

David Hume and Adam Smith: Comparing Mentor and Mentee Publications

In 1776, Adam Smith published what would come to be known as the original piece of economic text: *An Inquiry into the Nature and Causes of the Wealth of Nations* – often abbreviated to *The Wealth of Nations*. While he was traditionally thought to be a moral philosopher, and as philosophy was the topic of his earlier works, Smith grew to focus on the political economy (later simply called economics), and laid the groundwork on which classical economics were founded. He did not come to these conclusions and theories himself, however – he had a mentor in David Hume. Hume was also a philosopher by nature, but wrote on economic topics as well. Hume’s original works were published before *The Wealth of Nations*, and undoubtedly had some influence on Smith. With that in mind, Hume’s writings did not always align with Smith’s, and they did disagree on certain subjects. Smith considered Hume to be his mentor, and they were viewed by many to be contemporaries; despite this, their economic philosophies were not always compatible, and while they agreed on some topics, they held opposing views on others.

One of Smith’s main topics in *The Wealth of Nations* is labor, and he addresses many subdivisions of the topic within its pages. One of these many topics is the accumulation of capital, and the productive and unproductive forms of labor that add to it. Productive labor adds value to the product; unproductive labor does not. Productive labor includes that of manufacturers, who take raw materials and assemble them into a product, and adding value by doing so. Unproductive labor is performed by a menial servant, who does not add value to any product. This is not to say that unproductive labor should be done away with – Smith simply believes that no matter “how honourable, how useful, or how necessary soever, produces

nothing” that can be traded for an equal quantity of service itself (Smith 331). These two types of laborers are financed in two different ways. When a man puts some of his own stock into capital, or the wage fund (which finances business and employees), he expects to see it returned to him later on. He also expects it to return with some sort of profit attached to it, to make up for the opportunity costs associated with not having it. This sort of money, which can be replaced into the capital fund and earn more profit many times over, is a sort of renewable fund, and is used to employ the productive laborers. Money that is revenue, either that set aside as revenue or that which is above necessary levels to renew the wage fund, is used to employ the unproductive laborers – however, once this money is spent, it cannot be put back into the wage fund; it is simply spent. The proportion of capital to revenue in a country promotes the amount of industry in a nation, as well as the amount of idleness in a nation. To have more industry, there must be more capital; to have more capital, people must be parsimonious. Parsimony is the act of saving money, and saving it allows it to be used to employ more productive laborers and increase the country’s output. Prodigality and misconduct, on the other hand, are the causes of consumed money – that which is spent on unnecessary goods or unproductive laborers. Smith is very clear on his beliefs that people should engage in parsimony, and to avoid “pervert[ing]” the economy with idleness and spending (339). Public extravagance is not good for the economy, and he believes that even kings and high-ranking officials should be as parsimonious as possible, to set an example to the others in the country about how to spend their money. To have a stable economy with an ideal balance of industry and idleness, or for an economy to grow, parsimonious behavior is important and should be chosen by as many people as possible. Prodigality and other frivolous spending is to be done as little as possible, as it is not helpful to the nation, only to the individual.

Hume believes in the power of indulging in luxury, and that it provides benefits both to the individual and the country as a whole, when consumed in the proper quantities. Hume believes that luxury and personal spending are requirements for human happiness – he cites them as “action, pleasure, and indolence” (Hume 21). Without any of these three, human happiness is diminished and the whole composition is partially destroyed. Action and pleasure are recreational activities and the spending on them contributes to the individual happiness of people. Hume explains that when industry and the arts “flourish, men are kept in perpetual occupation, and enjoy...the occupation itself, as well as those pleasures which are the fruit of their labors” (21). When employment is high and steady, and personal spending and indulgences are taking place, people are always busy. They enjoy their work more, and get more personal pleasure from it, as well as the pleasures of the recreational activity. However, this luxurious spending impacts society as a whole as well. A great nation will have a variety of people with a variety of knowledges – those who can manufacture items, those who can weave on a loom, those who know astronomy, and those who are philosophers. As arts and knowledges advance, society improves in a variety of ways: people become more sociable and share knowledge, people move and cluster into cities, societies are formed. Together, “industry, knowledge, and humanity are linked together”, and improve society as a whole (23). These three topics, together, are not good only in private lives, but when spread amongst the public as well. Hume provides a very strong argument on luxury, and how it benefits society as a whole.

Hume and Smith directly contrast in their views on luxury. Hume, much like Smith, believes there is a limit of too much luxury and indulgence and a proper amount. Smith believes that limit is very low, and most, if not all, excess money should be used to replenish the wage fund. Hume calls those who hold this view “men of severe morals”, who blame all problems and

corruptions on “even the most innocent luxury” (20). Smith believes in parsimony and savings, and that by adding to the wage fund, society can benefit the most. Hume, oppositely, believes that spending on luxury items and knowledge benefits people individually and as a whole in society. While Hume does not frame his opinions on luxury spending in terms of labor as Smith does, he still manages to explain economically why this extra spending can benefit everyone. Smith, from almost entirely a labor perspective, displays how excessive spending, with no regard for savings, hurts the economy. Even though Hume was Smith’s mentor and directly criticizes his thinking, Smith believes in very little excess spending, while Hume advocates for luxury spending in the economy.

Smith discusses many topics of trade and money as well: those on the balance of trade, on restricting trade, and on the use of gold and silver with currencies. At the time of writing, mercantilism was still a popular theory on trade. Mercantilism is a policy revolving around exporting more goods than are imported, and accumulating as much gold and other precious metals as possible. Some mercantilists went as far as believing that no gold should ever leave the country, or that we should get our imports as low as possible if not eliminated, but these were not the predominant thoughts. Mercantilism’s heyday was in the 16th and 17th centuries, but could still be seen as a somewhat popular school of thought for trade and economics. Smith was an opponent of mercantilism, and criticized its basic policies. A main segment of mercantilism is the accumulation of gold – as well as other metals, but primarily gold – in order to increase the wealth of the country. According to Smith, gold is not the primary benefit of trade, and that there are other benefits to trade as well. Trade takes items that are produced at a surplus, where there is no demand for them, and brings them somewhere where they are underproduced or not produced, and there is demand for them. Not only does this satisfy other consumers, but there is

an additional value of trade, in that these consumers return to the producing nation goods that they want but may not be able to produce. Both nations now have happier people who have more access to a variety of goods (Smith 446). Additionally, by creating this larger market for goods, there is encouragement for more goods to be made, and therefore an encouragement for better productivity. Both merchants and consumers benefit from this increased productivity, as more money can be made, and more goods can be supplied (447). Gold and silver might be benefits of trade, but are also not only available from trade. In the American colonies, mines full of gold and silver are being discovered, and this effectively makes them cheaper – Smith estimates that approximately three times the amount of metals can be purchased at that time, compared to previous years. In discovering this, though, they become ineffective for money, as their value has decreased and carrying around a greater quantity of coins becomes overbearing past a certain point. According to Smith, trade should not be shunned, but instead welcomed; additionally, a new monetary system must be found, as surpluses of gold and silver will decrease their value.

Hume speaks on mercantilism as well, in his short essay *Of the Balance of Trade*. He brings up mercantilist fears, that gold and silver are being sent out of the country, where it should be kept and stockpiled. He calls these fears “groundless”, and compares this to worrying about the immediate and surprise loss of natural resources, like all waters drying up overnight (Hume 61). His beliefs lie in the natural correction of the market, and that eventually, all trade will become balanced, and shows two different situations in which the market would balance out. First, he discusses if Britain somehow lost the majority of its money overnight. Relatively, labor and the cost of goods would be in proportion, and goods in the country would become very cheap. This would be attractive to foreign markets, and they would buy many goods from Britain, and all their money would flow into the country. As money comes into the country,

prices can rise, and demand will slow, until the country is restored to its previous balance. The same is to be said if the country's money quintupled overnight: labor and the costs of goods would increase, but foreign goods would be more attractive. As money flows out of the country and foreign goods flow in, the prices will grow on foreign goods and Britain's prices will drop, until the previous balance returns. While mercantilists believe in running a trade surplus, according to Hume, this cannot continue to happen in the long run, and eventually prices and trade will even out (62-3). This is one of Hume's important contributions to economics, the reverse specie flow mechanism. Hume also discusses the idea of paper money as a currency system, as opposed to gold and silver. Banks have begun circulating paper currency, and critics of this were calling this "short-sighted", and were afraid this would make gold and silver useless and prevent them from accumulating more (68). Instead, Hume rationalizes that it is only a fictitious worry that paper currency is worth any less than gold or silver, and says that only in public negotiations is this a problem, and it is not a true problem, as the paper is worth the same as the gold and silver. It also does not need to be accumulated as metals do, and there is no reason to be amassing gold and silver in extreme levels. People were hoarding these metals in such quantities above "what should naturally circulate" or more than "any want of money" could be (74). Gold and silver are better off as goods that can be bought and sold, rather than as a currency that cannot be used when being hoarded away. Fear and jealousy are driving away trade and are encouraging hoarding of money, Hume states. These should not be concerns, and naturally, trade will even out, and money will still safely exist.

Hume and Smith align on their views of mercantilism and the balance of trade, but have different justifications. Smith uses more philosophical reasoning in his promotion of free trade, explaining that it makes people happier, but that it has economic benefits as well, like increased

product diversity and increased productivity. Hume instead challenges mercantilism, and by using his reverse specie flow mechanism, explains that running a trade surplus is unsustainable and cannot keep occurring. Neither mention the other's arguments, but the arguments as a whole are still in agreement. Gold and silver as a currency are also discussed by both authors. Smith says that with the increase of the metals coming into the country, it is devalued as a currency, and would be difficult to trade with. Hume discusses the use of paper money and dispels fears that it is any different than metallic currency. It is then less easily hoarded as well, and the gold and silver, as goods, have better chances of circulation. They agree in that the metals should be a consumed good rather than as a currency, and that an alternate form like paper money (although not specifically mentioned by Smith) would be better. Smith and Hume find common ground in terms of thoughts on the balance of trade and metallic currencies, and while they use different rationale, still reach the same conclusion together.

It is noteworthy that in discussion of the balance of trade, both Smith and Hume mention the discovery of the East Indies and the monetary consequences that are rooted from this area. Hume mentions it only briefly, for about a page, but nevertheless brings up the power of Spain and accumulation of wealth in this scenario. He says it would be difficult for someone to imagine a way that Spain could have kept all the money that came in from the Indies, and that nations now gain from trading with Spain and Portugal, because they attempted to keep too much money and cannot, so it now flows out of the country with trade (Hume 64-5). Smith delves deeper in the topic, and says that the discovery of the area was more important to opening trade than the discovery of the Americas, as they had richer mines for gold and silver, and were more advanced in almost every way. Europe found difficulty benefitting from this, though, as Portugal monopolized the trading situation, and demanded that all goods that flowed in or out of the East

Indies would first have to be negotiated and would have to go through Portugal. In response, Holland set up a trading company for the Indies, and infringed on the exclusivity that Portugal had. Many other European countries followed, but because each nation must set up a company to trade with, it is not free trade, and cannot be enjoyed as such. In terms of gold and silver, the amount purchased with other goods increases the wealth and revenue of countries, but in such little amounts that it is not to be of much concern (Smith 448-9). The East Indies were an interesting situation when looking at its effects on trade, but it is even more interesting that both Smith and Hume mention this case.

Smith and Hume often overlap in topics of discussion, and this happens yet again on the topic of taxation. Smith discusses taxes in Book 5 of *The Wealth of Nations*, and believes taxes should be implemented in society. Personal revenues come from three different sources: rents, profits, and wages. Rents are the money earned from land and its use, and increase as the quality of the land increases. Profits are the money earned off stock and the employment of such stock and other supplies. Wages are the money that workers make from their jobs. According to Smith, all three of these revenues should be taxed, and some taxes should fall on each source of revenue, and some taxes should fall on people in general, but indifferently on the source. Four “maxims with regard to taxes in general” are named, and are important comments to take into consideration when creating and implementing taxes. First, taxes must only be placed on people in proportion to what they can afford. Those who make less money and are living at subsistence do not have enough money for more than what is necessary, let alone luxuries. Putting large taxes on this group would be unfair, and it would cause many families to fall into poverty. Meanwhile, the wealthiest members of society indulge in much luxury, and live far above subsistence; they could easily handle a larger tax. In previous times, the burden of tax has fallen

upon the poorest of people while the richest were exempt from taxes, but this can no longer happen. It is the responsibility of the government to ensure that the taxes fall proportionate to those that can afford it, and that taxes are fair. Second, the payments and timings of taxes must be well-defined to those paying the taxes. Those paying taxes should know exactly how much they are expected to pay and when they are expected to pay it well in advance of when taxes are due. Those living at subsistence cannot be expected to have the exact amount of taxes ready to pay at any given moment, but should be given clear timing and warnings for its collections so that they are ready. Tax payers cannot be living in fear of the tax collector, but should be prepared. Third, taxes should be conveniently timed in payment, and should not fall when there is little money to pay it. In the case of taxes of rents, the taxes should occur as near to when the rent is paid as possible, so that the landowner has the necessary funds to pay it. It would be unfair to expect the landowner to have the money to pay taxes right before more rents are collected, as he may not have the funds at that time and could not afford it. The same idea is applied to wages and profits. For luxury goods, taxes should be applied at the time of sale, as the goods are not necessary, and by purchasing luxury goods, it is assumed that one can afford both the good and the tax on it. Finally, the majority of taxes collected should be going to the tax fund, and not to the collection of taxes, the implementation of the system, or any other expense. Taxes should pay for what the taxes are collected for, say, schools, and not to paying the wages of tax collectors and leaving little for the school. Business should not be impeded by tax collecting, as it takes away money from the business, and gives the owner less to pay towards taxes. Money should not be spent on destroying those who cannot pay taxes, either. Penalties must not ruin people, but should be enough to encourage lawful behavior. Collection of taxes should not be troublesome or done too often; the idea of taxes is to collect money, not to be “more burdensome to the people

than they are beneficial to the sovereign” (Smith 827). Taxes are important, but have many considerations that go along with them. Taxes should be regular, fair, and with warning, and should be placed on all three main sources of revenue a person can have.

Hume’s tax policies and recommendations are laid out in one of his essays, and he also discusses many considerations for tax policies and implementation. When taxes are put on commodities, three things can result from this: the poor must cut certain items from their lives to be able to afford the taxes, the wage rate must be raised so the poor can continue living at subsistence and the entirety of the tax will fall on the wealthy, or the poor will become more productive and increase industry without demanding any additional wages or compensation (Hume 83). If taxes appear rapidly without warning and are burdensome, either of the first two situations can occur. If taxes appear in moderation and do not cause problems for those paying them, the third situation is most likely to occur, and seem to energize the working class instead of penalizing them. Where to place taxes is a concern of Hume’s as well, and he recommends that taxes be placed on consumption. Those who are purchasing luxury items should be able to afford the luxury item as well as the tax placed on it, and because the item is not needed, it is technically a voluntary tax. For those not purchasing luxury items, but those of basic need, the taxes are also very beneficial. They are paid gradually, and not as a lump sum, and thus feel as if there is less impact. In general, these taxes encourage frugality and rational decision-making by consumers. There are several other types of taxes other than consumption taxes, but many of these are dangerous and harmful to people. Arbitrary taxes are the most harmful, as they are a punishment of sort placed on the industry. They also are unfair and place the burden heavily on consumers, and it is odd that they “have place among any civilized people” – a criticism of Hume’s that implies that these taxes are backwards and ineffective and should not still exist (86).

Poll taxes are also dangerous, as they can easily increase without any sort of balance, and can quickly become burdensome and difficult to pay. These sorts of taxes can ruin people; basic consumption taxes are unlikely to do so. While some politicians and others with influence believe that land should be the only source of taxes, because all taxes ultimately fall on the land, this is not true, as the taxes fall upon the individual goods. This allows the individual to make their own decisions on how to pay the taxes. With no control over wages, people cannot simply raise these wages; they face the choice of consuming less or increasing productivity, as previously noted. People are likely to try to push the burden of taxes onto others, and this can be problematic. If landowners are the only ones taxed, they are likely to push the tax onto the workers, who will suffer from the burden of these taxes. When taxes are spread wider and onto everyone, they cannot be placed elsewhere and cannot be avoided. This way, everyone pays their fair share, and there is no one who can avoid the tax. Taxes should be levied onto consumption, so that everyone can pay a fair share of the tax, and no burden is placed upon people, who are likely to adjust to the tax and accept it instead of protesting it.

Both Smith and Hume debate the consequences of taxation and where taxes should fall in their writings. The writings both discussed the burden of unfair placement of taxes, and avoiding putting the entire burden on the poor who cannot fully afford it. When living at subsistence, there is not much extra money for various wants or needs, let alone taxes; to keep the wage class from falling into poverty, the entirety of these taxes cannot fall on them. Additionally, taxes should be fair, and apply to everyone. Smith and Hume also agreed on taxing luxury goods. Since luxury goods are only bought by those living above subsistence and the goods are considered optional, by purchasing these goods, they also can afford the subsequent tax that comes with it. Taxes are something that need to be considered before implementing, and where the burden falls should be

carefully watched. The two writers disagree on where to apply the taxes, though. Smith believes that taxes should mostly fall on the three forms of revenue: wages, rents, and profits. Since all people earn these, taxes should apply proportionately to these. Hume disagrees, though, and thinks that taxes should be applied to consumer goods. Since all people need to buy goods, paying a little at a time on each good extends the tax to a broad range of time with small payments and does not burden people. Smith and Hume agree that taxes should be collected, and should be done in a fair way without any harm to those being taxed, but disagree in where the tax should be collected from.

Both Hume and Smith are influential philosophers and economists, and wrote some of the most important historical works in the beginnings of the study of economics. Both men wrote a variety of essays and publications on the subject, and were both published and respected men in their days. Even though they were very similar in time, subject, and nature, and had a particularly close friendship, their views on various economic topics were not always as similar as one would think. They agreed on certain things, like the considerations of taxation, mercantilism, and the balance of trade. Their arguments differ, though, on types of taxation and attitudes towards luxury spending and its impact on the economy. The impact of Hume can be seen in Smith's work in that they agree on certain topics, and even mention some of the same examples as justifications, such as the East Indies situation where discussing the balance of trade. However, Smith diverges from his mentor's standings and creates ideas that are fundamentally different in his own writings. Hume and Smith have different writings with different focuses: Hume primarily focused on philosophy, while much of Smith's writings centered on economics based on philosophy. While they may not have always agreed, there is a definite link between the two writers, and they are more similar than not in their writings.

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