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The Natural Harmony of Interests: Adam Smith and the Political Philosophy of the Classical School

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Abstract

This paper explores the idea of laissez-faire and economic liberation as a corollary to the emergence of the national economy. It discusses the extent to which the individual actor as identified in Adam Smith's economic philosophy is fundamental to the societal economy. It also reviews the essential role played by the individual actor towards the shaping of national or public policy.

Some authors suggest that economic freedom increases economic growth, however for economies that are emerging, it is better for the state to control, regulate and invest in economic activities until their industries are strong enough to engage in competition with large firms from developed nations.

Keywords: Adam Smith, Economic Philosophy, Market, Natural Harmony, Political Philosophy.

Introduction

The political philosophy of the 18th century Europe which emerged during the mercantilist era was marked by the thoughts of Adam Smith and the classical theorists. The economy during the mercantilist era emphasized the belief that a nation's wealth is based on the accumulation of gold and silver through exports, and government played a major role in heavily regulating domestic and foreign economic transactions. Adam Smith and classical theorists believe that there is a natural order in the economic system. A society of economic freedom is more conducive to the prosperity of all individuals and society in general. If left alone the economy is self-regulating, it will function as under the influence of an "*invisible hand*".

They suggest that domestic and foreign transactions should be free from government interference. Individuals will naturally pursue their own interests for their personal wellbeing; consequently, the general welfare of society will result unintentionally. Therefore, the functions of government as Smith suggests should be limited to ensuring "*national defense, administration of an impartial system of justice; and facilitation of certain public works and institutions that are beneficial to society*" (Ebenstein, & Ebenstein, 1991); in other words, establishing law and order to protect the interests of individuals.

The purpose of this paper is to explore the idea of laissez-faire and economic liberation as a consequence to the development of the national economy. It discusses the extent to which the individual actor as identified in Adam Smith's economic philosophy is fundamental to the societal economy and subsequently shapes national or public policy.

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Capital Accumulation System Prior to the Advent of Laissez-Faire

The theory of natural harmony of interests was put forth during Adam Smith's era as a better economic alternative to capital accumulation theory of mercantilism. Mercantilism is a "phase in the history of economic policy" (Haley, 1936); it is an economic thought and a commercial policy that emerged during the 17th century in Europe which legitimized the way the economic system worked at that time (Irwin, 1991). It was believed that the power of a nation's economy was reflected in the amount of gold and silver in its public treasury (McEachern, 2009). Mercantilism was supported by governments and states to secure and maximize the wealth of a nation by controlling the economic activities and resources they depended on, and setting economic rules and regulations that benefit the mother country so as to achieve a favorable trade balance for merchants and producers (Nettels, 1952). The rise of mercantilism coincided with Europe's expansion to the New World. The purpose of this system was to accumulate as much gold and silver as possible from colonies. In order to reach that goal, the policy was to restrict imports of finished goods and encourage exports as this can bring more wealth to nations (Ebenstein, & Ebenstein, 1991). States would acquire raw materials from colonies for cheap prices, manufacture and sell finished goods at higher prices for gold and silver (Nettels, 1952).

Mercantilism is a "*positive nuisance*" (Johnson, 1937; Wilson, 1957) that should have been abolished or avoided; but how, if it has made such a strong impact on economic policy? Mercantilism was a system based on military power and conquest according to Professor Viner (Wilson, 1957). He argues that wealth and power are interdependent and are the aims of national policy, however, national defense prevails on economic ends at times. According to Adam Smith, when it comes to enriching people, there are two systems of political economy based on commerce and agriculture. The mercantile system just brought confusion between wealth and money; exporting gold and silver would be a loss of wealth. Therefore, to prevent any loss of treasure, it was necessary to strictly control exports and imports. An economic system that rose in England and supported by Thomas Mun in his – "*a discourse of trade, from England unto the East Indies* in 1621" rapidly spread and was being applied by other European countries as a way to increase their wealth (Wilson, 1957).

Mercantilism was a "*flawed*" economic idea that the government and its representatives failed to understand; the merchants and producers supported this system with the sole purpose of advancing their own interests according to Adam Smith. In effect, this was regardless of the wellbeing of the general population (Nettels, 1952, Wilson, 1957). The role of the government according to Adam Smith is to foster national defense, administer an impartial system of justice and facilitate public works and institutions. But the governments during the mercantile era considered it a duty to accrue their national wealth and power for strategic and economic purposes by protecting the interests of merchants and producers against foreign competition. Thus, this led to the enactment of different protectionist laws and regulations such as Corn Laws on agriculture, the Navigation Act of 1651, the Stapple Act of 1663, and the protective tariff for domestic manufactures (Nettels, 1952).

In England, Nettels (1952) wrote that governments coordinated with merchants, shippers and manufacturers to find out their best interest and supported them with different subsidies. Irwin (1991) argued that government interference with commercial policy gives domestic merchants and manufacturers a large advantage when trading internationally because their cost of export becomes lower than their foreign competitors which in return yields more benefit to the mother country. However, there are divergences between the interest of influential merchants and the interest of the nation as a whole at times (Viner, 1948).

Haley's (1936) analysis of Heckscher's book on mercantilism discussed four major tenets of mercantilism as an economic policy:

* Unification of the state regarding "*customs barriers and tolls, the currency system, regulation of industrial activity, of domestic and foreign trade, and the system of weights and measures*" which was more successful abroad.

* Increase of the power of the state and the national income by establishing some rules and regulations to efficiently control economic services such as imports, exports and the marine, and all activities the state depends on.

* Increase the wealth of the state by means of protectionism of production through restrictions on imports especially with gold and silver, and promotion of exports of highly-priced goods, and also personal development of human capital to avoid unemployment.

* Mercantilism could be also characterized as a system of monetary policy in the fact that specific measures were established regarding the accumulation and use of money as capital, as a source of national wealth increase, as a positive asset in foreign relationships.

The fifth aspect Haley (1936) discussed about Heckscher's book on mercantilism was that the state believed in liberty and freedom of the individual but only for the purpose of increasing the wealth and power of the state and public good. Individuals would even receive various incentives from the state to do what they want but the ultimate results must benefit the state first. Adam Smith along with other classical economists such as John Ramsay, McCulloch, James Mill, David Ricardo, Nassau Senior and others opposed this idea of mercantilism as too many restrictions or government interference with the market discourage specialization and would not allow maximum efficiency and benefit for the people (Pincus, 2012).

Natural Harmony Interests in the Market

The Wealth or Nations (1776) by Adam Smith is a systematic explanation of how the economy of his era works. Adam Smith was a fervent supporter of economic freedom as it is essential to the development of wealth. Foreign and domestic economies at that time were heavily regulated by the government and that was a hindrance to individuals' specialization and economic growth. The government during the mercantilist era which Adam Smith opposed was known for poor economic policies and mismanagement of resources (Ebenstein, & Ebenstein, 1991). Most social philosophers then advocated for limited government interference, if none at all, in many areas. Government is not necessary a priori except when people have valuables that need to be protected.

Consistent with Adam Smith, economic activities if left alone function under the influence of a harmonious natural order (Viner, 1927); humans are individualistic and can naturally prosper as such instead of as a group, and without government interference. Humans generally act in favor of their own interests and due to their capacity of sympathy they will not deliberately do harm to others. By working to achieve what is best for him/her in a free market, an individual will indirectly influence the well-being of society at large. The role of the government then is to set the boundaries so that self-interests of all individuals can be maximized without causing harm to one another. The prosperity of people as individuals is what constitutes the wealth of the nation and this prosperity is only possible in a free economy where government is limited and individuals are specialized.

The wealth of the nation grows when there is division of labor, when individuals are specialized. The existence of free domestic and foreign trade is more conducive to such growth. Government interference in terms of heavy laws and restrictions on the economy, on domestic and foreign trade as was the case during the mercantilist era is counter-productive. The economy should be left alone, domestic and foreign transactions should be free from government interference. There is a natural harmony of interest between individuals regarding their personal growth and the flourishing of the economy when the government stays away from it. In keeping with Smith, the government has three major functions: to ensure "national defense, administration of an impartial system of justice; and facilitation of certain public works and institutions that are beneficial to society" (Ebenstein, & Ebenstein, 1991). These functions are too big to be carried out by individuals.

The government should guaranty the protection of individuals' properties from domestic harm as well as foreign invasion. When individuals' self-interests which are originally positive to them, are not regulated, they can be destructive to others (Viner, 1927). The government should also create a physical environment that facilitates commercial interactions of individuals among them domestically and with other nations through infrastructures such as highways, ports and airports. These can be financed by fees individuals pay for access and through taxation. This will protect the government from incurring heavy debts, and will keep it from overtaking the whole economy. However, if the government has to tax individuals to finance activities that will help individuals' growth, "*taxation should be proportionate to income*", "*certain*" and "*convenient*" for the individual. The ideal for individuals to acquire wealth, enjoy the fruit of their labor in a just environment and for the economy to keep growing can occur when government interference is limited to non-existent (Ebenstein, & Ebenstein, 1991), or when there is a system of total "*laissez-faire*" as the Physiocrats advocate (Viner, 1927).

Francois Quesnay (1694-1774) was the first to coin the phrase "laissez faire la nature" and was among the first to analyze economic growth as a function of capital accumulation which reminds the mercantilist ideology of exporting more to accumulate gold (Schachter, 1991). He is known as the main representative of the Physiocrats, a group of philosophers in the mid 1700's in France. The Physiocrats believed that the wealth of the nation depends only on agriculture and they basically focused mostly on domestic trade. They developed many economic tools among which the Tableau Economique as a tool that contributed to "*the development of national income analysis, quantitative methodology, and the conceptualization of the general equilibrium theory*". The economic system that the Physiocrats promoted though was and ideal system that did not actually value economic freedom because they were more aligned with the absolutism of the monarchy. The Physiocratic philosophy emphasized the natural order of things where everything is interdependent and exists in harmony, and the role of the government is to enforce this natural order by protecting the rights of individuals and setting boundaries for interactions within society (Schachter, 1991).

Men come into society with the expectations of mutual protection of property and human life; order is thus necessary to guaranty those expectations. The Physiocrats believe that the order of society is also a natural order, so when men violate the order in society they walk into their own destruction. So as in Adam Smith's view on individuals' self-interests, the Physiocrats believe that individuals will naturally work to acquire wealth and improve their wellbeing which will result in the general welfare of the society. Unlike Smith though, Quesnay believes that the measurement of wealth is the satisfaction of human needs with natural goods such as food, shelter and clothing. The Physiocrats advocated free trade but mainly for agricultural products. They believed that exports of raw material from domestic agriculture will bring more wealth into a nation and that will increase production because raw materials are the basis for everything else that is produced (Schachter, 1991).

The Physiocrats asserted that France was a poor country at the time compared to England because they focused on export of luxury products such as silk which benefited merchants instead of supporting farmers. They suggested that the government should establish free economy in terms of agriculture that will empower farmers because they are the productive class that brings wealth to the nation. Quesnay proposed three classes in society: the productive class that consists of farmers, the property owners' class who receive rent from their lands, and the sterile class that consists of manufacturers and merchants. The latter class does not bring any wealth to the nation; the profit they get comes from ripping of the farmers who produce the raw materials by paying them low prices that do not reflect the value of their production. They do not add any value to the products they manufacture or sell except the cost of the material and their personal labor; this is not good for the wealth of the nation. The solution for the Physiocrats then was to allow higher prices for agricultural products. The "laissez faire" of the Physiocrats was in practice meant to only benefit the aristocracy because they held the economy at that time (Schachter, 1991).

In their ideology of "laissez faire", which is rather freedom in the market of agriculture, the Physiocrats also advocated that farmers be completely relieved from the burden of taxation, but propose instead a single tax on the rent landowners received (Meek, 2013) because it is "above and beyond the cost of production" (Schachter, 1991). The ideology of the Physiocrats did not last long because of their close ties with the monarchy in an era where revolutions against absolutism and clericalism were underlying. Establishing free trade in agriculture although it could bring wealth to the nation would only increase the gap between classes and furthermore, this surplus of wealth will probably not be reinvested in agriculture but directed toward opulent lifestyles and wars, which was common of the ruling class in the 18th century (Schachter, 1991). The idea of "laissez faire", government's hands off the economy was rather biased toward one group of society, the farmers who have the monopoly of agriculture; and it does not allow the maximization of the nation's wealth let it alone the prosperity of each individual as the "laissez faire" of Adam Smith advocates.

Natural Harmony Interests and Modern Economy

Total economic freedom which would mean no government interference in the economy is quite utopic and this is even true in today's economy. The mercantilist ideas of protectionism are still valid today. With the advent of industrialization, competition is so intense globally that it requires governments to be strong in creating good infrastructure and mobilizing its population for economic development, this is even true for developing countries (Hall, 1987). Hall (1987) argues that economic development is about "brute self-interest", if those interests are ignored or neglected, it can lead to social or political unrest. Prosperous states are very pragmatic in managing their economies but Adam Smith discouraged state interference in the market because during his time, the state did not provide equal opportunity for all its citizens. In modern times, the market cannot be left alone; its efficiency depends on states capability to provide social infrastructure to all layers of society. By providing equal conditions for its citizens, strengthening social skill and supporting the economy internally instead of practicing laissez-faire, states allow their corporations to compete internationally (Hall, 1987).

A study by Scully (2008) investigated how economic liberalization affects economic growth and income inequality in twenty-six countries. He supports Adam Smith's idea that the role of government should be limited to establishing proper infrastructure and environment for economic development. When government interferes in the market it is usually for taxation purposes and taxation discourages people from engaging in economic activities. Now tax revenues should be used to improve infrastructure for economic growth instead of merely redistributing them to a certain group of people because this will negatively affect the national economy. Scully (2008) found that developed nations with more liberal economies have higher rates of economic growth. Economic growth though increases inequality to a small extent. However, overtime, economic freedom creates better outcomes for low income individuals more than tax revenue redistribution from government.

An article by Cooter, Hans and Schaefer (2010) discusses 3 approaches related to the growth of the national economy of developing nations. The state-led approach argues that in a free market developing nations are unable to accumulate capital so they should control the economy by owning and investing in and subsiding productive firms, and regulating the economy. The other approach of liberalization aligns Adam Smith theory of laissez-faire. The third approach argues that developing nations should establish legal institutions that will not be the state or the market itself, in other words, a separate institution that will enforce sanctions on rule breakers in the market. Cooter et al. (2010) argue that developing countries cannot rely on the ability of the market to correct itself as under the influence of an invisible hand because in a free market, small or emerging firms cannot compete with large firms from more advanced nations. Natural harmony of interests in the market will not work for developing economies because their firms do not have the same capabilities when entering international competition as larger firms. So, developed nations should protect their industries with tariffs like during mercantilism, regulate their economy and accumulate enough capital to finance investments before they deregulate because history reveals that developed economies first went through the process of strong protectionism before they chose to free their market (Cooter et al., 2010).

Conclusion

Natural harmony cannot endure without government interference. It is necessary for government to intervene in the economy, to regulate prices, correct market failures, and redistribute resources within society through taxation and subsidies whenever there is a need for it. Adam Smith and the classical economist elaborated a solution to the economy of their time that was running under the mercantilist system. But in today's economy relying on the invisible hand to regulate the market can be detrimental especially for developing economies. Some authors suggest that economic freedom increases economic growth, however for economies that are emerging, it is better for the state to control, regulate and invest in economic activities until their industries are strong enough to engage in competition with large firms from developed nations.

Conflicts of Interest

The authors declare that they do not have any conflicts of interest.

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