

## ADAM SMITH ON USURY: AN ESOTERIC READING

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### Abstract

In this paper I approach one of Smith's most discussed exceptions to the liberty principle. Numerous authors have treated the tension between Smith's endorsement of a ceiling on interest rates and his system of natural liberty. Almost all authors take Smith at face value. I argue that, given the religious underpinnings of usury policy and its firm standing in prevailing opinion, Smith wrote esoterically on the matter, in part to ensure that his works and his legacy would remain temperate, widely agreeable, and alive. One notable feature of Smith's esotericism is that as soon as he states his argument for the ceiling he subverts that argument by saying that under the regulatory ceiling lenders "universally prefer" "sober people" to "prodigals and projectors" and are able to discriminate accordingly, which leaves the discerning reader wondering why that wouldn't also be the case in the absence of any ceiling.

Should it be my fortune to gain any advantage over you, it must be with weapons which you have taught me to wield, and with which you yourself have furnished me: for, as all the great standards of truth, which can be appealed to in this line, owe, as far as I can understand, their establishment to you, I can see scarce any other way of convicting you of any error or oversight, than by judging you out of your own mouth.

Jeremy Bentham, 1787, Letter XIII, addressed to Adam Smith

### 1. Introduction

Adam Smith is known for having a presumption of liberty.<sup>1</sup> That is why any of his judgments contravening the liberty principle receive so much attention and scrutiny. One such

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<sup>1</sup> Numerous authors have noted Smith's strong presumption of liberty. See Viner, 1927, 219; Hollander, 1973, 256; Young & Gordon, 1996, 22; Griswold, 1999, 295; Smith, 2013, 796; and Otteson, 2016, 508.

case is Smith's support of the prevailing opinion on usury, which was that there should be a ceiling on interest rates "somewhat above the lowest market price" (WN, 356). The presumption of liberty places the burden of proof on the proponents of policies that violate the principle. One would think then, that Smith's support of the status quo would be accompanied by a robust, if not convincing, argument. Yet such is not the case. Jeremy Bentham demonstrated how flimsy Smith's defense is. Bentham's takedown serves as the touchstone for many modern scholars who take the position that Smith was simply wrong.

I suggest that Smith's position on usury is a case of esoteric writing. Smith's support for the status quo provides a cursory justification, all the while quietly intimating an attitude more skeptical of the restriction. Usury policy is arguably one of the most controversial policies that Smith addresses. Smith was a revered public figure and intellectual who engaged members of all walks of life including the church, state, bankers, merchants, and manufacturers. Smith's ultimate goal was instituting a liberal society, and he understood that certain aspects of such a society would be difficult for his audience to accept, such as the social tumult associated with growth and the increasing power and influence of a merchant class. Smith intentionally distanced himself from the merchant class so none could call him a shill for a group capable of disturbing the aristocratic hierarchy.

## **2. The Moral and Religious Underpinnings of Usury Policy**

Some of the earliest positions on usury are found in religious texts or religious supplements to core religious texts. The main line of argumentation justifying laws against usury is quite consistent through the Judeo-Christian tradition up to Smith's time. Proponents of usury laws make a moral argument that focuses on two key implications of usurious loans: preying on

the disadvantaged during a time of need, and the negative impacts that such actions have on the community.

The Judaic scriptures on usury can be generalized into a moral argument: lending with interest to those within your community is divisive and detrimental to social cohesion because it violates the tenet of universal charity. Individuals should want to help out their fellow Hebrews and expect nothing in return. Lending with interest diminishes the lender's sense of value in being charitable. The negative consequences of usury are thus twofold: a person's character and soul suffer when he or she worries more about profiting from another's misfortune than about helping a person in need, and society suffers problems in maintaining social cohesion by allowing such behavior to persist (Houkes 2004, 17-20). Missing from these collected passages is any mention of investment-type loans. The sentiment remains the same in the New Testament emphasizing charity within one's community and the effects of consumptive loans (Houkes 2004, 53-56).

Beginning in the twelfth century, the Scholastics ushered in a reinterpretation of church doctrine more consistent with their contemporary economic climate. Commercial loans, compensation for risk, contractual partnerships, and distribution of profit were all addressed in the Scholastics' works (Houkes 2004, 113-8; Ballor & Grabill [Cajetan] 2014, *xvii*). The predominant position, however, was still one that viewed usury as sinful and to be avoided. The primary focus was still on the moral implications of loaning to individuals in need.

Thomas Aquinas used natural law as the basis for his arguments allowing certain types of payments and contracts to exist without violating usury policy, and he represents a shift toward a policy friendlier to investment-type loans (Kitch 1967, 117). Advanced payment for goods was allowed for more than the principal, yet interest on monetary loans was still taboo (Condillac

2008, 172). Here a shift occurs to an acknowledgment that there are more types of loans than just to the needy. Aquinas is addressing productive loans designed to grow business, in addition to what would commonly be thought of as payday loans or loan sharking today.

Even into the Reformation moral arguments were a mainstay in justifying usury policy (Kitch 1967, 124). John Calvin and Wolfgang Musculus are two examples showing the breadth of opinion, yet the basis of the religious standpoint was still the moral argument rooted in Old Testament scripture. Universal charity continued to be a central theme, although an awareness of different types of loans was beginning to be discussed more regularly.

John Calvin rejected the traditional interpretation of the Old Testament scriptures instead arguing that the Old Testament was written to safeguard the Hebrew nation as it stood. Europe in the 1500s existed under different conditions. Calvin maintained, however, that some restrictions on usury were necessary. Commercial loans benefit society, yet consumptive loans still fall under the realm of charity where no interest should be charged. Hence Calvin advocated regulating interest (Houkes 2004, 251-3). Calvin's views on usury were quite liberal for his time and his reformist approach was not widely accepted in Britain. Only one British Calvinist espoused similar thoughts on usury, William Ames (Kitch 1967, 124).

Wolfgang Musculus took a much more hardline stance on usury. He viewed any form of payment beyond the principal as excessive (2013, 82-3&88). His emphasis was on universal charity and the negative effects of charging interest for consumptive loans (2013, 92-9). Musculus expected Christians to follow church doctrine regardless of what was legal (2013, 84-6). He acknowledged that productive loans differ from consumptive, but viewed profit even from a productive loan as avarice (2013, 100-101). Interestingly, he notes that civil law and Christian doctrine have diverged, but argues that the divergence does not eliminate the moral

underpinnings of the church's position on usury; rather it creates a degree of separation between moral arbiters and legislators.

The Reformation represents a shift in the use of the term *usury*. Prior to the Reformation usury referred to charging any interest. After the Reformation, *usury* meant charging interest in excess of a legal rate (Jones 2004, 3). The hardline approach to usury, meaning a condemnation of any form of interest, was held until around 1660 when a few additional reformers took a position similar to Calvin's (Kitch 1967, 125). This significant shift can be explained, in part, by the rise in the proportion of productive relative to consumptive loans. As the proportion of loans changed, the secular laws governing loans diverged from church doctrine. The moral argument is beginning to lose emphasis. Starting in the 1500s the English, for example, abandoned the prohibition and established legal rates of interest (Smith WN, 106). This is the policy and moral landscape in existence during Smith's time. The state is regulating interest rates and the church is slowly evolving to adapt to a more commercial society.

### **3. There are two types of loans, and they matter**

As we look into history, distinguishing loans as consumptive or productive allows us to trace how the purpose of loans changed over time. Consumptive loans are intended to provide a person with immediate funds to satisfy some form of consumption. The oldest texts describing such loans suggest that necessity motivated the borrower, who might be borrowing money to buy food or pay rent. Modern analogues would be car title loans and payday advances. Such loans carry a negative connotation, as did consumptive loans in the past, because they typically occur for borrowers with little to no alternative options paying an interest rate much higher than the market rate. Early Jewish texts were interested in the proper role of money within society, and how loaning money affected the members of their society, so a consumptive loan might be

necessary, even though not desirable. For Smith, such loans were unproductive because the money was being spent to satisfy an immediate want or need instead of being used as an investment that would lead to greater future production (Smith WN, 339)<sup>2</sup>. In a society that either has little physical capital, like the society of the ancient Hebrews, or highly concentrated capital, like feudal Europe, the predominant form of a loan is consumptive. Under such conditions, where individuals already have thin margins in terms of expendable income, loans are a matter of last resort. Few loans are for entrepreneurial purposes. Later, as commercial society blossoms the more common case would be a shortsighted borrower recklessly consuming beyond his or her means. Such behavior would fall under what Smith called prodigality (WN, 339).

Productive loans usually correspond to a form of investment. In modern times, productive loans are quite prevalent, but they were less frequent prior to the Industrial Revolution. You will note the emphasis of usury discourse shifts over time from applying primarily to consumptive loans to including productive loans. The discourse on usury shifts from abhorrence to tolerance to acceptance as the emphasis moves towards productive loans. There is still the potential for the moral argument regarding charity to be imposed upon productive loans, even though the two types of loans address very different instances of human activity. There is a deep-seated apprehension about loaning money at interest, one that gave weight to the moral arguments against usury even as commercial society grew.

The debate over usury reflects a larger trend in society. Commercial society fosters a more complex nexus of individuals, putting a strain on some of humankind's primitive

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<sup>2</sup> For Smith, consumptive loans do not necessarily contain the element of necessity emphasized in the Judeo-Christian usage; instead someone is borrowing to satisfy an immediate desire for material goods and services.

inclinations. Our social networks cease to be heavily defined by physical proximity (Clark and Lee 2017, 62). Commercial society replaces familial bonds with more impersonal exchanges in our daily lives, and this can be difficult to reconcile when it comes to how we view usury. Where we previously gave our cousin enough money to get him by, we are now offering that sum to a stranger so he or she can open a bakery or improve a brewery. Evaluating the latter using the same moral criteria as the former applies the uneasiness we feel at taking advantage of someone to the provision of money for productive projects (Clark and Lee 2017, 65). Yet, the moral arguments against usury are much less applicable to productive loans than to consumptive loans.

#### **4. Some Brief Remarks on Esotericism**

Writing esoterically can take the form of ambiguity, rendering the author's true attitudes difficult to decipher (Melzer 2014). There are many reasons why an author would engage in esoteric writing. Protective esotericism is the cloaking of dangerous truths. There are ideas that further the quest for knowledge and understanding, but run counter to the beliefs or superstitions of common folk (read non-philosophic). Expressing these ideas openly would be too jarring to the masses and could generate backlash and other problems (Melzer 2014, 164). Another reason to write esoterically is to protect oneself from the dangers of expressing unconventional or upsetting ideas. Expressing ideas that question church or state doctrine is a good way to end up being excommunicated, imprisoned, or executed. Avoiding persecution is what Melzer refers to as defensive esotericism (2014, 127-159). As I will show, Smith and his legacy faced potential damage for straying too far from the status quo on usury.

Writing in a manner that hides the truth yet leaves enough clues for some to navigate to the truth is a difficult task. Authors dissemble their true meaning in myriad ways, but some common themes have emerged over time. Melzer suggests that if something jars the reader, such

as incongruity or an uncharacteristic misquotation, it can serve as a marker for where an author has hidden his or her true meaning (2014, 296). An additional method is the use of dispersal. The author's whole argument is dispersed in pieces throughout his or her work. The author may make rather forceful statements or arguments within larger sections of the text that carry a unified theme, so changes in tone can be pieced together to reveal the hidden theme. Dispersal would require a thorough and careful reading by any censor to catch the author's esoteric meaning (Melzer 2014, 317).

An esoteric reading of Smith implies a message other than Smith's surface message. We must first review what Smith says on the surface, then explore Bentham's critique before asking whether Smith might have an esoteric teaching and what it might be.

#### ***4.1 Smith's Surface Message and Argumentation***

Smith frowned on spendthrifts and prodigals: "Every prodigal appears to be a public enemy" (WN 340). He likewise scorns the "golden dreams" of "chimerical projectors" and their "extravagant undertakings" (310 & 316). That Smith detested capital squandered lends some support to a straight reading of his endorsement of anti-usury laws. But here I will highlight other material, and treat his main discussion of the policy issue.

Smith defines interest in book I of WN, "That [*profit*] derived from it by the person who does not employ it himself, but lends it to another, is called the *interest* or the use of money." (WN 69, italics added). Later, in the chapter "Of the Profits of Stock," Smith introduces for the first time in WN the topic of restrictions on interest rates:

By the 37th of Henry VIII. all interest above ten per cent. was declared unlawful. More, it seems, had sometimes been taken before that. In the reign of Edward VI. religious zeal prohibited all interest. This prohibition, however, like all others of the same kind, is said

to have produced no effect, and *probably rather increased than diminished the evil of usury*. (WN 106; italics added)

A few pages later, the topic crops up in connection with the discussion of defective laws and institutions in China and other “stationary” systems, first by saying that insecurity and uncertainty raise interest rates, and then by a new paragraph:

When the law prohibits interest altogether, *it does not prevent it*. Many people must borrow, and nobody will lend without such a consideration for the use of their money as is suitable, not only to what can be made by the use of it, but *to the difficulty and danger of evading the law*. The high rate of interest among all Mahometan nations is accounted for by Mr. Montesquieu, not from their poverty, but partly from this, and partly from the difficulty of recovering the money. (WN 112-3; italics added)

The topic is introduced in the context of repressive economic systems and the results are bad. Smith has now said that restrictions “probably rather increased than diminished the evil of usury,” and that they add “the difficulty and danger of evading the law.” Smith shows pervasive awareness of evasions prompted by coercive laws, whether prohibitions, regulations, or taxes. In the matter of loans, interest rate restrictions are often evaded by fees. In his discussion of “the well-known shift of drawing and redrawing,” Smith says that “whatever money a [borrower] might raise by this expedient must necessarily have cost him something more than eight per cent. in the year, and sometimes a great deal more” (308, 310).

In the chapter on the accumulation of capital, Smith provides a paragraph that, though not addressing interest-rate restrictions, is important for an esoteric reading. With words that would later be quoted back at him, Smith suggests that bankruptcy and wasteful investment are rare:

With regard to misconduct, the number of prudent and successful undertakings is everywhere much greater than that of injudicious and unsuccessful ones. After all our complaints of the frequency of bankruptcies, the unhappy men who fall into this misfortune make *but a very small part of the whole number engaged in trade*, and all other sorts of business; *not much more perhaps than one in a thousand*. Bankruptcy is perhaps the greatest and most humiliating calamity which can befall an innocent man. The greater part of men, therefore, are sufficiently careful to avoid it. Some, indeed, do not avoid it; as some do not avoid the gallows. (WN 342; italics added)

A few pages later, in "Of Stock Lent at Interest," Smith says that "the borrower may use it either as a capital, or as a stock reserved for immediate consumption" (350). He continues:

The stock which is lent at interest is, no doubt, occasionally employed in both these ways, *but in the former much more frequently than in the latter*. The man who borrows in order to spend will soon be ruined, and he who lends to him will generally have occasion to repent of his folly. To borrow or to lend for such a purpose, therefore, is in all cases, where gross usury is out of the question, contrary to the interest of both parties; and though it no doubt happens sometimes that people do both the one and the other; yet, *from the regard that all men have for their own interest, we may be assured, that it cannot happen so very frequently as we are sometimes apt to imagine*. Ask any rich man of common prudence, to which of the two sorts of people he has lent the greater part of his stock, to those who, he thinks, will employ it profitably, or to those who will spend it idly, and he will laugh at you for proposing the question. Even among borrowers, therefore, not the people in the world most famous for frugality, *the number of the frugal and industrious surpasses considerably that of the prodigal and idle*. (WN 350; italics added)

Turning now to Smith's primary discussion of interest-rate restrictions (WN 356-359), Smith's opening paragraph reiterates the earlier remarks:

In some countries the interest of money has been prohibited by law. But as something can every-where be made by the use of money, something ought every-where to be paid for the use of it. This regulation, instead of preventing, has been found from experience *to increase the evil of usury*; the debtor being obliged to pay, not only for the use of the money, but for the risk which his creditor runs by accepting a compensation for that use. He is obliged, if one may say so, to insure his creditor from the penalties of usury. (WN 356; italics added)

Smith then turns to countries where interest is permitted but under a maximum legal rate:

**This rate ought always to be somewhat above the lowest market price**, or the price which is commonly paid for the use of money by those who can give the most undoubted security. If this legal rate should be fixed below the lowest market rate, the effects of this fixation must be nearly the same as those of a total prohibition of interest. The creditor will not lend his money for less than the use of it is worth, and the debtor must pay him for the risk which he runs by accepting the full value of that use. If it is fixed precisely at the lowest market price, it ruins with honest people, who respect the laws of their country, the credit of all those who cannot give the very best security, and obliges them to have recourse to exorbitant usurers. In a country, such as Great Britain, where money is lent to government at three per cent. and to private people upon good security at four, and four and a half, *the present legal rate, five per cent., is perhaps, as proper as any.* (WN 356-7; italics added)

Notice the “perhaps;” I have put in boldface at the end of this quotation qualifying Smith's endorsement of restriction. Here as elsewhere in WN,<sup>3</sup> Smith plainly likens a restriction or restraint to prohibition, which naturally suggests that the results of restrictions are similar to

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<sup>3</sup> For example, Smith opens Book IV, Chapter II: “By restraining, either by high duties, or by absolute prohibitions, the importation of such goods from foreign countries. . . .” (WN 452).

those of “total prohibition,” only mitigated. A simple logic would be that if total prohibition is bad, then restriction, a partial prohibition, is also bad, just not as bad.

Then follows paragraph 15, which opens: “**The legal rate, it is to be observed, though it ought to be somewhat above, ought not to be much above the lowest market rate**” (WN 357; boldface added), completing Smith's statements endorsing the status quo restriction, though he then goes on to defend that position:

If the legal rate of interest in Great Britain, for example, was fixed so high as eight or ten per cent., the greater part of the money which was to be lent, would be lent to prodigals and projectors, who alone would be willing to give this high interest. Sober people, who will give for the use of money no more than a part of what they are likely to make by the use of it, would not venture into the competition. A great part of the capital of the country would thus be kept out of the hands which were most likely to make a profitable and advantageous use of it, and thrown into those which were most likely to waste and destroy it. Where the legal rate of interest, on the contrary, is fixed but a very little above the lowest market rate, sober people are universally preferred, as borrowers, to prodigals and projectors. The person who lends money gets nearly as much interest from the former as he dares to take from the latter, and his money is much safer in the hands of the one set of people, than in those of the other. A great part of the capital of the country is thus thrown into the hands in which it is most likely to be employed with advantage. (357)

As George Stigler (1988, 208) put it, Smith “seems to assume that lenders would pay no attention to the probability of being repaid, but only to the promised interest rate.” It has been suggested that Smith intuits that the rate offered by lenders affects the pool of borrowers who apply for loans (in the asymmetric-information credit-rationing spirit of Stiglitz and Weiss (1981); see Hollander (1999, 528, 544-5)). But, even on the assembly of necessary assumptions, if the self-selection effects are such that high rates would too preponderantly attract bad

borrowers, Smith never explains why a lender would not simply offer lower rates, so as to alter his pool of credit applicants. As Hollander puts it: “The Stiglitz-Weiss solution has bankers imposing that interest rate (and other terms of the contract) which maximizes the expected return, Smith requires that the state undertake that function, removing a degree of freedom from lenders.” (1999, 544). Here, Smith's justification suggests that government knows better than individuals about the individual's own risks, costs, and benefits—a supposition that runs contrary to Smith's whole teaching, as Bentham will point out.

As scholars puzzle over Smith's reasoning, however, one needs to bear in mind something strewn obliquely in Smith's argument yet nonetheless lying in plain sight, namely, the last three sentences of the the paragraph just quoted. There Smith says that under the regulatory ceiling, lenders somehow know how to discriminate between the sober borrowers and “prodigals and projectors.” The sober borrowers are “universally preferred.” But if lenders can discriminate under the regulatory regime, why wouldn't they be able to discriminate in a free market? Smith's justification for the regulatory ceiling contains its own subversion!

After the justification there follows a final short paragraph on the interest-rate restrictions:

No law can reduce the common rate of interest below the lowest ordinary market rate at the time when that law is made. Notwithstanding the edict of 1766, by which the French king attempted to reduce the rate of interest from five to four per cent., *money continued to be lent in France at five per cent., the law being evaded in several different ways.* (357-8; italics added)

Thus Smith caps off the discussion with words that suggest a futility in trying to restrict interest rates and reminding readers of the many ways to evade restrictions.

Smith closes his chapter by relating the price of land and the rate of interest. Buying land and lending money are substitutes. Rent from land is a lower-risk endeavor; therefore, the return on rent is lower than the market interest rate. If the return on one becomes higher than the regular rate of return on the other, individuals shift from the lower-return investment to the higher return (Smith WN, 358-9). All of a sudden, Smith is back to his usual proposition that people manage their affairs prudently and reliably enough to ensure tendencies toward uniform risk-adjusted rates of returns. Notice that Smith's arguments address none of the traditional justifications for usury laws. There is nothing about the sin of profiting from those in need, or the duty to charity (see Pack 1997, 128).

#### *4.2 Bentham's Critique: some brief remarks*

Bentham in *Defence of Usury*, a set of letters published in 1787, vigorously deployed Smith's own reasoning to argue for a complete end to regulating interest rates. The first twelve letters address the arguments supporting the status quo. The thirteenth and final letter is addressed to Smith and criticizes him directly (Houkes 2004, 394; Persky 2007, 234). The *Defence of Usury* is often cited as the definitive work leading to eventual repeal of usury regulation (Rockoff 2009, 295). Joseph Persky (2007, 235) refers to—and concurs with—G.K. Chesterton's (1933) remark, “The modern world began by Bentham writing the *Defence of Usury*.” (67).

I shall not detail Bentham's critique of Smith. The letter addressed to Smith is well known and lucid. Bentham uses Smith's own words and teachings to criticize Smith. Besides, Bentham brings up most of the points that we have already seen here in which Smith suggests either the futility or mischief of restricting interest rates. Bentham quotes Smith on the foolish presumptuousness of “any statesman or lawgiver to direct private people in what manner they

ought to employ their capitals” (1818, 165-6); Smith taught us that people better know their “local situation” and their own interest. He quotes Smith on how monopolies are created and protected by restrictions “in almost all cases . . . a useless or a hurtful regulation” (1818, 166), and how ceilings on interest rates dampen the contesting of old established producers. And in an earlier letter, Bentham, like Smith, clearly propounds the presumption of liberty. In the final letter addressed to Smith (Letter XIII), Bentham exposes the fallacy of Smith's reasoning of bad loans driving out good by describing the motivation and ability of lenders to investigate the schemes that borrowers propose to undertake as “the *benefit of discussion*.” Bentham develops a defense of projectors as entrepreneurs who generate positive externalities. He readily accepts that some projects will fail, but the positive effects of the successful outweigh the negative consequences of failures (Pesciarelli 1989, 530).

Bentham speculates on how Smith fell into adopting the prevailing position:

After having had the boldness to accuse so great a master of having fallen unawares into an error, may I take the still farther liberty, of setting conjecture to work to account for it? Scarce any man, perhaps no man, can push the work of creation, in any line, to such a pitch of compleatness, as to have gone through the task of examining with his own eyes into the grounds of every position, without exception, which he has had occasion to employ. You heard the public voice, strengthened by that of law, proclaiming all round you, that usury was a sad thing, and usurers a wicked and pernicious set of men: you heard from one at least of those quarters, that projectors were either a foolish and contemptible race, or a knavish and destructive one: hurried away by the throng, and taking very naturally for granted, that what every body said must have some ground for it, you have joined the cry, and added your suffrage to the rest. (Bentham 1818, 184-186)

Bentham is not suggesting that Smith had dissembled, but he is imagining the psychology of a writer working in the face of established custom and public opinion. It would be but a small step to see that such circumstances might recommend moderate prose in a writer like Smith.

One of Smith's famous passages from TMS is about the man of public spirit in which he suggests that a good statesman must recognize when his desires conflict with his constituents'. Smith's advice is not to give up, but rather to seek a position of compromise. He harkens back to Solon and advocates that one should move in the direction of the desired outcome but recognize what the people are willing to accept and advocate a tempered position: "Like Solon, when he cannot establish the best system of laws, he will endeavour to establish the best that the people can bear." (TMS, 233). Perhaps Smith's surface position on usury is just that: a Solonic approach that encourages productive loans without quarreling with the moral arguments related to consumptive loans.

Smith, it seems, was agreeable to Bentham's argumentation. Smith spoke to William Adam, who spoke to George Wilson, who wrote to Bentham (4 December 1789):

Did we ever tell you what Dr Adam Smith said to Mr William Adam, the Council M.P., last summer in Scotland. The Doctor's expressions were that 'the *Defence of Usury* was the work of a very superior man, and that tho' he had given [Smith] some hard knocks, it was done in so handsome a way that he could not complain,' and seemed to admit that you were right. (George Wilson to Jeremy Bentham, quoted in Rae 1895, 423-24)

On the strength of this evidence, John Rae went so far as to say that Bentham's work "had the very unusual controversial effect of converting the antagonist against whom it was written," and that "it is reasonable to think that if Smith had lived to publish another edition of his work, he

would have modified his position” (Rae 1895, 423-24; Pesciarelli 1989, 532). Yet Smith made no reply to Bentham except, it seems, to give Bentham one or both of his works as a present (Viner 1965, 19; Paganelli 2003, 45). Perhaps Smith’s response was to spur Bentham to find the answers he had hidden in those works, notably TMS. As for revisions to WN, after the third edition of 1784, it was scarcely revised or altered, so Smith did not have any ripe occasion after Bentham's 1787 work. But a very lightly revised new edition of WN did appear in 1789, so Smith, though occupied with revising TMS, perhaps did have an opportunity to revise WN, and chose not to (Pesciarelli 1989, 535).

### 5. Surveying Other Authors on Smith and Usury

Here I touch on how authors have interpreted the matter. I offer a crude categorization of authors, first, by whether the author considers an esoteric reading. Most take an exoteric reading of Smith, which I then separate into three sub-categories, as shown in Figure 1.

Exoteric reading only	Esoteric
<p><b>A</b>  <u>Agrees or finds Smith’s argument coherent</u>            Keynes • Paganelli • Levy • Rockoff</p>	Stewart Klein Clark Diesel
<p><b>B</b>  <u>Finds a particular flaw in Smith’s argument</u>            Jadow • Pesciarelli</p>	
<p><b>C</b>  <u>Finds Smith’s argument quite unsound</u>            Friedman • Bentham • Stigler • Viner            Robbins • Rae • Persky</p>	
<p><b>D</b>  <i>Unclear</i>            Hollander</p>	

Figure 1: Authors on Smith’s Usury Position

The authors in set A tend to argue that Smith’s usury passages are not inconsistent with the rest of his writing. David Levy argues that Smith is consistent, because rules serve the

purpose of moral codes when individuals have imperfect information and systematic biases (Levy 1987, 399-400). Maria Pia Paganelli argues that Smith's position coheres when read through the lens of his moral philosophy provided in TMS. Smith's support of the status quo was a reasonable policy between two extreme and deleterious positions (Paganelli 2003, 46). John Maynard Keynes is a more difficult author to categorize, as he does not analyze Smith's position in detail. He agrees with Smith's conclusion that interest rates should be regulated. But it is unclear whether he finds Smith's arguments to be consistent. Keynes uses Smith's authority to bolster his own position. Keynes could fit into set A or B, but I have opted for A.

Set B consists of authors who partially agree with Smith's approach. These authors can be read as taking issue with Smith's passages, but following them up with a "that's ok, and here's why." Joseph Jadow says that Smith is concerned with regulating interest rates in order to prevent scarce capital from being used on consumptive loans and risky projects (Jadow 1977, 1199-1200). Enzo Pesciarelli emphasizes a distinction between how Smith uses the term "projector" compared to someone like Bentham. Smith paints such a person in a negative light; Bentham praises him. Both authors have a valued role for the entrepreneur, but approach the concept from different perspectives. Smith values a risk-averse type of projector, referred to as a "prudent" or "sober" man who tends to invest in known markets leading to slow, gradual growth, whereas Bentham prefers the risk-seeking projector willing to fail by trying new things, whose projects overall contribute to pronounced upshots in growth (Pesciarelli 1989, 521-536).

Numerous authors in Block C contend that Smith's position is wrongheaded and his argumentation falls far short of overcoming the presumption of liberty. Milton Friedman calls it "a highly uncharacteristic passage" (1976, 9). George Stigler (1965, 4; 1988, 209) calls Smith's position an "aberration" and "a strange argument." Jacob Viner finds Smith's reasoning weak

and says: "The one personal characteristic which all of his biographers agree in attributing to him is absent-mindedness, and his general principle of natural liberty seems to have been one of the things he was most absent-minded about." (1927, 227).

Samuel Hollander (1999) is especially hard to categorize. He too suggests that Smith's argumentation is weak. But there is a novel element in his article. He argues that, irrespective of all that Bentham had to say, at the time of Smith's writing WN the going rate of interest was inconsistent with the information that Smith provided, namely that "money is lent to government at three per cent. and to private people upon good security at four, and four and a half, the present legal rate, five per cent., is perhaps, as proper as any" (WN, 357.14). But Hollander shows government paying rates from 4.2 to 6.8 percent in the years 1777 to 1785, which, on Smith's logic, bumped the ceiling up two points from the rate paid by government; thus, he would recommend legal ceilings from 6.2 to 8.8 percent, not 5 percent. Hollander provides this insight, and the puzzle it raises, without offering a solution, saying "our main problem remains unanswered" (1999, 540-45). I offer the following: The information Smith provides was not, as of 1776, glaringly faulty; but it became more so in the following years. Is it possible that the faultiness alerts readers to look beyond the exoteric?

The authors on the right side of Figure 1 present those who offer an esoteric reading, and I include myself there just to make clear that I see the present piece as in that category. Listed there is Daniel Klein.<sup>4</sup> In a preface to the publication of a selection of Bentham, chiefly Letter XIII, Klein suggests that Smith favored liberalizing the status quo and that he "fudged" in assuming and defending the status quo policy (2008, 67-8). Others who have studied with Klein have incorporated the suggestion into their own speculations, notably the dissertation by Michael

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<sup>4</sup> Note: Daniel Klein chaired my dissertation committee.

J. Clark (2010, 89-94). The other author listed on the right-hand side of Figure 1, Dugald Stewart, warrants more attention.

## 6. Dugald Stewart on Smith on anti-usury laws

Dugald Stewart (1753-1828) was a friend and associate of Smith; he was son of Matthew Stewart, a friend and fellow classmate of Smith's at Glasgow (see TMS 124n7). Smith pays high tribute to Matthew Stewart in TMS (124).

For the matter at hand, Dugald Stewart is very important yet surprisingly overlooked. Stewart, without saying it explicitly, clearly insinuates strategy or dissembling in Smith on usury, both in the post-1811 editions of *Account of the Life and Writings of Adam Smith*<sup>5</sup> and at great length in Stewart's *Lectures on Political Economy* (Stewart, 1982 and 1971).

In the *Account*, Stewart ascribes to Smith a strong commitment to the liberty principle and free markets, but also a tactfulness in discourse and a gradualist view of reform.<sup>6</sup> He says that Smith and others recommended improvements too subtle in their mechanisms “to warm the imaginations of any but the speculative few,” improvements to be advanced “by enlightening the policy of actual legislators” (Stewart, EPS, 311). Smith's speculations “have no tendency to unhinge established institutions, or to inflame the passions of the multitude”; he did not concern himself with how his “liberal principles” were to be approached in practical reform, but “that he was abundantly aware of the danger to be apprehended from a rash application of political

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<sup>5</sup> In the modern version of Smith's *Essays on Philosophical Subjects* (EPS), Stewart's account is included, and the material on usury is in Note (J) (pp. 348-349). That note only first appeared (as “Note (G)”) in Stewart's 1811 volume of *Memoirs* and in Stewart's 1811 edition of the works of Smith (vol. 5).

<sup>6</sup>Rothschild sees Stewart on Smith similarly, although she thinks Stewart overstates or misunderstands Smith on liberty, speaking of Stewart's “redefining of his [Smith's] view of freedom” (2001, 52-66).

theories” (317), and he cites Smith's Solon passages. Emma Rothschild suggests that Stewart is offering “a defense of Smith, and of himself, against the terror of the times” (2001, 57). Even so, Rothschild notes that, compared to Condorcet, “Smith was, by contrast extraordinarily cautious and circumspect. The writings he published during his lifetime are replete with qualifications” (221).

In 1811, Stewart added notes to his *Account* and a very important one opens:

Among the questionable doctrines to which Mr Smith has lent the sanction of his name, *there is perhaps none* that involves so many important consequences as the opinion he has maintained concerning the expediency of legal restrictions on the rate of interest. The inconclusiveness of his reasoning on this point, has been evinced, with a singular degree of logical acuteness, by Mr Bentham, in a short treatise entitled *A Defence of Usury*; a performance to which (notwithstanding the long interval that has elapsed since the date of its publication), I do not know that any answer has yet been attempted; and which a late writer, eminently acquainted with the operations of commerce, has pronounced (and, in my opinion, with great truth), to be "perfectly unanswerable." It is *a remarkable circumstance*, that Mr Smith should, *in this solitary instance*, have adopted, *on such slight grounds, a conclusion so strikingly contrasted with the general spirit of his political discussions, and so manifestly at variance with the fundamental principles which, on other occasions, he has so boldly followed out, through all their practical applications.* This is the more surprising, as the French Economists had, a few years before, obviated the most plausible objections which are apt to present themselves against this extension of the doctrine of commercial freedom. (EPS [Stewart], 348; italics added)

Stewart cites Turgot, as well as Thomas Reid and John Law. And then he writes the following about Locke:

To this opinion Law appears evidently to have been led by Locke, whose reasonings (although he himself declares in favour of a legal rate of interest), seem, all of them, to point at the opposite conclusion. Indeed the apology he suggests for the existing regulations is so trifling and so slightly urged, that *one would almost suppose he was prevented merely by a respect for established prejudices, from pushing his argument to its full extent.* The passage I allude to, considering the period when it was written, does no small credit to Locke's sagacity. (Stewart 1982, 349; italics added)

Stewart is suggesting that Locke obscured his true opinion, and he insinuates that Smith did likewise. Stewart can hardly be more explicit in advocating an esoteric reading of Locke.

Such reading of Stewart is reinforced by his long chapter on the subject in the *Lectures on Political Economy* (vol. II, 146-95). There he enlarges on the above quotes, draws heavily on Bentham, and, like Bentham, repeatedly quotes Smith back at Smith: “Mr. Smith, whose general principles concerning the freedom of trade and of industry, one should naturally have expected, would have inclined him to the opposite opinion” (1971, 167-8). Stewart dwells on how Smith could take a position “in direct opposition to some of his fundamental maxims” (1971, 170 & 180). He deals with Locke at length, saying that, although Locke “declares in favour of a legal rate of interest,” “he was probably prevented, merely by a respect for established opinions, from pushing his conclusion to its full extent” (190). Stewart is plainly insinuating that Smith and Locke were playing the same game.

## **7 An Esoteric Reading of Smith**

Let us now look more closely at whether Smith was writing esoterically.

### **7.1 Smith’s Awareness of Esotericism**

There is a strong body of evidence showing that Smith was aware of esotericism. To begin with, Smith wrote a posthumously published essay<sup>7</sup> in which Smith rejects the Neoplatonist reading of Plato as having a double doctrine. Melzer goes on to say, “it is difficult to say whether this continued to be his view in his later years and also whether it involves a rejection of all esotericism—of every kind—or only the more extreme forms” (2014, 28-9). Melzer uses additional content to find hints that Smith was more open to the concept than his early essay conveys. In Smith’s correspondence are discussions including the need to use “‘irony’ and ‘disguise’” as well as agreeing with Hume’s admission “about the need to employ

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<sup>7</sup> See “The Principles Which Lead and Direct Philosophical Enquiries; Illustrated by the History of the Ancient Logics and Metaphysics” in EPS.

caution and dissimulation in writing” (2014, 372). Note the use of the word dissimulation, for it occurs elsewhere in Smith’s writings and serves as a connection between his private and public discourse.

Smith discusses the concept of dissimulation in his first major publication, TMS. Smith generally speaks of dissimulation as a vice; however, he has one passage that offers a justification for when such behavior can be tolerated. In a paragraph discussing the ability to command fear and anger, Smith notes that in extreme circumstances a person must show a valiant degree of command of both, in order to hide one’s true intentions.

This character of dark and deep dissimulation occurs most commonly in times of great public disorder; amidst the violence of faction and civil war. When law has become in a great measure impotent, when the most perfect innocence cannot alone insure safety, regard to self-defence obliges the greater part of men to have recourse to dexterity, to address, and to apparent accommodation to whatever happens to be, at the moment, the prevailing party . . . It may be employed indifferently, either to exasperate or to allay those furious animosities of adverse factions which impose the necessity of assuming it; and though it may sometimes be useful, it is at least equally liable to be excessively pernicious. (Smith TMS, 241-2)

Smith acknowledges that engaging in dissimulation is still a vice, but may be useful at times.

Ensuring one’s safety is key to Smith’s acceptance of a person engaging in such a practice.

Smith’s advice is consistent with the broader understanding of esoteric writing. Later in TMS

Smith has another passage that suggests he accepts the need for esotericism.

But the man who had the most frequent occasion to consult [those judging him], was the man of equivocation and mental reservation, the man who seriously and deliberately meant to deceive, but who, at the time, wished to flatter himself that he had really told the truth. With him they have dealt with variously. When they approved very much of the motives of his deceit, they have sometimes acquitted him, though, to do them justice, they have in general and much more frequently condemned him. (Smith TMS, 339)

Smith makes an oddly incongruous statement. How could a person intentionally deceive and intend to tell the truth at the same time unless he was targeting two audiences with two separate messages?

Addressing suicide is an area outside the usury question in which Smith demonstrates care in approaching a controversial topic. Smith took exception to the way in which Hume addressed suicide (TMS, 6). As footnote 36 on page 287 of TMS notes, the section on suicide was added to the sixth edition of TMS and is considered to be motivated by one of Hume's essays. Smith does not counter Hume's position outright. In fact, Smith's position, like Hume's, differs widely from the prevalent contemporary position on suicide. Smith and Hume's positions, while different, advocated decriminalizing suicide and were far outside the reigning views. Smith addressed Hume's essay in a manner that would make it easier for the public to accept by adding it to a section on the moral philosophy of the Stoics. Smith creates a buffer by burying a controversial modern argument within a discussion of an ancient philosophy while, in contrast, Hume took a direct approach, which met much more resistance. Smith's approach muddles the attribution between himself and the Stoics, thus softening the position somewhat.

The same precept is found in Smith's correspondence. Smith received a letter from the prominent Frenchman Pierre-Samuel Dupont de Nemours that highlights just such a predicament. Dupont was an important Physiocrat, philosopher, and public servant. To a certain degree he held a similar role as Smith in France, that of cultural royalty. Dupont sent his book and a letter to Smith. The letter, in part, served as an apology to Smith for it explains why Dupont had not fully endorsed the policies he personally supports (Prasch and Warin 2009, 67-68). Dupont hedged for the following reasons:

...that there are a large number of truths that I did not mention; that there are several passages in which I avoid confronting my readers' preconceptions, and I started by

applauding their openness and views before presenting better perspectives that should inspire us.

Sir, I wanted to persuade, prior to convincing, some people who are animated to the point of fanaticism, and who would believe they are engaged in righteous action...

...I had to fight a unanimous and universal opinion in my country. All public opinion deserves to be treated with respect, even more so when the administration is committed to opposing it...

I hope that you will forgive the deficiencies of my work that are not unknown to me and some of which were voluntarily committed.

It is more important to do well than to say well. ...By assaulting their eyes with a bright light, we would reconstitute their blindness. (Prasch and Warin 2009, 69).

Dupont shows a clear understanding of what the people can bear, what the punishment would be for exceeding such a threshold, and the necessity of caution. The last line about blinding the people is quite suggestive of esotericism. He suggests that too much truth all at once will harm the people rather than free them from ignorance.

Dupont makes similar statements directly in reference to Smith twenty years after his letter, writing about his own work. Dupont's comments on Smith are in Dupont's edition of the collected works of Turgot (Sautet 2011, 174). Dupont suggests that Smith, like himself, hid his true position out of caution when he alluded to

Smith's mistakes, which were not and could not have been the result of his great mind, but rather a sacrifice to popular opinion, a sacrifice that he thought was useful in his homeland. Under the circumstances in which he found himself at the time (and in which his government is still to be found), he thought that in order to maintain public peace, one should not assault infirm eyes with the bright light turned too directly towards them (Sautet 2011, 179)

Notice that Dupont uses the same "blinding light" phrase toward Smith that he used to describe his own choices twenty years prior. This link between Dupont and Smith has been noted by modern scholars such as Emma Rothschild (2001, 66-67). Dupont's suggestion that Smith had

hidden meanings “is supported by much of Smith’s correspondence, and by the revolutionary side or element of his published and unpublished work” (Rothschild 2001, 67).

There is further evidence of Smith’s flirting with esotericism in his unpublished works. A number of passages in the *Lectures on Rhetoric and Belles Lettres* (LRBL) suggest Smith’s awareness of crafting one’s message in varying manners depending on the audience. As Smith notes, the style that an author chooses depends on his or her intended audience. In order to effectively persuade a person, the author must recognize the prior knowledge and preferences of the audience. Controversial topics cannot be thrown out in the audiences’ face, rather, the audience must be won over gradually (Smith LRBL, 111-5, 146-7). Assuming Smith followed his own advice given in LRBL, then he would hesitate to wholly abandon usury laws given their wide acceptance in Scotland and the current policy of the crown. For the time being, it is enough to note that early in Smith’s academic career he lectured on the art of persuasion and advised students to be mindful of their audience. Good authors tailor their arguments to best address their audiences’ existing biases.

### **7.2 Smith’s Reasons to be esoteric**

Two of Smith’s close friends and colleagues faced censure from Christians. Henry Home, Lord Kames was threatened with excommunication for his *Essays on the Principles of Morality and Natural Religion*. David Hume was targeted by Calvinists for his skepticism and purported atheism. While Hume maintained his skeptical position, Lord Kames made efforts to tone down, and eventually remove, much of his controversial arguments by editing his essay and issuing a pamphlet of response (Home 2005, xvi-xvii). Hume faced further adversity in securing academic positions because his works were deemed critical toward religion, even atheistic. He missed out on a chair at Edinburgh (Lorkowski 2019); then his controversial positions caught the attention

of Frances Hutcheson, a devout Christian. Hutcheson used his influence to prevent Hume from being appointed the Chair of Moral Philosophy at Glasgow, the position vacated by Adam Smith (Phillipson 2010, 65, 126). While Smith wanted nothing more than to work with his dear friend, he knew it was unlikely. His comments on Hume's being passed over include an acknowledgment of Hume's conflicts with Presbyterian standards: "[T]he public would not be of my opinion [of Hume's appointment]; and the interest of the society will oblige me to have some regard to the opinion of the public" (Phillipson 2010, 126). Both Hume and Kames wrote in a manner challenging to church doctrine. Both served as a lesson for Smith in exercising caution when approaching matters that challenge church doctrine or authority.

Smith's hedging in favor of the status quo is Smith taking a safe position on a topic that is likely to attract the ire of a majority of society. At the same time, Smith puts forth no effort to address any of the moral and religious arguments supporting usury laws. The first question is whether Smith feared repercussions for denouncing usury laws from the religious orders. Smith did not feel compelled to address the moral aspects of usury in his works because as Codr notes from, "the eminent modern historian of usury Norman Jones... 'By the Eighteenth century the moral issue of usury was no longer of interest to most Protestant thinkers'" (2016, 3). Religious persecution is not what Smith feared most.

So what did Smith fear? One of Smith's letters indicates his surprise when he catches unexpected grief from the religious orders for one of his writings,

I have however, upon the whole been much less abused than I had reason to expect; so in this respect I think myself rather lucky than otherwise. A single, and as, I thought a very harmless Sheet of paper, which I happened to Write concerning the death of our late friend Mr Hume, brought upon me ten times more abuse than the very violent attack I had made upon the whole commercial system of Great Britian (Corr. 1987, 251).

Smith's personal correspondence reveals his awareness of the negative reception he received on a religiously sensitive topic, more importantly it also reveals that he expected resistance for publishing WN. Given Smith's expectation of resistance/reprisal to his arguments in WN, it makes sense he would cautiously approach some of the more controversial ones.

Smith knew that a liberal society would be a difficult endeavor to convince his audience to embrace because doing so threatened the status quo and those currently holding authority and wealth (Smith TMS, 40-41; Dellisanti 2018, 37). One of the parties standing to most directly benefit from a liberal society are the merchants and manufacturers whose increased wealth would be more visible than the dispersed benefits the rest of society receives. Attitudes towards commercial society were not entirely warm and embracing during the 18<sup>th</sup> century (DelliSanti 2018, 23-5). Smith is none too kind to merchants and manufacturers; he downplays the link between a liberal society and the rise of the merchant class by consistently addressing them as rude, rapacious, and ever scheming to advance their own interests at the expense of the public's (Smith WN, 115, 145, 266-7, 493-4; McNally 1988, 220-5). Smith's harsh language makes it clear that he does not endorse allowing the merchant class to become the next ruling class. Smith understands his audience and chooses to take a Solonic approach. If he comes across as too heavily favoring the liberal project he risks being dismissed as a dreamer or worse a schemer. Usury policy directly affects investment and growth, so it is a prime candidate for Smith to take a metered position on in order to make his endorsement of the liberal project more in line with what "the people can bear" (TMS, 233).

The evidence provided here and by Bentham is too much to be satisfied by Homer nodding. Smith's own corpus provides too many examples of his awareness of shrewd borrowers and lenders for his surface argument to carry weight. Further, Smith had opportunities to address

Bentham's critique, yet he made no effort to update WN or respond to Bentham. Rising to a state of cultural royalty subjected Smith to additional scrutiny and expectations of behavior. Smith dissembled his true, more liberal, position on usury to temper the degree of fervor for liberty his audience would perceive within his works, and to ensure he was not dismissed as a puppet for the merchant class.

The exchange between Smith and Bentham can serve as a symbol of the historically significant transition occurring during Smith's time. Smith's life spans the rise of commercial society and he certainly played a part in its rise. He serves as a bridge between the older, more tradition-bound regimes and commercial society. Bentham had the luxury of writing without the trappings of Smith's cultural position, and observed Smith's reception prior to formulating his own argument allowing Bentham to be more direct. Smith's position as cultural royalty and his desire to influence the adoption of a liberal society required more tact, which brings us to the crux of this paper. Adam Smith was intentionally diffuse about usury in order to address two different audiences, the cursory reader and the discerning.

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