

# Adam Smith's Relevance for 1976

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“History never repeats itself.” Yet “there is nothing new under the sun.” 1976 is not 1776. Yet there are many resemblances that make Adam Smith far more immediately relevant today than he was at the Centennial of *The Wealth of Nations* in 1876. Today as in 1776,

by restraining, either by high duties, or by absolute prohibitions, the importation of such goods from foreign countries as can be produced at home, the monopoly of the home market is more or less secured to the domestic industry employed in producing them (I, 418).

Today to a far greater extent than in 1776, restrictions on foreign trade are reinforced by detailed interventions into domestic trade. Today as then, government departs very far indeed from those elementary functions that Smith regarded as alone compatible with the “obvious and simple system of natural liberty.”

Adam Smith was a radical and revolutionary in his time — just as those of us who today preach *laissez faire* are in our time. He was no apologist for merchants and manufacturers, or more generally other special interests, but regarded them as the great obstacles to *laissez faire* — just as we do today. He had no great confidence in his chances of success — any more than we have today. He wrote:

To expect, indeed, that the freedom of trade should ever be entirely restored in Great Britain, is as absurd as to expect that an Oceana or Utopia should ever be established in it. Not only the

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prejudices of the public, but what is much more unconquerable, the private interests of many individuals, irresistibly oppose it. Were the officers of the army to oppose with the same zeal and unanimity any reduction in the number of forces, with which master manufacturers set themselves against every law that is likely to increase the number of their rivals in the home market; were the former to animate their soldiers, in the same manner as the latter enflame their workmen, to attack with violence and outrage the proposers of such regulation; to attempt to reduce the army would be as dangerous as it has now become to attempt to diminish in any respect the monopoly which our manufacturers have obtained against us. This monopoly has so much increased the number of some particular tribes of them, that, like an overgrown standing army, they have become formidable to the government, and upon many occasions intimidate the legislature. The member of parliament who supports every proposal for strengthening this monopoly, is sure to acquire not only the reputation of understanding trade, but great popularity and influence with an order of men whose numbers and wealth render them of great importance. If he opposes them, on the contrary, and still more if he has authority enough to be able to thwart them, neither the most acknowledged probity, nor the highest rank, nor the greatest public services, can protect him from the most infamous abuse and detraction, from personal insults, nor sometimes from real danger, arising from the in-

solent outrage of furious and disappointed monopolists (I, 435-36).

We are in a similar state today — except that we must broaden the “tribes” of “monopolists” to include not only enterprises protected from competition but also trade unions, school teachers, welfare recipients, and so on and on.

Adam Smith’s pessimism turned out to be only partly justified. In 1846, seventy years after *of Nations* appeared, the repeal of the Corn Laws in the United Kingdom ushered in a close approximation to that freedom of trade that he regarded as a dream. On the other side of the Atlantic, a comparable degree of freedom of international trade was never achieved, but an equal degree of internal trade was.

In the past century, we have come full circle. Throughout the world, the area of free trade — international and domestic — has declined. One restraint has been piled on another. Even where trade is freest, as within the massive United States economy, government today plays a far larger role than ever it did in Adam Smith’s time, let alone in the nineteenth century high tide of *laissez faire*.

Surely, the most cheerful message we could extract from Adam Smith in this year 1976 is that we too may turn out to be wrong when we too fear that “to expect . . . that the freedom of trade should ever be entirely restored” in the United States or Great Britain, “is as absurd as to expect that an Oceana or Utopia should be established in it.”

### **I. Specific Issues**

Adam Smith is relevant to 1976 not only in the general sense just outlined, reflecting

the turn of the wheel that has brought us back to an "overgoverned society," in Walter Lippman's phrase, but also in respect to highly specific issues of policy. I shall illustrate the extraordinary contemporaneity of ***The Wealth of Nations*** by examples from my own country; but I have no doubt that equally striking examples could be adduced by my fellow members for their own more than thirty countries.

1. We have recently been edified by the latest exhausting series of presidential primaries and the electoral campaign. Is there a better description of the participants' qualities, with their characteristic and simplistic preoccupation with short term issues and tactics, than Adam Smith's reference to "that insidious and crafty animal, vulgarly called a statesman or politician, whose counsels are directed by the momentary fluctuations of affairs." (I, 432-33)

2. A major proposal of the Democratic party is the Humphrey-Hawkins Bill, which is designed to "establish a process of long-range economic planning," which sets "a long-term full-employment goal . . . at 3 percent adult unemployment, to be attained as promptly as possible, but within not more than 4 years after the date of the enactment of this Act", and which enacts elaborate governmental machinery for these purposes.

Of the reams of print that have been spilled pro and con about this bill and its immediate predecessor (the Humphrey-Javits Bill), none is more succinct and to the point than this comment by Adam Smith:

The statesman, who should attempt to direct private people in what manner they ought to employ their capitals, would not only load himself with a

most unnecessary attention, but assume an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would be nowhere so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it (I, 421).

Has any contemporary political writer described Hubert Humphrey more accurately, or more devastatingly?

3. Or consider Adam Smith's comment on the proposal by presidential candidate Ronald Reagan to decentralise government by turning back functions and taxes from the federal government to the states and cities:

The abuses which sometimes creep into the local and provincial administration of a local or provincial revenue, how enormous soever they may appear, are in reality, however, almost always very trifling, in comparison of those which commonly take place in the administration of the avenue of a great empire. They are, besides, much more easily corrected (II, 222).

4. Or weigh his comment on the effect of the growth of government intervention into business in the form of ICC, FCC, Amtrak, Con-rail, etcetera, etcetera :

Though the profusion of government must, undoubtedly, have retarded the natural progress of [the United States] \* towards wealth and improvement, it has not been able to stop it (I, 327).

The uniform, constant, and uninterrupted effort of every man to better his

\*England in the original.

condition, the principle from which public and national, as well as private opulence is originally derived, is frequently powerful enough to maintain the natural progress of things towards improvement, in spite both of the extravagance of government, and of the greatest errors of administration (I, 325).

This comment is particularly relevant in light of the tendency for enemies of freedom to attribute all defects in the world to the market and all advances to beneficent governmental intervention. As Smith stresses, improvements have come in spite of, not because of, governmental intrusion into the market place.

5. John Kenneth Galbraith, who is currently doing a BBC television series on economists through the ages, has a view very different from mine of Adam Smith's relevance today. He writes that:

a sharp and obvious distinction must be made between what was important in 1776 and what is important now. The first is very great; the second, save in the imagination of those who misuse Smith as a prophet of reaction, is much less so. . . . Smith is not a prophet for our time.

Perhaps this attitude is simply Galbraith's defensive reaction to Smith's devastating 1776 review of Galbraith's 1958 *Affluent Society* with its stress on the contrast between private affluence and public squalor, and its denigration of "tail-fins" and other items of conspicuous consumption :

It is the highest impertinence and presumption . . . in kings and ministers,

to pretend to watch over the economy of private people, and to restrain their expense, either by sumptuary laws, or by prohibiting the importation of foreign luxuries. They are themselves always, and without exception, the greatest spendthrifts in the society. Let them look well after their own expense and they may safely trust private people with theirs. If their own extravagance does not ruin the state, that of their subjects never will (I, 328).

To which might be added Smith's devastating comment:

There is no art which one government sooner learns of another, than that of draining money from the pockets of the people (II, 346).

6. As another example of Smith's relevance to specific issues, here is his comment on the widely proclaimed "social responsibility of business," and on those nauseating TV commercials that portray Exxon and its counterparts as in business primarily to preserve the environment:

I have never known much good done by those who affected to trade for the public good.

He goes on to say, and here he was unduly optimistic,

It is an effectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it (I, 421).

Unfortunately, as George Stigler has often deplored, Adam Smith showed an uncharacteristic reticence at this point and never told us what those "few words" are.

7. It pains me to conclude this list of Smith's relevance to specific issues of 1976 — but candor compels it — with two cases in which Smith provides arguments for the interventionist and statist, one minor, the other extremely important.

The minor case is Smith's defence of a legal maximum interest rate — which in part provoked Jeremy Bentham's subsequent splendid pamphlet *In Defence Of Usury*.

Smith is, of course, realistic about the limitations of such legislation, noting that where “interest of money has been prohibited by law . . . [it] has been found from experience to increase the evil of usury.” (I, 338) Accordingly, he recommended that the legal maximum “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.” (I, 338) However, he goes on to say:

the legal rate . . . ought not to be much above the lowest market rate. 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 (I, 338).

This is a highly uncharacteristic passage. Where is that “highest impertinence and presumption” for which Smith elsewhere castigates ministers who “pretend to watch over the economy of private people”? Where is the faith earlier expressed in “the uniform, constant, and uninterrupted effort of every man to better his condition”? Where is the recognition that the usurer deserves the same description as he gives the smuggler:

a person who, though no doubt highly blameable for violating the laws of his country, is frequently incapable of violating those of natural justice, and would have been, in every respect, an excellent citizen, had not the laws of his country made that a crime which nature never meant to be so (II, 381).

8. The major case in which Smith provided an argument that has since been used effectively by the statist and interventionists is in the key passage in which he describes the “three duties” that “the system of natural liberty leaves the sovereign.” The first two are unexceptionable :

first, . . . protecting the society from the violence and invasion of other independent societies; secondly . . . protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or . . . establishing an exact administration of justice.

The mischief is done by the third:

the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because the profit could

never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society (II, 184-185).

The standard textbook case is the smoke nuisance : your chimney pours out smoke that dirties my collar; you are forcing me to trade a clean collar for a dirty one; I would be more than willing to do so at the right price; but the cost of engaging in such transactions is prohibitive; hence government regulations on smoke are recommended. Another standard case is the lighthouse-one that Smith would doubtless have accepted. The trouble is that there is no transaction between individuals that does not affect third parties to some extent, however trivial, so there is literally no governmental intervention for which a case cannot be offered along these lines.

This third duty, which calls for relatively extended consideration, is mischievous because on the one hand, properly interpreted, it does specify a valid function of government; on the other hand, it can be used to justify a completely unlimited extension of government. The valid element is the argument for government intervention from third party effects — or “external economies and diseconomies” in the technical lingo that has developed. If a person’s actions impose costs or confer benefits on others for which it is not feasible for him to compensate or charge them, then strictly voluntary exchange is not feasible; the third party effects are involuntary exchanges imposed on other persons.

Smith’s own statement of the “duty” is one-sided in two different respects. First, he considers only external economies not

external diseconomies. The currently popular pollution and environmental arguments can therefore not readily be included under his words, though his central point applies to them. Second, and far more important in my view, his statement does not allow for the external effects of the governmental actions in undertaking this duty, though as we shall see, his discussion of particular government activities does do so. The major consideration that gives rise to significant third party effects of private actions is the difficulty of identifying the external costs or benefits; if identification were relatively easy, it would be possible to subject them to voluntary exchange. But this same consideration hinders government actions, making it hard to evaluate the net effects of external costs and benefits and hard to avoid superimposing an additional set of external costs and benefits in taking supposedly corrective government action. In addition, governmental actions have further external effects, via its method of finance and via the danger to freedom from the expansion of government.

Perhaps the major intellectual fallacy in this area in the past century has been the double standard applied to the market and to political action. A market “defect” — whether through an absence of competition or external effects (equivalent, as recent literature has made clear, to transaction costs) — has been regarded as immediate justification for government intervention. But the political mechanism has its “defects” too. It is fallacious to compare the actual market with the “ideal” political structure. One should either compare the real with the real or the ideal with the ideal. Unfortunately, Smith’s wording lends itself readily to this fallacy.

Smith himself spelled out at considerable length the “public works” and “public institutions” he included in his third duty. They were first of all, those required to perform the first two duties of providing for defence and a system of justice. Second came those required “for facilitating the commerce of the society,” in which he included as “necessary for facilitating commerce in general,” “good roads, bridges, navigable canals, harbours, etc.” (II, 215) Though he recommended that the expense for these should so far as possible be defrayed by “tolls and other particular charges” (II, 215), he did not regard the feasibility of so financing them as eliminating the argument for governmental rather than private construction. If a bridge or navigable canal is to be financed by specific charges, why cannot it be a private enterprise? Smith considers the question explicitly, notes that “canals are better in the hands of private persons than of commissioners” (II, 216-17) but yet concluded, on what seem to me insufficient grounds, that “the tolls for the maintenance of a high road, cannot with any safety be made the property of private persons.” (II, 217) Smith proceeded from those works and institutions for facilitating commerce in general to those for “facilitating particular branches of commerce.” (II, 223) Here his main concern was with provision for protecting foreign trade, particularly with “barbarous” nations. But as he expanded his analysis, the section turns into his famous attack on joint-stock companies.

The final major category of institutions which Smith included in his third duty were “the institutions for the education of youth” (II, 244). Here again, he favoured financing them largely by specific fees. Despite Smith’s

acceptance of the appropriateness of governmental establishment and maintenance of such institutions, he devotes most of his discussion to a scathing attack on the effects of governmental or church control of institutions of learning — and his comments have a direct relevance today. He observes:

Those parts of education . . . for teaching of which there are no public institutions, are generally the best taught. When a young man goes to a fencing or a dancing school, he does not indeed always learn to fence or to dance very well; but he seldom fails of learning to fence or to dance (II, 253-54).

Today, try talking French with a graduate of a public high school — or of a Berlitz school.

Were there no public institutions for education, no system, no science would be taught for which there was not some demand; or which the circumstances of the times did not render it either necessary, or convenient, or at least fashionable to learn (II, 266).

Despite his initial assertion that the erection of institutions for the education of the youth is included in the third duty, these considerations lead him to ask “Ought the public, therefore, to give no attention . . . to the education of the people?” and to answer rather equivocally, “In some cases, it ought, in others it need not.” (II, 267) . . . “In a civilised and commercial society the education of the common people requires . . . the attention of the public more than that of people of some rank and fortune.” (II, 269) He concludes :

For a very small expense, the public can facilitate, can encourage, and can

even impose upon almost the whole body of the people, the necessity of acquiring those most essential parts of education [to read, write, and account]. The public can facilitate this acquisition by establishing in every parish or district a little school, where children may be taught for a reward so moderate, that even a common labourer may afford it; the master being partly, but not wholly paid by the public; because, if he was wholly, or even principally paid by it, he would soon learn to neglect his business (II, 270).

As this brief summary suggests, Smith himself did not regard his third duty as providing extensive scope for governmental activity. I do not criticise him for not recognising its potential for abuse. Though his prescience leads us to analyse *The Wealth of Nations* as if it were a contemporary publication, he did not have our experience but had to rely on his own. To illustrate in a trivial way, could anyone write today as he did then, “The post office . . . has been successfully managed by, I believe, every sort of government”? (II, 303)

But since he wrote, there is hardly an activity which has not been regarded as suitable for governmental intervention on Smith’s ground. It is easy to assert, as Smith himself does again and again, that there are “external effects” which make something or other in the “public interest” even though not in the “interest of any individual or small number of individuals.” There are no widely accepted objective criteria by which to evaluate such claims, to measure the magnitude of any external effects, to identify the external effects of the governmental actions, and to set them against the external effects of

leaving matters in private hands. Superficially scientific cost-benefit analysis erected on Smith's basis has proved a veritable Trojan horse.

## **II. General Issues**

Beyond the particular issues just discussed, Smith's great importance for 1976, and his great achievement — as Hayek and others have so eloquently pointed out — is the doctrine of an “invisible hand,” his vision of the way in which the voluntary actions of millions of individuals can be coordinated through a price system without central direction :

As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it . . . he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it (I, 421).

This is a highly sophisticated and subtle insight. The market, with each individual going his own way, with no central authority setting social priorities, avoiding duplication, and coordinating activities, looks like chaos

to the naked eye. Yet through Smith's eyes we see that it is a finely ordered and delicately tuned system, one which arises out of man's actions, yet is not deliberately created by man. It is a system which enables the dispersed knowledge and skill of millions of people to be coordinated for a common purpose. Men in Malaya who produce rubber, in Mexico who produce graphite, in the state of Washington who produce timber, and countless others, cooperate in the production of an ordinary rubber-topped lead pencil — to use Leonard Read's vivid image — though there is no world government to which they all submit, no common language in which they could converse, and no knowledge of the purpose for which they cooperate.

Smith is often interpreted — and criticised — as the high priest of egotism and selfishness. That is very far from being the case. He was, first of all, a scientist who, driven by a sense of “wonder,” excited by “incoherences” in the processes of the economy, sought “some chain of intermediate events, which, by connecting them with something that has gone before, may render the whole course of the universe consistent and of a piece.”<sup>\*</sup> The subtle analysis of the price system was the result.

But second, on the moral level, Smith regarded sympathy as a human characteristic, but one that was itself rare and required to be economised. He would have argued that the invisible hand was far more effective than the visible hand of government in mobilising not only material resources for immediate

<sup>\*</sup>Quoted words from Smith's *History of Astronomy*, as quoted by W.P.D. Wightman, “Adam Smith and the History of Ideas” *Essays on Adam Smith* edited by Andrew S. Skinner and Thomas Wilson (Clarendon Press, Oxford, 1975), p. 50.

self-seeking ends but also sympathy for unselfish charitable ends. And the nineteenth century is a dramatic vindication. In both the United States and the United Kingdom, that century comes about as close to Smith's system of natural liberty as it is reasonable to hope to achieve. And in both countries that century saw the greatest outpouring of eleemosynary and publicly directed activity that the world has ever seen. It was, in the United States, a century that produced a proliferation of private colleges and universities, of foreign missions, of non-profit community hospitals, of the Society for the Prevention of Cruelty to Animals, of the nongovernment "public" library, of the Rockefeller and Carnegie Foundations, and so on and on. In Britain, the overwhelming bulk of hospital beds today are in the hospitals constructed in the nineteenth century through voluntary activity.

Though Smith fully develops the regulating market mechanism only in *The Wealth of Nations*, already in the *Theory of Moral Sentiments*, he is fully aware of the difference between an imposed order and what he would have called a natural order. In what is my own favorite Smith quotation he gives a devastating critique of the modern well-intentioned interventionist who wants to attack major social problems via the political mechanism. Smith's name for him was "The man of system."

The man of system . . . seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chessboard; he does not consider that the pieces upon the chessboard have no other principle of motion

besides that which the hand impresses upon them; but that, in the great chess-board of human society, every single piece has a principle of motion of its own, altogether different from that which the legislature might choose to impress upon it. If those two principles coincide and act in the same direction, the game of human society will go on easily and harmoniously, and is very likely to be happy and successful. If they are opposite or different, the game will go on miserably, and the society must be at all times in the highest degree of disorder.\*

The failure to understand this profound observation has produced an invisible hand in politics that is the precise reverse of the invisible hand in the market. In politics, men who intend only to promote the public interest, as they conceive it, are “led by an invisible hand to promote an end which was no part of” their intention. They become the front-men for special interests they would never knowingly serve. They end up sacrificing the public interest to the social interest, the interest of the consumers to that of the producers, of the masses who never go to college to that of those who attend college, of the poor working class saddled with employment taxes to the middle class who get disproportionate benefits from social security, and so down the line.

The invisible hand in politics is as potent a force for harm as the invisible hand in economics is for good. At the moment, unfortunately, it seems to have the upper hand. But the outlook is not entirely bleak. The

\*Theory of Moral Sentiments, Arlington House reprint with introduction by E.G. West, pp. 342-43.

far greater capacity of the many millions of ordinary men to find ways around government regulations than of the fewer millions of bureaucrats to plug the leaks, provides some measure of freedom. The inefficiency of government arouses the resentment of the citizen, offers the hope of a tax revolt, and encourages a widespread anti-Washington sentiment. Perhaps it is not entirely chimerical to hope that our corn laws too will one day be overturned.