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ADAM SMITH'S ESSENTIALS: ON TRUST, FAITH, AND FREE MARKETS

BY
JERRY EVENSKY

When trust is shaken, individuals pull back and the market system contracts. Where trust grows, individual energy and creativity are unleashed and the system grows. In Adam Smith's vision of humankind's progress, trust is the central theme.

The Great Recession represents a classic case of a crisis of trust. Looking back to the work of Smith offers insight into the role of citizens and the State in creating a fruitful market environment based on trust, and the challenge of this process, given the human frailty of individuals (unfortunately, we are not angels) and the potential for State power to be captured and abused.

I. SMITH ON TRUST AND FAITH—AN INTRODUCTION

“Trust” and “faith” are not words commonly associated with Adam Smith. More often one hears his name along with the terms “self-interest,” “laissez-faire,” and most famously the “invisible hand” (The *Wealth of Nations* (hereafter *WN*), p. 456). In the stories told of Smith’s vision, the energy that sparks individual effort derives from self-interest, the freedom of choice afforded by laissez-faire liberates that energy, and the magical working of markets guided by the invisible hand makes this unleashed energy most productive of the wealth of nations.

These associations are not incorrect. In Smith’s analysis self-interest is the source of the energy that drives each individual in the “hope of bettering his condition” (*WN*, p. 99). The “unbounded freedom” (*WN*, p. 833) afforded by laissez-faire is essential if that individual energy is to be unleashed. Markets can seem magical

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in their ability to coordinate the labors of the legions of autonomous individuals who have a hand in bringing such things as a simple “woolen coat . . . which covers the day labourer” (*WN*, p. 22) to the market.¹ But in the story Smith tells, this energy is unleashed by human freedom in almost magical ways . . . only where trust prevails.

As defined here, “trust” is empirically based and probabilistic. We trust to a degree consistent with our perception of the available evidence. In human interaction we trust individuals and institutions to the degree that they have, over time, proved trustworthy. Faith is a leap beyond the rational calculus of probabilistic trust to belief without doubt.

If all individuals were angels we could take it on faith, no evidence—no probabilistic calculus necessary—that in all market interactions (indeed, in all interactions) we are dealing with individuals whose behavior is constrained by the rules of justice. In this case the “transaction cost[s]” (Williamson 2000, p. 599) associated with protecting oneself from the risk of immoral or unethical behavior would be zero, for there is no such risk when dealing with angels. In this ideal world, *laissez-faire* makes perfect sense, because it’s a perfect world. But in Adam Smith’s analysis, this is a normative limit, an ideal to which we compare the real. In Smith’s real analysis we leave the realm of faith and the issue becomes trust. When engaged in the market we must ask ourselves: To what degree can we trust the integrity of the other individual(s) involved in a potential market exchange? To the degree that our trust diminishes, the transaction costs associated with protecting ourselves from the risk of immoral or unethical behaviors rise.

Every market interaction involves a probabilistic calculus of the perceived risk so that the transaction costs can be assessed. This is a challenge in an intimate society. It is a daunting challenge in the global market system. In that larger economic system, one is unlikely to have direct information on the trustworthiness of the other parties involved, so in a *laissez-faire* environment, one must resort to proxies: risk assessments by others who, in turn, must themselves be assessed for risk. As the layers of this risk information filtering get thicker, the sources of the information move from almost transparent to almost opaque. In a complex economic system, we are often making risk assessments from behind something approaching an opaque “veil of uncertainty” (Buchanan 1991, p. 47)—we can’t be sure how to assess the risk assessment, much less the risk. This opaqueness of risk in a world in which

¹Smith offers this wonderfully powerful example to represent the amazing complexity of the market coordination required to produce an item that we see as so very ordinary and mundane:

Observe the accommodation of the most common artificer or day-labourer in a civilised and thriving country, and you will perceive that the number of people of whose industry a part, though but a small part, has been employed in procuring him this accommodation, exceeds all computation. The woollen coat, for example, which covers the day-labourer, as coarse and rough as it may appear, is the produce of the joint labour of a great multitude of workmen. The shepherd, the sorter of the wool, the wool-comber or carder, the dyer, the scribbler, the spinner, the weaver, the fuller, the dresser . . . (*WN*, pp. 22–23).

His list of the hands involved goes on for the better part of a page.

the only rule is *caveat emptor* makes for dangerous going,² but Smith believed it need not be so.

In Smith's analysis the establishment of a system of positive laws and the institutions to implement and enforce those laws provide an imperfect but potentially constructive solution to assessing risk in a world of less than angels. Establishing rules of justice and ensuring that the alignment of institutional incentives encourages individuals to follow those rules, no matter the individuals' ethics or lack thereof, reduces risk. To the degree this "[p]olice" (*LJB*³, p. 389; i.e., regulation) of market interactions increases trust, transaction costs are lowered and a wider, more productive market engagement is encouraged. To the degree that socialization of individuals as citizens inculcates "a sense of duty" (*Theory of Moral Sentiments* (*hereafter*, *TMS*), pp. 161–162) to the set of civic ethics embodied in these positive laws,⁴ individuals can be trusted to police their own behavior and the policing role of government, and thus the cost of community-based enforcement is reduced.⁵

Ideally one has faith in fellow citizens . . . in reality, one has trust. The weaker our trust, the greater the transaction costs, and the more constrained the market. Government can increase trust and reduce this cost by setting standards for market interaction and aligning incentives (including punishment) so that individuals are more likely to follow those standards. In this role government does not micro-manage individual choice; it sets boundaries on the range of choice. In the terms of James Buchanan's *Constitutional Economics*, this represents the government's setting and enforcing the rules of the game within which all strategies are fair play for the players in the game. Within this rule-bound game, creative pursuit of market success can be wonderfully rewarding for the individual and for society.

²All the more so given that many individuals don't assess even clear risk accurately, tending to see their own prospects as a better bet than the clear odds:

That the chance of gain is naturally overvalued, we may learn from the universal success of lotteries. The world neither ever saw, nor ever will see, a perfectly fair lottery; or one in which the whole gain compensated the whole loss; because the undertaker could make nothing by it. . . . The vain hope of gaining some of the great prizes is the sole cause of this demand. . . . There is not, however, a more certain proposition in mathematics than that the more tickets you adventure upon, the more likely you are to be a loser. Adventure upon all the tickets in the lottery, and you lose for certain; and the greater the number of your tickets the nearer you approach to this certainty (*WN*, pp. 122, 125).

“[T]he confidence which every man naturally has in his own good fortune, the principle upon which is founded the success of all lotteries. . . .” (*WN*, p. 918).

³There are two sets of *Lectures on Jurisprudence* from Adam Smith. The earlier of these is referred to as “Report of 1762-3” and the other as “Report dated 1766”. Following standard usage I will reference the first as *LJA* and the second as *LJB*.

⁴“The regard to those general rules of conduct, is what is properly called a sense of duty, a principle of the greatest consequence in human life, and the only principle by which the bulk of mankind are capable of directing their actions. . . . [U]pon the tolerable observance of these duties, depends the very existence of human society, which would crumble into nothing if mankind were not generally impressed with a reverence for those important rules of conduct” (*TMS*, pp. 161–162, 163).

⁵See Evensky (2005, ch. 2, 3, 4) for a detailed discussion of Smith's analysis of the development of civic values and citizenship, and the importance of this dynamic for the progress of society.

II. SMITH ON TRUST AND THE EMERGENCE OF MARKETS

Smith envisions humankind as evolving through four stages of progress. This dynamic begins in the “rude state” (*WN*, p. 276) of hunting and gathering, and successively passes through a stage of pasturage and then agriculture until it reaches what is, according to Smith, the final and most mature stage: that of a free-market, commercial society. Much of Smith’s work is dedicated to tracing the history of this four-stage progress of humankind with an eye toward culling from that history the principles that make progress possible. If there is one constant principle, according to Smith, that must always and at every transition from stage to stage be established for this stepwise progress to proceed, it is the establishment of a system of institutional structures and individual ethics that is consistent with the trust necessary for society to cohere in an increasingly complex form.

A hunting and gathering society is very small because the available means of subsistence are severely limited. In that small community the potential violations of trust are similarly limited. They are most often related to personal injury and insult because “[a]mong savages property begins and ends with possession, and they seem scarce to have any idea of anything as their own which is not about their own bodies” (*LJB*, p. 460).

Given the intimacy of this society, trust is policed first and foremost by the individuals themselves. If one feels unjustly treated, this engenders resentment, and the punishment comes in the form of revenge. A mutual understanding that revenge is the sanction for violations of trust encourages self-policing, which, in turn, increases the probability of trust. But even in this rude state, a rudimentary system of institutional police emerges in the form of tribal councils that adjudicate conflicts. These emerge in order to diminish the potential chaos of total vigilante justice. In his analysis of this very first stage of humankind’s progress, we see Smith begin to develop a theme that is the constant in his modeling of a constructive human society: “Order and good government” (*WN*, p. 405) that ensure that rules of justice are defined and enforced are essential for mutual trust among citizens. This trust is the *sine qua non* for social cohesion. Absent this trust, a society will degenerate into a war of all against all.

Society . . . cannot subsist among those who are at all times ready to hurt and injure one another. The moment that injury begins, the moment that mutual resentment and animosity take place, all the bands of it are broke asunder, and the different members of which it consisted are, as it were, dissipated and scattered abroad by the violence and opposition of their discordant affections. If there is any society among robbers and murderers, they must at least, according to the trite observation, abstain from robbing and murdering one another. . . . Society may subsist, though not in the most comfortable state, without beneficence; but the prevalence of injustice must utterly destroy it. . . . Justice . . . is the main pillar that upholds the whole edifice [of society]. If it is removed, the great, the immense fabric of human society . . . must in a moment crumble into atoms (*TMS*, p. 86).

The second stage of humankind’s progress is that of pasturage. Complexity increases in this second stage because “[a]mong shepherds the idea of property is further extended” (*LJB*, p. 460). “Those animalls which are most adapted for the use of man . . . are no longer common but are the property of certain individualls. The

distinctions of rich and poor then arise” (*LJA*, p. 202). Given the inculcation of a sense of duty, most individuals in society can be trusted to honor the property rights of others, but not all. Where personal trust ends, there must be a mechanism to ensure the trust of property owners that their possessions are secure. Absent that, they would have to incur very high, unproductive costs of securing their property or there would be chaos. Thus this emergence of significant private property “makes it [government] absolutely necessary.... [for property is] the grand fund of all dispute ...” (*LJA*, p. 208).

The third, agricultural, stage of humankind’s progress can sustain a much larger population because the production of the means of subsistence is greatly expanded. It is also in this agricultural stage that “property receives its greatest extension” (*LJB*, p. 460). This expansion of society and of the complexity of the issues within that society means it is no longer sufficient for the system of positive law to be “very short . . . [with] few distinctions in it, so that every man would understand it without any written or regular law” (*LJA*, p. 213). “Written and formall laws are a very great refinement of government” (*LJA*, p. 213) and, due to the complexity of expanding property rights issues, it is in the stage of agriculture that the institutionalization of a system of formal positive law is established.

Absent these institutions, the potential for dispute and injury expands significantly and society can degenerate into constant conflict. Where institutions emerge to ensure trust and security, progress is possible.

The central theme of Smith’s four stages of analysis is clear: Without trust there can be no progress.

III. SMITH ON TRUST IN A COMMERCIAL MARKET SYSTEM

For Smith, commerce is the most advanced stage of humankind’s progress because a healthy commercial market system provides the greatest wealth for the nation and thus the greatest capacity to enhance the well-being of society.⁶ If the nature of the wealth that provides this well-being is the fruits of production,⁷ the cause of this wealth is a growing capital stock to finance expanding commerce.⁸ Capital is the *sine qua non* of commercial progress, and trust is essential for capital.

⁶His metric of that well-being is the condition of the least among the working class:

Servants, labourers, and workmen of different kinds, make up the far greater part of every great political society. But what improves the circumstances of the greater part can never be regarded as an inconveniency to the whole. No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable. It is but equity, besides, that they who feed, clothe, and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves tolerably well fed, clothed, and lodged (*WN*, p. 96).

⁷“Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident, that it would be absurd to attempt to prove it” (*WN*, p. 660).

⁸Smith believed in the importance of capital but he was concerned about what I refer to (Evensky 2005) as the “quandary of capital.” “This quandary can best be described as follows: The accumulation of the capital necessary for the progress of opulence . . . seems to give rise to a class of accumulators who, being few in number, enjoy a concentration of control over capital that empowers them to extort market advantages, either directly or through government, in pursuit of greater returns on their capital” (p. 289).

Clearly, there is no incentive to accumulate capital if that stock is at all times vulnerable to the whim and power of individuals and institutions that feel no constraint in taking it. The emergence of accumulation depends, therefore, on trust that this accumulated wealth will be secure. The constraints of civic ethics and positive law are the only barriers that stand between one's wealth and its loss to unconstrained greed.⁹

In an expanding commercial market system populated by less than angels, government alone is not a sufficient constraint. Creative and dynamic commerce depends on individuals' freedom of choice. If, in a free society, individuals' choices are unconstrained by civic ethics, the expansion of government policing necessary to enforce appropriate constraints would turn that free society into a police state. Only where most individuals follow the dictates of civic ethics can the role of government police be lightly measured to constrain the unethical few.

But government itself must do this measuring. If those who control these powerful institutions are not themselves constrained by civic ethics, the power of government can be captured for the very purpose it is ideally established to police: unconstrained greed. We will return to this challenge of government below. Our point here is that in Smith's analysis, the success of a commercial free-market system depends on the citizens' trust that their fellow citizens are generally good citizens and that government will provide the police to discourage destructive behavior of those few who are not so good. Absent that trust, there would be no incentive to build the foundation of commerce: capital accumulation.

This trust that accumulation is secure is necessary but not sufficient for commerce. Having wealth to invest does not mean that one will, in fact, invest it. Smith envisioned investment as committing one's capital to a circuit of production.¹⁰ Indeed, accumulated wealth only becomes capital in Smith's analysis when it is engaged in this self-expanding circuit. Outside the circuit it is used for current consumption or it lays idle as "dead stock" (*WN*, p. 320).

Of the capital one commits to the circuit of production, some is still close at hand. This is fixed capital. Some leaves one's hands upon commitment. This is circulating capital. There are risks in both cases. A barn might burn down. A ship might be lost at sea. But the risks with circulating capital involve an added dimension of trust, for circulating capital passes through the hands of others. One's willingness to give control over that capital to others must certainly be a function of one's trust in the security of that wealth one has unleashed. Consider money, for example, as a "part of the circulating capital of a society. . ." (*WN*, p. 288).

When gold and silver emerged as a medium of exchange, it became necessary to establish

some expedient to ascertain with accuracy both weight and fitness. Coinage most effectually secures both these. The public, finding how much it would tend to

⁹It should be noted, as we will see below, that taxes are not, by definition, government greed. Responsible government fiscal policy to provide appropriate services warrants taxation, and among Smith's principles for appropriate tax policy, he writes that when the expenses are on account of "the general benefit of the whole society [i]t is reasonable . . . that they should be defrayed by the general contribution of the whole society, all the different members contributing, as nearly as possible, in proportion to their respective abilities" (*WN*, p. 814).

¹⁰See Evensky (2005, ch. 6) for a detailed discussion of Smith's circuit of production analysis.

facilitate commerce, put a stamp upon certain pieces, that whoever saw them might have the public faith [trust, as we define the terms here] that they were of a certain weight and fitness; and this would be what was at first marked upon the coin, as being of most importance (*LJB*, pp. 500–501).

Here again we see the essential role of government in warranting trust.

With the emergence of credit, the problem of trust expanded from the credibility of the currency itself to the credibility of the banks and their customers.

A private man who lends out his money to perhaps half a dozen or a dozen of debtors, may, either by himself or his agents, observe and enquire both constantly and carefully into the conduct and situation of each of them. But a banking company, which lends money to perhaps five hundred different people, and of which the attention is continually occupied by objects of a very different kind, can have no regular information concerning the conduct and circumstances of the greater part of its debtors beyond what its own books afford it (*WN*, p. 306).

To ensure the creditworthiness of their customers, Scottish banks traditionally required “frequent and regular payments” (*WN*, p. 305) upon the account, these frequent and regular payments being one way to monitor the solvency of those customers.

As for the importance of the banks’ trustworthiness, their issuing of bank notes can leverage productivity (*WN*, p. 292) when they are trusted (*WN*, p. 296). Smith makes the point that Scotland benefited from this banking innovation, but he notes that it “required an act of Parliament to regulate it” (*WN*, p. 297). Smith appreciated the value of a vibrant banking system creating credit for commerce.

It is not by augmenting the capital of the country, but by rendering a greater part of that capital active and productive than would otherwise be so, that the most judicious operations of banking can increase the industry of a country... The judicious operations of banking, by substituting paper in room of a great part of ... [the nation’s stock of] gold and silver, enables the country to convert a great part of this dead stock into active and productive stock; into stock that produces something for the country. The gold and silver money which circulates in any country may very properly be compared to a highway, which, while it circulates and carries to market all the grass and corn of the country, produces itself not a single pile of either. The judicious operations of banking, by providing, if I may be allowed so violent a metaphor, a sort of wagon-way through the air; enable the country to convert, as it were, a great part of its highways into green pastures and corn fields, and thereby to increase very considerably the annual produce of its land and labour. The commerce and industry of the country, however, it must be acknowledged, though they may be somewhat augmented, cannot be altogether so secure, when they are as thus, as it were, suspended upon the Daedalian wings of paper money, as when they travel about upon the solid ground of gold and silver (*WN*, pp. 320, 321).

A banking system facilitates commerce, but, as Smith’s “Daedalian wings” image makes clear, he understood that this innovation was not without significant risks. He advocated for banking regulation (*WN*, p. 329) because of the constant danger that

“bold projectors” (*WN*, p. 304) would exploit access to credit for unscrupulous schemes.

To the ethical, prudent businessperson, “[t]he coffers of the bank . . . resemble a water pond, from which, though a stream is continually running out, yet another is continually running in, fully equal to that which runs out; so that, without any further care or attention, the pond keeps always equally, or very near equally full. Little or no expense can ever be necessary for replenishing the coffers of such a bank” (*WN*, p. 304). But the activity of imprudent and/or unethical projectors can exploit this access to credit, draining the bank of resources and endangering its solvency.

Smith cites as an example “[t]he practice of drawing and re-drawing” (*WN*, p. 308) bills of exchange. This is, in effect, rolling over notes to cover prior notes. By “drawing and re-drawing upon one another . . . [and] discount[ing] their bills sometimes with one banker, and sometimes with another” (*WN*, p. 311), such schemers can draw a great deal of credit from a bank. If a “great circle of projectors” is involved, it is “as difficult as possible to distinguish between a real or fictitious bill of exchange; between a bill drawn by a real creditor upon a real debtor, and a bill for which there was properly no real creditor but the bank which discounted it; nor any real debtor but the projector who made use of the money” (*WN*, p. 312). This scheme becomes a trap for the bank because even if discovered, it is dangerous for the bank to stop lending. Refusing to continue to feed the beast can bring the entire scheme crashing down and take the bank down with it.

This kind of scheme can be avoided by responsible assessment, and mitigation, of risk by banks. Smith writes that “[t]raders and other undertakers may, no doubt, with great propriety, carry on a very considerable part of their projects with borrowed money. In justice to their creditors, however, their own capital ought, in this case, be sufficient to ensure, if I may say so, the capital of those creditors. . .” (*WN*, p. 307). But as Smith demonstrates, banks have a history of less than careful, responsible behavior.¹¹ Since a failure of the banking system is a public calamity, Smith felt it was absolutely both reasonable and responsible for government to police banking in order to ensure the public trust in the banking system.

On the regulation of banking,¹² Smith writes:

Such regulations may, no doubt, be considered as in some respect a violation of natural liberty. But those exertions of the natural liberty of a few individuals, which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments; of the most free, as well as of the most despotical. The obligation of building party walls, in order to prevent the communication of fire, is a violation of natural liberty, exactly of the same kind with the regulations of the banking trade which are here proposed (*WN*, p. 324).

¹¹Smith presents an extended analysis of the crisis caused by the Ayr Bank (*WN*, pp. 313–315). “The operations of this bank . . . aggravated in the long-run the distress which those projectors had brought both upon themselves and upon their country” (*WN*, p. 315).

¹²The particular issue he is discussing in this context is small-denomination paper, which he believes the government should not allow.

With each new stage of human progress, the context varies, but Smith's theme is constant. If commerce is to be constructive, every participant must enjoy a high degree of trust that every other participant is following rules designed for a constructive process. That trust begins with confidence in the civic ethics of the other participants, but such ethics are not impeccable, nor are they verifiable or enforceable. To the degree that opaqueness of privately accessible information makes trust problematic, the verification and/or the enforcement of ethical behavior must ultimately come from police by government.

IV. SMITH ON THE CHALLENGE OF GOVERNMENT—FACTION AND CAPTURE OF THE “POLICE”

Smith recognized that while government is essential, it is problematic. All too often the power of government to set the rules is captured by those whose goal is not constructive competition but competitive advantage. In modern terms, competition for control over government rule setting and enforcement becomes a rent-seeking game (Buchanan et al., 1980) played by factions that capture policy for their narrow, self-referential definition of “the good”: “Even to the great Judge of the universe, they [(the members of a faction)] impute all their own prejudices, and often view that Divine Being as animated by all their own vindictive and implacable passions. Of all the corrupters of moral sentiments, therefore, faction and fanaticism have always been by far the greatest” (*TMS*, p. 156).

For Smith, the factional scourge of Britain in his own day was the followers of the “Mercantile System” (*WN*, p. 642). This faction advocated with the “passionate confidence of interested falsehood” (*WN*, p. 496) for policies that were nominally designed to increase the wealth of the nation but were, in fact, intended to monopolize the channels of trade (especially with the American colonies) to the advantage of the very merchants and manufacturers who were advising the government on the nature and causes of the wealth of nations. “Of the greater part of the regulations concerning the colony trade, the merchants who carry it on, it must be observed, have been the principal advisers. We must not wonder, therefore, if, in the greater part of them, their interest has been more considered than either that of the colonies or that of the mother country” (*WN*, p. 584).

As the returns to this monopoly increased, so too increased the resources and in turn the power of this mercantile faction to have its voice heard and to extinguish the voices of those who resisted its advocacy.

This monopoly has so much increased the number of some particular tribes of them, that, like an overgrown standing army, they have become formidable to the government, and upon many occasions intimidate the legislature. The member of parliament who supports every proposal for strengthening this monopoly, is sure to acquire not only the reputation of understanding trade, but great popularity and influence with an order of men whose numbers and wealth render them of great importance. If he opposes them, on the contrary, and still more if he has authority enough to be able to thwart them, neither the most acknowledged probity, nor the highest rank, nor the greatest publick services can protect him from the most

infamous abuse and detraction, from personal insults, nor sometimes from real danger, arising from the insolent outrage of furious and disappointed monopolists (*WN*, p. 471).

Proposals of merchants and manufacturers should, according to Smith,

be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the publick, who have generally an interest to deceive and even to oppress the publick, and who accordingly have, upon many occasions, both deceived and oppressed it (*WN*, p. 267).

This infection of faction was, Smith believed, a potentially fatal disease that, if not treated, would destroy the British system of free people and free markets. It was diverting the flow of capital from the many channels to which it would naturally flow into those few most easily monopolized arteries of trade. This engorged those arteries, creating a risk of “rupture” (*WN*, p. 605) with potentially catastrophic consequences. This risk and the expenses of maintaining this monopoly¹³ were borne not by the beneficiaries of the monopoly but by society as a whole.

Smith was concerned about faction and government policy distortion as he wrote *The Wealth of Nations* at his home in Kirkcaldy, Scotland, from 1767 to 1773. These concerns became much more keen when he traveled to London in 1773 to have his book published. He expected this to be completed within months of his arrival in London, but it was delayed until 1776.¹⁴ Much of this delay was due to revisions he made to the manuscript as he learned first-hand at the seat of government (“inside the beltway” as we might say today) of the dramatic power of the mercantile faction.¹⁵ Indicative of his passion for addressing this issue is the trajectory of his career and his writing after the initial publication of *The Wealth of Nations* in 1776.¹⁶

Financially well set for life, Smith nevertheless actively pursued a position as a Commissioner of Customs. He sought this position because he wanted to learn more about the mercantile faction’s strategies. The Customs position offered him first-hand access to the dynamics of the mercantilists’ policy influence.

Based on his experience at Customs, in 1784 Smith published “Additions and Corrections” to *The Wealth of Nations*. The most significant of these was an entirely new chapter titled “Conclusion of the Mercantile System” (*WN*, p. 642). This chapter

¹³See Evensky (2005, ch. 9) for a discussion of Smith’s analysis of the consequences of the huge public debt accumulated by the British government in the wars fought to protect the interests of the mercantile faction.

¹⁴On 3 September 1772 Smith writes to Sir William Pulteny: “My book would have been ready for the Press by the beginning of this winter; but for interruptions . . . [that] will oblige me to retard its publication for a few months longer” (*Correspondence*, p. 164). In fact it took years, not months, to complete it.

¹⁵Smith spends many pages laying out the design of an optimal tax scheme for internationally traded goods to maximize revenue while at the same time eliminating barriers for the sake of monopoly, making trade more fluid, and discouraging smuggling—much of this written in London, as is clear from references to the year 1775 in the text. See, for example, *WN*, pp. 888, 896, 917, 923, 937.

¹⁶For more on the evolution of Smith’s work described in what follows, see Evensky (2005, ch. 8).

is a sharply damning, well-documented critique of the distortions created by the self-serving policies implemented at the behest of the mercantilists.

But most significant for the role of trust we are exploring here is his last work. In 1790, the year he died, Smith published a revised edition of the *Theory of Moral Sentiments*. The most significant change was an entirely new part titled “Of the Character of Virtue.” It was written at least in part to appeal to leaders of the future to move beyond faction and to guide policy not by the partial interest of faction, but for the common interests of the citizenry.

Clearly, he wrote, “particular orders and societies” are going to emerge in every country. The challenge facing the leader seeking to serve the common good is to create an order within which the “powers, privileges, and immunities” of the “particular orders and societies” are balanced such that there is no privileged faction (*TMS*, p. 230).

“[U]pon the particular distribution which has been made of their respective powers, privileges, and immunities, depends, what is called, the constitution of that particular state” (*TMS*, p. 230). This “constitution” inevitably represents both a delicate and a contestable balance of interests. This is especially so “in times of public discontent, faction, and disorder” (*TMS*, p. 231). It is in just such times that the nation needs a wise leader who will govern for the common good.

In times of civil discord, the leaders of the contending parties, though they may be admired by one half of their fellow-citizens, are commonly execrated by the other. . . .

The leader of the successful party, however, if he has authority enough to prevail upon his own friends to act with proper temper and moderation (which he frequently has not), may sometimes render to his country a service much more essential and important than the greatest victories and the most extensive conquests [of the patriot]. He may re-establish and improve the constitution, and from the very doubtful and ambiguous character of the leader of a party, he may assume the greatest and noblest of all characters, that of the reformer and legislator of a great state; and, by the wisdom of his institutions, secure the internal tranquillity and happiness of his fellow-citizens for many succeeding generations (*TMS*, pp. 231–232).

For Smith, this wise “reformer and legislator” is essential to civic progress, for only such a leader has the character to resist the entreaties from, and stand up to, the intimidation of faction. Only such a statesman can lead based on the principle *E Pluribus Unum*. Such a government establishes justice for all.

Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government (*WN*, p. 910).

When citizens have this confidence, society can flourish. Under such a constitution, individual citizens feel that the system of justice is just to them and thus warrants

their individual acceptance and adherence. This common commitment to civic ethics increases common trust and reduces the role of government, both of which unleash energy and creativity in an expanding market engagement.

Absent this confidence in the justice of institutions, there is no buy-in by individuals. There is no common civic ethics to which to commit. This lack of confidence in government increases the cost of maintaining social stability and decreases the productivity of society.

Smith cites, as an example of the extreme case of no buy-in, slaves: they have “nothing which could bind them to have any affection for their master, and the most severe discipline was necessary to keep them to their work” (*LJA*, p. 178). For this reason slavery is an inherently inefficient system of production.

More generally, where government is perceived as unjust, individuals will dismiss the authority of government and willfully violate what they believe are unjust rules. As an example of this, Smith cites the fact that the perverse incentives of the mercantilist policies of his day encouraged smuggling.

[T]he smuggler; a person who, though no doubt highly blamable for violating the laws of his country, is frequently incapable of violating those of natural justice, and would have been, in every respect, an excellent citizen, had not the laws of his country made that a crime which nature never meant to be so. In those corrupted governments where there is at least a general suspicion of much unnecessary expence, and great misapplication of the publick revenue, the laws which guard it are little respected (*WN*, p. 898).¹⁷

In contrast, where government is trusted and respected, citizens honor that worthiness by themselves being trustworthy: Smith cites the case of tax assessment in Hamburg as a classic example.

At Hamburg every inhabitant is obliged to pay to the state one-fourth per cent of all that he possesses; and as the wealth of the people of Hamburg consists principally in stock, this tax may be considered as a tax upon stock. Every man assesses himself, and, in the presence of the magistrate, puts annually into the public coffer a certain sum of money which he declares upon oath to be one-fourth per cent of all that he possesses, but without declaring what it amounts to, or being liable to any examination upon that subject. This tax is generally supposed to be paid with great fidelity. In a small republic, where the people have entire confidence in their magistrates, are convinced of the necessity of the tax for the support of the state, and believe that it will be faithfully applied to that purpose, such conscientious and voluntary payment may sometimes be expected (*WN*, p. 850).

Trust in government may be more difficult to establish in a larger state, but a common principle holds for all societies. As in Hamburg, government is most successful

¹⁷“An injudicious tax offers a great temptation to smuggling. But the penalties of smuggling must rise in proportion to the temptation. The law, contrary to all the ordinary principles of justice, first creates the temptation, and then punishes those who yield to it; and it commonly enhances the punishment too in proportion to the very circumstance which ought certainly to alleviate it, the temptation to commit the crime” (*WN*, pp. 826–827).

“where the people have entire confidence in their magistrates, are convinced of the necessity of the tax for the support of the state, and believe that it will be faithfully applied to that purpose...” In larger societies this implies using powers of the State as lightly, efficiently, and unintrusively as possible to carry out the necessary functions of the State. Simple principles, but a daunting challenge to implement in a world of competing interests. Given this challenge, Smith believed that the standard of successful leadership is not perfection.

The man whose public spirit is prompted altogether by humanity and benevolence . . . will accommodate, as well as he can, his public arrangements to the confirmed habits and prejudices of the people; and will remedy as well as he can, the inconveniencies which may flow from the want of those regulations which the people are averse to submit to. When he cannot establish the right, he will not disdain to ameliorate the wrong; but like Solon, when he cannot establish the best system of laws, he will endeavour to establish the best that the people can bear (*TMS*, p. 233).

One investment the government can make that can decrease the influence of faction and increase the likelihood that citizens will be diligent and constructive in their civic participation is public education.

An instructed and intelligent people . . . are always more decent and orderly than an ignorant and stupid one. . . . They are more disposed to examine, and more capable of seeing through, the interested complaints of faction and sedition, and they are, upon that account, less apt to be misled into any wanton or unnecessary opposition to the measures of government. In free countries, where the safety of government depends very much upon the favourable judgment which the people may form of its conduct, it must surely be of the highest importance that they should not be disposed to judge rashly or capriciously concerning it (*WN*, p. 788).

In a constructive society, trust and security are based on mutual respect among citizens and between the citizen and the State. It is the maturation of the citizen and of the State together that makes the emergence of a commercial free-market society possible. It is the trust engendered by this maturation of civic ethics and institutions that makes it possible for individuals to enter the market system with confidence that the competition will be a game played by just rules.

When trust is shaken, individuals pull back and the system contracts. Where trust grows, individual energy and creativity are unleashed and the system grows. In Smith’s vision of humankind’s progress, trust is the central theme.

V. ON THE ROLE OF FAITH IN ADAM SMITH’S MORAL PHILOSOPHY

Smith is first and foremost an empiricist. His examination of history is the foundation for his argument that humankind has progressed and that trust plays a central role in making that progress possible.

Smith’s unwavering belief that the human prospect is progress is not, however, empirical. It is a leap of faith.

In my book *Adam Smith's Moral Philosophy* (Evensky 2005), I assert that Smith is a deist and that this belief provides the hope for his moral philosophical vision.

My assertion has not met with universal acceptance. Consider Sam Fleischacker's comment: "Evensky himself smoothes over these gaps and tensions in Smith by way of an unfortunate departure from his generally careful mode of interpretation. This is his insistence on reading the hand of a benevolent deity, and a Pollyanna-ish view of progress, into Smith's texts, often without a shred of evidence on which to base such an interpretation" (Fleischacker 2007, p. 4). I respect Fleischacker very much. After all, he's insightful enough to write that among the "several books that attempt to give an overview of Smith's entire corpus . . . Evensky's is the best of these" (Fleischacker 2007, p. 1). So, if I didn't persuade him regarding my deity argument, then obviously my argument could use some development. I take this opportunity to do that development.

Trust is a constant theme in Smith's moral philosophical analysis of the prerequisites for progress. *Faith plays no operational role in the logic of that analysis*. Faith is, however, very important to his enterprise.

Smith's faith is the source of his hope for the human prospect, and his hope is the source of his intellectual energy. He spent his life trying to cull from history the principles of humankind's progress because he believed, as a matter of faith, that the benevolent deity had designed the universe with humankind under his special care, and had endowed humankind with the prospect of progress: "The idea of that divine Being, whose benevolence and wisdom have, from all eternity, contrived and conducted the immense machine of the universe, so as at all times to produce the greatest possible quantity of happiness, is certainly of all the objects of human contemplation by far the most sublime" (*TMS*, p. 236).

Smith's story of humankind's history is not a Pollyanna-ish story of inexorable progress guided by an invisible deistic hand. Every chapter of that history includes twists and turns, stagnation and decline, and countless tragedies. Smith's deity doesn't guide progress. Smith's deity has designed the *opportunity* for progress into the human condition. Seizing that opportunity is humankind's responsibility. As Bittermann writes:

Smith along with his contemporaries expected the world to become more intelligent, more tolerant, and more humane with the decline of superstition and the advance of knowledge. . . . Smith was undeniably a 'progressivist'.... Yet progress was not automatic. He did not look to Providence for direct aid in the economic and moral improvement of mankind. Man had to act on his own behalf ... Smith's own work as economist and philosopher were [sic] intended, most probably, as contributions toward this progress (Bittermann1940, pp. 733–734).

Smith was dedicated to this work based on his faith that gave him hope, and one hears the voice of this faith and hope consistently in Smith's work.

For example, Smith makes it clear that as a purely ethical standard, personal culpability is a matter of intention. But as a practical matter, assessment of intention is beyond human capabilities. We have no window into the soul of another.

Actions, therefore, . . . are by the Author of nature rendered the only proper and approved objects of human punishment and resentment. Sentiments, designs,

affections . . . are placed by the great Judge of hearts beyond the limits of every human jurisdiction, and are reserved for the cognizance of his own unerring tribunal. . . . [Here, as is often his theme,] every part of nature, when attentively surveyed, equally demonstrates the providential care of its Author, and we may admire the wisdom and goodness of God even in the weakness and folly of man (*TMS*, pp. 104–106).

More generally, with respect to our moral sentiments, Smith reminds us that there is design.

The happiness of mankind, as well as of all other rational creatures, seems to have been the original purpose intended by the Author of nature, when he brought them into existence. No other end seems worthy of that supreme wisdom and divine benignity which we necessarily ascribe to him . . . [B]y acting according to the dictates of our moral faculties, we necessarily pursue the most effectual means for promoting the happiness of mankind, and may therefore be said, in some sense, to co-operate with the Deity, and to advance as far as in our power the plan of Providence. By acting otherways, on the contrary, we seem to obstruct, in some measure, the scheme which the Author of nature has established for the happiness and perfection of the world. . . . (*TMS*, pp. 165–166).

He is indeed quite explicit about faith in the design.

In every part of the universe we observe means adjusted with the nicest artifice to the ends which they are intended to produce; and in the mechanism of a plant, or animal body, admire how every thing is contrived for advancing the two great purposes of nature, the support of the individual, and the propagation of the species. But in these, and in all such objects, we still distinguish the efficient from the final cause of their several motions and organizations. The digestion of the food, the circulation of the blood, and the secretion of the several juices which are drawn from it, are operations all of them necessary for the great purposes of animal life. Yet we never endeavour to account for them from those purposes as from their efficient causes, nor imagine that the blood circulates, or that the food digests of its own accord, and with a view or intention to the purposes of circulation or digestion. The wheels of a watch are all admirably adjusted to the end for which it was made, the pointing of the hour. All their various motions conspire in the nicest manner to produce this effect. If they were endowed with a desire and intention to produce it, they could not do it better. Yet we never ascribe any such desire or intention to them, but to the watch-maker. . . . [Having developed this design image to explain the relationship between efficient and final causes in nature, he turns to efficient and final cause in the human condition.] But though, in accounting for the operation of bodies, we never fail to distinguish in this manner the efficient from the final cause, in accounting for those of the mind we are very apt to confound these two different things with one another. When by natural principles we are led to advance those ends, which a refined and enlightened reason would recommend to us, we are very apt to impute to that reason, as to their efficient cause, the sentiments and actions by which we advance those ends, and to imagine that to be the wisdom of man, which in reality is the wisdom of

God. Upon a superficial view, this cause seems sufficient to produce the effects which are ascribed to it; and the system of human nature seems to be more simple and agreeable when all its different operations are in this manner deduced from a single principle [reason] (*TMS*, p. 87).

This vision of the design would make Cleanthes, David Hume's advocate for the design argument in his *Dialogues Concerning Natural Religion*, proud.

There are numerous places in Smith's work that directly and clearly attribute the design of the universe to the benevolent deity, the author of nature.¹⁸ Smith sees the analogy, he believes in the design, but he does not make Cleanthes' case for analogy as proof of design. It is not necessary, and in fact it diminishes the notion of faith. For Smith, faith is a leap of imagination.

Smith does not believe anyone has the vision to see into the study of the deity and spy the blueprint of the design. He knows he can only imagine, he cannot know, the principles of the design.¹⁹ He appreciates that there are mysteries beyond his comprehension. Indicative of the fact that his faith in the design does not represent "a Pollyanna-ish view of progress" is the mystery of human misery. Why in the course of humankind's progress would a benevolent deity so horrifically strew the path with so many failures and so much suffering of so many good people?²⁰ This is a mystery, but it did not shake his faith.²¹

In Hume's *Dialogues*, the skeptic Philo who makes the case against Cleanthes' design argument does so by undermining the argument by analogy.

¹⁸A reviewer wrote:

If Smith had not hidden his views on religious beliefs, hinted at strongly in Astronomy ('pusillanimous superstition') throughout his life from 1744, Adam Smith would have remained unknown, hence he wrote the way he did to appear conformist in religion, but managed to do so by appearing to be 'Christian', 'Providentialist', 'Deist', 'Stoic', and a sympathiser with 'Natural Religion', and all five at the same time (!) in 'Moral Sentiments'. He left a confusing trail deliberately; he did it so well that many scholars today still have not seen what he was up to.

This suggests that Smith was a religious skeptic from his early days and played a lifelong strategic game to disguise his true beliefs. I believe a more textured view of Smith, one consistent with his biographical circumstances and the evolution of his work (and his queasiness about publishing the *Dialogues* for Hume), is that his view of religion evolved along with, but beyond, that of the church of his contemporaries (see Sher [1985]) (a church he admired very much) from a traditional view (like his mother's) to one that was more in line with Philo's assertion in the *Dialogues* that belief in the deity is not a matter of doctrinal proof but of faith.

¹⁹See Evensky (2005, ch. 1) for more on the role of imagination in Smith's inquiries.

²⁰He cites "[t]he unfortunate Calas" (*TMS*, p. 120) as an example.

²¹

Every religion that acknowledges a God who is all-powerful, all-wise, all-knowing, and perfectly good faces the so-called problem of evil. How is the abundant evidence of unwilling suffering in sentient beings (physical evil), and of human wickedness and its consequences (moral evil), to be reconciled with the divine attributes? (Why does God allow cancer, war, injustice, and so on?) Answers that diminish any of the attributes are rejected as heterodox. . . . An inquiry that seeks to demonstrate the possible coexistence of all the divine attributes is known as *theodicy* (Waterman 2002, p. 916, emphasis in original).

When two *species* of objects have always been observed to be conjoined together, I can *infer*, by custom, the existence of one wherever I see the existence of the other; and this I call an argument from experience. But how this argument can have place, where the objects, as in the present case [the universe], are single, individual, without parallel, or specific resemblance, may be difficult to explain. And will any man tell me with a serious countenance, that an orderly universe must arise from some thought and art like the human, because we have experience of it? To ascertain this reasoning, it were requisite that we had experience of the origin of worlds; and it is not sufficient, surely, that we have seen ships and cities arise from human art and contrivance. . . . Can you pretend to shew any such similarity between the fabric of a house, and the generation of a universe? Have you ever seen nature in any such situation as resembles the first arrangement of the elements? Have worlds ever been formed under your eye; and have you had leisure to observe the whole progress of the phenomenon, from the first appearance of order to its final consummation? If you have, then cite your experience, and deliver your theory (Hume 1947, pp. 149–151, emphasis in original).

But while Philo rejects the empirical case for the design argument, he does not reject the notion of the design.

Here, Cleanthes, I find myself at ease in my argument. Here I triumph. Formerly, when we argued concerning the natural attributes of intelligence and design, I needed all my sceptical and metaphysical subtilty to elude your grasp. In many views of the universe and of its parts, particularly the latter, the beauty and fitness of final causes strike us with such irresistible force, that all objections appear (what I believe they really are) mere cavils and sophisms; nor can we then imagine how it was ever possible for us to repose any weight on them. But there is no view of human life, or of the condition of mankind, from which, without the greatest violence, we can infer the moral attributes, or learn that infinite benevolence, conjoined with infinite power and infinite wisdom, which we must discover *by the eyes of faith alone* (Hume 1947, pp. 201–202, emphasis added).

This, I believe, is Smith's position. We need not have proof to have faith. Indeed, it diminishes faith to require proof because it reduces a being of "infinite benevolence, conjoined with infinite power and infinite wisdom" to the finite realm of empirical inquiry.

In the sixth edition of the *Theory of Moral Sentiments*, published in 1790, Smith removes a long passage of the traditional religious language about God, repentance, doctrines of revelation, and atonement (*TMS*, pp. 91–92, note c-c) and replaces it with a single sentence: "In every religion, and in every superstition that the world has ever beheld, accordingly, there has been a Tartarus as well as an Elysium; a place provided for the punishment of the wicked, as well as one for the reward of the just" (*TMS*, p. 91).²²

²²Smith writes in his correspondence to Gilbert Elliot on 10 October 1759: "Man is accountable to God and his fellow creatures. But tho' he is, no doubt, principally accountable to God, in the order of time, he must necessarily conceive himself as accountable to his fellow creatures, before he can form any idea of the Deity, or of the rules by which that Divine Being will judge his conduct" (*Correspondence*, p. 52).

Even as Smith's own conception of religion becomes less institutional, he clings to his faith for its psychic utility, for the hope it offers. Recognizing that all too often the judgments of this life can be terribly unjust (again note his example of the injustice perpetrated on Jean Calas in the name of religion [TMS, p. 120]), he writes in his revisions to the sixth edition:

Our happiness in this life is thus, upon many occasions, dependent upon the humble hope and expectation of a life to come: a hope and expectation deeply rooted in human nature; which can alone support its lofty ideas of its own dignity.... That there is a world to come ... is a doctrine, in every respect so venerable, so comfortable to the weakness, so flattering to the grandure of human nature, that the virtuous man who has the misfortune to doubt of it, cannot possibly avoid wishing most earnestly and anxiously to believe it (TMS, p. 132).

This leap of faith, this act of imagination, provides the virtuous man who doubts the institutional doctrine of divine judgment with the tranquility and serenity that come with an abiding hope that justice will be done in the "life to come." It is this leap of faith that affords Smith hope with respect to the individual human prospect. It is this same leap of faith that motivates his hope for, and energizes his commitment to, humankind's prospect as progress.²³

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²³Having asked "whether this belief in a providential God underwrites any of Smith's claims about how social phenomena work" (Fleischacker 2004, p. 44), Fleischacker's analysis leads him to conclude that Smith's

beliefs in a providential God are clearly a matter of faith, not something for which empirical evidence could be given, and they serve a moral function rather than a scientific one. As far as I can see, the mention of God or Providence is not necessary to the argument of any empirical claim in TMS, much less to any claim in WN, which does not even make use of religious and teleological language. The religious language that backs up empirical explanations in TMS may be simply a rhetorical flourish, a nod to the conventions of the time, or it may be intended to allow the religiously inclined reader to see how Smith's secular, empirical explanations of human nature are compatible with the view that God establishes and rules all nature (Fleischacker 2004, p. 45).

I agree entirely up to the point of the explanation based on justification to others. I believe Smith is speaking for himself, not for the satisfaction of others, when he refers to the "benevolent deity."

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