Adam Smith, Self and Society

by Anne Emerson

We have moved from discussing economics as a technical discipline within the larger societal context, toward understanding cultural worldviews as "influencers" in the way we design economic and political systems. Regarding an ideal society within the context of Adam Smith's writing, there is a book review of "The Essential Adam Smith," by Heilbroner, on the Essays page of this website, Anniespicsandpoems.com. Smith believed in a society based on moral precepts.

Most of the world's cultural traditions recognize a tension between self and society. What is important here is that economists took from Smith the idea that if we all did the best we could do, tensions between self and society would be minimized. It's called the "invisible hand." It allegedly orchestrates the economy as if by magic, and produces a good outcome without deliberate guidance.

Smith favored a change from the feudal system (kings, lords, and manors, with serfs – almost slaves – working the land) to one of industry and commerce, not so much because he thought that it was going to solve all problems, but because he thought it would be better than feudalism. He was well aware of the potential for abuse of power, if power became concentrated. He warned against giving merchants (business people) control over the law, when the law was supposed to work for everyone.

That is, although Smith was a pioneer in understanding how wealth accumulates, his followers took a relatively minor part of his worldview and elevated it to a status that underexplored the interaction of technological progress with growth and change. The intellectual "sleight of hand" here has been a longtime emphasis on capital as engine of growth, rather than technological progress as engine of growth; and on prices as primary directors of resource allocation. Now that we understand more, we have added technological progress onto our "capitalist system" models and worldview.

What my research discovered is that "price as signal" is not the best indicator of what happens in labor markets. The inception of this perspective may be found in my doctoral dissertation, "Internal Migration in Algeria, 1966-1977: An Empirical Analysis." Its fulfilment may be found in the two working papers on this website, and in many hours of my attempts to explain it.

Its essence is quite simple – migrants are motivated primarily by jobs, not primarily by wages or salaries. When jobs are opening in their fields, they search for them. If taking such a job requires a move, they move. Compensation for people of similar socioeconomic status varies little by region, and therefore is insufficient, if not inadequate, to explain the migration decision. That implies that price (or wage, for short) signaling is inadequate to explain labor market adjustments in general.

Labor market compensation packages are notoriously "noisy," meaning that there is a large statistical variation among supposedly similar positions and employees. That complicates the situation but does not negate the results. That is, the economic worldview that says people move to where salaries are higher – and that the price of labor (compensation package, or "wage" for short) is the primary signal that motivates the decision to migrate, or to take a job in general – is not valid.

The first thing that should give an economist pause, in regard to the "wage-differential" (or price-motivated) hypothesis about job markets, is that there is a lively pattern of circulation among cities, in addition to rural-urban migrations, in Algeria and also in other countries. If one city offers a

higher wage, why would any wage-motivated migrant move to a "lower-wage" city? Yet, it seems to happen a lot. (I am not speaking here of asylum-seekers, although some of their societal issues can be similar.)

If a development economist reminds me that average wages are higher in cities than in rural regions, I will not disagree. What I will say is that the main reason for this is that there is a higher concentration of high-paying jobs in cities than in rural regions. This brings up the average wage overall, without offering better wage opportunities for low-wage workers in cities as compared to rural regions. The exception, of course, is that some people can improve their prospects by learning a skill. Hence, we subscribe to the view that education is the best way to improve our station in life.

So far, I doubt that I have said anything controversial, except that we shouldn't consider "price" (or wage) to be our economic motivating force. My professors argued that the price system model is "good enough," and why would I come up with something different?

The best way I can explain this is to remind you that real-world businesses are motivated by what their budgets will buy. That is, by revenues (price multiplied by quantity). Once you see this, you can watch how sectoral revenues change as the whole system gets richer. In agriculture, it's called Engel's law. The global operation of Engel's law forces farmers to do more with less. References are in my working papers, or in prior versions of my analysis. In particular, some analysts show that opening agricultural markets to "free trade" or "market pricing" benefits consumers in the form of lower prices, but does not benefit farmers. If farmers move toward earning "non-farm income," in these types of situations, how is that good for the growing of food?

I saw this job-market situation in a developing country, newly independent and with hydrocarbon revenues, where it was undoubtedly more obvious than in other places. Today, I see the same financial, or budgetary, forces operating everywhere. The analysis applies to far more industries and jobs than only to agriculture.

I came up with a new way of modeling growth and change, because I knew what I wanted it to find. I modeled "changing revenues to total industrial sector over the long run" rather than what is more customary (prices and wages to labor and capital, across two or more sectors in a nation state, where world prices are exogenous). You can call it a tautology if you like. Or you can apply it to the current global situation, where it can give you new insights.

Most importantly, what it tells you is that an industry such as agriculture (farming) has to feed more people with fewer resources over time, because farm budgets continuously decline relative to the whole economic pie. This is not in doubt.

You could argue that farming gets more efficient, so you don't need as many resources. Well, perhaps. We should have this debate. You can also argue that growing food takes a whole season, so, not only can production of farm commodities not compete with the rest of the system in terms of purchasing-power for resources (inputs), but also it can't compete in terms of time to market, as compared with most things techie once they have been invented. This state of affairs drives resources into "money-magnet" industries at the expense of "resource-losing" industries, even if that is not what we really need. My solution is to wind back what have been long-time perverse monetary incentives. I can explain why. Thanks for listening.