

ADAM SMITH AND THE ECONOMIC POLICY OF LAISSEZ FAIRE<sup>1</sup>

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INTRODUCTION

In the light of recent revisions the famous *Das Adam Smith Problem* is no longer one. Since the work by Macfie (see Macfie 1967) and the well-known introduction by Raphael and Macfie to *The Theory of Moral Sentiments, TMS*, (see Raphael and Macfie 1976) we know that there is no longer room for the schizophrenic Smith; always divided between self-love and altruism. The *Theory* and the *Wealth of Nations, WN*, the impartial spectator and the *homo economicus* do not have to be in opposition<sup>2</sup>.

But self-interest and public good are also the object of less refined disputes like those about the roles of the 'market' and the 'state'; two terms which in popular belief are regarded as antagonistic. These views have a profound impact on policy considerations where objectives such as efficiency, welfare, growth etc. are seen as a more or less natural outcomes of policies of privatization, liberalization, outward orientation and so on.

Adam Smith is often taken as the prophet of free competition and self-interest, but we shall see that the study of Smith provides

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<sup>1</sup>. This is a largely revised version of a paper presented at a round table on "History of Economic Thought: How and Why" held in Bergamo on May 1991. Apart from the participants at the round table and with the usual reservations I must thank in particular Enzo Pesciarelli and Stefano Zamagni for their comments on an earlier draft.

<sup>2</sup>. Contemporary scholars still investigate the relationship between the moral and economic dimensions of human behaviour; for instance on July 1991 a Summer School on "Ethics and Economics" was held in Siena. The contributions to that event provide a good sample of present opinions about the role of a utilitarian description of human behaviour.

interesting and unusual hints for modern economic debates, and in particular for *laissez-faire* policies. Smith is well aware of the complex nature of human societies, particularly civilized ones. In many cases he adopts a few simple principles to explain parts of complicated civil societies<sup>3</sup>. However, when dealing with the role and purposes of governments and legislators he tries to 'bridge' the gap between abstract theory and policy measures, between simplified models and real societies.

Section I examines the first chapters of the *Wealth* and the role of the social division of labour. These few pages are commonly known among economists, but a careful reading shows how many signals Smith inserts concerning the numerous complications which characterize civil societies. In particular we look for Smith's view of the principles which give rise to the division of labour.

Section II must engage in the unsympathetic but useful exercise, of sketching the popular view of Smith's economics, that is to say the opinion formed by a hasty reader of parts of the *Wealth*. This *popular Smith* is made up of very few components, a fact which implies several shortcomings, but also a few advantages and even some justifications.

Section III explores the relationship between the ethical and the economic dimensions in Smith's work and in particular the social and moral aspects which characterize the motivations and behaviour of the individual in society. Sympathy, fellow-feeling and persuasion are among the several virtues and affections which substantiate the existence of the social cement which keeps society together and makes it prosperous. Complexity is the rule

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<sup>3</sup>. Smith praises the Newtonian method of proceeding in the didactic discourse, that is to say one has by laying down some simple principles with which it is possible to account for several phenomena, connecting them in a natural order(see *Lectures on Rhetoric and Belles Lettres*, LRBL, pp.145-6).

in Smith's analysis of civil societies, simplicity in the sketch we have called *popular Smith*.

In section IV we examine the process of simplification of Smith's elaborate description of society which is at the origin of modern economics. In this *reductionist* approach few simple principles are used to explain the economic mechanisms of society. This view has the advantage of examining a wide range of phenomena with a few simple assumptions. And in this sense it provides a definition of economics as a separate branch of social science.

Section V shows that in Smith sympathy and natural order provide an extremely powerful framework for the successful working of competitive markets. But even under such favourable conditions Smith is quite careful in his policy recommendations; certainly he cannot be regarded as a naive supporter of *laissez-faire*.

In Section VI we see that Smith's lesson is particularly cogent when we move from economic theory to economic policy. Nowadays it is hard to share Smith's favourable views about the sympathetic nature of men and the benevolent natural laws; we lack the ethical, natural and theological grounds constituting the social cement binding together market and self-interest.

Simple assumptions about individual behaviour are not enough for the 'science of the legislator'. The complexity of civil societies should urge the lawmakers to handle many razors rather than a single knife. Whatever the place of the 'reductionist' approach in economic theory this view shows signs of fatigue in moving from theory to economic policy.

Two final warnings to the [benevolent] reader. First, the odd numbered sections concern Adam Smith, the even ones possible lessons for today's economics. This requires some jumping back and

forth, a gymnastic exercise which should highlight the differences between Smith's conceptions and modern views.

Second, this paper does not present any particularly new idea regarding Smith, or modern economics; many conclusions consist of such good common sense, that they will be difficult to rebut. This was done on purpose, the paper wants to raise issues on which the area of convergence is very large; a sort of intersection of propositions which are widely agreed upon both by smithologists and by economists. And it is precisely because the premises are so mild that the main conclusion should be widely accepted; and the conclusion is that Smith points out how frail the foundations of modern *laissez faire* policies really are.

#### SECTION I - THE DIVISION OF LABOUR AND ITS ORIGIN: SIMPLE EXPLANATION OF A COMPLEX SOCIETY

The use of simple principles to explain complicated human societies can be easily found at the very beginning of the *Wealth of Nations*. The first chapters of Book I include some very well known passages which can be taken as Smith's answers to various questions. These pages answer some fundamental problems in Smith's work, for instance that of the origin of wealth in commercial societies. Following a method frequently employed by Smith, the direct answer is based on a simple principle. The origin of wealth, he explains in chapter I, is to be found in the division of labour. The same chapter illustrates the division of labour and the way in which it operates. The division of labour is then a feature, perhaps *the* fundamental feature, of human societies, but

it is also *the* principle explaining the origin of wealth and one of the principles behind the organization of society.

The rest of the chapter describes the characteristics of the division of labour particularly inside each 'trade' and inside each firm, with the famous examples of the pin-maker (see *WN*, I.i.3). This 'technical' division of labour is accompanied by what we could call the 'social' division of labour, that is to say the specialization of men in different branches, business, arts, a theme which continues in chapter II<sup>4</sup>.

The main object of chapter II is crystal clear in the title: "*Of the Principle which gives occasion to the Division of Labour*", nevertheless some intricacies could arise. Notice: one principle not many, we again find the didactic method of the *Lectures on Rhetoric and Belles Lettres*. The main principle of wealth is itself the consequence of some other principle; the solution of one problem leads to another one, as one should expect when examining the complicated organization of civilized societies.

What is this principle? What triggers the division of labour? Note that in chapter II the 'social' division of labour is at the forefront; in this chapter we find the specialization of men into different activities.

"And thus the certainty of being able to exchange all that surplus part of the produce of his own labour, which is over and above his own consumption, for such parts of the produce of other men's labour as he may have occasion for, encourages

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<sup>4</sup>. On the division of labour in the *Wealth* see for instance Groenewegen 1977 p. 162-3, 171-2. On the sources of the idea of technical division of labour in Smith see Rashid 1986.

every man to apply himself to a particular occupation...."  
(WN, I.ii.3)<sup>5</sup>.

Is this the principle which gives origin to the division of labour? No, the passage above indicates some technical prerequisites for the specialization of men. Clearly without the advantages of the 'technical' division of labour inside each activity there would be no chance of achieving a surplus produce above necessary consumption and no stimulus towards specialization would arise. There would be many isolated men and no society; occasionally there could be tribes behaving like herds of animals, like the greyhounds of WN, I.ii.2.

It is in the first lines of chapter II that we find an answer to the problem of the origin of the division of labour. This time the principle Smith is looking for is not related to technology, that has already been examined, but it is inside man. Why have men and not greyhounds exploited the possibilities of technology? By themselves these possibilities are a necessary but not sufficient condition to obtain the material advantages of civilized societies. There must be a reason, or a principle, which explains the peculiarity of human race.

"This division of labour, from which so many advantages are derived, is not originally the effect of any human wisdom, which foresees and intends that general opulence to which it gives occasion. It is a necessary, though very slow and gradual consequence of a certain propensity in human nature to truck, barter, and exchange one thing for another." (WN, I.ii.1; see also I.ii.4).

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<sup>5</sup>. See also WN, I.iii.1 and *Lectures on Jurisprudence, Report of 1762-63, LJ(A)*, pp. 351-2. Of course the certainty to be able to sell one's own surplus produce requires the existence of surplus. This paper does not examine the technical features of the division of labour.

There are two aspects in this passage. First a negative one; men do not foresee the advantages in the division of labour, civilized societies are not the result of any plan or of any intentional decision by individuals.

The second aspect is a positive one, it tells us where the division of labour comes from. The origin lies in the disposition of human nature, a nature which is presented here in relatively simple terms. This new explanatory principle is satisfactory enough to avoid any further inquiry into the origin of the division of labour. Of course this principle does not directly explain *all* the complicated relationships between men in commercial societies, that is to say in the fourth stage of the history of human civilization<sup>6</sup>, but it is simple enough to convince the reader to follow Smith into further investigation of the causes of wealth. Smith's description of this aspect of human nature corresponds to our everyday experience as men in a commercial society, and to our imagination about the motivations behind human behaviour<sup>7</sup>. The answer implied in this passage appears extremely simple and appealing; our imagine of man's nature is not disturbed, or shocked, by Smith's sentence and we can easily be content with it, without feeling the need for further inquiry. According to Smith men would have a simple natural propensity which coupled with deception, generates the unintended consequences of human action. It is not yet the invisible hand, but it seems close enough to it.

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<sup>6</sup>. On Smith's view of the four stages theory see Meek 1977, pp. 18-ff.

<sup>7</sup>. The role of imagination and wonder in prompting new research and in pondering and 'digesting' old ones is clearly described in *The History of Astronomy*(see for instance *Essays on Philosophical Subjects*, EPS, pp. 89-91).

But if we carefully read these pages we see that the simple answer, though correct, and perhaps even sufficient for Smith's purpose in this part of the *Wealth*, is not complete. There are two reasons for being cautious.

First, for the modern reader, acquainted with Keynesian debates, 'certainty' is a terrible term to use. But even in Smith certainty does not only indicate the material condition for the division of labour; it implies trust and confidence among the exchanging parties. What are the moral conditions, the social norms and the legal requirements for a civilized society to exist and to become prosperous? These topics have been examined by Smith in his previous works.

Second in the second paragraph of the chapter we read:

"Whether this propensity be one of those original principles in human nature, of which no further account can be given; or whether, as seems more probable, it be the necessary consequence of the faculties of reason and speech, it belongs not to our present subject to enquire." (*WN*, I.ii.2).

In this phrase Smith makes three points:

- a) the propensity to truck, barter and exchange *does not seem to be* an original principle of human nature;
- b) this propensity *seems to be* a necessary consequence of reason and speech;
- c) the investigation of "those original principles in human nature....." is not the purpose of the *Wealth of Nations*.

The rest of this long paragraph is full of hints which might clarify Smith's position. In particular he contrasts the condition of men to that of animals, which are subject only to passions and are independent of one another. On the contrary

"in civilized societies he <man> stands at all times in need of the cooperation and assistance of great multitudes" (*ibid.*).

Thus men do not live in isolation and above all they have the means of persuasion to satisfy their needs which are unavailable to animals.

Hence one could start a useful search for the principles which foster the division of labour and illuminate the organisation of civil societies. But towards the end of the paragraph, there is one of the most famous passages in the history of economics:

'It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love,....' (*ibid.*).

The famous 'triple B'. This passage is so much in harmony with the present common understanding of what economics is all about that it does not surprise our imagination and does not stimulate our curiosity. A hasty reader would stop here, and would forget any further inquiry into the principles and motivations of the behaviour of the individual in society.

Technical division of labour, plus the natural disposition to truck, barter and exchange, plus self-love, plus the law of the unintended outcomes of human action seem to be sufficient to explain both the working of civilized societies and their origin. That is those human societies with an articulated division of labour. *Self-love* and *interests* overcome *feudal passions*, society is now organized by means of *contracts*. Hirschman's well-known story of the conflict between passions and interests at the heart of commercial society can now be narrated (see below Section VI).

Then by the end of paragraph 2 of chapter II of Book I a hasty reader might forget Smith's warning at the very beginning of that same paragraph, where we read that the propensity to truck, barter and exchange does not seem to be "one of those original principles in human nature, of which no further account can be given" (*ibid.*). But a further account is precisely what the hasty reader does not feel is necessary to look for, such is the power of the metaphor of the 'triple B'. No wonder and no surprise struck the imagination (see *The History of Astronomy in Essays on Philosophical Subjects*, EPS, pp. 35-40) of the hasty reader, hence he does not feel it necessary to look for other explanatory principles. The hasty reader ignores Smith's indications about possible areas of further exploration: for example benevolence and persuasion. Benevolence and persuasion may help, but they do not play any special role in the picture.

Of course a more patient reader may speculate that a further scrutiny will add to his understanding of the way in which Smith describes the working of civilized societies. But this confident reader should follow Smith's advice: in order to find the original principle which give rise to the division of labour one must abandon the *Wealth* and look elsewhere.

But let us postpone the further analysis; it now may be useful to sketch the conventional and still dominant opinion about Smith's view of market society.

## SECTION II - THE POPULAR SMITH

The hasty reader willingly takes the 'triple B' passage as the core of Smith's message; a core from which one could immediately

derive appropriate policies<sup>8</sup>. The beauty of a core-message rests largely on its simplicity, and perhaps this is one of the reasons for the success of this metaphor: a simple concept for a complicated story. Let us sketch this *popular* view, that is to say the opinion of our hasty reader about Smith's analysis of "civilized and thriving nations" (*WN*, Introduction.4.). The *popular Smith* model can be split into three elements.

a: Individuals behave as *economic men*: they are guided by:

a<sub>1</sub>: *instrumental rationality*, men calculate the relationship between means and ends, this relationship is fairly simple;

a<sub>2</sub>: *self-interest*, men optimise the above relationship.

B: There is a *natural order* (or an *economic machine*, or an *invisible hand*): this order is made up of two components:

B<sub>1</sub>: the laws of *unintended consequences* (they are independent of men's will);

B<sub>2</sub>: these laws produce *positive results*.

c: *Free competition* (competitive markets) performs the role of, it approximates, it is, the invisible hand; hence c=B.

*Popular Smith* = [a+c(B)].

This combination accounts for and justifies the faith in Mandeville and in his *Fable of the Bees*, that is to say how to

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<sup>8</sup>. In popular illustrations this passage is often taken as a direct evidence of Smith's support for *laissez faire*. Here Smith is explaining the origin of the division of labour, and particularly the complexity of civilized societies (see Sen 1987, p. 23). Of course in the *Wealth of Nations* the invisible hand comes in Book IV, chapter II, para. 9. On the various 'invisible hands' in Smith's work see for instance Ahmad, 1990.

The popular view of Smith often confuses free trade with the efficient allocation of resources, but for him free foreign trade is above all designed to widen the market and hence to favour the further division of labour and increase productivity (see Mynt 1946, p. 121).

turn 'private vices into public benefits'<sup>9</sup>. For the hasty reader this cocktail of self-love and *laissez faire* is sufficient to deliver the best available economic conditions for society<sup>10</sup>. Of course a policy of non intervention in the market game descends directly from point c above, which, note, take the place of B, which includes element B<sub>2</sub>.

In its simplicity the cocktail is already vast and complicated, and here we shall not tackle points B and c<sup>11</sup>. Even a is examined only inasmuch as it is necessary to follow Smith's suggestions concerning the behaviour and motivations of man in commercial societies<sup>12</sup>. Is the message of the *popular Smith* modified when we consider what he writes on the origin of the division of labour and the principles which guide man's moral conduct?

### SECTION III - THE INDIVIDUAL IN SOCIETY

We must return to the problem of the principles which explain the origin of the division of labour and which according to Smith, direct man's behaviour in civilized societies.

#### 1. The social dimension

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<sup>9</sup>. Of course all the elements in this picture have given rise to an enormous amount of scholarly work, but their detailed investigation is beyond the scope of this note. To mention only some of the major issues which deserve closer inspection: the concept of natural order; determinism versus relativism in Smith's work; the notion of the economic machine; the nature of the so-called law of unintended consequences.

<sup>10</sup>. Edmund Burke played an important role in establishing a conservative interpretation of Smith (see Rothschild 1992, pp. 86-7 in particular).

<sup>11</sup>. Point B<sub>1</sub> of section II could itself be divided into B<sub>1a</sub>: a general system of *interdependence*, B<sub>1b</sub>: *regularities*(laws) and B<sub>1c</sub>: *unintended consequences*. For a brief analysis of the notion of natural order in Smith and its comparison to Quesna'sy see Vaggi 1995, Section III.

<sup>12</sup>. The analysis of a<sub>2</sub>, that is to say of the extension of self-interest to incorporate all important motivations and judgements, will be the subject of another paper. On the problem of the ethical foundations of liberal society in Smith see for instance Evensky 1993.

As we have seen in Section I the answer to the problem of the origin of the division of labour is not in the *Wealth of Nations*, but chapter II of Book I provides several hints for this search. The social division of labour is the "necessary consequence of the faculties of reason and speech" (*WN*, I.ii.2). Language is the necessary vehicle of thought and hence the prerequisite for communication between men<sup>13</sup>.

But it is in the *Lectures on Jurisprudence*, *LJ*, that the answer clearly appears. In the *Lectures* we find several anticipations of famous passages of chapter II, Book I of the *Wealth*<sup>14</sup>. We have the example of the greyhounds whose concurrent passions should not be taken as an example of division of labour (see *WN*, I.ii.2; *LJ(B)*, p. 492-93; see also *LJ(A)*, pp. 352-53). We find the the brewer and the butcher (*LJ(A)*, p. 348), and in 1766 the brewer and the baker (*LJ(B)*, p. 493). We have the disposition to truck, barter and exchange (*LJ(A)*, p. 347). There, we have "the certainty of being able to exchange the surplus produce of their labours" (*LJ(A)*, p. 348), as a necessary condition for the division of labour.

But what is the origin of the division of labour?

It is not "an effect of human prudence" (*LJ(B)*, p. 492; see also *LJ(A)*, p. 351). This passage echoes the *Wealth* where it says that "the division of labour...is not originally the effect of any human wisdom" (*WN*, I.ii.1); or "of any human policy" (*LJ(A)*, p. 347). Therefore the division of labour is not the result of any human plan; the legislators and the rulers cannot empower it. Even

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<sup>13</sup>. Smith wrote an essay on the formation of languages (see *Considerations Concerning the First Formation of Languages*, in *LRBL*, pp. 201-ff.).

<sup>14</sup>. One must look under the heading *Police* and the Report of 1762-63, *LJ(A)*; is richer than the Report of 1766, *LJ(B)*, (see *LJ(A)*, pp. 347-53; *LJ(B)*, pp. 492-94).

the wise philosophers, who study the invisible chain of intermediate events (see *The History of Astronomy*, in *EPS*, pp. 42, 45, 50) and who know the advantages of the division of labour are not its authors. And the division of labour is not the result of human prudence, a sort of limited wisdom of ordinary people, a virtue which plays such a large role in the explanation of the conduct of the middling ranks<sup>15</sup>.

### Persuasion

As in the *Wealth* (see *WN*, I.ii.4) in the *Lectures* we again find the parable of the philosopher and the street porter which are useful to each other. Smith concludes:

"Thus we have shewn that different genius is not the foundation of this disposition to barter, which is the cause of the division of labour. The real foundation of it is that principle to *perswade* which so much *prevails* in human nature." (*LJ(B)*, p. 493, italics added).

We have thus discovered the foundation of the *propensity* (*WN*, I.ii.2), or *natural disposition* (*LJ(A)*, p. 347), to exchange; this is a *principle*, "one of those original principles in human nature, of which no further account can be given" (*WN*, I.ii.2). The propensity and disposition to truck, barter and exchange is a fundamental feature of human nature, but this unique characteristic of mankind is clearly subordinated to 'the principle to persuade'.

Moreover in the passage above Smith seems to consider the principle to persuade as the prevailing feature in human nature, it seems to dominate the other passions and sentiments of men. Of

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<sup>15</sup>. Smith statement is also quite important in connection with the role of prudence in *Theory*.

course often Smith accentuates a point; remember sympathy in the *Theory of Moral Sentiments* (see below Section III.2), and imagination in the *The History of Astronomy* (see *EPS*, pp. 88-ff.). But imagination also plays an important role in the *Theory*; it is thanks to imagination that men can approximate the 'impartial spectator' (see *TMS*, pp. 9-10).

However leaving aside the problem of the dominant human affection, we can say that the *principle to persuade* enjoys the same status as *sympathy* and *imagination* in explaining the behaviour of men, and the workings of their minds.

A passage in the *Report* of 1762-63 throws further light on the origin of the division of labour.

"If we should enquire into the principle of human mind on which this disposition of trucking is founded, it is clearly the natural inclination every one has to persuade. The offering of a shilling, which to us appears to have so plain and simple a meaning, is in reality offering an argument to persuade one to do so and so as it is for his interest. Men always endeavour to persuade others to be of their opinion even when the matter is of no consequence to them." (*LJ(A)*, p. 352)<sup>16</sup>.

If we had stopped at the second sentence of the quotation the hasty reader, who from time to time visits us, might think that persuasion is a way of showing its interest in exchanging to the other party. But the last sentence shows that the principle to persuade is not simply instrumental in building up a system of exchange. You, writes Smith, engage in the art of persuasion because

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<sup>16</sup>. This page of *LJ(A)* looks like a syllabus of Smith's work, we have: persuasion, interest, imagination, oratory, self command, dexterity <in managing men!>, contract.

"you are uneasy when one differs from you, and you endeavour to persuade <?him> to be of your mind; or if you do not it is a certain degree of self command, and to do this every one is breeding thro their whole lives." (*ibid.*)

Men dislike to be contradicted even if the issue concerns

"China or the *more distant moon*" (*ibid*, italics in the original; see also *LJ(B)*, p. 493-94).

"We ought then mainly to cultivate the power of perswasion, and indeed we do so *withouth intending it*. Since a whole life is spent in the exercise of it, a ready method of bargaining with each other must undoubtedly be attained." (*LJ(B)*, p. 494, italics added).

Persuasion is a principle of human nature and its practice becomes a sort of automatic behaviour for men in society. This attitude characterises their whole lives and it is because they continuously engage in this practice, and because the principle to persuade is such a prevailing feature in human nature, that men must surely find a method to establish exchanges and contracts, and this is what distinguishes men from dogs (see *LJ(B)*, p. 494; *LJ(A)*, p. 352; *WN*, I.ii.2.). The art of persuasion is not instrumental in establishing contracts and exchanges, contracts and transactions derive from the continuous exercise of persuasion<sup>17</sup>.

## 2. The moral dimension

### Sympathy

The *Theory of Moral Sentiments* opens with the following sentence:

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<sup>17</sup>. In a nation of hunters the disposition to barter and exchange originates with presents (see *LJ(B)*, p. 493).

'How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it.' (*TMS*, p. 9).

More than one century ago some German scholars interpreted passages like this in *Theory* and like the famous 'triple B' in the *Wealth of Nations* as if Smith had changed his mind about human nature after his encounter with French philosophy<sup>18</sup>. Sympathy and selfishness appeared as conflicting and alternative principles in guiding the actions of men. The two works also were in conflict. The so called *Das Adam Smith Problem* was thus born and led many economists to believe that there were two 'Smith', and that the 'mature' one relied solely on self-interest in his analysis of man's economic behaviour. An opinion still widespread today since the *popular Smith* provides the blend widely regarded as the foundation of modern economics. Even the late Jacob Viner maintained that there was an opposition between the *Theory* and the *Wealth of Nations* (see Viner 1928, pp. 119-20, 126).

Following more recent interpretations we are inclined to believe that there is not such a clearcut distinction between an 'ethical' Smith and an 'economic' one; even if, as we have already noticed, he often changes the emphasis on the various explanatory principles he uses. In their introduction to the *Theory* Raphael and Macfie show that there is no antagonism between Smith's two books (see Raphael and Macfie 1976, pp. 20-ff.; see also Macfie, 1967, pp. 112-3). There are valid reasons in favour of this interpretation. First, the two works are not as

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<sup>18</sup>. For a description of the origin of this interpretation see Raphael and Macfie 1976, pp. 20-1.

chronologically so distant as they could appear. It is well-known that Smith did not abandon *The Theory of Moral Sentiments*; he produced six editions of it during his lifetime (see Raphael and Macfie 1976, pp. 34-ff.) and we now use to the sixth edition published in 1790, the year of Smith's death. Second, in the advertisement to the sixth edition of the *Theory* Smith clearly states that he considered his whole work as a single research project (certainly including the students' notes which are now known as the *Lectures on Jurisprudence*), he did not see any opposition between the *Wealth of Nations* and the *Theory*<sup>19</sup>.

The fact that there is no opposition between a 'benevolent' moral philosopher and 'cinical' social scientist does not mean that there are no differences between the *Theory* and the *Wealth* in the emphasis concerning the leading passions and virtues of men. But here we do not intend to take sides on the *Das Adam Smith Problem*; the point is not whether this was a true problem. The assumption is much milder; the simple existence of the debate and the fact that we still refer to it indicates that Smith's view of the individual in society is more complicated than what is often believed. This may be a minor conclusion, but because it is almost obvious it has two important advantages: 1) it is shared by most of Smith's scholars and good common sense economists, and 2) hence it should not be too easily dismissed. Point a above deserves a closer scrutiny.

But let us examine what Smith means by 'sympathy'; in the second page of the *Theory* we find the definition:

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<sup>19</sup>. Professor Winch convincingly maintains that the *Wealth of Nations* and the *Theory* were meant to be two elements of that 'science of the legislator' whose description was Smith's ultimate ambition (see Winch 1983, pp. 255, 266).

"Sympathy, though its meaning was, perhaps, originally the same, may now, however, without much impropriety, be made use of to denote our fellow-feeling with any passion whatever" (*TMS*, p. 10)

We see that men are endowed by nature with this sensitivity for the well-being and for the passions of others, particularly for the less fortunate ones (see for instance *TMS*, pp. 43-4). This is the quality of *fellow-feeling*, a most important and useful quality of human nature.

But the hasty reader could be tempted to reconcile sympathy with point a<sub>2</sub> of the *popular Smith*. After all are not we sociable because it is convenient to behave so? Is not fellow-feeling a nuance of utility and self-love, which leads us to behave in a sort of sympathetic egoism? In discussing the systems of Hobbes and of his followers Smith makes clear that men do not live in societies for purely selfish reasons. Benevolence, or even the "natural love which he [man] bears to his own kind" (*ibid.*, p. 315), is not the by-product of self-love, or another way of representing our desire for our own welfare.

According to Smith we are not interested in the conditions of other men only because of the desire a comfortable and quiet life. The pursuit of an enjoyable and peaceful existence is a legitimate motive for human actions;

"Sympathy, however, cannot, in any sense, be regarded as a selfish principle" (*ibid.*, p. 317).

In the *Theory* Smith attacks Dr. Mandeville's system which proclaims that all human actions are led by vanity and private vices (see *ibid.*, pp. 308-14), though Smith recognizes that this

*licentious system* would have never been so successful "had it not in some respects bordered upon the truth" (*ibid.* p. 313).

Smith shows high appreciation for moderation in all passions.

"Every affection is useful when it is confined to a certain degree of moderation.....virtue consists not in any one affection, but in the proper degree of all the affections" (*ibid.*, p. 306).

This passage refers to Hume's system, "which places virtue in utility", the only difference with that of Smith being that in the latter sympathy is the true virtue (see *ibid.*). It seems that according to Smith it is sympathy which incorporates self-love and utility. Men are moved by a variety of passions, but no affection can overshadow the others, and, above all, sympathy guarantees that each man feels that he is part of a community and that he participates in the fortunes and misfortunes of others. Individual behaviour is a mixture of selfish and benevolent motives (see *ibid.*, p. 304) and no motivation can ever completely wipe out the others. Smith does not deny the role of utility and of self-interest, but he certainly does not believe that self-interest alone guides human behaviour<sup>20</sup>.

### 3. Laws, norms, rules

#### Justice

Men in society tend to persuade each other, but Smith is aware that society cannot rely only on the benevolence and sympathy of its components. The art of persuasion might fail to smooth out the different viewpoints; something more appropriate is needed to keep

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<sup>20</sup>. In a recent article Levy maintains that Smith's theory of the spectator is after all a kind of utilitarianism (see Levy 1995, pp. 308-9, 313-5)

together a community of individuals. In Book II Section II of the *Theory*, Smith explains the difference between the two virtues of beneficence and justice; with regard to justice he writes:

"There is, however, another virtue, of which the observance is not left to the freedom of our own wills, which may be extorted by force, and of which the violation exposes to resentment, and consequently to punishment. This virtue is justice and the violation of justice is injury" (*TMS*, p. 79).

Man has a natural inclination to live in society, and all members "are likewise exposed to mutual injuries" (*ibid.*, p. 85). Against these injuries, against "the disorders of human life" (*ibid.* p. 158) justice provides the punishment of which all people are afraid (see *ibid.* pp. 79, 86-7).

"Beneficence.....is the ornament which embellishes, not the foundation which supports the building.....Justice, on the contrary, is the main pillar which upholds the whole edifice" (*Tms*, p. 86).

The rules of justice are then the very foundations of society, because they are like the rules of grammar (see *ibid.* p. 175)<sup>21</sup>.

It deserves to be the subject of specific work, but a brief glance at the origin of the rules of justice and of the social norms is mandatory at this point.

"Our continual observation upon the conduct of others, insensibly leads us to form to ourselves certain general rules concerning what is fit and proper either to be done or to be avoided" (*TMS*, p. 159).

Mutual experience is the source of the general rules of morality, and it is through experience that men acquire the aptitude of the

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<sup>21</sup>. On the difference between justice and beneficence see Skinner 1992, pp. 146-8 and Pesciarelli 1989, pp. xxvii-xxix.

'impartial spectator', which is the ability to look at opposite interests with the eyes of a third person(see *TMS*, p. 135; see also Macfie 1967, pp. 52-3). This is how a sense of duty is formed, and this is "the only principle by which the bulk of mankind are capable of directing their actions"(*TMS*, p. 162). Therefore the rules of justice are not only the imposition of punishment, but they concur with general moral rules and social norms in keeping societies together and possibly in making them prosperous.

To exist societies need consensus on some general laws and rules of behaviour, human society requires compliance and respect for social norms, which have emerged from the observance of the mutual behaviour of its members. Indeed these rules and norms are the core and the very essence of human societies<sup>22</sup>.

The market itself is a system of rules, of relationships, of customs, and even of beliefs and of personal dispositions, whose formation may take centuries. The market is part of the natural order of a commercial society, but the natural order is not limited to the market. The simple principles of persuasion, sympathy, and of the division of labour, operate inside and through historical institutions, in some ways reflecting natural laws. Samuels underlines that economic activity takes place inside a framework of laws and order which favours the operation of market forces; this 'market-plus-framework' guarantees harmony in society(see Samuels 1966)<sup>23</sup>.

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<sup>22</sup>. Social norms, moral rules and positive laws contribute to make up the particular institutions of a society, a problem which takes us to the theme of the *Lectures on Jurisprudence*. We should also add economic characteristics, what Meek called the 'mode of subsistence,' to the elements which determine the institutions of a society (see Meek 1977, pp. 29-30).

<sup>23</sup>. Zamagni underlines the fact that markets are cultural institutions(see Zamagni 1992, pp. 10).

The division of labour, the separation of functions, the existing differences between men and even their different degrees of wealth do not harm the society and its complexity as long as a sentiment of fellow-feeling and obedience to the rules of justice prevail<sup>24</sup>. Men tend to be similar but at the same time do not need to be equal, differences are respected. This is the social miracle of the impartial spectator.

The ideal society, full of sympathetic individuals, is probably close to what Smith called 'a system of natural liberty'.

#### SECTION IV - REDUCTIONISM. BACK TO THE SIMPLE ECONOMIC MAN?

Notwithstanding the revisions of recent decades the popular view of Smith survives and prevails. The complicated society envisaged by Smith and the complex nature of man make the analysis of their interplay almost impossible, so why not to resort to some simplifications? The multifarious passions and virtues are substituted by plain self-interest; this is a 'reduction' of the complicated human motivations to a simple principle behind human motives. Self-interest simplifies human motivations (see Hirschman 1977, pp. 38-43, 108-12), the *homo economicus* is a stylized character with limited objectives (see Wilson 1976, p. 79) and as such it is much more tractable for economic theory.

Wilson borrows from Wicksteed a very convenient expression to indicate the code which guides the behaviour of this man in society, which now is the economic man: *non-tuism* (see *ibid.*, p. 81; Wicksteed 1910, p. 180). Non-tuism offers certain advantages: for instance I may also make exchanges with the people of an

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<sup>24</sup>. Loasby highlights the fact that the process of division of labour and of economic development will benefit from this "widely-shared sense of what is right and proper" (Loasby 1995, p. 7).

opposed tribe, but non-tuism is the opposite of fellow-feeling. Individuals do not care about the specific nature of the exchanging partner, fellow-feeling is not required and trust may be taken for granted, the market is the unique locus of socialization and prices are the only way in which people communicate and control each other(see *ibid.*, p. 82); prices are the signals showing the existence of an exchanging society.

The above assumptions amount to a *reductionist* conception of the grand issues described by Adam Smith. But this view has great advantages as far as the management of economic science is concerned; points a and c provide a mixture in which markets are capable of regulating "an extensive range of choices.....with a modicum of rationality"(Bowles 1991, p. 359). Individual motivations are restrained to self-interest alone, a<sub>2</sub> of Section II.

There is nothing terrible *per se* about reductionism, any approach is a reduction of a complicated society to some simple principles<sup>25</sup>. This approach should not be dismissed too easily, because it is implicitly founded on a precise description of the subject matter of economic science. It is important for economics to clarify its boundaries as a science with respect to anthropology, moral philosophy etc. Hence a reductionist operation is necessary to give birth to a new science, which investigates some of the aspects of civilized societies. Economists may well decide that they are concerned only with those economic actions of men which are strictly related to self-interest and to the operation of

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<sup>25</sup>. We only deal with the mainstream neoclassical version of reductionism; of course also the interpretation of Smith as surplus theorist is based on some simplification, but we do not intend here to compare the two interpretations. The stress is on the policy implications of the neoclassical 'reduction'.

markets. This is a perfectly legitimate way of defining the object and range of economic science, and we know from the *Theory* that Smith would have approved of this moderation and modesty.

The behaviour of the *economic agent* can be described to various degrees of refinement, which, even so, are infinitely less complicated than the actual motivations which guide men in societies. But the reductionist view takes *homo economicus*, a maximizing egoistic creature, and markets as if they were the whole society. Even if, as economists, we accept the concept of a simple economic man led by self-interest and the paramount role of market relations, can we ignore altogether social structures? Are not markets themselves the products of history and of specific social conformations? Indeed markets are a particular set of institutions.

The problem of maintaining order in a society of self-interested people goes back to Hobbes and Mandeville (see Bowles 1991, pp. 327-8). But if we want to draw some lessons from Smith we should at least acknowledge that social norms and the rules of conduct are more complex than simply private property, plus self-interests, plus *laissez-faire*. The more so because to a large extent these norms are part of men's ethics. And Jon Elster shows how difficult it can be to unravel the nature and origin of the norms and rules which constitute the 'cement of society' (see Elster 1989, pp. 15, 99-ff., 132-ff.).

The problem becomes more acute when we analyse the motion of societies instead. The nature of the social compact which includes laws, norms, customs, is changing rapidly<sup>26</sup> so that markets and

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<sup>26</sup>. The use of the simple *laissez faire* model is particularly risky in development and growth theories, which deal with long run movements and sometimes historical transformations in

individual motivations are bound to be affected. We cannot exclude that the new norms and rules will depend both on the initial conditions of society and also on particular historical process. Our two simple principles explaining the working of society, competitive markets plus self-interest, might show some path dependence.

Of course it is impossible to deny a possible role for a research programme based on the reductionist approach; we do not have such an 'exclusion theorem'. What are the implications of the reductionist view for economic policy<sup>27</sup>? But before tackling this subject we shall again go back to Smith.

## SECTION V - FROM THEORY TO POLICY: MORE PRINCIPLES AT WORK TOGETHER

### Sympathy and natural order

In Smith the intricate nature of society and the several motives which guide the behaviour of men are not obstacles to the establishment of the science of the legislator. In Adam Smith's world complexity is a resource not a limit and from this point of view the *Theory of Moral Sentiments* and the *Wealth of Nations* usefully complement each other.

From what we have seen in Section III we can say that for Smith the motivations which guide the behavior of men are much more complicated than those indicated in the *popular Smith*. Let us call

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societies. Think of the social and economic transformations in central and eastern Europe after 1989.

<sup>27</sup>. Winch says that there should not be such a separation between economic analysis and economic policy (see Winch 1995, p. 31). He is right but here we want to stress the minimal lessons we can derive from Smith's work, some good common sense conclusions which are hardly debatable. Therefore, we prefer to separate positive and normative analysis.

A the motives and behaviour of the smithian individual in society. Moreover points a, B, and c are somehow mixed. Natural dispositions play a role in human motivations; ethics is part of the process of institutional building; competitive markets are the outcome of trust, norms, laws and institutions. The sympathetic human nature and natural order provide a very convenient framework for free competition, and the markets now have flesh and blood, because they are also seen as the outcome of social norms and institutions<sup>28</sup>. Hence c too puts on new clothes and we prefer to substitute C for c.

Points a and c of the *popular Smith* become:

A: A<sub>1</sub>: Individuals in society tend to behave as *impartial spectators*.

A<sub>2</sub>: Men's action are guided by many passions including *sympathy* (which accounts for and temper self-interest).

C: The working of competitive markets is supported by A and B.

Without any pretension of providing an exhaustive view we could represent Smith's conception as follows:

*Smith* = [(A+B)+C], in this order.

The combination [(A+B)] is the core of the system and it creates a framework in which free-competition, C, is likely to display positive effects. All the more so "in a civilized and thriving country" (*WN*, I.i.11), which is characterised by a considerable degree of social division of labour.

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<sup>28</sup>. We could say that there is a sort of macrofoundation of microeconomics. This view is similar to Davis' deception-plus-market-plus-framework interpretation (see Davis 1990, p. 352). Davis stresses the role of the natural order; the invisible hand of Providence and deception are powerful tools to maintain harmony in society(see *ibid*, pp. 342).

The widespread sentiment of fellow-feeling favours, one could say guarantees, the existence of a society. *Within* a society characterised by mutual understanding and fellow-feeling, *laissez-faire* may certainly improve the well-being of mankind. In this world man's behaviour is the outcome of manifold passions, interests and virtues. In this world differences never undermine the *social compact*, which of course includes a social contract, but it is more than that. It also implies cohesion, consensus, common and widespread beliefs, all those features which make people feel that they are part of single entity, a society, whose destiny they share. In this society there is a glue which greatly enhances the operation of competitive markets; and it is also thanks to this *social cement* that society can try to approach a system of natural liberty.

These considerations show why Smith's view of society is not built on the antagonism between the market and the state. A society is made up both of institutional and market relationships; the 'market' and the 'state' are parts of this entity, which is characterized by social cohesion. The market and the state *may* favour social cohesion, but neither of the two can by itself adequately explain it<sup>29</sup>. Of course the state must not be used to grant exclusive privileges (see for instance *WN*, IV.i.33). But then the market too must not be a place where merchants and masters impose their power on other citizens (see *ibid.*, IV.iii.c.9).

Sympathy and natural order are two formidable principles to analyse the operation of markets but can also be used to organize the 'science of the legislator' with confidence in positive

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<sup>29</sup>. We do not want to discuss the different theories of the state, the only point we want to make is that in Smith's work the state is part of a civilized society, but does not exhaust it.

results, the two 'pillars' sustaining and reinforcing each other. This proposition is independent of the controversy over whether Smith embraced a deterministic approach or a relativistic one<sup>30</sup>. In both cases sympathy and natural order greatly favour the functioning of free competition. A society in which rich people are led both by an invisible hand and by the search for public approbation (see *TMS*, pp. 126-ff.) is an extremely well-suited setting both for economic theory and for policy prescriptions. In such a world there is no need for many interventions, but it is also easy to move from economic theory to economic policy, and indeed no clearcut separation is needed between these two aspects of a single theory of wealth.

#### Human and social failures

Notwithstanding the convenient assumptions about human behaviour and the positive influence of the natural order, Smith is not so optimistic about the workings of competitive markets. According to Viner Smith departs from pure *laissez faire* to the point that in the same *Wealth of Nations* major inconsistencies would surface (see Viner 1928 pp. 137-8). According to Viner's view there are three Smiths; a benevolent one in *The Theory of Moral Sentiments*, and two in the *Wealth of Nations*: both a more optimistic and a more sceptical one. Recently Smith's critique of the free market economy has been extensively investigated by Pack (see Pack 1991,

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<sup>30</sup>. A strictly deterministic view of the working of society in accordance to natural laws reduces the scope for free will and for government intervention in favouring the implementation of the 'system of natural liberty'. A more relativistic interpretation of Smith's methods would leave more uncertain outcomes for the operation of market forces. For a discussion of this problem see Skinner 1982, pp. 86-ff..

ch. 8), and the limits of *laissez faire* have been also forcefully stressed by Winch (see Winch 1991, pp. 102-4)<sup>31</sup>.

So extensive has been the revision of the interpretation of Smith as a unsophisticated supporter of *laissez faire* and as social optimist that we need only briefly mention a few instances which show the opposite<sup>32</sup>.

Even good and caring Nature cannot always overcome all the mischevious situations which can emerge in civil societies. War is a typical case which can corrupt "the propriety of our moral sentiments", because it is an occurrence in which

"the partial spectator is at hand and the impartial one at a great distance" (*TMS*, p.154).

In war the social cement falls apart and partiality prevails.

But even in calm periods men also suffer from a natural "love of domination and authority" (*LJ(A)*, p. 186), which make them desire to have others placed below them and to order rather than persuade them (*ibid.*, p. 192).

How can we be sure that the prevailing models and standards of behaviour would be those of virtuous men, leading the majority of the citizens to study wisdom and practice virtue (see *TMS*, p. 62)? Unfortunately among the great mob of mankind there is a "disposition to admire, and almost to worship, the rich and the powerful" (*ibid.*, p 61)<sup>33</sup>.

### Rhetoric and Sophistry

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<sup>31</sup>. Even Lord Robbins underlines that in several cases Smith suggests government intervention (see Robbins 1978, p. 38).

<sup>32</sup>. A more detailed investigation of these cases will require a different paper. Here we want only to highlight that Smith is well aware of all the possible complications involving not only the principles of competitive markets and self-love, but also those involving sympathy.

<sup>33</sup>. On the revisions concerning this point made by Smith in the sixth edition of the *Theory*, see Evensky 1993, pp. 409-10.

Even the principle of persuasion has a dark side. In the *Lectures on Rhetoric and Belles Lettres*, Smith differentiates the Didactick and the Rhetoricall Discourse<sup>34</sup>.

"The former.....has it in view to perswade no further than the arguments themselves appear convincing. The rhetoricall again endeavours by all means to perswade us; and for this purpose it magnifies all the arguments on the one side and diminishes or conceals those that might be brought on the side conterary to that which it is designed that we should favour." (*LRBL*, p. 62).

An exaggerated use of persuasion must be condemned; rhetoric leads to falsehood. As for all passions and emotions the golden rule even for persuasion is: moderation. Where is a typical example of a rhetorical disourse? Nonetheless than in the work of Dr. Mandeville.

"Though the notions of this author are in almost every respect erroneous.....These, described and exaggerated by the lively and humorous, though coarse and rustic eloquence of Dr. Mandeville, have thrown upon his doctrine an air of truth and probability which is very apt to impose upon the unskilful." (*TMS*, p. 308).

The search of the unskilful is beyond the scope of this paper, but the question is not as rhetorical as it might seem; the unskilful can, and perhaps should, be educated.

And speaking of possible social failures how not to mention

"the impertinent jealousy of merchants and manufacturers....the mean rapacity of merchants and

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<sup>34</sup>. For an analysis of persuasion in *LRBL* also see Fiori 1992.

manufacturers, who neither are, nor ought to be, the rulers of mankind."(*WN*, IV.iii.c.9).

Merchants and manufacturers may use their power to conceal the true principles of wealth and "to deceive and even oppress the publick"(*ibid.*, I.xi.p.10). Like Mandeville they have disseminated false theories. Talking of protectionism Smith writes that this doctrine could not

"ever have been called in question, had not the interested sophistry of the mercants and manufacturers confounded the common sense of mankind"(*ibid.*, IV.iii.c.10).

Even if he is equipped with two formidable assumptions such as sympathy A and positive natural order B, Smith is not an naive supporter of free markets. Above all he never reduced the whole society into to self-interest plus competitive markets. A and B are important guidelines for the legislator, who however must always reconcile these simple principles with the complexities of real societies.

Smith certainly was not a naive positivist.

#### Additional cement

Smith's analysis of the ethical foundations of the individual in society provides supplementary virtues which collaborate with the already powerful quality of sympathy. In the race for wealth and honour man must humble the arrogance of his self-love(see *TMS*, p. 83). Men must learn to restrain their passions and affections(see *LRBL*, p. 55). Self-command, which is recommended to us by a sense of propriety, permeates all virtues and principles which direct the conduct of the individual in society (see *TMS*, pp. 262-4). Of course the ability of men to exercise self-command on their

passions is linked to their role as impartial spectators, to the 'man within' each of us. But self-command is more than the capacity to look at ourselves with the eyes of a third person. It is the ability to modify and bend our feelings and behaviour, moderating all passions and affections<sup>35</sup>.

And together with the aptitude for educating ourselves there are the possibilities offered by education as an important component of society<sup>36</sup>.

Self-command and education are additional tools which can provide the necessary glue to society. Self-command and education help to assure, or at least to try to assure, that individual differences will not undermine the social compact and the sense of fellow-feeling, which is so important in helping society to exist and to prosper.

## SECTION VI - TWO CENTURIES LATER

It is time to come back to the implications of reductionism for economic policy with which we ended Section IV. But we will do so keeping in mind the lessons we can draw from Smith's analysis of the interplay between moral rules and economic laws.

The obvious starting point is the fact that after more than two centuries it is hard to accept some of the assumptions regarding man and nature, which characterized the thought of many scholars of the Enlightenment, from France to Scotland.

### Who is impartial?

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<sup>35</sup>. On the influence of stoic philosophy on Smith see Raphael and Macfie 1976, pp. 5-10.

<sup>36</sup>. On the role of education in Smith see for instance Skinner 1993.

We no longer we believe in the constant and sympathetic nature of mankind, in the widespread practice of self-command, in the natural human disposition at being the 'impartial spectator'. Now partiality is the rule; the economic man is but a pale character with respect to Smith's individual in society. Hence reductionism contents with a simplified economic creature, more or less corresponding to that of point a of Section II. However a, that is to say self-interest and instrumental rationality, not only implies limitations of the field of economic analysis, but now a is also a diminished version of A, of Smith's grand inquiry on the moral sentiments of man.

#### Order? Which order?

Even more difficult is to retain the belief in some sort of natural order of societies, quite independently of the theological flavour which we find in the *Theory of Moral Sentiments*<sup>37</sup>. All in all the reductionist approach maintains two components of B: the first is the idea that there are 'objective' laws<sup>38</sup>; the second is the belief that more or less these laws produce 'positive' consequences. In this case there is no particular restriction of the field of analysis, but both elements are now largely downgraded with respect to how they appear in Smith. Laws are no longer regarded as the direct expression of nature or as components of a natural order. The positive outcomes of economic laws are described either in terms of efficient allocation of

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<sup>37</sup>. The *Theory* is full reference to the Deity, to God, to providence. On the theism of Smith in the *Theory* see Viner 1928, pp. 120-1 and Macfie 1967, pp. 110-1.

<sup>38</sup>. Here 'objective' must be taken in the weak sense which it has in the oft aired layman's opinion that economic laws are 'neutral'.

scarce resources or as the maximisation of the growth rate. We call b this *diminished* version of Adam Smith's B.

As a consequence of this downgrading economic laws lose their natural, or even theological, flavour, and market mechanisms are described in terms of the more modest notions of supply and demand; then the Smithian market-plus-framework view C takes off the new clothes and reverts to a more humble c.

Thus the reductionist approach has given rise to a *popular model* which is widely used by most economists and which can be sketched as follows:

*Popular model* =  $[a+c(b)]$ .

The difference with the *Popular Smith* is that c now coincides with b (the diminished B).

There are two major differences between the *popular model* and *Smith*. First, the reductionist method simplifies and defines the subject of economics,  $[a+c(b)]$ . Second, this simplification also implies a limited view of the personality of individuals, from A to a; and the downgrading also involves the notion of natural order, hence B becomes an unpretentious b.

#### The economic policy of a popular model

Orphaned of such formidable and convenient assumptions as A and B, and of the ornate markets C how can we explore the economic features of contemporary society<sup>39</sup>? In particular how is it possible to provide indications for its progress and to establish a theory of economic policy?

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<sup>39</sup>. Referring to Hume, which of course prefers utility to sympathy as an ethical principle Robbins writes: "Without Hume's theory of justice, or something very much like it, the Classical theory of self-interest and the market would remain completely in the air."(Robbins 1978, p. 57).

Economic laws are no longer the 'inevitable' outcome of the natural order, but it is still widely believed that by and large economic laws would bring about the best possible world. Harmony is still with us, particularly in neoclassical theory<sup>40</sup>, even without the elaborate Smithian description of human nature and the eighteenth century confidence in natural laws.

After having limited the range of their investigations much too often economists analyse market choices by individuals as if they were sufficient to elucidate the movements of societies, indeed as if they were society. Often scholars forget modesty and propriety when they use economic theory to prescribe economic policies. The subject matter of economics has been 'diminished', but the pretence of suggesting the 'appropriate' policy measures is still there. Moreover these policies are more or less the same in different historical situations, where social norms and institutions differ.

Keep prices right, implement an outward orientated foreign trade, privatise public enterprises, avoid public deficits, let interest and exchange rates be fixed by international markets. These are some of the policies which are prescribed as the right medicines for the diseases of many different societies; for both developed and less-developed countries alike and now also for those belonging to the ex-eastern block. But what about the *prerequisites* for that social cement, that fellow-feeling, those rules, habits and norms which are essential elements for the definition of a society, and which have been largely responsible for the success of capitalism? Are we assuming that they exist

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<sup>40</sup>. On the relationship between natural order and harmony in the marginal utility school see Taylor 1929, pp. 28-31.

with the same degree of intensity and with the same features in Latin America, in East-Asia, in Sub-Saharan Africa and in Russia? Without A and B we have accepted a definition of economics which is more akin to a 'lilliputian' discipline than the 'promethean' science of the late eighteenth century. Nevertheless either implicitly or explicitly we still ask our 'lilliputian' discipline to accomplish approximately the same tasks as the 'grand views' of society in classical political economy. This is a boldness which Smith could not approve; how far can this discipline be trusted to provide direct policy indications? Are we not asking self-interest and competitive markets,  $[a+c(b)]$ , to achieve aims which are far beyond their scope *without* the support of A and B? Self-interest under the control of sympathy, and *laissez-faire* as part of a positive natural order were regarded by Smith as instruments which were likely, in many circumstances, to increase national wealth and to promote the prosperity of society.

#### A minimal society?

But let us see if we can find in Smith some support for the *popular model* and for the reductionist view.

"Society may subsist among different men, as among different merchants, from a sense of its utility, without any mutual love or affection;.....it may still be upheld by a mercenary exchange of good offices according to an agreed evaluation" (*TMS*, p. 86)

So after all the utilitarians are right and the *popular model* captures the fundamental features of Smith's thought? On the same page of the *Theory* we also find Smith's view that justice is the main pillar of society. So why not take property rights and self-

interest as the essential elements for the study of civil society? The defense of private property could mimick justice and self-interest could be a proxy for the 'sense of utility' which accompanies mercenary exchanges.

This solution raises two objections.

First, we have already seen that for Smith self-love is not the founding principle of human societies(see above Section III). In the passage above Smith indicates a sort of minimal requirement for the existence of society, provided there is at least an agreed evaluation according to which individuals behave and reciprocate.

For the second objection let Smith himself speak:

"Beneficence, therefore, is less essential to the existence of society than justice. Society may subsist, though not in the most comfortable state, without beneficence; but the prevalence of injustice must utterly destroy it"(*ibid.*, p. 86).

A society may subsist thanks to the rules of justice alone, but it cannot flourish and cannot become prosperous. If we then face problems of policy, including economic policy, we cannot ignore that the reductionist view has greatly downgraded its scope of analysis; property rights plus self-interest do not guarantee happiness and wealth.

"Mere justice is, upon most occasions, but a negative virtue, and only hinders us from hurting our neighbour"(*ibid.*, p. 82).

Obedience to the rules of justice on its own can neither explain the progress of society, nor form the basis for that economic policy, the *Police* in the *Lectures on Jurisprudence*, which is one of the subjects of the science of the legislator. The virtue of

justice alone is insufficient to attain that successful and prosperous system of natural liberty whose achievement is the ultimate end of human societies.

And in fact:

"Where the necessary assistance is reciprocally afforded from love, from gratitude, from friendship, from esteem, the society flourish and is happy" (*ibid.*, p. 85).

Then a society of mercenary exchanges can exist thanks to self-love and to a system of positive laws which establish and defend private property, and perhaps such a plain and simple society can be studied. But the purpose of the science of the legislator is the improvement of society, it is the well-being of its people, it is to devise means by which the individual impulse to bettering ones own conditions is channelled towards common prosperity. According to Smith the set of rules, norms and habits which can perform these tasks cannot be reduced to property rights. It is when we move from theory to policy that we see more clearly all the weaknesses of the *popular model*<sup>41</sup>.

The story of how 'interests' and the sweet rules of trade tamed the feudal 'passions' has already been written (see Hirschman 1977, pp. 88-91, 121-5). Smith, Hume, de Tocqueville are among the authors who established the superiority of the ideal system of natural liberty over feudalism and mercantilism. All of them owe a debt to Montesquieu and his view of modern society and of *doux commerce* (see Meek 1978, pp. 84-ff.). But A and B certainly greatly helped to tell that story. How can we be sure that commerce will not turn out to be sour? Can competitive markets, property rights and self-interest alone guarantee a happy end? Even Smith was not

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<sup>41</sup>. Recall the distinction between economic theory and economic policy at the end of Section IV (see note 27).

wholly optimistic, though armed with sympathy and natural order, and even the belief in overweening Deity. What about our diminished science?

The following are no answers but brief considerations on some recent ideas about the role and limits of economic policy.

#### The bounded economic agent

A first possibility could be that of using the welfare state to provide some of that social cement so helpful for *Smith*. The welfare state is, or has been, only a pale shadow of the Smithian virtues of benevolence, sympathy and fellow-feeling. If we cannot assume that economic men practice propriety and self-command let us assume that society as such is concerned with the poor. Thus we can set some boundaries for the players of the economic game. We can call these boundaries poverty line or basic income; the idea is that these notions define what is not acceptable for society. But inside the boundaries the game is played according to the rules of the *popular model*.

In recent debates on the transition of the ex-communist countries from command to market economies the notion of social safety-nets have been introduced. The market has its rules but we must guarantee that not too many people will fall below some minimal standards of quality of life. In the case of Less Developed Economies these requirements are often identified with acceptable conditions in health and education<sup>42</sup>.

The welfare state has been under heavy criticism for many years, but probably this system has been part of that social cohesion and

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<sup>42</sup>. The idea of social safety-nets also appears in Downie's comment on Wilson's paper, where it refers to things such as unemployment benefits and social security payments(see Downie 1976, p. 103; see also Zamagni 1992, p. 13).

widespread consensus which have greatly fostered the economic growth of western societies after 1945. Of course the welfare state is not simply a collection of fiscal devices, but a delicate mechanism of norms, of rules of conduct and of expectations.

#### The super-economic-agent

A second possibility could be that of assuming that each individual is equipped with all the relevant information about all possible choices and all their consequences, both in the present, and in the near and distant future. Everything is included in the individual welfare functions (see Hammond 1991, pp. 150-1). Thus each agent is confronted with an unrestricted domain of all possible finite decisions (see *ibid.*, pp. 156-8, 166). However complicated the present world has been made by continuous progress in the social division of labour, each individual is able to decode all possible effects of each of his actions.

But even more is needed; social norms must exist to keep society together and these social norms must coincide with the norms in individual welfare functions (see *ibid.*, pp. 169, 175.). Hammond appropriately calls this method *individual welfarism* (see *ibid.*, pp. 167, 169).

The behaviour of individuals no longer depends on the complex features of a specific society, now it is the social norms, hence the rules which define a society, which must derive from individual welfare functions. The peculiarities of such a society are the result of different specifications of this single universal tool, a welfare function, which contains all the information needed to describe both the behaviour of men and the predominant social norms. We thus have the complete

microfoundation not only of macroeconomics, but also of economic policy, and indeed of society.

A fascinating solution provided that *all* economic men are exceedingly well informed and that competition is maintained. Information is a non-excludible non-rival good.

#### The super-agent plus the super-legislator

A third possibility has been suggested by Robbins. The legislator "withdraws from the sphere of the pursuit of self-interest those possibilities which do not harmonize with the public good" (Robbins 1978, p. 56).

All the remaining possibilities are open for the economic man. The legislator does not decide what is the public good, but can exclude the public non-good; or at least he can decide what is unsociable.

This would take us to a theory of justice and of political organization, which is beyond the scope of this paper, but which probably requires some sort of comparison between utilitarianism and contractualism.

#### CONCLUSIONS

There are no definite answers about the boundaries of economic science. However if we accept a *reductionist* definition of economics, and if we ground the theoretical work on few specific assumptions, such as those which uphold the *popular model*: self-interest and competitive market,  $[a+c(b)]$ , we have the tricky problem of proceeding from theory to policy, and indeed to reality.

The economic realm of human behaviour has been severed from the moral and historical one; the more and more over the centuries which have elapsed since the age of the Enlightenment, and far beyond the initial suggestions of the 'founding fathers', Smith included<sup>43</sup>. Neoclassical economics, in particular, has based its remarkable theoretical structure largely on the few propositions which make up the *popular model*. The analysis has been impoverished, and it ignores the new manifold aspects of the social division of labour. In a more complicated and continuously changing world we always resort to the same basic instrument: the rational man maximizing utility.

How is it possible to make the journey back to the real world and to economic policy? How can social cohesion be defined in modern terms? Is it the same in rich and poor countries? If societies differ, how far will these differences affect the outcomes of the standardized policies devised by the theory?

These are some of the questions which should be answered before moving from the 'lilliputian' discipline to policy recommendations. Without the trust in a veritable and favourable natural order and in the sympathetic and constant nature of man, which so conveniently reassured the 'founding fathers' of the eighteenth century, economics should observe the Smithian virtues of propriety and modesty. In presenting their recommendations for a better world both theory and policy should dedicate more attention to the specific features of each society, to its particular social structures, to the norms and rules which guide the behaviour of real individuals.

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<sup>43</sup>. Skinner notices that history, economics and ethics were divorced in the nineteenth century (see Skinner 1982, pp. 10-17).

As we wrote in the introduction these are obvious conclusions on which accord should be extremely large. Many scholars point out that Smith's ideal society is a complicated world which cannot be limited to self-interest, plus property rights, plus free competition. It is a society with real individuals moved by a variety of ethical considerations (see Sen 1987, p. 7), but in which there is mutual trust which plays a role of paramount importance. For instance Dasgupta ascribes a role to trust similar to that accorded by Smith; trust is that ever-ready lubricant which is the essential and implicit requisite of the transactions in the standard model of a market economy (see Dasgupta 1988, p. 49). Trust is a public good, a positive externality (*ibid.*, p. 63)<sup>44</sup>. But also some contemporary non-economists have underlined, in various ways, the importance of trust and of common beliefs in securing the prosperity of society. Fukuyama, after having decided that history was no longer interesting, has discovered that trust is of great help to the economy<sup>45</sup>. Schluter and Lee underline the R Factor, which indicates the Relational Proximity and implies mutual knowledge and sense of obligation. The R factor is a powerful and almost indispensable supplement to the free market in order to achieve efficiency<sup>46</sup>. Robert Putnam underscores the advantages of Italian regional societies with a long history of high levels of 'civic community', a mixture of trust, co-operation, tolerance and widespread participation by citizens (see Putnam 1993, chapter 6 in particular).

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<sup>44</sup>. The important role of trust, particularly at the international level, has been highlighted by Porta and Scazzieri (see Porta and Scazzieri 1994, pp. 1-4, 7).

<sup>45</sup>. Francis Fukuyama, *Trust: the social virtues and the creation of prosperity*, Free Press, New York, 1995.

<sup>46</sup>. Michael Schluter and David Lee, *The R Factor*, Hodder and Stoughton, London, 1993.

The view that social and ethical elements are important promoters of prosperity, success and happiness in societies seems to be spreading fast. Why then does economic policy continue to prescribe old nineteenth century recipes?

Towards the end of his account of the life of Adam Smith and referring to the "unlimited freedom of trade" Dugald Stewart tells us to beware of the legislators who ask for a straightforward application of general principles.

"These cautions with respect to the practical application of general principles were peculiarly necessary from the Author of 'The Wealth of Nations'....because the unlimited freedom of trade.....is extremely apt, by flattering the indolence of the statesman, to suggest .....the idea of carrying it into immediate execution"(Stewart 1793, p. 318).

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"theories which attempt to delineate the principles of a perfect legislation.... ought to be considered merely as descriptions of the *ultimate* objects at which the statesman ought to aim. The tranquillity of his administration, and the immediate success of his measures, depend on his good sense and his practical skill"(*ibid.*, p. 319, italics in the original).

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