CHAPTER ONE

Adam Smith and His Ancestors

When Adam Smith suggested that "an invisible hand" would tend to harmonize individual and social interests, and that attempts by the state to interfere with this would run counter to the national interest, he was living in the midst of a society dominated by a morass of regulations on trade. There were taxes and protective tariffs, of course, but there were also countless regulations and monopolies, many of which would seem incredible today: apprenticeship laws, regulations on the quality of goods, primogeniture mandates, laws of settlement, corporation laws, and sundry guild controls. These measures established a web of monopoly privileges that often generated substantial riches for their beneficiaries. Though governments were influenced by ideas about trade, what they created was an irrational patchwork of regulations: monopolies that had been created so that governments could raise money by selling them, regulations that existed to make it easier for taxes to be levied, regulations imposed because powerful merchants had argued for them. Competition was hampered on all sides.

How did men think about these problems of economic policy—about their origins and about the means of dealing with them? Economic analysis did not begin with Adam Smith. Indeed, it is not possible to understand Smith without a working knowledge of what came before him—as far back, at least, as the ancient Greeks. It was a commonplace from the Greeks onward to see individuals as tending to pursue their self-interest, but this self-interested behavior was thought to engender results contrary to the national interest unless restrained by the long arm of the state. The base effects ascribed to self-interest, as well as the content given to the national or social interest, varied across authors and over time, but the necessity of employing government to harness self-interest was a recurring theme.

One of the defining features of economic thought and analysis prior to the nineteenth century was its naturalistic or natural law orientation.[1] Individual and class roles within the socioeconomic system, the legitimacy of actions, and the goals to be pursued were among the factors considered to be given by a higher authority and thus beyond human control. Harmonization of individual and social life with the dictates of nature

[1] See, for example, Schabas (2006).

was paramount for proper social ordering, and good governance entailed putting into place a system of earthly laws that facilitated this. The role of government was thus something given rather than something to be worked out in pragmatic fashion. We find in this early "economic" literature no theory of governmental behavior to speak of, no serious analysis of the ability of government to carry out the tasks ascribed to it by the authors. What we see instead—in many cases, at least—is an assumed natural order of things and consequent statements of how government should act so as to facilitate the operation of a social-economic system that comports with the dictates of natural law.

ADAM'S ANCESTORS

The Greeks and the Scholastics: Pursuit of a Higher Good

The profound influence of Greek thinking on Western intellectual life is most prominently evidenced in areas such as philosophy, rhetoric, and political theory, but it also extends into economics.[2] One would search in vain for a Greek treatise on economics: the Greeks would have thought absurd the idea that one could make a study of the economic system as an autonomous subject. For the Greeks—as for most economic commentators prior to the nineteenth century—the economy was but one piece of a larger social system, and this led them to examine economic issues as one facet of a broad-based social theory.

The two centuries prior to the time of Plato and Aristotle had been a period of economic liberalization, and with this came an enormous surge in commercial activity—including international trade. Moreover, tremendous economic upheaval and social instability accompanied the rapid commercial expansion, and this greatly influenced Plato and Aristotle's economic thinking. They believed that the instability resulted from the pursuit of financial gain, which, as the fable of Midas made clear, both knew no limits and brought with it dire consequences. Just as Midas had destroyed himself in the pursuit of gold, so too had the pursuit of wealth imperiled Greek society. It was partly in response to this threat that Plato and Aristotle undertook to contemplate what life would look like in the ideal state, and their analysis was built around the question of what, in such a state, would constitute "the good life"? It was clear to them that economic growth had undesirable effects, and they stressed the need for an economic system that generated a relatively stationary level of economic activity. Their ideal

[2] Excellent discussions of Greek economic thought can be found in Todd Lowry's *The Archaeology of Economic Ideas* (1987) and Barry Gordon's *Economic Analysis before Adam Smith* (1975).

system was one in which the citizens of the state had a reasonable standard of economic well-being, and in which economic relationships satisfied the dictates of justice. The task for government here was to structure a system of laws that would facilitate this.

Both Plato and Aristotle were deeply suspicious of the ability of the forces of material self-interest to generate a just and harmonious social order. Self-interest and the pursuit of financial gain, they thought, tended to go hand-in-hand, and the negative consequences of this were observable all around them. Not surprisingly, then, they frowned upon commercial activity in general, seeing it as, at best, a necessary evil that allowed people to acquire the possessions sufficient to meet their needs. The potential for earning vast sums of money through trade, however, made commerce an irresistibly attractive line of work for many Greek citizens and thus something destined to continue to expand in scope and influence unless somehow checked. Relatively strict limits on commercial activity were thought by the philosophers to be the most straightforward means of attaining their objectives for the ideal state, and this is where the state was to play a central role within the Greek system. Aristotle, seeing no other means for the achievement of satisfactory economic coordination, advocated fairly wide-ranging governmental control over economic activity. He saw the market as "a creature of the state" (Lowry 1987: 237) and suggested that regulation was something that could and should be readily applied to deal with any problems that cropped up (*Politics* 1327a). So important was this aspect of the government's operations for Aristotle that among the "indispensable offices" of the state, he listed first "the office charged with the care of the marketplace" (*Politics* 1321b18; Lowry 1987: 237).

To rein in self-interest and avoid the potential problems that its unrestrained exercise could cause, Plato and Aristotle advocated policies including a prohibition on lending at interest, the elimination of profits, and statutory fixing of prices—all of which they believed would help to keep commercial activity in check. Moreover, while both Plato and Aristotle recognized that the development of an economic system that could generate a satisfactory level of material well-being required harnessing the power of the division of labor, they objected to the internationalization of the division of labor—foreign trade—owing to the base influences they believed it would introduce (and had already introduced) into society. The philosophers recommended various government actions to mitigate incentives to seek private gain through foreign trade, including the creation of separate domestic and international trading currencies. Such a dual-currency system would make it easier for the state to control the extent of international trading activity and allow for the confiscation of illicit gains.

Given that politics and economics were part of the same body of analysis for Plato, it is not surprising that his distrust of self-interested individual action bled over into the political arena. The ideal state could not, for Plato, evolve via democratic action; he opposed participatory governance and did not believe that the citizens could understand how to achieve the efficient outcomes of the ideal state unless they submitted themselves to the guidance of a ruler possessing superior intelligence.[3] The idea that the state should be governed by such a ruler-expert was a reflection of Plato's conception of the division of labor, which, in turn, gave effect to his belief that each person has a single task for which he is best suited by nature. This ruler would have the flexibility to adapt the laws of the state to meet situational needs, something that was not so easily done in a system governed by laws rather than by an individual. Although not himself immune from the influence of self-interest, this ruler could be trusted to govern in the interests of society as a whole because to act unjustly would be damaging to his psychic harmony and thus contrary to his self-interest. Given that the ruler ruled justly, obedience on the part of the subjects would be in their self-interest. It was thus part of the ruler's task to get his subjects to understand that their interests were served by submission to his rule. The result, as Todd Lowry (1987: 93) has pointed out, would be a state that was "rationally organized . . . an efficient, static, changeless society administered by experts."

The intellectual legacy left by the ancient world, and by Aristotle in particular, began to gain currency in the thirteenth century. This marked the beginning of the Scholastic period, which was characterized by a renewed emphasis on learning, the application of rationality or reason, and, with this, the rise of the university as a home for learning and scholarship. Scholastic scholarship, like that of the Greeks, ranged over a broad spectrum of topics and included the systematic analysis of matters economic. That there were certain significant parallels between the respective analyses of the Greeks and the Scholastics is not surprising, as Thomas Aquinas (1225–74), the foremost of the schoolmen, made the reconciliation of Holy Scriptures and the teachings of the Church with the rule of reason, particularly as manifested in the writings of Aristotle, the centerpiece of his work. One sees in Aquinas a tendency for those things that Aristotle considered "unnatural" to be found inconsistent with scripture, and conversely, in keeping with Aquinas's view that religion and reason should lead one to the same conclusions.

Scholastic economic commentary was motivated by and bound up with the discussion of Christian morality and ethics.[4] The Scholastics' contempla-

[3] Aristotle shared Plato's nondemocratic bent but did not go all the way with the philosopher-king brand of expert advocated by Plato. See Kraut (2002) and Keyt and Miller (1991).

[4] On Scholasticism generally, see Gordon's *Economic Analysis before Adam Smith* (1975) and Odd Langholm's *The Legacy of Scholasticism in Economic Thought* (1998).

tion of the relationship between man and his Creator necessarily involved a consideration of relations between individuals in a social context, the biblical mandate to "love they neighbor as thyself" being on essentially equal footing with the command to "Love the Lord thy God with all thy heart, and with all they soul, and with all thy mind, and with all thy strength."[5] The attempt to work out the practical content of this led the Scholastics to consider the operation of the commodity exchanges and the monetary system. The Scholastic inquiry into social-economic issues was motivated by the basic question, "What ought a Christian man to do?" Justice was central, of course, but its attainment on this earth was rendered problematic by man's sinful nature. One of the effects of sin was that individuals were more concerned with self than with others,[6] and the results were seen to be both contrary to the will of God and (perhaps as a consequence) harmful to the social order.

The influence of man's sinful nature came through in a variety of ways in both the commodity and money markets. Though the Scholastics tended to be more favorably disposed toward commercial activity than the Greeks, it was not because the Scholastics approved of the unbridled pursuit of wealth. Rather, they were generally of the mind that market outcomes would satisfy the dictates of justice in the absence of monopoly or fraud. The problem, of course, was that monopoly and fraud were seen to be regular consequences of unrestrained behavior, as sellers would attempt to exploit consumers by charging the maximum price that they could get away with, whether for goods or, in the case of usury, for the use of money. In the former instance, regulations were considered appropriate means of preventing unjust pricing practices. In the case of usury, Aquinas followed Plato and Aristotle in supporting prohibitions on lending at interest—grounding this in the Old Testament biblical dictum that "thou shalt not charge interest to any of my children that is poor by thee"—although this view eroded slowly over time as later Scholastic writers came to understand the opportunity cost associated with lending.[7]

While the Scholastics devoted a great deal of effort to the question of usury between the thirteenth and sixteenth centuries, monetary issues in general were a significant economic problem during this period, and they attracted plenty of commentary from the Scholastic writers. Monarchs in need of funds to finance military expansion and regal lifestyles regularly succumbed to the temptation to debase the national currency, calling in old

[5] Mark 12:30–31 (King James version).

[6] Indeed, the command to "love thy neighbor as thyself" may be seen as a response to exactly this problem.

[7] See Aquinas ([1274] 1948). The reader may find Aquinas's interpretation of this passage a bit broad, as it could be said to apply only to the poor or, say, fellow Jews ("thy neighbor"). See the discussion in Gordon (1975) for further commentary on this.

coins and reminting at the same face value but with reduced precious metals content—meaning that more coins were available after the reminting and so leaving a "surplus" to be pocketed by the monarch. The citizens were no less in need of funds, and they responded similarly—by clipping coins and selling the clipped bits of gold and silver. Commoner and Crown alike were thus subject to the temptations of self-interest. The effects of this pursuit of gain were clear: currency destabilization that resulted in significant macroeconomic fluctuations. One Scholastic response to these problems was to support measures that would eliminate such practices. The authority of the monarch, however, rendered debasement prevention laws problematic, and the technology of coining at that time made it virtually impossible to prevent clipping. One artifact of this dilemma was widespread Scholastic support for some degree of price control—in this case, the regulation of prices within certain upper and lower limits. If controlling the quality of the currency was problematic, price controls could at least serve to mitigate the extent of the fluctuation in the value (or purchasing power) of money over time.

The self-interested behavior arising from man's sinful nature was also at the heart of the Scholastics' support for private property. Plato was a staunch supporter of common property, but Aristotle was equally adamant that private property was necessary in that people would not take sufficient care of things owned in common because the benefit of such care did not redound to them. Not surprisingly, the Scholastics followed Aristotle, but gave the position religious underpinnings. Most of the Scholastic writers had taken vows of poverty, and many were mendicants, which made it logical that they would consider common property as the ideal. Nonetheless, they were very much of the mind that private property was optimal for society as a whole. The problem with common property, they said, was the negative incentive effects that it provided for sinful, worldly people—these being sufficiently severe to render common property unworkable. The one exception to this position, it seems, was the communal monastic institutions—the monks' discipline of mind presumably placing them above the self-interested actions that were thought to be so problematic for laymen.

For both the Greeks and the Scholastics, then, relatively extensive regulation of economic activity—whether by governmental, religious, or other authorities—was thought to be a necessary tool for bringing about a harmonious social-economic order. There was not so much an overarching theory of the state here as there was a set of supposedly naturally ordained ends that authorities could (and, indeed, necessarily should) assist society in attaining. In particular, the operation of the forces of self-interest was said to promote outcomes inconsistent with those prescribed by nature or by God, and regulatory action was necessary to prevent, or at least minimize, the more base impacts of self-interested behavior.

Mercantilism's Golden Rule

Self-interest began to take an entirely different form in the economic writings of the sixteenth and seventeenth centuries. The literature of this period was produced not by theologians writing manuals on doctrine or the Christian life, but by businessmen and merchants who wrote pamphlets in an attempt to influence government policy and popular sentiment in ways that promoted their particular interests. Significantly, the dissemination of this pamphlet literature was greatly aided by the advent of the printing press. While self-interested advocacy was often the motivation for this work, many of these writers appealed (for obvious reasons) to the larger national interest to justify their proposals. In spite of its polemical nature, however, this work evidenced systematic methods of analysis that were absent from many earlier economic writings, as a result of which certain insights were gained into the workings of the economic system.

The mercantile period, as this era came to be known,[8] saw a shift in the focus of the analysis away from moral concerns to those of a more worldly nature. Mercantilist doctrines were aimed at promoting economic growth and consolidating the power of the nation-state, including the provision of revenues sufficient to meet its needs. The means for achieving these ends was the accumulation of gold and silver bullion, on the grounds that a nation's wealth and political-economic power were directly tied to its stocks of precious metals.[9] One avenue for increasing the nation's bullion stock was via the colonization of the metals-rich New World. Trade, however, offered a second avenue: Selling one's goods to other nations brought bullion into the country, while importing the goods produced by other nations sent it out. Precious metals accumulation, then, was directly tied to the magnitude of a nation's trade surplus. The link between bullion accumulation and the self-interest of those promoting it was simple: The maximization of the trade surplus meant protecting domestic industry from foreign competition and promoting the sale of domestically produced goods on world markets—all of which worked to the advantage of certain domestic business interests. Those who stood to gain from these policies sought to gain popular support for them by appealing to a larger national interest—national wealth, political power, increased employment—that would ostensibly be served if the policies were enacted. That political and economic objectives here were mutually reinforcing—and

[8] The term "mercantilism" was coined in the 1760s—and so relatively late in the mercantile era—by the Marquis de Mirabeau, but it achieved canonical status when Smith used the term to describe the trade policies that he was attacking in *The Wealth of Nations.*

[9] Eli Hecksher's *Mercantilism* offers the most expansive treatment of the subject. Lars Magnusson's *Mercantilism: The Shaping of an Economic Language* (1994) is a useful recent treatment.

worked to the benefit of the mercantile interests—can be seen when one notes that bullion accumulation went hand-in-hand with the development of military strength, including naval power, which at once protected both nation and trade shipments; with the acquisition of colonies, which brought empire, sources of raw materials for manufacturing, and markets for exports; and with the slave trade, which offered up low-cost labor.

While the justice-related questions that so concerned the ancient Greeks and the Scholastics were largely absent from the mercantilist literature, there was a degree of continuity with Greek and Scholastic thought in the view that individual self-interest, if given free rein, would run counter to the national interest, and that broad-based government intervention in economic activity was necessary to minimize these tendencies.[10] Self-interested behavior, in the mercantilist view, would lead to diminishing bullion stocks, and thus reduced national wealth—and for two reasons. First, traders would see the opportunity for gain from the importation of foreign goods, and the payment for those goods would be made in bullion. Second, self-interest on the part of consumers was bound to lead to what the mercantilist writers considered "excessive" consumption of both domestic and foreign goods, and especially luxuries. The former would diminish the quantity and raise the price of domestically produced exports, thereby reducing their competitiveness on world markets, while the latter increased the quantity of imports. The effect of all of this would be to harm the nation's trade balance and thus its stock of precious metals.

Given that people's natural inclinations would lead them to pursue courses of action that worked against the national interest, bullion accumulation, and thus the maintenance of a favorable balance of trade, required the implementation of a wide-ranging scheme of economic policy that would check this self-interested behavior. Import restriction and export promotion were only the most obvious policies proposed by the mercantilist writers. Even here, however, there were trade-offs to be dealt with. A number of writers recognized, for example, that outright prohibitions on imports and excessively high tariffs would serve only to encourage smuggling and even destroy markets for one's exports. Moreover, exceptions were allowed for consumer necessities and raw materials that could not be produced at home in the necessary quantities. Beneficial export policies were thought to include the removal of customs duties and other export impediments, subsidies for the export of manufactured products, and restrictions on the export of raw materials—the last of these because

[10] It should be noted here that the continuity was hardly intentional. The mercantilist literature is noticeably devoid of references to previous economic thinking.

these raw materials could be used by other nations to produce manufactured goods that would compete with domestically produced products. These policies, then, would result in the export of products with the highest value added, thus bringing in the largest possible quantity of bullion in payment. The policies advocated by the mercantilist writers, however, went well beyond these basic import and export controls to include the regulation of precious metals exchanges—including prohibitions on bullion exports, exchange rate controls, and protecting the quality of coinage—and related regulations restricting the hoarding of bullion and its conversion into plate, jewelry, and so forth, to ensure sufficient currency in circulation to fuel the nation's economic activity. Strategic policies that would favor certain important national industries and protect infant industries were also much in vogue, as were labor-related policies—including loose immigration and tight emigration rules, and subsidies to encourage workers to relocate to manufacturing centers—that would serve to keep labor supply up and wages low, thus facilitating the price-competitiveness of exports. In general, the rod against which policy proposals should be measured was, for the mercantilists, the effect they would have on the nation's stock of precious metals.

While its rhetoric centered on the pragmatic idea of nation-state building, the mercantilist mode of reasoning was not without its own natural law aspect. As Jacob Viner (1937: 100–101) has pointed out, the mercantilists

> managed ingeniously to adapt the doctrine of [divine] providence to their own particular views . . . [using] the doctrine either to justify the restriction of certain products to Englishmen, on the ground that Providence had assigned them to this country, or appealed to the doctrine in support of that branch or type of trade which they wished to have fostered, while completely forgetting the doctrine when attaching other branches or types of trade.

In fact, these appeals to providence, often couched in nationalistic garb, regularly served as a mask to shield what was really self-interested advocacy on the part of the author: the attempt to use governmental policy to support private interests. Yet there was more to the natural law aspect than just this effort to mask self-interest. Mercantilism departed from previous thinking by viewing the economic system as "an independent territory with its own distinctive laws." Here, economic welfare depended greatly on "the statesman's ability to rule according to the laws dictated by an independent economic realm," this being necessary owing to the inability of self-interested private action, as translated through the market mechanism, to promote most effectively the interests of the nation, whether this be measured by political power or precious metals stocks (Magnusson 1993: 6–8).

Physiocracy

The French mercantile apparatus had its origins in the policies laid out by Jean Baptiste Colbert (1619–83), who was finance minister during the reign of Louis XIV. In an effort to provide sufficient revenues to finance the Crown, and so solidify its power, Colbert introduced a wide-ranging set of policies that benefited the manufacturing sector, in the mercantile way, while retarding the development of the agricultural sector. Legal barriers to the movement of foodstuffs within the country caused some regions to experience severe shortages of food while other regions had surpluses. The monarchs did not help matters. Profligate court spending and the need to finance military activities meant that substantial tax revenues were necessary. The nobles were exempt from taxes, which meant that the tax burden fell on the common people. There was little money available for investment in agriculture, which caused a progressive deterioration of agricultural output and thus returns on investment. These problems were further exacerbated by the movement of the population from the countryside to the cities. As a result, food was in extremely short supply, and life for the common people of France during this period was very difficult.

Given the extent of these hardships, it is not surprising that the backlash against mercantilist thinking was first evidenced in a significant way in France in the eighteenth century. Vincent de Gournay—who is widely credited with popularizing the expression, "laissez-faire, laissez-passer"[11]—and Pierre de Boisguilbert attempted to make the case for economic liberalism against the restrictions on resource movement imposed by Colbert.[12] The most prominent strain of anti-Colbertism to emerge in France, however, was the product of that group of intellectuals known then as "les économistes" but who later became known as the Physiocrats. Led by François Quesnay (1694–1774), and Victor Riqueti, Marquis de Mirabeau (1715–89), the Physiocrats were the first organized group—or "school"—of economic thinkers, and their doctrine was very much a reaction against Colbert's mercantilist policies that promoted French manufacturing at the expense of agriculture. As Quesnay and Mirabeau pointed out in their classic work, *La Philosophie Rurale*, first published in 1763,[13] these policies, combined with wars and high tax burdens, served to impoverish the agricultural peasant proprietors and thus retarded productivity advances in the agricultural sector, where the continued use of cattle rather than horses to plow land

[11] See, for example, Higgs (1897: 67).

[12] For an excellent treatment of Boisgilbert, see Faccarello (1999).

[13] *Philosophie Rurale* went through several subsequent revisions. See Meek (1962) and the introduction to the works of Quesnay (2005) for an analysis of the evolution of this work and its arguments.

yielded output levels per acre significantly lower than those of nations such as England.

The Physiocrats were very much a product of the enlightenment mentality of eighteenth-century France. The world as they saw it consisted of a set of self-evident truths arising from natural law—the term "physiocracy" means "rule of nature"—and they believed that these truths could be discovered through human reason. Quesnay, who was the personal physician to Madame de Pompadour, the mistress of King Louis XV, exemplified this link between the natural and social realms. His medical science perspective infused his political economy, which posited an essential commonality between the body human and the body social, with each governed by its own particular set of laws set down by nature.[14] These natural laws extended to the economic system and, according to the Physiocrats, the state that governed best would govern in accordance with them.

For the Physiocrats, agricultural production was the cornerstone of economic activity. The reasoning behind this position was straightforward: agriculture alone, they said, generated a *produit net*—a net product, a surplus of output over input. Manufacturing was said to be sterile. In the Physiocratic system, the net product was the sole source of funds for investments in increased agricultural productivity, as well as the source of the tax base.[15] Quesnay and the Physiocrats saw the growth of this surplus as the only possible source for the financial capital needed to advance the technology of French agricultural production to match that of other nations. The mechanics of this were elegantly demonstrated in Quesnay's *Tableau Économique*—the economic table—which was devised and employed to show exactly this relationship between investments in agriculture and the growth of the net product, and rendered with a degree of scientific sophistication heretofore unseen in economic argumentation.[16]

Given the importance of the net product for economic development, it is not surprising that the Physiocrats made its increase the goal for society. It was against this rod—rather than the stock of precious metals—that the efficacy of all policy proposals was to be judged. As Mirabeau put it in a letter to Rousseau (quoted in Meek 1962: 20),

> The whole moral and physical advantage of societies is . . . summed up in one point, *an increase in the net product*; all damage done to society is determined by this fact, *a reduction in the net product*. It is on the two scales

[14] On the relationship between Quesnay's political economy and his medical background, see Groenewegen (2001).

[15] Given that the manufacturing sector generated no surplus over costs, the Physiocrats argued that any tax ultimately came out of the net product, whether directly or indirectly.

[16] Quesnay's works (2005) show many of the tableaux that Quesnay and Mirabeau employed, and a number of these are reproduced, with commentary, in Meek (1962).

of this balance that you can place and weigh laws, manners, customs, vices, and virtues.

From a Physiocratic perspective, then, the mercantilists had things exactly backward in promoting manufacturing. Self-interested behavior, however, was also a big part of the problem, according to the Physiocrats.[17] First, it generated an enormous demand for manufactured goods, and luxuries in particular. Secondly, the significant returns available in the manufacturing sector, especially in light of the mercantilist policies in place, attracted resources from profit-seeking entrepreneurs that could otherwise have been invested in agriculture. Given that any expenditures on the production and consumption of manufactured goods inevitably reduced the net product, self-interest and social interest were once again seen to be in conflict.

The importance of the net product, and thus of agricultural production, set the Physiocrats steadfastly against policies that restricted agricultural production for the benefit of the manufacturing sector—such as the prohibitions on agricultural exports that served to keep food prices, and thus manufacturing wages, low. In rejecting the mercantilist policy scheme, Quesnay argued that the sole function of the state is the provision of security: national defense and the appropriate system of laws—those that harmonized with natural law. The Physiocratic position on government interference with commerce and its consonance with the laissez-faire views set out by Gournay and Boisgilbert is nicely illustrated in Quesnay's essay on "Corn," where he argues that "all trade ought to be free. . . . It is enough for the government to watch over the expansion of the revenue of the kingdom's property; not to put any obstacles in the way of industry; and to give the people the opportunity to spend as they choose." ([1757] 1993: 79). Elsewhere, in his "General Maxims for the Economic Government of an Agricultural Kingdom," Quesnay says that "complete freedom of trade should be maintained; for THE POLICY FOR INTERNAL AND EXTERNAL TRADE WHICH IS THE MOST SECURE, THE MOST CORRECT, AND THE MOST PROFITABLE FOR THE NATION AND THE STATE, CONSISTS IN FULL FREEDOM OF COMPETITION" ([1767] 1993: 237).[18] This freedom of trade or competition entailed freedom in the production and circulation of goods, the reduction or elimination of transport tolls, improvement of transportation infrastructure, and the substitution of a single tax on the net product for the arbitrary tax system that so oppressed the agricultural sector.

It would seem from all of this that the Physiocrats were attempting to establish a case for the market, and hence the beneficial working of self-interest. It would be incorrect, though, to label their system one of laissez-

[17] On the importance of self-interest for Quesnay, see his "Essai Physique sur L'Économie Animale" (reprinted in Quesnay 2005), as well as the discussion in Steiner (1994, 1998) and Faccarello and Steiner (2006).

[18] The French version of the "Maxims" is reprinted in Quesnay (2005).

faire, in spite of their claims regarding noninterference and a minimalist state. In fact, the "appropriate system of law" to which Quesnay referred added up to a rather activist state. In addition to their support for the loosening of restrictions on agricultural production, the Physiocrats also pushed for the implementation of policies that would favor the agricultural sector, including agricultural price supports, legal ceilings on interests rates to hold down the cost of borrowing for agricultural proprietors, limitations on the importation of foodstuffs, and restrictions on the export of manufactured products—this last on the grounds that export promotion led to political pressures to hold down food prices in order to keep manufacturing wages, and thus costs, low. Quesnay even suggested that the government needed to educate citizens in the basic principles of natural law, lest they make improper decisions ([1767] 1993: 213). That is, far from proposing a minimalist and inactive state, the Physiocrats looked to achieve their aims through the state's agency, replacing mercantilist policies with those that favored the agricultural sector and the interests it represented.[19] That the Physiocrats were not truly disposed to noninterference—or willing to trust self-interested behavior to properly allocate resources—can be seen in Quesnay's statement that "the government's economic policy should be concerned only with encouraging productive expenditures and trade in raw produce . . . " ([1767] 1993: 233) and in his harnessing of the rhetorical power of the *Tableau* to "demonstrate" both the error of Colbert's policies and the beneficial effects of the policies favored by the Physiocratic writers.[20]

Self-interest, then, could not be relied upon to promote the growth of the net product any more than it could be trusted to promote stability, Christian justice, or bullion accumulation. Left to their own devices, people would spend and invest in ways inimical to the national welfare, and the power of the state was the only means by which the social interest could be effectively promoted. And, as was the case for Plato, Quesnay and the Physiocrats placed great emphasis on the role of the expert—in this case, the monarch—who alone was sufficiently in tune with natural law to govern according to its dictates.

THE HAND OF ADAM

The Physiocratic revolt against mercantilist policies was picked up and extended by Adam Smith in his *Inquiry into the Nature and Causes of the Wealth of Nations* (1776). Smith was born in 1723 in the Scottish coastal

[19] See Samuels (1962: 149) and Groenewegen (2002: 216).

[20] Even Gournay and Boisgilbert were not immune from this somewhat selective invocation of laissez-faire. See, for example, Pitvay-Simoni (1997).

village of Kirkcaldy, and his education under Francis Hutcheson at the University of Glasgow imbued him with the Scottish Enlightenment perspective.[21] This enlightenment mentality had many facets, including a broad-based view of human motivation—as against, for example, the strong self-interest view that Bernard Mandeville extolled in his *Fable of the Bees* (1714)—and a concern with the origins, development, and structure of civil society. These characteristics are reflected in the emphases on moral philosophy and political economy in the Scottish Enlightenment tradition, and Smith, who spent more than a decade as a professor of moral philosophy at the University of Glasgow (where he inherited Hutcheson's chair), evidences both of these emphases in his writings.

While of common purpose with the Physiocrats in their attack on mercantilism, Smith, who had spent several months in their company in 1766, also considered Physiocratic doctrine erroneous.[22] For Smith, the wealth of a nation consisted in the value of its produce rather than in the national stock of precious metals or, as with the Physiocrats, the net product of agriculture. The role for government within the economic system, then, was to facilitate the growth of national wealth, so defined. In this sense, Smith demonstrated an important commonality with the mercantilist and Physiocratic writers, but, as he himself recognized, accomplishing the goal of maximizing the value of output required a very different role for government than that posited by earlier writers.

This Scotsman understood full well the complexity of the human psyche and wrote about it eloquently and at great length in his *Theory of Moral Sentiments* (1759), the book that gave Smith his wide reputation and was, in fact, more influential during his own lifetime than was *The Wealth of Nations.* Even so, Smith shared with his ancestors the view that individuals are motivated primarily by self-interest in economic affairs. Smith's position, in a nutshell, was that individuals tend to be motivated most strongly by benevolence in dealings with those closest to themselves (such as immediate family), but that the force of benevolence weakens—and that of self-interest strengthens—as one moves progressively farther away from the self. Given that relations between individuals tend to be relatively anonymous in the realm of economic affairs, Smith considered self-interest to be the

[21] On the Scottish Enlightenment generally, see Broadie (2003). Ian Simpson Ross's *The Life of Adam Smith* (1995) provides a detailed analysis of Smith's life and work. The secondary literature on Smith is voluminous. For a selection of perspectives on Smith, see Hollander (1973), Skinner (1996b), Rothschild (2001), Winch (1996), and Haakonssen (2006).

[22] Smith spent 1764–66 in France as a tutor to the young Duke of Buccleuch, giving up his university professorship to do so. He developed good relations with several of the Physiocrats, including Quesnay, and, in spite of his criticism of the Physiocratic system, insisted that it was "perhaps, the nearest approximation to the truth that has yet been published upon the subject of political œconomy" (from *Wealth of Nations*; see [1776] 1981: IV.ix.38).

dominant motive in that arena. As he says early on in *The Wealth of Nations*, "In civilized society [man] stands at all times in need of the cooperation and assistance of great multitudes, while his whole life is scarce sufficient to gain the friendship of a few persons." As a result, this help must come primarily from relative strangers, and Smith contends that "it is in vain for him to expect it from their benevolence only." He is more likely to secure their assistance if he is able to "interest their self-love in his favour, and show them that it is for their own advantage to do for him what he requires of them." Smith then goes straight to the point: "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner," he says, "but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages" ([1776] 1981: I.ii.2). The other-regarding aspect of our nature, then, cannot be expected to play a governing role in the marketplace.

What distinguished Smith from his ancestors on this score was not that he saw self-interest as a dominant feature of commercial life; after all, we have already seen that self-interested behavior was a centerpiece of the earlier literature, and Smith, like his predecessors (but unlike, say, Mandeville), disapproved of many of the manifestations of self-interested behavior. Rather, the distinguishing feature of Smith's analysis was his attitude toward its effects ([1776] 1981: IV.ii.4):

> Every individual is constantly exerting himself to find out the most advantageous employment for whatever capital he can command. It is his own advantage, indeed, and not that of society, which he has in view. But the study of his own advantage naturally, or rather necessarily, leads him to prefer that employment which is most advantageous to the society.

Smith was arguing here that the individual pursuit of self-interest serves the best interests of society as a whole, that self-interest and the social interest are partners rather than enemies. So understood, the operation of self-interest is something to be facilitated rather than restrained. It hardly needs noting that this marked a significant break with past economic thinking.

Such a dramatic departure cries out for an explanation: How does this coincidence of private and social interests occur? Here, Smith is at once vividly descriptive and maddeningly vague in making what is assuredly his most famous pronouncement. Smith contends that a person will attempt to employ his capital where he expects that it will yield for him the highest return, and, in doing so, "He generally … neither intends to promote the public interest, nor knows how much he is promoting it." Yet, Smith argues, even though intending his own gain, "he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention"—that end being the interest of society as a whole ([1776]

1981: IV.ii.9). An invisible hand—this is as specific as Smith gets. What Smith meant by this is anyone's guess, and plenty of guesses have been offered, ranging from God to government.[23] But whatever it is, Smith was convinced of its propensity to channel self-interest in socially useful directions.

This perception of an essential congruence—some would say, more strongly, a harmony—between private and social interests explains the strong parallels in Smith's critiques of mercantilism and Physiocracy. Smith saw that self-interest, if channeled in the proper directions, could work in the national interest. If not so channeled, however, it would lead to all manner of conspiracies to restrain trade. The mercantilists and Physiocrats, in contrast, believed that its operation tended to work directly counter to the national interest and needed to be forcibly checked by the state. Smith saw the respective favoritisms of the mercantilists and the Physiocrats, as well as the policy schemes that attended them, promoting flows of labor and capital resources into these favored sectors at rates in excess of what would arise naturally via the operation of self-interest. The problem, of course, was that if the resource-flows generated by the motive of self-interest promoted the greatest increases in national wealth, then measures that worked to deflect resources from these courses would necessarily restrict economic growth by comparison. In Smith's words ([1776] 1981: IV.ix.50),

> [E]very system which endeavors, either, by extraordinary encouragements, to draw towards a particular species of industry a greater share of the capital of the society than what would naturally go to it; or, by extraordinary restraints, to force from a particular species of industry some share of the capital which would otherwise be employed in it; is in reality subversive of the great purpose which it means to promote. It retards, instead of accelerating, the progress of society towards real wealth and greatness; and diminishes, instead of increasing, the real value of the annual produce of its land and labour.

This idea was at the heart of Smith's argument for (relatively) free trade. To take just one example cited by Smith, to produce at home that which could be produced more cheaply abroad—as mercantilist policies advocated—serves only to reduce the value of the nation's output, enriching the individual businessman who is the beneficiary of the protection while harming the interests of society as a whole.

What is often lost in the discussions of Smith's critiques of mercantilism and Physiocracy is that Smith never questions the internal logic of either system. The mercantile literature does a very good job of laying out a pro-

[23] See Samuels (2009a,b).

gram for promoting precious metals accumulation and the Physiocrats for promoting the growth of agricultural output. The problem, for Smith, was that both the mercantilists and the Physiocrats had misapprehended the nature of wealth, and as a result believed that the growth must be facilitated by governmental support for a particular segment of the economy. There was thus a perceived disconnect between self-interested behavior and the growth of national wealth, and this could, in their view, be resolved only via state action. Against this, Smith argued that the growth of national wealth, properly understood, was facilitated by self-interested action and that attempts to interfere with it in the national interest managed to work exactly contrary to that interest.

None of this is meant to suggest that Smith saw self-interested behavior as an unmitigated good nor that he believed people *ought to* behave in self-interested fashion. For example, Smith understood, with the Scholastics, that businessmen were constantly looking to exploit any possible advantage in ways detrimental to both consumers and their fellow producers. In one of many cutting remarks that he made about the business class, Smith said, "People of the same trade seldom meet together, even for merriment and discussion, but the conversation ends in a conspiracy against the publick, or in some contrivance to raise prices" ([1776] 1981: I.x.c.27). Smith believed, however, that competition, if allowed to flourish and supported by appropriate legal structures, would be the rule rather than the exception, and that such an environment would greatly curtail the extent to which the base effects of self-interest could manifest themselves.

While showing a healthy degree of confidence in the effects of self-interested behavior when channeled through the market, Smith's position is grounded in more than a basic optimism about private activity. He also had a very negative view of the abilities of statesmen and civil servants—one that was quite justified by the state of politics in Britain during the period, which is often described as being "shot through with corruption and venality" (Prest 1991: 68).[24] Indeed, *The Wealth of Nations* is replete with pejorative characterizations of government agents, such as Smith's reference to "that insidious and crafty animal, vulgarly called a statesman or politician" ([1776] 1981: IV.ii.39)—a personal favorite of Frank Knight, one of the founders of the Chicago school. Not surprisingly, this dim view of government officials translated into a belief on Smith's part that the state tends not to be capable of improving upon the results of private activity. Smith found it perfectly evident that "any individual" can judge the disposition of his resources "much better than any statesman or lawgiver can do for him" ([1776] 1981: IV.ii.10). In fact, he says,

[24] See also Hill (2006) and the references cited by Hill and by Prest (1991).

> The statesman, who should attempt to direct private people in what manner they ought to employ their capitals, would not only load himself with a most unnecessary attention, but assume an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it. ([1776] 1981: IV.ii.10)

Where the state had for centuries been characterized as the savior from the negative influences of self-interest, Smith was arguing the reverse. The expert had been transformed into the delusional bumbler, susceptible to capture by a business class always looking to further its own interests at the expense of the public. It is not just that self-interest does the job, then—it does it *better* than can the state. In fact, Smith suggests that the force of self-interest is sufficiently powerful and positive that it can even overcome some degree of mismanagement by politicians ([1776] 1981: IV.ix.28).[25]

All of this having been said, Smith did not see the situation as hopeless where government was concerned. In fact, he subscribed to what might be called an "improvability thesis" regarding state action. He was of the mind that much of what he considered bad policy resulted from ignorance and prejudice on the part of government agents, and he held out hope that the extent of this could be reduced—and legislative performance thus improved—if government officials were properly instructed.[26] *The Wealth of Nations*, of course, was a recipe for exactly that.

Smith's take on things, in short, is that markets are quite successful at facilitating the growth of national wealth and that government interference with this process will tend to be more harmful than helpful. All of this was nicely summed up by Smith ([1776] 1981: IV.ix.51) when he was rounding out his critique of mercantilism and Physiocracy and giving his summary prescription for enhancing the wealth of the nation:

> All systems either of preference or restraint, therefore, being thus completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and his capital into competition with those of any other

[25] What makes Smith's position here all the more interesting is that he spent that last part of his career in the civil service, as Commissioner of Customs for Scotland. That his time in the civil service seemingly did not cause him to revise his views (Smith made multiple revisions to *The Wealth of Nations* during this period) suggests that his bureaucratic sojourn may have only served to confirm his original position.

[26] On this aspect of Smith, see Stigler (1971). Stigler is critical of Smith for failing to realize that politicians, too, are inevitably self-interested and as such beyond having their performance enhanced by instruction.

> man, or order of men. The sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society.

This is all well and good, of course, but it leaves one wondering what, for Smith, is the appropriate role for government within such a system. He suggests that there are only three duties that fall to the state ([1776] 1981: IV.ix.51):

> According to the system of natural liberty, the sovereign has only three duties to attend to; three duties of great importance, indeed, but plain and intelligible to common understandings: first, the duty of protecting the society from the violence and invasion of other independent societies; secondly, the duty 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; and, thirdly, the duty of erecting and maintaining certain publick works and certain publick institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because the profit could never repay the expence to any individual or small number of individuals, though it may frequently do much more than repay it to a great society.

Smith's "certain publick works and certain publick institutions" is actually a reasonably broad category and includes not only the standard roads, bridges, canals, and harbors—which serve to facilitate commerce—but also education, to counteract what he saw as the mind-numbing effects of the division of labor, temporary monopolies given to joint-stock companies to facilitate new trade avenues, and religious instruction for clergy.[27]

One would be severely mistaken, though, in thinking that Smith actually confined the operations of the state to this narrow band. Smith was certainly in favor of doing away with the trade restrictions of the mercantilists, apprenticeship and settlement laws (which inhibited the free flow of labor), legal monopoly, and the laws of succession that impeded free trade in land. Yet, in addition to the basic governmental functions noted in the previous paragraph, he also allowed for exceptions to his generally free-trade attitude to encourage and protect industries essential to national defense

[27] Smith's list of appropriate governmental functions is virtually identical to that offered by Sir William Petty in his *Treatise of Taxes and Contributions* (1662), the exception being the social safety net included by Petty. The absence of such in Smith may owe to his belief in the ability of labor markets to clear relatively quickly and thereby eliminate involuntary unemployment.

and to level the playing field for domestic products subject to tax at home, and he suggested that retaliatory tariffs would be beneficial if (although only if) they induced other countries to lower their trade barriers. Beyond this, Smith offered at least a degree of support for regulations dealing with public hygiene; legal ceilings on interest rates to prevent excessive flows of financial capital into high-risk ventures; light duties on imports of manufactured goods; the mandating of quality certifications on linen and plate; certain banking and currency regulations to promote a stable monetary system; various regulations that were in the interest of the laboring classes (to offset employers' bargaining power advantage); and the discouragement of the spread of drinking establishments through taxes on liquor, as well as various other regulations that would compensate for the imperfect knowledge and foresight—what is sometimes called diminished telescopic faculty—of individuals.[28] All of this has led Jacob Viner to conclude that while Smith's "one deliberate and comprehensive generalization" regarding the proper functions of the state would "narrowly restrain" its activities, the actual range of activities pointed to by Smith was so extensive that if Smith "had been brought face to face with a complete list of the modifications to the principle of laissez faire to which he at one place or another had granted his approval, I have no doubt that he would have been astounded at his own moderation" (1927: 102).

Smith, then, was not a doctrinaire advocate of laissez-faire. He had an inherent suspicion of the ability of government to manage economic affairs properly, but he also recognized that there were various policy actions that could improve the national welfare, and that the ability of government officials to govern wisely could be improved if they were properly instructed.[29] At least as important, though, was Smith's recognition that the market does not operate absent government; indeed, Smith calls political economy "a branch of the science of a statesman or legislator" ([1776] 1981: IV.i.1), making it, in part at least, a branch of jurisprudence. Smith found in the system of natural liberty a regulating mechanism that previous commentators had been unable to discern—a coordinating force that would keep self-interest from becoming totally destructive.[30] Yet, he also understood that governmental action supplies the legal-institutional process through and within which markets function. It was not government that Smith opposed. Both the *Wealth of Nations* and his *Lectures on Jurisprudence*

[28] See Skinner (1996a) for an excellent elaboration of Smith's rather broad-based conception of the appropriate functions for the state.

[29] See Viner (1927: 112).

[30] While Smith's writings have a natural law flavor to them—as evidenced, for example, in his use of the invisible hand and system of natural liberty concepts—his views on the appropriate role for government are not so much derived from a broad set of general principles as from the examination of specific circumstances and problems.

(1978) show that he fully understood the integral relationship between government and economy. What Smith was after was the appropriate set of policies that, working in tandem with the self-interest that he believed governed behavior in the economic realm, would facilitate the growth of national wealth.

So yes, Smith had turned the tables in arguing and elaborating an analytical system of political economy, which showed that self-interest, channeled through the market, could be trusted to move resources into the uses most conducive to the growth of national wealth.[31] But it is also important to be clear on what Smith had *not* done here. Smith was not, as some have imagined, a proto-modern.[32] Smith's view of man is not economic man with his rational, single-minded pursuit of his self-interest. Ronald Coase has argued quite correctly that "Adam Smith would not have thought it sensible to treat man as a rational utility-maximiser. He thinks of man as he actually is—dominated, it is true, by self-love but not without some concern for others, able to reason but not necessarily in such a way as to reach the right conclusion, seeing the outcomes of his actions but through a veil of self-delusion" (1976: 545–46). Furthermore, Smith did not argue that private action was optimal, in the modern efficiency sense, nor even that it was always superior to governmental alternatives. Smith considered the link between private and social interests partial and imperfect, but he was also of the mind that self-interest, properly channeled, tended to engender positive results, rather than negative ones, and that government interference with its operation in the economic sphere would generally lead to inferior results.

Self-interest, then, had finally found legitimacy.

[31] Bear in mind that the Physiocrats, for all of their laissez-faire rhetoric, did not trust self-interest to grow the net product, but instead urged policies that favored agriculture. Moreover, while Gournay and Boisgilbert may have been more laissez-faire oriented than the Physiocrats, they both advocated policies at odds with their rhetoric and had only minimal impact on subsequent literature, as compared to Smith.

[32] See, for example, Evensky (2005), Samuels and Medema (2005), and Medema (2009a).