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Adam Smith and Economic Development: theory and practice.

Adam Smith describes at least two models of economic development—the 4 stages of development model and the development of town and cities. The models present an unfolding view of economic growth from primitive to advanced stages. But Smith´s historical example systematically contradicts his models. Is Smith, then, endorsing models of economic growth or criticizing them?

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What do we make of theoretical models when none (or very little) of the empirical data fit the model? In this paper, I show some of the problems of considering economic development models in Adam Smith independently from the historical empirical evidence he offers with them. Smith indeed offers clear models of economic development both in his Lectures on Jurisprudence and in the Wealth of Nations. Yet, Smith also presents lists of historical examples which contradict his theory, maybe questioning the general validity of those models.

I first look at the theory of the four stages of development as presented in the Lectures on Jurisprudence, then at some of the historical examples of development in the Wealth of Nations, namely, the development of towns as well as the development of early civilizations and of late colonial development, all of which presents exceptions to Smith's theoretical model.

What I will not do is to formalize Smith's model as Eltis (1975) and Hollander (XXXx) have already done, but stay with Smith's narrative. I will not take part in the debate on Smith's materialism (Pascal 1938, Meek 1976, Skinner 1982) or lack of it (Winch 1983, Haakonssen 1989), about which Salter (1992) provides a review, but look at Smith's use of models of growth and the examples he uses. While I agree with Myint (1977) that Smith has a `trade-cum –development' theory, I differ from Myint (1958) when he looks at the validity of Smith's model with actual empirical facts. I focus exclusively on what Smith himself offers as empirical data. Additionally, while I agree with Bowles (1986) that the disconnection between theory and facts is a problem, I do not share his view that this is a failure on Smith's part due to the influence the Physiocrats had on him. If Smith failed to establish "that the 'natural progress of opulence' described the way in which economies would, if left to themselves, develop, and that his failure … results from his methodological approach and, in particular, from the fact that the 'natural progress of opulence' was an a priori concept formulated without reference to historical evidence" (p. 110), why would Smith be bothered to continuously list historical evidence which contradict his model? I will not provide a definite answer to why the empirical evidence Smith offers to his theoretical model are contradictions to that same model, but raise the question as to whether Smith himself was questioning the use of models.

LJ

The clearest exposition of Smith's theory of development comes from the set of his students' notes complied into the Lectures of Jurisprudence. The Lectures on Jurisprudence were found in XXX and not published by Smith or during Smith's time. Given Smith asked to burn all his non published writing before he died, and that the lectures are students note, not Smith's own notes, some may hesitate to use them with the same weight as Smith's approved published works. LJ are generally considered useful though because they contain, among others, earlier draft of what would become the Wealth of Nations.

In these lectures we can find what is known as the four stages of development theory. The four stages theory was a common construct of the Scottish Enlightenment, as demonstrated by Berry (1997) and Smith (2006). And Smith, consistently with this Scottish background, presents his version of it. On December 24, 1762, Smith tells his students "there are four distinct stages which mankind passes thro: --1st, the Age of Hunters, 2dly, the Age of Shepherds; 3dly, the Age of Agriculture; and 4thly, the Age of Commerce" (LJA, 14). During the semester he elaborates on this "natural progress which men make in society" (LJA 207). Smith explains we start from hunting societies, where the "the first method [these small societies] would fall upon for their subsistence would be to support themselves by the wild fruits and wild animalls which the country afforded" (LJ 14). By eventually realizing that domesticating animals are an easier source of food, we eventually arrive at the age of shepherds. Population growth would follow a more stable supply of food and would push for an ever more steady provision. "Then they would naturally turn themselves to the cultivation of land and raising plants and trees as produced nourishment fit for them. ... And by this means they would gradually advance into the age of agriculture" (LJA 14). So, after having enough flocks and herds to be able to afford to cultivate some land, and after having enough produce to support themselves, people will have superfluous products with which will start to trade. And society will eventually develop into its age of commerce. Each stage of development has its appropriate form of justice and of government and its appropriate customs. And from each stage a society will eventually carry into the following stage. This is "the normal process of development" (Skinner 1975, p. 155). The theory is simple, clear, and quite reasonable.

If *I* were to give an historical example to explain and corroborate this model, I would say: take country x for example. During century y, people were few and they were hunters. As population increased, they became shepherds. In century yy, more or less, they started to cultivate land extensively and now, x is in its commercial age. But this is not the way Smith gives empirical support to his theory. He tells his students that North American Indians are an example of the first stage of development "tho they have no conception of flocks and herds, have nevertheless some notion of agriculture ...[even if] this can hardly be called agriculture" (LJA15). "The Tartars and Arabians subsist almost entirely by their flocks and herds. The Arabs have little agriculture, but the Tartars none at all" (LJA 15). And France is offered as an example of commercial society, without any previous stage of it being mentioned. We do encounter the Tartars and the Arabs again, on Febry 21, and Febry 23 1762. But here Smith tells his students that this natural gradual development somehow stalled with them as they are "two great nations who have been merely shepherds as far back as we can trace them and still are so without the least agriculture" (LJA 213).

So Smith tells his students there is a model of development and offers them examples of societies that do not develop. The situation does not improve when we look at what Smith tells posterity, with his published works.

WN

In the WN the explicit mention of the four stage of development disappears. There are references to hunters, shepherds, agricultural and commercial societies, and the development from one stage to another, especially in Book III and V, but not a model as clear as the one used with his students. Yet, if we keep the model of the four stages of development in mind (and even if we do not), we run into additional empirical problems.

Assuming the implicit presence of a 4 stages model, what does Smith tells us of civilizations that have evolved over time? Take Rome. Smith tells us "Rome...was originally founded upon an Agrarian law" (WN IV.vii.a.3, 556). Where is that age of shepherds, not to speak of the age of hunters, which precedes the age of agriculture?

Let's look at something more recent then. Book III is a broad account of the feudal era, from its beginning to its fall. Here Smith also tells us that "the cultivation and improvement of the country, therefore which affords subsistence, must necessarily, be prior to the increase of the towns, which furnishes only the means of conveniency and luxury" (WN III.i.2, p. 377). He also tells us that "According to the natural course of things, therefore, the greater part of the capital of every growing society is, first, directed to agriculture, afterwards to manufactures, and last of all to foreign commerce. This order of things is so very natural, that in every society that had any territory, it has always, I believe, bee in some degree observed' (WN III.i.8, p.380). This seems to echo his lectures: first one develops agriculture (the country) and then, with the surplus products, one starts trading and developing trading centers such as cities.

The theoretical model of stage development is back. The chapter where this idea is presented is indeed titled "Of the natural Progress of Opulence." But Smith describes the development of Europe as "unnatural and retrograde" (WN III.i.9, p. 380). Rather than going from the agricultural stage to the commercial one, Smith tells us, we went from an agricultural stage back to a barbaric stage, to then jump into a commercial stage, following which agriculture improved. Europe developed foreign trade first, then manufacturers, and only later agriculture. This is not a minor point Smith makes. He spends three of the four chapters of Book III telling his readers the story of how the natural order of things is inverted. He even explicitly warns his readers of this inversion of the natural course of things at the end of the first chapter by saying: “But though this natural order of things must have taken place in some degree in every society, it has, in all modern states of Europe, been, in many respects, entirely inverted” (WN. III.i. 9. p. 380).

A combination of exogenous events such as the barbaric invasions and of local politics, ranging from primogeniture laws to privileges the kings would grant to cities in exchange for support against the nobility, gave incentives to people to cluster in cities for protection, to develop trade, then manufacturers, and only later on to export to the countryside the entrepreneurial spirit of commerce which develops the country, rather than vice-versa. This is why the European development had been “unnatural and retrograde.” The historical data we are offered gives us exactly the opposite result than the predicted result. The theoretical model, by itself, has therefore problems in explaining historical facts.

Blecker (1997) explains the relevance of this 'unnatural and retrograde order.' “It allows for the endogenous development of absolute advantages and surplus capacities by exploiting scale economies through the market-widening effects of trade. … It is a view of economic development as a process in which countries develop in an interdependent manner, rather than autonomously. In the 'unnatural and retrograde order', the evolution of national economies is fundamentally influenced and determined by their position vis-a-vis each other in the international division of labour. In this vision of an integrated global economy, an international division of labour arises endogenously along with the productive capabilities of the nations that comprise it, as nations tend to develop absolute advantages cum surplus capacities in those goods in which (for reasons that may be historical accidents) they initially specialize” (534). Should Blecker be correct, the question remains, and actually it becomes even more resonant: why would Smith offers us a model of 'natural development of opulence' if his actual model is the 'inverted' one?

Let's consider another factor. Smith, in LJ, tells his students that the engine of change is population growth. One society develops enough means of subsistence to sustain a larger population and, because of the larger population is pushed to find additional means of subsistence, going from hunting to the more stable domestication of animals, to agriculture and finally to commerce. This feedback loop is presented also in WN, even if the emphasis is now more on population growth as a symptom of economic growth: if there is more to survive with more people will survive (WN I.viii). But while the theory predicts a more or less constant growth, in practice we observe three different patterns. An economy (and its population) can increase, stay the same or decrease. So Smith tells us that in North America there is more growth than in England (WN i.viii.23). "China had been long one of the richest, that is, one of the most fertile, best cultivated, most industrious, and most populous countries in the world. It seems however, to have been long stationary" so that there does not seem to be much difference between the description of Marco Polo and the ones from Smith's contemporaries (WN i.viii.24). And while China does not seem to decline, Bengal does, as well as some other English settlements in the East Indies. In Bengal "notwithstanding [subsistence should not be very difficult] three or four hundred thousand people die of hunger every year" (WN I.viii.26). The reason? "The mercantile company which oppresses and domineers in the East Indies" (WN I.viii.27).

What does a model of development tells us then, as Smith presents it? Not much it seems, when the historical account of it is taken into consideration. Customs, institutions, and other historical accidents seem to play a large explanatory role in Smith's models.

Let us look at yet another example. Smith tells us both parties involved in trade benefit from trade. In particular, in his theory of development he tells us "rich and civilized nations can always exchange to a much greater value with one another, than with savages and barbarians" (WN IV.i.33). The historical example Smith gives us? An explicit contradiction to this theory. The discovery of America brought about "a new sett of exchanges ... which ought to have proved as advantageous to the new, as it certainty did to the old continent. The savage injustice of the Europeans rendered an event, which ought to have been beneficial to all, ruinous and destructive to several of those unfortunate countries"(WN IV.i.32). Additionally, while the peoples of America were `savages`, the populations of the East were highly civilized, rich, and advanced. Contrary to the prediction of the theory, "Europe, however, has hitherto derived much less advantage from its commerce with the East Indias, than from that with America" (WN IV.i.33). Smith‘s explanation? Contingencies. Politics affects the consequences of trading with a setoff countries rather than another. The East Indies trade is highly monopolized while trade with America is freer (WN IV.i.33 and IV.vii.c.100). The growth deriving from trading with the East Indies is therefore less than the one from America, contrary to his model prediction.

In defense of Smith, it is often claimed that the American experience resembles his theory (WN II.v.21p.366 and III.i.5 p.378-9). But if we take Brewer (1998) seriously, even this is an empirical failure of Smith's theoretical model. Brewer claims the North American colonies cannot be considered an example of natural development for two reasons. First, the process of colonization itself implies that the barbaric colonies are colonized by civilized cultures. "An open economy surrounded by more civilized centers" (p. 93) can hardly be consider the norm, rather, it is an exception. "Second, … In the North American colonies, of course, modern institutions were imported from Europe, where they were… the result of a (much slower) process of development" (p. 93) And indeed Smith tells us that the difference between the success of America and the degradation of Bengal is the adoption of the British constitution in America (WN I.viii.26 p. 91).

Finally, since for Smith capital is at the base of economic growth, let's look at how Smith develops a theory of capital allocation that maximizes growth once we have international trade already. "It is thus that the private interests and passions of individuals naturally dispose them to turn their stock toward employments which in ordinary cases are most advantageous to society. But if from this natural preference they should turn too much of it towards those employments, the fall of profit in them and the rise of it in all others immediately dispose them to alter this faulty distribution. Without any intervention of law, therefore, the 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" (WN IV.vii.c.88). But again, this is not what happens in reality, according to Smith. The historical data Smith offers us tell us passions and interests will be regulated through monopolistic privileges. They "derange more or less this natural and most advantageous distribution of stock" (WN IV.vii.c.89) that the theoretical model predicts. In practice, poor countries such as Denmark overinvest capital in their monopolies with the East Indies and rich countries such as Holland underinvest it (WN IV.vii.c.95-96).

Again, a model of economic growth, by itself, is not a good predictor or a good explanation of history. Other factors, such as lobbying and the privileges granted to special interest groups, play a role as important as other economic variables, if not more.

Looking at book V, where we have the most explicit reference to the 4 stages, still does not improve the performance of the model. Smith uses the description of the four different stages of development to explain differences in military organization and performance. Techniques and discipline of the military change with each different stage. The military develops from a group of thugs to a proper army. So far so good. But then we have the description of Rome, both in Book V and in Book III. The sophisticated and civilized Roman Empire, given its proven powers, relaxed its military discipline (WN V.I.a.36) and barbaric uncivilized German tribes over-run it. "The rapine and violence which the barbarians exercised against the ancient inhabitants, interrupted the commerce between the towns and the country. The towns were deserted, and the country left uncultivated, and the Western provinces of Europe, which had enjoyed a considerable degree of opulence under the Roman empire, sunk into the lowest state of poverty and barbarism" (WN III.ii.1). This is a step backward, a destruction of civilization (Skinner 175, p. 159) which challenges the linearity of the development of the four stages.

In Smith's defense, one could claim that Smith tells us that the real commercial societies are in fact superior to any societies in their previous stage of development. Only opulent, therefore only commercial, societies can afford the expenses of modern firearms. Yet, he also tells us "the unavoidable effects of the natural progress of improvement have, in this respect, been a good deal enhanced by a great revolution in the art of war, to which a *mere accident*, the invention of gun-power, seems to have given occasion" (WN V.1.a.44 p. 708. Emphasis added). Poor and barbarous nations overrun opulent and civilized nations, unless we introduce firearms. But firearms are introduced by "*mere accident.*" The model prediction works only with an exogenous random event.

Conclusions

A book on the nature and causes of the wealth of nations ought to be a book on economic development. It is, as it is many other things. Contemporary economists have noticed it and have tried to understand the models of economic development at the base of Smith's narrative. Smith has therefore been `translated` in formal modeling language. This is a very useful exercise which helps us better understand Smith's position and economic development. But I do not think this is enough either to understand Smith nor economic growth.

Smith presents models of development and at the same time offers a long range of historical examples with which to understand the models and their predictive and explanatory powers.

Interestingly enough, though, many of the examples he chooses to use do not fit the models. They seem to contradict them.

Smith tells us it is possible to model the economic system linked to the progress of opulence which took centuries and centuries to develop. But he also seems to tell us opulence developed in unpredictable forms. It happened only in certain part of the world, and even there not stably and not necessarily in its most effect form.

But if the model is a general model of human behavior, why do we see different results in different parts of the world? Why Smith offers so much contradicting data? I would not go as far as Brewer (1998) in saying “in sum, Book Three of the Wealth of Nations is a bit of fraud” (p. 93). Yet, Smith’s results of his empirical tests are indeed problematic and may open the door for questioning of the nature of the model itself. Is Smith hinting whether we should question the presence of a natural order in nature that can be modeled? Or our ability to do so? What if the system of natural liberty which is part of the economic development is indeed the result of peculiar circumstances and historical accidents? What if freedom and prosperity are generated simply by good luck? (Forbes 1975, 198) Smith does not seem to be able (or willing?) to exclude that possibility.

Alternatively, if we want to save the possibility of a useful theory, what Smith seems to indicate to us is the inappropriateness of the kind of theory used. He may have a model of growth, but without a deep understanding of the institutional, cultural, and historical context in which it is applied, its explanatory powers of historical data become irrelevant.

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