

Freeing Smith from the “Free Market”: On the Misperception of Adam Smith on the Economic Role of Government

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The Fall of Adam

That Adam Smith stands for the themes of laissez-faire, noninterventionism, and minimal government is a dominant theme in economics and elsewhere—including among those critical of the laissez-faire position. Innumerable examples of this view—which we shall call the “minimalist” view of Smith—appear in the economics literature past and present.

This minimalist view of Smith has long pervaded the Chicago and Virginia traditions. George Stigler (1965, 1), Smith’s best friend in the estimation of some, noted in his AEA presidential address that “the main burden of Smith’s advice . . . was that the conduct of economic affairs is best left to private citizens—that the state will be doing remarkably well if it succeeds in its unavoidable tasks of winning wars, preserving justice, and maintaining the various highways of commerce.”¹ Milton Friedman (1978, 7) speaks of “those elementary functions” of government “that Smith regarded as alone compatible with the ‘obvious and

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1. Elsewhere, Stigler (1976, 1201) argues that “the crucial argument [of Smith’s] for unfettered individual choice in public policy was the efficiency property of competition.”

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simple system of natural liberty.” He also says that “the market, with each individual going his own way, with no central authority setting social priorities, avoiding duplication, and coordinating activities, looks like chaos to untutored eyes.” Yet, “through Smith’s eyes we see that it is a finely ordered and effectively tuned system, one which arises out of men’s individually motivated actions, yet is not deliberately created by men” (17). And while Smith “fully develops the self-regulating market mechanisms only in the *Wealth of Nations*, in the *Theory of Moral Sentiments* he was already fully aware of the difference between an imposed order and what he would have called a natural order” (18). Within the public choice camp, we note, for example, William C. Mitchell’s (2001, 6) contention that members of the Virginia school (among which he numbers himself) “seek not weak or impotent governments but ones having sufficient authority to carry out Adam Smith’s limited government agenda.” This same sentiment is reflected in Edwin G. West’s (1990, 14) claim that a “necessary Smithian condition for overall prosperity . . . was *limited* government.”

Economists typically classified as advocating a more interventionist approach to the economic role of government see Smith in a way virtually identical to this Chicago-Virginia view. Paul Samuelson (1962, 7), for example, speaks of Smith’s “attacks on . . . state interference and . . . his spirited championing of *laissez faire*.” Richard Musgrave (1985, 7) contends that “the traditions of British authors, from Adam Smith on, viewed the market as the rule and the public sector as the exception, needed to step in if and where a specific market failure occurs.” And John Kenneth Galbraith (1987, 72) says that Smith “rigorously confines the activities of the state to provision for the common defense, the administration of justice and the provision of necessary public works.”

It should come as no surprise that this view continues to pervade contemporary economics, including economics textbooks. In his public finance text, Joseph Stiglitz (1988, 7) writes that Smith “advocated a limited role for government” and that “Adam Smith’s ideas had a powerful influence on both governments and economists,” including nineteenth-century classical thinkers “who promulgated the doctrine known as *laissez faire*, which argued that government should leave the private sector alone [and] it should not attempt to regulate or control private enterprise” because “unfettered competition would serve the best interests of society.” Stiglitz also asserts that “Smith argued that one did not need to rely on government or on any moral sentiments to do good. The public interest, he maintained, is served when each individual simply does what

is in his own self-interest" (62). A perhaps even more extreme example of this view of Smith is found in Harvey Rosen's public finance book, where Rosen (2002, 5–6) equates Smith with "Libertarians, who believe in a very limited government" and "argue against any further economic role for government" beyond the provision of defense, justice, and public goods such as "roads, bridges, and sewers—the infrastructure required for society to function."

In spite of the prevalence of this minimalist view of Smith in the literature and the illustriousness of many of its expositors, this interpretation cannot be sustained when one examines the corpus of Smith's writings.

Smith's Legal-Economic Nexus

We will not argue that Smith's view of the economic role of government is unambiguous. The minimalist interpretation of Smith has *multiple* competitors—some of which portray a more activist economic role of government; some of which suggest not a strict laissez-faire approach by Smith but a laissez-faire-with-exceptions approach, in which the exceptions are very important and sometimes rather broad-based;² and some of which interpret Smith, and the classical school as a whole, not at all in laissez-faire terms but through a market-plus-framework model in which social control and social change through law figure prominently.³ Smith clearly opposed mercantilism. The issue is whether or not this opposition to mercantilism is extended to oppose other forms of government "activism." The answer is, quite clearly, "no."

The interpretive problem arises in part because Smith has a tripartite model of society comprised of three modes of social control: moral rules, law, and the market. Each works in its own way to channel individual behavior into directions socially apprehended. His *Theory of Moral Sentiments* covers moral rules; his *Wealth of Nations* addresses the market; and, while he never published his planned third volume, we have insights into his thinking from two sets of lecture notes, *Lectures on Jurisprudence*. Viewing any of these works in isolation is almost certain to lead to error, and this is the root of the problem with the "Smith as noninterventionist" approach.

An Inquiry into the Nature and Causes of the Wealth of Nations is the reference of choice for most commentary on Smith's view of the economic role of government. But one must recognize that Smith discusses

2. See, e.g., Viner 1927.

3. See, e.g., Rothschild 2001 and Pack 1991.

the economic role of government here only insofar as he deems necessary for his particular purpose: the elaboration of a program to promote the increase of national wealth against the backdrop of the extant mercantilist system.⁴ Smith portrays a market economy, his “obvious and simple system of natural liberty,” in which the market both provides economic freedom and serves as a mechanism of social control—the latter particularly by harmonizing the actions of self-interested agents.

In his discussion of the expenses of the sovereign or commonwealth, Smith ([1776] 1976, 687–88) identifies three duties of the sovereign:

that of protecting the society from the violence and invasion of other independent societies (689);

that of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice (708–9);

that of erecting and maintaining those publick institutions and those publick works, which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature that the profit could never repay the expense 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. The performance of this duty requires, too, very different degrees of expense in the different periods of society (723).

The immediate discussion is continued in his next paragraph:

After the publick institutions and publick works necessary for the defence of the society, and for the administration of justice, both of which have already been mentioned, the other works and institutions of this kind are chiefly those for facilitating the commerce of the society, and those for promoting the instruction of the people. The institutions for instruction are of two kinds: those for the education of youth, and those for the instruction of people of all ages. (723)

The defense of a society against the aggression of other societies is clear enough. Not so clear is what is and is not covered under the protection, “as far as possible,” of “every member of the society from the

4. In the case of the three listed duties of government (about which more below), the principal focus of discussion is how to raise the revenue with which to finance the expenses of government (Smith [1776] 1976, 723).

injustice or oppression of every other member of it,” or how the preceding language equates with or is amplified by “the duty of establishing an exact administration of justice.” Such protection in practice will depend in part on the definitions of injustice and of oppression and of the evidence thereof—in sum, on the specification of rights and the content given to them. Smith’s model provides for such a function, or duty, of government but seemingly leaves it to society to work out the details.

Similarly elastic is the notion of public works and institutions that comprise the third duty, although someone paging through book 5 of the *Wealth of Nations* cannot help but be struck by the expansive set of tasks elaborated by someone who is considered the Godfather of laissez-faire.⁵ Moreover, government is portrayed by Smith as, among other things, a *facilitator* of commerce. His position is not that government needs to stay out of the way and let individual enterprise reign; rather, he lays out a specific (and lengthy) set of activities for government to undertake if it wishes to promote the national wealth. What it is, however, is a very *different* set of tasks from those undertaken by a mercantile government.

What is so evidently missing from the minimalist view of Smith is that the three stated duties, read narrowly, do not exhaust the economic role of government—although a strong case can be made that the content given to them by Smith itself negates any attributions of minimalism. Smith’s criticism of the existing system points to the dynamic process in which existing law is made subject to critique and reform. Smith clearly intended his work to be a contribution to that process of legal change. He understood full well the ubiquity and importance of law, and his argument for “the obvious and simple system of natural liberty” actually constituted a revolutionary doctrine in terms of introducing legal change. Indeed, the system of natural liberty was, for Smith, a legal-governmental construct through and through, and its establishment and maintenance a clear-cut instance of governmental “activism.”

Smith’s broad-based conception of the economic role of government is made clear when one pays attention, first, to what Smith has to say about government and property, and the machinations of special interests; and, second, to the treatment of law and government, as well as property, in the *Lectures on Jurisprudence* (1978). Of particular import is Smith’s recognition that government itself is not exogenous to the system; it is due to and to a large extent the instrument of the propertied, of

5. See Viner 1927 for an elaboration.

those, that is, who use government to cement and institutionalize their systemic social power. As Smith (1978, LJB, 404) says, "Till there be property there can be no government, the very end of which is to secure wealth and to defend the rich from the poor." Also central here, as in the *Wealth of Nations*, is Smith's reliance on his stages theory of history. These stages are defined largely in terms of their respective systems of law and government and point to the ubiquity and importance of legal social control and the effects of changes therein. And from a practical perspective, in the *Wealth of Nations* the particulars of all of the three duties are said by Smith to vary with the stage of history.

Smith's relative silence in the *Wealth of Nations* on topics of the structure and content of law, perhaps especially concerning property, should not be surprising. Like most people writing on the economic role of government, Smith typically took the regnant legal system and body of law as background. Also like most people, he did not hesitate to criticize either the legal system or the law. In other words, he was selective in what he implicitly accepted. He was lecturing on law and government, and was planning, at least early, to write a volume on law and government. With this volume left unwritten, Smith's most elaborate treatment of government and law was given, not surprisingly, in his lectures on jurisprudence. The modern editors of the lectures quote the account of them given by John Millar, to the effect that Smith lectured on justice as a branch of morality, its gradual progress between stages or ages, the effect of changes in technology ("those arts which contribute to subsistence") and the accumulation of property in generating legal change ("in producing correspondent improvements or alterations in law and government"), and lastly "those political regulations which are founded, not upon the principle of *justice*, but that of *expediency*, and which are calculated to increase the riches, the power, and the prosperity of a State" (Meek, Raphael, and Stein 1978, 3). Accordingly, it is clear from the editors' list of topics discussed in the lectures (24–27) that Smith covered under public jurisprudence the organization of government and the rights of subjects; under domestic law, the relative rights of family members and of slaves and others; under private law, property and its transfer, and injury to person, reputation, and property; and under police, a short discussion of cleanliness and security and a lengthy discussion of cheapness or plenty, that is, of the kinds of policies and theoretical topics also discussed in the *Wealth of Nations*.

The lectures suggest that in working out, through changing the law, pragmatic resolutions to conflicts over property, a society—that is, government and law—is involved in more than a simplistic administration of justice: government is involved in the continuing revision of the legal foundations of the economic system. The lectures have an empirical facet indicating that Smith appreciates both the ideal juridical and material economic facets of legal change. Systems of law are constantly working toward what they “ought to be” and it is only through experience/observation that policy makers can make decisions. Once a law is tried and fails to fulfill (or no longer fulfills) the social need it was intended for, new laws are tried. This process is discussed repeatedly in Smith’s works, appearing in discussions of property origins, secondary forms, transference, tax systems, voting systems, citizenship definitions, and so on. The government, here, is a player, and a necessary one.

Conclusion

If government and law seem anathema in the *Wealth of Nations*, it is because of Smith’s opposition to the direction of certain *activities of* government at the time. The point of the *Wealth of Nations* is not that government is bad, but that government was doing bad things in promulgating mercantilist policy. This does not negate the centrality of government and law in Smith’s obvious and simple system of natural liberty, that is, of the natural order of things. Combining both the *Lectures* and the *Wealth of Nations*, not only are law and government part of Smith’s system and not only is legal change also part of Smith’s system, but, relative to the mercantilist agenda he opposes, his system includes what established interests could and in fact did oppose as *revolutionary*. In sum, to favor the market process, with Smith, does not require the belief in a minimalist view of the economic role of government, and such a view certainly finds no support in Smith’s writings.⁶

6. This raises the obvious question of why the minimalist view of Smith is so prevalent in the literature, including among a number of brilliant scholars. The analysis of this question goes beyond the bounds of this essay, but is treated in Medema and Samuels 2005 and Medema 2005.

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