



A Nation of Shopkeepers

By John Mauldin | August 25, 2014

Supply-Side (Voodoo) Economics?

Some Thoughts on Adam Smith

Adam Smith, Revolutionary

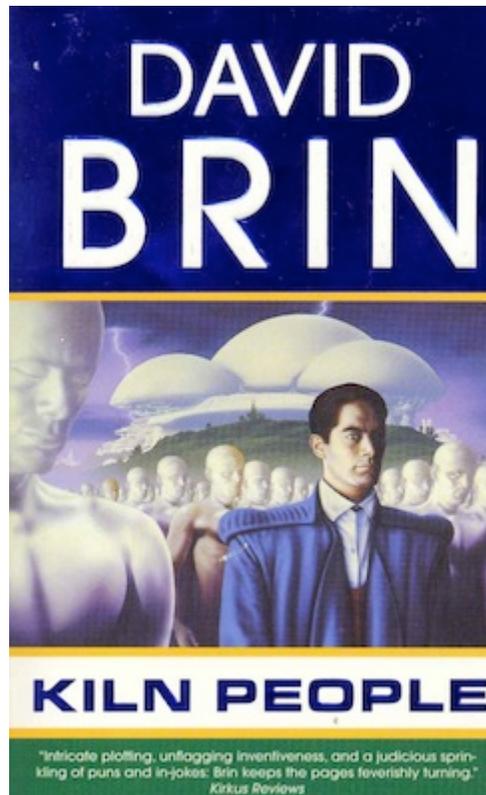
San Antonio, Washington DC, NYC(?), and Training Day

“To found a great empire for the sole purpose of raising up a people of customers may at first sight appear a project fit only for a nation of shopkeepers. It is, however, a project altogether unfit for a nation of shopkeepers; but extremely fit for a nation whose government is influenced by shopkeepers.”

– Adam Smith, *The Wealth of Nations*

One of the great pleasures of writing this letter is the fascinating correspondence and the relationships that develop along the way. The internet has allowed me to meet a wide range of people all over the world – something that never happened to me pre-1999. Not only do I get to meet a wide variety of people, I also come into contact with an even wider range of knowledge and ideas, much of which comes my way from readers who send me work they think I’ll have an interest in. I have a bountiful, never-ending source of thoughtful material, thanks to you.

This week’s letter emanates from a rather provocative email I received from David Brin. Science-fiction aficionados will immediately recognize him as the many-time winner of every major sci-fi writing award and an inductee into the Science Fiction Hall of Fame. Non-SF junkies might remember the movie *The Postman* (with Kevin Costner). Brin’s 2002 book [Kiln People](#) is one of my favorites, and I think it’s one of the more important books for trying to understand the impact of technology in our future. Will the science he describes be available? Probably not. But different technological variations on it will be, I think. And the book has a great plot. (David is also something of an expert on the role of and loss of privacy, which is a central theme of the book.)



David is something of a polymath. His degrees are in astrophysics and space science (Caltech and UCSD), but like many science fiction writers he is interested in almost everything. He frequently takes me to task, always constructively, sometimes publicly, about my writing. He is also a bit of an Adam Smith junkie.

I am going to use his latest complaint as a launching point for today's letter. He was responding to [last week's *Outside the Box*](#), about the future of robotics and automation, which I introduced with a shot off the bow at the reigning Keynesian paradigm. He objects.

Today's letter will be more philosophical in nature than most – we won't be looking for technical signals; but it's August – half the trading world is on vacation (except for the unsleeping computers run by high-frequency traders, which create the bulk of the volume these days), and so any technical signal we picked out this week would be suspect. Yes, August is a great time to think philosophical thoughts about the political economy. So, without further ado, let's see what has my close friend Dr. Brin so upset.

Supply-Side (Voodoo) Economics?

John, excellent missive on automation. I share your overall optimism.

Still... although Keynesianism deserves lots of criticism for the 30% of the time that it has proved wrong... and Hayek had a lot of good and important things to say... it remains disappointing that you do not use your influence to help hammer nails into the coffin of the

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Rentier Caste's catechism... Supply Side (Voodoo) Economics (SSVE), which is not just 30% wrong. It has proved to be almost 100% diametrically opposite to right, with every forecast that SSVE ever made having proved to be calamitously wrong.

Adam Smith might have had some problems with Keynes... and some with Hayek. But Smith warned us incessantly about the horrific economic effects of favoring monopolistic-collusive rent-seeking oligarchs, who destroyed freedom and markets in 99% of human cultures. When the Olde Enemy – who wrecked freedom and markets across 6000 years... the enemy Smith warned against and the US Founders rebelled against... comes roaring back... aren't you behooved to help raise the hue and cry?

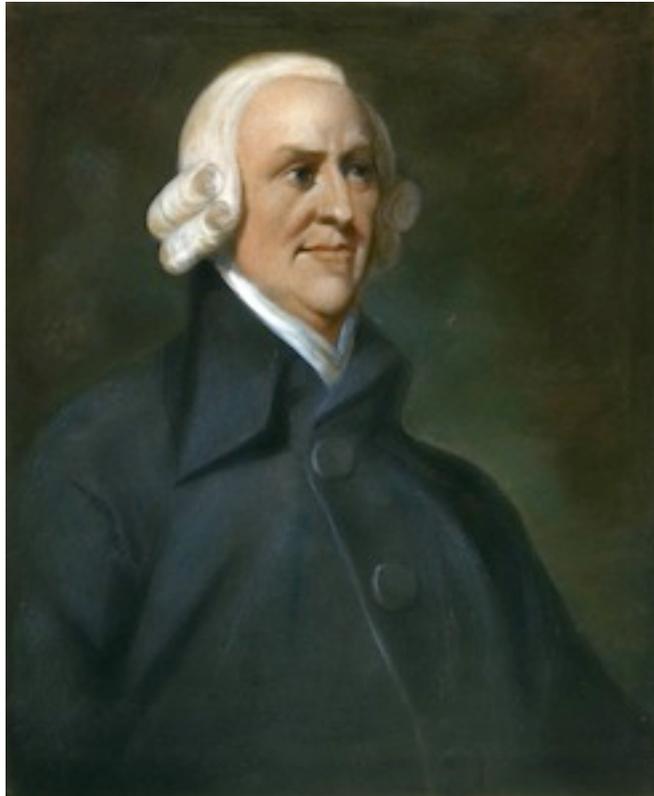
Some Thoughts on Adam Smith

David,

You will perhaps forgive me if I use you as a straw man to draw out a few principles for my readers. And I'm sure you'll have an eloquent answer posted within a few hours. (Interested readers will be able to find that at <http://davidbrin.blogspot.com/> along with fascinating commentary on all matters technological and philosophical. David relishes his role as self-appointed uber-contrarian.)

Your comments on Keynesianism and supply-side economics are so wrong that I think I will hold my tongue and save my criticisms of them for next week. You are expressing a common meme that totally buys into the reigning economic nonsense that passes for thinking about economic theory – a sin you're usually not guilty of. But I'm not about to respond to you (not anymore!) with an off-the-top-of-my-head analysis, so I will spend the bulk of my week thinking about secular stagnation and the causes of growth, and *then* respond.

Neither is what follows totally off the top of my head; there was some work involved. What I would like to take up is Adam Smith views on the *rentier* class, which, for me at least, is a far more intellectually interesting topic than Keynesianism versus... SSVE. You keep quoting Adam Smith at me as if somehow Adam Smith's is a gospel that must be adhered to. And I admit to being a serious Adam Smith enthusiast. Smith demonstrates an amazing amount of intellectual prowess. I stand in awe. His insight seems even more profound when you put the man in the context of his times.



And Smith was totally a man of his times. He was making observations about the changing nature of the economy and wealth in mid-18th-century Scotland and England, and his thoughts were disturbing to many of his associates at the top – the 1%, in modern parlance. He described a political economy in such stunning detail that it has influenced minds for almost 250 years. Yet, he was an early explorer in a land (that of the political economic landscape) that was not yet much trodden. He did however come along at a time when people were trying hard to understand the changes erupting around them. England especially and Scotland to some extent were transforming from a feudal agrarian society (which Smith clearly did not like) to one that was more commercial, as the Industrial Revolution took root and began to send forth green shoots.

Smith welcomed change, but with some reservations that are not often talked about. We'll look at some of them today. As we will see, Smith was a complicated person. But he is best understood if we put him back into his times and recognize that he is not penning his observations on the “wealth of nations” to deal with our situation today, though many of his insights are timeless.

Over the last 200 years, the ways scholars have looked at Adam Smith have changed. There have been Adam Smith fads. While the fact is not much discussed in modern-day polite society, Smith was a clear influence on Hegel, who of course informed Marx. As hard as it is to understand today, there were those along the way who thought Smith was foundational to Marxism. In the 19th century, socialists and neoliberals of all stripes approvingly cited Smith's *Wealth of Nations*.

Smith was not held in much favor by classical economists, though that has changed. Who can forget Margaret Thatcher moaning that she could not win the hearts and minds of Scotland,

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“home of the very same Scottish Enlightenment which produced Adam Smith, the greatest exponent of free enterprise economics till Hayek and Friedman.” Yet only a few years later Gordon Brown (a Scot and English Prime Minister) offered up a speech in which he claimed that Adam Smith (who lived in the region Brown represented in Parliament) would in fact be center-left, were he on the scene today.

You, David, are seemingly part of a coterie described by Neil Davidson in “[The Battle for Adam Smith](#)” in the *Scottish Review of Books*. (Note: Davidson makes some points I categorically disagree with, but I think he has an excellent handle on the history.)

Finally, there have been attempts, perhaps surprisingly from the radical left, to discern in Smith’s work a model of a ‘real free market’ which has been violated by ‘the global corporate system’. As John McMurty writes, ‘every one of Smith’s classical principles of the free market has been turned into its effective opposite’. This is an attractively counter-intuitive idea, which challenges the neoliberals on their own terms. Other writers, like the late Giovanni Arrighi have gone further and argued, not only that the market system envisaged by Smith can be distinguished from capitalism, but that ‘market-based growth’ distinct from ‘capitalist growth’ is now embedded in Chinese or perhaps East Asian development more generally.

[Sidebar: American readers may be puzzled to learn that [neoliberalism](#) is a label for “economic liberalism which advocates under classical economic theory support for economic liberalization, privatization, free-trade trauma, open markets, deregulation, and reductions in government spending in order to enhance the role of the private sector of the economy.” Who knew that the large fraction of my readers who consider themselves conservative thinkers are actually neoliberals? Sadly, the word is now generally used pejoratively by the left. Personally, I think it is more fun to think of oneself as a neoliberal than as an Austrian.]

On the other hand, conservative British Parliament members of the Whig Party were castigated by one observer for superstitiously worshipping Smith. And certainly, (conservative) neoliberal thinkers have quoted Smith appreciatively.

Thus, it turns out that Smith can be read in many different ways. “A man hears what he wants to hear and disregards the rest.” Let’s take a look at some context.

In Book 1 of *Wealth of Nations*, Smith noted that the division of labor was changing the character of commercial society. In his classic analysis of the manufacturing of pins (probably from French sources), he wrote about the amazing productivity possible when different aspects of the manufactory process were divided among artisans (laborers). (He decided there were 18 different processes involved, although current scholarship would suggest there were as few as nine, but his point is still made.) He saw the same dynamic at work in a variety of industries, and he approved. He really did not like the feudal system and “overlords” (*rentiers*) who benefited from association with the king and other authorities, living on “rents” for which they performed no useful work. He valued productive activity far more than anything else, apparently.

I think it will be useful here to pull a few paragraphs from Book 1 of *Wealth of Nations*. (Interested

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readers can find the whole book for free at [The Library of Economics and Liberty](#).)

To take an example, therefore, from a very trifling manufacture; but one in which the division of labour has been very often taken notice of, the trade of the pin-maker; a workman not educated to this business (which the division of labour has rendered a distinct trade), nor acquainted with the use of the machinery employed in it (to the invention of which the same division of labour has probably given occasion), could scarce, perhaps, with his utmost industry, make one pin in a day, and certainly could not make twenty. But in the way in which this business is now carried on, not only the whole work is a peculiar trade, but it is divided into a number of branches, of which the greater part are likewise peculiar trades. One man draws out the wire, another straightens it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving, the head; to make the head requires two or three distinct operations; to put it on is a peculiar business, to whiten the pins is another; it is even a trade by itself to put them into the paper; and the important business of making a pin is, in this manner, divided into about eighteen distinct operations, which, in some manufactories, are all performed by distinct hands, though in others the same man will sometimes perform two or three of them. I have seen a small manufactory of this kind where ten men only were employed, and where some of them consequently performed two or three distinct operations. But though they were very poor, and therefore but indifferently accommodated with the necessary machinery, they could, when they exerted themselves, make among them about twelve pounds of pins in a day. There are in a pound upwards of four thousand pins of a middling size. Those ten persons, therefore, could make among them upwards of forty-eight thousand pins in a day. Each person, therefore, making a tenth part of forty-eight thousand pins, might be considered as making four thousand eight hundred pins in a day. But if they had all wrought separately and independently, and without any of them having been educated to this peculiar business, they certainly could not each of them have made twenty, perhaps not one pin in a day; that is, certainly, not the two hundred and fortieth, perhaps not the four thousand eight hundredth part of what they are at present capable of performing, in consequence of a proper division and combination of their different operations.

In every other art and manufacture, the effects of the division of labour are similar to what they are in this very trifling one; though, in many of them, the labour can neither be so much subdivided, nor reduced to so great a simplicity of operation. The division of labour, however, so far as it can be introduced, occasions, in every art, a proportionable increase of the productive powers of labour. The separation of different trades and employments from one another seems to have taken place in consequence of this advantage.

But that classic observation and explanation of productivity gains from the division of labor and free markets is a long way from the laissez-faire capitalism of Hayek and Friedman.

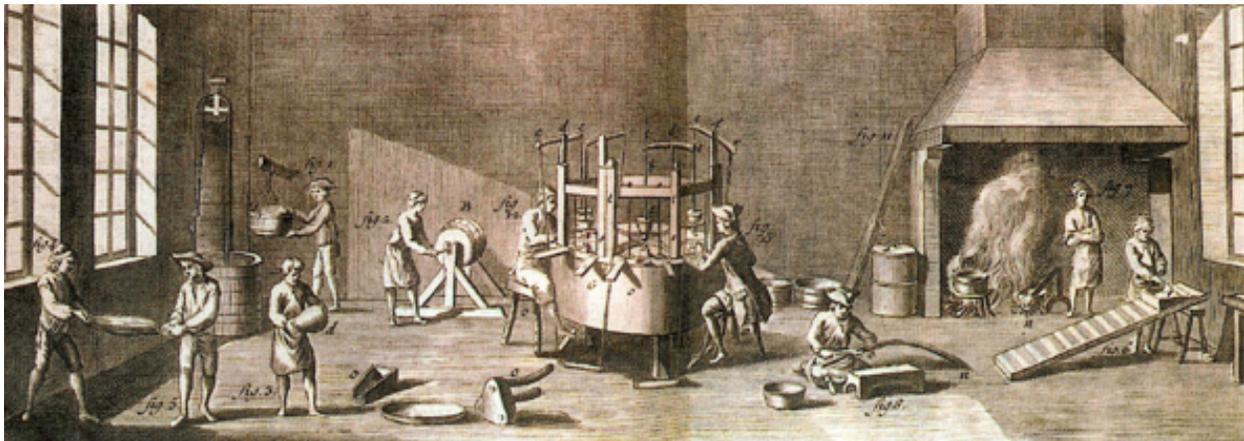
Let's return to Neil Davidson:

Anachronistic misconceptions concerning his work could of course be corrected by the radical expedient of actually reading *The Wealth of Nations* and *The Theory of Moral Sentiments*, preferably after situating them in their historical context, namely Scotland's

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emergence from feudalism. When Smith attacked unproductive labour, he was not making some timeless critique of state employees, but thinking quite specifically about Highland clan retainers. When he opposed monopolies, he was not issuing a prophetic warning against the nationalisation of industries in the twentieth century, but criticising those companies which relied for their market position on the possession of exclusive royal charters in the eighteenth. Above all, unlike his modern epigones, he did not see the market as a quasi-mystical institution that should be made to penetrate every aspect of social life; but rather as a limited mechanism for liberating humanity's economic potential from feudal and absolutist stagnation.

We have to remember that Adam Smith was writing *The Wealth of Nations* in 1776 – prior to Watt and the steam engine. The Industrial Revolution was in its infancy. The pin manufacturing process described in Smith's Book 1 produced about 5000 pins a day for each laborer's work. By 1820 there were 11 pin factories in Gloucester alone, yet 119 years later (in 1939) there were only 12 in all of England. By the late 1970s there were only two. But the productivity of the manufacturing process had grown to 800,000 pins per day per person! That is an increase of 160 times. Of course that is using automated and computer-driven machines. Not that I would suggest it, but if you start searching for information on pin manufacturing today, you quickly get bogged down in the intricacies of manufacturing procedures for hundreds of different types of pins, all of which are ridiculously cheap. My guess is that productivity has leapt significantly further in the last few decades.



Smith was troubled by some of the implications that he saw in early manufacturing jobs. Remember when you read the excerpt from *Wealth of Nations* below that this is from one of the leading lights of what was called the Scottish Enlightenment. If someone were to say those things today, we would question his enlightenment. Just saying. Back to Davidson (emphasis mine):

Even so, the advocacy of Smith and his colleagues for what they called ‘commercial society’ was very conditional indeed. He intuited, long before capitalist industrialisation began in earnest, that it would lead to massive deterioration in the condition of labourers and their reduction to mere ‘hands’. Understood in the context of the Scottish Enlightenment conception of human potential, the description of pin manufacture at the beginning of *The Wealth of Nations*, reproduced from 2007 on £20 banknotes, not only

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celebrates the efficiency of the division of labour, **but also shows the soul-destroying repetition that awaited the new class of wage labourers.** In Book V, in contrast to the more frequently cited Book I, Smith explicitly considered the way in which the division of labour, while increasing the productivity of the labourers, did so by narrowing their intellectual horizons:

The man whose whole life is spent in performing a few simple operations, of which the effects, too, are perhaps always the same, or very nearly the same, has no occasion to assert his understanding, or to exercise his invention, in finding out expedients for removing difficulties which never occur. He naturally loses, therefore, the habit of such exertion, and generally becomes as stupid and ignorant as it is possible for a human creature to become. The torpor of his mind renders him not only incapable of relishing or bearing a part in any rational conversation, but of conceiving any generous, noble, or tender sentiment, and consequently of forming any just judgment concerning many even of the ordinary duties of private life. Of the great and extensive interests of his country he is altogether incapable of judging; and unless very particular pains have been taken to render him otherwise, he is equally incapable of defending his country in war.... His dexterity at his own particular trade seems, in this manner, to be acquired at the expense of his intellectual, social, and martial virtues.

Smith contrasts this unhappy state of affairs with that existing under earlier modes of subsistence – modes which, remember, he was committed to transcending:

It is otherwise in the barbarous societies, as they are commonly called, of hunters, of shepherds, and even of husbandmen in that rude state of husbandry that precedes the improvement of manufactures, and the extension of foreign commerce. In such societies, the varied occupations of every man oblige every man to exert his capacity, and to invent expedients for removing difficulties which are continually occurring. Invention is kept alive, and the mind is not suffered to fall into that drowsy stupidity, which, in a civilized society, seems to benumb the understanding of the people.... Every man, too, is in some measure a statesman, and can form judgments concerning the interest of the society, and the conduct of those who govern it.

I have a fantasy about bringing Adam Smith into the world of 2014. I think he would be overwhelmed, totally fascinated, and at times horrified to see what his intellectual children have done in the last 238 years. But what he would also see is the massive improvement in the standard of living for even those we consider to be poor, at least in the developed world. Overall, he would have to be pleased.

Yet, to show him pictures of the factories that have developed over the centuries or to take him to some of the manufacturing companies in Asia, where thousands of workers sit on benches doing the same thing day after day after day, would disturb him. And yet, there are lines of workers waiting to take those jobs.

[As an aside, David, one of my great hopes for robotics and automation (which I think was apparent in [last week's Outside the Box](#)) is that they will help relieve humanity of mind-numbingly repetitive work and allow us to explore more interesting, life-fulfilling options. Granted, that means we have to figure out how to allow people to make a living in the process. But the transformation of technology in any particular field has always been a rather messy business in regards to labor. Going from an agrarian society to where, in the US, only 1% work in agriculture today (yet feed much of the world) was tumultuous and at times violent. Change is not easy.

It appears that the new generation of robots is allowing companies in the US (and the rest of the developed world) to be far more competitive and is actually increasing the number of jobs in the US as manufacturing is brought back here. While that trend is good for our workers, it means workers somewhere else are being squeezed. But back to our original theme.]

Adam Smith, Revolutionary

I agree with Milton Friedman in the essay he presented at the Adam Smith Institute on its bicentennial in St. Andrews:

Adam Smith was a radical and revolutionary in his time – just as those of us who today preach laissez faire are in our time. He was no apologist for merchants and manufacturers, or more generally other special interests, but regarded them as the great obstacles to laissez faire – just as we do today.

Friedman went on to note that contemporary free-marketers would have to extend their categories of special interests, broadening “the tribes of monopolists to include not only enterprises protected from competition but also trade unions, school teachers, welfare recipients, and so on and on.”

Let's move on to your point about the depredations of crony capitalism and the use of government to create special opportunities for profit not available to ordinary citizens as one of the main sources of headwinds to growth (Will get back to your critique of supply-side economics. What you called the Olde Enemy.) I think one of the primary roles of government should be to create a level playing field. I think we can agree on this. And we can find further agreement in examining the original thinking of Adam Smith in its historical context, rather than in trying to apply it to the current structure of capitalism.

Sadly, politics as it operates today is the art of employing highly paid lobbyists and other insiders to get governments to enact laws that you favor. We can't entirely get away from that system (as some of my libertarian anarchist friends would like to do), as we do need a government that will provide and enforce rules and regulations so that the playing field can remain level. But special benefits are not part of a level playing field.

You focus on what I like to call crony capitalism. That is just one aspect of your critique, but let's deal with it first.

One simplistic way to subvert cronyism would be to lower the corporate tax rate to something like 15%, making the US as competitive as any nation in the world, but at the same time eliminate all

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of the 3000-odd tax benefits doled out to various corporations. When you and I personally pay more in income taxes than General Electric, something is seriously wrong. Start the corporate tax at \$100,000. The form is a postcard. How much your corporation makes minus \$100,000 times 15% is your tax. Income generated outside of the United States is taxed at 10%. End of story. I understand that 15% might seem low to most people, but it would dramatically increase the amount of taxes that we actually collect.

Whoever is the next president should direct (in concert with Congress) the various federal departments to take another look at rules that favor one company or group over another and figure out how to eliminate them. That is not just corporations. I agree with Friedman: include trade unions and other associations. Get rid of the barriers of entry to industries and jobs. Credentials are all well and fine, but not barriers to entry.

(I would also restructure the personal income tax code in such a way as to eliminate almost all deductions, but that is an argument for another letter.)

Next week I'll deal with your confusion about the roles of supply-side economics and Keynesianism in steering the economy. This is actually a very important topic, as it relates to the current economic discussion about secular stagnation (to which a passing reference in the robotics letter probably caught your attention). You are confusing correlation with causation.

What to do about economic growth is perhaps the single most important question of our time, as the demographics of the developed world are shifting in such a way is that we will simply not have enough money for us all to be able to retire in the style to which we have been accustomed by our governments. An extra 1-2% of growth per year, however, can cover a multitude of structural secular sins. Just as true stagnation would transform even minor sins into those worthy of capital punishment.

As Dr. Woody Brock frequently notes, growth is a choice. And most of the choices that drive growth or hobble it have nothing to do with monetary policy. Monetary policy is just one part of the equation. The banter today about structural secular stagnation is more about making excuses for the failure of theoretical positions than it is about how to actually apply the mechanisms that would allow the "invisible hand" of Adam Smith to produce growth.

And, in this, Adam Smith is 100% relevant: "To found a great empire for the sole purpose of raising up a people of customers may at first sight appear a project fit only for a nation of shopkeepers. It is, however, a project altogether unfit for a nation of shopkeepers; but extremely fit for a nation whose government is influenced by shopkeepers."

By "raising up a people of customers" Smith means that focusing on overall economic growth and specifically on the growth of the income of individuals should be at the forefront of the social project. A government that does not allow for increases in productivity and thus an improvement in lifestyles will not be one in which the citizens are happy.

We'll close with that thought for now, but let me offer a precursor to next week, from a recent essay by Woody:

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1. Northern Europe Pre- and Post-Industrial Revolution circa 1700–1850: The growth in productivity is estimated to have been zero, on average, in the period 1000 BC to 1700 AD. Productivity growth did not increase, nor did living standards, nor did life expectancy. This continued to be the case worldwide after 1700, except in Northwestern Europe where the Dutch Republic and England (after its Glorious Revolution of 1688) adopted new policies including patent protection, the rule of law, respect of property rights, and so forth. Nations that did not follow suit stagnated.

2. China Pre- and Post-1979: Growth during the Cultural Revolution was negative. It then exploded to over 10% for twenty years. Why this reversal? It was largely because entrepreneurial behavior was de-criminalized. Recall Premier Deng’s legendary mandate, “It is now glorious to go get rich.” Additionally, the government adopted a massive infrastructure plan that represented *productive* investment spending in contrast to the *unproductive* spending that occurred during 2008–2012 (“see-through cities”).

San Antonio, Washington DC, NYC(?), and Training Day

I have been enjoying my time at home these last few weeks. Right now I am scheduled to be nowhere else until I head to San Antonio for the [Casey Research Summit](#) September 19-21. My next trip after that falls at the end of the month, when I head to Washington DC for a private conference and a few meetings. That is all that is on my schedule for the next 60 days, and then it gets a little busy. I can’t recall having this much time at home for a decade or two, at least.

Bill Dunkelberg, the chief economist for the National Federation of Independent Business, came to see me last week, and we spent the day trying to decide whether to write a book about the future of work. It is a complicated project, but it is part and parcel of the theme we discussed today, which is economic growth and the division of labor. If the work landscape shifts under the feet of an increasingly large number of people as their jobs are automated, then that means we have to help people transition. And better yet, train them in disciplines that have very little chance of being automated in the next 30 or 40 years. From the perspective of the Long View, our education system is completely broken. We are not training our children to deal with the future, and we are not helping people transition into sustainable independence. Our welfare and disability rolls are growing faster than new jobs are being generated. Dunk and I are trying to come up with an outline and research topics over the next few weeks, just to see if we even think we have the capability to write on the topic. I’ll let you know.

One of the benefits of being home is the opportunity to get to the gym on a regular schedule. I can feel and see the results. Plus, it is easier to adhere to a stricter diet plan (basically shunning all extraneous carbs), and that is helping, too. It seems strange to me, but I will be turning 65 in another month (on October 4). My goal is to be able to do 65 push-ups and to be close to my target ideal weight by then. I am getting into the gym nearly every day and trying to schedule a trainer for six days out of seven each week. Some part of my body is sore pretty much all the time; the trainer just makes sure it’s a different part every day. Getting out of shape was just not a good idea.

I was having lunch today with some of my kids and was surprised to learn the Labor Day is next

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weekend. Where has the summer gone? And speaking of summer vacation, I note that Senator Rand Paul spent some time in Guatemala performing eye surgeries. I read that he also visited with some patients he treated there 15 years ago. Journalists and political commentators are always talking about *optics*. Sen. Paul is doing something about optics in a tangible way. His patients will be able to line up a putt with their own eyes. Optics indeed.

I smile at the small irony that I will be writing about growth and labor productivity next week, on Labor Day weekend. I didn't plan it that way, but it does make it more fun. Have a great week.

Your trying to increase his personal productivity analyst,



John Mauldin

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