



## Episode 704: Adam Smith, Not the Founder of Economic Science

Guest: Gene Epstein

**WOODS:** Now, some of you folks may remember, not only Gene's previous appearances on the show, but also that Gene moderated the now notorious debate on Alexander Hamilton between Michael Malice and me.

**EPSTEIN:** That's right.

**WOODS:** And the debating society of which that was a part is no more, but Gene has stepped into the breach and started his own, so tell us about that.

**EPSTEIN:** Yeah, please, everybody, write this down and go into the website, because you can register right now and get an invitation. It's called [TheSohoForum.org](http://TheSohoForum.org). And some of the young people on my staff advised me to give it that sort of locational name, because it is going to be in a huge art gallery in Soho, capacity 150 seats, which would have meant of course that people would have been out on the street when Tom debated Michael Malice. And then there's a downstairs office as well. [TheSohoForum.org](http://TheSohoForum.org) has its first debate on September 19th — that's a Monday night — in Lower Manhattan. You'll find the address.

And it's going to be Heather MacDonald of the Manhattan Institute versus Tim Lynch of Cato debating the following resolution: there is a war on cops that makes everyone less safe. That's Heather's contention. Tim Lynch of Cato Institute is going to contradict that. Further along in the calendar, we have Walter Block of Mises on November 1st defending the idea that libertarians should vote for Trump. Opposing him will be Nick Gillespie of *Reason*. And everything is going to be the Oxford-style debate format where you vote before and after the resolution, so we technically have a winner.

So again, that's [TheSohoForum.org](http://TheSohoForum.org), and I know that Tom has a huge following in New York, because I saw those people ran to the rafters when Tom debated Alexander Hamilton a few months ago. And Tom, you, as you know, are cordially invited to come. I had a couple of ideas for you. Maybe sometimes I'll be able to inveigle you to come to The Soho Forum.

**WOODS:** Well, I can't say I would absolutely rule it out. I would say that the debate I had with Michael was one of my favorite moments as something of an academic that I've ever had, by far.

**EPSTEIN:** You want to retire undefeated champion, Tom. I guess that's what it's all about, because —

**WOODS:** (laughing) I know it, but every time somebody does that all the upstarts are suspicious, that this guy knows he's just one event away from being removed from his perch.

**EPSTEIN:** Exactly, and Malice wants a rematch, so we'll see if that ever happens. Anyway —

**WOODS:** We've got to think of something that we disagree on strongly enough.

**EPSTEIN:** Sure.

**WOODS:** All right, I'll also link to [TheSohoForum.org](http://TheSohoForum.org) at [TomWoods.com/704](http://TomWoods.com/704); that'll be the show notes page for today.

**EPSTEIN:** Great.

**WOODS:** All right, okay, let's talk then about the topic that you proposed. I actually haven't done an episode on Adam Smith after over 700, and some listeners may know that Murray Rothbard was highly critical of Adam Smith in his book — was it *Economic Thought Before Adam Smith*? I actually can't remember.

**EPSTEIN:** Yeah, you know, it's got various titles. It's a fantastic two-volume history of economics. It's one of my favorite books, by the way. It's up —

**WOODS:** Yeah, *History of Economic Thought from an Austrian Perspective*, that's right.

**EPSTEIN:** Yeah, and Rothbard did not live to complete the third volume, which would have taken us through John Maynard Keynes. That was a big tragedy.

**WOODS:** Yeah, we didn't get the 20th century.

**EPSTEIN:** But the first two volumes are fantastic, yeah.

**WOODS:** Yeah, yeah, yeah, they absolutely are. But he's so critical of Adam Smith that there was a backlash from Adam Smith libertarians against Rothbard's treatment of Smith —

**EPSTEIN:** Yes.

**WOODS:** So that's gone back and forth. And people I respect are on both sides of that dispute about Adam Smith.

**EPSTEIN:** Yes.

**WOODS:** So why do you bring this up now? Why does this matter?

**EPSTEIN:** Well, as a matter of fact, it's always been an issue for me, and I have a way to end the madness, to come to a truce on this subject. I too — by the way, that two-volume work of Rothbard's is one of my favorite books of his, and I love most of his books. It's sort of like almost like bathtub reading, because it's such an entertaining tour through the personalities and all the issues, going back to Plato and Aristotle. It's a fantastic book. And his attack on Adam Smith is mostly true, as far as it goes, but I think that it's a bit imbalanced.

But on the other side, my own story is, for example, when I was watching a great series called *EconPop*, put on by John Papola, who's — I don't know if he's been on your show. I got into an argument with a lot of people who also have been on your show. That includes Don Boudreaux; that includes Mark Skousen; it includes Johan Norberg. Those people, all I said is, please, let's stop calling Adam Smith the father of economics. He wrote a great book. I believe he wrote a great book. But it's a deeply flawed book. It's got so much in it that socialists can use against us that if you keep putting it out there as what amounts to the bible of economics and of free market economics then you are going to be vulnerable to those who would point out that there's so much in that book that could give aid and comfort to socialists. That's all I'm saying.

All I'm saying is that let's declare there is no father of economics; there are a bunch of uncles, a bunch of elders, and they include a lot of French writers, who by and large I personally prefer, although I love a lot of what's in Adam Smith. But those French writers include Cantillon; they include of course Jean-Baptiste Say, Trudeau, others that Rothbard led me to, who originated the concept of entrepreneurship. For example, I got into an argument with Skousen, Mark Skousen who's a great guy, taught me a lot. And Mark actually thought that the term entrepreneurship was originated by Jean-Baptiste Say, and I had to point out to him laboriously, because he questioned it a couple of times — he said, "Are you really reading from the original French?" In fact, the term is trotted out extensively and discussed extensively by Cantillon in a book published 21 years before Adam Smith's book was published and in a book that we know Adam Smith read, because he cites Cantillon in his own book.

But I wrote you a couple of examples of the ways in which Adam Smith has been used against us. I have two examples, which I wrote to you, from Noam Chomsky, the left-wing social and political, who, by the way, for other reasons I also admire. Let me just read one, which Chomsky wrote about in a book called *Prophets Before People*. He writes contemptuously, "Adam Smith held that humans were meant 'truck and barter,'" — that's a quote from Adam Smith — and on the basis of this and similar assumptions developed his justification for free market capitalism."

Now Chomsky has us dead to rights, incorrect. Adam Smith had this perverse idea that people trade not for mutual benefit — he doesn't mention that at all — but to truck and barter. They have a propensity to truck and barter, and as Murray Rothbard wrote, this is as if human beings were lemmings determined by forces external to their own chosen purposes, the truck-and-barter tendency. There's plenty of room in the free market economy for people who have no propensity to truck and barter, for people who love to trade, for people who don't like to trade. And that has nothing to do with exchange in a market economy. People exchange for mutual benefit.

So again, that's just one example among so many in which Adam Smith went off the rails and said things that give aid and comfort to socialists. So that's my only point, my only core point. He wrote a great book, a flawed book filled with problems, willled with insights, filled with great stuff, filled with bad stuff. It's just one book among many, and that's my only case.

**WOODS:** At some point we have to talk about Smith and prices, because this is a big thing for Rothbard, how prices are determined. And of course it's a big thing for the Austrians, and it's a big thing for any school of economic thought. But Rothbard is going to come down on Smith because he's going to say Smith has a largely cost and production theory of where consumer prices come from. Why is a consumer price such and such? Well, because in long-run equilibrium it's going to approximate the costs of production that go into the production of the thing.

Whereas Rothbard's view is that it's the opposite, that consumer prices come from consumer valuations of the good, and then those valuations get imputed to the various capital goods, the various higher order goods up through the structure of production. Those things get their value from the fact that consumers want the completed good, and so their role in producing that completed good is in effect where their prices come from. So it's the opposite. It's not like there are these costs that just appear out of nowhere. Like for example, where do the costs of production themselves come from? They're not just dropped from heaven.

Rothbard's view is that the key thing is the consumer, and then the production of the good and the prices of the goods that go into the production of that good come from the consumer's valuation being imputed up the structure of production. It doesn't come from, well, let's see, it costs this much to do this, this much to do this, so I guess I'd better price my good at this. An individual entrepreneur may think of it that way, because it seems like that's what he's doing, but that's not the systematic explanation of what's happening.

**EPSTEIN:** I agree. I think in this discussion, Tom, it's sort of two tracks. I have a huge correspondence with a lot of people I really like and I really respect out there who are just absolutely drunk on Adam Smith in my view, and that's Don Boudreaux, Mark Skousen, Russ Roberts — they think that this is *the* book. And you're right in making that point that you just made.

But I want to go for the easier points. I want to show that in particular the — Peter Schiff had an argument in the mud, in Occupy Wall Street that you can see on video where some kid is quoting Adam Smith back to him. And how about just pointing out, related to what you just said, that Adam Smith made a distinction between value in use and value in exchange? He talked about the Marxist idea of essentially production for use versus production for exchange or production for profit. He couldn't figure out the water-diamond paradox, at least not in that book. Ironically, Rothbard points out, that he had resolved it in his lectures. But it doesn't, mysteriously, occur in his book.

And so he writes very, very clearly that value has two meanings, and that water is so much more valuable than diamonds and yet it can be sold for nothing, and diamonds are so much less valuable than water and yet they're sold for so much, and this gives any kid the impression that capitalism is all screwed up. And that of course is about the value in use, value in exchange. It's a mantra of the left wing. And so that's such an obvious flaw in that book amongst so many that are so obvious that, again, all you've got to do is — if you and I were a couple of left-wing opportunists, we could use Adam Smith against the free market-types in so many different, obvious ways.

And that's my key point. There are so many obvious weaknesses in that book that give aid and comfort to socialists that we should simply end the madness and quit calling this book as written by the father of modern economics. It's got some wonderful things in it and some terrible things in it, and George Reisman, another guy you had on the show, wrote in his book *Capitalism* I think the best statement ever, the best summary statement, which is that this book has some of the greatest things in economics and some of the worst things. It's got both, that's all. And what you just talked about, Tom, is fascinating and relevant, but in a way it's sort of on a second level of abstraction from the obvious flaws in Smith's book.

The other one — let me mention one other point, that Chomsky, Noam Chomsky, again, the great left-wing critic who was a rock star in his day, ran all over the world, he goes after Adam Smith on the division of labor, because indeed he's right to point out that later on in *The Wealth of Nations*, Smith is talking about how the division of labor makes people as stupid and ignorant as it is possible for a human creature to be.

**WOODS:** Right.

**EPSTEIN:** That's the egregious stuff. And then Smith actually wanted government to step in to improve these people, and Rothbard is absolutely right to say that Smith could not even make up his mind about the division of labor. In the beginning, of course, in the first chapter, he writes a paean to the division of labor, that it enhances human intelligence, and then later on toward the end of that book he's suddenly attacking the division of labor for the way it makes people stupid. And so again, Chomsky is fairly quoting that and saying, look, if you're going to cite Adam Smith as the father of modern economics, recognize, you free-marketeers, that Adam Smith is really not in your camp. He saw flaws in your view, and you ought to face up to it. Well, what we really need to face up to is that Adam Smith wrote a great book that is deeply, deeply flawed.

**WOODS:** What are we to think about the controversy over the labor theory of value and Smith?

**EPSTEIN:** Oh, well, there, no indeed, the whole emphasis on labor and wages is — we are, George Reisman points out that — again, interestingly you and I could carve up that book. We could take 300 pages and say this is probably close to the greatest stuff on the free market ever written. We could take another 300 pages, and we could say this is the greatest stuff on left-wing economics ever written — not the greatest stuff. Well written, not persuasive, but it's certainly in favor of socialism.

As Reisman points out, Adam Smith very, very specifically states that before the capitalists and the landowners came along, we had wage earners, wage earners who were getting the full value of their product. This is absolutely explicit in Smith. And then the capitalists and the landowners come along and take a piece of the action. And I'm practically quoting from memory, in which Smith certainly uses again the phrase "division of labor." Had this not happened, had the capitalists and landowners not come on the scene, then they would have benefitted from the division of labor and all the rest and things would have been okay. And it's just gasp provoking. He's literally forgetting that the direction of production is something that the capitalists play a key role in.

And that probably, that may well be because Smith was — and this is of course my big hobbyhorse; let's talk about this — because Smith was tone-deaf, by and large, tone-deaf to the role of the entrepreneur. And that's, by the way, another reason why, again, I got some pushback from some of the people I just mentioned who said any left-winger who misreads Smith as though he's giving aid and comfort to the left-wingers is just reading him out of context. And I wanted to write back, how about the fact that Smith favored the usury laws? How about the fact that he specifically wrote that the interest rates should be capped legally at 5%?

**WOODS:** I was just going to ask you about that. Now, how does he justify that?

**EPSTEIN:** Well, he talks about how if we do that you'll keep out — and I'm looking for the term — the prodigals. Actually there's another obscure word. The prodigals and the coasters, I think? But anyway, we have to avoid lending to prodigals. And that's what I — no, he's being reasonable — but you have to understand that Smith really does take this seriously, because he's stipulating that 5% is kind of high, that most loans are going to go to 3 and 4%, but I'm going to be reasonable and put it up to 5%, because I'll allow a little bit of this profligacy in, but 5% at least will keep out the prodigals. And now here's something interesting. Rothbard actually quotes Roger Garrison, who's in Mises, saying that Smith probably knew what he was doing; he just didn't like lavish consumption. We all know that. And of course those that defend Smith will of course admit that.

But I believe when I read Cantillon, I get the feeling that something else is involved, that — Cantillon, by the way, makes fun, absolutely satirizes the people who believe in the usury laws. I actually have a quote in front of me from Cantillon, in which he's

talking about how many entrepreneurs, many operators — and he keeps using the word "entrepreneur," Cantillon does — in which he says that entrepreneurs can often borrow at 20% and turn a profit. And then Cantillon writes, "Nothing is more entertaining than the multitude of laws and rules made in every century on the subject of the interest of money always unnecessarily by wiseacres who hardly understand the facts of commerce." Now, I interpret that as a direct rebuke to Smith, because again, Cantillon is having fun, and I guess partly having fun because Cantillon had the advantage of being a businessman and pointing out and recognizing that entrepreneurs often borrow at double-digit rates of interest and turn a profit. So that's the other big whole in Adam Smith.

And again, I'm going for the obvious weak points in Adam Smith, the obvious cases in which a Chomsky or a kid in the mud at Occupy Wall Street — by the way, Peter, I have high regard for him just like you do. The moment the kid cited Adam Smith, Peter immediately said, oh, of course, that was the father of modern economics. And I groaned watching this. I realized, well, who knows what this kid is going to toss at him. He tossed at Peter something involving how Smith thought that capitalism led to monopoly, and Peter was mostly right in saying that Adam Smith didn't really believe this. But the kid could have quotes some passages in which he talks about when Smith does indeed talk about the dangers of monopoly under capitalism and that when capitalists get together they plot against the people.

He had a very deep suspicion and sort of hostility toward businessmen. This, by the way, is something that Thomas Sowell emphasized as well. Thomas Sowell actually praised Smith for this. He thought that Smith had a deep suspicion of businessmen, but on the other hand he recognized that the free market is still a good system. But Smith's hostility to businessmen I think did indeed get in his way as well. So that's another flaw in Smith.

**WOODS:** I'm looking at a passage by Roger Garrison that tries to take apart this whole Smith on usury thing, and there are people who have said, oh, isn't it curious that Smith contradicts himself or, let's say, takes an inconsistent position, which I think is a better way of putting it, in advocating a price ceiling here, given that we know that when you do that you're going to create all kinds of disturbances and disruptions and you're going to — obviously there'll be only so much credit offered at X%, and so only certain people who are super duper qualified are going to be able to get loans at that amount, so it's going to create a shortage of credit. Isn't that unusual that he would do that?

But what Garrison points out is that's not understanding him at all. He wants a shortage of credit. That's why he advocates the policy. Garrison says, "He was trying," — as you say, Gene — "He was trying to reduce the amount of funds borrowed for certain categories of loans." And he said that only prodigals and projectors, people who are most likely to waste and destroy capital, would be willing to borrow at, say, 8 or 10%. So Smith, therefore, recommended an interest ceiling at 5%. And so Rothbard says, "So Smith knew full well that a low interest ceiling would not benefit marginal borrowers by providing them with cheap credit. He knew that these laws would dry up

credit altogether for marginal borrowers, and he sought precisely that result." So this is not a case of, boy, isn't that funny? He's normally free market and he just doesn't understand his own analysis of this one case. He does understand it, but his own moral views are overtaking his economic analysis.

**EPSTEIN:** Yes. No, I think that's very true as far as it goes. I can only say that from my perspective, the fact that, again, Smith specifically mentions Cantillon at one point in his own book, and then if you read Cantillon as sort of entertaining and ride his discussion of entrepreneurs who turn short-term profits from borrowing at high rates of interest and supplying wage earners and the farms, that you wonder whether Smith might have been a little bit — might have had a better perspective if he'd recognized — I guess something else that sort of maybe offended his Scottish sensibilities — recognized the role of the entrepreneur that Cantillon was able to recognize. And that of course gets to in a way the key problem, or my key problem, with Smith.

Another guy who's been on your show is my friend Michael Strong. Michael's writing a book about entrepreneurship, and he neglects to state — I told him — the book is called *Blind Spot*. And I think it's a good book and process, but he neglects to point out that the blind spot of so many modern economists about entrepreneurship is echoed, of course was repeated most egregiously, by the blind spot in Smith about entrepreneurship when he had full access to Cantillon. I mean, that's the other point — and so therefore, I think related to Smith's problems and blind spot is that that he could read Cantillon, he could read what essentially is two chapters on the role of the entrepreneur, Cantillon specifically stating that the entrepreneur buys at fixed prices, and then he faces uncertainty.

Then again, actually in a way I think the best chapter on entrepreneurship in Cantillon is when he's talking about these high rates of interest that entrepreneurs borrow at and the way they turn a profit on these high rates of interest, which allows them — again, it's not even like for the future. It's that they're actually supplying needs in the relatively short run by seeing ways in which the entrepreneur is going between the market, so to speak, and buying cheap and selling dear and borrowing. Indeed, I mean, Cantillon talks about how without entrepreneurs we might not even have very high rates of interest, that there would just be a few nuts who would borrow. So again, this is I think a part of Smith's blind spot.

But I agree with Garrison, but I would introduce the point that had Smith taken seriously Cantillon's discussion of high rates of interest at which entrepreneurs borrow, then I think we could add another dimension to Smith's inability in this regard. And then we could recognize, for example, that there's been a big debate over payday lending, in which people are supposedly charged high rates of interest, and indeed they are, in the short run. Wage earners, a guy needs \$400 to get his car fixed, and he borrows against his paycheck, and the rates of interest are high. And you and I could of course say, hey, look, the father of modern economics thought that interest rates should never be higher than 5%, so you people who love the free market had better recognize that the guy who taught you economics agrees with us. You know, he doesn't agree with you. Interest rates should not be higher than 5%. So that, again, is the



other key case in which we make ourselves vulnerable if we keep promoting Adam Smith as the guy who wrote the book about the free market.

**WOODS:** Richard Cantillon, in case people don't know, was an economist in the early 18th century, who wrote a work that I will also link to at [TomWoods.com/704](http://TomWoods.com/704) — I believe the Mises Institute has an edition of it, the "Essay on the Nature of Commerce in General," that Rothbard loved very much, and Mark Thornton's done a lot of work on, that, as you say, puts the entrepreneur front and center.

**EPSTEIN:** Yes.

**WOODS:** What else do we want to say on Adam Smith before we call it a day?

**EPSTEIN:** Well, what I do want to emphasize as well is that there are still some wonderful things in Adam Smith's book. I want to reach my hand across the table to those people who seem to have this great love of that book. There are passages in that book that I also love. Rothbard does talk about the undoubted importance of Adam Smith's famous passages on the invisible hand, but I also think, however, that Adam Smith wrote some wonderful things in favor of free trade. And indeed, he did connect I think free trade with the division of labor. He talked about — let me quote a couple of sentences. Maybe we can end on that. I have in front of me:

"The tailor does not attempt to make his own shoes but buys them of the shoemaker. The shoemaker does not attempt to make his own clothes but employs a tailor. The farmer attempts to make neither the one nor the other that employs those different artificers. All of them find it for their interest to employ their whole industry in the way in which they have some advantage over their neighbors. What is prudent in the conduct of every private family can scarce be folly in that of a great kingdom." So the word "kingdom" we might bridle that, but I think that's a very eloquent dispense of free trade.

And one other passage, which sounds — we haven't yet mentioned my favorite economist from the 19th century, maybe yours, which of course is Bastiat, who wrote some wonderful, fiery stuff about the free market. But here's one passage that sounds like Bastiat, which I love, from Adam Smith. "The statesman who should attempt to direct private people in what manner they ought to employ their capital would not only load himself with the most unnecessary attention but assume an authority which could safely be trusted not only to no single person but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it."

So that is a passionate indictment of the attempt on the part of government to intervene in the market. It's written by Adam Smith; it's one of many great passages in that book. Let's end the madness; let's recognize he wrote some great things, he wrote some terrible things in that book. Let's make it one among many books about economics, not the only book, which is unfortunately what so many of our colleagues

and comrades do. And when they do that, they make themselves vulnerable to attacks by socialists.

**WOODS:** Gene, I appreciate your time. I'm going to link to the stuff we've been talking about, including the Rothbard books, and we'll have to talk again soon. Thanks so much.

**EPSTEIN:** Sure, thank you, Tom.