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Recovering Adam Smith's ethical economics

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> *While some men are born small and some achieve smallness, it is clear that Adam Smith has had much smallness thrust upon him* (Sen 2010, 54).

Adam Smith is famous for founding economics as an independent field of study by synthesising and systemizing classical economics in *The Wealth of Nations* (1776). But he was also a significant moral philosopher in his own right whose *Theory of Moral Sentiments* (1759) was respected by his contemporaries, including Immanuel Kant and his close friend David Hume. In this brief essay I want to right a wrong by showing how deeply Smith's ethics was integrated into his approach to economics. Smith saw economics as a branch of moral philosophy (Griswold 1999, chap. 1), and he saw capitalism as an ethical project whose success required political commitment to justice and freedom, not merely an understanding of economic logistics.

These days Smith is best known as an economist, and specifically as the defender of the famous "invisible hand" of free-market economics, wherein the self-interested actions of private individuals, mediated through free markets, generate results that are good for society as a whole. The market-system comprehends the true level of demand for any good and provides the appropriate incentives—profits—for producers to adjust their output to match. No external intervention or guidance is necessary. A great deal of contemporary (neo-classical) economics can be understood in terms of translating Smith's invisible hand metaphor into a systematic theoretical form, with a particular emphasis on the economic efficiency of perfectly competitive markets.

However the popular view of Smith among economists that has resulted from this emphasis is twice distorted. Firstly, it is based on the narrow foundations of a few select quotations from *The Wealth of Nations* (WN) that are taken in isolation as summing up his work (Smith only mentions the "all important" invisible hand once); and secondly, these quotations have been analyzed in a particularly narrow way. Both selection and interpretation have been driven by contemporary mainstream economists' interest in justifying orthodox economic methodology and their peculiar (Mandevillian not Smithian) assumption of the selfish utility-maximising *homo economicus*. The Chicago School economist George Stigler once famously declaimed, "The Wealth of Nations is a stupendous palace erected upon the granite of self-interest" (Stigler 1975, 237). What such Whig "historians" have achieved is the diminution of Smith's economics to those bits which can be claimed to be early (and flawed) fore-runners of contemporary economic concepts and techniques.[1]

But anyone who cares to read Smith's *Wealth of Nations* for themselves will find an economics discussed and justified in explicitly moral terms, in which markets, and the division of labour they allow, are shown to both depend upon and produce not only *prosperity* but also

[1] See, for one example among many, the Whiggish mistreatment of Smith's trade theory in contemporary history of economics textbooks analysed by Reinhard Schumacher (Schumacher 2012).

justice and *freedom*, particularly for the poor. With those concerns in mind, it should not be surprising that Smith was a staunch and vehement critic of those particularly grotesque sins associated with early capitalism: European empires and the slave trade.[2]

Smith's defence of capitalism (or, in his terminology, "commercial society") is unambiguous but qualified. There is no inconsistency here. Smith's commitment to a realistic liberalism led him to endorse commercial society over any previous socio-economic system as a social order in which the most people possible could live decent lives. But he was not the blind zealot for the market he is now sometimes portrayed as. Smith was acutely aware of the possible ethical shortcomings of commercial society and, for example, carefully read and responded to Rousseau's powerful critiques of its materialism, inequality, and inauthenticity (Rasmussen 2008; Hanley 2008). While the structural features of commercial society set the terms of its main opportunities and challenges, they did not determine the outcome. Commercial society was for Smith an ethical project whose greatest potential benefits had to be struggled for, and which could and should be much better than it was.

The Enlightenment concern for perfecting social order was both the background to Smith's thinking and a goal Smith eschewed. As Rousseau put it in *The Social Contract*,

> The problem is to find a form of association which will defend and protect with the whole common force the person and goods of each associate, and in which each, while uniting himself with all, may still obey himself alone, and remain as free as before ([1762] 2008, sec. I.6).

While Rousseau sought a perfect and absolute solution to the problem through his famous social contract, Smith argued that, under conditions of freedom and justice, society could endogenously produce a decent social order for co-ordinating moral and economic conduct without centralised direction or coercive moral policing by religious or secular authorities. In this sense his project can be seen as a working out of Locke's liberal political philosophy at the institutional level. Smith was not interested in what a perfect society might look like, but rather with understanding the world as it was and how it might be improved, i.e., with real world economics. So instead of analysing the requirements of a perfectly just society he analysed the socio-economic order of the new commercial society then coming into being, characterized by an enormously increased division of labour, dependence on strangers, formal property rights, and individual mobility. And he saw that commercial society had enormous potential for enhancing general prosperity, justice, and freedom.

Prosperity

Smith analysed the wealth of a nation as the ability of its ordinary citizens to command goods to satisfy their wants, i.e., not only the total wealth but also its *distribution*. Smith noted that a European peasant was now materially better off than many African kings (WN I.i.11), but he attributed this not to any innate European superiority (as all too many 19th century political economists went on to do) but to changes in political economy. The recent increase in the wealth of certain nations was due to the increasing role of markets in their economies, which

[2] With regard to the latter, see the debate in these pages between Marvin T. Brown, Bruce Elmslie and myself in 2010 (Brown 2010a; Elmslie 2010; Wells 2010; Brown 2010b).

made possible and rewarded the technical innovations and efficient organisation of labour that dramatically increase productivity.

That benefits the ordinary citizens of a country—i.e. the working poor—in two ways. Firstly, when producers compete fairly and freely with each other to supply the public with cheaper (and better) products there is a natural tendency for the market price to fall towards the actual cost of production, and for the costs of production themselves to fall, meaning cheaper products for consumers (and less profits for producers). This aspect is central to contemporary mainstream defences of the market. But Smith also noted that the rise in labour productivity meant that wage labourers (the bulk of the population) could exchange their labour for a greater command of those goods. Thus, Smith praised the expansion of markets for their role in increasing the purchasing power of ordinary citizens and thereby the *real wealth* of a nation. A concern for equitable distribution was constitutive of his understanding of prosperity and the subject-matter of economics. As he noted:

> No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable. It is but equity, besides, that they who feed, cloath and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves tolerably well fed, cloathed and lodged (WN I.viii.36).

Justice

Smith's commitment to "equity" for the working class was behind the vehemence of his opposition to mercantilist ("business economics") arguments for policies that would protect or promote the profits of producers and intermediaries. Smith saw such pro-business arguments—which arguably persist as the core of neoliberalism (Harvey 2007)—whether for direct subsidies or competition-restricting regulations, as an intellectually bankrupt and often morally corrupt rhetorical veil for what were actually "taxes" upon the poor (what we now call "rents").[3] Such taxes are unjust and outrageous because they violate fair play both in the deceptive rhetoric by which they are advanced and by harming the interests of one group in society (generally, the poor and voiceless) to further the interests of another (unsurprisingly, the rich and politically connected). Smith explicitly moralised the point,

> To hurt in any degree the interest of any one order of citizens, for no other purpose but to promote that of some other, is evidently contrary to that justice and equality of treatment which the sovereign owes to all the different orders of his subjects (WN IV.viii.30).

Justice was thus central to Smith's critique of the crony capitalism of his time, and to his alternative proposal of a "system of natural liberty" characterised both by a level playing field (the responsibility of political institutions) and a commitment to "fair play" (the moral responsibility of economic actors). The quotation above is often taken to indicate Smith's rejection of the interests of the poor by ruling out the kind of redistributive policies found in a modern welfare state as akin to a referee changing the results of a game to favour one "team"

[3] See for example Smith's scathing criticism of the ban on wool exports to promote the interests of English textile manufacturers, which was imposed by particularly onerous methods (WN IV.viii).

over another. Yet that misses Smith's commitment to *procedural fairness*, which introduces a concern that the rules of the game—the institutional arrangements that decide who should get what share of the gains of economic activity—should themselves be fair. If a country's economy creates great wealth but the share going to the workers versus the owners of capital is kept artificially low by unfair institutions—such as restrictions on workers' ability to bargain (WN I.viii.13)—that is a gross injustice which keeps the country less prosperous than it ought to be. Smith thus appears a more radical critic of the structural origins of economic inequality than many today on the political left. In Smith's time no less than in our own, a political commitment to a free society and a free economy does not imply that we should simply accept our existing socio-economic institutional arrangements (cf Grusky 2012). On the contrary, it implies rigorous scrutiny and reform.

But Smith's moral condemnation of mercantilism has further relevance to today's business-economics dominated policy discussions. According to Smith's diagnosis, the mercantilist system's great success was in nationalising the corporation model of towns in the feudal system, leading to great efficiency gains as the size of the market increased. But in doing so it had also nationalised the "underling" ethics of monopolist tradesmen and manufacturers, who preferred to lobby collectively for self-serving rights and privileges at the political level than to compete on equal terms with others in the market. The "impertinent jealousy of merchants and manufacturers" when coupled to political influence allowed the hijacking of the state's power and authority to promote the interests of a well-connected few in the name of the national interest, such as the extractive economic policies that Smith considered had driven the American colonies to revolt. But this was due not only to straightforward interest group capture but also the ideological capture of the state by the particular—skewed—perspective of merchants and manufacturers. That fostered an invidious political ideology: a zero-sum view of trade as competition rather than cooperation, in which the prosperity of other nations is seen as national defeat. This remains with us today, deeply lodged in the "common-sense" understanding of our politicians, many of their advisers, and self-appointed media pundits. In Smith's day, UK plc competed against France ltd; now we are all supposed to fear the rise of China Inc.

It should be obvious by now that Smith was no cold heartless utilitarian who put his faith in a ghostly Invisible Hand. But he was a professor of rhetoric as well as moral philosophy, and he was acutely aware of who the likely readers of the *Wealth of Nations* would be. So he supplemented his arguments for the moral priority (even sacredness) of justice with hard-nosed utilitarian arguments about its instrumental role in social order and economic development. For example, when people gain equality before the law and thus security from the predations of the powerful, they have the security they need to make the investments that increase productivity.[4]

[4] See for example Smith's discussion of the legal protections of tenancy extended to English yeoman farmers, which, together with their rights to political representation, "have perhaps contributed more to the present grandeur of England than all [the] boasted regulations of commerce taken together" (WN III.ii.14). Unsurprisingly the legal property rights of the poor is also an important theme of contemporary development economics, perhaps most notably in the work of Hernando de Soto, though it has unfortunately and unnecessarily become associated with a general neo-liberal programme.

Liberty

Freedom from constraints, freedom from domination, and the freedom of moral autonomy were also central to Smith's economics. Smith is of course most associated with the first of these, also called classical or negative *liberty*, because of his famous endorsement of the "natural system of liberty" in which:

> Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men (WN IV.ix.51).

A great deal of WN is concerned with identifying and criticising the artificial and unjustified obstacles placed in the path of ordinary people trying to get on with their own lives and to better their condition. Smith argued forcefully, and in great econometric detail, that England had become richer in spite of and not because of the government's mercantilist policies.

But such mercantilist regulations were wrong not only because they reduced economic efficiency by reducing and distorting competition (the hard-nosed utilitarian argument). They were also wrong because of the insufferable impertinence of a government (or any other body) taking it upon itself to manage people's affairs on their behalf. This was not only a matter of the freedom of great merchants to engage in high international trade. Smith was particularly exercised about the 18th century English laws that deprived wage-labourers, whose only means of subsistence was to sell their labour, of the right to change occupations, negotiate wages, or even move around the country. Of course that produced an inefficient allocation of economic resources: not enough wheel-wrights in one place, too many in another. But even more importantly it disrespected the natural right of ordinary people to make decisions on matters of the greatest consequence to them, which were no-one else's proper business, and about which they were best placed to judge. These policies, justified by chimerical arguments about the public good, reduced and distorted the options available to ordinary people to help themselves and through such artificial helplessness induced real hardship and destitution.

One should note that liberty was a maxim for Smith rather than a dogma (a goal, not a side-constraint as the libertarian Robert Nozick might put it), and he was in favour of government interventions and regulations properly justified by the public interest. As to interventions, while Smith's "laissez-faire economics" proposed taking government out of the business of micro-managing the economy, it also outlined a clear and extensive government responsibility for ensuring the conditions for a flourishing free and just economic system. That included organising (though not necessarily directly providing) public goods that private market actors did not have the necessary credibility, scale, profit-incentives, or long-term perspective to provide, including legal justice, universal education, and security.

Smith's regulatory proposals were directed at preventing systemic failures and some remain highly pertinent. For example, he proposed banking regulations which though "in some respect a violation of natural liberty" upon a few individuals were justified by the government's duty to protect "the security of the whole society" (WN II.ii.94). And he argued for fixing the rate of interest at a relatively low level (just above the prime market rate) in order to prevent imprudent “prodigals” (sub-prime borrowers) and “projectors” (speculators with crazy South Sea Bubble type schemes) from getting access to credit and thus diverting it from prudent investment and putting the financial system at risk. Unlike supporters of the Efficient Market Hypothesis (and his contemporary Jeremy Bentham (Bentham 1818 [1787]), Smith saw prudence as a personal virtue, more cautious than enterprising, and thought markets were good at teaching it, but unfit to substitute for it. The economists who promoted deregulation of banking and lending in recent times on the grounds that “the market always knows best” may have cited Smith, but they hadn't read him.

Freedom from domination

Smith also argued that commercial society produced freedom from domination (or “republican freedom” in modern terminology). The feudal system that Smith describes as preceding commercial society (and whose traces could still be seen in his own time in parts of Scotland) was a society characterised by direct relationships of dependence; a world of great landowners with the absolute power of lords over their tenant farmer subjects and retainers. Contemporary communitarians like Alasdair MacIntyre and Charles Taylor may portray such relationships as the basis for an “authentic” human life, or rhapsodise over the “enchanted world” in which such people lived. But Smith cut through the romance of feudalism and analysed them as master-slave relationships that reduced the humanity of all parties.

The appearance of commercial society changed all that for the better. In commercial society informal webs of mutual obligation are transformed into formal consensual relationships between independent agents because these are far more economically productive (feudalism is out-competed). The division of labour mediated by extensive markets replaces closed relationships of direct dependence, in which some must subordinate themselves to the whims of their masters and curry favour to survive, with open networks of inter-dependence spread among the thousands of people involved in producing and bringing to market the most ordinary essentials of life.[5]

On the production side, this liberates workers to sell their labour without having to sell their souls. If people find the working conditions in one employment oppressive they are allowed to take their labour elsewhere. In markets themselves the very fact that people interact as relative strangers, and therefore appeal to each other’s self-interest rather than their benevolence (as beggars must), means that they meet in conditions of relative equality where they must endeavour to persuade others of the qualities of their goods by the gentle arts of persuasion. In this sense, markets economise on love, which is a good thing because, as beggars know all too well, love is scarce.

Moral autonomy

Smith believed that personal autonomy—self-determination—could flourish in commercial society, because its circumstances gave the greatest possible number of people access to the basic requirements for moral self-development. The increased wealth and security that followed a proper administration of justice allowed the mass of ordinary people—not only the

[5] See WN I.i.11 for an evocative description of the distributed production of goods in commercial society.

aristocratic elite—the leisure to reflect about matters beyond their daily subsistence. Freedom from artificial constraints and domination allowed them to control important aspects of their own lives, from religion to employment, while taking greater responsibility for how they lived. The markets themselves could be schools for certain virtues (the "doux commerce" thesis also associated with Montesquieu (Hirschman 1982)). For example, people who worked for themselves would be more prudent and temperate; people who interacted through markets would be more honest than when trapped in sycophantic relationships with masters (Wells and Graafland 2012). As a result, Smith considered commercial society compatible with the moral autonomy of its ordinary citizens, and believed that such societies would exhibit more moral decency, though less moral greatness, than either classical or contemporary "savage" societies.[6]

Unlike the classical philosophers with their metaphysical elitism, Smith was an enlightenment liberal who firmly believed in the fundamental equality of human beings, and attributed differences in status and achievement far more to the effects of circumstances than to innate qualities. "The difference between the most dissimilar characters, between a philosopher and a common street porter, for example, seems to arise not so much from nature, as from habit, custom, and education" (WN I.2.4). No matter how far you rise, you are still fundamentally equal to others. (Even "philosophers".) With these liberal commitments in mind it is not surprising that Smith celebrated the possibility for ordinary people to have the leisure, freedom, and education to reflect on their moral lives and decide for themselves who they should be. Nor that he thought the "boring" bourgeois decency they would tend to attain was a social achievement that outweighed the loss of aristocratic-romantic virtues like magnanimity, courage, or "authenticity".

Conclusion

Smith's economic analysis was thoroughly entangled with a deeply humanistic ethical perspective. The picture of the real Adam Smith this reveals is of a "true friend" of commerce, supporting the project because of its achievements and its even greater potential, but constructively critical about both the shortcomings of the mercantilist society he lived in and commerce in general. He endorsed commercial society for its tremendous contribution to advancing the prosperity, justice, and freedom of all its members, and most particularly of the poor and powerless in society. But he was no naive ideologue for free markets and profits. He criticised the political machinations and moral character of the very merchants and manufacturers who, he acknowledged, were driving economic development. He not only argued that they should act better, but also proposed institutional measures to restrict their worst proclivities, particularly by getting government out of the business of economic micro-management and thus out of the business of crony capitalism. Though its promise was great, the rise of commercial society meant the loss or sidelining of traditional values and ways of life, and posed new challenges of its own. Its success was not predetermined, but had to be worked for. That is a lesson some modern economists and politicians would do well to relearn.

[6] The reasons for Smith's scepticism that moral excellence would thrive in commercial society despite people's greater opportunities to live an excellent life relate to his recognition of the psychological attractions of the material success that would also become more generally accessible, for "An augmentation of fortune is the means by which the greater part of men propose and wish to better their condition. It is the means the most vulgar and the most obvious" (WN II.3.28).

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