

Laissez Faire: Adam Smith's Version

Adam Smith believed that he was recommending the economics of the free market when he wrote *The Wealth of Nations*. He thought that his theoretical system had, as its dynamic principle, the competitive spirit; that, within the framework of natural justice, economic growth would be enjoyed by the three 'original great orders' which comprised civilized society — the landlords, capitalists and labourers. He was wrong.

Smith was not wrong in thinking that theoretically the economics of capitalist competition could function efficiently to the advantage of all. His error arose from the deduction that his specific system provided such an outcome, that it would secure the dual aim of freeing people to pursue private aims while guaranteeing the natural harmony of the total system. For his was not a description of how to construct a free market: he insulated the landlords from the competitive spirit. Until this is appreciated the science of political economy will be severely limited in its influence on public policy.

For two centuries Smith's book has been the 'bible' for the buccaneering entrepreneurs who built factories and mass-produced cheap goods, and for the rational thinkers — the technologists, scientists and engineers and organisational managers — who trampled theological mysticism under foot in favour of science. But when Smith penned *The Wealth of Nations* he betrayed the spirit of the free market. At the abstract level, his testament promoted a philosophy that relentlessly exposed the special privileges and the monopoly power that politicians and manufacturers tried to invoke to their profitable advantage, but the book also set the seal of approval on an institutional framework that crippled capitalism at its conception. And so Adam Smith's victims were not just the toiling masses who were subjected to the tortuous economic pressures that reduced so many of them to misery. A death blow was also administered to the very idea of the free market.

Laissez faire is now discredited because, by popular agreement, it has failed to work to everyone's satisfaction. It was out of resignation to this 'failure' that the philosophy of the New Deal developed: the belief that a mixed

economy would do what the free market was incapable of accomplishing. But the interpretation of the history of industrial society ever since publication of *The Wealth of Nations* has been grossly defective, which is why the critics have been able to conclude that unrestrained competition is inherently evil. Collective action, collective ownership of capital and centralised bureaucratic planning are now — in degrees varying only according to vested interests — acclaimed as the remedial alternatives.

The analyses have been wrong because the historians and social scientists have taken all the tenets of Adam Smith as necessarily intrinsic to the capitalist market. They have pursued their enquiries into a malfunctioning system without questioning the necessity for those property rights which have underpinned that system; without questioning whether, had a modified configuration of property rights existed, the free market might have achieved its goals without the evil consequences which have beset industrial society. Across the political spectrum, from Marxist left to conservative right, the arguments and counter-arguments have progressed without adequate reflection on whether a reform of the principles of property ownership and the rationale which motivates the owners of these rights might be sufficient to improve the operations of the free market without recourse to those bureaucratic modifications that deny the 'perfect liberty' that Smith wished to attain.

The debate about capitalism as a mode of production, therefore, has been in the terms validated by Adam Smith. But contrary to what he thought he was doing — and his readers interpreted him as doing¹ — Smith developed an economic framework which entailed a fatal element of monopoly power. He wrote about an 'invisible hand' guiding the system to the benefit of everyone, but he recommended the preservation of a structure of property rights which by its very nature struck at the heart of individual liberty and economic prosperity.

Critics, then, are opponents of Adam Smith — not of *laissez faire*. For the freely competitive market system with a capitalistic ethos has yet to be put to trial. Responsibility for the slums of Bolton in the 19th century, and the hunger of the Jarrow marchers in the 20th century, must be laid at the feet of Adam Smith and the politicians and practitioners who happily accepted his values; these tragedies, as we shall see, are *not* a necessary part of *laissez faire* capitalism. The search for a system which combines personal freedom and social stability with economic prosperity for everyone is a realisable dream, and its pursuit must start with an analysis of the defects in the philosophical justification advanced to legitimise the history of western industrial society: *The Wealth of Nations*.

Dr Smith was a careful Scottish scholar. He had taught at the University of Edinburgh, travelled to France where he studied the Physiocratic system of economics, and was an accomplished logician and natural scientist. His great

book was not specifically prepared for the Industrial Revolution which was fermenting all around him. He wanted to define the principles of a free and just economic system of relevance to any civilized society. Indeed, surprisingly, he was not well acquainted with the great strides in mechanical inventions which characterised the two decades during which he wrote the book which he published in 1776.²

The clues to Smith's fatal errors were contained in his first book, *The Theory of Moral Sentiments* (1759),³ which was a discourse on ethics. In this, he distorted the way in which income was divided between the landlords and the landless. In doing so, however, he linked 'the invisible hand' with the process, and the free market was generally held to be guilty of what subsequently happened.

Smith knew the facts. The natural fertility of the earth, nurtured by human labour, increased the output that fed a greater multitude. But, he insisted:

It is to no purpose that the proud and unfeeling landlord views his extensive fields, and without a thought for the wants of his brethren, in imagination consumes himself the whole harvest that grows upon them. The homely and vulgar proverb, that the eye is larger than the belly, never was more fully verified than with regard to him.⁴

Smith insisted that, given the limited capacities of the landlord's belly, he was obliged to 'distribute' his surplus food. The rich 'consume little more than the poor; and in spite of their natural selfishness and rapacity . . . they divide with the poor the produce of all their improvements'. Underpinning the whole structure of Adam Smith's economics was this naive claim that landlords shared the surplus output among every person in society; more than that, however, the distribution was effectively an *equal* one. Of landlords, he said:

They are led by an invisible hand to make *nearly the same* distribution of the necessaries of life which would have been made had the earth been divided into equal portions among all its inhabitants; and thus, without intending it, without knowing it, advance the interest of the society, and afford means to the multiplication of the species.⁵

So land redistribution was not on the agenda of reforms that might be necessary to improve the new mode of production. For 'the invisible hand' ensured that people enjoyed 'nearly the same distribution' as if the earth had been divided into equal portions among all.

Smith insulated the landlords from criticism by claiming that they were not responsible for the existing distribution of property rights, and that in any event nobody was really excluded from a share of wealth:

When providence divided the earth among a few lordly masters, it neither forgot nor abandoned those who seemed to have been left out in the

partition. These last, too, enjoy their share of all that it produces. In what constitutes the real happiness of human life, they are in no respect inferior to those who would seem so much above them. In ease of body and peace of mind, all the different ranks of life are nearly upon a level, and the beggar, who suns himself by the side of the highway, possesses that security which kings are fighting for.⁶

All was well, then; the 'fitness' of the system was bestowed with a certain 'propriety and beauty'⁷ that was the free market.

Smith appears to confuse the differences between the division of the *products* of the earth, with the *value* of that output as it is exchanged across the stalls in the market towns. Landlords may not hoard all the food that is grown on their land; but nor do they distribute its value on a nearly equal basis, as Smith would have us believe — as any landless beggar sunning himself on the side of the highway could have told the young Professor of Moral Philosophy from Glasgow.

Adam Smith was not a fool, and his attention to detail was meticulous. So we can account for the apparent shallowness of his economic reasoning only in terms of his having to fit reality to his theory. He must, at the outset, have decided that property rights to land should not be distributed in the new industrial system. In doing so, he was hamstringing capitalism.

In *The Wealth of Nations*,⁸ Smith attacked the manufacturers who sought to monopolise markets in order to inflate the price of their products; yet while he recognises that rent was a monopoly price for the use of a finite resource, he did not recommend any action to destroy that particular monopoly. He acknowledged that 'perfect liberty' was associated with the need to allocate capital and labour to their most efficient uses, to maximise the output of goods at the lowest possible prices; yet he condoned the under-use or misallocation of land. In sum, then, he expected labour and capital to work their damndest to maximise the welfare of society; yet he sought to protect the landlords, whose income and property rights were not to be invaded for the sake of improving the operations of 'the invisible hand'.

The theoretical formulations in *The Wealth of Nations* could have been used to predict the tragedies which would consequently afflict industrial society. For he offered a perfectly clear hypothesis about the determination of economic rent, containing all the elements of the theory which was later to be popularly associated with the name of David Ricardo. With this theory, Smith predicted that progress was biased in favour of the landlord class.

... every improvement in the circumstances of the society tends either directly or indirectly to raise the real rent of land, to increase the real wealth of the landlord, his power of purchasing the labour, or the produce of the labour of other people.⁹

Anticipating Henry George's formulations on the distribution of national income by over a century, Smith even noted that 'The real value of the landlord's share, his real command of the labour of other people, not only arises with the real value of the produce, but the proportion of his share to the whole produce rises with it'.¹⁰ Smith was under no illusions that rent was an unearned income; and here he acknowledges that it was a rising proportion of national wealth, a fund which lent itself peculiarly well to finance those activities that were suitable candidates for public sector expenditure.

But instead of grasping the historic opportunity presented to him of influencing events for the good of all, Smith reinforced the structural defects and human prejudices which were consequently unleashed in all their fury as never before in the history of mankind, given a new dimension by the scale of operations which is a distinguishing characteristic of the industrial mode of production. Whereas in a 'natural' system based on agriculture, suffering arising from exploitation was limited to individual cases or small groups, now it was transformed into the disgusting deprivations of millions, the malevolent disease stretching itself right round the globe in a system which failed to correspond with Smith's vision of natural harmony.

Smith would have abhorred the living portrayal of his system. Unlike his predecessors in the first half of the 18th century,¹¹ he advocated high wages as a stimulus to hard work. He was anxious about what sociologists today call 'alienation', the dulling effect on the spirits of people who specialised in monotonous conveyor-belt activities in the factory. He was a humane man who recognised that, in addition to self-interest, the virtue of 'sympathy' was a necessary part of the development of individual personality and of civilized society.

The competition of Smith's 'free' market was complemented by the co-operation entailed by the division of labour. Such defects as may arise in the market he sought to attribute to personal motives (as when businessmen conspire to fix prices) rather than to institutional inadequacies. The model that he delineated was not amoral; on the contrary, he saw it as founded on natural justice.

For Smith, natural justice established itself of its own accord for every man, so long as the laws of justice were not violated. Competition was virtuous, and not the naked thing of Marx's nightmares, the operation of some mythical 'law of the jungle' in which the weak are destroyed by the strong. One of Smith's rules was the concept of fair play. He illustrated what he understood by this rule, as it applied to each and every person.

In the race for wealth, and honours, and preferments, he may run as hard as he can, and strain every nerve and muscle, in order to outstrip all his competitors. But if he should juggle, or throw down any of them, the

indulgence of the spectators is entirely at an end. It is a violation of fair play, which they cannot admit of.¹³

The equal opportunity for everyone to strive as hard as he or she could, and be rewarded accordingly, in a growing economy which ensured the employment of all, was an intrinsic part of his vision of the good life. So long as all the participants played the game fairly, according to the rules, all would be well. But what if the rules handicapped some of the players in such a way that there was no fair way in which they could either win the race or even reach the finishing line? What if the rules prevented some of the would-be participants from even joining the game? These were critical questions to which Smith should have addressed himself, for the structure of property rights, and in particular the monopoly of land, biased the system against some of the players.

Smith may, as some have stated, 'laid about the landlords in his rhetoric',¹⁴ but in fact he proposed nothing to deal with them. On the contrary, he sought to excuse the disparity of wealth and income, and was insensitive to the way in which these would interfere with the dynamics of a competitive system.

Adam Smith recognised that rent was exacted by the use of monopoly power,¹⁵ and he did not try to hide his appreciation of that fact. Landlords, he agreed, 'are the only one of the three orders whose revenue costs them neither labour nor care, but comes to them, as it were, of its own accord, and independent of any plan or project of their own'.¹⁶ But he sought to excuse them by invoking a general psychological disposition.

As soon as the land of any country has all become private property, the landlords *like all other men*, love to reap where they never sowed, and demand a rent even for its natural produce.¹⁷

Like all other men? To which group in the economy was he referring? He advanced evidence that capitalists and labourers earned their incomes, but was not able to offer any justification for the reappings of the land monopolists; nor could he. So he sought to justify the role of the landlords by claiming that their exactions were the normal psychological failings of all men. He was unwilling to admit that the unwarranted division of income — the result of the exercise of that monopoly power for which he condemned the mercantilists — would disrupt competition.

To maintain his position, he invoked metaphysics; a 'principle of preservation' would correct any malfunctioning in the system, as a result of which even poor, landless people would find jobs as country labourers or urban craftsmen. Unfortunately, that was precisely what the crippled hand could not accomplish for all men, at all times. When landless peasants resorted to the town for work, they joined a labour market which was conveniently placed at

the disposal of the entrepreneurs who were then able to exploit the vulnerability of wage-seekers.¹⁸

Were the tools available to enable Smith to propose the means by which the frictions in the market system could be eliminated, so that the system could operate closer to its theoretical ideal? Before defining an answer, we need to look at the dynamics of the land market.

Land as a factor of production has certain unique qualities. For practical purposes, its supply is fixed, at the local level. Ultimately, the world is a closed economy. To control land, therefore, is to wield total power. But there is a more fundamental characteristic which differentiates land from capital and labour: the life span of people and machines is finite; the life of a plot of land is infinite. This has an important consequence for an economy relying simultaneously on competition and co-operation. Land monopolists can — and do — refuse to play the game whenever they choose. If they are not satisfied with the price that they are offered for their land, they can withdraw it from use without fear. They know that the value of the land is constantly appreciating, and that the rental revenue they forego today will be recouped in a few years through an increase in the value of the land (which is the capitalisation of a given number of years' revenue). People, on the other hand, cannot play the game for any length of time. If they withdraw their labour they starve; and there is no way in which their lost wages can be recovered. Similarly with capital. If the owners withdraw machines, these rot away; the rate of depreciation can be slowed down, but only at the expense of maintaining them while they are idle.

When it comes to a confrontation in the market, then, landowners win. They have time on their side.¹⁹ The system, consequently, malfunctions; and the usefulness of concepts like supply and demand, equilibrium analysis, optimum allocation of resources, efficient distribution of income — the analytical tools of the economist — are seriously restricted.

There is only one free market solution to the partial paralysis which is otherwise present in the industrial system: a fiscal obligation on the possession of land. A tax levied on the market value of *all* land would constitute a continuous pressure on the possessors, a cost analagous to that on the capitalist who must maintain his machines while they are idle. If the tax was levied at a high enough rate, the effect would be immediate. Either people would use the land to best effect, or, since they could not carry the tax liability for long while the land was not yielding an income, they would have to relinquish it to others. The tax on land values, then, would induce those who possessed land to play the game of competition and co-operation. They could not withdraw from participation and expect to take the land with them. Within this fiscal framework the 'invisible hand' would be restored to health and would be capable of handling, in an orderly way, the multiplicity of

problems with which it is presented by a community of people with scarce resources, limitless wants and a diversity of tastes.

Adam Smith would not accept this solution. It is true that he regarded land values as 'peculiarly' suitable for taxation, since such a tax falls on an economic surplus and could not be passed on to consumers in the price of goods.²⁰ The levied tax, furthermore, was in no way a disincentive to the enterprise and effort of workers or capitalists. Land, said Smith, was suited to taxation because its value was difficult to conceal, in contrast to the value of capital. A register of land values could easily be compiled, regular valuations carried out and the tax collected at moderate cost. But he, like the landlords who dominated the British Parliament, resisted the application of the tax on the value of *all* land. In fact, he explicitly opposed a tax on the rental income which could be imputed to idle land. His reasons for declaring this position illuminate his ideological orientation.

In his discussion on the 'Taxes upon the Rent of Houses', Smith twice stated that it would be wrong to levy a tax on unused land. 'The ground-rents of uninhabited houses ought to pay no tax,' he declared emphatically.²¹ In his review of the position in Holland, he claimed that taxes on uninhabited houses there posed problems for their owners. 'There seems to be a hardship in obliging the proprietor to pay a tax for an untenanted house, for which he can derive no revenue, especially so very heavy a tax,' he wrote.²² He failed to confront other problems associated with empty houses, such as the hardships of people living in slums and workhouses who would have preferred to live in the buildings which remained empty for durations longer than the normal time lapse between occupants on the move.²³ What stopped the owners from off-loading the tax burden, either by selling the houses or letting them to tenants?

Smith was careful to protect his theory of property with his four famous maxims on taxation, the first of which was that people ought to contribute to the exchequer a proportion of their 'revenue which they respectively enjoy'.²⁴ The ability to pay was viewed as conditional on income actually being received, rather than potential income that could be imputed to the possession of a revenue-yielding resource. So a person may own a thousand acres which the citizens of London or New York may wish to use for factories, homes or recreation; but because the owner chooses not to let others have access to them (i.e., he decides to forego the potential income), he ought to be free of tax liability. Such was Adam Smith's fair play.

Thus it was that priority was accorded to land monopolists. Smith accurately recorded how people were denied access to marginal coal mines²⁵ (which could only yield sufficient income to pay for the labour and capital inputs), and to unimproved agricultural land,²⁶ until they were able to pay rent. This was not just a descriptive account, however. Adam Smith, the

champion of mass production, the division of labour and competition as the means to achieving the lowest prices possible for industrial products, prescribed as sound policy the increase in the prices of food and raw materials to generate rent for the land monopolists. These price increases, 'instead of being considered as a public calamity, ought to be regarded as a necessary forerunner and attendant of the greatest of all public advantages'.²⁷

When Smith noted that 'rent makes the first deduction from the produce of the labour which is employed upon land',²⁸ he was prescribing an order of priorities. Yet in a competitive system, economic rent is a surplus *after* the deduction of wages (for labour), and interest (for capital) from the value of output.

Smith could have altered the order in which income was distributed, by encouraging the establishment of a competitive system in which landlords were forced to compete through the introduction of a tax on the value of land. He refused to lend his weight to this fiscal reform, which had at the time been promoted by Newcastle schoolteacher Thomas Spence (who was imprisoned for his impudence).²⁹ Adam Smith thus established an intellectual tradition of opposition to the special taxation of rent that can be traced through the 19th century classical economists beginning with David Ricardo³⁰ and on to Herbert Spencer.³¹ They all had a crystal-clear appreciation of the theory of economic rent, and they understood the macro-economic impact of land monopoly, but they were ultimately unwilling to advocate a fully-fledged fiscal policy designed to destroy the greatest of the monopolies that undermined the operations of the capitalist system.

This tradition was embodied in the British institutions which were subsequently replicated in the colonies right around the world. While the land monopolists could employ anti-social strikes with impunity, withholding land from those who needed to use it, the story was different for the men and women who worked in the factories. When *they* went on strike, they were severely attacked by the might of the State. A Manchester magistrate condemned 'This species of restraint or coercion', for it might 'be ultimately a great evil as nothing can be more clear than that commerce in every respect should be allowed to be entirely unshackled and free'.³² Free men in a fair society would have no reason to go on strike, which is an act of desperation; they would have no reason to shackle commerce, for in doing so they cause themselves hardship. But strikes were the name of the game: the rules were originally established by the land monopolists — didn't they withdraw their acres from production when it suited them? These rules had been sanctified by Adam Smith. So working people were forced to use the system of withdrawing their labour as the only counter to the unequal power of the landowner and the capitalist. Thus was born a system grounded on the principles of deprivation and conflict.

Notes

- 1 Smith offered us 'a theoretical perfect machine — the mechanical operation of an economic stabilizer', according to A. L. MacFie, *The Individual in Society*, London: George Allen & Unwin, 1967, p. 104.
- 2 C. P. Kindleberger, 'The Historical Background: Adam Smith and the Industrial Revolution', in *The Market and the State*, eds.: T. Wilson and A. S. Skinner, Oxford: Clarendon Press, 1976; and R. Koebner, 'Adam Smith and the Industrial Revolution', *Econ. Hist. Rev.*, 2nd Series, Vol. XI, 1959.
- 3 A. Smith, *The Theory of Moral Sentiments*, 1759; page references are to the edition published by Liberty Classics, Indianapolis, 1969.
- 4 *Ibid.*, p. 304.
- 5 *Ibid.*, italics added.
- 6 *Ibid.*, pp. 304-305.
- 7 *Ibid.*, p. 297.
- 8 Page references are to the Edwin Cannan edition published by The University of Chicago Press, Chicago, 1976.
- 9 *Ibid.*, p. 275.
- 10 *Ibid.* Smith appears to contradict himself on this point on p. 335; but this later reference contains no supporting argument, whereas his earlier conclusion — which we accept as the correct one — is fully elaborated. John Stuart Mill arrived at the same conclusion on the distribution of national income in favour of the landlords: see his *Principles of Political Economy*, Bk V, Ch. 2, sec. 5.
- 11 A. W. Coats, 'Changing attitudes to labour in the mid-eighteenth century', *Econ. Hist. Rev.*, Vol. XI, 1958/9.
- 12 See *The Theory of Moral Sentiments*, and T. Wilson, 'Sympathy and Self-Interest', in Wilson and Skinner, *op. cit.*
- 13 *The Theory of Moral Sentiments*, *op. cit.*, p. 162.
- 14 E. H. Phelps Brown, 'The Labour Market', in Wilson and Skinner, *op. cit.*
- 15 *The Wealth of Nations*, *op. cit.*, pp. 162, 370.
- 16 *Ibid.*, pp. 276-277.
- 17 *Ibid.*, p. 56. Our emphases.
- 18 *Ibid.*, pp. 74-75.
- 19 There is one partial exception to this. Where people have borrowed money to speculate in land, the cost of servicing loans during a recession causes some of them to sell at a loss. But the overall effect is the same, for the new owners, buying at attractive prices, then proceed to sit on the land until they reap the speculative profits which were being sought by the previous owners.
- 20 *Op. cit.*, pp. 370-371.
- 21 *Ibid.*, p. 370.
- 22 *Ibid.*, p. 372.
- 23 A survey in Liverpool in 1773 revealed that 412 of the 6,340 houses were empty, which could not have been the result of a surplus stock: there were 8,000 families resident in the city, which meant that about 2,000 families had to share their homes with others. Rents were calculated to be high — 'very few can be supposed to let under £5', according to J. Aiken, *A Description of the Country from Thirty to Forty Miles round Manchester*, London, 1795, pp. 343, 374.
- 24 *Op. cit.*, p. 350.
- 25 'The landlord will allow nobody else to work them without paying some rent, and nobody can afford to pay any.' *Ibid.*, p. 184.

26 *Ibid.*, p. 252.

27 *Ibid.*, p. 253.

28 *Ibid.*, p. 73.

29 Mingay comments on this period: 'Prudence was the counsel that prevailed . . . in fiscal matters. The protection of property was the overriding consideration, and no-one knew where economical reform might end — after all, a reassessment of the land tax, by now a very modest burden, might prove to be its unforeseen and disastrous consequence'. G. E. Mingay, *English Landed Society in the Eighteenth Century*, London: Routledge & Kegan Paul, 1963, p. 262.

30 D. Ricardo, *Principles of Political Economy and Taxation* (1817), in *The Works of David Ricardo*, London: John Murray, 1888, p. 121.

31 For a critique of his recantation on the land tax issue, which he had delineated in *Social Statics* (1850), see H. George, *A Perplexed Philosopher* (1892), New York: Robert Schalkenbach Foundation, 1946.

32 J. L. and B. Hammond, *The Skilled Labourer 1760-1832*, London: Longmans, Green & Co., 1933, p. 115.