An Inquiry into the Nature and Causes of the Wealth of Nations

Adam Smith

1776

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[Brackets] enclose editorial explanations. Small ·dots· enclose material that has been added, but can be read as though it were part of the original text. Occasional •bullets, and also indenting of passages that are not quotations, are meant as aids to grasping the structure of a sentence or a thought. Every four-point ellipsis . . . . indicates the omission of a brief passage that seems to present more difficulty than it is worth. Longer omissions are reported between brackets in normal-sized type. Cross-headings in SMALL CAPITALS that are not in the original are marked by small ·dots·. Each of them announces the start of a new topic; there is often no mark of where that topic ends.

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Glossary

accommodation: Smith often uses this word in a broader sense than we are familiar with, a sense in which someone's 'accommodation' refers to all the comforts and conveniences he enjoys, not merely the place where he lives.

alienation: Selling something to someone outside the family of its present owner.

allodial: 'Pertaining to the absolute ownership of an estate' (OED)

arbitrary: It means 'dependent on individual human decisions'. An 'arbitrary government' is contrasted with one in which the rule of law is absolute.

art: Any practical activity that is governed by rules, involves techniques, requires skill. Also **artificer**.

benefice: Property and/or guaranteed income of a rector or vicar (higher in rank than a curate).

bounty: A handout from the state to the exporter of certain sorts of goods.

cattle: Sometimes used to cover horses, hogs, and sheep as well as bovine livestock. Not deer.

chairmen: Carriers of sedans, hired especially in winter to enable the passenger to avoid walking in water and mud.

contempt: On a few occasions Smith uses 'contempt of x' to mean 'attitude of regarding x as negligible'.

creditable: Respectable, decent.

effectual demand(er): A technical term of Smith's, explained on page 22.

entail: A property is entailed if it must by law remain in the possession of the family that now owns it.

equipage: This imprecise term covers: coach and horses, servants' uniform, elegant cutlery and dishes, and so on.

factory: Replaces Smith's 'manufactory' throughout.

finally paid: A tax is 'finally paid' by the person who pays it with no **retribution**.

generous: Mainly used in today's sense of 'free in giving', but a few times in the older sense of 'noble-minded, magnanimous, rich in positive emotions' etc.

genius: Aptitude for a particular activity.

income, revenue: In this version, private individuals have incomes; Smith usually says that they have revenues.

industry: Work, e.g. the work of a farm labourer.

journeyman: In Smith's usage, a skilled worker who is available to be hired but is not anyone's permanent fixed-wage employee, and is paid according to output rather than time.

magistrate: In this work a 'magistrate' is anyone with an official role in the enforcement of law; on page 180 the emperor Augustus is referred to as 'the magistrate'.

manufacturer: Smith quite often uses this in something like our sense, though he often expresses that with the phrase 'master manufacturer'. Sometimes the undecorated noun is used to refer to anyone who *works in* manufacturing; there is a striking example of this on page 107.

meanest: Lowest on the social scale.

money: When Smith mentions particular sums of money in the terminology of 'pounds', 'shillings' and 'pence', those words are usually replaced by the conventional symbols, so that for example '£13/6/8d' means 'thirteen pounds six shillings and eightpence'; '6/-' means 'six shillings'; '8d' means 'eightpence'.

parish: A town or village or neighbourhood that has its own church. To 'come on the parish' = 'to live in a workhouse, at public expense', always in wretched conditions.

pecuniary: Having to do with money; a worker's 'pecuniary wages' are what he is paid in cash for his work.

perfect liberty: Smith regularly uses this phrase, as he explains on page 22, to mean 'being free, so far as the law is concerned, to practise any trade you choose'.

perpetuities: Legal arrangements under which estates can never be sold or given away.

prince: In this work *prince* isn't a title and doesn't designate a rank; it stands for any ruler of a state, whether a king or queen or duke or count etc.

principle: Smith often uses this word in a sense, once common but now obsolete, in which 'principle' means 'source', 'cause', 'driver', 'energiser', or the like.

prodigal: Unwisely free in spending; 'the prodigal son' does *not* mean 'the son who left home and then returned' but 'the son who foolishly squandered all his money'.

projector: Someone who tries to start a new enterprise. On pages 117 and 123 there are strong suggestions of 'someone who rashly or foolishly tries' etc.

rent certain: A rent stated as a fixed amount of money per month, year, etc., rather than as a fixed proportion of some variable quantity such as profitability of land.

retribution: Sometimes used in the now obsolete sense of 'recompense' or 'repayment'. The word is left untouched in this version in case Smith means by it something more special than that. See also **finally paid**.

revolution: The revolution Smith refers to on page **??** and a few other places is the sequence of events in 1688 in which James II (Roman catholic) was replaced by the Dutch William and Mary of Orange (protestant) as joint sovereigns of England.

rude: As applied to societies: primitive. As applied to products such as metals and grains: unprocessed.

save-all: 'a means of preventing loss or waste' (OED).

science: In early modern times this word applied to any body of knowledge or theory that is (perhaps) axiomatised and (certainly) conceptually highly organised. Smith's use of the word seems looser than that, but you may have to interpret individual occurrences on the basis of their context.

station: social status.

sumptuary law: Law setting limits on how much individuals may spend.

theory: This is nearly always a replacement for Smith's 'system'. The work contains the phrase 'theories of political economy' (once) and 'systems of political economy' (many times), and it's clear that for Smith the phrases are synonymous.

tolerable: reasonable, allowable, fairly acceptable.

undertaker: In Smith's usage, the 'undertaker' of a project is the entrepreneur who launches and risks his capital in it.

united kingdom: In Smith's day this phrase applied to the combination of England (including Wales) and Scotland. Only in 1801 did 'the United Kingdom' become an official name for those two plus Ireland.

workshop: This word is used throughout to replace 'workhouse', to avoid the distracting suggestion of 'poorhouse'.

Book II.
The nature, accumulation, and employment of stock

Introduction

In that rude [see Glossary] state of society where there is no division of labour, exchanges are seldom made, and every man provides everything for himself, it is not necessary that any stock should be accumulated, or stored up beforehand, in order to carry on the business of the society. Every man tries to meet by his own industry his own occasional wants as they occur. When he is hungry, he goes to the forest to hunt; when his coat is worn out, he clothes himself with the skin of the first large animal he kills; and when his hut begins to go to ruin, he repairs it as well as he can with the trees and the turf that are nearest it.

But once the division of labour has been thoroughly introduced, the product of a man's own labour can meet only a very small part of his occasional wants. Far more of them are met by the product of other men's labour, which he purchases with the product—i.e. the price of the product—of his own labour. But this purchase can't be made until the product of his own labour has been completed *and sold*. So a stock of goods of various kinds must be stored up somewhere, sufficient to maintain him and supply him with the materials and tools of his work at least until both these events have happened. A weaver can't apply himself entirely to his special business unless there is beforehand stored up somewhere, in his possession or someone else's, a stock sufficient to maintain him, and to supply him with the materials and tools of his work, until he has completed and sold his web. . . .

Just as the accumulation of stock must be previous to the division of labour, so labour can be more and more subdivided only in proportion as stock is previously more and more accumulated. The quantity of materials that the same number of people can work up increases •as labour comes to be increasingly subdivided, and •as each workman's operations are gradually made simpler and a variety of new machines are invented for facilitating and abridging those operations. As the division of labour advances, therefore, in order to give constant employment to an equal number of workmen, an equal stock of provisions, and a greater stock of materials and tools than what would have been necessary in a ruder state of things, must be accumulated in advance. But the number of workmen in every branch of business generally increases with the division of labour in that branch; or rather it is the increase of their number which enables them to class and subdivide themselves in this manner.

The accumulation of stock is a prerequisite for carrying on this great improvement in the productive powers of labour, and it naturally leads to this improvement. The person who employs his stock in maintaining labour wants to employ it in such a way as to produce as much work as possible. So he tries •to make the best distribution of employment among his workmen, and •to provide them with the best machines he can invent or afford to purchase. How much he can achieve in both these ways is generally proportional to the extent of his stock, i.e. to the number of people it can employ. The quantity of industry, therefore, not only increases with the increase of the stock that employs it, but in consequence of that increase the same quantity of industry produces a much greater quantity of work.

Those are in general the effects of the increase of stock on industry and its productive powers.

In this Book I shall try to explain the nature of stock, the effects of its accumulation into capital of different kinds, and the effects of the different uses of those kinds of capital. The Book is divided into five chapters. **(1)** In the first I try to show what the parts or branches are into which the stock of an individual or of a society naturally divides itself. **(2)** In the second I try to explain the nature and operation of money, considered as one branch of the general stock of the society. The stock that is accumulated into capital may be employed by the person to whom it belongs or lent to someone else. In **(3) (4)** the third and fourth chapters I try to examine how it operates in both these situations. **(5)** The fifth and last chapter discusses the effects that the different employments of capital immediately produce on the quantity of national industry and of the annual product of land and labour.

Chapter 1. The division of stock

When the stock a man possesses is only enough to maintain him for a few days or a few weeks, he seldom thinks of deriving any income from it. He consumes it as sparingly as he can, and tries by his labour to acquire something to make up for it before it is consumed altogether. In this situation his income is derived solely from his labour; this is the situation of most of the working poor in all countries.

But when he owns enough stock to maintain him for months or years, he naturally tries to get income from most of it, reserving only as much for his immediate consumption as can maintain him until this income begins to come in. So his whole stock is distinguished into two parts. That part that he expects to provide him with this income is called his **capital**. The other part, which supplies his immediate consumption, consists in

- **(i)** the portion of his whole stock that was originally reserved for this purpose;
- **(ii)** his income, from whatever source derived, as it gradually comes in; or
- **(iii)** things that were purchased by either of these in former years, and are not yet entirely consumed, such as clothes, household furniture, etc.

The stock that men commonly reserve for their own immediate consumption consists in one or more of these three.

There are two ways in which capital can be employed so as to yield income or profit to its employer.

First, it can be employed in raising, manufacturing, or purchasing goods, and selling them again with a profit. The capital used in this way yields no income or profit to its employer while it either •remains in his possession or •continues in the same shape. A merchant's goods yield him no income or profit until he sells them for money, and the money yields him as little until it is again exchanged for goods. His capital is continually going from him in one shape, and returning to him in another; and it is only by means of such circulation or successive changes that it can yield him any profit. Such capital, therefore, may very properly be called *circulating capital*.

Secondly, it can be employed in the improvement of land, in the purchase of useful machines and instruments of trade, or other such things that yield income or profit without changing masters, or circulating any further. Such capital, therefore, may very properly be called *fixed capital*.

Different occupations require very different proportions between the fixed and circulating capital employed in them. The capital of a merchant, for example, is altogether a circulating capital. He has no need for machines or instruments of trade, unless his shop or warehouse is considered as such.

Some part of the capital of every master artificer or manufacturer must be fixed in the instruments of his trade. This part is very small in some and very large in others, A master tailor requires no other instruments of trade but a parcel of needles. Those of the master shoemaker are a very little more expensive. Those of the weaver rise a good deal above those of the shoemaker. But most of the capital of all such master artificers is circulated in the wages of their workmen or the cost of their materials, and is repaid with a profit by the price of the work.

In other works a much greater fixed capital is required. In a large iron-work, for example, the furnace for melting the ore, the forge, the slitting-mill, are instruments of trade that are very expensive to make. In coal works and mines of every kind, the machinery needed for drawing out the water and for other purposes is often still more expensive.

Of the farmer's capital, the part employed in the instruments of agriculture is fixed, the part employed in the wages and maintenance of his working servants is circulating. He makes a profit from the former by keeping it in his possession, and from the other by parting with it. The price or value of his working cattle [see Glossary] is a fixed capital, as is the value of the instruments of husbandry; their maintenance is a circulating capital, like that of the working servants. The farmer makes his profit by keeping the working cattle and by parting with their maintenance. Both the price and the maintenance of the cattle that are bought in and fattened, not for work but for sale, are a circulating capital. The farmer makes his profit by parting with them. A flock of sheep or a herd of cattle that is bought in not for work nor or sale but to make a profit from their wool, their milk, their increase, is a fixed capital. The profit is made by keeping them. Their maintenance is a circulating capital. The profit is made by parting with it; and it comes back—with its own profit and the profit on the whole price of the cattle—in the price of the wool, the milk, the increase. The whole value of the seed is also a fixed capital. Though it goes backwards and forwards between the ground and the granary, it never changes masters and therefore doesn't actually circulate. The farmer makes his profit not by its sale but by its increase.

The general stock of any country or society is the same as that of all its inhabitants or members; so it naturally divides itself into the same three portions, each of which has a distinct function.

(1) The first is reserved for immediate consumption, and provides no income or profit. It consists in the stock of food, clothes, household furniture, etc. that have been purchased by their proper consumers but aren't yet entirely consumed. The whole stock of mere dwelling-houses at any one time in the country is also a part of this first portion. The stock that is laid out in a house, if it is to be the owner's residence, ceases from that moment to serve as capital or to provide any income to its owner. A residence as such contributes nothing to its inhabitant's income; and though it is extremely useful to him, that is in the same way as his clothes and household furniture are useful to him. They are a part of his expense, and not of his income. If his house is to be let to a tenant for rent, because the house itself can't produce anything the tenant must always pay the rent out of some other income that he derives from labour, stock, or land. Thus, though a house can yield income to its owner, and thereby serve as capital to him, it can't yield any revenue to the public or serve in the function of capital to it; the revenue of the whole body of the people can't be increased *at all* by it. Clothes and household furniture sometimes yield a revenue in the same way, serving as capital for particular persons. In countries where masquerades are common, it is a trade to let out masquerade dresses for a night. Upholsterers often let furniture by the month or by the year. Undertakers let the furniture of funerals by the day and by the week. Many people let furnished houses, and get a rent for the use of the house and of the furniture. But the income derived from such things must always be ultimately drawn from some other source of income. . . . A stock of houses, well built and properly taken care of, may last many centuries; but although their total consumption is a long way off, they still count as stock reserved for immediate consumption, just like clothes and household furniture.

(2) The second portion of the society's general stock is the fixed capital, which provides revenue or profit without circulating or changing owners. It consists chiefly of the four following articles:

- **(i)** Useful machines and instruments of trade that facilitate and abridge labour.
- **(ii)** Profitable buildings that procure income not only to the owner but to the person who occupies them and pays rent for them; such as shops, warehouses, workshops, farm-houses,. . . .etc. These are a sort of instruments of trade, and can be regarded as such.
- **(iii)** Improvements of land that has been profitably laid out in clearing, draining, enclosing, manuring, and putting it into the best condition for ploughing and growing. An improved farm is comparable with the useful machines that facilitate and abridge labour, enabling an equal circulating capital to provide more income to its employer. . . .
- **(iv)** The acquired and useful abilities of all the members of the society. The acquisition of such talents—by the maintenance of the acquirer during his education, study, or apprenticeship—always costs a real expense, which is a fixed capital that is realized, as it were, in his person. Those talents make a part of his fortune and also of the society's. The workman's improved skill is comparable with a machine or instrument of trade that facilitates and abridges labour, costing a certain expense but repaying it with a profit.

(3) The third portion of the society's general stock is the circulating capital, which provides income only by circulating or changing masters. It is also made up of four parts.

- **(i)** The money by means of which all the other three are circulated and distributed to their proper consumers.
- **(ii)** The stock of provisions that are in the possession of the butcher, the grazier, the farmer, the corn-merchant, the brewer, etc. and from the sale of which they expect to derive a profit.
- **(iii)** The materials of clothes, furniture, and buildings that are not yet made up into any of those three shapes and remain in the hands of the growers, the manufacturers, the mercers, and drapers, the timber-merchants, the carpenters and joiners, the brick-makers, etc.
- **(iv)** Work that is made up and completed but is still in the hands of the merchant and manufacturer and not yet distributed to the proper consumers; such as the finished work in the shops of the smith, the cabinet-maker, the goldsmith, the jeweller, the china-merchant, etc.

The circulating capital consists in this way in the •provisions, •materials, and •finished work of all kinds that are in the hands of their respective dealers, and of the •money needed for circulating and distributing them to those who are finally to use or consume them.

Three of these four parts—provisions, materials, and finished work—are regularly withdrawn from it and placed in the fixed capital or in the stock reserved for immediate consumption.

All fixed capital is originally derived from circulating capital and has to be continually supported by it. All useful machines and instruments of trade are originally derived from circulating capital that provides •the materials they are made of and •the maintenance of the workmen who make them. They also require capital of the same kind to keep them in constant repair.

No fixed capital can yield any income except through circulating capital. The most useful machines and instruments of trade won't produce anything without the circulating capital that provides the materials they are employed on and the maintenance of the workmen who employ them. Land, however improved, won't yield income without circulating capital that maintains the labourers who cultivate and collect its product.

The sole purpose of the fixed and circulating capital is to maintain and increase the stock that can be reserved for immediate consumption. It is this stock that feeds, clothes, and lodges the people. Whether they are rich or poor depends on how much those two capitals can provide to the stock reserved for immediate consumption.

So much of the circulating capital is continually being withdrawn from it and placed in the other two branches of the society's general stock that it would soon cease to exist if it didn't take in continual supplies. These are principally drawn from the product •of land, •of mines, and •of fisheries. These provide continual supplies of provisions and materials, some of which are then manufactured into finished work that replaces the provisions, materials, and finished work continually withdrawn from the circulating capital. The mines also provide what is needed for maintaining and increasing the part of the circulating capital that consists in money. For though in the ordinary course of business this part is not, like the other three, necessarily withdrawn from it and placed in the other two branches of the society's general stock, it must (like all other things) eventually be wasted and worn out, or lost or sent abroad; so it also needs continual replacement supplies, though no doubt much smaller ones.

Lands, mines, and fisheries all need fixed *and* circulating capital to cultivate them; and their product replaces (with a profit) not only those capitals but all the others in the society. Thus the farmer annually replaces to the manufacturer the provisions he had consumed and the materials he had worked up the year before; and the manufacturer replaces to the farmer the finished work that he had wasted and worn out in the same time. This is the real exchange that is annually made between those two kinds of people, though the rude product of the one is seldom directly bartered for the manufactured product of the other: the farmer doesn't often sell his corn and cattle, his flax and wool, to the very person from whom he chooses to purchase clothes, furniture, and instruments of trade. Rather, he sells his rude [see Glossary] product for money with which he can purchase the manufactured product he wants, wherever it is to be had. Land even replaces, in part at least, the capital with which fisheries and mines are cultivated. The product of land is what draws the fish from the waters; and the product of the earth's surface is what extracts the minerals from its depths.

The product of land, mines, and fisheries—when their natural fertility is equal—is in proportion to the extent and proper application of the capital used on them. When the amounts of capital are equal and equally well applied, it is in proportion to their natural fertility.

In any country where there is a tolerable security, every man of common sense will try to use whatever stock he can command to procure present enjoyment or future profit. If it is used in procuring present enjoyment, it is a stock reserved for immediate consumption. If it is used in procuring future profit, it must do this either by staying with him (fixed) or going from him (circulating). In a situation where there is a tolerable security, a man who doesn't employ all the stock he commands—whether it's his own or borrowed—in one or other of those three ways must be perfectly crazy.

In unfortunate countries where men are continually afraid of the violence of their superiors, they often bury or conceal a large part of their stock so as to have it always available to take with them to some place of safety in case of need. This is said to be a common practice in Turkey and, I believe, in most Asian countries. It seems to have been a common practice among our ancestors during the violence of feudal times. In those times treasure-trove was regarded as a considerable part of the revenue of the greatest sovereigns in Europe. It consisted in treasure found concealed in the earth, to which no particular person could prove any right. Back then, such treasure was regarded as so important that it was always considered as belonging to the sovereign, not to the finder or the proprietor of the land, unless the right to it had been conveyed to the latter by an explicit clause in his charter. This put it on the same footing as ·the output of· gold and silver mines, which were never supposed to be comprehended in the general grant of the lands except where there was a special clause in the charter. It was different with mines of lead, copper, tin, and coal—things of smaller consequence.

Chapter 2. Money, considered as a part of the society's general stock. The expense of maintaining the national capital.

I showed in Book I that the price of most commodities falls into three parts, of which one pays the wages of the labour, another the profits of the stock, and a third the rent of the land that had been employed in producing and bringing them to market; that there are indeed some commodities whose price is made up of only the wages of labour and the profits of stock; that in a very few it consists solely in the wages of labour; but that the price of every commodity has to consist in one or more of those three parts, and every part that doesn't go to rent or wages must be somebody's profit.

As I said: since this is the case for every particular commodity taken separately, it must be the case for all the commodities composing the whole annual product of the land and labour of any country taken together. The whole price or exchangeable value of that annual product must fall into the same three parts, and be parcelled out among the inhabitants of the country as the wages of their labour, the profits of their stock, or the rent of their land.

. . . .In the rent of a private estate we distinguish between the •gross rent and •the net rent, and we can make the same distinction with regard to the revenue of all the inhabitants of a large country.

A private estate's gross rent is whatever is paid by the farmer; the net rent is •what remains of that after the landlord has deducted the expense of management, of repairs, and all other necessary charges; i.e. •what he can, without hurting his estate, place in his stock for immediate consumption, or to spend on his food, equipage, the ornaments of his house and furniture, his enjoyments and pastimes. His real wealth is in proportion to his net rent, not his gross rent.

The gross revenue of all the inhabitants of a large country includes the whole annual product of their land and labour. The net revenue is •what they have left after deducting the expense of maintaining their fixed capital and their circulating capital, i.e. •what without encroaching on their capital they can place in their stock reserved for immediate consumption, or spend on their subsistence, conveniences, and pastimes. Their real wealth, again, is in proportion to their net revenue, not their gross revenue.

Obviously the whole expense of maintaining the fixed capital must be excluded from the society's net revenue. It can never include ·the costs of· the materials needed for supporting their useful machines and instruments of trade, their profitable buildings, etc. or the product of the labour needed for working those materials into the proper form. The price of that labour may indeed make a part of it, because the workmen so employed may put the whole value of their wages in their stock for immediate consumption. But in other sorts of labour the price and the product both go to this stock—the price to that of the workmen, the product to that of other people whose subsistence, conveniences, and pastimes are increased by the labour of those workmen.

The intention of the fixed capital is to increase labour's productive powers, i.e. to enable the same number of labourers to do much more work. In a farm where all the necessary buildings, fences, drains, communications, etc. are in perfect order, the same number of labourers and labouring cattle will raise a much greater product than they would in one of equal extent and equally good ground but not provided with equal conveniences. In manufacturing the same number of hands using the best machinery will work up a much greater quantity of goods than they would with less perfect instruments. Expense that is properly laid out on fixed capital of any kind is always repaid with great profit, and increases the annual product by a value much greater than the value of the support such improvements require. Still, this support does require a certain portion of that product. A certain quantity of materials, and the labour of a certain number of workmen—both of which might have been immediately used to increase the food, clothing, and lodging, the subsistence and conveniences of the society—are thus diverted to another use; highly advantageous indeed, but still different from this one. That is why improvements in mechanics that enable the same number of workmen to do more work with cheaper and simpler machinery than before are always regarded as advantageous to every society. [He goes on for some time repeating and illustrating this.]

The expense of maintaining the fixed capital in a large country is comparable with the expense of repairs in a private estate. The expense of repairs is often necessary for supporting •the product of the estate and consequently •the landlord's gross and net rent. But when by a better direction it can be reduced without any lessening of product, the gross rent is not lower than before and the net rent is greater.

But though the whole expense of maintaining the fixed capital is excluded from the society's net revenue, it is not the same with the expense of maintaining the circulating capital. Of the four parts of which the latter is composed—money, provisions, materials, and finished work—the last three are regularly withdrawn from it and placed in the society's •fixed capital or in their •stock reserved for immediate consumption. Whatever portion of those consumable goods is not used in maintaining the former goes entirely to the latter and constitutes a part of the society's net revenue. So the maintenance of those three parts of the circulating capital takes nothing from the society's net revenue except for what is needed for maintaining the fixed capital.

A society's circulating capital is different from an individual's in this respect. That of an individual is totally excluded from his net revenue, which must consist purely in his profits. But though every individual's circulating capital is part of the circulating capital of the society he belongs to, that doesn't block it from also constituting a part of their net revenue. The whole goods in a merchant's shop can't all be placed in his own stock reserved for immediate consumption, they may be in that of other people, who from a revenue derived from other funds may regularly replace their value to him together with its profits, without causing any lessening of his capital or of theirs.

So **money** is the only part of a society's circulating capital the maintenance of which can cause any lessening in their net revenue.

In their effects on a society's revenue, its fixed capital is very like the part of its circulating capital that consists in money. ·There are three aspects to this resemblance·.

(i) Those machines and instruments of trade etc. require a certain expense, first to construct them and then to support them, these expenses being deductions from the net (but not the gross) revenue of the society; similarly, the stock of money that circulates in a country requires a certain expense, first to collect it and then to support it, these expenses being deductions from the net (but not the gross) revenue of the society. A certain quantity of very valuable materials (gold and silver) and of very skilled and intricate labour, instead of increasing the stock reserved for immediate consumption, the subsistence, conveniences, and pastimes of individuals, is used in supporting ·money·, that great but expensive instrument of commerce through which every individual in the society has his subsistence, conveniences, and pastimes regularly distributed to him in their proper proportions.

(ii) The machines and instruments of trade etc. that compose the fixed capital of an individual or a society don't constitute a part of the gross or of the net revenue of either; similarly, money—through which the society's whole revenue of is regularly distributed among its members—does not itself constitute any part of that revenue. The great wheel of circulation is altogether different from the goods that are circulated by means of it. The society's revenue consists entirely in those goods and not in the wheel that circulates them. In computing a society's gross revenue or its the net revenue, we must always deduct from •the whole annual circulation of money and goods •the whole value of the money, not a farthing of which can ever be a part of either.

If this proposition appears doubtful or paradoxical, that is because of the ambiguity of language. When properly explained and understood, the proposition is almost self-evident.

When we talk of a particular sum of money, we sometimes mean only the metal pieces of which it is composed, and sometimes we include in our meaning an obscure reference to the goods that can be had in exchange for it, or to the power of purchasing that comes from owning it. Thus, when we say that the circulating money of England has been computed at £18,000,000 we mean only to express the amount of the metal pieces which some writers have computed (or rather have supposed!) to circulate in England. But when we say that a man is worth £50 or £100 a year, we usually mean to express not only •the amount of the metal pieces that are annually paid to him but also •the value of the goods he can annually purchase or consume, •what ought to be his way of living, i.e. the quantity and quality of the necessities and conveniences of life in which he can properly indulge himself. . . .

If a man's weekly pension is a guinea, he can in the course of the week purchase with it a certain quantity of subsistence, conveniences, and pastimes. In proportion as this quantity is large or small, so are his real riches, his real weekly income. His weekly income is certainly not equal both to the guinea and to what can be purchased with it, but only to one or other of those two equal values, and more properly to the guinea's worth rather than to the guinea.

If his pension was paid to him not in gold but in a weekly bill [= promissory note] for a guinea, his income surely would consist not in the piece of paper but in what he could get for it. A guinea may be considered as a bill for a certain quantity of necessities and conveniences on all the tradesmen in the neighbourhood. The income of the person to whom it is paid consists not in the piece of gold but in what he can get for it, i.e. what he can exchange it for. If it couldn't be exchanged for anything, the gold coin—like a bill on a bankrupt—would be of no more value than the most useless piece of paper. [Smith has two more paragraphs essentially repeating all this. Then:]

But if this is obvious enough even with regard to an individual, it is still more so with regard to a society. The amount of the metal pieces that are annually paid to an individual is often precisely equal to his income, which makes it the shortest and best expression of its value. But the amount of the metal pieces that circulate in a society can never equal the income of all its members. A guinea that pays one man's pension today may—the very same coin—pay that of another tomorrow, and of a third the day after; so the amount of the metal pieces that annually circulate in a country must always be worth much less than the whole money pensions annually paid with them. But the power of purchasing—the goods that can be bought with the whole of those money pensions as they are successively paid—must always be precisely of the same value as those pensions; as must likewise be the income of the persons to whom they are paid. So that income consists not in those metal pieces. . . .but in the power of purchasing, in the goods which can successively be bought with them as they circulate from hand to hand.

Thus, money—the great wheel of circulation, the great instrument of commerce—. . . .is a very valuable part of a society's capital, but makes no part of its revenue, The metal pieces of which it is composed, in the course of their annual circulation, distribute to every man the income that properly belongs to him, but they make no part of that income.

(iii) The machines and instruments of trade etc. that compose the fixed capital resemble the part of the circulating capital that consists in money in a third way: just as

- •every saving in the expense of erecting and supporting those machines that doesn't diminish the introductive powers of labour is an improvement of the net revenue of the society

so also

- •every saving in the expense of collecting and supporting the part of the circulating capital that consists in money is an improvement of exactly the same kind.

[Now a paragraph explaining this, though 'it is sufficiently obvious' and 'has partly been explained already'. Then:]

·Paper money and metal money·

The substitution of paper for gold and silver money replaces a very expensive instrument of commerce with one that is much less costly and sometimes equally convenient. Circulation comes to be carried on by a new wheel that costs less to erect and maintain than the old one. But *how* this happens, and how it tends to increase either the gross or the net revenue of the society, is not so obvious and may require some further explanation.

There are several sorts of paper money; but the circulating notes of banks and bankers are the sort that is best known and seems best adapted for this purpose.

When the people of a country have so much confidence in a particular banker's fortune, probity and prudence that they believe he is always ready to pay on demand such of his promissory notes as are likely to be presented to him at any time, those notes come to have the same currency as gold and silver money. . . .

Suppose a banker lends his customers promissory notes to the value of £100,000. Because those notes serve all the purposes of money, his debtors pay him the same interest as if he had lent them that much money. This interest is the source of his gain. Though continually some of those notes come back to him for payment, some of them continue to circulate for months and years together. So although he generally has in circulation notes to the value of £100,000, he may not need more than £20,000 in gold and silver to answer occasional demands; which means that that much gold and silver perform all the functions that £100,000 could otherwise have performed. . . . Thus, £80,000 of gold and silver can be spared from the circulation of the country; and if operations of the same are carried on at the same time by many banks and bankers, the whole circulation can be conducted with one fifth of the gold and silver that would otherwise have been required.

Consider this example: The whole circulating money of a country amounts at a particular time to £1,000,000 sterling, that being enough for circulating the whole annual product of their land and labour. At some later time different banks and bankers issue promissory notes to the value of £1,000,000, reserving in their coffers £200,000 for answering occasional demands; so there remains in circulation £800,000 in gold and silver and £1,000,000 of bank notes, i.e. £1,800,000 of paper and money together. But the annual product of the land and labour of the country has required only £1,000,000 to circulate and distribute it to its proper consumers; that annual product can't be immediately increased by those operations of banking; so £1,000,000 will still be sufficient to circulate it. The goods to be bought and sold being the same as before, the same quantity of money will be sufficient for buying and selling them. . . . So the other £800,000. . . .cannot be employed in this country; but it is too valuable to be allowed to lie idle, and will therefore be sent abroad, to seek the profitable employment that it cannot find at home. But the paper cannot go abroad, because at a distance from the banks that issue it and from the country in which payment of it can be enforced by law it will not be received in common payments. Gold and silver, therefore, to the amount of £800,000 will be sent abroad, and the channel (so to speak) of home circulation will remain filled with £1,000,000 of paper instead of £1,000,000 of the metals that filled it before.

The gold and silver thus sent abroad is exchanged for foreign goods of some kind, to supply the consumption either of some other foreign country or of their own.

If they employ it in purchasing in one foreign country goods to be consumed in another—i.e. in what is called the *carrying trade*—any profit they make will be additional to the net revenue of their own country. It is like a new fund, created for carrying on a new trade; domestic business being now transacted by paper, and the gold and silver being converted into a fund for this new trade.

If they employ it in purchasing foreign goods for home consumption, they may either **(a)** purchase goods—e.g. foreign wines, foreign silks, etc.—that are likely to be consumed by idle people who produce nothing, or **(b)** purchase an additional stock of materials, tools, and provisions, to maintain and employ an additional number of industrious people, who reproduce with a profit the value of their annual consumption.

In the case of **(a)** it promotes prodigality [see Glossary], increasing expense and consumption without increasing production or establishing any permanent fund for supporting that expense. This is in every respect hurtful to the society.

In the case of **(b)** it promotes industry; and though it increases the society's consumption it provides a permanent fund for supporting that consumption, because the people who consume reproduce with a profit the whole value of their annual consumption. The *gross* revenue of the society—the annual product of their land and labour—is increased by the whole value that the labour of those workmen adds to the materials on which they are employed; its *net* revenue is increased by what remains of this value after deducting the cost of supporting the tools and instruments of their trade.

It seems almost unavoidable that most of the gold and silver employed in purchasing foreign goods for home consumption will be employed in purchasing **(b)**-type goods. Some •individual men may sometimes increase their expense greatly though their income does not increase at all, but we can be sure that no •class or order of men ever does so; because the principles of common prudence, though not always governing the conduct of every individual, always influence the conduct of the majority of every class or order. And the income of idle people, considered as a class or order, cannot be increased at all by those operations of banking. . . .

When we compute the quantity of industry that the circulating capital of any society can employ, we must think of the circulating capital as consisting only of provisions, materials, and finished work; the other part of it, money, serves only to circulate those three and must always be deducted. To put industry into motion there have to be

- •materials to work on,
- •tools to work with, and
- •wages or recompense for the sake of which the work is done.

Money is not a material to work on or a tool to work with; and though the workman's wages of are commonly paid in money, his real income—like everyone else's—consists not in the money but in the money's worth; not in the metal pieces but in what can be purchased using them.

[Three paragraphs on the arithmetic (as it were) of how to compute a country's circulating capital and how its value relates to relates to 'the whole value of the annual product circulated by means of it'. Then:]

An operation of this kind has been performed in Scotland in the past 25 or so years, by the erection of new banking companies in almost every considerable town and even in some country villages. The effects of this have been precisely what I have described. Scotland's business is almost entirely carried on by means of the paper of those banking companies. . . . Silver seldom appears except in the change of a twenty shilling bank note, and gold still seldomer. But though the conduct of those companies has been questionable, and has accordingly required an act of parliament to regulate it, the country has evidently derived great benefit from their trade. [He reports that Glasgow's trade is said by some to have doubled in 15 years after banks opened there, and Edinburgh's quadrupled; but he suspects that these are exaggerations.]

[Then about a page giving further details of the advantages to the Scottish economy of paper money, and an account of two ways Scottish banks have had of issuing promissory notes = paper money. We rejoin Smith when he starts on the second of these:]

The banks invented another method of issuing their promissory notes, namely by granting what they call 'cash accounts', i.e. by giving credit to the extent of a certain sum to any individual who could procure two persons of undoubted credit and good landed estate to vouch for him that whatever money was advanced to him would be repaid on demand, together with the legal interest. Credits of this kind are, I believe, commonly granted by banks and bankers in many parts of the world. But the easy terms on which the Scotch banking companies accept repayment are, so far as I know, exclusive to them, and may have been the principal cause of the great trade of those companies and of the benefit the country has received from it.

Whoever has a credit of this kind with one of those companies, and borrows (say) £1,000 on it may repay this sum piecemeal by (say) £20 at a time, with the company adjusting the interest proportionally. All merchants and almost all men of business find it convenient to keep such cash accounts with them, and are thereby interested to promote the trade of those ·banking· companies by readily receiving their notes in all payments, and by encouraging all those with whom they have any influence to do the same. . . .

By means of these cash accounts every merchant can without imprudence carry on a greater trade than he otherwise could do. Suppose there are two merchants, one in London and the other in Edinburgh, who employ equal stocks in the same branch of trade; the Edinburgh merchant can without imprudence carry on a greater trade and employ more people than the London merchant. The London merchant must always keep by him a considerable sum of money—either in his own coffers, or in those of his banker who gives him no interest for it—in order to answer the demands continually coming on him for payment of the goods that he purchases on credit. Suppose the ordinary amount of this sum is £500; then the value of the goods in his warehouse must always be £500 less than it would have been if he had not been obliged to keep such a sum unemployed. [Smith spells it out: less stuff in the warehouse, so fewer sales, so less profit, so fewer people employed; unlike the merchant in Edinburgh, who doesn't need to keep cash on hand, because he can meet 'occasional demands' by drawing on his 'cash account with the bank'; therefore etc.]

The whole paper money that can easily circulate in a country can never exceed the value of the gold and silver that it replaces. . . . If the lowest paper money current in Scotland are 20-shilling notes, the whole of that currency that can easily circulate there cannot exceed the sum of gold and silver that would be needed for transacting the annual exchanges of 20 shillings value and upwards usually transacted within that country. If the circulating paper exceeded that sum, the excess—which could not be sent abroad or employed in the circulation of the country—must immediately return on the banks to be exchanged for gold and silver. Many people would see that they had more of this paper than was needed for their business at home; and as they could not send it abroad they would immediately demand payment for it from the banks. When it was converted into gold and silver they could easily find a use for it by sending it abroad; but they could find none while it remained in the shape of paper. So there would immediately be a run on the banks to the whole extent of this superfluous paper. . . .

[Smith now offers about 20 pages of detailed discussion of paper money, including much about ways of trying to get dishonest advantages relating to it; attempts by banks to prevent those; mistakes by banks that didn't fully understand what was going on; transactions between dealers and dealers versus transactions between dealers and consumers; and so on. Three passages out of all this are reproduced here because of their more general interest. The first comes after an account of restrictions on what values of paper money may be issued, on the grounds that allowing paper to stand in for coins for amounts as low as five shillings will tend to drive silver and gold out of the country.]

This may be said:

> 'To restrain private people from receiving in payment the promissory notes of a banker for any sum, whether

great or small, when they themselves are willing to receive them; or, to restrain a banker from issuing such notes, when all his neighbours are willing to accept them, is a manifest violation of the natural liberty that it is the proper business of law to support, not to infringe.'

Such regulations can indeed be seen as in some respect a violation of natural liberty. But exercises of the natural liberty of a few individuals that might endanger the security of the whole society *ought to be* restrained by the laws of all governments—of the most free as well as of the most despotic. The obligation to build party walls to prevent fires from spreading is a violation of natural liberty, exactly on a par with the regulations of the banking trade proposed here.

* * * * *

It has been said that the increase of paper money, by increasing the quantity of the whole currency and thus lessening its value, inevitably increases the money price of commodities. But as the quantity of gold and silver that is taken from the currency is always equal to the quantity of paper that is added to it, paper money does not necessarily increase the quantity of the whole currency. [He gives examples, including: 'Corn is as cheap in England as in France, though there is a great deal of paper money in England and hardly any in France.' He adds that paper money would be worth less than gold and silver if it weren't •guaranteed that it could •on demand and •immediately be exchanged for gold and silver. Various tricks and devices by banks (and other issuers of paper money) to ensure *delay* in paying metal for paper are described, including this one:]

The paper currencies of North America consisted not in •bank notes payable to the bearer on demand but in •government paper that could not be redeemed until several years after it was issued; and though the colony governments paid no interest to the holders of this paper, they declared it to be—and in fact made it be—legal tender of payment for the full value for which it was issued. But allowing the colony security to be perfectly good, £100 payable after 15 years in a country where interest is at 6% is worth little more than £40 ready money. Thus, to oblige a creditor to accept this as full payment for a debt of £100 actually paid down in ready money was an act of violent injustice such as may never have been attempted by the government of any other country that claimed to be free. It bears the evident marks of having originally been. . . .a scheme of fraudulent debtors to cheat their creditors.

* * * * *

If bankers are restrained from issuing any circulating bank notes (or notes payable to the bearer) for less than a certain sum; and if they are required to provide immediate and unconditional payment of such bank notes as soon as they are presented, their trade can be made in all other respects perfectly free without this bringing any risk to the public. Many people have been alarmed by the recent multiplication of banking companies in both parts of the united kingdom; but in fact this *increases* the security of the public. It obliges all the banking companies to be more circumspect in their conduct: they have to avoid extending their ·paper· currency beyond its due proportion to their ·metal· cash, to protect themselves against the malicious bank-runs that the rivalry of so many competitors is always ready to bring on them. Also, it keeps the circulation of each individual banking company within a narrower circle, and reduces their circulating notes to a smaller number, ·and this contributes to the public's safety in another way by· dividing the whole circulation into a greater number of parts, so that when one company fails (which in the course of things must sometimes happen) this is of less consequence to the public. This free competition also obliges all bankers to be more liberal in their dealings with their customers, lest their rivals should steal them away. In general, if any branch of trade or division of labour is advantageous to the public, it will always be *more* advantageous in proportion as competition within it is free and general.

Chapter 3. The accumulation of capital; productive and unproductive labour

One sort of labour adds to the value of the item on which it is bestowed; another sort has no such effect. We may call these ‘productive’ and ‘unproductive’ labour respectively. Thus the labour of a manufacturer [see Glossary] generally adds to the value of •the materials he works on, •his own maintenance, and •his master’s profit. The labour of a domestic servant, on the other hand, adds to the value of nothing. Though the manufacturer has his wages advanced to him by his master, he really costs him nothing because the value of those wages is generally restored—with a profit—in the improved value of the item on which his labour is bestowed. But the maintenance of a domestic servant is never restored. A man grows rich by employing a number of manufacturers; he grows poor by maintaining a number of domestic servants. The labour of the latter has its value, and deserves its reward as well as that of the former. But the labour of the manufacturer fixes and realizes itself [Smith’s phrase] in some particular item or vendible commodity, which lasts for at least some time after that labour is past. It is a certain quantity of labour (as it were) stored up to be employed on some other occasion. That item—or the price of that item—can later put into motion a quantity of labour equal to that which originally produced it. The labour of the domestic servant, on the other hand, does not fix or realize itself in any vendible commodity. His services generally perish in the instant of their performance, and seldom leave behind them any trace of value for which an equal quantity of service could later be procured.

The labour of some of the most respectable orders in the society is like that of domestic servants in that respect. The sovereign is an unproductive labourer, and so are all the officers of justice and of war who serve under him. They are the servants of the public, and are maintained by a part of the annual product of the industry of other people. However honourable, useful, or necessary their service is, it produces nothing for which an equal quantity of service can be procured later on. The protection, security, and defence of the commonwealth, the effect of their labour this year, will not purchase its protection, security and defence for next year. In the same class must be ranked

- •some of the gravest and most important professions—churchmen, lawyers, physicians, men of letters of all kinds; and
- •some of the most frivolous—players, buffoons, musicians, opera-singers, opera-dancers, etc.

. . . .The work of the noblest and most useful of these is like the declamation of the actor, the harangue of the orator, or the tune of the musician, in that it perishes in the very instant of its production.

Both productive and unproductive labourers, and people who do not labour at all, are all equally maintained by the annual product of the land and labour of the country. This product. . . .must have certain limits. So the more (or less) of it that is employed in any one year in maintaining unproductive hands, the less (or more) will remain for the productive hands; and the next year’s product will be accordingly be less (or more), because—setting aside the spontaneous productions of the earth—the whole annual product is the effect of productive labour.

The whole annual product of the land and labour of a country is •ultimately destined for supplying the consumption of its inhabitants and for giving them an income; but •at the outset—when it first comes from the ground or from the hands of the productive labourers—it naturally falls into two parts:

(1) one initially destined for replacing capital, or for renewing the provisions, materials, and finished work that had been withdrawn from capital;

(2) the other constituting income for the owner of this capital as the profit of his stock, or for someone else as the rent of his land.

Thus, of the product of land, one part replaces the farmer's capital; the other pays his profit and the rent of the landlord. . . . Of the product of a great factory, one part (always the larger) replaces the capital of the undertaker of the work; the other pays his profit, and thus constitutes an income for the owner of this capital.

That part that replaces capital is never immediately employed on anything but the wages of *productive* labour. The part that is immediately destined for constituting income, either as profit or as rent, may maintain either productive or unproductive hands.

Whatever part of his stock a man employs as capital, he always expects it to be replaced to him with a profit. So he employs it only in maintaining productive hands; and after having served as capital for him it constitutes income for them. Whenever he employs any part of it in maintaining unproductive hands of any kind, that part is right then withdrawn from his capital and placed in his stock reserved for immediate consumption.

[Smith now explains that unproductive labourers and people who do not labour at all are all maintained by the incomes of others, and the 'others' may be from any level in society. He continues:] Even the common workman, if his wages are considerable, may maintain a domestic servant; or he may sometimes go to a play or a puppet-show, and so contribute his share towards maintaining one set of unproductive labourers; or he may pay some taxes, and thus help to maintain another set, more honourable and useful, indeed, but equally unproductive. But no part of the annual product that had been originally destined to replace capital is ever directed towards maintaining unproductive hands until after it has put into motion its full complement of productive labour. . . . The workman must have *earned* his wages before he can employ any part of them in this manner. That part, too, is generally a small one. It is his spare income only, of which productive labourers seldom have much (though they generally have some; and in the payment of taxes the largeness of their number may compensate somewhat for the smallness of their individual contributions). So unproductive hands get their subsistence mainly from the rent of land and the profits of stock. These are the two sorts of income of which the owners generally have most to spare. They are free to maintain productive *or* unproductive hands, as they choose; but they seem to have some predilection for the latter. The expense of a great lord generally feeds more idle people than industrious ones. The rich merchant, though with his capital he maintains only industrious people, he commonly uses his income in the same sort of way as the great lord.

Thus, the proportion between productive and unproductive hands depends very much on the proportion between •the part of the country's annual product that is initially destined for replacing capital and •the part that is destined for constituting income, either as rent or as profit. This proportion is very different in rich countries from what it is in poor ones.

Thus, at present, in the opulent countries of Europe, a very large, often the largest, portion of the product of the land is destined for replacing the capital of the rich and independent farmer; the other for paying his profits, and the rent of the landlord. But. . . [and now Smith describes how things were in France in feudal times, when the land was poor and those who worked on it often virtual slaves. Then:]

In the opulent countries of Europe great amounts of capital are at present employed in trade and manufactures. In the ancient state, the little trade that was stirring, and the few homely and coarse manufactures that were carried on, required very little capital; but they must have yielded large profits. The rate of interest was nowhere less than 10%, and their profits must have been sufficient to pay this. At present the rate of interest in the improved parts of Europe is nowhere higher than 6% and in some of the most improved it is as low as 2%. Though the part of the income of the inhabitants that comes from the profits of stock is always much greater in rich countries than in poor ones, that is because the stock is much greater; in proportion to the stock, the profits are generally much less.

So the part of the annual product that is immediately destined for •replacing capital is not only greater in rich countries than in poor ones, but bears a much greater proportion to the part that is immediately destined for •constituting rent or profit. ·To put this in another way·: The funds destined for the maintenance of productive labour are not only greater in rich countries than in poor ones, but bear a much greater proportion to the funds which, though they can be employed to maintain either productive or unproductive hands, generally have a predilection for the latter.

The proportion between those different funds determines the general character of the country's inhabitants as to industry or idleness. We are more industrious than our forefathers, because the funds destined for the maintenance of industry today are greater in proportion to those that are likely to be employed in the maintenance of idleness than they were two or three centuries ago. Our ancestors were idle because of a lack of sufficient encouragement to industry. It is better, says the proverb, to play for nothing than to work for nothing. In mercantile and manufacturing towns—e.g. many English towns and in most Dutch ones—where the lower ranks of people are chiefly maintained by the employment of capital, they are in general industrious, sober, and thriving. In towns that are principally supported by the constant or occasional residence of a ·royal· court, and where the lower ranks of people are chiefly maintained by the spending of income, they are in general idle, dissolute, and poor; as at Rome, Versailles, Compiègne, and Fontainbleau. [He illustrates this in terms of the two kinds of towns in Europe, noting certain exceptions—especially London, Lisbon and Copenhagen—and explaining why they are so. Summing up the general thesis:] Sometimes the inhabitants of a large village, after having made considerable progress in manufactures, have become idle and poor because a great lord took up his residence in their neighbourhood.

The proportion between capital and income, therefore, seems to regulate the proportion between industry and idleness: where capital predominates, industry prevails; where income, idleness. Every increase or decrease of capital naturally tends to raise or lower the real quantity of industry, the number of productive hands, and consequently the exchangeable value of the annual product of the land and labour of the country—the real wealth and income of all its inhabitants.

Capital is increased by parsimony, and diminished by prodigality and misconduct.

Whatever a person saves from his income he adds to his capital, and either •uses it himself to maintain more productive hands or •enables someone else to do so by lending it to him at interest, i.e. for a share of the profits. The capital of an •individual can be increased only by what he saves from his annual income or his annual gains, and the same holds for the capital of a •society, which is just the capital of all the individuals who compose it.

Parsimony, not industry, is the immediate cause of the increase of capital. Industry indeed provides the stuff that parsimony accumulates; but whatever industry might acquire, if parsimony did not save and store it the capital would never grow.

Parsimony, by increasing the fund destined for the maintenance of productive hands, tends to increase the number of those hands whose labour adds to the value of whatever it is they are working on. So it tends to increase the exchangeable value of the annual product of the country's land and labour. . . .

What is annually saved is as regularly consumed as what is annually spent, and nearly at the same time; but it is consumed by a different set of people. The portion of his income that a rich man annually **spends** is usually consumed by idle guests and domestic servants, who leave nothing behind in return for their consumption. The portion that he annually **saves**, because for the sake of the profit it is immediately employed as capital, is also consumed nearly at the same time, but by a different set of people: by labourers, manufacturers, and artificers, who reproduce with a profit the value of their annual consumption. . . .

[The annual savings of a frugal man, Smith says, constitute a perpetual fund for the support of an increasing number of productive hands. This is guaranteed not by law but by] a very powerful principle [see Glossary], namely the evident interest of every individual to whom any share of the fund ever belongs. If any part of it is ever employed to maintain any but productive hands there will be an evident loss to the person who thus perverts it from its proper destination.

The prodigal perverts it in that way. By not confining his expense within his income, he encroaches on his capital. . . . By diminishing the funds destined for the employment of productive labour, he diminishes the quantity of the labour that adds a value to whatever it is that is worked on, and thus diminishes the value of the annual product of the land and labour of the whole country, the real wealth and income of its inhabitants. If the prodigality of some were not balanced by the frugality of others, the conduct of every prodigal would tend to beggar himself and indeed his country. [Smith adds that this is true whether the prodigal spends his money at home or abroad. He goes into some detail on this:]

This may be said:

> 'Because this expense is not on foreign goods and so doesn't involve any export of gold and silver, the same amount of money would remain in the country as before.'

Yes, but if the quantity of food and clothing thus consumed by unproductive hands had been distributed among productive ones, *they* they would have reproduced the full value of their consumption, plus a profit. So the same amount of money would have remained in the country as well as a reproduction of an equal value of consumable goods. There would have been two values instead of one.

Furthermore, the same amount of money can't long remain in any country where the value of the annual product is diminishing. The sole use of money is to circulate consumable goods. By means of it, provisions, materials, and finished work are bought and sold and distributed to their proper consumers. So the amount of money that can be annually employed in any country is limited by the value of the consumable goods annually circulated within it. This value must go down if the annual product goes down, and that will reduce the amount of money that can be employed in circulating the goods. But money that is thrown out of domestic circulation in this way will not be allowed to lie idle. The interest of whoever owns it requires that it be employed; but having no employment at home it will be sent abroad and used to purchase consumable goods that may be of some use at home; and this will happen despite any laws prohibiting it.

In this way its annual export will for some time add to the annual consumption of the country something beyond the value of its own annual product. What in the days of its •prosperity had been saved from that annual product and employed in purchasing gold and silver will contribute for some time to support its consumption in •adversity. In this case the export of gold and silver is not the cause but the effect of the country's decline, and may even alleviate the misery of that decline for a while.

On the other hand, when the value of a country's annual product increases, the quantity of money it has also naturally increases. The value of the consumable goods annually circulated within the society being greater, more money will be needed to circulate them. So a part of the increased product will naturally be employed in purchasing the additional gold and silver needed for circulating the rest. In this case the increase of those metals will be the effect, not the cause, of the public prosperity. . . .

Thus, whatever we may imagine the real wealth and revenue of a country to consist in—whether in

- •the value of the annual product of its land and labour, as plain reason seems to dictate, or in
- •the quantity of the precious metals that circulate within it, as vulgar prejudices suppose

—either way, every prodigal appears to be a public enemy and every frugal man a public benefactor.

The effects of failure in projects are often the same as those of prodigality, because each . . . .leads to some diminution in what would otherwise have been the productive funds of the society. But the circumstances of a large nation are seldom much affected by the prodigality or the misconduct of individuals, because the profusion or imprudence of some is always outweighed by the frugality and good conduct of others.

The principle that prompts a man to *spend* is the passion for present enjoyment. Though this is sometimes violent and hard to restrain, it is in general only momentary and occasional. But the principle that prompts a man to *save* is the desire to better his condition; and this, though generally calm and dispassionate, comes with us at birth and never leaves us until we die. It hardly ever happens that a man is so perfectly and completely satisfied with his situation as to be without any wish for any alteration or improvement. The means by which most men propose and wish to better their condition is the most common and the most obvious one, namely an increase of fortune; and the most likely way for anyone to increase his fortune is by saving and accumulating some part of what he acquires, either regularly and annually or on some extraordinary occasion. Thus, although the principle of •expense prevails in almost all men sometimes and in some men almost always, in most 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.

With regard to failure in business, the number of prudent and successful undertakings is everywhere much greater than that of injudicious and unsuccessful ones. After all our complaints of the frequency of bankruptcies, the unhappy men who fall into this misfortune are only a very small part of the whole number engaged in trade and other sorts of business; perhaps no more than one in a thousand. Bankruptcy may be the greatest and most humiliating calamity that can befall an innocent man, so most men are sufficiently careful to avoid it. Some, indeed, do not avoid it; as some do not avoid the gallows.

Large nations are never impoverished by private prodigality and business failures, though they sometimes are by public ones. In most countries most of the public revenue is employed in maintaining unproductive hands, such as the people who compose a numerous and splendid court, a great ecclesiastical establishment, great fleets and armies; people who in time of peace produce nothing, and in time of war acquire nothing that can make up for the expense of maintaining them, even while the war lasts. Such people. . . .are all maintained by the product of other men's labour. When there are too many of them, they may in a particular year consume so much of this product that they don't leave enough for maintaining the productive labourers who are to produce it again next year. In that case, the next year's product will be less than that of the current year, and if the same disorder continues, that of the third year will be still less than that of the second. Those unproductive hands. . . .may consume so great a share of the whole revenue—thus obliging so many to encroach on their capital, i.e. on the funds meant for the maintenance of productive labour—that all the frugality and prudence of individuals cannot compensate for the waste and degradation of product occasioned by this violent and forced encroachment.

This frugality and prudence seems usually to be sufficient to outweigh not only the private prodigality and business failures of individuals but also the public extravagance of government. The uniform, constant, and uninterrupted effort of every man to better his condition is the principle from which public and national (as well as private) affluence is originally derived; and it is often powerful enough to maintain the natural progress of things towards improvement, in spite of the extravagance of government and the greatest errors of administration. Like the unknown principle of animal life, it often restores health and vigour to the constitution in spite of the disease and of the absurd prescriptions of the doctor.

The annual product of a nation's land and labour can be increased in its value only by increasing either •the number of its productive labourers or •the productive powers of the labourers already employed. [Smith goes on to explain how each of these nearly always requires additional capital, so that when a nation's level of prosperity goes up fairly steadily over a long period of time, that will be because its capital has increased during that period. He illustrates this in terms of the over-all prosperity of England at the time of

•Caesar's invasion,
•'the Saxon heptarchy',
•the Norman invasion,
•the wars of the Roses,
•the start of Elizabeth's reign,
•the restoration that put Charles II on the throne,
•his writing of this book.

He adds that there are ups and downs in a period that is over-all one of improvement. For example in the immediately preceding century:] The fire and the plague of London, two Dutch wars, the disorders of the revolution, the war in Ireland, four French wars, together with the two rebellions of 1715 and 1745. The four French wars set the nation back at least £200,000,000. . . . If those wars had not given this particular direction to so much capital, most of it would naturally have been employed in maintaining productive hands, whose labour would have replaced (with a profit) the whole value of their consumption. . . . More houses would have been built, more lands would have been improved, and those that had been improved before would have been better cultivated; more manufactures would have been established, and those that had been established before would have been more extended. It is hard even to imagine the height to which the real wealth and revenue of the country might have been raised by now.

But though the great expense of government must have slowed the natural progress of England towards wealth and improvement, it has not been able to stop it. The annual product of its land and labour is undoubtedly much greater today present than it was either at the Restoration or at the Revolution ·of 1688·. So the capital annually employed in cultivating this land and maintaining this labour must also be much greater. In the midst of all the demands of government, this capital has been silently and gradually accumulated by the private frugality and prudence of individuals—by their universal, continual, and uninterrupted effort to better their own condition. It is this effort, protected by law and allowed by liberty to exert itself in the most advantageous way, which has maintained the progress of England towards affluence and improvement at almost all former times, and which it is to be hoped will do so at all future times. Just as England has never been blessed with a very parsimonious government, so parsimony has never been the characteristic virtue of its inhabitants. So kings and ministers show the highest impertinence and presumption when they purport to watch over the economy of private people, and to restrain their expense either by sumptuary [see Glossary] laws or by prohibiting the import of foreign luxuries. They are themselves—always and with no exceptions—the greatest spendthrifts in the society. Let them look after their own expenses, and they can safely trust private people with theirs. If the extravagance of kings and ministers does not ruin the state, that of their subjects never will.

Some modes of expense contribute more to the growth of public affluence than others.

The income of an individual may be spent in either of two ways: **(a)** in things that are consumed immediately, so that one day's expense can neither alleviate nor support that of another; or **(b)** in more durable things that can be accumulated, so that each day's expense can—as the person chooses—either alleviate or support and heighten the effect of the following day's. A man of fortune may **(a)** spend his income on a profuse and sumptuous table, and in maintaining many domestic servants and a multitude of dogs and horses; or, contenting himself with a frugal table and few attendants, **(b)** lay out most of his income in adorning his house or his country villa, in useful or ornamental buildings, in useful or ornamental furniture, in collecting books, statues, pictures; or in things more frivolous, jewels, baubles, ingenious trinkets of different kinds; or, what is most trifling of all, in amassing a great wardrobe of fine clothes. . . . If two men of equal fortune spent their income in these two ways—one each—the magnificence of **(b)** the person whose expense had been chiefly on durable commodities would be continually increasing, every day's expense contributing something to support and heighten the effect of that of the following day; whereas **(a)** that of the other would be no greater at the end of the period than at the beginning. The **(b)** man would also, at the end of the period, be the richer of the two. He would have a stock of goods of some kind; it might not be worth all that it cost, but it would always be worth something. No trace or vestige of the **(a)** man's expense would remain, and the effects of ten or twenty years' profusion would be as completely annihilated as if they had never existed.

Just as the **(b)** mode of expense is more favourable than the **(a)** one to the affluence of an individual, so is it also to that of a nation. The houses, the furniture, the clothing of the rich soon become useful to the lower and middling ranks of people, who can buy them when their superiors grow weary of them. [He gives examples, including:] The marriage-bed of James I of Great Britain, which his Queen brought with her from Denmark as a present fit for a sovereign to make to a sovereign, was recently the ornament of an alehouse at Dunfermline.

The expense that is laid out on **(b)** durable commodities is favourable not only to accumulation but also to frugality. If a person goes too far in it he can easily reform without exposing himself to the censure of the public. Not so with the **(a)** man: to reduce very much the number of his servants, to reform his table from great profusion to great frugality, to lay down his equipage after he has once set it up, are changes that cannot escape the observation of his neighbours, and are taken to imply some acknowledgement of preceding failure; which is why few of those who have launched out too far into this sort of expense have then had the courage to reform, until ruin and bankruptcy obliged them. But if a person has spent too much on building, furniture, books, or pictures, no imprudence or failure can be inferred from his changing his conduct. These are things in which further expense is often made unnecessary by former expense; and when the person stops short, he appears to do so not because he has exceeded his fortune but because he has satisfied his desires.

Also, the expense that is laid out on durable commodities usually maintains more people than does the expense that is employed in the profuse hospitality. Of 300 lb of provisions that may sometimes be served at a great festival, up to a half is thrown on the dunghill, and there is always a great deal wasted and abused. But if the expense of this entertainment had been employed in setting to work masons, carpenters, upholsterers, mechanics etc., a quantity of provisions of equal value would have been distributed among far more people who would have bought them in pennyworths and pound weights, and not have lost or thrown away a single ounce. . . .

I am not saying that the **(b)** sort of expense always betokens a more liberal or generous spirit than the other. When a man of fortune spends his income chiefly in **(a)** hospitality, he shares most of it with his friends and companions; but when he employs it in **(b)** purchasing such durable commodities, he often spends it all on his own person, giving nothing to anyone else. So the **(b)** sort of expense, especially when directed towards frivolous objects—little ornaments of dress and furniture, jewels, trinkets, gew-gaws—often indicates a disposition that is not only trifling but also base and selfish. All that I am saying is that the **(b)** sort of expense is more conducive than the **(a)** sort to the growth of public affluence, because it always occasions some accumulation of valuable commodities, is more favourable to private frugality and consequently to the increase of public capital, and maintains productive rather than unproductive hands,

Chapter 4. Stock Lent at Interest

The stock that is lent at interest is always regarded as capital by the lender. He expects that in due time it will be restored to him, and that in the meantime the borrower will pay him an annual rent for the use of it. The borrower may use it either as capital, or as a stock reserved for immediate consumption. If he uses it as capital, he employs it in maintaining productive labourers, who reproduce the value with a profit; so that he can restore the capital and pay the interest, without alienating or encroaching on any other source of income. If he uses it as a stock reserved for immediate consumption, he is acting the part of a prodigal, and in maintaining the idle dissipates what was destined for the support of the industrious. He cannot restore the capital *or* pay the interest without alienating or encroaching on some other source of income, such as the property or the rent of land.

The stock that is lent at interest is employed in the former of these ways much more often than in the latter. The man who borrows in order to spend will soon be ruined, and the lender will generally come to repent of his folly. [Smith goes on to say that that's why this kind of borrowing/lending is not very common. He continues:] The only people to whom stock is commonly lent without their being expected to make any very profitable use of it are country gentlemen who borrow on mortgage. Even they hardly ever borrow merely to spend. What they borrow, one may say, is commonly spent before they borrow it. They have generally consumed such a great quantity of goods, advanced to them on credit by shop-keepers and tradesmen, that they have to borrow at interest in order to pay the debt. The borrowed capital replaces the capital of those shop-keepers and tradesmen; it is borrowed not in order to be spent but in order to replace capital that had already been spent.

Almost all loans at interest are made in money, either of paper or of gold and silver; but what the borrower really wants, and what the lender provides, is not the money but the goods the money can buy. If he wants it as a stock for immediate consumption, it is those goods only that he can place in that stock. If he wants it as capital for employing industry, it is from those goods only that workers can be provided with the tools, materials, and maintenance needed for carrying on their work. By means of the loan the lender (as it were) assigns to the borrower his right to a certain portion of the annual product of the land and labour of the country, to be employed as the borrower pleases.

The quantity of stock—or, as it is commonly expressed, the quantity of money—that can be lent at interest in any country is not regulated by

> the value of the money, whether paper or coin, that serves as the instrument of the different loans made in that country,

but by

> the value of the part of the annual product that. . . .is destined for replacing capital that the owner does not care to be at the trouble of employing himself.

Because such capital is commonly lent out and paid back in money, it constitutes what is called 'the moneyed interest'. . . . But the money is (as it were) only the deed of assignment that conveys from one person to another those portions of capital that the owners do not care to employ themselves. Those portions may be almost any amount greater than the amount of the money that serves as the instrument of their conveyance, because the same pieces of money can successively serve for many loans as well as for many purchases. [He gives a detailed example, concluding:] Those loans may be all perfectly well secured, the goods purchased by the debtors being so employed that in due time they will bring back, with a profit, an equal value either of coin or of paper. And just as the same pieces of money can thus successively serve as the instrument of different loans, so they may likewise successively serve as the instrument of repayment.

As the share of the annual product that is destined for replacing capital increases in any country, the moneyed interest increases with it correspondingly. The increase of the portions of capital from which the owners wish to derive income without having the trouble of employing them themselves naturally accompanies the general increase of capital—which is to say that as stock increases, the quantity of stock to be lent at interest gradually increases.

As the quantity of stock to be lent at interest increases, the interest inevitably diminishes, not only from the general causes that make the market price of things go down as their quantity goes up, but also from other causes which are special to this particular case. As capital increases in any country, the profits that can be made by employing capital necessarily diminish. It gradually becomes harder to find within the country a profitable way of employing new capital. So a competition arises between different owners of capital, with one trying to give his capital the employment that is occupied by someone else's; but on most occasions he can do this only by dealing on more reasonable terms. He must not only sell more cheaply what he deals in, but in order to get it to sell he must sometimes buy it dearer too. The demand for productive labour grows every day greater and greater because of the increase of the funds destined for maintaining it. Labourers easily find employment, but the owners of capital find it difficult to get labourers to employ. Their competition raises the wages of labour, and sinks the profits of stock. But when the profits that can be made by the use of capital are in this way diminished at both ends, so to speak, the price that can be paid for the use of it—i.e. the rate of interest—must be diminished with them.

[Smith opposes the view—held by Locke and Montesquieu and others—that the lowering of interest-rates throughout Europe was caused by the discovery of more gold and silver in the West Indies. He says that Hume has 'fully exposed' this 'fallacy', but devotes more than a page to his own refutation of it, his basic view being that if during a given period •the quantity of commodities annually circulated within a country remains the same while •the amount of money used to circulate them increases, that increase makes only one trivial difference to the economy, namely making money cheaper.]

On the other hand, if •the quantity of commodities annually circulated within a country increases while •the amount of money that circulates in them remains the same, that will produce many important effects besides that of raising the value of the money. The country's capital might *nominally* be the same but would *really* be increased. [And so on.]

In some countries the interest on money has been prohibited by law. But as something can everywhere be *made by* the use of money, something ought everywhere to be *paid for* the use of it. This regulation, instead of preventing the evil of usury has been found from experience to increase it. [Smith's explanation boils down to this: because lending at interest is illegal, the lender is running an especially large risk, and the borrower has to compensate him for this by paying an extra-high rate of interest.]

In countries where interest is permitted, the law generally fixes the highest rate that can be taken without incurring a penalty, this being done to prevent the extortion of usury. This rate ought always to be somewhat above the lowest market price, i.e. the price that is commonly paid for the use of money by those who can give the most undoubted security. If this legal limit is fixed below the lowest market rate, the effects of this limit must be nearly the same as those of a total prohibition of interest. The creditor will not lend his money for less than the use of it is worth, and the debtor must pay him for the risk he runs in accepting the full value—·above the legal limit·—of that use. . . . In a country, such as Great Britain, where money is lent to government at 3% and to private people with good security at 4% or 4.5%, the present legal limit of 5% is perhaps, as proper as any.

The legal rate ought not to be *much* above the lowest market rate. If the legal rate of interest in Great Britain were fixed at 8% or 10%, most of the money available for lending would be lent to prodigals and projectors [see Glossary], the only ones who would be willing to pay this high interest. Sober people who won't give for the use of money more than a *part* of what they are likely to make by the use of it would not venture into the competition. A great part of the capital of the country would thus be kept out of the hands that were most likely to make a profitable and advantageous use of it, and thrown into those that were most likely to waste and destroy it. Where the legal rate of interest is fixed at just a little above the lowest market rate, sober people are universally preferred as borrowers to prodigals and projectors. The person who lends money gets nearly as much interest from the former as he dares to take from the latter, and his money is in much safer hands. A great part of the country's capital is thus thrown into the hands in which it is most likely to be employed with advantage.

No law can reduce the common rate of interest below the lowest ordinary market rate at the time when that law is made. Despite the edict of 1766 by which the French king tried to reduce the rate of interest from 5% to 4%, money continued to be lent in France at 5%, the law being evaded in several ways.

The ordinary market price of land depends everywhere on the ordinary market rate of interest. The person who has capital from which he wishes to derive income without taking the trouble to employ it himself deliberates whether he should •buy land with it or •lend it out at interest. The greater security of land, together with some other advantages that almost everywhere come with this sort of property, will generally dispose him to settle for a smaller income from land than what he might have by lending his money at interest. These advantages compensate for a certain difference of income; but if the rent of land should fall very far short of the interest on money, nobody would buy land, which would soon reduce its ordinary price. On the other hand if the advantages of land should *much* more than compensate for the difference, everyone would buy land, which again would soon raise its ordinary price. [He gives some figures illustrating this, from France and England.]

Chapter 5: The different uses of capital

Though all capital is destined for the maintenance of productive labour only, the amount of labour that equal portions of capital can put into motion varies extremely according to the diversity of their employment; as does likewise the value that such employment adds to the annual product of the country's land and labour.

Capital may be employed in four ways:

(1) in procuring the rude product annually required for the use and consumption of the society—e.g. the improvement or cultivation of lands, mines, or fisheries;

(2) in manufacturing and preparing that rude product for immediate use and consumption—this being the work of master manufacturers;

(3) in transporting either the rude or the manufactured product from places where they abound to places where they are wanted—the work of wholesale merchants;

(4) in dividing particular portions of either kind of product into such small parcels as suit the demands of those who want them—the work of retailers.

It is difficult to conceive that capital should be employed in any way that does not fall into one of those four categories.

Each of those four methods of employing capital is essentially necessary either to the existence or extension of the other three, or to the general convenience of the society.

(1) If capital were not employed in providing rude product to a certain level of abundance, neither manufactures nor trade of any kind could exist.

(2) If capital were not employed in manufacturing that part of the rude product that requires a good deal of preparation before it can be fit for use and consumption, either •it would never be produced because there would be no demand for it, or •it would be produced spontaneously, and so would be of no value in exchange and could add nothing to the wealth of the society.

(3) If capital were not employed in transporting the rude or manufactured product from places where it abounds to places where it is wanted, no more of either sort of product could be produced than would be consumed in the neighbourhood. The merchant's capital exchanges one place's surplus product for another's, and thus encourages the industry and increases the enjoyments of both.

(4) If capital were not employed in dividing certain portions either of rude or manufactured product into such small parcels as suit the occasional demands of those who want them, everyone would have to purchase more of the goods he wanted than his immediate occasions required. If there was no such trade as a butcher, for example, every man would have to purchase a whole ox or a whole sheep at a time. This would generally be inconvenient to the rich, and much more so to the poor. If a poor workman had to purchase six months' provisions at a time, much of the stock that he employs as capital in the instruments of his trade, or in the furniture of his shop, yielding him income, would have to go into the part of his stock that is reserved for immediate consumption and yields him no income. As things are, he can employ almost his whole stock as capital, and the benefits of this much more than compensate for the additional price that the retailer's profit imposes on the goods. The prejudices of some political writers against shopkeepers and tradesmen are baseless. Taxing them or restricting their numbers is so far from being necessary that they *cannot* become so numerous as to hurt the public, though they may hurt one another. [He explains this, saying that the more retailers there are the more competition there will be among them, and so the lower their prices will be. He continues:] Their competition may ruin some of themselves; but taking care of this is the business of the parties concerned, and can safely be trusted to their discretion. . . . Some of them may decoy a weak customer to buy what he has no occasion for, but this evil is of too little importance to deserve the public attention, nor would it necessarily be prevented by restricting their numbers. For example, the general disposition to drunkenness among the common people arises not from the multitude of ale-houses but from other causes.

The persons whose capital is employed in any of those four ways are themselves productive labourers. Their labour, when properly directed, fixes and realizes itself in the saleable commodity on which it is bestowed, and generally adds to its price at least the value of their own maintenance and consumption. The profits of the farmer, the manufacturer, the merchant, and the retailer are all drawn from the price of the goods that the first two produce and the last two buy and sell. But equal amounts of capital employed in those four ways will immediately put into motion very different amounts of productive labour, and increase in very different proportions the value of the annual product of the land and labour of the society to which they belong.

The capital of the retailer replaces, together with its profits, that of the merchant from whom he purchases goods, and thereby enables him to continue his business. The retailer himself is the only productive labourer whom it immediately employs. His profits constitute the whole value that its employment adds to the annual product of the society's land and labour.

The capital of the wholesale merchant replaces, together with their profits, the capital of the farmers and of the manufacturers from whom he purchases the rude and manufactured product that he deals in, thereby enabling them to continue their trades. It is chiefly by this service that he contributes indirectly to support the productive labour of the society, and to increase the value of its annual product. His capital employs too the sailors and carriers who transport his goods, and increases the price of those goods by the value not only of his profits but of their wages. This is all the productive labour that the merchant's capital immediately puts into motion, and all the value that it immediately adds to the society's annual product. Its operation in both these respects is a good deal superior to that of the retailer's capital.

Part of the capital of the master manufacturer is employed as •fixed capital in the instruments of his trade, and replaces, together with its profits, that of the artificer from whom he purchases them. Part of his •circulating capital is employed in purchasing materials, and replaces, with their profits, the capital of the farmers and miners from whom he purchases them. But a great part of it is always. . . .distributed among the workmen he employs. It increases the value of those materials by their wages, and by their master's profits on the whole stock of wages, materials, and instruments of trade employed in the business. So it puts immediately into motion a much greater quantity of productive labour, and adds a much greater value to the annual product of the society's land and labour, than an equal amount of capital in the hands of any wholesale merchant.

No equal capital puts into motion a greater quantity of productive labour than that of the farmer. His labouring servants *and* his working cattle are productive labourers. In agriculture, also, nature labours along with man. Her labour costs nothing, but its product has its value as well as that of the most expensive workmen. The most important operations of agriculture seem to be intended partly to •increase fertility but much more to •direct the fertility of nature towards the production of the plants most profitable to man. A field overgrown with briars and brambles may produce as great a quantity of vegetables as the best cultivated vineyard or corn field. [Smith elaborates this, speaking of 'those powers of nature, the use of which the landlord lends to the farmer' and contrasting farming with manufacturing in which 'nature does nothing'. He concludes:] Of all the ways in which capital can be employed, its employment in agriculture is by far the most advantageous to the society.

The capital employed in the agriculture and in the retail trade of any society must reside within that society. Their employment is confined almost to a precise spot—the farm, the shop. And they must generally belong to resident members of the society, though there are exceptions to this.

The capital of a wholesale merchant, on the other hand, seems to have no fixed or necessary residence anywhere, but may wander from place to place according as it can buy cheap or sell dear.

The capital of the manufacturer must reside where the manufacture is carried on; but where this shall be is not always necessarily determined. It may be a long way from where the materials grow and from where the product is consumed. [He gives examples.]

It matters little whether the merchant whose capital exports the surplus product of a society is a native or a foreigner. If he is a foreigner, that reduces by *one* the number of the society's productive labourers, and reduces the society's annual product only by the profits of that one man. . . . His capital gives a value to the society's product by exchanging it for something for which there is a demand at home, and his being a foreigner makes no difference to this. . . .

It matters more that the manufacturer's *capital* should reside within the country. It necessarily puts into motion a greater quantity of productive labour, and adds a greater value to the annual product of the society's land and labour. But it can be very useful to the country even if it doesn't reside within it. The capital of the British manufacturers who work up the flax and hemp annually imported from Baltic coast are surely very useful to the countries that produce them. Those materials are a part of the surplus product of those countries; and if that were not annually exchanged for something that is in demand there it would be of no value and would soon cease to be produced. The merchants who export it replace the capital of the people who produce it, and thereby encourage them to continue the production; and the British manufacturers replace the capital of those merchants.

A country may not have enough capital

- •to improve and cultivate all its lands,
- •to manufacture and prepare their whole rude product for immediate use and consumption, and
- •to transport the surplus part of the rude the or manufactured product to distant markets where it can be exchanged for something for which there is a demand at home.

The inhabitants of many parts of Great Britain do not have enough capital to improve and cultivate all their lands. Much of the wool of the southern counties of Scotland is—after a long land transport through very bad roads—manufactured in Yorkshire, because of the lack of capital to manufacture it at home. In many little manufacturing towns in Great Britain the inhabitants do not have capital sufficient to transport the product of their own industry to the distant markets where there is demand and consumption for it. Any merchants among them are really only the agents of wealthier merchants residing in greater commercial cities.

When the capital of any country is not sufficient for all those three purposes, the more of it that is put into •agriculture the greater will be the quantity of productive labour that it puts into motion within the country; •manufacturing comes second in this respect, and •the trade of export third. [So a country that hasn't enough capital for all three purposes, Smith says, should work to improve the situation by concentrating on agriculture. He continues:]

It has been the principal cause of the rapid progress of our American colonies towards wealth and greatness that almost all their capital has been employed in agriculture. They have no manufactures except for the household and coarser ones that necessarily accompany the progress of agriculture and are the work of the women and children in every private family. Most both of the export and coasting trade of America is conducted by the capital of merchants who live in Great Britain. Many of the stores and warehouses from which goods are retailed in some provinces, particularly in Virginia and Maryland, belong to merchants who live in the mother country. . . . If the Americans somehow stopped the importing of European manufactures, thus •giving a monopoly to such of their own countrymen as could manufacture similar goods and •diverting a considerable part of their capital into this employment, they would retard instead of accelerating the increase in the value of their annual product, and would obstruct instead of promoting their country's progress towards real wealth and greatness. This would be even more the case if they tried in the same way to monopolize to themselves their whole export trade.

The course of human prosperity seems hardly ever to have continued long enough to enable any large country to acquire enough capital for all those three purposes; unless we credit the wonderful accounts of the wealth and cultivation of China, of ancient Egypt, and of the ancient state of Indostan—the wealthiest countries (according to all accounts) that ever were in the world—and even they are chiefly renowned for their superiority in agriculture and manufactures, and do not appear to have been eminent for foreign trade. . . .

How much is added to a country's quantity of productive labour also depends considerably on what *sort* of wholesale trade any part of its capital is employed on.

All wholesale trade—all buying in order to sell again by wholesale—falls into three sorts:

- **(1)** the home trade, purchasing the product of the industry of a country in one part of the country and selling it in another;
- **(2)** the foreign trade of consumption, purchasing foreign goods for home consumption;
- **(3)** the carrying trade, transacting the commerce of foreign countries or carrying the surplus product of one to another

(1) Capital that is employed in purchasing the product of a country's industry in one part of the country in order to sell it in another generally replaces by every such operation two distinct lots of capital that had both been employed in the country's agriculture or manufactures, thus enabling them to continue that employment. When it sends out from the residence of the merchant a certain value of commodities, it generally brings back in return at least an equal value of other commodities. When both are the product of domestic industry, this operation replaces two distinct lots of capital which had both been employed in supporting productive labour, thereby enabling them to continue that support. . . .

(2) Capital employed in purchasing foreign goods for home consumption, when this purchase is made with the product of domestic industry, also replaces two distinct lots of capital; but only one of them is employed in supporting domestic industry. The capital that sends British goods to Portugal and brings back Portuguese goods to Great Britain replaces by every such operation only one lot of British capital. The other is a Portuguese one. . . . [He adds some remarks about the relative slowness of income from such foreign trade.]

The foreign goods for home-consumption may sometimes be purchased not with the product of domestic industry but with some other foreign goods. These last, however, must have been purchased either immediately by the product of domestic industry or with something else that had been purchased by it; for foreign goods can never (except in war and conquest) be acquired except in exchange for something that had been produced at home, either immediately or through two or more exchanges. [He elaborates on the latter theme, concluding that] the capital employed in such a roundabout foreign trade of consumption will generally give less encouragement and support to the productive labour of the ·home· country than an equal amount of capital employed in a more direct trade of the same kind.

. . . .So far as the productive labour of the ·home· country is concerned, foreign trade of consumption using gold and silver has all the advantages *and* inconveniences of any other equally roundabout foreign trade of consumption. . . . It seems indeed to have one advantage over the others: because of their small bulk and great value, the transport of those metals is less expensive than that of almost any other foreign goods of equal value. Their freight is less, and their insurance not greater; and no goods are less liable to be damaged by transport. . . .

(3) The part of a country's capital that is employed in the carrying trade is altogether withdrawn from supporting its productive labour, and goes to support that of some foreign countries. Though it may by every operation replace two distinct lots of capital, neither of them belongs to the home country. The capital of a Dutch merchant that carries the corn of Poland to Portugal and brings back the fruits and wines of Portugal to Poland replaces by every such operation two lots of capital, neither of which had been employed in supporting the productive labour of Holland. . . . Only *the profits* return regularly to Holland, and constitute the whole addition that this trade necessarily makes to the annual product of the land and labour of that country. [Then some remarks about whether such trade contributes to the shipping of the home country. Smith days that it need not do so: the Dutch merchant might effect the commerce of Poland and Portugal by engaging the services of British ships.]

So the capital employed in a country's home trade will generally give encouragement and support to a greater quantity of productive labour in that country, and increase the value of its annual product more, than an equal amount of capital employed in the foreign trade of consumption; and the capital employed in this latter trade has in both these respects a still greater advantage over an equal amount of capital employed in the carrying trade. The riches and (so far as power depends on riches) the power of a country must always be in proportion to the value of its annual product, the fund from which all taxes must ultimately be paid. But the great object of the political economy of every country is to increase its riches and power. It ought therefore to give no preference to the •foreign trade of consumption above •home trade, or to the •carrying trade above either of those two. It ought neither to force nor to allure into either of those two channels a greater share of the capital of the country than what would naturally flow into them of its own accord.

Each of those branches of trade, however, is not only advantageous but necessary and unavoidable when the course of things, without any constraint or violence, naturally introduces it.

When the product of any particular branch of industry exceeds what the demand of the country requires, the surplus must be sent abroad and exchanged for something for which there is a demand at home. If this is not done a part of the country's productive labour must cease, and the value of its annual product diminish. The land and labour of Great Britain generally produce more corn, woollens, and hardware than the demand of the home market requires. Only if the surplus is sent abroad and exchanged for something for which there is a demand at home can this surplus acquire a value sufficient to compensate for the labour and expense of producing it. What makes the neighbourhood of the sea-coast and the banks of navigable rivers advantageous situations for industry is just the fact that they facilitate the export and exchange of such surplus product for something that is more in demand there.

When the capital stock of a country rises so high that it cannot be all employed in supplying the country's consumption and supporting its productive labour, the surplus part of it naturally flows into the carrying trade and is employed in performing the same offices to other countries. The carrying trade is the natural •effect and symptom of great national wealth; but it does not seem to be the natural •cause of it. Those statesmen who have been disposed to favour it with particular encouragements seem to have mistaken the effect and symptom for the cause. Holland, in proportion to the extent of the land and the number of its inhabitants, is by far the richest country in Europe, and has accordingly the greatest share of the carrying trade of Europe. England, perhaps the second richest country in Europe, is likewise thought to have a considerable share of it; though what is commonly taken to be England's carrying trade may often be found to be merely a roundabout foreign trade of consumption. . . .

The extent of the home trade and of the capital that can be employed in it is limited by the value of the surplus product of all the distant places within the country that have occasion to exchange their respective productions with one another. That of the foreign trade of consumption is limited by the value of the surplus product of the whole country and of what can be purchased with it. That of the carrying trade is limited by the value of the surplus product of all the countries in the world; so its possible extent is in a way infinite in comparison of that of the other two, and can absorb the greatest amount of capital.

The only motive that determines the owner of any capital to employ it in agriculture, in manufactures, or in some particular branch of the wholesale or retail trade is the consideration of his own private profit. The different quantities of productive labour that it may put into motion, and the different values that it may add to the annual product of the society's land and labour, never enter into his thoughts. Thus, in countries where agriculture is the most profitable of all employments, and farming and improving the most direct roads to a splendid fortune, the capital of individuals will naturally be employed in the manner most advantageous to the whole society. But the profits of agriculture seem to have no superiority over those of other employments of capital in any part of Europe. In every corner of it in the past few years projectors [see Glossary] have entertained the public with magnificent accounts of the profits to be made by the cultivation and improvement of land. Without going into the details of their calculations, a simple observation may satisfy us that their conclusion must be false. We see every day the most splendid fortunes that have been acquired in the course of a single life by trade and manufactures, often from very little capital and sometimes from none. Nothing like that in agriculture has occurred in Europe during the present century. In all the great countries of Europe, however, much good land still remains uncultivated, and most of what is cultivated is far from being improved as much as it could be. Agriculture, therefore, is almost everywhere capable of absorbing much more capital than has ever yet been employed in it. What circumstances in the policy of Europe have given the trades that are carried on in towns so much advantage over the trade that is carried on in the country that private persons often find it more for their advantage to employ their capital in the most distant carrying trades of Asia and America than in the improvement and cultivation of the most fertile fields in their own neighbourhood? I shall try to answer this at length in the following two books.