

The History of “Capitalism”

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The origin story of “capitalism”, the economic philosophy that governments should take a laissez-faire approach to regulating markets--that they should not regulate them at all and private property should be paramount, is a remarkable subject. The popular version is as mythological as George Washington’s cherry tree while the historical truth may be too shocking for many self-espoused “capitalists” to handle.

Imagine a poll of Americans asking who invented capitalism. After we cull from our sample those who give preposterous answers like Jesus or Ben Franklin, the overwhelming majority of the remaining respondents will undoubtedly say that Adam Smith invented capitalism. This is not an unreasonable belief. On the back of my hard copy of The Wealth of Nations (Barnes and Noble, 2004) the publisher advertises this writing “is widely credited with laying the theoretical and philosophical foundations for capitalism.”

Early on in President Obama’s first term, some politician claimed he had given Obama a copy of the Wealth of Nations, hoping very much that our first black President would learn from it. I cannot remember who this man was, though a Google search finds numerous people saying they wished Obama would put it on his reading list. Based on his policies, my guess is someone in the Obama administration has read it, while all those conservatives who claim to worship it like an auxiliary Bible have only skimmed select quotes from it.

The most salient flaw in the theory that Adam Smith invented “capitalism” is that the word capitalism appears nowhere in the Wealth of Nations. Indeed, the word capital is barely mentioned, for Smith preferred to call the instruments of production “stock” rather than capital.

Forty-one years later, David Ricardo wrote The Principles of Political Economy and Taxation. By this time, capital had become a more widespread term. The word capitalist appears throughout Ricardo's tome. However, in the usage of the time, a capitalist was simply a person who made his living by owning and renting capital; this too is what I mean when I use the term. I enclose "capitalist" and "capitalism" in quotes when I am employing these words in their more common, though etymologically imprecise, sense. The distinction is important because a true capitalist has a strong incentive to behave hypocritically, telling the rest of us to do as they say and not as they do. Capitalism is better thought of as a lifestyle than a philosophy, one that only a very few of us may ever enjoy. Like Smith, Ricardo did not use this word capitalism. It is a phraseology that originated still later.

Of course, mere semantics cannot prove our thesis. Smith could certainly have conceived "capitalism" without calling it such. So what was his intention in writing the Wealth of Nations? Based on that Google search, one would infer that Smith sermonized about the nobility of the profit motive and the importance of letting the rich hold onto their wealth. As he did indeed scribe near the start (p. 12), "It is not from the benevolence of the butcher the brewer, or the baker that we expect our dinner, but from their regard to their own interest."

Towards the middle of the book (p. 300), he goes on to write his most famous excerpt: "Every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. . . . He intends only his own gain; and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention."

Unfortunately for the state of modern economics, it would seem these are the only sentences that most of Smith's lionizers bother to read. They fill in what lies between with the conceits of their imagination instead of his. The purpose of his book was expressly not to justify a grossly unequal distribution of wealth. He was not bothered in the slightest by the possibility of laborers combining together to extort more wages than they are worth, aside from his offering an explanation of why he did not observe this to happen. Instead, Smith was primarily concerned by the ease with which capitalists and merchants use the legal system to interfere with markets so as to acquire more profit than they deserve. He explicitly warned laborers and landlords not to trust capitalists seeking political power because the monetary interests of capitalists are contrary to those of landlords and laborers. Thus, the Wealth of Nations, in many respects is a diatribe against the presidential campaigns of Mitt Romney and other plutocrats.

So how did Adam Smith get linked to "capitalism" as most people understand the word today? We can thank Karl Marx for that. Marx, along with Engels, set out to write an entire three-volume work titled Capital, though only the first volume was completed during Marx's lifetime. Ironically, Capital does not present a theory of capital. It does not even define capital. Yet it does portray capitalists as the boogeymen of the Industrial Age.

Marx was an excellent sociologist but a terrible economist. Probably because the field of sociology was too new for him to be aware of it, he fancied himself as an expert on political economy, though he cared not at all about the principal questions regarding tradeoffs and scarcity that define economics as a science. Most of his understanding of economics can be traced back to Ricardo's Principles of Political Economy and Taxation.

Aside from being an insightful economist far ahead of his time, Smith was also a talented writer, much more talented than Ricardo. In fairness to Ricardo, Smith's writings may be more

perspicacious now, in the light of the mathematical theories developed over the last two and a half centuries, than they were for Ricardo in 1817. When Smith describes his supply and demand model, modern readers can picture an upward-sloping supply curve intersecting a downward-sloping demand curve. Ricardo had no such pictures to draw upon, so many of Smith's ideas went over his head. Filtered through Ricardo, they sailed light years above Marx.

Always comfortable with an ad hominem attack, Marx vilified Smith as an apologist for the capitalists. In fact though, while Smith would have rejected Marx's theoretical constructs, he would almost certainly have agreed with Marx's empirical findings about how workers were being exploited. Smith understood that the greed of capitalists, though necessary for overall prosperity, had to be reined in by a sound government. Nevertheless it was convenient for Marx to make Smith the figurehead of his opposition.

Marx conceived "capitalism" as the antithesis of his own communist ideology, and he ascribed its invention to Smith. Less discriminating economists did embrace both the label and the tenets of "capitalism" to separate themselves from Marx and his followers. It is a testament to how much influence Marx has had on Western thought that almost everyone on both sides accepts as historical truth the fiction Marx planted in our mindset—the greatest lie he ever told—that Smith and his intellectual descendants are merely pitchmen for their capitalist patrons. Most people who bother to read through the whole Wealth of Nations come away from it confused, thinking that perhaps Smith was not such a good writer. Those who delve into Smith's earlier (1759) Theory of Moral Sentiments must really do tremendous mental gymnastics to preserve their world-view that he advocated laissez-faire "capitalism". Nevertheless, they manage to do that, and the myth persists.