodigal.<sup>12</sup> As individuals we have an interest in protecting our capital and investing it productively. This in turn leads to the gradual accumulation of capital on the aggregate level of the nation.

In *TMS* Smith provides us with a more fully realised character sketch of the prudent man. Here prudence is depicted as the virtue of the middle classes: a virtue which is solid, but not heroic; necessary for a happy life, but not sufficient for a great life. Nonetheless Smith underlines that it is a virtue which is always approved of by our conscience.

the prudent man is always both supported and rewarded by the entire approbation of the impartial spectator, and of the representative of the impartial spectator, the man within the breast (Smith, 1976b, p. 215).

However much we approve of the virtue of prudence our admiration of it is a "cold esteem" (Smith, 1976b, p. 216) which does not rise to ardent admiration. Smith goes on to discuss the various levels of disapproval that we level at imprudence arising from foolishness, prodigality, and dishonesty. The point here seems to be that, like justice, we come to expect individuals to behave in a prudent fashion.

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11 "By what a frugal man annually saves, he not only affords maintenance to an additional number of productive hands, for that or the ensuing year, but, like the founder of a publick workhouse, he establishes as it were a perpetual fund for the maintenance of an equal number in all times to come" (Smith, 1976a, p. 338).

12 Parsimony is not directed or proscribed by law, instead: "It is always guarded...by a very powerful principle, the plain and evident interest of every individual to whom any share of it shall ever belong" (Smith, 1976a, p. 338).

It is, if you like, the baseline for social life.<sup>13</sup> Just as following the rules of justice is necessary for society to exist, and for us to create the space for improving our situation, so prudence is the baseline necessary among the population in order for society to continue in an advancing state or as Ryan Hanley puts it “Prudence is thus insufficient unto itself, though it constitutes a necessary point of departure for the development of a more complete ethical system” (Hanley, 2009, p. 130).

Smith’s sketch of the prudent man dwells on his desire to be good at his job, to be respected by his peers for his skill, his modesty, and his reticence at becoming involved in politics or the affairs of others. The prudent man knows his own business and is not “a bustler in the affairs of others” (Smith, 1976b, p. 215). The key to the prudent man’s approach is cautious investment with security as the first concern:

It is rather cautious than enterprising, and more anxious to preserve the advantages which we already possess, than forward to prompt us to the acquisition of still greater advantages. The methods of improving our fortune, which it principally recommends to us, are those which expose to no loss or hazard; real knowledge and skill in our trade or profession, assiduity and industry in the exercise of it, frugality, and even some degree of parsimony, in all our expenses (Smith, 1976b, p. 213).

Of course this is not to say that the prudent man is entirely risk averse. He is simply unwilling to risk losing what he has for uncertain gain [however large]. The prudent man can thus be seen to exercise self-command over both the desire to better his condition and the desire to acquire the approval of society.

He has no anxiety to change so comfortable a situation, and does not go in quest of new enterprises and adventures, which might endanger, but could not well increase, the secure tranquillity which he actually enjoys. If he enters into any new projects or enterprises, they are likely to be well concerted and well prepared. He can never be hurried or drove into them by any necessity, but has always time and leisure to deliberate soberly and coolly concerning what are likely to be their consequences (Smith, 1976b, p. 215).

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13 See Berry, 2013, p. 141.

So Smith seems to be suggesting that prudence predominates over prodigality in society and that this is reflected in the disapproval of prodigals and the universal cool regard for the prudent. We do not hail the prudent as great men as it is the virtue that we expect from all men. Indeed Smith links this attitude to the shame felt at bankruptcy which he argues is the ‘most humiliating calamity’ (Smith, 1976a, p. 342).

### EXAMPLES OF PRUDENCE: BANKS

One concrete manifestation of the importance of Smith’s emphasis on prudence is his discussion of banking. Smith’s experience of the developing Scottish banking system led him to recognise the centrality of making the savings of prudent individuals available for investment in improving enterprises. Paper money as developed by the Scottish Banks allowed for the circulation of capital. The problem, as with the Ayr Bank, was that intemperate lending threatened to dissipate capital and thus reduce the long term progress of the economy. He asks us to imagine the difference between the lending strategy of a private person and a bank. If I am to lend you some of my hard won capital then I will only do so if I am certain of your good character and of the likely success of your plan. So

frugal debtors of private persons, on the contrary, would be more likely to employ the money borrowed in sober undertakings which were proportioned to their capitals, and which, though they might have less of the grand and the marvellous, would have more of the solid and the profitable... (Smith, 1976a, p. 317).

This is then contrasted with banks who lend to those unknown to them. These are likely to attract “chimerical projectors” (Smith, 1976a, p. 317) whose grand plans will be less well considered and less practically achievable than the more modest plans of improvement of personal debtors. It’s important to note that this is not an observation that depends on the scale of the debt for Smith. The point is rather about the nature of the knowledge and the relationship between lender and debtor. One type of relationship encourages prudent projects and prudent lending, the other encourages careless speculation. Smith’s

advice on banking is that it should be undertaken and structured in as prudent a fashion as possible. The policy advice that follows involves legal regulations, such as that on the rate of interest and the exclusion of small notes, which he compares to the regulations mandating fire walls (Smith, 1976a, p. 324), as a violation of natural liberty, but one which can be justified on pragmatic grounds. But the recommendations also involve allowing failing banks to fail. Part of the argument here is that this creates a moral hazard situation, where prudent behaviour is encouraged by the failure of imprudent lenders. Smith seems to feel that this advice needs further defence and elaboration and he provides this with a passage which argues that the disruption caused by such event would be short-lived and less dramatic than imagined (Smith, 1976a, p. 314-316). Indeed the point he makes here seems to parallel the point that we have seen above about the resilience of an economy dominated by the prudent in the face of the intemperance of prodigals and the misguided policy of mercantilists. The parallel is made explicit:

Every injudicious and unsuccessful project in agriculture, mines, fisheries, trade, or manufactures, tends in the same manner to diminish the funds destined for the maintenance of productive labour. In every such project, though the capital is consumed by productive hands only, yet, as by the injudicious manner in which they are employed, they do not reproduce the full value of their compensation, there must always be some diminution in what would otherwise have been the productive funds of society (Smith, 1976a, p. 341).

That having been said, the economy is able to draw on the careful behaviour of the prudent slowly, cautiously, acting to improve their own situation in the best way they know how. If this holds then, as Smith argues, we can be content that good investments will outweigh bad investments.

Exactly the same argument is employed when Smith comes to discuss what form of company organisation he prefers. Again the stress is on ensuring a sense of personal responsibility and prudence. Smith expresses a clear preference for partnerships above joint stock companies. His argument is straightforward enough:

being managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same

anxious vigilance with which the partners in a private copartnery frequently watch over theirs (Smith, 1976a, p. 741).

In other words, joint stock companies do not ensure prudent behaviour.

To further underline the point we have been making here we can return to our initial interest: the connection between macro level unintended consequences analyses and micro level individual behaviour. In the famous invisible hand passage in the *Wealth of Nations* the entire analysis turns on the macro outcomes of prudent individual investment. Careful investors, according to Smith, invest close to home. This is not because of national pride or benevolence, but from a desire for security. The unintended consequence of this careful investment is the support of domestic industry in a manner more efficient than political attempts to do so. The invisible hand metaphor is used here to illustrate how prudent behaviour by individuals can produce macro level beneficial unintended consequences:

By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it (Smith, 1976a, p. 456).<sup>14</sup>

## RESULTS AND CONCLUSION

Let us be quite clear about what Smith is arguing here. He is not being naively optimistic when he says that economic development will continue regardless. He has an argument about why that is the case. It is because most people, most of the time, act in a prudent fashion. Provide a stable legal and political system and they will use their local knowledge to trade with others and slowly improve their situations. That some people do not, that some are bold projectors, or intemperate lenders, or prodigals, or spendthrift governments, or partial mercantilists, will in the long run make little difference. His argument is an optimistic one: that the system of a commercial

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<sup>14</sup> In Smith, 2006 I make the case for reading invisible and arguments as one sub set of the broader category of unintended consequences explanations.

society is robust enough to bounce back from the crises that arise from imprudence.

Moreover, by understanding this aspect of Smith's work we can see how he is able to offer advice to individuals on how to adopt a successful strategy for economic activity while at the same time accepting the reality that the outcomes of these interactions will not reflect the intentions of any particular actor. As a result we are able to understand the limits of effective purposive action by individuals. By thinking of Smith's account as having both a macro and a micro level of advice we come to a better understanding of the operation of the invisible hand. This most Smithian of ideas is the operation of individuals acting prudently within the institutional framework of a market economy as outlined in the *Wealth of Nations*.

To conclude, as we saw above, Smith was no utopian about commercial society or the possibility of all of his views being enacted. But in the *Wealth of Nations* he saw himself as offering evidence that he saw as supporting economic development. In another context Smith argued that "What is prudence in the conduct of every private family, can scarce be folly in that of a great kingdom" (Smith, 1976a, p. 457). But one might have added that what is prudence in the conduct of every family will overcome the folly that might exist in a great kingdom.

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