

West's "Cantillon and Adam Smith": A Comment*

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Introduction

Students and admirers of Adam Smith will welcome Edwin West's reappraisal of the relationship between Smith and Cantillon. They have come to expect that each new effort by West will be a treat, and they have come to accept that each will be ever so slightly biased in favor of Smith. West's readers will not be disappointed with the present treat, and they will find that West has been eminently fair to both Adam Smith and Richard Cantillon.

The goals of the reappraisal are quite modest. West seeks to establish to the extent possible that Cantillon was, in some sense, a forerunner and inspirer of Smith. And in the process of achieving this goal, he seeks to learn more about both writers. We soon realize, though, that the evidence he presents and his discussion of it easily outdistance his stated goals. West looks beyond the conventional comparison of these two writers. Smith and Cantillon are obviously poles apart on the issue of Mercantilism versus the system of natural liberty. West focuses his attention instead on the interstices of argument. It is here that he finds a certain affinity between the two. Both Cantillon and Smith approach the microeconomic topics, such as the question of wage differentials, in the same way.

I will argue that the separation of what West calls the "big positions" and the microeconomic analysis, together with his discussion of the latter, allows us to relate Smith to Cantillon in a more comprehensive way. With the aid of a few additional considerations from the standard literature, West's reappraisal helps us to construct a "grand view" that shows how the contrasting visions of these two thinkers are related to one another in terms of both analysis and policy. The payoffs of the "grand view" are threefold. (1) It allows us to see that some of Smith's

*Edwin G. West's paper, "Richard Cantillon and Adam Smith: A Reappraisal," was published as a Carleton University Economics Working Paper, #80-12, August 1980; Prof. Garrison's paper, however, stands on its own as a contribution to the history of economic thought.—Ed.

positions that West regards as surprising, particularly his position on usury, are not surprising at all. (2) It brings to the surface a common denominator among the microeconomic issues in which Smith improved on Cantillon and another common denominator among the microeconomic issues in which he fell short of Cantillon. (3) It shows clearly how these two sets of issues are related to the respective "big positions" of the two writers.

The "grand view" will first be presented in a skeletal and gestalt form. It will then be squared with standard interpretations of Cantillon and Smith. Finally, it will be tested by the evidence provided in West's reappraisal. The goals of this comment are admittedly less modest than those of West's paper. I can only ask that the performance be evaluated with this in mind.

The Economics of the Here and Later

West limited his discussion to the microeconomic issues, but his insights into these issues point the way to a fruitful comparison on the level of macroeconomics. The comparison I have in mind, however, requires that we take a rather unflattering view of both Cantillon and Smith. This may explain why the following formulation has remained so long below the surface. The unflattering view of Cantillon is the common view: Cantillon the Mercantilist. Although he evidenced deep understanding of a market economy and opposed state intervention of most sorts, he advocated interventions that would result in a more favorable balance of trade.

Left to its own devices the market would, in general, allocate resources in a satisfactory manner. But the market would not allocate as many of the world's resources to the homeland as Cantillon preferred the homeland to have. That is, on the level of macroeconomics Cantillon was not satisfied with the interspatial allocation, or more specifically the international allocation, of resources. He therefore advocated those interventionist policies that were aimed at increasing the wealth of one nation at the expense of others. (The fact that the policies advocated would not actually achieve the objectives sought will be dealt with later.)

The unflattering view of Smith is not so commonplace, but it is one that, once stated and explained, should command broad acceptance. There is in Smith's writings an important macroeconomic analogue to the Mercantilists' position. Stated simply, *Smith is to time as Cantillon is to space*. In general, the market's allocation of resources was perfectly satisfactory to Smith. But its intertemporal resource allocation under the system of natural liberty left much to be desired. The market will not allocate as many of the world's resources to capital formation, and hence to *future* consumption, as Smith would prefer to see. He was therefore inclined to advocate those interventionist policies that were aimed at increasing the capital stock at the expense of consumption, or what amounts to the same thing, increasing future consumption at the expense of present consumption.

Although Smith sees his intertemporal bias as "entirely different" from the interspatial bias of the Mercantilists, his economics of time is clearly equivalent to their

economics of space. This is nowhere more clear than in Smith's own comparison. After explaining the unreasonableness of international restraints aimed at making the balance of trade more favorable, Smith argues that

There is another balance . . . very different from the balance of trade, and which, according as it happens to be either favorable or unfavorable, necessarily occasions the prosperity or decay of every nation. This is the balance of annual produce and consumption. If the exchangeable value of annual produce . . . exceeds that of the annual consumption, the capital of the society must annually increase in proportion to this excess.¹

But Smith maintains that "This balance of produce and consumption is entirely different from, what is called, the balance of trade."² The difference, though, is nothing but a reflection of the metaphysical difference between time and space. From the standpoint of economic efficiency the two balances can be treated the same. Under the system of natural liberty there will be a natural balance in the allocation of resources between one country and another as well as between one period of time and another. From the standpoint of policy they *were* treated the same. Smith advocated a favorable balance of produce and consumption in the same sense that Cantillon and the other Mercantilists advocated a favorable balance of trade.

This relationship between Cantillon and Smith shows up in West's paper in a slightly disguised form. West compares the "zero sum game" on the Mercantilists with the "dynamic system" of Smith. Although the connotations of these terms make Smith's vision look more appealing, the terms themselves are based on the relationship just outlined. Cantillon was concerned with the allocation of resources among nations at a given period of time; Smith was concerned with the allocation of resources among periods of time for a given nation.

West is content to impute the dynamics of Smith's vision to the constant improvement in technology brought about by the division of labor.³ If this were the end of the story, there would be nothing objectionable about Smith's vision. The division of labor is an inevitable result of the system of natural liberty. But there is more to the story. Smith wanted the system to be a little more dynamic than natural liberty, by itself, would allow for. He evaluated the market against a standard that was more future oriented than the market itself, and he prescribed policy accordingly. While Cantillon preferred *here to there*, Smith sacrificed *now for later*.

Productive and Unproductive Labor—Once Again

Although West did not deal directly with the issue of productive versus unproductive labor in his reappraisal, Smith's distinction between the two categories of labor figures importantly into the "grand view" that I am proposing. The distinction is important as a manifestation (probably the most pronounced manifestation) of Smith's bias against the present and in favor of the future. Before highlighting further the intertemporal aspects of this issue, it may be helpful to discuss briefly the alternative perspectives.

Much has been written about this curious distinction that dominates the third chapter of Book II of *The Wealth of Nations*. Undoubtedly, the controversy is at least partly attributable to Smith's own choice of words. The word "useful" is used early in the book as a synonym for "productive"; later on the same word is used to characterize both productive and unproductive labor.⁴ Most modern texts on the history of economic thought begin their treatment of Smith's distinction with the claim that Smith has been maligned or misinterpreted on this issue. Presumably the misinterpretation consists of taking "unproductive" to mean "useless," and viewing unproductive laborers as wards of society. Under this misinterpretation, unproductive laborers would be dependent on productive laborers in the same way that welfare recipients are dependent on income earners and—worse yet—in the same way that non-agricultural classes are dependent, in the Physiocrat's view, on agriculture.⁵ The now-dominant interpretation entails a purely stipulative distinction. Productive labor produces capital goods; unproductive labor produces services. Remaining dissatisfaction with this view hinges on the fact that it does not readily accommodate the categories of durable consumer goods or human capital. A more interesting source of dissatisfaction is the incongruous use of antonyms to contrast services with capital goods. In what sense are they opposites?

Smith's distinction between productive and unproductive labor is to be linked not to his journey to France but to his upbringing in Scotland. The basis for the distinction is not Physiocratic fallacies but Presbyterian values. Productive labor is future oriented; unproductive labor is present oriented. The former is good and the latter is bad. This is the sense in which the two categories are opposites. This value bias is clearly acknowledged by West in his book on Smith. He points out that "Smith, like a prudent steward of a Scottish aristocrat's estate, could hardly disguise a strong personal preference for much private frugality, and therefore for 'productive labor,' in the interest of the nation's future accumulation."⁶ West quotes from *The Theory of Moral Sentiments* to show that Smith's standard of intertemporal values is exhibited by his impartial spectator. In modern parlance we would say that the impartial spectator has a zero rate of time preference.

The spectator does not feel the solicitations of our present appetites. To him the pleasure which we are to enjoy a week hence, or a year hence, is just as interesting as that which we are to enjoy this moment.⁷

The quotation can be extended to show the impartial spectator's view of mere mortals who have a positive rate of time preference.

When for the sake of the present, therefore, we sacrifice the future, our conduct appears to him absurd and extravagant in the highest degree, and he cannot enter into the principles which influence it.

It is also quite clear that in the absence of the influence of the impartial spectator, individuals would fall far short of Smith's standard.

The pleasure which we are to enjoy ten years hence interests us so little in comparison with that which we may enjoy to-day; the passion which the first excites is naturally so weak in comparison with that violent emotion which the second is apt to give occasion to, that the one could never be any balance to the other"⁹

It is not difficult to see how Smith's standard of zero time preference, coupled with his awareness of sharply positive time preferences, could lead him to make the very policy recommendations that West found to be surprising. Smith sought to correct this natural imbalance by policies aimed at creating a favorable balance of produce and consumption. He sought to reallocate resources away from the present and toward the future, that is, away from the employment of unproductive labor and toward the employment of productive labor. And, as we will see, this is precisely what his particular anti-usury scheme was to achieve.

Micro-affinity and Macro-repelleny

Our "grand view" allows us to see how Cantillon and Smith can reinforce one another on the level of microeconomic analysis and at the same time write at cross purposes on the level of macroeconomic policy. Their writings were microeconomically similar because each had a good understanding of the market process; they were macroeconomically different because they were attempting to reallocate resources in different ways. A more detailed look at Smith's proposed credit controls will strengthen the idea that Smith's intertemporal economics and Cantillon's international economics are analytically equivalent. A brief consideration of Smith's views on sharecropping and other issues will demonstrate the utility and generality of our "grand view."

West found Smith's support for an interest-rate ceiling to be surprising on two counts. (1) A ceiling on interest "would aggravate 'the evil of usury' by increasing the costs of borrowing" This is a consequence that Smith clearly recognized in the case of a complete prohibition of interest charges, that is, in the case where the ceiling is set at zero percent. (2) Usury laws conflict "with the major assumption in *The Wealth of Nations* that each individual has the best knowledge of his own interest."¹⁰ Not much needs to be said in response to this second point. It should be clear enough by now that a strong intertemporal bias is rooted deep in Smith's thinking.

The first point, which in West's view involves an inconsistency, is more interesting. The inconsistency vanishes when we realize that Smith was not interested in reducing the cost of borrowing with his credit controls. He was trying to reduce the amount of funds borrowed for certain categories of loans. And his anti-usury scheme was well suited for this. Smith notes that money is lent to the government at three percent, and to sound businessmen at four, and four and a half. Only "prodigals and projectors," people who are most likely to "waste and destroy" capital, would be willing to borrow at eight or ten percent. Smith therefore recommended

an interest ceiling at five percent.¹¹ This policy was not aimed at allowing the prodigals and projectors to obtain funds more cheaply, but at preventing them from obtaining any funds at all. These funds would be diverted, then, into the hands of those who are more future oriented. West spells out these consequences clearly but remains surprised at Smith. We now see that the values held by Smith and the policies recommended are wholly consistent.¹²

There is an additional similarity between a favorable balance of trade and a favorable balance of produce and consumption that has not yet been mentioned. Restraints on international trade are aimed at making the balance of trade more favorable, thereby increasing the wealth of the nation. In reality, of course, these restraints reduce the potential gains from trade, thereby reducing the wealth of the nation. Mercantilist policy is ultimately self-defeating. This, West points out, was recognized by Cantillon himself. Smith's own blueprint for increasing wealth was similarly self-defeating, although there is no evidence that this was ever recognized by Smith. Credit controls may be aimed at making the balance of produce and consumption more favorable, thereby increasing the wealth of the nation. In reality credit controls serve only to reduce the gains from intertemporal exchange. Individuals may prefer, say, one unit of a consumption good now to two or even five units of the good next year. If this preference is not allowed to be expressed in the market, then the wealth of the nation, reckoned in terms of present value, i.e. discounted at a rate corresponding to the individuals' true time preferences, will actually decrease. Wealth, correctly conceived, will be maximized in a system that restrains neither the international nor the intertemporal allocation of resources.

The issue of share-tenancy provides a modest test of our "grand view." West makes the judgment that Smith had less of an intuitive grasp of this issue than did Cantillon. Smith's shortcomings on this issue are imputed to a historical misperception and to a belief, supposedly held by Smith, that output had to be divided between landlord and sharecropper on a fifty-fifty basis.¹³ Neither of these explanations are very satisfying. They are at odds with our general perception of Smith's acumen. West did make an observation, however, that leads us towards a more satisfactory explanation of Smith's views on the issue. Smith faulted the system of share-tenancy because "It would not be in the interest of the cultivators to invest capital in the land from their own share of the produce . . ." ¹⁴ Compared to sharecropping, fixed-rent farming gave rise to a greater rate of capital accumulation, and hence was more future oriented. We need look no further for an explanation of Smith's dissatisfaction of the share-tenancy system.

The generality of the proposed "grand view" can be put to the test by a consideration of West's concluding remarks. On the basis of his reappraisal, West itemizes the issues on which Smith improved upon the analysis offered by Cantillon, as well as the issues on which Smith fell short of or failed to profit from Cantillon. There is an interesting point to be made about these two categories of issues. While West reappraised the two writers on an issue by issue basis, the sum-

mary verdict fits neatly into our "grand view." That is, for the issues on which Smith surpassed Cantillon, the interspatial considerations dominate; for the issues on which Smith fell short of Cantillon the intertemporal considerations dominate. Smith improved on the issues of wage differentials, the theory of location and the effects of embargoes on gold exports. He failed to improve on the issues of usury, share-tenancy, the theory of the entrepreneur, and the theory of profit.¹⁵

In summary terms we can say that Smith succeeded in ridding economic theory of the interspatial bias associated with Cantillon and other Mercantilists, and then proceeded to introduce a strong intertemporal bias. From the vantage point of the twentieth century it can be said that the interspatial battle has long since been won—due largely to the efforts of Adam Smith. The intertemporal battle, however, is still being fought.

Concluding Remarks

West's paper covered considerably more ground than I have chosen to deal with in my comments. I have not been concerned, for instance, with the extent to which Cantillon's *Essai* is the "cradle" of economics as Jevons claimed, or the extent to which Smith actually drew upon Cantillon's work. I have attempted instead to show how the visions of Cantillon and Smith square with one another on both the microeconomic and the macroeconomic levels.

My comments have been sufficiently unflattering to Smith to require some statement of appeasement. Does this pervasive intertemporal bias in Smith's writings reduce our appreciation for Smith's contribution? No. It only suggests the sort of filters we must put on our glasses in order to achieve the fullest appreciation of his writings. We must filter out the intertemporal bias when we read Smith just as we filter out the interspatial bias when we read Cantillon. When we read Edwin West, of course, we need neither filters nor glasses.

NOTES

1. Adam Smith, *The Wealth of Nations*, Modern Library Edition (New York: Random House Inc., 1937), p. 464.
2. *Ibid.*
3. Edwin G. West, "Richard Cantillon and Adam Smith: A Reappraisal," Carleton University Economics Working Paper #80-12, August 1980 (following page references are to June 1980 manuscript), p. 5.
4. Smith, *Wealth of Nations*. Cannan points out this ambiguity in a footnote on p. 315.
5. For a brief discussion of the controversy see Joseph A. Schumpeter, *History of Economic Analysis* (New York: Oxford University Press, 1954), pp. 628-31.
6. Edwin G. West, *Adam Smith: The Man and His Works* (New Rochelle, New York: Arlington House, 1969), p. 173.
7. *Ibid.*
8. Adam Smith, *The Theory of Moral Sentiments* (Indianapolis: Liberty Classics, 1969), p. 311.
9. *Ibid.*, p. 312.
10. West, "A Reappraisal," p. 21.

11. Smith, *Wealth of Nations*, p. 339-40.
12. It is worth noting that the chapter in which Smith recommends credit controls immediately follows the chapter in which he deals with the distinction between productive and unproductive labor.
13. West, "A Reappraisal," p. 23-4.
14. *Ibid.*, p. 24.
15. *Ibid.*, p. 31.