

**An Austrian (Mis)Reads Adam Smith:  
A Critique of Rothbard as Intellectual Historian**

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*Rothbard's posthumous Economic Thought Before Adam Smith is notable for its villification of 'the quiet Scottish professor.' While there is little disagreement that Smith was at best an ambivalent champion of free markets, Rothbard's indictment of him as a proto-Marxist is less than persuasive. We argue that Rothbard's book suffers from logical flaws, selective and incomplete textual evidence, a misunderstanding of Das Adam Smith Problem and the relevant literature, and an unawareness of modern incentive-based theories of the firm and state anticipated in Book V of The Wealth of Nations.*

## An Austrian (Mis)Reads Adam Smith: A Critique of Rothbard as Intellectual Historian\*

### 1. Introduction

How could the ‘quiet Scottish professor,’ a shameless plagiarist who ‘originated nothing [important] that was new’ (p. 435), and whose few innovations were either incorrect or inconsequential, achieve such durable fame? This, as Rothbard (1995) describes it in his posthumous two volume ‘Austrian perspective’ on the development of economics, is the real ‘Adam Smith problem.’ From Rothbard’s viewpoint, the spread of the ‘Smithian gospel’ owes much to an unfortunate combination of *zeitgeist* and a ‘triumphant movement of ... disciples’ (p. 478) after Smith’s death. As a result, the reader learns, Smith and his disciples, the best known of whom was Dugald Stewart, derailed economics for decades and, worse, facilitated the birth of Marxian economics. It is this crime, in the end, that seems to animate much of the invective in *Economic Thought Before Adam Smith*.

There is no doubt, of course, that admiration of Smith is, more than ever, ‘non-denominational,’ and the motives of Rothbard and some, but not most, Austrians to distance themselves from *The Wealth of Nations* (hereafter, *WN*) have themselves become a matter of discussion.<sup>1</sup> Our purpose is to evaluate

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<sup>1</sup> As several readers have reminded us, Hayek, for example, counted himself part of the ‘Smithian tradition,’ as have most of his followers. In his ‘Individualism: True and False,’ Hayek (1948, p. 154, n. 3) praises Smith’s treatment of ‘spontaneous order’ as seminal and identifies Menger as ‘among the first in modern times consciously to revive the methodical

Rothbard's treatment of Smith on its own terms, however. To this end, we reconsider four main areas of contention in each of the sections that follow: the division of labor and economic development, the determination of value and prices, the specie flow mechanism and international trade, and the invisible hand. We then conclude with a brief discussion of the rhetorical structure of *WN*.

We are not the first to appraise Rothbard's achievements as an intellectual historian and, as one referee notes, his advocates have defended his critique of Smith as both a 'deliberate exaggeration' and a 'textbook abbreviation' of Rashid's (1998) controversial work.<sup>2</sup> We are of course sensitive to the issue of authorial intention, more so since we shall ourselves claim that Rothbard misconstrues the rhetorical structure of *WN*, but remain unconvinced. In any case, much of what follows is applicable to 'muted' versions of Rothbard's arguments. Concerning the first line of defense, it seems to us that the villification of Smith is as much the consequence of Rothbard's overenthusiastic attachment to the so-called 'Kauder thesis' as it is a strategic decision. Kauder (1953, 1965) turned the Weberian thesis about Protestantism and the rise of capitalism on its head: from this perspective, Smith, the moderate Calvinist, is suspicious of the individual and Cantillon, the Roman Catholic, is a *bona fide* champion of unfettered markets. The problem is that without Smith's Calvinism, the nexus between the classical tradition Rothbard opposes and Protestantism

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individualism of Adam Smith and his school.' Furthermore, he asserts that 'we can still learn more about the behavior of men from [*WN*] than from most of the more pretentious modern treatises on social psychology' (ibid, p. 138). Inasmuch as the same paper also demonstrates Hayek's familiarity with Adam Ferguson's *Essay on the History of Civil Society* (1767) and other influential 'pre-Adamite' works, it cannot be said, *contra* Rothbard (1995) and Rashid (1998), that Smith's intellectual debts have somehow been obscured. The admiration of von Mises and at least some of his followers for Smith is perhaps less enthusiastic, but still quite real.

almost vanishes: the assimilation of Ricardo, the ‘Portuguese Jew turned Quaker’ (pp. xii, 444) on the basis of James Mill’s influence, is facile, and the identification of Marx as a Protestant thinker, either German or British, is tenuous *prima facie*. Without Ricardo or Marx, the post-Cantillon ‘Kauderization’ of economics stands or falls on Smith’s ostensible heresies, and this, in turn, boxes Rothbard in.

As far as the second ‘line of defense’ is concerned, we, too, find the influence of Rashid (1998) on Rothbard to be obvious and substantial, but to the extent that this includes the particular issues discussed here, our criticisms extend to both.<sup>3</sup>

This does not mean, of course, that Rothbard’s principal theme, the mature Smith’s obvious reluctance to champion unfettered markets, is itself suspect. For most intellectual historians, however, the evolution (or devolution, as Rothbard would have it) of Smith’s views between *The Lectures on Jurisprudence* (*LJ*, hereafter) and *WN* is familiar: historians of economics have discussed *Das Adam Smith Problem* for decades. In our view, in fact, Rothbard’s most immediate difficulties stem from his imperfect knowledge of the ‘problem,’ and the substantial literature devoted to it. It does not, as he insists, reflect the ‘big gap between the natural rights-*laissez faire* views of [*The Theory of Moral Sentiments*, hereafter *TMS*], and the much more qualified views of the later and decisive ... [*WN*’ (p. 471, fn 1). Rather, and in its simplest form, it concerns the apparent substitution, between *TMS* and *WN*, of ‘self-interest’ for ‘empathy’ as the

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<sup>2</sup> The inaugural issue of the *Quarterly Journal of Austrian Economics*, for example, includes several papers on Rothbard’s treatment of Adam Smith. See, for example, Pack (1998) and Trescott (1998).

<sup>3</sup> This said, we do not discuss two of Rashid’s most controversial claims here – that Smith, the eventual customs officer, was a ‘friend of the state,’ and an incorrigible plagiarist. We should mention, however, that other Austrians (Hayek, 1948, for example) familiar with both Smith and his predecessors have not reached the same conclusion. For a brief review of Rashid’s *The Myth of Adam Smith* (1998) from a non-Austrian perspective, see Harcourt (1999).

principal motive of human action. Raphael & Macfie (1982) and Heilbroner (1982) reconsidered the problem, its intellectual roots and its 'solution' in considerable detail, and, from our perspective, brought the debate to a sensible close.<sup>4</sup>

Rothbard's demonization of Smith, ironic inasmuch as the intellectual bonds that connect Smith and Marx are well known, is first manifested in his peculiar explanation of *WN*'s canonical status. In his account, the difficulties of *WN* stimulated the establishment of cottage industries that attempted to 'clarify and systematize the contributions of the Master' (p. 437) and which, in turn, staked *WN*'s claim as the Bible of political economy. The reader is invited to infer that it became influential *because* it was 'sprawling, inchoate [and] confused' (p. 436). This is an old bluff, well known from the literature on Keynes, and one that confuses correlation for causation. The observation that some, even most, of the watershed contributions to economics - a list that includes *WN* but also, for example, Böhm-Bawerk's *Theory of Capital* - reveal the strains of what Keynes (1936, p. iv) called 'long struggle[s] of escape ... from the old [ideas], which ramify ... into every corner of our minds' does *not* mean that their elevation was somehow the result of unresolved confusions and internal contradictions. Nor does it mean that confusion or, for that matter, length is a precondition for influence. In more specific terms, it is unreasonable to attribute Smith's pivotal role within the classical tradition to his successors' inability to penetrate and resolve the confusions in *WN*.

## 2. The Division of Labor

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<sup>4</sup> Heilbroner (1982, p. 427), for example, concludes that 'the economic man who is the active agent of [*WN*] is the prudent man who is the product of [*TMS*].' The 'problem' admits other solutions, of course; see, for example, Collings & Ortmann (1997).

Rothbard is correct, albeit in a narrow sense, when he observes, following Schumpeter (1954), that the division of labor assumes a ‘swollen and gigantic importance’ (p. 441) in *WN*. His prosecution of the indictment is unpersuasive, however. For instance, it is not obvious that Smith's provocative reconceptualization of economic development puts ‘into the shade such matters as capital accumulation and the growth of technical knowledge’ (p. 441). Readers familiar with modern macroeconomics, for example, have sometimes discerned elements of an endogenous growth/positive feedback parable in the first chapters of Smith's treatise, one in which the division of equipped (!) labor causes output and therefore income per worker to rise and, as this income is spent, the ‘extent of the market’ to increase, which in turn provides the means with which more workers are absorbed and furnished with new, and perhaps different, tools. Is Smith's version of the parable complete? No, of course not. Is it even consistent with the determination of ‘natural prices’ in subsequent chapters? Once more, in all likelihood, no. But do these particular ‘laws of motion’ allow for the accumulation of capital? Yes. We surmise that what bothers Rothbard is not the absence of capital accumulation *per se*, but rather the passive role of the entrepreneur in this simple parable. In this context, Smith's well known friendships with, for example, Watt, the ‘father of the steam engine,’ and Carron, the owner of the important Scottish iron works that bore his name, suggest that if the ‘euthanasia of the entrepreneur’ is indeed a feature of *WN*, it should be construed as a deliberate, not accidental, act.<sup>5</sup>

The notion that Smith also overlooked the role of technological progress runs afoul for similar reasons. As an intellectual historian committed to the construction of an Austrian narrative, Rothbard sometimes fails to differentiate

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<sup>5</sup> At least one referee believes that Rothbard's *bête noire* here is not the neglect of the entrepreneur, but rather the connection between the division of labor and Hayek's division of knowledge.

‘not Austrian’ from ‘not at all.’ Smith identifies several sources of innovation and technological improvement in the sections on the division of labor, but none involves the much lamented entrepreneur or, to be more precise, the entrepreneur as either ‘projector’ or ‘speculator’ (Pesciarelli, 1989).<sup>6</sup> He finds, for example, that in their efforts to reduce the inevitable burdens of wage labor, workers themselves are responsible for much embodied (if incremental) improvement:

A great part of the machines made use of in those manufactures in which labour is most subdivided, were originally the inventions of common workmen, who, being each of them employed in some very simple operation, naturally turned their thoughts toward finding out easier and readier methods of performing it. (*WN*, p. 9)

In another well known passage that follows, Smith draws attention to specialized groups of inventors and technicians, an example of the division of labor across occupation and function:

Many improvements have been made by the ingenuity of the makers of the machines, when to make them became the business of a particular trade; and some by that of those who are called philosophers or men of speculation, whose trade it is, not to do anything, but to observe everything ... In the progress of society, philosophy or speculation becomes, like every other employment, the principal or sole trade of a particular class of citizens. (*WN*, p. 10)

Furthermore, it can be said that Smith anticipated at least one modern theory of entrepreneurship, in particular Wiggins’ (1995). In his discussion of ‘the five circumstances ... which vary the wages of labour,’ Smith (1776, p. 111) includes an explanation of how ‘the wages of labour in different employments vary according to the probability or improbability of success in them.’ ‘To excel

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<sup>6</sup> Pesciarelli does argue, however, that Smith both recognizes and praises the entrepreneur as

in any profession,' he infers, 'in which but few arrive at mediocrity, is the most decisive mark of what is called genius or superior talents' (*WN*, p. 107). Wiggins argues that the innovator becomes an entrepreneur because, as a worker in a firm, he is unable to capture the rewards of his innovation. It is as an owner, of course, and therefore residual claimant, that these rewards are captured. Wiggins constructs a simple model whose basic component is the 'likelihood of success': the smaller this likelihood, and the greater the potential rewards, the greater the firm's moral hazard if it fails to reward the innovator, a signal that he is perhaps better off (on the margin, at least) as an entrepreneur. The discussion in *WN*, Book I, Chapter X, anticipates this treatment, and others, by more than two centuries, in which context Rothbard's substitution of 'no vision' for 'another vision' precludes more subtle criticism and, worse, misleads readers.

From a broader perspective, Smith's treatment of the entrepreneur has less in common with Cantillon (1755), whom Rothbard favors, than Say (1803), who, in the words of Hebert & Link (1988, p. 34), 'directed attention away from the uniqueness of the entrepreneurial role.' (For a recent review of the treatment of entrepreneurs in the classical tradition, see van Praag, 1999.)

It is not just the 'swollen importance' of the division of labor in *WN* to which Rothbard objects, however, but also the ostensible account of its origins. Following Cannan, Smith's familiar 'propensity to truck, barter and exchange' is dismissed as a poor substitute for the benefits of trade in a world where endowments, preferences and methods of production can differ, the 'older and truer motive power of specialization' (pp. 442-443) Rothbard discerns in Cantillon and others. The reader then learns that this substitution was the inevitable result of Smith's belief that 'all laborers are equal' (p. 442) and his consequent 'rejection of the idea of innate differences in natural talents and

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'prudent undertaker.'



abilities' (p. 443). Once more, however, Rothbard's reliance on 'broad brushstrokes' undermines his position: Smith's own egalitarianism, as manifested in his famous comparison of porters and philosophers, is as much 'methodological' as 'philosophical.' As labor economists have understood for some time, one response to the 'How much do innate differences matter?' starts with another, perhaps simpler, question: 'How much of the variation in *economic* outcomes can be explained *without* reference to them?' It is possible, in other words, to judge Smith's methods innovative, even if one disagrees with his conclusions. Furthermore, because of these methods, Smith is in a much better position to inquire whether specialization is the cause, or the effect, of these differences, even if such ambivalence then complicates the identification of 'economic primitives.'<sup>7</sup> Does all of Smith's 'hand wringing' mean that Cantillon (1752) is a better proto-Austrian? No doubt. It also means, however, that Smith was not the crude leveller Rothbard implies, and that he cannot be dismissed with what amounts to a handwave.

To repeat, it is Smith's exploration of these issues, not his own beliefs, that constitute a fundamental, and perhaps radical, departure from most of his predecessors, notwithstanding the influence of Cantillon (*WN*, p. 99, fn. 1, for example) and others. The five circumstances that, from his perspective, explain much of the variation in wages include, in modern language, differential human capital (*WN*, pp. 101-103), and several manifestations of moral hazard, including the efficiency wage hypothesis (Matthews, 1996; Michl, 1993). Inasmuch as these are considered hallmarks of the modern industrial organization literature –

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<sup>7</sup> It should be remembered, contra Rothbard and most Austrians, that this issue remains unsettled. In their critique of Becker's 'new home economics,' for example, Folbre & Hartmann (1988) underscore the implicit presumption that male/female differences are the cause of the division of labor within households, rather than its predictable effect. For another example, see Rossetti's (1992) deconstruction of Menger.

see Klein & Leffler (1981), Wiggins (1995) and Holmstrom & Tirole (1988), for example – Smith’s achievements are all the more remarkable.

Rothbard then endorses the charge, first popularized in West (1964), that there is a ‘total contradiction’ in the treatments of the division of labor between the First and Fifth Books of *WN*: West and others have found it difficult to reconcile the defense of affordable education in Book V, which is in some measure predicated on the deleterious effects of specialization, with the identification of the division of labor as the wellspring of economic growth in Book I. Such criticism misses the mark, however, to the extent that it rests on the suspect notion that broad economic phenomena (in particular, industrialization) must be unidimensional. In crude terms, there is no logical contradiction in the proposition that X causes both Y and Z, and that Y is desirable but Z is not. Smith’s particular hypothesis, that the division of labor is both the engine of growth *and* a source of alienation, is no more inconsistent than the claim that *Economics Before Adam Smith* is uneven. Rothbard’s obvious displeasure with the ‘socialist gripers’ (p. 442) who found inspiration in the dualism of economic development in *WN* is, once more, beside the point: whether or not the division of alienates workers, there is no *logical* flaw in Smith’s treatment.

The subsequent claim that Smith ‘failed to apply his analysis of the division of labor to international trade’ (p. 442) is also unwarranted. Consider this characterization of what John Stuart Mill later called the ‘vent for surplus’ parable, cited in Hollander (1973):

Between whatever places foreign trade is carried on, they all of them derive two distinct benefits from it. It carries out that surplus part of the produce of their land and labour for which there is no demand among them, and brings back in return for it something else for which there is a demand. It gives a value to their

superfluities, by exchanging them for something else, which may satisfy a part of their wants, and increase their enjoyments. By means of it, *the narrowness of the home market does not hinder the division of labour in any particular branch of art or manufacture* from being carried to the highest perfection. *By opening a more extensive market for whatever part of the produce of their labour may exceed the home consumption, it encourages them to improve its productive powers, and to augment its annual produce to the utmost, and thereby to increase the real revenue and wealth of the society.* (*WN*, p. 415, emphasis added)

While the observation that ‘it was to be left to James Mill to [articulate the principle] of comparative advantage’ (p. 442) is unproblematic, this does not mean, as Hollander (1973, pp. 269-270) reminds us, that Smith never connected the division of labor and international trade. Rather, the Smithian and Ricardian (or Millian, as Rothbard prefers) models describe distinct features of trade: the former, which considers the connection between effective demand and the division of labor/output per worker, is perhaps more dynamic, while the latter is the more familiar static parable.

Rothbard's conscious decision to streamline the discussion of international trade - Hollander (1973), for example, is mentioned but dismissed in a few brief sentences elsewhere - proves to be an ironic one: in the presence of returns to scale, the connections between specialization, international trade and the benefits of unfettered competition become more complicated. In other words, conscious or not, Smith's emphasis on the division of labor undermines the traditional comparative advantage argument. Furthermore, as Matthews (1995) shows, the connection had been drawn, in more than similar terms, some time earlier, in Louis Messance's *Reflections on the Price of Wheat* (1767), whose influence on *WN* deserves more attention than either Smith or his readers have afforded.

Last, while few readers will be surprised that Rothbard then endorses the Koebner (1959) critique, which asserts that Smith revealed little awareness of either the Industrial Revolution or its possible importance, some will be disappointed with the manichean version articulated there: it is asserted, for example, that while Smith knew John Roebuck<sup>8</sup> well, he ‘showed no indication that he knew of [the Carron Iron Works’] existence’ (p. 444), that despite his friendship with James Watt, ‘he displayed no knowledge whatever of [Watt’s] leading inventions’ (p. 444), that ‘he made no mention ... of the canal boom’ (p. 444) or the ‘existence of the burgeoning cotton textile industry’ (p. 444) and so on. Rothbard, who was at least familiar with the Cannan edition and its index, should have known that the Carron Works are mentioned at least once (*WN*, p. 76) in Cannan’s index. He should have also known that, as Hollander (1973, p. 109) notes, ‘Smith’s emphasis upon the use of coal in iron-making is highly revealing, for widespread use of coal in place of charcoal occurred only after mid-century at the Carron Company, which pioneered the Darby process,’ and that David Hume discussed the finances of Carron with Smith (Hollander, 1973, p. 216); that ‘Smith was thoroughly familiar with the severe problems relating both to the perfection and commercial application of the steam engine’ (Hollander, 1973, p. 217); that he discussed the short run consequences of free trade on fixed investments in silk; and that the same Cannan index includes four specific references to the construction and maintenance of canals (*WN*, pp. 147, 682, 684, 714). Hollander (1973, p. 237) concludes that ‘Smith did in fact recognize and deal with many of the important technological developments prior to 1776, with the significant exception of those occurring in the cotton industry. While both sides in what could be called the Koebner-Hollander debate are

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<sup>8</sup> John Roebuck’s introduction of large, lead-lined vats facilitated mass production of sulphuric acid, an important contribution to iron production. For more on this ‘rough index of industrial production,’ see Landes (1969, p. 109).

vulnerable to criticism, Rothbard's treatment will persuade few readers already familiar with the controversy.

### 3. Value

Rothbard's jeremiad against the mature Smith's treatment of the nature and determination of value - the relevant chapters are classified 'an unmitigated disaster' and 'not only ... a degeneration from his teacher Hutcheson ... but [also] from Smith's own previous unpublished lectures' (p. 448) - opens on a curious note. It is asserted that while Smith had both understood and resolved the so-called value paradox in the earlier *LJ*, 'a dozen years after ... [he] finds himself unable to solve [it]' (p. 449). The simplest explanation, which Rothbard either overlooks or is unfamiliar with, is that Smith did not consider it a paradox and therefore felt no need to explain it (see Meek, 1956). From this perspective, the famous passages on water and diamonds serve to establish the useful distinction between value in use and value in exchange, and nothing more.

With the principle that value in use is a prerequisite but not sufficient for value in exchange in place, Smith then limits his attention to the natural prices of what the more deliberate Ricardo (1817) later characterized as 'reproducible commodities.' Within this framework, 'effectual demand' determines the extent of the market and therefore the degree of specialization, and influences deviations between market and natural prices - but it does not determine these prices. More important, perhaps, while Rothbard's treatment of natural prices

reveals an awareness of this distinction, he contends that ‘at best, the long run price is useful in providing a vital clue to the direction of price and production changes in the real world’ (pp. 450-451) but is not itself ‘real.’ He concedes that these ‘chimera’ are important, ‘but only for explaining the directional tendencies and the underlying architectonic structure of [the] economy, and also for analysis of how uncertainty affects real world income and economic activity’ (p. 451). Our own reaction, and we suspect that of most readers, is ‘Only?’ Since Smith understood, even if he did not emphasize, the determination of market prices in the short run, as reflected in his still classic treatment of the market for blackcloth, it seems reasonable to conclude that his characterization both includes and extends that of Hutcheson and others. That is, one *could* conclude that Smith embeds the determination of market prices within a broader framework.

Rothbard's views on the value paradox are perhaps best understood as another reaction to Smith's treatment of entrepreneurship. Because the world described in *WN* is not one in which perpetual flux creates opportunities for Misesian entrepreneurs to arbitrage, but rather a less turbulent one in which ‘prudent undertakers’ are responsive to simple price and profit signals, it was reasonable for Smith to consider the determination of value and distribution for stable ‘architectonic structures.’ Rothbard's world is of course one in which discussions of this sort are moot. But even if von Mises' vision is a less ‘settled’ one than Smith's, it seems unreasonable to us to describe the latter as a degeneration.<sup>9</sup>

We also find it difficult to substantiate Rothbard's claim that ‘whereas market price is changeable and ephemeral [in *WN*], “cost” is somehow

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<sup>9</sup> Smith's world is likewise not one in which Schumpeterian winds of ‘creative destruction’ forever disturb a relative calm.

determined objectively and exogenously' (p. 452). In particular, Smith extended the distinction between natural and market prices to the market for labor power, and devoted considerable attention to the case where the market price, which depends on 'the demand for those who live by wages,' itself a function of 'revenue and stock,' exceeded the natural price, defined in the classical sense as the wage that allowed workers and their families to reproduce themselves over protracted periods. In other words, Smith is prepared to concede, *contra* Rothbard, the existence of substantial deviations between the market and natural prices of labor, if not output. To be sure, the further resolution of natural prices into their component parts conflates 'natural' and 'average' wages, but this is not the substance of Rothbard's criticism. Rothbard *does* draw renewed attention to Smith's confused treatments of natural profits and natural rents, but could have pushed this line of criticism further: some readers have discerned in Smith affinities with Ricardo's and Marx's explanations of distribution, in which the 'passive undertakers' find themselves squeezed between unproductive landowners and subsistence workers.

Rothbard's treatment of the sections on the labor embodied and labor commanded theories of value prompts other concerns.<sup>10</sup> It is asserted that 'side by side with the standard cost of production analysis [is] another, new, and far more bizarre theory ... [in which] ... the relevant cost of production [is] simply the quantity of labor embodied in its production' (pp. 452-453), so that Smith 'may plausibly be held responsible for the emergence and the momentous

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<sup>10</sup> There is little doubt that Smith claimed that purchasing power over labor (labor commanded) was a measure of the value of commodities. Most historians also believe, however, that Smith also hints that the value of commodities is equal to the labor, both direct and indirect, required to produce them (labor embodied). Ricardo, who discerned the presence of both in *WN*, also demonstrated that the two were inconsistent, and argued for the latter.

consequences of Marxism' (p. 453). This is at best reckless, however. First, and most important, it should be recalled that the much discussed sixth chapter opens with:

In that early and rude state of society which precedes both the accumulation of stock and the appropriation of the land, the proportion between the quantities of labour necessary for acquiring different objects seems to be the only circumstance which can afford any rule for exchanging them for one another. (*WN*, p. 47)

But, a few paragraphs later, Smith recognizes that:

[In more advanced states, the labourer] must in most cases share [the whole produce of labour] with the owner of the stock which employs him. Neither is the quantity of labour commonly employed in acquiring or producing any commodity the only circumstance which can regulate the quantity which it ought commonly to purchase, command or exchange for. An additional quantity, it is evident, must be due for the profits of the stock which advanced the wages and furnished the materials of that labour. (*WN*, p. 49)

Rothbard's failure to disclose Smith's *caveat*, let alone discuss it, is seriously misleading.

Second, it is absurd to hold Smith responsible for the 'momentous consequences' of Marxism because, as Marx himself noted, Ricardo's identification of labor as the source of value was definitive and much more influential. (Once more, the choice of Smith over Ricardo as 'villain' baffles us.<sup>11</sup>)

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<sup>11</sup> One of our referees speculates that Rothbard's reluctance to villainize Ricardo reflects his preference for the 'deductive spirit' of *Principles of Political Economy*, in contrast to the 'inductive spirit' characteristic of *WN* and, for that matter, *TMS*. If so, this preference must have been quite pronounced: few historians of economics would claim that Smith's commitment to the labor embodied notion of value, the basis for the 'momentous consequences of Marxism,' rivaled Ricardo's.



Third, to describe Smith's deliberations on the particular role of socialized labor in the creation and measurement of value as new is to suppose an intellectual vacuum where none existed. As Meek (1956, p. 41) observes:

The notion that the exchange of commodities is in essence the exchange of labour of the men who produce them became something of a commonplace as the century progressed. Writers like Hume, Gervaise and Tucker popularized the idea that commodities produced for exchange consisted essentially of a mass of congealed or crystallized social effort. Others, like Frances Hutcheson, developed the concept of the social division of labour, and some, like Harris, developed it in close association with a theory of value which laid considerable emphasis on labour.

Commonplace or not, the notion of labor value was, in various and sometimes inconsistent incarnations, an important element of the intellectual culture in which Smith worked. Finally, Rothbard's own choice of textual evidence is itself peculiar:

The real price of every thing ... is the toil and trouble of acquiring it. What every thing is really worth to the man who has acquired it, and who wants to dispose of it or exchange it for something else, is the toil and trouble which it can save himself, and which it can impose upon other people. (*WN*, p. 30)

This comes not from the sixth chapter of Book I, however, but the fifth - 'Of the Real and Nominal Price of Commodities' - and leads into the discussion of labor commanded, not labor embodied, as an index of 'real' value.

#### **4. Monetary Theory**

Rothbard (pp. 460-462) identifies two principal faults with the mature Smith's monetary theory: the abandonment, between *LJ* and *WN*, of Hume's price specie

flow mechanism, and the effort to integrate the theories of money and value, which somehow led economics down the 'erroneous and fateful road ... of fractional reserve credit.' Smith never commits the first 'fault,' however, and the second, if indeed it is such, should be viewed in terms of Smith's broader purpose. We first note that while the differences between Hume's seminal parable and Smith's more complicated characterization should not be overlooked, neither should their fundamental similarities:

When the quantity of gold and silver imported into any country exceeds the effectual demand, no vigilance of government can prevent its exportation. All the sanguinary laws of Spain and Portugal are not able to keep their gold and silver at home ... If, on the contrary, in any particular country their quantity fell short of the effectual demand, so as to raise their price above that of the neighbouring countries, the government would have no occasion to take any pains to import them. (*WN*, p. 404)

For Smith, then, the specie flow mechanism constituted the stabilizing dynamics around the equilibrium distribution of specie across nations, the architectonic structure of international finance.

Rothbard's fascination with Humean 'process analysis' and his rejection of such equilibria as chimerical - see the discussion of natural prices - blinds him to Smith's broader purpose. Because the search for the form and determinants of this equilibrium is Smith's principal focus, which leads to the first of the Rothbard's 'faults,' the second was perhaps inevitable to the extent that the integration of monetary and value theories provided the desired structure. In more provocative terms, Hume and, for that matter, Cantillon do not commit the same alleged 'errors' because neither characterizes the rest points for the specie flow mechanism.

## **5. The Invisible Hand**

Rothbard's lament that the economist most identified with the invisible hand metaphor was a reluctant champion of free markets is of course correct, and this is perhaps what most non-specialist readers should remember about *Economics Before Adam Smith*.<sup>12</sup> The substance of Rothbard's critique is the familiar catalogue of 'obligations of the state' found in Book V - defense of the realm, public education, public works, coins and regulation of paper, etc. Because it is familiar and has been so for decades (Knies, 1883, for example), however, we suspect that few Austrians or libertarians will be outraged anew, or that few interventionists will find fresh comfort. It is therefore disappointing that Rothbard chooses not to evaluate Smith's specific rationale for each.

Smith possessed an exceptional, and almost modern, understanding of the strategic dimensions of rhetorical, moral and economic issues, and this is nowhere more evident than in Book V of *WN*. In particular, there is an awareness that the same incentive structure was characteristic of such problems as the interaction of speaker/writer and listener/reader (Collings & Ortmann, 1997), the acquisition of self-command (Ortmann & Meardon, 1995), the extraction of effort (Matthews & Ortmann 1997), incentives in joint-stock companies, teaching and preaching (Ortmann 1999), and incentives in the provision of public goods and the remedies for externalities.

The incentive structure of each of these problems is isomorphic to a principal-agent or prisoners' dilemma game. In these situations, players must choose between two actions – in principal-agent games, trust or monitor/inspect

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<sup>12</sup> We were surprised, in fact, that Rothbard even concedes Smith's commitment to the metaphor. Rothschild (1995), for example, finds that both references to an invisible hand in Smith's writing and lectures before *WN* were ironic, and suggests that the famous third, buried in Book IV, could be, too.

and high or low effort and in the prisoners' dilemma, cooperation or defection - and their strategic choices can produce outcomes that are suboptimal from a social standpoint *if* the participants do not interact often enough or if information conditions are such that reputations are difficult to establish. Smith understood well the pervasiveness of such interaction, and the incentive problems that underlie them.

The existence of such choices, and hence the potential for the misalignment of incentives and Pareto-inefficient outcomes, complicates and sometimes undermines the case for free markets. This problem, now considered so standard that it is included in most, if not all, economics primers, seems to have escaped Rothbard's attention. In *Economic Thought Before Adam Smith*, the desirable properties of competitive markets seem to be axiomatic, an uncontestable point of departure. In this context, of course, Rothbard's indignation at the mere mention of state intervention in *WN* is understandable, but hardly useful.

Smith was not, of course, an unqualified advocate of state intervention, and devoted considerable attention to the possibilities for abuse. He also understood the relative costs and benefits of the two principal enforcement mechanisms - reputation and third parties. While he characterized the incentive problems that afflicted joint-stock companies, and educational and ecclesiastical institutions, for example, his commitment to market-based solutions - which build on reputational enforcement of quality and effort - was a consistent one. Smith also stressed the need for application of a 'benefit principle' whenever possible.<sup>13</sup> This, too, seems lost on Rothbard, who never considers the circumstances that led Smith to consider state intervention.

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<sup>13</sup> This is the simple, if not then well understood, principle that even if markets fail, the benefits of state intervention ought to be weighed against its possible costs.

## 6. Conclusion

From a more general standpoint, Rothbard fails to discern the rhetorical structure of *WN*. The infamous Book V, perhaps the first modern treatment of incentive-compatible state intervention, was one of Smith's principal concerns.<sup>14</sup> He could not make the case for efficient, and one assumes limited, intervention, however, without a prior critique of mercantilist forms of intervention. Even this approach required rhetorical strategies, however, inasmuch as some, perhaps most, of his intended audience were otherwise predisposed. Smith, whose earlier lectures demonstrate a remarkable command over rhetorical principles, chooses to emphasize first the desirable properties of economic freedom in Books I, II and III – he writes in obvious but not explicit opposition to mercantilism – and to postpone his direct criticism of mercantilist principles until Book IV, when the reader's confidence has been won. It is not until after this, in Book V, that he is free to articulate his own, more nuanced, case for appropriate state intervention. Judged in terms of modern theories of the state and firm (Tirole 1988, 1994), he succeeds.

Rothbard's neglect of the modern literature on incentives therefore exacerbates the flaws in his treatments of both *Das Adam Smith Problem* and modern scholarship on Smith. Given these, few readers, Austrian or otherwise, will find *Economic Thought Before Adam Smith* a decisive contribution to our understanding of the discipline's foundations.

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<sup>14</sup> Indeed, based on their reading of Smith's teachings on rhetoric, Ortmann & Meardon (1995) conclude that the material in Book V was his *main* concern.

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