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A Study of Adam Smith's Original Contributions to Economic Theory and Decision Making under Uncertainty

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Abstract

The current, dominant belief among economists that Smith had made no original contributions to economic theory, outside of presenting an original system of thought that was composed of the original analysis of other thinkers, is incorrect. Smith made four unique contributions which have been overlooked. The first contribution was clear cut recognition that probabilities could not be calculated exactly using precise, single number answers .Probabilities were indeterminate and/or imprecise. The mathematical laws of the probability calculus can't be applied, in general, to decision making in the real world. Smith rejects any decision making approach based on fair, or mathematical, lotteries .Secondly, Smith was the first to explicitly recognize that real world decision making was very uncertain, as opposed to being based on the mathematical concept of risk which was based on known probabilities and outcomes leading to expected value and expected utility calculations a la Jeremy Bentham's rational economic calculator of probable odds model .Third, Smith was the first to recognize that, as long as the probabilities were greater than 0 , retaliatory tariffs might lead a country that had imposed a tariff on another country to rescind that decision .There was room for a set of strategies in conflicts between nations over tariffs involving war ,threats, negotiations, mediation, and retaliation implying tit for tat or chicken strategies .Fourth, Smith recognized that the main threat to economic prosperity originated from projectors, prodigals, and imprudent risk takers (J M Keynes's speculators and rentiers) ,who were able to obtain bank loans in order to try to leverage their debt position many times over. The result would be that the bank's deposits would be wasted and destroyed. This will lead to a recession or depression. Smith did not add this last sentence because it is obvious.

Keywords: Economic Theory, Adam Smith, Economics, Uncertainty Theory

Section 1.) Introduction

This paper will be organized in the following manner. Section Two will review the literature on Smith as it relates to the issue and topic of the originality of Smith's economic thought and analysis in certain ,specific areas of economics. Sections Three, Four, Five and Six will cover the original contributions that Smith made. They are four major contributions. First, Smith stated that most probabilities are indeterminate and/or imprecise; they are not exact or calculable. Second, the uncertainty versus risk distinction is clearly stated by Smith in his chapter 10, Part I exposition of the decision to become either a shoemaker or a lawyer .Smith gives a number of examples in which he illustrates the differences facing the decision maker. These examples are presented clearly and in detailed fashion. A reader familiar with the work of J. M. Keynes and D. Ellsberg will soon realize that Smith is presenting a Keynes-Ellsberg type analysis involving different weights of the evidence or ambiguous probabilities with different grades of reliability for the decision maker. Third, Smith discusses how one can make use of retaliatory tariffs as a strategic device aimed at the removal of the original, offending tariff in a conflict between two nations leading to conflict resolution. Finally, Smith carefully discusses the dangers inherent to the economy as a whole if speculation dominates over investment in fixed capital goods over time.

We need a benchmark to define what original work is. The following definition as to what counts as original work will be used in this paper. Brief side comments, asides and *obiter dicta* are not considered as leading to any original contribution. An original contribution must be backed up with substantial analysis and commentary.

Smith's work on uncertainty, probability, decision making ,and indeterminate/imprecise interval estimates was carried out primarily in Part I, Chapters 10 and 11 of the Wealth of Nations (WN,1776),although he came back to the topic of the impact of uncertainty in Part V of the WN when it came time to discuss the topic of Taxation. Unfortunately, his contributions concerning the impact of uncertainty in decision making have been overlooked for well over two centuries

Consider the following examples of commentaries on Smith's views on uncertainty and risk:

"Although the concept of uncertainty was not assigned any essential role in Adam Smith's analytical framework, Smith was the first classical economist to use the word interchangeably with probability. In his discussion of wage differentials in 'the liberal professions' such as lawyers, Smith (1937:106) indicates that by uncertain he meant the 'probability or improbability of success."(Davidson,Paul ,1996,p.22).

There are some of errors of omission and commission committed by Professor Davidson in this one paragraph about Adam Smith, uncertainty, and probability.

Let us see what Smith clearly said about uncertainty in the WN. Consider Smith's definition of the term "uncertain".

Adam Smith gave the following definition of the term" uncertain" in the Wealth of Nations that has been overlooked:

" That of the Yorkshire cloth, which is made altogether of English wool, is said, indeed, during the course of the present century, to have fallen a good deal in proportion to its quality. **Quality, however, is so very disputable a matter, that I look upon all information of this kind as somewhat uncertain. "**(Underline added by author) (Smith, 1776, p.244)

Smith's statement above makes it very clear that his discussion of uncertainty does not relate to probability, but to the quality of the information base which is being used to analyze a particular problem .On p.778 ,Smith had specified that uncertainty came in degrees. Smith specifies that there is an intermediate degree of uncertainty, just like Boole and Keynes would do later in the Laws of Thought (1854) and A Treatise on Probability (1921),respectively.

For example, Aspromourgos (2014), makes no improvement on Davidson's assessment of Smith concerning Smith's views on uncertainty:

"While all these four[Turgot, Smith, Cantillon , Steuart-author's insert] writers apparently lacked any clear sense of the risk/ uncertainty distinction, they understood clearly enough that

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calculable risks could be priced. One could enquire further as to what knowledge of probability theory and risk pricing was potentially available to them. But whatever the answer to that question, all they required for their merely qualitative propositions about the subject was an intuition that risk, understood as an undesirable attribute of activities or contracts, could be compensated for by a payment of some magnitude. They did not need to understand the mathematics of risk or insurance pricing in order to recognise that risks could be compensated for by definite premia".(Aspromourgos,2014,p.35)

As we will see below in section 3, and contrary to Aspromourgos, his assessment above does not apply to Smith. Smith had an excellent command of probability theory and its limitations. He had a very advanced understanding of the uncertainty versus risk distinction. He understood that risk would involve an imprecise, gross estimate that certainly can't be described as "calculable" risk (see p.714 of the WN for the entire quote concerning Smith's imprecise risk analysis). Aspromourgos's quotation from WN that, "since '[t]he value of the risk . . . though it cannot, perhaps, be calculated very exactly, admits, however, of such a gross estimation as renders it, in some degree, reducible to strict rule and method' (WN: 756–57)". (Aspourmourgos, 2014, p.31; the reader should note that the citation from pp.756-57 appears on p.714 of the Modern Library edition-author's insert), directly contradicts his claim that risks are calculable for Smith.

Section2.) Review of the Literature

Jacob Viner's 1927 contribution is generally cited in the literature on Adam Smith as providing the support for the conclusion that Adam Smith made no original contribution to economics outside of his creating a whole system of thought whose parts were composed of the original work of others. Viner makes the following unsubstantiated assertions:

"There is much weight of authority and of evidence, however, that Smith's major claim to originality, in English economic thought at least, was his detailed and elaborate application to the wilderness of economic phenomena of the unifying concept of a coordinated and mutually interdependent system of cause and effect relationships which philosophers and theologians had already applied to the world in general**".(**Viner,1927,p.198)

and

"Smith's major claim to fame, as I have said, seems to rest on his elaborate and detailed application to the economic world of the concept of a unified natural order, operating according to natural law, and if left to its own course producing results beneficial to mankind. On every detail, taken by itself, Smith appears to have had predecessors in plenty. On few details was Smith as penetrating as the best of his predecessors. There had been earlier pleas for freedom of internal trade, freedom of foreign trade, free trade in land, free choice of occupations, free choice of place of residence. Some philosophers, notably Shaftesbury and Smith's own teacher, Hutcheson, had already extended to economic phenomena, though sketchily, the concept of an underlying natural order manifesting itself through the operation of physical forces and individual psychology. But Smith made an original forward step when he seriously applied him-self to the task of analyzing the whole range of economic process with the purpose of discovering the nature of the order which underlay its surface chaos. Claims have been made for the Physiocrats**,** but the evidence indicates that Smith had already formulated his central doctrine before he came into contact with them."(Viner,1927,pp.199-200)

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Viner's claims were then reinforced by Schumpeter in his 1954 contribution in his *History of Economic Analysis* on Smith's work, where he claims that "…But though *The Wealth of Nations* contains no really novel ideas…" (Schumpeter,1954,p.185). This is not correct. Schumpeter, certainly one of the top 10 economists of all time, simply missed Smith's contributions, for instance, on probability, decision making, and uncertainty (ambiguity). The same conclusion holds for other heavy weight economists like Thorstein Veblen, Frank Knight,and Paul Samuelson. Only J M Keynes understood the message Smith conveyed in the WN.Thus,the General Theory can be viewed as an updating of the important parts of the WN.

Salim Rashid's numerous contributions seek to go beyond the false, easily refuted claims of Vinerand Schumpeter by reinforcing the idea that Smith never made a single, original contribution to economics beyond the claim that he combined the contributions of others into an original system of thought. Rashid disputes even this. He claims that Smith was a very clever and tricky neo-plagiarist (Rashid,1990,pp.1-21).Rashid also repeats the canards that Smith published no original work :

" It is now generally accepted by historians of economic thought that in the nine-tenth century Adam Smith's work was much over praised for its originality and design. " (Rashid,1990,p. 1)

and

"More than fifty years ago, at a time when detailed studies of the seventeenth and eighteenth centuries were much in vogue, Jacob Viner had asserted that on "few details" did Smith's analysis exceed that of his predecessors. Given Viner's judgment, one would have thought that a top priority for scholars would have been to establish, point by point, a comparison between Smith and his predecessors. While some work on these lines has been done, notably by Douglas Vickers on the theory of money and by S. G. Checkland on banking, a comprehensive analysis of this issue is still lacking. The studies of Vickers and Checkland have clearly shown how Smith fell behind his age on a number of issues, so it will not do to claim that Smith "synthesized" the best ideas of his predecessors. "(Rashid,1990,p. 2)

and

"Jacob Viner, of course, was an admirer of Smith, so it was possible for Smith scholars to accept his judgment in silence. When an unsympathetic critic such as Joseph Schumpeter repeated the same charge in 1954 in more forthright language, a reviewer of the ***History*** of ***Economic Analysis*** charged Schumpeter with envy. Why has the Viner-Schumpeter assertion been ignored in recent evalua- tions of Smith? Surely the large volume of detailed historical study done between 1900 and 1954 suffices to shed adequate light on this issue. It is important to reach methodological agreement on the question of priorities: If we permit feathers to be freely borrowed, who is to tell the peacock from the crow? "(Rashid,1990,p. 3).

The reaction of the reviewers of Rashid's 1998 book, titled "The Myth of Adam Smith",was basically to agree that Smith had never, ever published a single piece of original analysis in the WN:

"It is not difficult to substantiate the assertion that Smith was not original. This is
well known to historians of thought. The productiveness of the division of labour; the operation of "demand" and "supply" in a loose sense; the canons of taxation; none of these

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were novelties in 1776. Rashid's contribution is to underline this lack of novelty by a scholarly exploration of the many and curious antecedents of Smith's thought. If Smith was not original; how much was true? It is not a demanding task for the modem critic to find Smith's doctrines badly wanting. "(Coleman.1999,p.142)

and

"The book is a full scale attack on Smith's reputation…Coming from one of Rashid's reputation it cannot be taken lightly. He has done his homework …economists and serious historians of economics are also found wanting in their appraisal of Smith. It is a book which historians of economic thought and Smith specialists alike should read."(Young,1999,p.96)

And

"For every economist who has ever idolized Adam Smith or wished they could be more like him, Salim Rashid's The Myth of Adam Smith is the valuable antidote. Rashid is unusual among economists in that he really does not care much for Smith. In this well-researched book, Rashid presents a strong case against what he regards as Smith's overblown reputation. Rashid's book is not rancorous or nasty. Rather, Rashid asks the reader for pity, as after years of study he has" to struggle to find something nice to say about Smith" (p. vii).In Rashid's view, "what is true" in The Wealth of Nations "is not original and what is original is not true" (p. 3). According to Rashid, Smith made no advances in microeconomics; indeed, "if we identify economics with the use of the concepts of 'demand and supply' then Adam Smith never did become an economist" (p. 9). From the point of view of neoclassical economics, Smith' sprice theory was inadequate; it is not clear what determines the natural rate of profit, and Smith is confused on the determinants of rent. Also, Smith was behind the best of his age in macroeconomics and monetary theory."(Pack, 1999,p.661-662)

and

"Now we learn that his long study has led to a deeply disillusioned assessment of Smith's place…he must now "struggle to find something nice to say about Smith"(Hueckel,2000,p.405).

There appears to be a major problem within the economics profession of correctly evaluating what original thought is and is not. The errors made by Viner, Schumpeter, Rashid etc. appear to follow from the blind acceptance that probabilities must be exact, precise, single number answers that sum to one(see Levy,1999,pp.82,85-90). This is, of course, Jeremy Bentham's approach, which was rejected in to by Smith that the "uncertainties" can do calculate exactly and summed up. Smith's very clear statement that this is not the case ,made on p.714 of WN, appears to have been overlooked for some 238 years. His exposition on pp.106-113 appears not to have been understood for 238 years. Note that Smith's discussion on these pages does not express support for either the behaviorist or Tversky and Kahneman " errors and heuristics" approaches, as Smith rejects the claim of the behaviorists and Tversky and Kahneman that the use of the mathematical laws of the probability calculus must be the normative criteria aimed for by all rational decision makers.

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Section 3.) Probabilities are not precise

Smith's summary of how probability can be applied and used in the real world shows that probabilities can't be calculated exactly:

"The value of the risk, either from fire, or from loss by sea, or by capture, **though it cannot, perhaps, be calculated very exactly, admits, however, of such a gross estimation, as renders it, in some degree, reducible to strict rule and method.** The trade of insurance, therefore, may be carried on successfully by a joint-stock company, without any exclusive privilege. Neither the London Assurance, nor the Royal Exchange Assurance companies have any such privilege."(Smith, 1776, p.714, author's underscore)

The mathematical laws of the probability calculus cannot be applied except under some of conditions discussed by Smith on pp.106-113 of the WN. This will be discussed in the next section. These conditions approximate J M Keynes's requirement that the weight of the evidence, w, must equal, approach ,approximate or be close to 1 in order to use the mathematical laws of the probability calculus. Only in such cases will the probability distribution or sample space of all possible outcomes be specified and known by the decision maker before he needs to choose and reaches a decision. Decisions, then, based on a great deal of evidence and/or highly stable, repetitive outcomes, where the generating process is clearly understood by the decision maker, can be based on precise probabilities. However, it is only in some of the physical, life, and biological sciences that such precise probabilities exist.

Section 4.) Unreliable probabilities with different weights of evidential support

Consider Smith's presentation of illustrations dealing with the problems concerning the decision to undertake a particular career choice:

"Fifthly, the wages of labour in different employments vary according to the probability or improbability of success in them.

The probability that any particular person shall ever be qualified for the employments, to which he is educated, is very different in different occupations. In the greatest part of mechanic trades success is **almost certain**; **but very uncertain** in the liberal professions. Put your son apprentice to a shoemaker, there is **little doubt (little uncertainty-author's insert)** of his learning to make a pair of shoes; but send him to study the law, it is **at least twenty to one** if he ever makes such proficiency as will enable him to live by the business. In a perfectly fair lottery, those who draw the prizes ought to gain all that is lost by those who draw the blanks. In a profession, where twenty fail for one that succeeds, that one ought to gain all that should have been gained by the unsuccessful twenty. The counsellor at law, who, perhaps, at near forty years of age, begins to make something by his profession, ought to receive the retribution, not only of his own so tedious and expensive education, but of that **of more than twenty others**, who are never likely to make any thing by it. How extravagant so ever the fees of counsellors at law may sometimes appear, their real retribution is never equal to this. Compute, in any particular place, what is likely to be annually gained, and what is likely to be annually spent, by all the different workmen in any common trade, such as that of shoemakers or weavers, and you will find that the former sum will generally exceed the latter. But make the same computation with regard to all the counsellors and students of law, in all the different Inns of Court, and you will find that their annual gains bear but a very small

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proportion to their annual expense, even though you rate the former as high, and the latter as low, as can well be done. The lottery of the law, therefore, is very far from being a perfectly fair lottery; and that as well as many other liberal and honourable professions, is, in point of pecuniary gain, evidently under-recompensed.
Those professions keep their level, however, with other occupations; and, notwithstanding these discouragements, all the most generous and liberal spirits are eager to crowd into them. Two different causes contribute to recommend them. First, the desire of the reputation which attends upon superior excellence in any of them; and, secondly, the **natural confidence** which every man has, more or less, not only in his own abilities, but in his own good fortune. " (Smith,1776,pp.106-107;Boldface added by author)

Smith has presented two very different types of decision theoretic problems in this example. The first problem deals with assessing the probability of successfully mastering the shoemaker profession .This problem is a problem of risk ,where there is a great amount of solid evidence to support the decision choice because there is practically little doubt, ambiguity ,vagueness or uncertainty about the expected outcome. It is similar to the first of Daniel Ellsberg urn problems in Ellsberg's two urn problem from his Quarterly Journal of Economics article in 1961 .Ellsberg presented a two urn problem in this article. The first urn had a total of 100 balls, 50 red balls and 50 black balls, while the second urn also had a total of 100 red and black balls in unknown proportions. The probability of successfully mastering the law –liberal arts profession problem is ,on the other hand, a problem of ambiguous probabilities or uncertainty, similar to the second Ellsberg urn problem .
Smith rejected the Benthamite Utilitarian approach that decision makers could calculate the odds of their different choices precisely. They can't .The economics profession has gone astray since 1790 because they seriously underestimated the problem of a decision maker being able to actually estimate approximately a reliable, point estimate for a probability .They chose to follow Bentham's highly dubious claim that decision makers can calculate the odds of all different possible outcomes and then choose the best one.
It is not possible to apply the probability calculus if inequality constraints are present, as they are in the law-liberal arts profession problem, but not in the shoemaker profession problem.
Finally, the problem of overconfidence in the ambiguous, uncertain probabilities of successfully mastering the law profession foreshadows Ellsberg's use of the Wald optimism-pessimism index or Keynes's "animal spirits", which measured the optimism-pessimism of the decision maker with respect to his estimates of the probabilities. Smith argues persuasively that the probabilities are over estimated. This would accord with Keynes's view in the General Theory that investment in long lived capital projects depends in great part on the optimistic outlook taken by the decision maker.
The conclusion reached is that Smith, for the very first time in history, is presenting a decision theoretic approach to uncertainty that places him heads and shoulders above any of his contemporaries. Bentham, for just one example, can only be regarded as being completely ignorant of the basic issues involved when compared to Smith.

Section 5.) Retaliatory Tariffs as a Strategic device to induce the Repeal of tariffs

Smith recommended that countries that had tariffs placed in their goods retaliate by imposing a retaliatory tariff, as long as the probability of getting the original tariff rescinded was greater than 0, aimed at returning to the status qua position that existed before the tariff was imposed-no protective tariffs on either country's imports.
Smith was a long time advocate of revenue tariffs, the aim of which was not to support industries with low quality, high price products from competition from other industries offering better quality goods at lower prices, but to raise revenue to support the cost of public education and public goods.

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Smith presents the case of France versus Flanders.

Thus,

"The case in which it may sometimes be a matter of deliberation how far it is proper to continue the free importation of certain foreign goods, is when some foreign nation restrains, by high duties or prohibitions, the importation of some of our manufactures into their country. Revenge, in this case, naturally dictates retaliation, and that we should impose the like duties and prohibitions upon the importation of some or all of their manufactures into ours. Nations, accordingly, seldom fail to retaliate in this manner. The French have been particularly forward to favour their own manufactures, by restraining the importation of such foreign goods as could come into competition with them. In this consisted a great part of the policy of Mr. Colbert, who, notwithstanding his great abilities, seems in this case to have been imposed upon by the sophistry of merchants and manufacturers, who are always demanding a monopoly against their countrymen. It is at present the opinion of the most intelligent men in France, that his operations of this kind have not been beneficial to his country. That minister, by the tariff of 1667, imposed very high duties upon a great number of foreign manufactures. Upon his refusing to moderate them in favour of the Dutch, they, in 1671, prohibited the importation of the wines, brandies, and manufactures of France. The war of 1672 seems to have been in part occasioned by this commercial dispute. The peace of Nimeguen put an end to it in 1678, by moderating some of those duties in favour of the Dutch, who in consequence took off their prohibition. It was about the same time that the French and English began mutually to oppress each other's industry, by the like duties and prohibitions, of which the French, however, seem to have set the first example, The spirit of hostility which has subsisted between the two nations ever since, has hitherto hindered them from being moderated on either side. In 1697, the English prohibited the importation of bone lace, the manufacture of Flanders. The government of that country, at that time under the dominion of Spain, prohibited, in return, the importation of English woollens. In 1700, the prohibition of importing bone lace into England was taken off; upon condition that the importation of English woolens into Flanders should be put on the same footing as before.

There may be good policy in retaliations of this kind, when there is a probability that they will procure the repeal of the high duties or prohibitions complained of. The recovery of a great foreign market will generally more than compensate the transitory inconveniency of paying dearer during a short time for some sorts of goods. To judge whether such retaliations are likely to produce such an effect, does not, perhaps, belong so much to the science of a legislator, whose deliberations ought to be governed by general principles, which are always the same, as to the skill of that insidious and crafty animal vulgarly called a statesman or politician, whose councils are directed by the momentary fluctuations of affairs. When there is no probability that any such repeal can be procured, it seems a bad method of compensating the injury done to certain classes of our people, to do another injury ourselves, not only to those classes, but to almost all the other classes of them. for that alone would seldom affect them considerably, but some other manufacture of theirs. This may, no doubt, give encouragement to some particular class of workmen among ourselves, and, by excluding some of their rivals, may enable them to raise their price in the home market. Those workmen however, who suffered by our neighbours prohibition, will not be benefited by ours. "(Smith,1776,pp.434-435).

The reader should note that the probabilities Smith is talking about would not be precise and calculable, but imprecise or indeterminate.

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Section 6.) The Impact of the Speculative Demand for Money on an Economy

Smith's own assessment of his concerns about the use of money obtained as loans by projectors, prodigals, and imprudent risk takers (these are the same categories as Keynes's rentiers and speculators) was that they were the main cause of downturns in the economy. Dealing with projector's speculative behavior, due to the undeletable negative externalities they imposed on the rest of society, required a policy of having the central bank maintain permanent low rates on interest on bank loans. This policy had to be combined with a policy of credit restrictions placed on their access to bank loans. These two policies required that there be a large number of small banks and not a small number of large banks. These policies would support the sober, middle class; small businessmen's need to obtain fixed capital .This would support the goals of business creation, expansion and job creation.
Thus,

"The legal rate, it is to be observed, though it ought to be somewhat above, ought not to be much above the lowest market rate. If the legal rate of interest in Great Britain, for example, was fixed so high as eight or ten per cent. The greater part of the money which was to be lent, would be lent to prodigals and projectors, who alone would be willing to give this high interest. Sober people, who will give for the use of money no more than a part of what they are likely to make by the use of it, would not venture into the competition. A great part of the capital of the country would thus be kept out of the hands which were most likely to make a profitable and advantageous use of it, and thrown into those which were most likely to waste and destroy it. Where the legal rate of interest, on the contrary, is fixed but a very little above the lowest market rate, sober people are universally preferred, as borrowers, to prodigals and projectors. The person who lends money gets nearly as much interest from the former as he dares to take from the latter, and his money is much safer in the hands of the one set of people than in those of the other. A great part of the capital of the country is thus thrown into the hands in which it is most likely to be employed with advantage. "(Smith,1776,p.339)

Viner, like the vast majority of modern economists, had great trouble with this:

"To the great indignation of Jeremy Bentham, he approved of the prevailing restriction of the maximum rate of interest to 5 per cent, on the ground that if a higher rate were current, "the greater part of the money which was to be lent, would be lent to prodigals and projectors, who alone would be willing to give this high interest ..... A great part of the capital of the country would thus be kept out of the hands which were most likely to make a profitable and advantageous use of it, and thrown into those which were most likely to waste and destroy it." We may be inclined to agree with Bentham that this is an inadequate defense of the usury laws, but what makes it significant for our purposes is that it involves an admission on Smith's part that the majority of investors could not be relied upon to invest their funds prudently and safely, and that government regulation was a good corrective for individual stupidity. " (Viner,1927,p.228)
Unfortunately, Viner does not understand Smith's position. The question is for what purpose is the loan going to be used, to create an asset or a debt? Keynes's GT is merely an elaboration of Smith's basic point-is the business cycle going to consist of business booms based on investment in fixed durable capital goods or speculative bubbles, based on debt leverage in the stock, money and real estate markets ,that eventually crash and deflate after creating inflationary price rises in those markets. Smith is not claiming that "…investors could not be relied upon to invest their funds prudently and safely". He is stating that all bank loans must be directed to support the type of activity that produces goods and services and not those activities whose only goal is to extract a profit without the production of such goods and

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services. Then type of person Smith is talking about is John Law, Richard Cantillon and Andrew Dexter, Jr., who was responsible for the depression of 1807-1810 on the Eastern Coast of the USA.
Smith's statement above is the best ,clear cut, concise, general and direct summary of the problem faced by economies that allow Tulip ,Mississippi, and South Sea speculative bubbles to occur. Smith's approach is a pro-active one-an ounce of prevention is worth a pound of cure. This is also Keynes's view in the GT, which no longer viewed discretionary demand management techniques aimed at obtaining an optimal bank rate of interest ,combined with public works expenditures ,as leading to optimal economic growth, as advocated by Keynes in his *A Treatise on Money*(1930).

One can use a comparison-contrast between George Romney and Mitt Romney to distinguish the characteristics of the long run investor in fixed capital versus the short run speculator-manipulator in stocks, money, and real estate.

George Romney would have used the bank loans to expand his business and create employment. His investments increase the amount of fixed capital available to each work .This makes each worker more productive and will result in an increase in their real wages/salaries over time. The standard of living and quality of life of the work force will improve over time. We can categorize George Romney as a follower of Adam Smith. He is one of the sober people who promotes employment and economic growth leading to an expansion in the middle class and greater income equality.

Mitt Romney would use his bank loans to manipulate his debt position through leveraged buyouts and financial derivatives, which weigh down the firms that are bought out with huge amounts of debt. No improvements take place in the capital stock. Workers are laid off and see their real compensation reduced over time. We can categorize Mitt Romney as a follower of Jeremy Bentham. He is some combination of projector, prodigal and imprudent risk taker. He promotes layoffs and unemployment which leads to the contraction of the middle class and greater income inequality

Smith would use the central bank to monitor the behavior of the member banks to prevent any loans from being given to projectors like Mitt Romney. The loans would be skewed toward the George Romney's so that the unsatisfied fringe of borrowers would always consist of speculators and projectors.

Keynes's involuntary unemployment category is unemployment resulting from the negative impacts created by speculators as they attempt to leverage their debt position. One can eliminate practically all involuntary unemployment simply by eliminating all loans to rentiers and speculators while maintaining fixed low rate of interest permanently over time. There will be no room for discretionary demand management using expansionary and contractionary monetary and fiscal policies based on manipulating the income tax rates and interest rates over time except in the special situation where the central bank has failed in its primary task of preventing speculative behavior.

Smith also recognized that if tolerable security and safety did not exist , then decision makers would attempt to hoard money. This, of course, is nothing other than Keynes's precautionary demand for money. Fear of the future course of events will result in increased balances being held by decision makers to protect themselves from the activities of projectors and imprudent risk takers. Therefore, it is up to the state and central bank to provide measures and assurances aimed at providing an atmosphere where security and safety is paramount. Bank

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deposit insurance and an effective safety net to deal with unemployment must be provided by the state.

7.) Conclusions

Adam Smith made some major, original contributions to economics and the theory of decision making in the WN in 1776. These contributions have either been overlooked and/or not understood by the economic profession for over two centuries. All of these contributions would later be improved upon and re- emphasized by J M Keynes in his General Theory in 1936.

The most probable reason for this is that the economics profession has travelled down the wrong path since 1790 and followed the recommendations of Jeremy Bentham and not Adam Smith."New Economic Thinking" is not needed. The "old "economic thinking of Smith (and Keynes) provides a clear set of guidelines for creating a prosperous, growing economy over time.

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