

Before Hegemony: Adam Smith and the Birth of Free Trade in 18th Century Britain
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PAPER ABSTRACT: In attempting to explain Britain's movement toward free trade in the nineteenth century, much academic work has centered on the 1846 repeal of the Corn Laws. (Irwin 1989; Schonharhardt-Bailey 2006) This focus is understandable given the symbolic importance of the Corn Laws to both protectionists and free-traders alike. British policymakers, however, first began their march toward free trade more than half a century earlier, in the midst of the “colonial crises” that tore the British Empire asunder.

This paper argues that these innovations followed directly from the efforts of Adam Smith to respond to these crises with an alternative bundle of foreign economic policies. Rather than integrating the colonies within the empire and fostering security for Britain, Smith argued that the mercantilists' attempts to direct trade had driven the American and Irish colonies into open rebellion and exacerbated Anglo-French tensions. Smith convinced key policymakers—including several Prime Ministers—that such crises could be averted by liberalizing commerce with both its colonies and its traditional rival, France. The success of these experiments in the 1780s inspired the subsequent movements towards free trade in the nineteenth century.

This paper makes three distinct contributions. First, it challenges one of the most influential theories of IPE by demonstrating that openness can come *before* hegemony, not just during and after (Kindleberger 1973; Krasner 1976; Keohane 1984). Second, it reveals that crises may often lead to shifts *from* closure *toward* openness, rather than just toward closure (Schattschneider 1935; Eichengreen 1983). Finally, it advances our understanding of the crucial role intellectuals play in shaping policymakers' responses to crisis (Hall 1989; Goldstein and Keohane 1993; Legro 2000; Blyth 2002).

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The eighteenth century saw the heyday of mercantilist political economy in Britain. Throughout, Britain remained committed to a fixed exchange rate regime and open capital markets, eschewing the pursuit of monetary policy autonomy. While Isaac Newton's accidental overvaluation of gold in 1717 led to a shift in the commodity to which the pound sterling was pegged, Britain was the paragon of commitment to the international commodity money standard in the eighteenth century.

British policy makers combined this commitment to market-led monetary policy with vigorous intervention in trade and commerce and an active fiscal policy. British policy makers carefully managed trade and commerce and radically expanded the taxing and spending of the government towards the end of increasing their control over the macroeconomic effects in the economy.¹

For the first three-quarters of the eighteenth century, British policy makers explicitly considered the merits of policies governing trade and commerce in terms of whether they would help Britain to secure a positive balance of trade and capital inflows. By the end of the eighteenth century, a growing number of policy makers doubted both the efficacy and the necessity of such "management." By the middle of the nineteenth century, British policy makers fully embraced free trade and a minimalist fiscal policy. The 1783 Peace of Paris marked a decisive first step in a long, winding road toward the complete adoption of the classical liberal combination of macroeconomic policies—market-determined monetary policy, *laissez-faire* trade and commerce, and minimalist fiscal policy—in the nineteenth century.

This chapter attempts to explain the radical shift in British macroeconomic policy from a framework in which trade and commerce were managed and fiscal policy was active to a

¹ Heckscher, *The Continental System: An Economic Interpretation*, Ch I.

combination in which government intervention was minimized and the balance of trade was left to be freely determined by the market.

Much like the adoption of the fixed exchange rate regime in the 1690s, Britain's shift from mercantilism to classical liberalism has attracted considerable scholarly attention—and for the same reasons. First, it was clearly significant in the economic history of Great Britain, and, as a result, it has been interesting to British historians. Second, it has attracted considerable attention as a proving ground for political scientific theories about the determinants of political and economic policy. Most of these explanations, however, focus on the policy shifts in the 1840s, when the movement gained the greatest amount of momentum.²

In fact, Britain's shift to the classical liberal macroeconomic policy bundle began in earnest in the 1780s. This was the first time policy makers devised policy based on the premise that trade and commerce did not need to be managed to achieve policy makers' macroeconomic goals. For the first time in centuries, British policy makers entertained the possibility that achieving a positive balance of trade ought not be the primary goal of foreign economic policy. The 1780s saw the beginnings of British policy makers' commitment to the assumption that full employment follows naturally from free markets and government intervention creates both deadweight loss and unemployment.

I argue that this decisive shift followed from Adam Smith's challenge to the mercantilist framework. To bear this out, we need to consider the development, adoption, and implementation of Smith's classical liberal framework. By carefully considering the "hard core" of the mercantilist framework, particularly as espoused by John Locke, Smith was able to develop a robust alternative framework. Smith made several moves in his *Wealth of Nations* to

² Schonhardt-Bailey, *From the Corn Laws to Free Trade*. Irwin, "Political Economy and Peel's Repeal of the Corn Laws."

sell his framework. First, he attempted to demonstrate the compatibility of his framework with the empirical regularities present at the time. More significantly, however, Smith sought to combat the appeal of the mercantilist framework by caricaturing the assumptions that underlay their framework. While some mercantilist intellectuals mounted a response, they did not rescue the premises of the mercantilist framework from Smith's caricature, leaving the framework undefended from the brunt of Smith's assault. The ability to slowly move towards Smith's framework, evaluating the costs and benefits of the move along the way, enhanced the appeal among policy makers of "experimenting" with trade liberalization. When each relaxation of the restraints seemed to policy makers to bring the benefits Smith promised, the classical liberal framework earned increased support. By the mid-nineteenth century, few British policy makers clung to mercantilism.

This chapter considers the development, adoption, and implementation of Adam Smith's classical liberal framework each in turn. This chapter follows the model used in the last chapter, developing an analytic narrative to trace the multi-step process in which: Smith's initial disdain for mercantilism was developed into a robust, alternative policymaking framework; this framework was sold to and adopted by policy makers; and this framework shaped subsequent foreign economic policy.

There were, however, some significant differences between the manner in which Locke's framework had been adopted and that in which Smith's framework was. The nature of Smith's policy prescription—that government management of the economy be reduced—was such that it could be (and was) implemented gradually. Whereas Locke's advocacy of a fixed exchange rate required a stark change in policy, Smith's prescriptions of "liberalization" allowed for experimentation and slow implementation.

The narrative deployed in this chapter reflects these differences. The nature of the process was essentially the same in both cases: a rival framework is developed by formulating an alternative “hard core,” this framework is sold to policy makers on the grounds of its intellectual merits, and this framework is utilized to shape subsequent policymaking. But the rendering of each component reflects the different manifestation of each in the case of the rise of classical liberalism. For instance, Locke refined his framework even as he tried to sell it to policy makers. Many of the developments in his framework were made in direct response to the criticisms issued by his rivals and the challenges his framework faced among policy makers. Smith, by contrast, developed his framework almost entirely out of the public eye. So, when he issued the *Wealth of Nations* in 1776, Smith did not have the well-placed group of advocates that Locke enjoyed, but neither did he have to face the well-entrenched opponents that stood ready to defend the established framework. As a result, this chapter places more emphasis on the process of development and less on the selling and implementation of Smith’s classical liberal framework.

I. Smith's Rival Policy Framework

Adam Smith built his rival—classical liberal—policy framework in direct response to the system and framework developed by the mercantilists. Smith first attempted to explain how so rotten a framework had come to be embraced in the first place. He then offered his alternative framework, prescribing policies both on the management of trade and commerce and on the exchange rate regime.

1. *Explaining and Combating Mercantilist Policy*

Adam Smith's *materialist* account of historical development made selling his reformist policies rather awkward. Having argued that the policy framework in each age was devised to satisfy the ruling class, Smith would have a hard time justifying his efforts to sell policies that deliberately ran *counter to* the interest of the ruling classes—in modern society, the merchants and manufacturers—but *in* the interests of the poorly represented laborers and consumers. Knowing that he could not combat the power of entrenched interests, Smith instead attempted to challenge mercantilism on *intellectual* grounds.

Despite his argument—and perhaps even his belief—that policy always followed the interest of the ruling class, Smith nevertheless argued that the mercantilist policymaking framework had been adopted because policymakers had been duped by “the absurd notion that wealth consists in money.”³

These mistaken ideas had given rise to policymakers' expectation that the employment and opulence of the nation depended on capital inflows. He explained,

Money is not the ultimate object of any mans desires. But as we generally look no farther than money, and commonly say we want money, they have been of

³ Smith, *Lectures on Jurisprudence*, 535.

opinion that the great quantity of money should be the view of a nation also. This system has occasioned many errors in the practise of this and other nations...in endeavouring to raise the quantity of money, which can be of no service farther than as a medium of circulation.⁴

In the latter version of the lectures, Smith linked this notion directly to the mercantilists' emphasis on the balance of trade. He wrote,

The idea of publick opulence consisting in money has been productive of other bad effects. Upon this principle most pernicious regulations have been established. These species of commerce which drain us of our money are thought dissadvantageous and these which increase it beneficial; therefore the former are prohibited and the latter encouraged.⁵

Thus, according to Smith, the mercantilist policy framework, which was premised upon the pursuit of a positive balance of trade ascended because of policymakers' mistaken ideas.

Smith never fully resolved the tension between his historical materialism and his specific explanation for the ascendance of mercantilism. Perhaps Smith was merely issuing what he thought were the correct ideas to be, perhaps, adopted in a later age. Perhaps, on the other hand, Smith had only adopted the historical materialist position to set himself apart from Locke and his faith in the power of ideas to inspire the "invention" of money, the "invention" of political society, and the ways in which men used both. Regardless, Smith did both issue an historical materialist argument and a rival system to combat that of the mercantilists. Needless to say, Smith could not be both *right* and *successful* in influencing policy. But perhaps he would have been content to achieve either.

2. *Classical Liberalism on the Management of Trade & Commerce*

It was easy for Smith to prescribe commercial policies on the basis of his classical liberal system. Smith's system held that full employment and economic growth followed *naturally* as

⁴ Ibid., 384.

⁵ Ibid., 511.

individuals pursued their personal gain. Government, for Smith, generally created inefficiency and inequality, both of which stifled economic growth and raised unemployment.⁶ The solution, of course, was to minimize the role the government played in the economy: “it is by far the best police to leave things to their natural course, and allow no bounties, nor impose taxes on commodities.”⁷

Nowhere was this more applicable than in the case of international trade. Smith insisted that the mercantilists’ concern over the balance of trade was “absurd,” meaning that it was an obsession with something that required no attention whatsoever. Money is always in sufficient supply as long as one has goods; and all attempts to damn up the supply of money are either ineffectual or immensely costly.⁸ Following what he suggested was Locke’s mode of reasoning, Smith generalized from the case of the individual to that of the nation. Smith induced that because an individual could not ruin himself unless by spending more than he had, neither could a nation. As such, the balance of trade can be no threat: “No nation can ever be ruind by [a negative balance of trade]. The same thing ruins nations as individualls, viz their consumption being greater than their produce.”⁹

Goods and not money were wealth according to Smith. Introducing policies to restrict the latter in pursuit of the former was the very *opposite* of the means by which the wealth of the public would be increased. Smith reasoned,

All commerce that is carried on betwixt any two countries must necessarily be advantageous to both. The very intention of commerce is to exchange your own commodities for others which you think will be more convenient for you. When

⁶ LJ(B) 512. Smith also posited that taxes reduced “nationall opulence” by reducing the purchasing power of the lower classes. LJ(A) 362.

⁷ LJ(B) 499.

⁸ Smith explained, “There can be no fear of want of money, for if their [*sic.*] be too little it will soon be supplied by the exportation of goods, and if too great it will be sent abroad for goods either in specie or melted down.” LJ(A) 386, 391.

⁹ LJ(A) 393.

two men trade between themselves it is undoubtedly for the advantage of both...The case is exactly the same betwixt any two nations.

Smith wrote with exasperation, “The goods which the English merchants want to import from France are certainly more valuable to them than what they give for them. Our very desire to purchase them shews that we have more use for them than either the money or the commodities which we give for them.”¹⁰ Why, then, would bureaucrats on the Board of Trade, locked away in government offices, question the judgment of those men and women in the marketplace? What good could come from denying consumers the opportunity to spend their money how they pleased?

Smith’s suggestion of the optimal policy on trade and commerce was unambiguous:

From the above considerations it appears that Britain should by all means be made a free port, that there should be no interruptions of any kind made to foreign trade, that if it were possible to defray the expences of government by any other method, all duties, customs, and excise should be abolished, and that free commerce and liberty of exchange should be allowed with all nations and for all things.¹¹

The policy prescribed by the classical liberal framework was thus a policy of *laissez-faire* free trade.

3. *Classical Liberalism on the Exchange Rate Regime*

The commercial regime prescribed by the classical liberal policy framework was directly opposite to that prescribed by the mercantilists. Smith made sure of that. The classical liberals’ exchange rate regime, however, was entirely consonant with that of the mercantilist policy framework. Both frameworks rejected exchange rate adjustment in favor of a firm commitment to maintaining a fixed exchange rate regime.

¹⁰ Smith, *Lectures on Jurisprudence*, 511.

¹¹ LJ(B) 514.

Once again, the bulk of Smith's analysis on this point was taken directly from John Locke. The mercantilists' policy of commercial management had always been Smith's prime target and combating that received the lion's share of his attention. Essentially capitulating this point to the mercantilists, Smith merely adopted many of the theories Locke had developed. On these matters, however, Smith was less careful than he was on trade. While Smith issued many of Locke's conclusions and arguments, at several points he built them on sloppy reasoning. This was of little matter, though, since Smith suggested no deviation from the status quo on these points.

Naturally, when discussing the exchange rate regime, Smith turned to the recoinage controversy of the 1690s. Weaving a narrative to explain the rationale of mercantilist policy, however, Smith both got some of the elementary facts wrong and mistook some of the key issues. Smith correctly reported that Parliament elected to repair the clipped currency at the public expense. He then suggested, however, that Parliament, "[a]s they had been at this expence...thought it just and proper to prohibit the exportation of money for the future." Smith continued,

The merchants however complained of this hardship, and were then allowed to export money to a small extent. The great complaint, however, was always scarcity of money. In order to remedy this, the government established a common office for coining money where every one might get their gold and silver turned into coin without any expence.¹²

The "facts" of this narrative, however, were simply wrong. The Act of 1663 allowed the free export of both bullion and foreign coin.¹³ The Act of 1666 established free coinage, meaning that patrons of the Royal Mint could have precious metal bullion converted into English specie free

¹² LJ(B) 509.

¹³ *An Act for the Encouragement of Trade*, 15 Car. II, c. 7.

of charge.¹⁴ Throughout this period, the melting and export of English coin remained illegal.¹⁵ Either the student recording Smith's lecture grossly misunderstood the relevant history or, more likely, Smith invented the narrative to fit the mercantilists into his tidy boxes.

The account given here also mistakes some of the key issues in the debates concerning exchange rate regimes. Smith seems to have misunderstood the nature of the "public expense" involved in the recoinage of 1696. There was then, as there always is, the cost of operating the mint. These costs included the wages to pay the mint's employees and the cost of their tools. These costs depended on the number of coins they converted regardless of the quantity of precious metal they put into each. In the recoinage of 1696 there was also a second cost: the expense of "making good the deficiency of the clipped coin"—the "expense" of restoring light coins to their full weight. This was the several million pound expense cited by Smith. The former set of costs was a tool that could be used to manipulate the specie points—and thus manipulate the exchange rate—while the latter involved a purely distributive question. As discussed in the previous chapter, the seigniorage charged by the mint to convert bullion into specie is unrelated to the question of who should bear the cost of restoring light coins to their full weights. Yet, Smith conflated the two issues, apparently believing that free coinage was a necessary concomitant of the public bearing the cost of restoring the coins.

The reports of Smith's lectures also conflate the weight of coins and their level of purity.

The earlier report runs,

I pointed out the reasons also which brought the coin below the originall standard in point of weight, for in point of purity it is at present as high as ever. This has been brought about by the temporary and fraudulent views of the government, who found their interest at times to diminish the coin by adding a greater quantity of alloy, in order to pay off their various debts with a small quantity of silver and gold.

¹⁴ 8 Charles II. C. 5.

¹⁵ See the discussion above for references to the various acts in 1690s criminalizing the melting of English coin.

The contradiction here is readily apparent: how could the purity of coins have been preserved if the government continuously substituted alloy for precious metal?¹⁶

This contradiction may have been the result of a simple mistake (on the part of Smith or the reporter), but it was likely the result of Smith attempting to make the facts of history fit the story he wanted to tell. As we saw above, William Lowndes went to pains to show that the purity of English coins had not been altered for centuries. The changes in the official weights of coins were responses to *autonomous* changes in the coins' market exchange value caused by their wear and clipping. Smith followed Lowndes (and Locke) in asserting that the purity of English coins had not changed, but he refused to accept that the market might have caused the problems in the coin and the government, the solution. Instead of rethinking his theory in the face of contradictory evidence, Smith simply changed the evidence.

Smith's poor grasp of the facts surrounding England's exchange rate regime did not cause him to hesitate in developing prescriptions concerning exchange rate policy. Building on Locke's model of the determinants of coins' values, Smith joined the orthodoxy in celebrating England's fixed exchange rate regime.

While Smith did a poor job of explaining it, he adopted wholesale Locke's model of the determinants of coins' values. Initially, Smith issued a simplistic version of Locke's model: the exchange value of a coin is determined not by its extrinsic stamp but by its intrinsic content. "The stamp gives it no additionall value; it merely ascertains the value," Smith explained.¹⁷ Several days later, Smith introduced the all-important caveats Locke had emphasized. Conversion, Smith explained, ensured that a "coind gold can never bear a greater price than the uncoined ingot of equall weight." Smith recognized, however, that conversion often came at a

¹⁶ LJ(A) 374.

¹⁷ LJ(A) 372-73.

price. Following Locke, Smith explained that the risk of illegally melting coins *could* allow the price of bullion to rise vis-à-vis specie and the increase in usability of specie (generated by the sovereign's certification of its metallic content) *could* allow the exchange value of coins to rise above their intrinsic value. Smith also followed Locke in recognizing that the supply of and demand for currency drove the international movement of precious metals, ensuring that coins' exchange values always remained within the specie bands.¹⁸

Predictably, Smith appropriated Locke's prescription that the mint manipulate the costs of conversion. By charging for the conversion of bullion into specie, the state would both recuperate the cost of operating the mint and decrease the melting of coin. The reported language is quite strong: by instituting such a charge, "[t]here would then be no temptation to melt or export the coin." To say that the small charge Smith proposed would eliminate all melting and exporting amounts to a denial of the price-specie-flow model. Such a charge would only raise the cost of conversion and *decrease* the amount of conversion by raising the minimum exchange necessary to trigger conversion. In modern terms, such "gold devices" would shift the "gold points" and expand the size of the "gold band," but they would not eliminate the operation of the price-specie-flow mechanism altogether.¹⁹

In the latter series of lectures, Smith oversimplified the problem of frequent conversion in the same manner. "This might have been easily prevented by fixing a certain price upon the coinage of bullion, or by ordaining the Master of the Mint to be paid by the persons who brought their money to be coined," Smith suggested. Here, however, Smith went one step beyond merely appropriating Locke's ideas without giving the proper attribution. Smith was so bold as to

¹⁸ LJ(A) 385-86.

¹⁹ LJ(A) 386. Smith may have used such strong language in his lecture, but his system depended on the operation of the price-specie-flow model. While his understanding of the workings of this model may not have been as rich as that enjoyed by Locke, Smith certainly did not intend to reject it.

proclaim that he was the first to make such a proposal. The solution, in Smith's rendering, was quite simple, "But such a regulation was never thought of"—no doubt because the mercantilists were too stupid to recognize so obvious a corrective. In reality, however, the solution was not so simple; and Adam Smith was not the first to recommend this response. As Smith well knew, John Locke had developed this prescription in the same terms in the 1690s.²⁰

Smith condemned exchange rate alteration on the same grounds as Locke had: alteration upsets the measure of value provided by currency, it creates uncertainty, which slows the economy, and it (unjustly) transfers wealth between those locked into nominal agreements (like debtors and creditors). At one point, Smith's language was copied almost verbatim from Locke's *Some Considerations*. Suggesting that alteration in the standard might be appealing in the short term, Smith retorted that "like all other frauds it is merely a temporary temptation, and in the whole is a loss to those who practise it."²¹

²⁰ LJ(B) 509.

²¹ LJ(A) 373-75. Locke wrote, "the due proportions of Silver ought to be kept in each Species, according to the respective Rate set on each of them by Law. And when this is ever varied from, it is but a Trick to serve some present occasion; but is always with loss to the Country where the Trick is play'd." Locke, *Some Considerations*, 309.

II. Smith's Early Efforts to Influence Policy

Smith made his first overtures to policymakers in the late 1750s. Leaning on the power of the *Theory of Moral Sentiments*, these efforts established Smith in several policymakers' minds as a professor of considerable merit. Their initial response was just to send their sons to him for their education. Over time, however, these links grew into strong connections, and policymakers began to consult Smith on matters of political and economy policy. By the mid-1760s, Smith was working in London with several of the most powerful policymakers in Britain, including Chancellor of the Exchequer Charles Townshend and leader of the opposition the Second Earl of Shelburne.

Smith's entry into the policy realm, however, proved to be premature. The second component of his system of political economy—the application of his principles to government policy—still existed only as a series of revised lecture notes. And while Smith could prove persuasive in person, he had not yet put the pieces in place to extend the reach of his influence beyond his lectures. When Smith clashed with Townshend (his principal patron in London) on the organization of commercial policy within the empire, he retreated to Scotland with the express purpose of completing his second work: *The Wealth of Nations*.

Part II of this chapter traces Smith's early attempts to influence policymakers. These early attempts—while largely unsuccessful in and of themselves—served two crucial functions. First, they established the connections through which Smith would eventually influence policy. Second, they enriched Smith's understanding of the role ideas can and do play in policymaking, prompting him to spell out in the clearest possible terms the application of his ideas to contemporary policy questions.

1. *Smith the Teacher*

By the late 1750s, Adam Smith was eager to begin selling his rival policymaking framework to the elite that governed the British Empire. He saw the *Theory of Moral Sentiments* (published in London in the spring of 1759) as a means to advertise his services. Not yet having been to London, however, Smith was acquainted with few of the policymakers who could affect the changes he envisioned. Smith entrusted this charge to the judgment of his better-connected friends David Hume, Alexander Wedderburn, and John Dalrymple. They served him well. Smith's printer later reported that he sent copies (partly at Smith's expense) to eighteen of the most influential policymakers and intellectuals in London.²²

That April, Hume reported that "the Public seem disposd to applaud [Smith's treatise] extremely." Hume mentioned particularly the reaction of MP Charles Townshend, one of the policymakers to whom Smith had sent his work. Townshend was "so taken with the Performance," Hume wrote, that he immediately resolved to coax Smith into serving as the private tutor to his stepson, Henry Scott, the third Duke of Buccleuch. Hoping to retain Smith at the University of Glasgow, Hume attempted to intercede but failed. Townshend contacted Smith, and the two began a process of resolving the terms on which Smith would take up the commission.²³

By this time, Smith had acquired a considerable reputation as a teacher. The previous November, Gilbert Elliot, an MP and close friend of David Hume's, encouraged Sir William Petty-Fitzmaurice (later the 2nd Earl of Shelburne and Prime Minister) to send his younger brother to Glasgow to live with and study under Smith. Petty passed this recommendation on to his father, and the arrangements were made. Petty's younger brother, the Honorable Thomas

²² 31. From David Hume - 12 Apr 1759; 33. From Andrew Millar - 26 Apr 1759. Smith, *Correspondence*, 31-36, 39-40.

²³ 31. From David Hume - 12 Apr 1759. *Ibid.*, 31-36.

Henry Petty-Fitzmaurice, traveled up to Scotland and came under the tutelage of Adam Smith in the winter of 1758-59.²⁴

Smith did his best to nurture the indirect relationships he was developing with these highly placed policymakers. In February, he wrote to Viscount Fitzmaurice (who was in the army at the time), ostensibly to report on his younger brother's progress. After a short paragraph offered by way of an update, Smith attempted to initiate a discussion of politics. He offered some reflections and opinions on current political events and pressed the viscount to send his perspectives back.²⁵ Despite being a reluctant correspondent in general, Smith wrote several letters to the 1st Earl of Shelburne in March and April of 1759. Smith raved about the progress and good habits of the young Fitzmaurice. But, as with the elder son, Smith also endeavored to ingratiate himself with the earl. He encouraged Shelburne to visit the two of them in Glasgow. Criticizing the unemployment created by the engrossment of the Scottish nobility, Smith praised the earl (who was Irish) for embracing the “noble and important duty of attempting to introduce arts, industry and independency into a miserable country, which has hitherto been a stranger to them all.”²⁶

Shelburne's reply followed in late April. He thanked Smith for his compliments, but his focus was almost entirely on the education of his son. He was clearly delighted with Smith's reports; and he committed the direction of the boy's education to Smith's hands. Smith did inspire confidence in him—but as a *teacher* not as a policy consultant.²⁷ Shelburne was so

²⁴ 27. From Gilbert Elliot - 14 Nov 1758. Ibid., 26-28.

²⁵ 28. To Lord Fitzmaurice - 21 Feb 1759. Ibid., 28-29.

²⁶ 29. To Lord Shelburne(1) - 10 Mar 1759; 30. To Lord Shelburne(1) - 4 Apr 1759. Ibid., 29-32.

²⁷ 32. From Lord Shelburne(1). Ibid., 36-38.

pleased with Smith's tutoring that he subsequently recommended Smith and Glasgow to an Irish friend. Smith thanked the earl in turn.²⁸

Soon thereafter, Shelburne received the copy of the *Theory of Moral Sentiments* that Smith had sent to him. Shelburne's letter to Smith is lost, but Smith's reply bears out the concerns Shelburne raised. Smith wrote,

Your Lordship makes me very vain when you mention the satisfaction you have had in reading the book I lately published, and the engagements you think I have come under to the Public. I can, however, assure your Lordship that I have come under no engagements which I look upon as so sacred as those by which I am bound as a member of this University to do everything in my Power to serve the young people who are sent here to study, such especially as are particularly recommended to my care.

Shelburne was impressed with Smith's treatise. But like many a parent paying top dollar for his or her child's education, Shelburne grew concerned that Smith's research ambitions would distract him from his responsibilities in the classroom. Shelburne may have even heard about Townshend's efforts to recruit Smith away from Glasgow and into his private employ. This was all the more concerning to him given that he had recommended Smith to his friends. Shelburne evidently wondered whether Smith would be around to complete their education.²⁹

Smith's reply was designed to allay these concerns. Indeed, his language could not have been stronger: he had no commitment more "sacred" than his obligation "to do everything in [his] power to serve the young people who are sent [there] to study."³⁰

Smith's overture, however, did not comport with reality. Just as Smith had lied to his students about John Locke's ideas, so too did Smith lie to Shelburne about his commitment to teaching. The truth was that Smith had already committed to Townshend to leave Glasgow when the Duke of Buccleuch finished at Eton. Within days of offering these assurances to Shelburne,

²⁸ 35. To Lord Shelburne - 23 July 1759. Ibid., 41-42.

²⁹ 37. To Lord Shelburne - 31 Aug 1759. Ibid., 36-45.

³⁰ 37. To Lord Shelburne - 31 Aug 1759. Ibid.

Smith met with Townshend to discuss these arrangements. In preparation for their work together, Smith drew up a reading list for the duke and had the books sent to him in London.³¹

The circumstances in which Smith took up the tutorship of Buccleuch provide further evidence of his lack of commitment to Glasgow and his desire to ingratiate himself to the policymakers in London. In October of 1763, Charles Townshend wrote to Smith, “The time [is] now drawing near when the Duke of Buccleugh intends to go abroad.” Townshend conveyed the timeframe he had in mind: “The Duke is now at Eton: He will remain there until Christmass. He will then spend some short time in London...but it were to be wished He should not be long in Town.”³²

This timing, however, was quite inconvenient for Smith. Leaving in January or February would amount to leaving in the middle of the term, and he had students for whom he was responsible. In mid-December, Smith reported the turn of events to Hume. “I accepted [Townshend’s] proposal,” he wrote, “but at the same time expressed to Mr Townshend the difficulties I should have in leaving the University before the beginning of April, and begged to know if my attendance upon his Grace would be necessary before that time.” At that point, Smith was still hopeful that Buccleuch’s departure could be pushed out past the end of the winter term. In the end, however, Townshend was insistent on his original timeframe; and Smith obliged his new patron. Smith traveled to London in January 1764, en route to Paris.³³

Since Townshend had first written to Smith in 1759, the former’s political career had enjoyed a meteoric ascendance. In March 1761, Townshend became Secretary at War, a position

³¹ 39. To Charles Townshend - 17 Sep 1759. Ibid., 47-48.

³² 76. From Charles Townshend - 25 Oct 1763. Ibid., 95-96.

³³ 78. To David Hume - 12 Dec 1763. Ibid., 98. Ernest Campbell Mossner and Ian Simpson Ross, “Life and Works of Adam Smith,” in *The Correspondence of Adam Smith*, ed. Ernest Campbell Mossner and Ian Simpson Ross (Oxford: Clarendon Press, 1997), xx.

that allowed him to exert direct influence on British policy concerning its war-torn colonies.³⁴ Two years later, Townshend was promoted to the presidency of the Board of Trade, where he continued to propose reforms of imperial fiscal policy. After unsuccessful maneuvering cost him both his spot on the Board of Trade and a tenured offer to be Lord of the Admiralty, Townshend spent two years as an opposition MP. He rejoined the government in 1765, speaking in favor of the ill-fated Stamp Act. Townshend was rewarded with the lucrative position of paymaster general and was courted by several successive ministries to become the Chancellor of the Exchequer, among the most powerful positions in the government. William Pitt the Elder eventually persuaded Townshend to accept the measurable pay cut involved in accepting the Chancellorship, which Townshend did in mid-1766. By the mid-1760s, Charles Townshend was among the most powerful policymakers in the British Empire.³⁵

Meanwhile, Smith's prospects with the Fitzmaurice family declined for the time being. In 1761, the 1st Earl of Shelburne died, passing the title on to his elder son. In the same year, the younger son (Smith's student) left Glasgow for Oxford to study law with William Blackstone. These transactions brought Smith into contact with the newly made 2nd Earl of Shelburne, who was in the early stages of a promising career.³⁶ At some point in the early 1760s—most likely in 1761—Smith and Shelburne shared a carriage together down to London. Shelburne later recounted the unparalleled impact Smith bore on his thinking,

³⁴ By 1761, Britain was in the midst of the global conflict the Seven Years' War.

³⁵ Peter D. G. Thomas, "Townshend, Charles (1725-1767)," in *Oxford Dictionary of National Biography*, ed. H. C. G. Matthew and Brian Harrison (Oxford: Oxford University Press, 2004).

³⁶ Shelburne's success in the military combined with his father's advancing position, propelling his early entry into a career as a member of parliament in both the Westminster and Dublin parliaments. When his father died, he took up seats in the Houses of Lords in the two countries. In 1764, he was made first lord at the Board of Trade, with a seat in the cabinet. Two years later, he was appointed Secretary of State for the Southern Department. (At this time, Britain had two secretaries of state.) John Cannon, "Petty, William, Second Earl of Shelburne and First Marquess of Lansdowne (1737-1805)," in *Oxford Dictionary of National Biography*, ed. H. C. G. Matthew and Brian Harrison (Oxford: Oxford University Press, 2004).

“I owe to a journey I made with Mr. Smith from Edinburgh to London the difference between light and darkness through the best part of my life. The novelty of his principles, added to my youth and prejudices, made me unable to comprehend them at the time, but he urged them with so much benevolence, as well as eloquence, that they took a certain hold which, though it did not develop itself so as to arrive at full conviction for some few years after, I can truly say has constituted ever since the happiness of my life, as well as the source of any little consideration I may have enjoyed in it.”

While it would later prove pivotal to Shelburne’s intellectual development, his trip with Smith on the road to London was not quite the experience of Saint Paul on the road to Damascus. Shelburne was intrigued by Smith’s heresy, but he was not instantly converted to Smith’s classical liberal policymaking framework. Smith had sowed the seeds of dissension, but the crop had not yet born fruit.³⁷

At this point, Smith’s best route to effect change in British economic policy ran through Charles Townshend. In Smith’s eyes, Townshend exhibited the trifecta that would maximize his ability to influence policy. Having defended trade liberalization in the past, Townshend must have appeared as though he would be amenable to Smith’s radical ideas.³⁸ Second, Townshend was a rising star among the elite that governed the British Empire. Finally, and most importantly, Townshend was able to imagine Smith outside the University of Glasgow. Whereas the 1st Earl of Shelburne pressed Smith to remain at Glasgow, Townshend wrested Smith from the North and plunged him into London and Paris—the two foci of intellectual and political life in Western Europe in the eighteenth century. Whereas Shelburne complemented Smith’s teaching by sending him more teenagers to guide, Townshend celebrated Smith’s research and policy acumen by pressing him to mix with the brightest and most influential men of his age. So, when Townshend called Smith down to London, Smith did not hesitate to hitch his wagon to the star of

³⁷ Rae surmised that the trip occurred in 1761. John Rae, *Life of Adam Smith* (London: Macmillan & Co., 1895), 153-55.

³⁸ Jacob Viner, “Guide to John Rae’s *Life of Adam Smith*,” in *Life of Adam Smith*, ed. Jacob Viner (New York: Augustus M. Kelley, 1965), 83-84.

Charles Townshend—even if it came at the cost of his “sacred” commitment to the students at the University of Glasgow.

2. *Smith’s Work on the Continent*

Smith traveled with the 3rd Duke of Buccleuch on the European continent from February 1764 to November 1766. Smith’s decision to accept Townshend’s offer advanced his political economy project in several ways.

First, the tutorship of the duke brought Smith into close contact with Townshend. Townshend encouraged his stepson to take full advantage of the unique opportunity to learn from Smith and those to whom Hume had given them letters of introduction. A letter to his stepson reveals Townshend’s vision of an ideal marriage between Smith’s theorizing and their family’s political position. Smith, he wrote, “is learned without being singular in his notions of our Government, and from him you will grow to be a grounded politician...Mr. Smith will make you a politician and time will afterwards, in your example, demonstrate the truth of my opinion.”³⁹

Townshend did not hesitate to take his own advice. Correspondence between Townshend and Buccleuch suggests that the former exchanged letters with Smith frequently. The few letters that survive between Townshend and Smith reveal familiarity and point to additional (now lost) exchanges on commercial and fiscal policy.⁴⁰ Later evidence reveals that Smith used his travels through France as an opportunity to collect financial and fiscal data on Townshend’s behalf.⁴¹

Second, the duke’s “grand tour” proved as enriching and broadening to the tutor as it did to the pupil. The tour was Smith’s first trip abroad; and with letters of introduction from Hume and Townshend, Smith became acquainted with some of the greatest political and economic

³⁹ WR Scott, “Adam Smith at Downing Street, 1766-7,” *The Economic History Review* 6, no. 1 (1935): 83.

⁴⁰ 302. From [Charles Townshend] - End of Oct or Dec 1766; 94. To Charles Townshend - 26 Aug 1766; 95. To [Charles Townshend] - 27 Aug 1766. Smith, *Correspondence*, 114-17, 328-34.

⁴¹ Scott, “Smith at Downing Street,” 83.

thinkers of his age including Voltaire, François Quesnay (the founder of the physiocratic economic system), and the philosophes.⁴² These encounters proved important to the development of Smith's system of political economy, if only by serving as an additional useful foil.⁴³

Finally, the light duties of merely guiding the duke provided Smith with the opportunity to begin the process of transforming his lecture notes into his treatise on political economy. In July 1764, Smith wrote to Hume, "I have begun to write a book in order to pass away the time. You may believe I have very little to do."⁴⁴ The book to which Smith referred was his *Inquiry into the Nature and Causes of the Wealth of Nations*.

3. *The Early Draft of the Wealth of Nations*

Eager to catch the attention of Townshend and, perhaps, to solicit his opinion, Smith sent a copy of an early draft of the work to Charles Townshend. Some portion (perhaps all) of the material Smith sent to Townshend survives. This material, although brief and partly in outline form, provides considerable insight into Smith's early understanding of the scope, purpose, and framing of his best-known treatise. In short, it reveals that Adam Smith saw his project as an attempt to challenge John Locke head on.

Smith's inquiries into the cross-national development gap became the centerpiece of his work. The first chapter (which, if it had been written, has not survived) was presumably an introduction. The second chapter was entitled, "Of the nature and causes of public opulence." There Smith asked plainly: how is it that the luxury of a "common day labourer in Britain" "is much superior to that of many an Indian prince, the absolute master of the lives and liberties of a

⁴² Smith discussed some of these connections (arranged by Hume and Townshend) in a letter to Hume in July 1764. 82. To David Hume - 5 July 1764. Smith, *Correspondence*, 101-02.

⁴³ The physiocrats became the other target for Smith in Book IV of the *Wealth of Nations*. That attack, however, was secondary to the assault on the mercantilists. Smith's discussion of mercantilism is more than five times longer than his discussion of physiocracy.

⁴⁴ 82. To David Hume - 5 July 1764. Smith, *Correspondence*, 101-02.

thousand naked savages”? He found this question especially puzzling given that, “In a civilized society the poor provide both for themselves and for the enormous luxury of their superiors...Among savages, on the contrary, every individual enjoys the whole produce of his own industry.” What, Smith asked, could cause such a tremendous disparity of wealth between nations?⁴⁵

Just as in his lectures, Smith’s research question and the very words he used to formulate it all came directly from John Locke’s *Second Treatise*. Here, however, this question was framed as animating the entire work.

The major purpose of Smith’s inquiry seems to have been to demonstrate conclusively that development is wholly independent of the form money. He outlined, “money, serving only to circulate commodities, is so much dead stock which produces nothing.” As such, “whatever contrivance can enable any nation to circulate the produce of its industry with a smaller quantity of money than would otherwise be necessary, must be extremely advantageous; because the quantity of money saved may be exchanged abroad for commodities...” Directly contradicting Locke’s hierarchy of forms of money, Smith suggested that nonmetallic money may be more useful than metallic. Smith enumerated his argument that the quantity of currency is unrelated to national wealth: “national opulence, or the effect of national opulence, either at home or abroad, neither consists in nor depends upon the quantity of money, or even of gold and silver, that is in the country.”⁴⁶

As in the lectures, Smith attempted to resolve Locke’s puzzlement over the development gap by pointing to the division of labor. Smith explained, “The *division of labour*, by which each individual confines himself to a particular branch of business, can alone account for that superior

⁴⁵ Adam Smith, “Early Draft of the *Wealth of Nations*,” in *Lectures on Jurisprudence*, ed. Ronald L. Meek, D. D. Raphael, and Peter Stein (Oxford: Oxford University Press, 1978), 562-63.

⁴⁶ *Ibid.*, 576.

opulence which takes place in civilized societies, and which, notwithstanding the inequality of property, extends itself to the lowest member of the community.”⁴⁷ Unlike Locke’s rendering of the “invention of money” as having been created in a moment of human genius and foresight,⁴⁸ Smith insisted that the division of labor is entirely *natural*, it

is originally the effect of no human wisdom which foresees and intends that general opulence to which it gives occasion. It is the necessary tho very slow and gradual consequence of a certain principle or propensity in human nature, which has in view no such extensive utility.⁴⁹

Locke had suggested that the quality of monetary forms differed across populations, giving rise to different levels of development. Smith insisted, by contrast, that the division of labor “is a propensity, common to all men...to truck, barter, and exchange one thing for another.”⁵⁰ Once again, Smith posited that the “cause of the slow progress of opulence” is due to both “natural impediments” (like the initial ignorance of mankind) and “oppressive or injudicious government.”⁵¹

There was little here that was new. As in his lectures, Smith took up the questions and issues raised by Locke, appropriated many of his responses and formulations, and set about refuting them. It is worth highlighting, however, that John Locke remained Adam Smith’s clear target in the early versions of the *Wealth of Nations*.

4. *The Culminating Colonial Crisis*

The decline of the first Rockingham ministry in the summer of 1766 brought William Pitt the Elder (the Earl of Chatham) to power. Hoping to transcend the factious divisions of party, Chatham appointed a ministry composed “of the best and ablest men, without any regard to

⁴⁷ Ibid., 564. Emphasis added.

⁴⁸ Locke, *Second Treatise*, § 36.

⁴⁹ Smith, “Early Draft,” 570-71.

⁵⁰ Ibid.

⁵¹ Smith, *Lectures on Jurisprudence*, p 578-79.

parties, distinctions, or *connections*.”⁵² Townshend was made Chancellor of the Exchequer and the 2nd Earl of Shelburne was made Secretary of State for the Southern Department, responsible for the administration of the American colonies. The two ministers, both highly competent and ambitious, were immediately at odds over the political and economic organization of the British Empire.⁵³

The division between the two leading ministers was particularly acute over the growing crisis in the American colonies. Continued expansion westward increased contact with hostile groups of Native Americans as well as settlers from rival empires, particularly Britain’s archrival France. While exacerbating tensions, these settlements simultaneously stretched the lines of defense thin. These conflicts provided some of the sparks for the global conflagration that was the Seven Year’s War (1756-1763)—known by the American colonists the French and Indian War. Postwar British policy aimed at both forcibly limiting this expansion and shifting the financial burden of frontier defense to the American colonists themselves. Military victory, however, seemed to only encourage further westward expansion, preventing the drawdown in troops anticipated—and needed—by the British exchequer Charles Townshend.⁵⁴

Like most Britons, Townshend believed that the American colonists ought to help to defray the increase in public expenses created by the expansion of the Empire. Townshend, however, was more optimistic than most that the Americans could be compelled to do so. In the 1750s, Townshend had (unsuccessfully) proposed several schemes to increase American taxes, and he was among the most steadfast supporters of the infamous Stamp Act of 1765.⁵⁵

⁵² John Brooke, *The Chatham Administration, 1766-1768* (New York: St. Martin’s Press, 1956), 12. Emphasis in original.

⁵³ Vincent T. Harlow, *The Founding of the Second British Empire, 1763-1793*, 2 vols. (London: Longmans, Green and Co., 1956), i: 182-83.

⁵⁴ *Ibid.*, i: 183-85.

⁵⁵ Townshend spoke strongly in favor of the measure in February 1765, issuing the logic we have come to associate with the act:

Whereas Townshend was determined to take a hard line against the American colonists, Shelburne followed Chatham's policy of moderation. While he insisted that law and order be maintained, Shelburne worked to entice the Americans back into the fold by liberalizing the restraints on their commerce.⁵⁶ Shelburne had opposed the Stamp Act and supported its repeal. He was one of the only five Members of Parliament to vote against the infamous Declaratory Act, which, accompanying the repeal of the Stamp Act, reasserted the right of parliament to tax and regulate the colonies.⁵⁷

5. *Smith with Townshend and Shelburne*

Smith and Buccleuch arrived back in England in November of 1766, in the midst of the turmoil and division that racked the British Empire from the settlements of Illinois and towns of New England to the highest positions in the Chatham ministry. Eager to restore the accounts of the exchequer, Townshend must have seen Smith as a potential resource for shaping and effecting his commercial policies. Even before Smith left Paris, Townshend had invited him to join him London.⁵⁸

Smith happily accepted the invitation. He “long[ed] passionately to rejoin [his] old friends,” many of whom were now in London.⁵⁹ More importantly, however, Townshend's offer was an unparalleled opportunity to play a direct role in reforming British commercial and trade

And now will these Americans, children planted by our care, nourished up by our indulgence until they are grown to a degree of strength and opulence, and protected by our arms, will they grudge to contribute their mite to relieve us from the heavy weight of that burden which we lie under?

The Stamp Act provoked rioting throughout the colonies and protests in Britain. When popular opinion turned against the act, Townshend noticeably failed to speak with the government in favor of its repeal. Thomas, “Townshend, Charles (1725-1767).” When presenting his own plan for raising revenue, Townshend justified it on the grounds that it followed the spirit of the Stamp Act. Lord Edmond George Fitzmaurice, *Life of William, Earl of Shelburne*, 3 vols. (London: 1875), ii: 38.

⁵⁶ Harlow, *Founding of the Second British Empire*, i: 182-85.

⁵⁷ Fitzmaurice, *Life of William, Earl of Shelburne*, i: 377. While Shelburne agreed that Parliament retained the right to regulate the colonies, he did not want to unnecessarily antagonize the colonists.

⁵⁸ Scott, “Smith at Downing Street,” 79-80.

⁵⁹ 99. To Andrew Millar - Oct 1766. Smith, *Correspondence*, 121-22. Scott, “Smith at Downing Street,” 79-80.

policy. Smith immediately saw the American crisis—centered as it was around questions of imperial commercial management—as the inevitable result of mercantilist foreign economic policy. He saw this as the perfect time to launch his assault on the British commercial system. This was the opportunity for which he had been gunning for upwards of a decade.⁶⁰

During his stay in London, Townshend tasked Smith with collaborating on a draft of his “History of the Sinking Fund.” Townshend’s paper was an attempt to document the origin and development of the sinking fund—the fund of surplus tax revenues dedicated to paying the principle and interest of the public debt—together with some speculation on its usefulness in the current fiscal crisis. It is difficult to determine how heavily Smith influenced the content of the document since the bulk of the paper is in Townshend’s hand, with the exception of a number of figures, calculations, and revisions made by Smith.⁶¹

The sinking fund figured directly into the Shelburne-Townshend controversy on imperial commercial and fiscal policy. Shelburne hoped to diffuse tensions with the colonies by ratcheting down the exchequer’s impositions on the American taxpayers. Increasing the public debt would allow the exchequer to meet its obligations without increasing revenue. This meant less taxation in the American colonies. We know that in 1782, Shelburne became an outspoken advocate of establishing a new sinking fund to ease fiscal strain imposed by the American Revolution. Shelburne may, however, have suggested relying on a sinking fund as early as the mid-1760s. Regardless, Shelburne was clearly willing to sacrifice revenue in the interest of stability and peace.⁶²

⁶⁰ Scott, “Smith at Downing Street,” 84.

⁶¹ The manner and extent of the funding of the sinking fund were among the most controversial fiscal questions in the eighteenth century. See P. G. M. Dickson, *The Financial Revolution in England: A Study in the Development of Public Credit, 1688-1756* (New York, : St. Martins Press., 1967).

⁶² The typical story is that Shelburne became a believer in the power of a sinking fund after his close friend Richard Price proposed the scheme in 1772. Harlow, *Founding of the Second British Empire*, i: 410. Fitzmaurice, *Life of*

Townshend, however, was not content to fund the government by increasing the debt. Simply put, Townshend was determined to raise taxes and to raise them particularly on the Americans. He divulged his plan to Adam Smith:

I will suggest another Plan: which is the simple one of ameliorating the branches of your Revenue, enriching the Sinking Fund, and appropriating the frequent and future Surplus in time of peace. The Branches I would ameliorate are your Customs, by a better method of preventing illicit trade, your Excise by better changes and regulations in the Soap and tea duty: by lessening the duties on Coffee, and by varying the duties on Spirits... I will add to these a *real* American Revenue.

Townshend, however, was a true believer in the power of the government's fiscal arm. Sounding more like a mercantilist than an apostle of free trade, he explained to Smith,

I would enrich the Sinking Fund by new taxes *in themselves* proper, such as the late duty on French Cambricks, a tax on Servants, and other such wise regulations for the encouragement of labour and commerce. I would also fall upon plantations in the forests, and the settlement of waste lands, which adding people and produce would of course encre[as]e interior consumption, the only true source of solid Revenue.

These taxes, as Townshend admitted, were not designed merely to collect revenue. The tax on French cambric was really a protectionist duty designed to protect English wool. The tax on servants was a tax designed to curb the "luxury" of the upper classes. Thus, Charles Townshend believed that commercial policy *could* and *should* be used to influence the patterns of production and consumption in an economy.⁶³

These, however, were the tenets of mercantilism. Townshend's suggestion that policymakers could devise "wise regulations for the encouragement of labour and commerce" was the very cornerstone of the mercantilist case for interventionist commercial policy. His desire to effect "the settlement of waste lands, which adding people and produce would of course

William, Earl of Shelburne, iii: 92-95. Price, a British economist, was an outspoken apologist for the American Revolution.

⁶³ 302. From [Charles Townshend] - End of Oct or Dec 1766. Smith, *Correspondence*, 328-34. All emphases are from Townshend.

encre[as]e interior consumption, the only true source of solid Revenue” sounds as if it could have come directly from the pen of John Locke himself.

There has been some considerable division between scholars on the extent to which Smith endorsed and even helped to design Charles Townshend’s infamous Revenue Act of 1767 (later known as the “Townshend Duties”). Clearly, Smith was in London at the time; and he did collaborate with Townshend on his “History of the Sinking Fund.” On this basis, Jacob Viner concluded that “Smith’s main activity during his stay in London at this time was work with Townshend on his disastrous taxation project.”⁶⁴ CR Fay—who had previously anointed John Locke as the worst English economist of all time—came to a similar conclusion, blaming Smith for giving Townshend the advice that resulted in the loss of First British Empire.⁶⁵ Others, however, have cited the conspicuous lack of evidence and wondered how such a rendering could possibly be reconciled with Smith’s subsequent stand on the American crisis in the *Wealth of Nations*.⁶⁶

It is almost certain that Adam Smith played no part in the design or the effecting of Charles Townshend’s revenue bill. Indeed, it is far more likely that Smith joined forces with the 2nd Earl of Shelburne, working directly for the Secretary of State to thwart the exchequer’s commercial and fiscal policy. These conclusions follow from Smith’s subsequent arguments on the points raised by Townshend and the timing of several key shifts in Smith’s relationships during his time in London.

Smith must have reacted rather strongly to Townshend’s commercial scheme. In the *Wealth of Nations*, Smith considered two of the specific taxes Townshend proposed. He was ambivalent about Townshend’s tax on servants. On the one hand, it taxed consumption rather

⁶⁴ Viner, “Guide to John Rae’s *Life of Adam Smith*,” 85.

⁶⁵ C. R. Fay, *Adam Smith and the Scotland of His Day* (Cambridge: Cambridge University Press, 1956), 116.

⁶⁶ Smith, *Correspondence*, 332-33 n21. Scott, “Smith at Downing Street,” 88-89.

than production, which Smith favored. On the other hand, the burden it imposed fell squarely on the shoulders of the middle class.⁶⁷ Smith, however, was *not* ambivalent about the tax on French cambric. While Townshend saw the tax as exemplary of the duties he hoped to propose, Smith treated it as exemplary of the very types of commercial restrictions he despised. The tax on French cambric was emblematic as one of the “unreasonable” restraints designed to secure a positive balance of trade.⁶⁸ Smith’s position on the American crisis (discussed below) set him further at odds with the Chancellor of the Exchequer. While Charles Townshend may have supported trade liberalization in the 1750s, the Townshend of the 1760s clearly sought to use interventionist economic policy to shape and “manage” Britain’s trade and commerce. This was anathema to Smith’s political economic system; and if he continued to collaborate with Townshend after receiving this letter, it is not likely that collaboration continue much longer.

The likely reason why there is no evidence showing Smith’s hand in the Townshend Acts is that Smith had almost certainly abandoned the Townshend camp even before he presented his bill to Parliament. As Townshend made clear in his letter to Smith, he originally intended to justify raising taxes by taking the “sinking fund” option off the table. With a robust history of Britain’s sinking funds, Townshend could demonstrate to Parliament that a funded debt was not a long-term solution to their budget problems.

In the event, Smith and Townshend never finished the “History of the Sinking Fund.” When Townshend presented his plan to raise taxes at the end of January 1767, he relied instead on a *constitutional* justification for imposing new taxes on the colonies. In his speech before Parliament, Townshend praised the Stamp Act, ridiculed the Americans’ much-issued distinction

⁶⁷ Smith, *Wealth of Nations*, 857. Kirk Willis suggests that the tax on servants was adopted by North after reading the *Wealth of Nations*. His narrative, however, is incorrect: the tax antedated the *Wealth of Nations*. Kirk Willis, “The Role in Parliament of the Ideas of Adam Smith, 1776-1800,” *History of Political Economy* 11, no. 4 (1979): 524.

⁶⁸ Smith, *Wealth of Nations*, 473.

between “internal” and “external” taxes, and insisted that the Americans be made to contribute their part to the support of the empire. Townshend did not yet mention specifics, but Shelburne reported to Chatham that he had “heard, from general conversation, that Mr. Townshend has a plan for establishing a board of customs in America, and by a new regulation of the tea duty here, and some other alterations, to produce a revenue on imports there.”⁶⁹

In contrast to Townshend, Shelburne was optimistic that the dual problems of western expansion and public expenditure could be resolved by organizing the settlement of the newly acquired territories. In particular, Shelburne hoped to offer parcels of land in exchange for quit-rents paid by the settlers to the exchequer. Whereas Townshend’s plan attempted to contain western migration and increased the tax burden on those remaining in the East, Shelburne sought to organize the western migration and collect revenue from those migrants who enjoyed the benefits of free land and frontier protection.⁷⁰

Shelburne’s plan, however, was only in its infancy. Townshend had been issuing proposals to raise an American revenue for more than a decade. Shelburne, by contrast, was young and had only recently turned his attention to American affairs. When pressed, Shelburne resisted issuing what he admitted was a “crude and undigested plan.” More than anything, Shelburne needed time to work out the details of his alternative scheme.⁷¹

Time, however, was not on Shelburne’s side. In the early winter of 1766-67, Chatham’s poor health forced him to retreat to Bath. His absence created a power vacuum into which Townshend quickly stepped. Taken by surprise, Shelburne attempted to organize a rearguard action to delay the advance of Townshend’s plan at least until the Prime Minister’s health was restored.

⁶⁹ Fitzmaurice, *Life of William, Earl of Shelburne*, ii: 37-39.

⁷⁰ *Ibid.*, ii: 38-39.

⁷¹ Harlow, *Founding of the Second British Empire*, i: 187.

As the Chatham ministry divided into rival factions led by Townshend and Shelburne, Adam Smith came to the aid of the 2nd Earl of Shelburne. Smith's defection into the Shelburne camp was almost certainly aided by Smith's old friend David Hume. In February 1767, General Henry Seymour Conway, the Secretary of State at the Northern Department, appointed Hume to be his under-secretary.⁷² While American affairs fell under Shelburne's purview as Secretary of State at the Southern Department, Conway nonetheless joined him in resisting Townshend's revenue bill.⁷³ Hume would have been in an excellent position to reconnect Smith with Shelburne.

That same month, Shelburne and Smith met and discussed the American crisis in the terms established by the Americans—meaning on the proper relationship between representation and the support of the empire. Shelburne tasked Smith with researching Greek and Roman history for examples that might prove enlightening. Several days later, Smith reported his findings: ancient colonists typically lost their right to vote in the metropole but retained their other political rights; and Greek and Roman colonies frequently failed to offer military and economic support to their empires.⁷⁴

These precedents seemed to support Shelburne's policy of moderation rather than the hard line adopted by Townshend. Townshend considered the colonists in America to be British subjects the same as the subjects in London, Sheffield, or Bristol. As such, he insisted that they ought to be made to pay their taxes just like all the other British subjects. Smith's report, however, suggested that, as a practical matter, colonists in previous empires enjoyed distinct legal status. They had different rights and privileges but also different responsibilities from their

⁷² John Robertson, "Hume, David (1711–1776)," in *Oxford Dictionary of National Biography*, ed. H. C. G. Matthew and Brian Harrison (Oxford: Oxford University Press, 2004).

⁷³ Clive Towse, "Conway, Henry Seymour (1719–1795)," in *Oxford Dictionary of National Biography*, ed. H. C. G. Matthew and Brian Harrison (Oxford: Oxford University Press, 2004).

⁷⁴ 101. To Lord Shelburne - 12 Feb 1767. Smith, *Correspondence*, 122–24.

fellows in the metropole. As Smith would later argue in the *Wealth of Nations*, the colonists' special situation and status had to be recognized if an amicable relationship were to be continued. Smith's research no doubt emboldened Shelburne to continue his battle against what Shelburne saw as Townshend's rash, reactionary policy.

Shelburne's efforts, however, were for naught. Throughout January and February of 1767, Shelburne pleaded with Chatham to return from Bath and restore order to his disintegrating ministry. At first, Chatham was dilatory, responding that he was presently too ill "to enter into any detail of things" and that "his fixed purpose had always been and still was, not to be a proposer of plans but as far as a seat in one House enabled him, an unbiased judge of them." In late January, however, the government suffered a decisive defeat when the opposition voted to lower the land tax in Britain. The opposition suggested that the loss of revenue this imposed could be made up by Townshend's promised American revenue. In other words, the government had elected to shift some of the tax burden from Britain onto the American colonies. Upon hearing of this, Chatham returned to London in early March determined to "crush the preposterous union of clashing factions." He moved boldly, attempting to remove Townshend from office. When Lord North refused to replace Townshend, however, the Prime Minister took it as a sign that opinion had moved in favor of the sitting Chancellor. Much to Shelburne's great chagrin, Chatham returned to the country, leaving Townshend free to effect his plan. In June, Townshend's Revenue Act became law; and the duties became effective the following November. Historians of the American Revolution know all too well the pivotal role of the Townshend Duties in the dissolution of the First British Empire.⁷⁵

⁷⁵ Harlow, *Founding of the Second British Empire*, i: 187-89.

6. *Smith's Return to Scotland*

At some point between March and May of 1767, in the midst of Charles Townshend's ascendance, Adam Smith left London and returned to his home in Kircaldy, Scotland. His express purpose was to complete the *Wealth of Nations*.⁷⁶ In a letter written to Hume shortly after his return home, Smith expressed the great relief he felt upon retiring from the bustle and intrigue of London to the quiet solitude of Kircaldy and his writing. He wrote, "My Business here is Study in which I have been very deeply engaged for about a Month past...I feel myself...extremely happy, comfortable and contented. I never was, perhaps, more so in all my life."⁷⁷

Scholars like Viner and Fay have no way of explaining Smith's abrupt return to Scotland. If, in fact, Smith were instrumental in the creation of Townshend's infamous revenue bill, it is most unlikely that Smith would have abandoned Townshend before the bill was voted on in Parliament in June. Smith—who abandoned his colleagues and students in the middle of a term simply to maintain good relations with Townshend—had been working to secure this kind of influence in government for years. It is inconceivable that Smith would have retreated to Kirkcaldy at the very moment Townshend had united the opposition and taken over the Chatham ministry.

The more likely narrative is that Smith and Townshend quickly realized how sharply their policymaking frameworks clashed. Charles Townshend largely clung to the mercantilist premise that the trade and commerce of the British Empire could and should be managed by policymakers in the metropole. Adam Smith, of course, rejected such intervention as both unjust and unwise.

⁷⁶ In late March, Smith ordered several boxes of books sent north. 102. Thomas Cadell - 25 Mar 1767. Smith, *Correspondence*, 124.

⁷⁷ 103. To David Hume - 7 Jun 1767. *Ibid.*, 125.

Nowhere was their disagreement clearer than on the governance of the American colonies. When Townshend and Shelburne began to clash over this same issue, Smith must have found that the 2nd Earl of Shelburne and *not* Charles Townshend was the policymaker whose plans best fit within the framework of his classical liberal system. Working in the Department of State (albeit under General Conway rather than the Earl of Shelburne), Smith's friend David Hume likely facilitated Smith's defection over to the Shelburne camp. By February, Smith was doing research on behalf of Shelburne—highly unlikely if Smith were still under the patronage of Shelburne's archrival, Charles Townshend.

Townshend's success in March dealt a strong blow to the Shelburne faction; and the rise of his crypto-mercantilist policies must have been more than a little disappointing to Smith. Here was a policymaker who had previously espoused free trade rhetoric but nonetheless sought to manage trade and commerce. The veritable collapse of the Shelburne faction combined with the seeming durability of the mercantilist impulse among policymakers to drive Smith out of London and back to his treatise.

Powerless in the wake of Townshend's ascendance, Shelburne likely encouraged Smith to return to his treatise. Smith later reported to Shelburne that "Since I came to this country I have employed myself pretty much in the manner that I proposed." Remembering, perhaps, the force of Smith's argumentation on their trip to London five years earlier, Shelburne must have joined Smith in concluding that the British commercial system could not be countered without first thoroughly denouncing the theory on which it rested. Evidently, however, Smith conveyed a timeframe for finishing the work in terms of months rather than in terms of years. Knowing that

he had lost the initiative and still unready to present his rival plan, Shelburne must have expected that Smith's promised treatise promised could only help their shared cause.⁷⁸

Smith's correspondence with Hume in the spring and summer of 1767 shows a declining interest in London's political intrigue. "You will give me great comfort by writing to me now and then, and by letting me know what is passing among my friends at London," Smith wrote. He also queried Hume on some specific pieces of legislation.⁷⁹ For his part, Hume had almost totally given up on politics. In June, he and General Conway tendered their resignation in protest of Townshend's Revenue Act.⁸⁰ Their resignation, however, was not accepted; and their protest did not "occasion a total Change of Ministry," as Hume had hoped it would.⁸¹ Hume stayed on for the time being, and Smith focused his attention on the composition of his *Wealth of Nations*.

⁷⁸ 113. To Lord Shelburne - 27 Jan 1768. Ibid., 137-38.

⁷⁹ 103. To David Hume - 7 Jun 1767. Ibid., 125.

⁸⁰ Towse, "Conway, Henry Seymour."

⁸¹ 107. From David Hume - 14 Jul 1767. Smith, *Correspondence*, 130.

III. The *Wealth of Nations*

The scope and focus of the Early Draft of the *Wealth of Nations* suggests that Adam Smith originally intended to focus much of his work on a critique of Locke's explanation for divergent development. Smith outlined a number of chapters and points that would be used in support of these points, but the bulk of the written prose was dedicated to formulating the paradox of the unequal *Wealth of Nations* and elucidating his explanation: the nature and development of the division of labor.

When Smith composed the *Wealth of Nations* over the course of the following decade, his purpose remained largely the same as it had originally been: to explain the nature and causes of the wealth of nations. In both his historical analysis of economic development and his theoretical attack on the mercantilist system of political economy, the *Wealth of Nations* borrowed heavily from Smith's lectures on jurisprudence. There were, however, several major innovations that came with the production of the treatise. Smith's attempt to understand the nature of his disagreement with Locke caused him to both refine his understanding of the functions of money and to develop an alternative theory of saving and economic growth. Smith's experience working with policymakers in London also prompted him to make clear suggestions about how his framework could and should be applied to a range of contemporary policy areas.

SMITH'S NARRATIVE

Smith's account of the origin, purpose, and nature of government in the *Wealth of Nations* differed little from the account he gave in his lectures on jurisprudence. Here, just as he

had there, Smith directly challenged Locke's narrative of the introduction of government with the express purpose of subverting his account of the nature and purpose of political society.

1. Scarcity

In the *Second Treatise*, Locke argued that money is introduced in the state of nature. Money, by increasing the possibility of intertemporal exchange, increases demand, which stimulates production. The economic growth that results creates scarcity, which necessitates the introduction of political society.

Like Locke, Smith recognized that money, in the form of cattle, was used in the "rude ages of society."⁸² But, wholly inverting the elements in Locke's narrative, he claimed that the government itself created the scarcity of land and that this scarcity then largely necessitated the introduction of metallic money. His evidence on this point is fragmentary, scattered, and marked by some variation. In all of his accounts, however, the scarcity of land is the product of its division by the civil authority and engrossment by the rich.⁸³ The only historical account Smith provided of the "engrossing of uncultivated lands" occurs in his discussion of the confusion caused by the decline of the Roman Empire. Smith's point was that domination of the government by the rich allowed them to appropriate far more land than they intended to or even could cultivate. Of course, he was not suggesting that land was undivided prior to this point, but

⁸² Smith, *Wealth of Nations*, 38.

⁸³ "That the chiefs of an independent nation which settles in any country, either by conquest or otherwise, as soon as the idea of private property in land is introduced never leave any part of the land vacant, but constantly, from that greediness which is natural to man, seize much greater tracts of it to themselves than they have either strength or stock to cultivate. From the same greediness and rapacity, being unwilling to divide the profits of this land with any freeman, what they cannot or will not cultivate by their own strength they endeavour to cultivate by the strength of slaves, whom they either conquer in war or purchase in some other way, and in whose hands no stock ever can accumulate." Smith, "Early Draft," 579.

this throws into relief his stark contrast with Locke: both that so much uncultivated land might become engrossed and that this engrossment happens long after the introduction of money.⁸⁴

2. *The Nature and Origin of Government*

Smith's plan to explain the source of economic growth in terms of man's desire to achieve status proves rather straightforward: men toil because they desire approbation. Using this same fundamental human impetus to explain the consequent rise of inequality, however, poses something of a challenge. Locke had reasoned that men's desire for security resulted in the "Invention of Money," some of the practical implications of which were to "[give] them the opportunity to continue and enlarge" their different proportions of property, namely by allowing the inequality in their industry to compound over time. For Locke, then, inequality was an externality of economic growth.

Smith followed Locke in recognizing the apparent correlation between development and inequality, but Smith wanted to attribute inequality to human nature itself. Smith suggested that government—understood as the consolidation of power by some at the expense of others—was the principal source of inequality within society. Whereas Locke had argued that government was created after money had widened inequality and created a scarcity of land, Smith argued that government itself was the means through which inequality was deepened and scarcity, created. For Smith, money is the product of the age of shepherds, after "the inequality of fortune first begins to take place, and introduces among men a degree of authority and subordination." He explained that government came about "naturally," but also reminded the reader that "The rich, in particular, are necessarily interested to support that order of things, which can alone secure them in the possession of their own advantages." Then, in a move that ought to remind us of his

⁸⁴ Smith, *Wealth of Nations*, 381-82.

passages on the creation of distinction in the *Theory of Moral Sentiments*, he explained that the authority of superiors is bolstered by the support of inferiors desirous of maintaining their own status and status more generally: “Men of inferior wealth combine to defend those of superior wealth in the possession of their property, in order that men of superior wealth may combine to defend them in the possession of theirs.” Smith closed with what might be seen as a direct response to Locke: “Civil government, so far as it is instituted for the security of property, is in reality instituted for the defence of the rich against the poor, or of those who have some property against those who have none at all.”⁸⁵ In a statement that differs slightly from the account in his *Lectures on Jurisprudence*, Smith roundly posited that “[t]here is no period accordingly in which authority and subordination are more perfectly established” than the age of shepherds.⁸⁶

REFINEMENTS IN SMITH’S SYSTEM

1. The Invention of Money

Smith’s rendering of the invention of money developed considerably in the interim between his lectures in the early 1760s and the publication of the *Wealth of Nations* in 1776. As in his lectures at Glasgow, Smith acknowledged that “In the rude ages of society, cattle are said to have been the common instrument of commerce... though they must have been a most inconvenient one...” In his lectures, Smith suggested that cattle became an unsuitable medium of

⁸⁵ Ibid., 715. Cf. Locke: “The great and *chief end* therefore, of Mens uniting into Commonwealths, and putting themselves under Government, *is the Preservation of their Property.*” Locke, *Second Treatise*, § 124.

⁸⁶ Smith, *Wealth of Nations*, 713. His statement in the *Lectures on Jurisprudence*:

These allodial lords, possessing great territories and having great wealth in rents of the produce itself, came to have a great number of dependents as they possessed the whole or the greatest part of the lands of the kingdom. This inequality of property would, in a country where agriculture and division of land was introduced but arts were not practis’d, introduce still greater dependance than amongst shepherds, tho there too it is very great. For amongst the shepherds one who had got possession of flocks or herds had them maintain’d by the produce of the land, tho’ he did not pay any thing for it. But when the lands were all appropriated, tho one had property in cattle it could be of no service to him unless he got liberty to pasture them from some of these great lords.

Smith, *Lectures on Jurisprudence*, 244-45.

exchange when the scarcity of land prevented some individuals from herding cattle. In the *Wealth of Nations*, however, Smith's explanation for the transition from cattle and other forms of currency to metallic coins is different. He explained,

In all countries, however, men seem at last to have been determined by irresistible reasons to give the preference, for this employment, to metals above every other commodity. Metals can not only be kept with as little loss as any other commodity, scarce any thing being less perishable than they are, but they can likewise, without any loss, be divided into any number of parts, as by fusion those parts can easily be re-united again; a quality which no other equally durable commodities possess, and which more than any other quality renders them fit to be the instruments of commerce and circulation.⁸⁷

We can almost see Smith here struggling against a Lockean tide. For the first time, Smith acknowledges that metallic money's usefulness may lie in part in its durability, due to it being "less perishable"—a term he surely appropriated from Locke.⁸⁸ Smith's emphasis, however, is on money's use as a medium *exchange*. He frames the second sentence as if he were making an addition to the standard theory that metallic money is not perishable by noting that it can be easily divided and reunited. These qualities are crucial to multilateral exchange but not necessarily so for exchanges used just to "store" value. The second half of Smith's statement confirms the premises of the first by explicitly stating that all these qualities are judged by their ability to "be the instruments of commerce and circulation."

The crucial distinction between this account of the introduction of money and that offered by Locke lies in the reasons for which money is originally introduced. For Locke, money is introduced to store value, to stockpile purchasing power. Of course, he explicitly recognizes that these qualities will allow money to serve as a medium of commerce, but this is only because

⁸⁷ Smith, *Wealth of Nations*, 38-39.

⁸⁸ Throughout his chapter "Of Property," Locke used variants of the term "perish" eight times, frequently to contrast money with those things that are more useful but also more perishable. One instance runs, "And thus *came in the use of Money*, some lasting thing that Men might keep without spoiling, and that by mutual consent Men would take in exchange for the truly useful, but perishable Supports of Life." Locke, *Second Treatise*, § 47. See also §§ 37-38, 46, 48.

other individuals accept it for the purpose of storing value. For Smith, men's intentions differ from those ascribed to them by Locke. In Smith's account, men were driven by "the propensity to truck, barter, and exchange one thing for another" in their efforts to acquire the wealth requisite to achieving distinction.⁸⁹ Men freely used cattle for some time *because it served as a good medium of commerce*. Upon realizing that money could be divided without loss of value, they adopted it because it was a *better* medium of commerce.

Twenty years' of inquiry garnered Smith the same insights into the nature and uses of money that "Mr. Locke" had hit upon one century previously. But they also clarified the precise nature of his disagreement with Locke. Whereas Smith had originally assumed that their differences were derived from Locke's misunderstanding of money, he later came to recognize that the real difference lay in their perception of the primary reason men use money. Locke considered money first and foremost as a store of value. Smith, on the other hand, considered money principally as a medium facilitating multilateral exchange—as a solution to what economists have since come to call "the double coincidence of wants problem." In modern terms, Locke expected that individuals had what JM Keynes later called an "excessive liquidity preference" while Smith expected that they had little or no such liquidity preference.

2. *Smith's Theory of Economic Growth*

Smith's grappling with the questions of time led him to develop one of the single greatest innovations in the *Wealth of Nations*: his theory that economic growth was derived from investment in "productive" rather than "unproductive" labor. He seems to have arrived at this largely by posing a question to himself after engaging with Locke on the question of the most important function of money. Smith knew that Locke posited that money precipitated economic

⁸⁹ Smith, *Wealth of Nations*, 25.

growth, and, as we have just seen, he also came to recognize that money could be used for intertemporal exchanges. But, even *if* money were to allow for intertemporal exchanges, how could this, in and of itself, cause a gradual increase in production? After all, perishables would still perish, regardless of whether they were exchanged for more durable things like money. What's more is that Locke clearly realized this eventuality. As Smith read him, the spoilage restraints still largely applied: the ability to exchange goods for money would not allow production to exceed demand; and once a well-functioning medium was able to ensure that all the producers had been put in touch with all the potential consumers, money could not, as it appeared to Smith, induce them to increase production merely by allowing them to store value. Money, then, could only enhance those factors already responsible for economic growth. The questions become: what were these factors and how did they work?

Smith worked through these questions in his chapter "Of the Accumulation of Capital" in Book II of the *Wealth of Nations*. There, he first posited his imaginative distinction between "productive" and "unproductive" laborers. The former were those whose industry reproduced the capital they consumed while producing it; and the latter were those who did not.⁹⁰ At first glance, this seems to be a rather pointed attack on the rich "masters" and a defense of the laboring poor. Smith was not blind to the voluptuous and wasteful living of the rich, and he was always happy to undermine the authority of the rich; but the critique was more abstract and general, and, as a result, it was also all-encompassing. He immediately designated those serving under the sovereign (particularly the military) as unproductive laborers, reminding us that "The protection, security, and defence of the commonwealth, the effect of their labour this year, will not purchase its protection, security, and defence, for the year to come."⁹¹ This distinction even carried into

⁹⁰ Ibid., 330.

⁹¹ Ibid., 331.

the arts: “Like the declamation of the actor, the harangue of the orator, or the tune of the musician, the work of all of them perishes in the very instant of its production.”⁹²

The balance between productive and unproductive labor was rooted in the division of capital. There was that part that was “destined for replacing a capital, or for renewing the provisions, materials, and finished work, which had been withdrawn from a capital” and that other part that “constituted a revenue either to the owner of this capital, as the profit of his stock; or to some other person, as the rent of his land.”⁹³ Smith then explained that the ratio between productive and unproductive labor was largely determined by the ratio between these two types of capital:

The proportion, therefore, between the productive and unproductive hands, depends very much in every country upon the proportion between that part of the annual produce, which, as soon as it comes either from the ground or from the hands of the productive labourers, is destined for replacing a capital, and that which is destined for constituting a revenue, either as rent, or as profit.⁹⁴

But then he also suggested that capital is used almost exclusively to replace capital, while the destination of revenue is not strictly predetermined:

That part of the annual produce of the land and labour of any country which replaces a capital, never is immediately employed to maintain any but productive hands...That which is immediately destined for constituting a revenue either as profit or as rent, may maintain indifferently either productive or unproductive hands.⁹⁵

This point that revenue can either go to support further capital production or be spent employing idle men was crucial. It became the tool Smith used to resolve the “rich country—poor country

⁹² As he put it,

There is one sort of labour which adds to the value of the subject upon which it is bestowed: There is another which has no such effect. The former, as it produces a value, may be called productive; the latter, unproductive labour. Thus the labour of a manufacturer adds, generally, to the value of the materials which he works upon, that of his own maintenance, and of his master’s profit. The labour of a menial servant, on the contrary, adds to the value of nothing.

Ibid., 330-31.

⁹³ Ibid., 332.

⁹⁴ Ibid., 333-34.

⁹⁵ Ibid., 332.

debate.” Those nations in which the rich spend more of their revenue on replacing capital enjoy more growth than those that squander it on “unproductive” labor.⁹⁶

After deriving this variable to account for differential economic growth, Smith directly responded to the question about the role of the timeframe in exchanges. Still recognizing that all goods and services must be consumed in the present, Smith argued that the most significant factor was *who* was consuming them and *to what end*. Was capital (in the form of revenue) being squandered on the “idle guests” and “menial servants” of the rich “who leave nothing behind them in return for their consumption?” Or was the same “food, cloathing, and lodging” being spent on those who were producing more capital? In a single, critical statement he concluded that “The consumption is the same, but the consumers are different.”⁹⁷

From here, Smith developed a notion of “saving,” which is really just consistent reinvestment of capital into productive labor. He asserted that a community’s industriousness is not innate but determined by the amount of capital available—probably a notion that he derived from his assumption that men prefer to maximize the number of their exchanges so as to increase their potential status. The manner in which this industry and the supply of capital is increased is through “parsimony,” and they are both diminished by “prodigality and misconduct.” Extrapolating once again from the case of the individual to that of the nation, Smith explained that, “[a]s 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...can be increased only in the same

⁹⁶ He made this point specifically:

That part of the annual produce, therefore, which, as soon as it comes either from the ground, or from the hands of the productive labourers, is destined for replacing a capital, is not only much greater in rich than in poor countries, but bears a much greater proportion to that which is immediately destined for constituting a revenue either as rent or as profit. The funds destined for the maintenance of productive labour, are not only much greater in the former than in the latter, but bear a much greater proportion to those which, though they may be employed to maintain either productive or unproductive hands, have generally a predilection for the latter.

Ibid., 335.

⁹⁷ Ibid., 337-38.

manner.” Interestingly, he asserted that “[p]arsimony, and not industry, is the immediate cause of the increase of capital.” While industry does produce capital, “if parsimony did not save and store [it] up, the capital would never be the greater.” Oddly, Smith jumped to the conclusion that “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.” The “tends to” here is important: demand does not create its own supply beyond a certain point, particularly in the case of something like a labor force, which might take years to develop. Nonetheless, Smith wrote, “[Parsimony] puts into motion an additional quantity of industry, which gives an additional value to the annual produce.” Apparently, it just puts it into motion, like the springs of a clock that have been wound and lie waiting to be released.⁹⁸

The power caught up in those springs is rooted in human nature, specifically the never-ending desire to achieve status. In a series of passages that could have been lifted directly from the *Theory of Moral Sentiments*, he argued that “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 a statement that serves as, perhaps, the most important bridge between the *Theory of Moral Sentiments* and the *Wealth of Nations*—with each engaged in different sides of the same project—he reasoned that “An augmentation of fortune is the means by which the greater part of men propose and wish to better their condition.” And “the most likely way of augmenting their fortune,” he suggested, “is to save and accumulate some part of what they acquire.” He closed by addressing head-on the desire to consume superfluously:

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

⁹⁸ Ibid., 337.

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.

At first pass, this statement sounds almost Lockean: men would rather save than consume. We might even infer that it was inspired, at least in part, through Smith's extensive engagement with Locke on this point. But we must also keep in mind precisely what Smith means by "saving" and "frugality." Saving and frugality are actually spending—but spending on productive labor. In his analysis, frugality means either investing in or loaning to the (apparently) limitless supply of labor that lacks only the capital they need to work longer, harder hours.⁹⁹

If the energy in the spring is rooted in human nature, the hand holding the spring is attached to the oppressive arm of government. This analysis is found in Smith's discussion of "prodigality" and "misconduct." Contrasting the influence of the individual with that of a nation of individuals, he argued that "the circumstances of a great nation" cannot "be much affected either by the prodigality or misconduct of individuals." The real threat on these fronts is from "publick prodigality and misconduct" as "almost the whole publick revenue, is in most countries employed in maintaining unproductive hands." His reasoning here is sound: excessive government expense might force people to dip into their private capital stock (which they would have otherwise reinvested) to support the regime. This can become a significant problem: it might "oblige so great a number to encroach upon their capitals...that all the frugality and good conduct of individuals may not be able to compensate the waste and degradation of produce occasioned by this violent and forced encroachment."¹⁰⁰

The silver lining to this cloud, however, is that man's desire to achieve status is powerful enough that it can overcome the inimical effects of almost any government policy. In one of the more widely cited passages from the *Wealth of Nations*, Smith tells us,

⁹⁹ Ibid., 342.

¹⁰⁰ Ibid.

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.

And so, the “invisible hand” was generally strong enough to hold off the strong arm of government from gaining complete subordination. “Like the unknown principle of animal life,” he wrote, “it frequently restores health and vigour to the constitution, in spite, not only of the disease, but of the absurd prescriptions of the doctor.” It is to the inception and development of this “doctor” that we must now turn our attention.¹⁰¹

SMITH’S ATTEMPT TO SUPPLANT THE MERCANTILIST POLICYMAKING FRAMEWORK

Smith may have realized that his disagreement with Locke about how individuals use money was rooted in a disagreement about human nature. Locke’s relatively risk-averse individuals preferred currency with high exchange values, made conservative investment and purchasing decisions, and hoarded cash. Smith’s relatively risk-acceptant individuals were more willing to accept specie substitutes, made riskier investment and purchasing decisions, and minimized their cash balances. As argued above, this deeper difference led to divergent views about not only individuals’ economic behavior but also about how and why they enter into political society and what role government intervention can play in the economy.

In constructing the *Wealth of Nations*, however, Smith was far less interested in developing and presenting the true tenor of his disagreement with Locke than he was in subverting and supplanting the mercantilist economic system Locke helped to construct. From a rhetorical standpoint, there was little to be gained and much to be lost by redeveloping Locke’s

¹⁰¹ Ibid., 343.

political economic system and tracing out the two theorists' actual terms of disagreement. It would be far easier and more effective to burn a straw man.

1. Smith's Attack on Mercantilism

Just as in his lectures on jurisprudence, Smith's argued in the *Wealth of Nations* that the mercantilists had fallen prey to the "popular notion" that "wealth consists in money."

Once again, Smith presented Locke as the arch mercantilist. That Smith may have become intimately aware how central Locke's influence and interlocutions had been to his account was apparently not enough to garner Locke a fair or full treatment, but it did save Locke from some of Smith's typical abuse. The discussion of "consumability,"¹⁰² for instance, was briefer and reflected a more mature understanding of Locke's theory. Smith wrote,

Mr. Locke remarks a distinction between money and other moveable goods. All other moveable goods, he says, are of so consumable a nature that the wealth which consists in them cannot be much depended on, and a nation which abounds in them one year may, without any exportation, but merely by their own waste and extravagance, be in great want of them the next. Money, on the contrary, is a steady friend, which, though it may travel about from hand to hand, yet if it can be kept from going out of the country, is not very liable to be wasted and consumed.¹⁰³

Here, we see Smith acknowledging in a way he had not previously the real tenor of Locke's argument. As we have seen, Smith argued in his lectures that Locke was a simpleton who had assumed money must be more valuable than commodities because it can be used to purchase them. In the *Wealth of Nations*, however, Smith acknowledged that Locke gave them both value, but different relative values. And, most importantly, Smith noted the temporal concerns upon which Locke placed so much emphasis: money is *more* valuable because it lasts throughout time and could potentially allow consumption to be spread out over time. It seems

¹⁰² Smith does not use that term once in the *Wealth of Nations*.

¹⁰³ Smith, *Wealth of Nations*, 430.

quite clear that Smith had spent some time rereading Locke and rethinking his position, particularly those issues related to the temporal aspect of the economy.¹⁰⁴ But for all this engagement outside the text, Smith's explicit engagement with Locke in the text decreased significantly. He cited Locke only *three* times explicitly and only directly challenged him in the single instance we have just examined. Despite the tremendous impact Locke bore on Smith's development, Smith was increasingly less interested in pressing Locke directly on his monetary theory.¹⁰⁵

The notion that money consisted in wealth, however, remained a useful straw man for Smith, allowing him to throw into relief his own claims that money's real purpose was to circulate goods. "Money," Smith argued, "the great wheel of circulation, the great instrument of commerce, like all other instruments of trade, though it makes a part and a very valuable part of the capital, makes no part of the revenue of the society to which it belongs."¹⁰⁶ As such, money had no value of its own, and it was not to be included in calculations of national wealth, "[t]he revenue of the society consist[ing] altogether in...goods, and not in the wheel which circulates them."¹⁰⁷ Elsewhere, Smith put things more bluntly: "The sole use of money is to circulate consumable goods."¹⁰⁸ His tact, however, had changed slightly. Instead of demonstrating this doctrine methodically, he merely asserted it as a commonplace—confident now, at least in his

¹⁰⁴ As we have seen, Locke, even at his most philosophical, devoted a section specifically to explaining that money is less valuable than the "perishable Supports of Life" for which we exchange it. See above.

¹⁰⁵ At one point, Smith lifted several passages from Locke's writings on money and copied them almost verbatim. Smith, *Wealth of Nations*, 54n. And, of course, much the purpose of this thesis is to reveal the enormous impact of "Locke's ghost" on Smith's critique of the mercantile system.

¹⁰⁶ *Ibid.*, 291. The claim that they misunderstood the true role of money, however, persists very strongly. In another passage reminiscent of its predecessor in the *Lectures on Jurisprudence*, Smith explained that money is not valuable because it is "neither a material to work upon, nor a tool to work with," and the workman's "real revenue... consists, not in the money, but in the money's worth; not in the metal pieces, but in what can be got for them." Smith, *Wealth of Nations*, 295. The location of this passage, however, appears a full four pages later, after Smith had elaborated the manner in which paper money is able to function as an effective medium of exchange. This slight difference is subtle, and it is only to the very observant reader that this important transition becomes apparent.

¹⁰⁷ Smith, *Wealth of Nations*, 289.

¹⁰⁸ *Ibid.*, 339.

own mind if not explicitly on the page, that even Locke would have agreed with him on that point. In one of his most excessive rhetorical flourishes, Smith actually began to undercut the importance of his own argument by suggesting that “[i]t would be too ridiculous to go about seriously to prove, that wealth does not consist in money, or in gold and silver; but in what money purchases, and is valuable only for purchasing.”¹⁰⁹ If this were painfully obvious, however, what precisely was Adam Smith up to?

The point, of course—and Smith had come to realize this—was that *nobody* did believe this. But he was unwilling to offer any other explanation for the origins of the “British commercial system.” It was too easy and too tempting to assert that the mercantilist obsession with the balance of trade was rooted in their assumption that men desire to collect little pieces of metal.

“Nothing,” as he explained, “can be more absurd than this whole doctrine of the balance of trade, upon which, not only these restraints, but almost all the other regulations of commerce are founded.”¹¹⁰ He explained the connection between the mercantilists’ fallacious identification of wealth with money and their advocacy of achieving a positive balance of trade quite clearly in the *Wealth of Nations*,

The two principles being established, however, that wealth consisted in gold and silver, and that those metals could be brought into a country which had no mines only by the balance of trade, or by exporting to a greater value than it imported; it necessarily became the great object of political œconomy to diminish as much as possible the importation of foreign goods for home-consumption, and to increase as much as possible the exportation of the produce of domestick industry. Its two great engines for enriching the country, therefore, were restraints upon importation, and encouragements to exportation.¹¹¹

¹⁰⁹ Ibid., 438.

¹¹⁰ Ibid., 488.

¹¹¹ Ibid., 450.

Smith made the same connection in his depiction of Locke's account as well. Continuing right from where we left Smith earlier, he said,

Gold and silver, therefore, are, according to [Locke], the most solid and substantial part of the moveable wealth of a nation, and to multiply those metals ought, he thinks, upon that account, to be the great object of its political œconomy.¹¹²

Once again, this treatment of Locke is rendered fairer by being more precise. In this depiction, money is not the wealth but the “moveable” wealth, a fine distinction but one that begins to take into account Locke's emphasis on the importance of landed capital. In fact, had Smith not been so precise as to acknowledge that Locke counted money only part of the moveable wealth, he would have directly contradicted Locke's statement in the *Second Treatise* “that the increase of *hands* and the right employing of them is the great art of government.”¹¹³ In another instance, Smith contended that this concern with ensuring a positive balance of trade was only more complex—and not any less wrong—than the more traditional embargoes prohibiting the export of specie and bullion themselves.¹¹⁴

2. *The Contrast According to Smith*

As Smith rendered things, the terms of the disagreement were clear: Locke and the mercantilists had said the introduction and accumulation of money was the cause of economic growth, while he maintained that economic growth depended on the rate at which capital was reinvested in “productive” labor. Smith recognized that both men were addressing the same issue. Indeed, he found many of Locke's colorful characterizations of the paradox too good to pass up; and slight variations on these themes appear throughout Smith's work—despite his exclusion of virtually every mention of Locke from his published writings. But Smith's

¹¹² Ibid., 430.

¹¹³ Locke, *Second Treatise*, § 42.

¹¹⁴ Smith, *Wealth of Nations*, 434.

explanation for why they differed in their conclusions was simple: Locke, like the rest of the proponents of the “mercantile system” had fallen prey to the popular and incorrect notion “that wealth consists in money.” This supposed misunderstanding of the nature of wealth then led Locke to falsely equate economic growth with the introduction of money. In other words, Locke’s poor economics was responsible for the difference in their explanations; as Smith saw it, Locke’s was wrong, and his was right.¹¹⁵

SMITH’S APPLICATION OF THE CLASSICAL LIBERAL FRAMEWORK TO COLONIAL TRADE

Adam Smith’s experience in London impressed upon him the importance of thoroughly denouncing the theory that underpinned the mercantilist policymaking framework. The bulk of the *Wealth of Nations* was intended to do just that. Despite the political setbacks of the previous decade and the seeming tenacity of the mercantilist policymaking framework, Smith was still hopeful that British policymakers might be nudged towards reforming the commercial policy of the British Empire. In the hope of influencing policy in his own lifetime, Smith addresses many of the key issues of his day, issuing policy proposals within the classical liberal policymaking framework. This section addresses the specific proposals Smith made regarding British colonies in general and the crisis of the revolting American colonies in particular.

1. Colonies and the Support of Empire

The debate between Charles Townshend and the 2nd Earl of Shelburne in the 1760s was *not* about the *right* of Parliament to tax the American colonies. Both the Townshend faction and the Shelburne faction agreed that the Americans ought to contribute their fair share to the support of the British Empire. Their disagreement was really about *how* that revenue could and should be

¹¹⁵ Ibid., 429-31.

generated. Shelburne hoped that American settlers could be enticed into committing to providing regular tax payments (“quit-rents”) in exchange for western lands. Townshend, by contrast, wanted to forcibly contain the Americans on the eastern seaboard, to actively manage their trade and commerce, and to coerce the colonists into providing revenue.

The passage and subsequent implementation of Townshend’s Revenue Act of 1766 propelled the First British Empire inexorably towards its demise. Writing ten years after Townshend’s duties were implemented and in the wake of the American Declaration of Independence, Adam Smith entered the debate firmly on the side of the 2nd Earl of Shelburne. He first discussed the political economy of colonies generally and then turned his attention to the specific case of the American colonies in the British Empire.

Smith argued that, in principle, every colony “ought to afford, in time of peace, a revenue to the publick sufficient not only for defraying the whole expence of its own peace establishment, but for contributing its proportion to the support of the general government of the empire.”¹¹⁶ This principle, however, had rarely been realized in practice. Employing the research he had done at Shelburne’s behest ten years earlier, Smith pointed out that few of the ancient Greek and Roman colonies offered contributions proportioned to the costs of their administration and defense. In practice, Smith suggested, the American colonies had proven to be liabilities in this respect: not only had they never “furnished any military force for the defence of the mother country,” but “[t]heir military force has never yet been sufficient for their own defence.”¹¹⁷

Smith dismissed the American colonists’ objections that they were being taxed without representation. He pointed out that their taxation was lighter and their representation no worse than that of their fellows living in the British Isles. This eventuality, in Smith’s rendering, was

¹¹⁶ Ibid., 617.

¹¹⁷ Ibid., 593.

less the product of “salutary neglect,” as Edmund Burke had argued, than the real difficulty all empires face in extracting military and financial support from their colonies.¹¹⁸ The colonists’ “yelps for liberty”—as Samuel Johnson called them—were mere rhetoric.¹¹⁹ Indeed, the asymmetry of power was such that it was far more likely that the Americans would evade paying their taxes (however they were levied—directly or indirectly, by Parliament or by the colonial assemblies) than that Parliament would abuse its taxing power. Smith’s analysis turned on the practical reality that the Americans *could not* be coerced into supporting the British Empire, even if, in theory, they ought to do so.¹²⁰

2. *The Value of the Colonial Trade*

Smith argued that the colonial trade was far less valuable than was generally assumed. For Smith, employments of capital were advantageous in so far as they increased employment and economic growth.¹²¹ The colonial trades, however, are carried out over long distances and frequently involve indirect exchanges. These features tend to tie up capital for long periods and inefficiently connect producers with consumers. Smith concluded that “A foreign trade of consumption carried on with a neighbouring, is, upon this account, in general, more advantageous than one carried on with a distant country; and for the same reason direct foreign trade of consumption...is in general more advantageous than a round-about one.” The implication, of course, was that Britain ought to increase trade with its neighbors across the

¹¹⁸ Edmund Burke, “Speech for Conciliation with the Colonies [March 22nd, 1775],” in *The Writings and Speeches of Edmund Burke* (Boston: Little, Brown and Company, 1901), 117. Burke, Edmund, “Speech for Conciliation with the Colonies.”

¹¹⁹ In one of his most memorable rhetorical flourishes, Samuel Johnson queried, “If slavery be thus fatally contagious, how is it that we hear the loudest yelps for liberty among the drivers of negroes?” Samuel Johnson, *Taxation No Tyranny; an Answer to the Resolution and Address of the American Congress* (London: 1775), 89.

¹²⁰ Smith, *Wealth of Nations*, 620-21.

¹²¹ Smith posited, “The most advantageous employment of any capital to the country to which it belongs, is that which maintains there the greatest quantity of productive labour, and increases the most the annual produce of the land and labour of that country.” *Ibid.*, 600.

English Channel—despite their traditional enmities—rather than those across the Atlantic Ocean.¹²²

The colonial trade, while less valuable than generally assumed, was still beneficial to Great Britain. That trade, however, became considerably deleterious when it was supported and carried on by *monopoly*.¹²³ Smith's critique followed naturally from his theory of political economy.

John Locke and the mercantilists feared that excessive liquidity preference would combine with currency appreciation (caused by the perpetual scarcity of precious metals) and deflation to reduce output and employment below their maximum levels. These tendencies could be combated by increasing the quantity of money in the economy, but individuals' hesitance to accept currency with low intrinsic values created a constraint on the autonomy states enjoyed in their monetary policies. States' commitment to fixed exchange rate regimes meant that monetary policy autonomy could only be secured by achieving capital inflows. The desire to attain this autonomy drove Locke and the mercantilists to advocate the organization and management of the economy towards the end of securing a positive balance of trade. The development of empires and the monopolization of key trades were designed to secure capital inflows.

Adam Smith, of course, rejected the necessity of paying any attention to the balance of trade. The cornerstone of Smith's system of political economy was the expectation that the level of employment and the rate of economic growth were maximized by default in the unregulated market. Smith posited,

It is thus that the private interests and passions of individuals naturally dispose them to turn their stock towards the employments which in ordinary cases are most advantageous to the society... Without any intervention of law, therefore, the

¹²² Ibid., 600-03.

¹²³ Smith distinguished between “the effects of the colony trade and those of the monopoly of that trade. The former are always and necessarily beneficial; the latter always and necessarily hurtful.” Ibid., 607.

private interests and passions of men naturally lead them to divide and distribute the stock of every society, among all the different employments carried on in it, as nearly as possible in the proportion which is most agreeable to the interest of the whole society.

Simply put, entrepreneurs' desire to maximize profit naturally drives them into those employments that prove most beneficial to society. "All the different regulations of the mercantile system," however, "necessarily derange more or less this natural and most advantageous distribution of stock."¹²⁴ Thus, in Smith's system, unemployment was created and economic growth constrained by government intervention in the economy.

These effects were nowhere more prevalent than in the case of the colony trade. "[T]he avowed purpose of the monopoly," Smith explained, is "[t]o augment our share of the colony trade beyond what it otherwise would be."¹²⁵ The capital to fund this trade, however, could only come at the cost of investment in other, naturally more profitable, investments.¹²⁶ Smith argued,

whatever forces into a branch of trade of which the returns are slower and more distant than those of the greater part of other trades, a greater proportion of the capital of any country, than what of its own accord would go to that branch, necessarily renders the whole quantity of productive labour annually maintained there, the whole annual produce of the land and labour of that country, less than they otherwise would be.

Smith thus concluded that while Britain had benefited considerably from the trade with the colonies, it could have enjoyed greater economic growth and fuller employment if it had left its trade and commerce free from government intervention. Smith went so far as to suggest that increased trade with France—England's immortal rival—would prove more beneficial than the colonial trade under the British commercial system.¹²⁷

¹²⁴ Ibid., 630.

¹²⁵ Ibid., 608.

¹²⁶ Ibid., 596.

¹²⁷ Ibid., 595, 608. Earlier, Smith advocated increasing trade with France despite its ancient enmity: "If [France and Britain], however, were to consider their real interest, without either mercantile jealousy or national animosity, the commerce of France might be more advantageous to Great Britain than that of any other country, and for the same reason that of Great Britain to France." Smith, *Wealth of Nations*, 495.

Beyond the opportunity costs imposed by this monopoly, Smith enumerated several externalities created by this aspect of the British commercial system. The first of these was the system's effect on Britons' economic habits and manners. The inflated rate of profit in the colonial trade, Smith argued, "seems every where to destroy that parsimony which in other circumstances is natural to the character of the merchant. When profits are high, that sober virtue seems to be superfluous, and expensive luxury to suit better the affluence of his situation."¹²⁸

More importantly, the monopoly of the colonial trade created a dangerous dependence of Britain on its colonies. As a result of the government's encouragement, "The industry of Great Britain, instead of being accommodated to a great number of small markets, has been principally suited to one great market."¹²⁹ The implication of this was that "By suiting...to one particular market only, so great a part of the industry and commerce of Great Britain, it has rendered the whole state of that industry and commerce more precarious and less secure, than if their produce had been accommodated to a greater variety of markets."¹³⁰ Citing the repeal of the Stamp Act, Smith argued that this dependence allowed the colonies to dictate terms to their mother country.¹³¹

Taking together the cost of supporting the colonies, the economic effects of the monopolized colony trade, and the strategic implications of maintaining control over the colonies, Smith developed a devastating indictment of British colonial policy in North America. He roundly concluded, "Under the present system of management, therefore, Great Britain derives nothing but loss from the dominion which she assumes over her colonies."¹³²

¹²⁸ Smith, *Wealth of Nations*, 612.

¹²⁹ *Ibid.*, 604.

¹³⁰ *Ibid.*, 607.

¹³¹ *Ibid.*, 605.

¹³² *Ibid.*, 616.

3. *Explaining the Colonial Monopoly*

Smith's critique begs the questions: if the monopoly of the colonial trade were so costly to Britain, why had it had been adopted in the first place and why had it persisted for so long? Smith offered several explanations. The first, as we have seen, centered on policymakers' understanding of the economy. The mercantilists had incorrectly equated wealth with money and sought to maintain a positive balance of trade so as to secure capital inflows. The development of colonial monopolies was believed to secure these inflows.¹³³

The second explanation focused on the dominance of policymaking by particular special interests. England's restrictions on trade and commerce, Smith argued, concentrated investment in trade and manufacturing while simultaneously limiting competition in those fields. It thus artificially lowered the costs of those enterprises while allowing them to raise their prices. The development of colonies increased the demand for these goods further increasing the profits of these industries. The practical effect was to transfer wealth from consumers to producers, from landholders and laborers to merchants and manufacturers. This transfer was no accident. In one of the most widely cited passages from the *Wealth of Nations*, Smith argued, "To found a great empire for the sole purpose of raising up a people of customers, may at first sight appear a project fit only for a nation of shopkeepers. It is, however, a project altogether unfit for a nation of shopkeepers; but extremely fit for a nation whose government is influenced by shopkeepers."¹³⁴

The tenacity of this system—and its tendency to reproduce itself time and again—could also be explained partly by path dependency. Once these regulations had been established, patterns of production and consumption naturally developed themselves in response to them. As

¹³³ Ibid., 450.

¹³⁴ Ibid., 612-13.

a matter of justice and efficiency, Smith worried that sudden changes—although optimal in the long run—could have devastating short-term consequences. Consequently, Smith suggested caution and patience when reforming the commercial system:

Humanity may in this case require that the freedom of trade should be restored only by slow gradations, and with a good deal of reserve and circumspection. Were those high duties and prohibitions taken away all at once, cheaper foreign goods of the same kind might be poured so fast into the home market, as to deprive all at once many thousands of our people of their ordinary employment and means of subsistence.¹³⁵

Smith exclaimed, “Such are the unfortunate effects of all the regulations of the mercantile system! They not only introduce very dangerous disorders into the state of the body politick, but disorders which it is often difficult to remedy, without occasioning, for a time at least, still greater disorders.” Perhaps discouraged by his failure to dissuade Townshend from his course ten years earlier, Smith concluded “In what manner, therefore, the colony trade ought gradually to be opened...or in what manner the natural system of perfect liberty and justice ought gradually to be restored, we must leave to the wisdom of future statesmen and legislators to determine.”¹³⁶

4. Smith’s Proposals for the American Colonies

Despite his expectation that the British Empire could not be dismantled overnight, Smith offered some clear, decisive suggestions about how Britain ought to address the current crisis with the revolting American colonies. He offered two plausible plans: ideally, the government ought to grant the Americans independence and establish a free trade with them; barring that, the government ought to strengthen the political union and quell the rebellion by granting the colonists seats in Parliament.

¹³⁵ Ibid., 469.

¹³⁶ Ibid., 606.

Smith did not think the American colonies were worth the cost of their support even when they wanted to remain a part of the empire. They certainly were not worth the cost required to keep them in the empire against their will. All of the benefit of their development could be enjoyed and none of the cost of preserving their welfare, suffered, if they were granted independence and allowed to trade with Britain freely. Smith defended the proposal with uncanny eloquence. If independence were granted, he postulated,

Great Britain would not only be immediately freed from the whole annual expence of the peace establishment of the colonies, but might settle with them such a treaty of commerce as would effectually secure to her a free trade, more advantageous to the great body of the people, though less so to the merchants, than the monopoly which she at present enjoys.

This overture, Smith suggested, might actually restore the affection and admiration that previously bonded the colonists to their mother country:

By thus parting good friends, the natural affection of the colonies to the mother country, which, perhaps, our late dissensions have well nigh extinguished, would quickly revive. It might dispose them not only to respect, for whole centuries together, that treaty of commerce which they had concluded with us at parting, but to favour us in war as well as in trade, and, instead of turbulent and factious subjects, to become our most faithful, affectionate, and generous allies; and the same sort of parental affection on the one side, and filial respect on the other, might revive between Great Britain and her colonies, which used to subsist between those of ancient Greece and the mother city from which they descended.

Smith recognized, however, recognized that this proposal was radical and dismayed at the likelihood of seeing it realized. “To propose that Great Britain should voluntarily give up all authority over her colonies, and leave them to...enact their own laws, and to make peace and war as they might think proper,” Smith lamented, “would be to propose such a measure as never was, and never will be adopted, by any nation in the world.”¹³⁷ Smith was thus a realist, and he doubted that either the colonists or the imperialists would willingly swallow their pride and return to the antebellum status quo.

¹³⁷ Ibid., 616-17.

Smith coupled his idyllic proposal with one he expected was more likely to be accepted. Recognizing that even opposition leaders like the 2nd Earl of Shelburne were determined to maintain connections with the American colonies, Smith argued that political union could only be preserved by offering the colonists seats in Parliament. Smith's argument turned on his essential premise that the pursuit and maintenance of *status* was humans' prime objective. The consternation in the colonies, Smith suggested, was instigated by the "leading men of America" who "desire to preserve their own importance." Caring more about their social status than their personal welfare, these rebels "have rejected...the proposal of being taxed by parliamentary requisition, and like other ambitious and high-spirited men, have rather chosen to draw the sword in defence of their own importance."¹³⁸

The American Revolution had only increased the self-importance of the leaders of the revolution: "From shopkeepers, tradesmen, and attorneys, they are become statesmen and legislators, and are employed in contriving a new form of government for an extensive empire, which, they flatter themselves, will become...one of the greatest and most formidable that ever was in the world."¹³⁹ As a result, there was only one way to entice these "leading men" to come back into the fold and thus snuff out the revolution: they must be granted seats in Parliament. By doing so, "a new method of acquiring importance, a new and more dazzling object of ambition would be presented to the leading men of each colony." "Instead of piddling for the little prizes which are to found in...the paltry raffle of colony faction," Smith posited, "they might then hope...to draw some of the great prizes which sometimes come from the wheel of the great state

¹³⁸ Ibid., 622.

¹³⁹ Ibid., 623.

lottery of British politicks.” This would not only be more just, but it would also remove the primary cause of dissension: the need among the American elite to preserve their status.¹⁴⁰

¹⁴⁰ Ibid., 622-24.

IV. The Adoption & Implementation of Smith's Classical Liberal Framework

While the *Wealth of Nations* was recognized immediately by the intellectual community as a *tour de force*, Adam Smith's classical liberal policymaking framework was only gradually adopted and implemented by British policymakers. It made its first impressions on policy through Prime Minister Lord North in the late 1770s. The 2nd Earl of Shelburne (Prime Minister 1782-83) was Smith's first "disciple" and confessed adherent. The work begun by Shelburne was largely continued by his follower William Pitt the Younger when he became Prime Minister in 1783. Through his effect on the ideas of these three Prime Ministers, Smith inspired reform on Britain's political and economic relationship with the American colonies, Ireland, and foreign rivals like France. By the turn of the nineteenth century, Smith's ideas had become the touchstone for British policy, and policymakers turned from debating *whether* they ought to make policy in the image of his suggestions to *which* policies most closely implemented his ideas.

1. *The Reception of the Wealth of Nations*

The *Wealth of Nations* was published the 8th of March 1776. The critical reaction to Smith's treatise was overwhelmingly positive. The book was widely reviewed; and the assessment in the *Monthly Review* was typical: Smith's book had "from an happy union of fact and theory has deduced a system, which, we apprehend, is on the whole more satisfactory, and rests on better grounds, than any which had before been offered to the Public." The vagueness of

many reviews was more a product of the work's considerable length, complexity, and abstractness than any disdain on the part of the readers.¹⁴¹

Smith's friends and colleagues wrote with similar reactions. Hoping to manage his friend's expectations, Hume cautioned Smith not to expect it to receive the attention it deserves immediately—"The reading of it necessarily requires so much attention. And the Public is disposed to give so little, that I shall still doubt for some time of its being at first very popular." In the end, however, Hume thought that it had "[d]epth and solidity and acuteness, and is so much illustrated by curious facts, that it must at last take the public attention."¹⁴² Others wrote with similar assessments. William Robertson congratulated Smith for denouncing the "narrow and illiberal arrangements introduced by the mercantile supporters of Revolution principles, and countenanced by Locke and some of their favourite writers." He predicted that, in time, Smith's book could "occasion a total change in several important articles both in police and finance."¹⁴³ Hugh Blair suggested that Smith's work would serve as his entrée to the most powerful circles of British policymakers: "I Cannot believe but that they will place you at some of the great Boards in England. They are Idiots if they do not."¹⁴⁴ Adam Ferguson was the most effusive: "You are surely to reign alone on these subjects, to form the opinions, and I hope to govern at least the coming generations."¹⁴⁵

2. *Lord North's Reliance on Smith*

In fact, the *Wealth of Nations* was noticed by policymakers far more quickly than Smith's friends imagined it would be. In 1777 and again in 1778, Lord North proposed several taxes

¹⁴¹ Richard F. Teichgraber, III, "'Less Abused Than I Had Reason to Expect': The Reception of the *Wealth of Nations* in Britain, 1776-90," *The Historical Journal* 30, no. 2 (1987): 341-42. Governor Pownall was among the few to offer strong criticism of the work. Smith did not respond publicly to any of his reviewers.

¹⁴² 150. From David Hume - 1 Apr 1776. Smith, *Correspondence*, 149-50.

¹⁴³ 153. From William Robertson - 8 Mar 1776. *Ibid.*, 192-93.

¹⁴⁴ 151. From Hugh Blair - 3 Apr 1776. *Ibid.*, 189-90.

¹⁴⁵ 154. From Adam Ferguson - 18 Apr 1776. *Ibid.*, 193-94.

discussed by Smith in the *Wealth of Nations*. The first was the tax on servants, which was originally suggested to Smith by Townshend and not among Smith's favored taxes. The other three—a tax on property sold by auction, an excise on malted liquors, and a tax on inhabited houses—were all enthusiastically endorsed by Smith in the *Wealth of Nations*.¹⁴⁶ While North did not explicitly cite Smith, he did subsequently reward and acknowledge him by appointing him to the Commissionership of Customs for Scotland.¹⁴⁷

Smith became connected directly to North's ministry through Alexander Wedderburn, a former student of Smith's and the Solicitor General under Lord North. Wedderburn and Smith remained in close touch throughout the 1760s and 1770s. Although he believed in Smith's "system," Wedderburn initially doubted the conclusions Smith drew when he applied them to the American colonies. In June 1776, Wedderburn wrote, "Your Reflections a month ago upon the bad advices from America are all confuted by the favourable accounts lately received, which prove that our preparations have been seasonable, our Plans wise and the execution of them in all the departments of government active and vigorous." Such was the government's view when the revolutionaries appeared disorganized and unprepared in the summer of 1776.¹⁴⁸

Burgoyne's surrender at Saratoga in October 1777, however, prompted the North ministry to reconsider their policy. North wrote to the king, "[The] consequences of this most fatal event may be very important and serious and will certainly require some material change of system. No time shall be lost, and no person who can give good information left unconsulted in

¹⁴⁶ Kirk Willis, "The Role in Parliament of the Economic Ideas of Adam Smith, 1776-1800," *History of Political Economy* 11, no. 4 (1979): 524.

¹⁴⁷ *Ibid.*: 524n.

¹⁴⁸ 159. From Alexander Wedderburn – 6 Jun 1776. Smith, *Correspondence*, 197-98.

the present moment.”¹⁴⁹ That autumn, Wedderburn, contacted his old teacher, soliciting his opinion on the situation.¹⁵⁰

Smith replied the following February, issuing a short memorandum that largely recapitulated the points he had made several years previously in the *Wealth of Nations*. He insisted, in short, that coercing the American colonies into cooperation would, at best, prove ineffective and, at worst, prove more costly than the meager benefits obtained. Citing the ambition of the American leaders, Smith argued that the only practicable solution was to grant the colonies representation in Parliament. Once again, however, Smith acknowledged the radical nature of his proposals, admitting that “a solitary philosopher like myself seems scarce to have a single advocate.”¹⁵¹

As American schoolchildren learn, Lord North’s ministry stayed its course despite the defeat at Saratoga and the entry of Britain’s European rivals on the side of the Americans. Indeed, the “rebels” success only inflamed George III’s anger. He gave up hope of retaining the reigns of government in the colonies. “It was a joke,” he said, “to think of keeping Pennsylvania.” But he remained determined to make the colonists pay. He resolved to never acknowledge their independence and to indefinitely maintain a state of open hostilities with the colonists. Maintaining his garrisons in New York, Rhode Island, Canada, and Florida, the king planned to capriciously bombard, sack, and raze the American settlements within a day’s march of these strongholds.¹⁵²

¹⁴⁹ Sir John Fortescue, ed., *The Correspondence of King George the Third* (London: 1928), iii: 504.

¹⁵⁰ Adam Smith, “Smith’s Thoughts on the State of the Contest with America, February 1778,” in *The Correspondence of Adam Smith*, ed. Ernest Campbell Mossner and Ian Simpson Ross (Oxford: Clarendon Press, 1997).

¹⁵¹ *Ibid.*, 382.

¹⁵² Sir George Otto Trevelyan, *George the Third and Charles Fox: The Concluding Part of the American Revolution* (London: Longmans, Green, and Co., 1912), i: 4-5.

Against this impassioned reaction, Smith's abstract memorandum proved ineffective. That is not to say, however, that his proposals did not ultimately bear fruit. While "mad King George" had no time for Smith's conciliatory approach, more reasonable minds in the government headed Smith's advice. Smith's suggestions became a template for the treaty the 2nd Earl of Shelburne negotiated with the Americans, and the North ministry returned to Smith for advice concerning Ireland the following year.

John Locke, John Cary, and other mercantilists had argued that Ireland's trade and commerce needed to be carefully managed to ensure they served the interest of the British Empire. These regulations—like most of the regulations established in London to govern the Emerald Isle—were never popular among the Irish. In the autumn of 1779, however, their clamors came to a head. Explicitly citing Smith's *Wealth of Nations*, they demanded that Britain liberalize the restrictions governing their economy. The North ministry agreed to begin the process of reform, but they worried about the effects dramatic change would wreak on the British imperial economy.¹⁵³

Naturally, the government turned to Adam Smith for his professional opinion. In October 1779, Smith was contacted by both the Earl of Carlisle, the President of the Board of Trade, and his old friend Henry Dundas, the lord advocate for Scotland (the man who essentially governed Scotland on behalf of the ministry). Smith replied to the two, considering several different types and levels of liberalization. He suggested that anything up to and including complete liberalization would be mutually beneficial. He wrote, "Nothing, in my opinion, would be more highly advantageous to both countries than this mutual freedom of trade. It would help to break down that absurd monopoly which we have most absurdly established against ourselves in favour of almost all the different classes of our own manufacturers." Smith offered to put Dundas

¹⁵³ Willis, "The Role in Parliament of the Economic Ideas of Adam Smith," 527.

in touch with “some persons” who could to assuage the reaction of those Britons affected by the reforms.¹⁵⁴

Here, Smith enjoyed more success with the North ministry than he did on the issue of the American crisis. In December of 1779, Lord North proposed several measures to remove the major restrictions on Irish commerce. While high level members of the North ministry consulted with Smith, none cited him in the debates on Parliament. Regardless, North’s reforms marked the first step in a long road to Britain’s adoption of “free trade.”

3. *Shelburne: The First Smith Disciple in Parliament*

While Shelburne originally hesitated (in 1761) to adopt Smith’s classical liberal policymaking framework, by the 1780s he was a zealous convert. Shelburne read the *Wealth of Nations* “with avidity,” and Smith was sure to send the earl each successive edition. Smith frequently visited Shelburne, staying with him both at his house in London and at Bowood Park in Wiltshire. Even those scholars who have attempted to minimize Smith’s influence on policy in the eighteenth century have admitted that “Shelburne may properly be called Adam Smith’s earliest disciple in Parliament.”¹⁵⁵

The 2nd Earl of Shelburne ascended as Prime Minister in July 1782. Having been a leader of the opposition since the decline of the Chatham ministry in 1767, the new Prime Minister reveled in his opportunity to radically change the course of British policy.¹⁵⁶ In the Speech from the Throne that December, Shelburne announced his ambitious agenda. He explained that the objective of his government was to secure “an entire and cordial reconciliation” with the

¹⁵⁴ 200. From Henry Dundas – 30 Oct 1779; 201. To [Henry Dundas] – 1 Nov 1779; 202. To [Lord Carlisle] – 8 Nov 1779. Smith, *Correspondence*, 239-44.

¹⁵⁵ Willis, “The Role in Parliament of the Economic Ideas of Adam Smith,” 528-29.

¹⁵⁶ The previous July, Shelburne set his sights on instituting “a grand and general reform.” *The Parliamentary History of England from the Earliest Period to the Year 1803*, 36 vols. (London: T.C. Hansard, 1806-1820), 23: 144, 3 July 1782. Cited below as *Part. Hist.*

Americans. Pursuant to that, as he explained, he had agreed to recognize the former colonies as “free and independent states” in the peace treaty under negotiation with France. He praised the recent liberalization of the Anglo-Irish trade: “The liberal principles adopted by our concerning the rights and the commerce of Ireland, have done you the highest honour.” He set these reforms as a template for future policy and pressed for “a revision of our whole trading system, upon the same comprehensive principles, with a view to its utmost possible extension.”¹⁵⁷

Shelburne’s ministry was short-lived, and he was unable to implement all of the radical reforms he envisioned. His greatest achievement as Prime Minister, however, was to establish a peace after the American Revolution on the terms prescribed by Adam Smith.

Shelburne managed the negotiations with great care, dealing directly with foreign plenipotentiaries at several points. He wrote to both Benjamin Franklin and Monsieur de Reyneval. Shelburne’s hope was that a new “federal union” could be established between Britain and the American states. Barring that, Shelburne was willing to grant the American colonies complete independence and to go to every possible measure to ensure that both countries embraced a complete freedom of trade. This, he hoped, would at least advance the cause of restoring friendship between the two countries.¹⁵⁸ Shelburne’s treaty with the French also included a provision to roll back the trade restrictions raised by the two ancient rivals over the last century. The several peace treaties negotiated by Shelburne thus closely followed the reforms Smith had been advocating so strenuously for several decades.

The close match between Shelburne’s policies and Smith’s proposals was not a coincidence. When it came time to defend the treaties in Parliament, Shelburne did so in language strikingly reminiscent of that used by Smith in the *Wealth of Nations*. Shelburne’s first

¹⁵⁷ Ibid., 23: 204-10, 5 December 1782.

¹⁵⁸ Harlow, *Founding of the Second British Empire*, 229-34.

defense turned on a general criticism of “monopolies.” Monopolies, he argued, “forbid rivalry, and rivalry is of the very essence of the well-being of trade.” The commercial system hurt Britain more than anyone else. Monopolies, Shelburne insisted, are “always unwise; but if there is any nation under heaven, who ought to be the first to reject monopoly, it is the English.” The vigor and strength of British industry ensured that Britain could compete with the producers of any nation in the world. Fortunately, European nations had recently become “eager to throw off the vile shackles of oppressive ignorant monopoly.”¹⁵⁹

Shelburne’s second defense of the treaties turned on his desire to promote good relations with the United States. As if to say that Britain had finally adopted Smith’s position, Shelburne borrowed Smith’s formulation, announcing that “We prefer trade to dominion.”¹⁶⁰

Shelburne’s treaties were ratified shortly after Shelburne’s ministry gave way to the rise of the Fox-North Coalition. The adoption of these liberal treaties brought British policymakers one step closer to the complete adoption of Adam Smith’s classical liberal policymaking framework.

4. *Pitt’s Inheritance*

While the 2nd Earl of Shelburne made marked progress in deconstructing the British commercial system, he left much to his successors. The man who did the most to carry this mantle forward was William Pitt the Younger. When he became Prime Minister in December 1783, Pitt set out to continue the reforming tradition established by Shelburne.

Pitt explicitly referred to himself as a “scholar” of Adam Smith.¹⁶¹ The admiration was mutual. Smith praised the young Prime Minister: “What an extraordinary man Pitt is—he makes

¹⁵⁹ *Part. Hist.*, 23: 409, 17 Feb. 1783.

¹⁶⁰ *Ibid.*, 23: 410, 17 Feb. 1783.

¹⁶¹ Rae, *Life of Adam Smith*, 405.

me understand my own ideas better than before.”¹⁶² Pitt saw Smith as a revolutionary intellectual who had constructed a pattern on which the British Empire ought to be reestablished; and Smith saw Pitt as the vigorous crusader who was smart enough, young enough, and passionate enough to see the work through.

Not all of the policies Pitt proposed were as radical as Smith may have considered ideal; and not all of the reforms Pitt proposed were successfully made into laws. Armed with the *Wealth of Nations*, however, Pitt did see through a number of radical changes in Britain’s political and economic policy.

In 1785, Pitt authored a proposal—mirroring the suggestions made by Smith—to create a complete freedom of trade between Britain and Ireland in exchange for a proportioned contribution by the Irish to the support of the imperial navy. Pitt was able to push this through the Parliament at Westminster, but the Irish rejected it, objecting to the suggestion that they ought to contribute anything to the support of the British navy. Pitt, however, persevered on this issue. In 1800, he successfully oversaw the political and economic union of Ireland with Great Britain. The union embodied Smith’s earlier suggestions. When the union was debated in Parliament, Sylvester Douglas defended it by widely citing and reading from the *Wealth of Nations*.¹⁶³

Pitt’s greatest reform of the commercial system was the passage of the Treaty of Commerce with France in 1786. As a part of Shelburne’s peace treaty with France, it was agreed that protective tariffs between the two countries would be substantially reduced unless new terms

¹⁶² Quoted in George Pellew, *The Life and Correspondence of the Right Honourable Henry Addington, First Viscount Sidmouth*, 3 vols. (London: 1847), 1: 151. Another version that remark runs: “What an extraordinary man Pitt is, he understands my ideas better than I do myself.” Quoted in J. A. Lovat-Fraser, *Henry Dundas, Viscount Melville* (Cambridge: 1916), 128.

¹⁶³ Willis, “The Role in Parliament of the Economic Ideas of Adam Smith,” 518n, 35-7.

were agreed upon.¹⁶⁴ In 1786, Pitt sent William Eden to negotiate a new commercial treaty with the French. Eden was not the true believer in free trade that Pitt was, but he understood his obligation to fulfill Pitt's directive. Eden returned with a treaty that lowered tariffs dramatically (to a mere 10 or 15% *ad valorem*) and eliminated restrictions on some goods completely.¹⁶⁵

¹⁶⁴ John Ehrman, *The British Government and Commercial Negotiations with Europe, 1783-1793* (New York: Cambridge University Press, 1962), 28-30. W. O. Henderson, "The Anglo-French Commercial Treaty of 1786," *The Economic History Review* New Series, 10, no. 1 (1957): 104-06.

¹⁶⁵ Heckscher, *The Continental System: An Economic Interpretation*, 18-22.

V. Conclusion: Smith's Influence on Policy

When Smith died in July 1790, he must have died pleasantly surprised at the rapid adoption of his ideas: the American colonies had been given independence, trade between Britain and the United States and Ireland was almost entirely free, and the commercial rivalry between France and Britain greatly softened. The considerable success of his ideas must have prompted Smith to rethink his notion that interests tended to overrule ideas in the creation of policy.

Smith's two greatest early advocates—Shelburne and Pitt the Younger—each offered their own assessment of the influence of the intellectuals' ideas on policy. Shelburne was evidently disappointed and embittered that more of his reforms had not been implemented. His explanation, however, was borrowed directly from Smith,

“It requires no small labour to open the ideas of either the public or of individuals, but when that is accomplished, you are not got a third of the way. The real difficulty remains in getting people to apply the principles which they have admitted, and of which they are now so fully convinced. Then springs the mine composed of private interests and personal animosity. There cannot be a better instance than what is now pending. Professor Adam Smith's principles have remained unanswered for above thirty years, and yet when it is attempted to act upon any of them, what a clamour!”¹⁶⁶

William Pitt the Younger was considerably more optimistic. He expected that Smith's “extensive knowledge of detail, and depth of philosophical research, will...furnish the best solution to every question connected with the history of commerce, or with the systems of political economy.”¹⁶⁷

¹⁶⁶ Shelburne's pessimism ran throughout the memoir. His disappointment in realizing his reforms had inspired disaffection with popular rule. In the same memoir, he praised the two men—Louis XIV and Oliver Cromwell—who were seen at the time as epitomizing despotic rule. He remarked, “In the seventeenth century France was, on the whole, systematically and wisely governed with some slight interruptions. Louis XIV was a king in every sense of the word.” He similarly suggested that Oliver Cromwell “did set more things forward than all the Kings who reigned during the century, King William included.” The only worse possible character to praise at the time would have been Napoleon Bonaparte. Fitzmaurice, *Life of William, Earl of Shelburne*, 1: 22-25.

¹⁶⁷ *Part. Hist.*, 29: 834, 17 Feb. 1792.

Pitt's assessment proved to be the more prescient. The political and economic arrangements initiated in Paris in 1783 marked a turning point in British political-economic policymaking. The agreements themselves were relatively modest. The American colonies would be granted independence and considerably favorable access to British markets; and British and French policymakers agreed to a schedule for rolling back the excessive restrictions that had stifled Anglo-French trade for the last century. These agreements, however, were a crucial first step away from mercantilism and toward the classical liberal policymaking framework. Such policies had been unthinkable within the mercantilist policymaking framework. Indeed, protection from commercial rivals and extensive management of the colonial trades were the two pillars of the British commercial system. The reforms of the 1780s were substantively significant and, just as important, a symbolic rejection of the mercantilist policymaking framework.

The debate surrounding the adoption of mercantilism in the 1690s had turned on the question of whether the Royal Mint ought to retain its power to adjust the value of the English currency or whether it ought to adopt a fixed exchange rate. There were only two possible responses to this question: either England ought to adopt a permanently fixed exchange rate or it ought to consider its exchange rate to be adjustable. Thus, the adoption of the mercantilist policymaking framework was undertaken in a single stroke in the winter of 1696 when Parliament voted to restore England's badly worn and clipped coins to their official weights. This commitment was renewed with each successive act by Parliament mandating the maintenance of a stable rate of exchange between England's currency and the precious metals.

The shift to the classical liberal policymaking framework was different in this respect. Adam Smith had pressed policymakers to minimize the level of government intervention in the economy as much as possible on every front. He followed the mercantilists in exscheming

exchange rate adjustment and pressing for the continued openness of the capital account. His prime object was to eliminate the elaborate system of government interventions crafted by the mercantilists to secure control over the current account. While the first element of Smith's classical liberal system was "old hat," the second comprised a direct assault on the foundations of the British Empire.

Whereas the decision over the exchange rate regime was necessarily binary—either the rate would be fixed or it was adjustable—the level of government intervention in the current account is continuous. So, despite calling for extensive reform, Adam Smith's classical liberal policymaking framework could be implemented gradually. Indeed, Smith himself cautioned against fully implementing his framework immediately. He suggested that extricating the government from the market too quickly would cause more dislocation and hardship than would allowing the inefficiency of government regulation to persist while reforms were instituted gradually.¹⁶⁸

British policymakers followed Smith's advice. Beginning with the Peace of Paris of 1783, British policymakers began a conscious campaign to slowly but surely decrease the intrusion of the state in the market. Whereas the mercantilists had encouraged policymakers to constantly investigate new ways to manage commerce, British policymakers at the end of the eighteenth century began experimenting with new techniques—like reciprocal trade agreements—to secure the liberalization of trade and commerce. With the exception of the temporary reversions during the French Revolutionary and Napoleonic Wars, British political economic policy followed a clear trajectory away from mercantilism and toward classical liberalism. The Peace of Paris of 1783 was followed by the Anglo-French Commercial Treaty of

¹⁶⁸ See the discussion above.

1786. Several years later, William Pitt the Younger rationalized the British commercial code along the lines prescribed by Smith.

Even before Napoleon had been defeated, William Huskisson renewed the call for liberalization in the early 1810s. By the 1820s, the “free trade movement” was back on track. As President of the Board of Trade, Huskisson oversaw reform of the Navigation Acts, the repeal of the labor laws, and several tariff reductions. His attempts to liberalize the Corn Laws mostly floundered during his lifetime; but this issue became the *cause célèbre* around which Richard Cobden and John Bright organized the free trade movement of the 1830s and 1840s. The dramatic turn of Prime Minister Sir Robert Peel against the laws in 1846 ushered in their final demise. Throughout the 1850s, Richard Cobden fought to liberalize British commercial and trade policy. In 1860, he pushed through the Cobden-Chevalier Treaty, “which virtually eliminated trade barriers” between Britain and France. This treaty was the capstone of the free trade era in Great Britain.¹⁶⁹

In Continental Europe, the so-called “golden age of free trade” proved to be short-lived. By the 1870s, Austria-Hungary, Germany, and Italy all began to reclose their markets to foreign goods. Shortly thereafter, France followed suit. In 1892, France reneged on its obligations under the Cobden-Chevalier Treaty with the passage of the protectionist Méline Tariff. By the turn of the century, European governments were managing their trade and commerce as much as ever before.

Throughout this period, however, Britain remained the lone exception, the stalwart free trader in a sea of protectionism. Only the First World War prompted deviation from Britain’s commitment to classical liberalism. Just as during the French Revolutionary and Napoleonic Wars, the British war effort required a temporary movement back towards autarky. As hostilities

¹⁶⁹ Krasner, “State Power and the Structure of International Trade,” 325.

increased, the British government restricted the convertibility of the pound, imposed capital controls, and took a more active role in managing trade and commerce. Relying on this combination of restrictions and interventions, the British government attempted to maintain an artificial peg against the dollar at or near \$4.76 per pound.¹⁷⁰

¹⁷⁰ D. E. Moggridge, *The Return to Gold, 1925: The Formulation of Economic Policy and Its Critics* (London: Cambridge University Press, 1969), 10-12.

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