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ADAM SMITH AND ECONOMIC LIBERALISM

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FOREWORD

Founded in 1984, The David Hume Institute specialises in the study of public policy issues which employ the professional skills of economists and lawyers. Apart from commissioning publications (as listed on the back cover) and organising conferences, it has sponsored The Hume Lecture series. Professor Skinner's lecture is the fifth in this series to be published.

The Institute has followed closely the numerous, sometimes bizarre, claims made by policy makers and their critics to be the legitimate intellectual descendants of David Hume's close friend Adam Smith. The **Wealth of Nations** risks the charge levelled by the ignorant theatregoer who viewed Hamlet as a derivative work 'full of quotations'. Full of pithy quotable comments it certainly is, but the work requires close study in order to grasp its policy message and its relevance for contemporary policy debate. Professor Skinner, a member of the Institute's Advisory Council, is ideally fitted to inform us on what Adam Smith actually said and meant.

The Institute is obliged to make it clear that it has no political orientation and is not necessarily in agreement with the views of its lecturers and authors. It will be crystal clear to the reader, however, that the Institute is fortunate indeed in having persuaded Professor Skinner to allow it to publish his text.

Alan Peacock
Executive Director.

Adam Smith and Economic Liberalism

I

Adam Smith was born in 1723 and died in 1790. His life spanned events of great importance in Great Britain; the Rebellion of 1745 which was designed to restore the House of Stuart; the humiliation of France in 1763, which gave Britain a degree of influence which was only matched by that enjoyed by Holland in the seventeenth century; the beginning of the French Revolution.

These events are all very distant and yet Smith's teaching in certain areas commands and has commanded, support from a wide range of thinkers attracted by his eloquent claim that the sovereign should discharge himself from a duty:

> 'in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society' (WN, IV. ix. 51). [1]

The celebration to mark the fiftieth anniversary of the book showed wide and continuing acceptance of this doctrine.

In 1876, at a dinner held by the Political Economy Club to mark the centenary of the **Wealth of Nations** one speaker identified free trade as the most important consequence of the work done by 'this simple Glasgow professor'. It was also predicted that 'there will be what may be called a large negative development of Political Economy tending to produce an important beneficial effect; and that is, such a development of Political Economy as will reduce the functions of government within a smaller and smaller compass'. It is hardly surprising that a contemporary leader in the **Times** could claim that 'the time is not yet distant when the supremacy of Adam Smith's teaching shall surpass his largest hopes'. [2]

Nor is Professor Stigler's famous claim, uttered a hundred years later on the occasion of the 1976 conference, lightly to be dismissed: 'Adam Smith is alive and well and living in Chicago'. Smith is, after all, a modern authority, in the eyes of the Chicago School and many others, including Mrs. Thatcher.

It is not the intention of this paper directly to dispute Professor Stigler's claim, but rather to suggest that Smith's position is subtler and more informative than it sometimes appears. Especially is this the case when we see Smith's economic analysis in the context of his treatment of ethics and jurisprudence. When Smith was a professor in Glasgow he lectured on ethics, jurisprudence and economics in that order and we also know that he intended to publish a third book (on government) which would have completed a comprehensive system of the moral sciences; a grand design which was still possible to contemplate and largely to execute in his time.[3]

The main parts of Smith's great system represented by the **Theory of Moral Sentiments** (1759), the **Lectures on Jurisprudence**, and the **Wealth of Nations** (1776) are important of themselves, and also inter-related. The **Moral Sentiments**, based on the ethical part of the lecture course delivered in Glasgow, is primarily concerned with the way in which moral judgement is formed and in part designed to explain the emergence of those barriers which control our passions. The argument gives prominence to the emergence of general rules of conduct, including the rules of law, but also confirms that accepted standards of behaviour are related to environment so that they may vary in different societies at the same point in time and in the same society at different points in time. The lectures on jurisprudence, on the other hand, help to explain the emergence of government and its changing structure through time in terms of an analysis which features the use of four distinct socio-economic stages; the stages of hunting, pasture, agriculture and commerce. This dimension in Smith's thought has attracted the admiring attention of Marxist scholars. [4]

In the context of the **Wealth of the Nations**, the main thrust of the argument is designed to explain the origin of the feudal form of government and the emergence of the stage of commerce. While the same points are made in the **Lectures**, the constitutional dimension is there more marked in the sense that Smith was concerned to explain a gradual shift in the

balance of power which, at least in the peculiar circumstances of England, had led to the House of Commons assuming a position of some dominance.

The ethics and Smith's historical treatment of constitutional law were also closely linked with the analysis of political economy which was to follow.

The lectures on public jurisprudence help to specify the nature of the system of positive law which will be consistent with the attainment of the stage of commerce and throw some light on the form of government which might be expected. The same analysis helps to explain the structure of the modern economy and the emergence of a situation where all goods and services command a price. Here 'Every man ... lives by exchanging, or becomes in some measure a merchant' (WN, I. iv. 1). If Smith gave prominence to the role of self-interest in this context and in this area of activity, auditors of the lectures on ethics, and readers of the **Moral Sentiments** would be aware that the drive to better our condition had a social reference; that 'it is chiefly from this regard to the sentiments of mankind, that we pursue riches and avoid poverty' (TMS, I. iii. 2. 1). Later in the book the position was further clarified when Smith stated that we tend to approve the **means**, as well as the **ends**, of ambition. 'Hence... that eminent esteem with which all men naturally regard a steady perseverance in the practice of frugality, industry, and application'; and esteem which is alone capable of sustaining such conduct, since in the normal course of events the 'pleasure which we are to enjoy ten years hence interests us to little in comparison with that which we enjoy today' (TMS, IV. 2. 8).

It is significant to note that the most complete discussion of the complex social psychology of the 'economic Man' is to be found in the **Moral Sentiments** - and especially in Part VI which was added in the last year of Smith's life.[5]

As far as the purely economic analysis is concerned, the familiar tale need not detain us; it is sufficient to be reminded that in the **Wealth of Nations** the theory of price and allocation was developed in terms of a model which made due allowance for distinct factors of production land, labour, capital) and for the appropriate forms of return (rent, wages, profit). This

point, now so obvious, struck Smith as novel and permitted him to develop an analysis of the allocative mechanism which ran in terms of inter-related adjustments in both factor and commodity markets. The resulting version of general interdependence also allowed Smith to move from the discussion of 'micro' to that of 'macro' economic issues, and to develop a model of the 'circular flow' which relies heavily on the distinction, already established by the Physiocrats, between fixed and circulating capital.[6]

But these terms, which were applied to the activities of individual undertakers, were transformed in their meaning by their application to society at large. Working in terms of period analysis, Smith in effect represented the working of the economic process as a series of activities and transactions which linked the main socio-economic groups (proprietors, capitalists, and wage-labour). In Smith's terms, current purchases in effect withdrew consumption and investment goods from the circulating capital of society; goods which were in turn replaced by virtue of productive activity in the same time period.

Looked at from one point of view, the analysis taken as a whole provides one of the most dramatic examples of the doctrine of 'unintended social outcomes', or the working of the 'invisible hand'. The individual undertaker (entrepreneur), seeking the most efficient allocation of resources contributes to overall economic efficiency; the merchant's reaction to price signals helps to ensure that the allocation of resources accurately reflects the structure of consumer preferences; the drive to better our condition contributes to economic growth. Looked at from another perspective, the work can be seen to have resulted in a great conceptual system linking together logically separate, yet inter-related, problems such as price, allocation, distribution, macro-statics and macro-dynamics.[7]

The argument is also buttressed by a series of judgements as to **probable** patterns of behaviour and **actual** trends of events. It was Smith's firm opinion, for example, that in a situation where there was tolerable security, 'The sole use of money is to circulate consumable goods. By means of it, provisions, materials, and finished work, are bought and sold, and distributed to their proper consumers' (WN, II. iii. 23). In the same way he contended that the savings generated during any (annual) period would

always be matched by investment (WN, II. iii. 18); a key assumption of the classical system which was to follow. In the case of Great Britain, Smith also pointed out that real wages had progressively increased during the eighteenth century, and that high wages were to be approved of as a contribution to productivity (WN, I. vii, 44). The tone is buoyant with regard to economic growth, and is duly reflected in the policy stance which Smith was to adopt.

II

Smith's prescriptions, with regard to economic policy, followed directly on the analysis just considered. He called on governments to minimise their 'impertinent' obstructions to the pursuits of individuals. In particular he recommended that the statutes of apprenticeship, and the privileges of corporations should be repealed on the ground that they adversely affect the working of the allocative mechanism. In the same chapter Smith pointed to the barriers to the deployment of labour generated by the Poor Laws and the Laws of Settlement (cf. WN, I. x. c.; IV. ii. 42).

He also objected to positions of privilege, such as monopoly powers, which he regarded as creatures of the civil law. The institution was again represented as impolitic and unjust: unjust in that a position of monopoly is a position of unfair advantage, and impolitic in that the prices of the goods so controlled are 'upon every occasion the highest which can be got' (WN, I. vii. 27).

In this context we may usefully distinguish Smith's objection to monopoly in general from his criticism of one manifestation of it; namely, the mercantile system, described as the 'modern system' of policy, best understood 'in our own country and in our own times' (WN, IV. 2). In Smith's view the most dramatic example of this policy was to be found in the regulations which controlled the relationship between Britain and America, and which were designed in effect to create a single economic community based upon complementary activities and markets. But again he noted that such a policy was liable to 'that general objection which may be made to all the different expedients of the mercantile system; 'the

objection of forcing some part of the industry of the country into a channel less advantageous than that in which it would run of its own accord' (WN, IV. v. a. 24).[8]

But if this is the general position with which Smith is usually associated it should be noted that he was prepared to justify a wide range of policies, all of which have been carefully catalogued by Jacob Viner in his justifiably famous article on 'Adam Smith and Laisser Faire' (1928). For example Smith was prepared to justify the use of stamps on plate and linen as the most effectual guarantee of quality (WN, I.x. c. 13), the compulsory regulation of mortgages (WN, I. ix. 16) and government control of the coinage. In addition he defended the granting of temporary monopolies to mercantile groups on particular occasions, to the inventors of new machines, and, not surprisingly, to the authors of new books (WN, V. i.e. 30).

Four broad areas of intervention are of particular interest, in the sense that they involve wider issues of general principal. First, Smith advised governments that where they were faced with taxes imposed by their competitors in trade retaliation could be in order especially if such an action had the effect of ensuring the 'repeal of the high duties or prohibitions complained of'. Secondly, Smith advocated the use of taxation, not simply as a means of raising revenue, but as a means of controlling certain activities, and of compensating for what would now be known as defective telescopic faculty, i.e. a failure to perceive our long-run interest. In the name of the public interest, smith supported taxes on the retail sale of liquor in order to discourage the multiplication of alehouses (WN, V. ii. g. 4) and differential rates on ale and spirits in order to reduce the sale of the latter (WN, V. ii. k. 50). To take another example, he advocated taxes on those proprietors who demanded rents in kind rather than cash, and on those leases which prescribe a certain form of cultivation. In the same vein, we find Smith arguing that the practice of selling a future revenue for the sake of ready money should be discouraged on the ground that it reduced the working capital of the tenant and at the same time transferred a capital sum to those who would use it for the purposes of consumption (WN, V. ii. c. 12).

The examples are few, but the basic principles are extremely important and capable of wide application. Smith is here suggesting that the state is

justified in intervening to offset the consequences of ignorance and lack of knowledge or fore-thought on the part of individuals or groups of individuals.

Smith was also well aware, to take a third point, that the modern version of the 'circular flow' depended on paper money and on credit; ;in effect a system of 'dual circulation' involving a complex of transactions linking producers and merchants, dealers and consumers (WN, II. ii. 88); transactions that would involve cash (at a level of the household) and credit (at the level of the firm). It is in this context that Smith advocated control over the rate of interest, set in such a way as to ensure that 'sober people are universally preferred, as borrowers, to prodigals and projectors' (WN, II. iv. 15).[9] He was also willing to regulate the small note issue in the interests of a stable banking system. To those who objected to this proposal, he replied that the interests of the community required it, and concluded that 'the obligation of building party walls, in order to prevent the communication of fire, is a violation of natural liberty, exactly of the same kind with the regulations of the banking trade which are here proposed' (WN, II. ii. 94).

Although Smith's monetary analysis is not regarded as amongst the strongest of his contributions, it should be remembered that the witness of the collapse of major Banks in the 1770's was acutely aware of the problems generated by a sophisticated credit structure. It was in this context that Smith articulated a very general principle, namely, that 'those exertions of the natural liberty of a few individuals, which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments; of the most free, as well as of the most despotical' (WN, II. ii. 94). One wonders what he might have made of the recent stock market crash.

While the state must provide for the important services of justice and defence, emphasis should be given, finally, to Smith's contention that a major responsibility of government must be the provision of certain public works and institutions for facilitating the commerce of the society which were 'of such a nature, that the profit could never repay the expence to any individual or small number of individuals, and which it, therefore, cannot be expected that any individual or small number of individuals should-

erect or maintain' (WN, V. i. c. 1). In short he was concerned to point out that the state would have to organise services or public works which the profit motive alone could not guarantee.

The examples of public works which smith provided include such items as roads, bridges, canals and harbours - all thoroughly in keeping with the conditions of the time and with Smith's emphasis on the importance of transport as a contribution to the effective operation of the market and to the process of economic growth. But although the list is short by modern standards, the discussion of what may be called the 'principles of provision' is of interest for the emphasis given to situations where market forces **alone** will not generate services or facilities which are necessary to the economic well-being of the whole.

So far we have treated the linkages between the parts of Smith's course in a particular way; that is by looking forward from the ethics and the jurisprudence to the economic analysis, and thus to the policy prescriptions which have just been considered. But there is also a sense in which it is useful to look back to the ethics and the jurisprudence from the vantage point supplied by the **Wealth of Nations.**

III

With regard to the ethics. the most important aspect is surely to be found in Smith's concern with the social and psychological costs of economic growth.[10]

Two major issues arise:

It will be recalled that for Smith moral judgement depends on our capacity for acts of imaginative sympathy and that such acts can only take place within the context of some social group (TMS, III. i. 3). However, Smith also observed that the mechanism of the impartial spectator might well break down in the context of the modern economy, due in part to the size of some manufacturing units and of the cities which housed them.

Smith observed that in the actual circumstances of modern society, the poor man could find himself in a situation where the 'mirror of society (TMS, III. i. 3) was inoperative. As Smith noted, the 'man of rank and fortune is by his station the distinguished member of a great society, who attend to every part of his conduct, and who thereby oblige him to attend to every part of it himself'. But, Smith went on, the 'man of low condition', while 'his conduct may be attended to' so long as he is a member of a country village, 'as soon as he comes into a great city, he is sunk in obscurity and darkness. His conduct is observed and attended to by nobody, and he is therefore very likely to neglect it himself, and to abandon himself to every sort of low profligacy and vice' (WN, V. i. g. 12); a problem unlikely to be offset by membership of the family, since the prevailing mode of earning subsistence makes it easy for its members to 'separate and disperse, as interest or inclination may direct' (TMS, VI. ii. 1. 17, 13).

In the modern context, Smith suggests that the individual thus placed would naturally seek some kind of compensation, often finding it not merely in religion but in religious sects: that is, in small social groups within which the individual can acquire 'a degree of consideration which he never had before' (WN, V. i. g. 12). Smith noted that the morals of such sects were often disagreeably 'rigorous and unsocial',[11] and recommended two policies to offset this.

The first is learning, on the ground that science is 'the great antidote to the poison of enthusiasm and superstition'. It is interesting to observe that what Smith had in mind was an informed 'middling' rank of men whose influence would support the poor. In this context, Smith suggested that government should act 'by instituting some sort of probation, even in the higher and more difficult sciences, to be undergone by every person before he was permitted to exercise any liberal profession, or before he could be received as a candidate for any honourable office of trust or profit' (V. i. g. 14).

The second remedy was through the encouragement given to those who might expose or dissipate the folly of sectarian bitterness by encouraging an interest in painting, music, dancing, drama - and satire (V. i. g.15).[12]

If the problem of solitude and isolation consequent on the growth of cities explain Smith's first group of points, a related trend in the shape of the division of labour helps to account for the second. In discussing this important source of economic benefit (which is emphasised to an extraordinary degree in the **Wealth of Nations**) Smith noticed that it could involve costs. Or, as Smith put it in one of the most famous passages from the **Wealth of Nations**:

> 'In the progress of the division of labour, the employment of the far greater part of those who live by labour, that is, of the great body of people, comes to be confined to a few very simple operations; frequently to one or two. But the understandings of the greater part of men are necessarily formed by their ordinary employments. The man whose whole life is spent in performing a few simple operations, of which the effects too are, perhaps, always the same, or very nearly the same, has no occasion to exert his understanding, or to exercise his invention in finding out expedients for removing difficulties which never occur. He naturally loses, therefore, the habit of such exertion, and generally becomes as stupid and ignorant as it is possible for a human creature to become' (WN, v. i. f. 50).

It is the fact that the 'labouring poor, that is the great body of the people' must necessarily fall into the state outlined that makes it necessary for government to intervene.

Smith's justification for intervention is, as before, market failure, in that the labouring poor, unlike those of rank and fortune, lack the leisure, means, or (by virtue of their occupations) the inclination to provide education for their children (V. i. f. 53). In view of the nature of the problem, Smith's programme seems rather limited, but he did argue that the poor could be taught 'the most essential parts of education .... to read, write, and account' together with the 'elementary parts of geometry and mechanics' (V. i. f. 54,55).

It is interesting to observe in this context that Smith was prepared to go so far as to infringe the natural liberty of the subject, at least where the latter is narrowly defined, in recommending that the 'public can impose upon almost the whole body of the people the necessity of acquiring those

most essential parts of education, by obliging every man to undergo an examination or probation in them before he can obtain the freedom in any corporation, or be allowed to set up any trade either in a village or town corporate (V. i. f. 57).

Distinct from the above, although connected with it, is Smith's concern with the decline of martial spirit which is the consequence of the nature of the fourth, or commercial stage.

In the **Wealth of Nations** Smith seems to have had in mind the provision of some kind of military education which he supported as a contribution to the well-being of the individual.

He concluded that 'Even though the martial spirit of the people were of no use towards the defence of the society, yet to prevent that sort of mental mutilation, deformity and wretchedness, which cowardice necessarily involves in it, from spreading themselves through the great body of the people, would still deserve the most serious attention of government' (WN, V. i. f. 60). Smith went on to liken the control of cowardice to the prevention of 'a leprosy or any other loathsome and offensive disease' - moving Jacob Viner to add public health to Smith's already lengthy list of governmental functions.[13]

IV

Smith not only identified the various services which the state was expected to provide; he also gave a great deal of attention to the forms of organisation which would be needed to ensure efficient delivery.

In the discussion of defence, for example, he noted that the 'wisdom of the state' (V. i. a. 14) would have to be deployed given the expense of modern warfare and the structure of the modern economy. Of the options open to Governments, he preferred a standing army to a militia because the former would be more specialised and therefore more efficient (V. i. a. 14). Recognising the political dangers which were involved in this solution, he was careful to add that it would be acceptable only:

> 'where the sovereign is himself the general, and the principal nobility and gentry of the country the chief officers of the army; where the military force is place under the command of those who have the greatest interest in the support of the civil authority, because they have themselves the greatest share of that authority' (V. i. a. 41).

Smith argued that since the (great) expense involved was laid out ' for the general benefit of the whole society', it ought to be defrayed 'by the general contribution of the whole society, all the different members contributing, as nearly as possible, in proportion to their respective abilities' (V. i.i. 1).

In the case of justice, Smith contended that the sovereign has the duty 'of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it' (V. i. b. 1). Here he contended that effective provision of so central a service depended crucially on a clear separation of the judicial from the executive power (V. i. b. 23).

As Alan Peacock has pointed out, Smith's efficiency criteria are distinguished from this basic issue of organization, the argument being, in effect, that the services provided by attorneys, clerks, or judges should be paid for in such a way as to encourage productivity.[14] Smith also ascribed the 'present admirable constitution of the courts of justice in England' to the use of a system of court fees which had served to encourage competition between the courts of kings's bench, chancery, and exchequer (WN. V. i. b. 20,21). A further interesting and typical feature of the discussion is found in Smith's argument that although justice is a service to the whole community, none the less, the costs of handling specific causes should be borne by those who give occasion to, or benefit from, them. He therefore concluded that the 'expence of the administration of justice ... may very properly be defrayed by the particular contribution of one or other, or both of those two different sets of persons, according as different occasions may require, that is, by fees of court' (V. i. i. 2), rather than by a charge on general funds.

Smith's treatment of justice is of interest because it reveals many of the basic principles which underlie his discussion of public finance. In general Smith believed that the state should ensure that services are provided

indirectly (rather than by means of provision organised and controlled from the centre); that such services should be self-financing wherever possible, and especially that those services should be 'so structured as to engage the motives and interests of those concerned'.[15]

In the case of elementary education he argued that the British Government should ensure provision by setting up institutions similar to the Scottish Parish Schools:

> 'where children may be taught for a reward so moderate, that a common labourer may afford it; the master being partly, but not wholly paid by the publick; because if he was wholly, or even principally paid by it, he would soon learn to neglect his business' (V. i. f. 55).

The 'incentive' argument is also eloquently developed in Smith's treatment of universities where he argued that degrees can be likened to the statutes of apprenticeship (Corr., 177) and protested against the idea of universities having a monopoly of higher education (Corr., 174). In particular Smith objected to a situation where professors enjoyed a stable and high income irrespective of competence or industry (WN, V. i. f. 7). In the same context he argued in favour of free movement of students between teachers and institutions (V. i. f. 12, 13) as a means of inducing teachers to provide appropriate services. Smith concluded:

> 'The expence of the institutions for education and religious instruction is ... beneficial to the whole society, and may, therefore, without injustice, be defrayed by the general contribution of the whole society. This expence, however, might perhaps with equal propriety, and even with some advantage, be defrayed altogether by those who receive the immediate benefit of such education and instruction, or by the voluntary contribution of those who think they have occasion for either the one or the other' (V. i. i. 5).

The theme was continued in the discussion of 'public works' where Smith suggested that the main problems to be addressed were those of equity and efficiency.

With regard to equity, Smith argued that public works such as highways, bridges, and canals should be paid for by those who use them and in

proportion to the wear and tear occasioned. At the same time, he argued that the consumer who pays the charges generally gains more from the cheapness of carriage than he loses in the charges incurred:

> 'The person who finally pays this tax, therefore, gains by the application, more than he loses by the payment of it. His payment is exactly in proportion to his gain. It is in reality no more than a part of that gain which he is obliged to give up in order to get the rest. It seems impossible to imagine a more equitable method of raising a tax' (WN, V. i. d. 4).

In addition, he suggested that tolls should be higher in the case of luxury goods so that by this means 'the indolence and vanity of the rich is made to contribute in a very easy manner to the relief of the poor, by rendering cheaper the transportation of heavy goods .....' (V. i. d. 5).

Smith also defended the principle of direct payment on the ground of **efficiency**. Only by this means, he argued, would it be possible to ensure that services are provided where there is a recognizable need; only in this way would it be possible to avoid building roads through a desert for the sake of some private interest; or a great bridge 'thrown over a river at a place where nobody passes, or merely to embellish the view from the windows of a neighbouring palace: things which sometimes happen, in countries where works of this kind are carried on by any other revenue than that which they themselves are capable of affording' (V. i. d. 6). In the same vein he argued against government 'taking the management of the turnpikes into its own hand', and settling the charges, on the ground that the tolls levied would come to reflect the needs of the state rather than of the roads; that such charges would be highly regressive, and that 'it would be still more difficult, than it is at present, to compel the proper application of any part of the turnpike tolls' (V. i. d. 14).

Smith also argued that while governments must be responsible for establishing major public works, care should be taken to ensure that the services were administered by such bodies or under such conditions as made it in the interest of individuals to do so effectively. Smith tirelessly emphasized the point, already noticed in the discussion of justice, namely, that in every trade and profession 'the exertion of the greater part of those who exercise it, is always in proportion to the necessity they are under of

making that exertion' (V. i. f. 4). On this ground he approved of the expedient used in France, whereby a construction engineer was made a present of tolls on a canal for which he had been responsible - thus ensuring that it was in his interest to keep the canal in good repair.

Smith used a number of such devices: advocating for example that the administration of roads would have to be handled in a different way from canals because of course they are passable even when full of holes. Here he suggested that the 'wisdom of parliament' would have to be applied to the appointment of proper persons, with 'proper courts of inspection' for 'controlling their conduct, and for reducing the tolls to what is barely sufficient for executing the work to be done by them' (V. i. d. 9).

Smith also recognised that such services could not always be paid for by those who used them, arguing that in such cases 'local or provincial expences of which the benefit is local or provincial' ought, so far as possible, to be no burden on general taxation, it being 'unjust that the whole of society should contribute towards an expence of which the benefit is confined to a part of the society' (V. i. i. 3). But here again it is argued (in the interests of efficiency) that such services 'are always better maintained by a local and provincial administration, than by the general revenue of the state, of which the executive power must always have the management' (V. i. d. 18).

It is also worth noting that even where recourse has to be made to general taxation, Smith argued that such taxes should be imposed in accordance with the generally accepted canons of taxation;[16] that so far as possible such taxes should avoid interference with the allocative mechanism, and that they ought not to constitute disincentives to the individual effort on which the working of the system has been seen to depend (for example, taxes on profits).

V

The historical dimension of Smith's work also affects the treatment of public policy, noting as he did that in every society subject to a process of transition, 'Laws frequently continue in force long after the circumstances,

which first gave occasion to them, and which could alone render them reasonable, are no more' (WN, III. ii. 4). In such cases Smith suggested that arrangements which were once appropriate but are no longer so should be removed, citing as examples the laws of succession and entail which were represented by Smith as the remnants of a past, feudal society. While Smith's treatment of justice and defence provide remarkable examples of his capacity to deploy historical materials, perhaps the most interesting aspect of the discussion from the standpoint of the emphasis on Smith and public policy, arises from the broadly constitutional dimension of his historical treatment of jurisprudence, to which we drew attention at the outset.

It will be recalled that for Smith the fourth economic stage could be seen to be associated with a particular form of social and political structure which influence the outline of government and the context within which it must function. It may be noted in this connection that Smith associated the fourth economic stage with the advent of freedom in the 'present sense of the term'; that is, with the elimination of the relation of direct dependence which had been characteristic of the feudal agrarian period. Politically, the significant and associated development appeared to be the diffusion of power consequent on the emergence of new forms of wealth such as trade and manufacture which, at least in the peculiar circumstances of England, had been reflected in the increased significance of the House of Commons as compared to the House of Lords.[17]

In elaborating on this theme, Smith suggested that 'free governments' of the kind established in England and confirmed by the Revolution Settlement in the late seventeenth century inevitably operate within a particularly sensitive political and economic environment.

Smith drew attention to the fact that modern government of the British type was a complex instrument. Smith seems to have felt, for example, that the management of Parliament through the distribution of offices was 'a necessary feature of the British mixed government' (Cf. WN, IV. vii. c. 69);[18] a point which is in turn linked to the fact that the pursuit of office was itself a 'dazzling object of ambition': a competitive game with as its object the attainment of 'the great prizes which sometimes come from the wheel of the great state lottery of British politics' (WN, IV. vii. c. 75).

Smith added, in a passage which reflects the psychological assumptions of the **Theory of Moral Sentiments** (I. iii. 2, 'Of the Origin of Ambition'), that:

> 'Men desire to have some share in the management of publick affairs chiefly on account of the importance which it gives them. Upon the power which the greater part of the leading men, the natural aristocracy of every country, have of preserving or defending their respective importance, depends the stability and duration of every system of free government' (WN, IV. vii. c. 74).

This point lead on to another which was emphasised by Smith, namely that the same economic forces which had served to elevate the House of Commons to a superior degree of influence had also served to make it an important focal point for sectional interests - a development which could seriously affect the legislation which was passed and thus affect that extensive view of the common good which ought ideally to direct the activities of Parliament, in fulfilling the functions of government outlined above.

It is recognised in the **Wealth of Nations** that the landed, moneyed, manufacturing, and mercantile groups all constitute special interests which could impinge on the working of government. Smith referred frequently to their 'clamorous importunity', and in speaking of the growth of monopolies pointed out that government policy ' 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' (WN, IV. ii. 43). In this connection it was suggested that the nature of the colonial relationship with America had been the product of the 'sneaking arts of underlying tradesmen'. He concluded that: 'Of the greater part of the regulations concerning the colony trade, the merchants who carry it on, it must be observed, have been the principal; advisers. We must not wonder, if, in the greater part of them, their interest has been more considered than either that of the colonies or that of the mother country' (WN. IV. vii. b. 49). Indeed Smith went further in suggesting that the legislative power possessed by employers generally could seriously disadvantage other classes in society. As he put it: 'Whenever the legislature attempts to regulate the

differences between masters and their workmen, its counsellors are always the masters . When the regulation, therefore, is in favour of the workmen, it is always just and equitable; but it is sometimes otherwise when in favour of the masters' (WN, I. x. c. 61; cf. I. viii. 12, 13). Smith thus insisted that any legislative proposals emanating from this class:

> 'ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from and order of men, whose interest is never exactly the same with that of the publick, who have generally an interest to deceive and even to oppress the publick, and who accordingly have, upon many occasions, both deceived and oppressed it' (WN, I. xi. p. 10).

But at the same time, Smith noted that governments on the English model were likely to be particularly sensitive to public opinion - and as frequently constrained by it. Smith made much of the point and in a variety of ways. He noted, for example, that even if the British Government of the 1770's had thought it possible voluntarily to withdraw from the current conflict with America it could not pursue this eminently rational course. As he remarked in a Memorandum addressed to Alexander Wedderburn, Solicitor-General in Lord North's administration at the time of Saratoga: 'tho this termination of the war might be really advantageous, it would not, in the eyes of Europe appear honourable to Great Britain; and when her empire was so much curtailed, her power and dignity would be supposed to be proportionally diminished. What is of still greater importance, it could scarce fail to discredit the Government in the eyes of our own people ... (it) ... would have everything to fear from their rage and indignation at the public disgrace and calamity, for such they would suppose it to be, of thus dismembering the empire' (Corr., 383).

Smith gave a great deal of attention to the general problems presented by the confirmed habits and prejudices of a people and to the need to adjust legislation accordingly. For example, he likened the fear of engrossing and forestalling in discussing the corn trade, 'to the popular terrors and suspicions of witchcraft' (IV. v.b. 26), and described the law dealing with the exportation of wheat as one which 'though not the best in itself, is the

best which the interests, prejudices, and temper of the Times would admit of' (IV. v. b. 63). The reference to Solon in the context of the previous discussion finds an echo in the **Moral Sentiments** (VI. ii. 2. 16) where it is stated that when the legislator: 'cannot conquer the rooted prejudices of the people by reason and persuasion, he will not attempt to subdue them by force ... He will accommodate, as well as he can, his public arrangements to the confirmed habits and prejudices of the people; and will remedy as well as he can, the inconveniences which may flow from the want of those regulations which the people are averse to submit to. When he cannot establish the right, he will not disdain to ameliorate the wrong; but like Solon, when he cannot establish the best system of laws, he will endeavour to establish the best that the people can bear.'[19]

In short, we have to add government failure[20] to the problem of market failure, where the former may be related to the problem of structure as well as to public opinion - ironically, one of the most important pillars of freedom.

VI

While the modern reader has to make a considerable effort to understand Smith's intentions, students of his course in Glasgow and perhaps contemporary readers of his work, would quite readily perceive that the different parts were important of themselves and also that they display a certain pattern of inter-dependence. As we have seen, the ethical argument indicates the manner in which general rules of conduct emerge, and postulates the need for a system of force-backed law, appropriately administered if social order is to be possible. The treatment of jurisprudence showed the manner in which government emerged and developed through time, and threw some light on the actual content of rules of behaviour which are likely to prevail in the four different socio-economic states.

It would also be evident to Smith's students that the treatment of **economics** was based upon psychological judgements (such as the desire for status) which are only explained in the ethics, and that this branch of

Smith's argument takes as given the particular socio-economic structure which is appropriate to the fourth economic stage, that of commerce.

The modern reader too will find much instruction in Smith's work, especially if the separate parts are seen, as Smith intended they should be, as making the parts a greater whole; an achievement which invites us to consider that economics, ethics, and jurisprudence should be seen as the essential components of what is now known as a system of social science.

This is not, of course, to minimise the importance of what many regard as Smith's major achievement.

The **Wealth of Nations** did, after all, provide the basis of classical economics in the form of a coherent, all-embracing account of 'general interconnexions'.[21] As Jacob Viner has pointed out, the source of Smith's originality lies in his 'detailed and elaborate application to the wilderness of economic phenomena of the unifying concept of a co-ordinated and mutually interdependent system of cause and effect relationships which philosophers and theologians had already applied to the world in general'.[22]

It was this aspect of the **Wealth of Nations** which led Smith's biographer, Dugald Stewart, to comment on its beautiful progression of ideas, and to draw a parallel between it and the mathematical and physical sciences (Stewart, IV. 22). In the words of another contemporary (and trenchant critic), Smith's completed work would be regarded as an 'Institute of the Principia of those laws of motion, by which the operations of the community are directed and regulated and by which they should be examined'.[23] The analogy with Newton is particularly apt, especially in view of Smith's admiring assessment in the concluding sections of the **Astronomy**, and in the **Lectures on Rhetoric** (LRBL, ii. 133-34).

The 'laws of motion' of the economy to which Thomas Pownall referred exposed the point that the exchange economy functioned effectively as a consequence of the activities of individuals who were unconscious of the end which these activities served to promote, namely benefit to society at large. Smith's general policy prescriptions follow:

In the words of a later commentator, Lord Robbins, Smith bequeathed to his successors in the classical school an opposition to conscious paternalism; a belief that 'central authority was incompetent to decide on a proper distribution of resources'. But above all Smith developed an important argument to the effect that economic freedom 'rested on a two fold basis: belief in the desirability of freedom of choice for the consumer and belief in the effectiveness, in meeting this choice, of freedom on the part of producers'.[24] Smith added a dynamic dimension to this theme in a passage which reminds us that his interests were not narrowly academic. As Smith made clear in his discussion of the Corn Laws:

> 'That security which the laws in Great Britain give to every man that he shall enjoy the fruits of his own labour, is alone sufficient to make any country flourish, notwithstanding these and twenty other absurd regulations of commerce; and this security was perfected by the revolution, much about the same time that the bounty was established. The natural effort of every man to better his condition, when suffered to exert itself with freedom and security, is so powerful a principle, that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often encumbers its operations' (WN, IV. v. b. 43).

This is Smith's true position; a position which helps to explain continuing interest in his work. Yet it is also important for the modern reader to recall that the agenda for action by governments was partly determined by Smith's choice of the problems to be addressed. He was not, for example, concerned (as Steuart had been) to analyse or to consider the socio-economic problems which are likely to be involved in the transition from a primitive version of the exchange economy to the relatively elaborate capital using system which actually attracted his attention. Nor was Smith concerned with the problem of regional imbalance or underdeveloped economies generally. Moreover, Smith's views on economic adjustments were relatively long run which allowed him to discount certain areas of concern. As J. A Schumpeter once remarked of the German economist, von Justi, 'he was much more concerned than A. Smith with the practical problems of government action in the short run vicissitudes of his

time and country ... His laisser-faire policy was laisser faire plus watchfulness, his private enterprise economy a machine that was logically automatic but exposed to breakdowns and hitches which his government was to stand ready to mend ... his vision of economic policy might look like laisser faire with the nonsense left out'.[25]

This was not Smith's position. Yet even given this, the list of government functions is, as we have seen, quite impressive serving to remind the modern reader of two important points.

First, that Smith's list of recommended policies was longer than some popular assessments suggest. Smith emphatically did not think in terms of 'anarchy plus the constable', to use Carlyle's phrase. As Jacob Viner has observed:

> 'Adam Smith was not a doctrinaire advocate of laisser-faire. He saw a wide and elastic range of activity for government, and he was prepared to extend it even further if government, by improving its standard of competence, honesty, and public spirit, showed itself entitled to wider responsibilities'.[26]

Another commentator, A. L Macfie, once humorously remarked, on reviewing Viner's list of specific policies garnered from the **Wealth of Nations**, that 'they add up to suggest a formidable state autocracy; a socialist spread of controls that would make some modern socialist's eyes pop'.[27]

As Robbins has noted, in making a different but related point:

> 'The English Classical Economists never conceived the system of economic freedom as arising *in vacuo* or functioning in a system of law and order so simple and minimal as to be capable of being written down on a limited tablet of stone (or a revolutionary handbill) and restricted to the functions of the night-watchman. Nothing less than the whole complex of the Benthamite codes - Civil, Penal and Constitutional - was an adequate framework for their system.'[28]

Second, it is important to recall the need to distinguish between the **principles** which Smith used in justifying intervention (which may be of universal validity) and the specific **agenda** which he offered (and which

may reflect his understanding of the situation which he actually confronted at the time of writing).

The principles which justify intervention are, after all, wide-ranging in their implications. On Smith's argument, the state should regulate activity to compensate for the imperfect knowledge of the individuals; it is the state which must continuously scrutinise the relevance of particular laws and institutions; the state which has a duty to regulate and control the activities of individuals which might otherwise prove damaging to the interest of society at large, and it is the state which must make adequate provision for public works and services (including education) in cases where the profit motive is likely to prove inadequate. Such basic principles are open to wide application notably in the circumstances of a modern society. It is this point which helps to explain Eric Roll's judgement that Smith and Keynes 'would find much common ground in respect of the broad principles that should guide the management of the economy'.[29]

Smith would surely have had sympathy with Keynes' reading of a different situation, which led him to defend an **enlargement** of government activity 'both as the only practicable means of avoiding the destruction of economic forms in their entirety and as the condition of the successful functioning of individual initiative'.[30]

We are reminded of E. R. Seligman's warning to readers of the 1910 edition of the **Wealth of Nations**, namely that they must avoid 'absolutism' and respect the point that recent 'investigation has emphasised the changing conditions of time and place and has emphasised the principles of relativity'.[31] It is not appropriate uncritically to translate Smith's policy **prescriptions** from the eighteenth to the twentieth century - moreover this would be quite inconsistent with Smith's own teaching. Smith's work was marked by relativity of perspective - dominant features of the treatment of scientific knowledge in the essay on **Astronomy** and the analysis of rules of behaviour in the ethics.

The interpretation of Smith's intentions and the process of forming a judgement as to his relevance today are not easy tasks. Yet there are some

areas of immediate interest which are less ambiguous but which have not attracted quite as much attention as they deserve.

First, there is the issue of market failure. There can be no doubt that if Sir James Steuart and Adam Smith adopted different perspectives on the economic process, they agreed on at least one proposition, namely that governments must intervene in this event simply because there is no alternative agency. The problem which remains to perplex us, is exactly that which exercised our eighteenth century predecessors and over which they differed: it is the problem of how and with what degree of confidence we can identify just where and when markets have failed. To intervene too readily may involve some distortion of market forces; to delay too long may generate unacceptable social and economic costs.

Second, we should not the attention which Smith gave to the general problem of government failure. As we have see, he offered a sophisticated analysis of the structure of modern government and the pressures to which it is subject, treating all of this as an integral part of the discussion of economic policy and of public finance. Smith would certainly have been surprised to find Professor Tullock referring to a newly established 'economics of politics' in a book published two hundred years after his own.[32]

Finally, more attention could be given to Smith's concern that the state should ensure the provision of important services but at the same time arrange that they are so organised as to ensure efficient delivery. This is the aspect of the book which should appeal to Mrs. Thatcher - and also perhaps to Mr. Gorbachev. Smith would not have been surprised at such an unlikely association, believing as he did that the principles of human nature were constant over time and place, irrespective of differing political philosophies.

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Some passages are re-produced with the kind permission of Oxford University Press and of MacMillans. But the purpose of the present article differs from both of the above in the sense that it is concerned to examine the extent to which Smith's authority can be claimed for the modern doctrine of economic liberalism.

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References to Wood (1983) give date of article on first publication, followed by volume and page number. References to Smith's works employ the usages of Glasgow edition, that is,

WN	:	**The Wealth of Nations;**
TMS	:	**Theory of Moral Sentiment;**
Astronomy	:	'The History of Astronomy', from **Essays on Philosophical Subjects** (EPS);
Stewart	:	Dugald Stewart, 'Account of the Life and Writings of Adam Smith';
LJ (A)	:	**Lectures on Jurisprudence,** Report dated 1762-63;
LF (B)	:	**Lectures on Jurisprudence,** Report dated 1766;
LRBL	:	**Lectures on Rhetoric and Belles Letters;**
Corr.	:	**Correspondence of Adam Smith;**
EAS	:	**Essays on Adam Smith,** ed. A.S. Skinner and T. Wilson (1975).

In the Glasgow edition, WN was edited by R.H. Campbell, A.S. Skinner and W.B. Todd (1976);

TMS, by D.D. Raphael and A.L. Macfie (1976);

Corr., by E.C. Mossner and I.S. Ross (1977);

EPS, by W.P.D. Wightman (1980);

LJ (A) by R.L. Meek, D.D. Raphael, and P.G. Stein (1978), and LRBL, by J.C. Bryce (1983). Oxford University Press.

References to Corr. give page number.

References to LJ and LRBL give volume and page number from the MS.

All other references provide section, chapter, and paragraph number in order to facilitate the use of different editions.

For example:

Stewart, I. 12 Dugald Stewart "Account', Section I, para. 12.

TMS, I. i. 5.5 TMS, Part I, section i, chapter 5, para. 5.

Wn, V. i. f. 26 WN, Book V, chapter i, section 6, para. 26.

1 This claim is one of those leading principles which Smith dated from the lectures which were delivered in Edinburgh (1748-1751). See Stewart (IV. 35).

2 This paragraph is based on Black (1976), 50-51.

3 Cf. the advertisement to the sixth edition of TMS.

4 Cf. Roy Pascal (1938) and R.L. Meek (1967). The economic dimension is also emphasised by David Reisman (1976).

5 See for example, T. Wilson (1976).

6 Cf. Skinner (1979), chapter 5.

7 See for example, Richardson (1975) and Lowe (1975).

8 Cf. Skinner (1979), chapter 8.

9 This argument gave rise to Jeremy Bentham's letter XIII in the Defence of Usury (1787). The materials are included in Corr., Appendix C.

10 Cf. Joseph Cropsey (1975) and Robert Heilbroner (1975). The theme of 'alienation' has been developed by E.G. West (1975); Robert Lamb (1973) and D.N. Winch (1978), chapter 5. On the treatment of education, see M. Blaug (1975).

11 Smith suggested that the state should encourage a number of religious sects in the interest of stability (i.e. a kind of competitive equilibrium) at WN, V. i. g. 16.

12 To this extent, Smith regarded types of labour, previously defined as unproductive (WN, II. iii) to be indirectly productive of benefit.

13 Viner (1928), Wood, i. 162.

14 A.T. Peacock (1975), EAS, 553-67.

15 Rosenberg (1960), 68; cf. Ricketts (1978).

16 See WN, V. ii. b.

17 See Forbes (1975) and Winch (1978) for analyses of Smith's politics.

18 Forbes, op. cit., 183.

19 Cf. Haakonssen (1981), 97, 164.

20 Sir James Steuart also gave a great deal of attention to the constraints imposed on the sovereign by economic laws. See Skinner (1966), lxxxi. A. O. Hirschman (1977) contrasts the positions adopted by Steuart and Smith in this respect. The problem of government failure has been highlighted by E. G. West (1976).

21 Lionel Robbins (1953), 172.

22 Viner (1928), Wood, i. 143.

23 Thomas Pownall (1776), in Corr. 354.

24 Robbins, op. cit., 12.

25 Schumpter (1954), 172.

26 Viner, Wood, i. 164.

27 Macfie (1967), Wood, i. 348.

28 Robbins, op. cit., 188.

29 Roll (1976), Wood, ii. 154.

30 J. M. Keynes (1936), 380.

31 E.R.A Seligman (1910), xv.

32 Gordon Tulloch (1976), 2.

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