General Hamilton and Dr. Smith

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In December 1791 Alexander Hamilton, the first U.S. Secretary of the Treasury, completed at the request of the House of Representatives a Report on the Subject of Manufactures (1791). Accompanying equally seminal reports on a national bank and on public credit, the Manufactures report laid out a compelling case for federal government encouragement of manufacturing industry and proposed a menu of broad policy options for achieving that objective. Several of Hamilton's policy proposals were in fact implemented, although with varying emphasis over time, during the century that followed. Market-oriented (as distinguished from homespun) manufacturing activities had been held back prior to the U.S. revolution by Crown policies that favored the importation of manufactured goods from Great Britain. However, Hamilton enumerated more than a dozen examples of already-successful manufacturing enterprises in the thirteen original states to support his argument that additional manufacturing activities could succeed.

Hamilton began his report with a detailed precis of arguments from "respectable patrons of opinions ... unfriendly to the encouragement of U.S. manufactures." No specific "patron" is mentioned by name, but the arguments are enclosed in quotation marks, suggesting that extant texts are being cited. The reader familiar with Adam Smith's Wealth of Nations (1776) cannot avoid being struck that the gist of most arguments characterized by Hamilton can be found in that great work -- notably in Book II, Chapter V; Book III, Chapters I and IV, and Book IV, Chapter IX. Indeed, one can identify in the report's early pages at least ten "arguments" that correspond closely with those advanced by Smith. The most pointed Smithian argument, from Book II, Chapter V, pp. 446-447, of the first (1776) edition, reflecting Smith's recognition that land in the colonies was both abundant and inexpensive, was as follows:

> It has been the principal cause of the rapid progress of our American colonies towards wealth and greatness, that almost their whole capitals have hitherto been employed in agriculture. They have no manufactures, those household and coarser manufactures excepted which necessarily accompany the progress of agriculture, and which are the work of the women and children in every private family.... Were the Americans, either by combination or by any other sort of violence, to stop the importation of European manufactures, and, by thus giving a monopoly to such of their own countrymen as could manufacture the like goods, divert any considerable part of their capital into this employment, they would retard instead

> of accelerating the further increase in the value of their annual produce, and would obstruct instead of promoting the progress of their country towards real wealth and greatness.

But an effort to correlate Hamilton's version word-for-word yields nothing but frustration. Nor can the lack of correlation be attributed to the possibility that Hamilton quoted from later editions of Smith's masterpiece, since detailed analysis reveals that there was little substantive change in the articulation of arguments across successive editions. A mystery is posed.

The solution to the mystery comes from recognizing that, despite the quotation marks, Hamilton was writing his own precis of Smith's arguments rather than quoting from the original. This inference is supported by a later passage that Hamilton finds "sufficiently judicious and pertinent to deserve a literal quotation" (my emphasis). Here I quote literally from Hamilton (1791), p. 63:

> "Good roads, canals, and navigable rivers, by diminishing the expence of carriage, put the *remote parts of a country* more nearly upon a level with those in the neighborhood of the town. They are *upon that account* the greatest of all improvements. They encourage the cultivation of the remote, which must always be the most extensive circle of the country. They are advantageous to the town by breaking down the monopoly of the country in its neighborhood. They are advantageous *even to that part of the country*. Though they introduce some rival commodities into the old market, they open up many new markets to its produce. Monopoly besides is a great enemy to good management, which can never be universally established, but in consequence of that free and universal competition, which forces every body to have recourse to it for the sake of self defence...."

Aside from differences in punctuation, capitalization, and the use of italics, Hamilton's version is a verbatim (but unattributed) quotation from Smith's first edition, Book I, Chapter XI, pp. 183-184. From this it seems clear that Hamilton is relying upon Smith as his main "respectable patron of opinions."

Rejecting Smith's monopoly caveat, Hamilton provides inter alia a forerunner to what we now call the notion of learning by doing (1791, p. 44):

> But though it were true, that the immediate and certain effect of regulations controuling the competition of foreign with domestic fabrics was an increase of price, it is universally true, that the contrary is the ultimate effect with every successful manufacture. When a domestic manufacture has attained to perfection, and has engaged in the prosecution of it a competent number of persons, it invariably becomes

> cheaper. ... The internal competition, which takes place, soon does away every thing like monopoly, and by degrees reduces the price of the article to the *minimum* of a reasonable profit on the capital employed.... In a national view, a temporary enhancement of price must always be well compensated by a permanent reduction of it.

The United States government did pursue policies to encourage manufactures, and with the British Crown's preventive measures abolished, manufacturing activity did rise while agriculture's share of national employment fell. Reliable early statistics are scarce, but Figure 1, splicing and interpolating several data series, shows trends from 1820 to 2010 in the share of total U.S. civilian employment in the manufacturing plus minerals industries as contrasted to the agriculture sector (including farm owners).[1] For agriculture, contrary to Adam Smith's exhortations, the employment share declines almost monotonically from 71.8 to less than two percent. The manufacturing and mining share is seen to rise from roughly 8.4 percent, which was presumably higher than it was in Hamilton's time, peaking at 29 percent before the Great Depression of 1929. It soared to a record (civilian sector) share with all-out World War II mobilization, but then began a gradual decline. I have argued elsewhere (Scherer 2012, pp. 138-139) that the trends are explained mainly by differing productivity growth rates (generally higher than those for all economic activities) and (following e.g. Engel's Law) income elasticities of demand. The manufacturing-mining employment trend reversal following World War II was also influenced by increased import competition, but roughly comparable figures reveal that changing nonfarm commodity trade balances (from positive to negative) can only explain about six percentage points of the roughly 18 point manufacturing-mining share decline.

I return in conclusion to another striking result from the attempt to compare the arguments of "respectable patrons" quoted by Hamilton to the actual text of Adam Smith's arguments. Note in the first quotation from Smith's first (1776) edition that he refers to "our American colonies." One might expect the Revolutionary War and independence to have induced textual changes. But in the fifth (1789) edition, the same phrase, "our American colonies," appears. More nuanced changes are found at other points. Edward Cannan, editor of the Modern Library version of the fifth (1789) edition, observes in a footnote at p. 465 that Smith substituted "the present disturbances" for "the late disturbances" in several but not all references to the American revolution. Cannan expresses puzzlement over the language Smith chose and its inconsistency. We

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1. The sources are U.S. Bureau of the Census (1960), pp. 72-73; and the 1965, 1995, and 2012 editions of the annual Economic Report of the President. Weiss (2003) provides an even earlier 1774 agriculture share estimate of 76 percent.

too are puzzled. Perhaps he had as much difficulty recognizing a fait accompli as his sovereign King George III. Or perhaps he was too consumed by his duties as Commissioner of Customs to reflect such remote historical changes in his several revised editions.

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Figure 1

U.S. Employment Shares for Agriculture and Manufacturing and Mining