

Smith, *The Wealth of Nations*, Book 2, chapter 2, 'Of Money...'

This is a long and relatively difficult chapter, so here is a brief reader's guide to help you find your way about in it.

Guide

pp. 381–388. Here Smith is in effect developing his concepts of Gross National Product and Net National product, and considering the issue of depreciation (i.e. what must be subtracted from GNP to yield NNP). Along with these pages, consider too p. 420, and the account of money as 'dead stock'.

pp. 382–393. Smith examines the role of banks in economizing on the use of metallic money, hence freeing real resources for other uses. Implicit here is the concept of the velocity of circulation of money (a modern account of which can be found in any macro textbook).

pp. 393–397. He gives an illustration of his general ideas on banking, by reference to the Scottish case in particular, and also by way of contrast with England.

pp. 397–399. He considers the constraints on the issue of bank money, and the problems arising from over-issue.

p. 406 (top half). He spells out what he considers to be the proper lending business of the banks, and what sort of lending is improper.

pp. 424–427. He argues against the idea that an increase of paper money will lead to inflation, so long as paper money is convertible into precious metals on demand. But if bank note are not so convertible, inflation may indeed result.

p. 429. He argues for the virtues of competition in banking.

You should study carefully all of the pages referred to in the Guide. Pages not specifically referred to may be given less emphasis, though I suggest a quick read through them to try to get the gist of what Smith is saying.

Focus questions

1. Write down Smithian equations defining GNP (= "whole value of annual produce"), NNP and depreciation. That is, put his verbal discussion of these ideas into a compact schematic form.
2. According to Smith, in what precise way do the banks aid in the development of the economy? In particular, what is the mechanism whereby the banks aid in the growth of international trade?
3. What, according to Smith, were the advantages of the Scottish banking system over that in England?
4. What are the advantages, for Smith, of broad competition in the sphere of banking? On the other hand, what general constraints does Smith reckon should be placed on such competition, and why?