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ADAM SMITH'S FREEDOM AND JUSTICE

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In the Committee discussions of November 3, Mr. Redfield suggested an examination of the problems of freedom in American society as they were seen by James Madison and then the introduction of the qualifications and developments which are required in the light of present conditions. Since Madison's central focus was political, it seems to me it would be worth supplementing such an analysis with one on the views of Madison's contemporary, Adam Smith, whose views are focussed on the economic and so largely complement those of Madison. A summary analysis is attempted here.

Before making this analysis, two things should be noted: First, the terms "freedom" and "justice" belong particularly to the arsenal of political analysis, and Smith's analysis does not run primarily in these terms even though he is dominantly concerned with what they imply. Second, where later writers have found and corrected minor weaknesses in Smith's analysis, it is the perfected analysis which will be considered Smith's since we are here concerned with the grand design and not the detail. For both of these reasons, Smith's exact phrases are often less relevant to the analysis than the content we can now see he was reaching for.

Adam Smith lived in a period in which guild restrictions were breaking down but still survived; in which the communal manors, though

dissolving, still survived; in which government-created trade monopolies were operating, and in which there were many other restrictions on freedom of enterprise. It was also a period in which, except for the monopolies and manors, the great bulk of production was carried on by individual producers with an apprentice or two or at most a very few workers. It was in this milieu of guild restriction and the just price, monopoly grants by the state, the collective enterprise of the manors and the activities of small independent producers that Smith created his economic model of free enterprise and free markets with supply and demand equated by flexible prices.

We need not, here, go into the mechanism of adjustment which explains how such a theoretical model could be expected to work. That constitutes the great body of classical economic theory. What is immediately important is, first, the restrictions on freedom which Adam Smith accepted as the political assumptions of his model and, second, the kind of freedom and justice which <sup>and his followers</sup> he expected his model economy to provide.

As to the restrictions on the freedom of the individual, the most important to Smith's model were:

- 1) the limit on the freedom of individuals to use force on others
- 2) the limit on the freedom of individuals to interfere with the possessions of others
- 3) the limit on the freedom of individuals to break contracts they have made with others
- 4) the limit on the freedom of individuals to create money.

There were, of course, other restrictions on freedom which Smith presumably accepted but which we can here disregard.

The major freedoms which Smith assumed to be unrestricted in his model were:

- 1) the freedom of an individual to produce whatever he wished for sale in the market (no government-granted monopolies and no guild restrictions)
- 2) the freedom of an individual to sell whatever he had in the market for whatever price he could get (no just-price restrictions)
- 3) the freedom of the individual to buy whatever he wanted in the market for as low a price as he could find
- 4) the freedom of the individual to use or consume whatever he owned in whatever manner he chose
- 5) the freedom of the individual to "sell" his labor to whomever he could for whatever he could get and the corresponding freedom of the individual to hire whomever he could for whatever the latter was willing to take
- 6) the freedom of the individual to lend or borrow from others on whatever terms could be agreed on.

Thus, within the limits set on force, property, contract and money, each individual in this <sup>whole</sup> economy would be free to produce, buy, sell, and consume as he pleased.

Smith expected this economy not only to provide great freedom to the individual but also a high degree of justice. If each individual sought

out his own self-interest (selfish or otherwise), the unseen hand of market forces would:

- 1) bring about the employment of each individual in the most productive manner possible in the light of his ability and his free choice of activity
- 2) result in the maximum production and consumption possible in the light of the available resources, technical knowledge, and peoples' wants (including the desire for leisure and the desire for one kind of work rather than another)
- 3) reward each individual according to his contribution to production.

Within the area of activity with which Smith was concerned, i. e., the activity of using resources to satisfy wants, the conditions of his model would produce an optimum of freedom and justice according to a code of ethics Smith found acceptable. The restrictions on freedoms in his model were designed to increase greatly the value to the individual of the freedoms he retained and were presumed not to involve injustice (assuming just enforcement). Also, the reward of each individual according to his contribution to production seemed to Adam Smith a just result even though quite a different measure of justice was employed within the individual family and in some degree within the manor.

There are two things about Smith's model that should be recognized. First, it is an atomistic model. As Professor Seligman so well said, Adam Smith was pre-Industrial Revolution. It is true that Smith analyzes the division of labor in terms of a little pin factory; but this is, in a sense, an anachronism. Also, he definitely rejects the corporation as a form of

business enterprise except under very special conditions. The essence of his theoretical model is one of individual producers and consumers and does not introduce the special factors associated with the factory and the corporation.

The other thing to be noted is that neither Smith nor his followers thought that real life would exactly mirror the conditions of their model but only that in practice things would work out fairly much as the theory of their model prescribed. On this basis they regarded their theory as a practical guide to policy in the achieving of freedom and justice. The fact that perfect freedom and justice were not achieved in the workaday world only meant that effort should go toward making the conditions more nearly those of the theoretical model since, if those conditions were perfectly met, perfect freedom and justice would be achieved, subject to the specific limitations on freedom prescribed for the model and to the ethic of contribution-reward. This difference between the practical rough-and-ready freedom and justice and the theoretically perfect freedom and justice is important because in what follows I shall be concerned with the theoretically perfect, not with the approximation in practice.

Whether Adam Smith's actual writing (1776) was familiar and accepted by the Founding Fathers, I have not discovered. But it is clear that the climate of opinion of which it was a crystallization was very much a part of the background of the framers of the Constitution and that his actual writing did influence thinking and policies soon after its adoption.

So much for the main substance of Adam Smith's freedom and justice. If we follow out Mr. Redfield's suggestion, we must ask, "What are the qualifications which are required in the light of present-day conditions?"

From the point of view of Smith's analysis, by far the most important single development since his day is the change wrought by science and technology in the size of business enterprise. In place of individual producers, perhaps with an apprentice or hired hand, which Smith envisaged as the basic producing unit, we have the big corporations. Two-thirds of the assets of all manufacturing enterprise in the United States are in the hands of big corporations, each with assets of \$100 million or more. Most of the transportation and communication is by big corporations. In agriculture, the dominant form is still the one-man enterprise with often a hired hand. In some other activities this form still dominates--the lobsterman of the Maine coast, the local barber shop or hair dresser, the local diner--but for practical purposes, it is the predominance of big corporate enterprise which has brought the biggest departure from the basic assumptions of Adam Smith's theoretical model.

What then are the modifications in Adam Smith's analysis which need to be introduced in order to take account of the modern corporation and still provide the maximum of the freedom and justice which he sought? To answer this would be a large order since, if corporate enterprise is substituted for individual enterprise in Smith's analysis, and sole reliance is placed on self-interest and the unseen hand of market forces, almost

none of the objectives of freedom and justice that Smith had in view would be achieved even in theory. In a corporate economy, it seems clear that, even with effective anti-trust enforcement, the combination of self-interest and market forces would not by itself alone be sufficient to bring about the most productive employment of each individual, the maximum production and consumption consistent with resources, or the reward of each individual according to his contribution to production. Let us consider these in turn.

1. Freedom and Justice in Employment -- I believe it can be shown that, for a corporate model operating perfectly on the basis of self-interest, market forces would not bring about the employment of each individual in the most productive manner. Rather, I think it can be shown in theory and with perfect operation that periods of underemployment would from time to time remove the freedom of some individuals to work and create injustice in determining who is not allowed to work. In such a pure corporate model, I think theory will show that full employment would be largely a matter of chance with excessive unemployment more likely than full employment. In practice, we have been forced by circumstance to give government rather than the unseen hand the responsibility for maintaining full employment and have provided unemployment insurance. Thus practice is more in line with the theory of a corporate model than with that of an atomistic model, though the new practice is perhaps more a reaction to pragmatic conditions than to revised theory. Only recently Secretary of Labor Mitchell almost complacently predicted a considerable increase in unemployment this winter and spring though he said he did not believe the volume of unemployment would become "serious." Asked what volume of unemployment would be serious, he is reported as giving the figure of 5 million. Government economists are reported as privately predicting that unemployment will climb above 4 million by February. The unemployed

will incur a big cut in their income -- usually through no fault of their own -- and the persons selected by the unseen hand to receive this cut will be selected in most cases on a basis that would seem to bear only remote relation to justice.

2) Maximum Production and Consumption -- I believe theoretical analysis of the corporate model will also show that, even at "full employment," maximum production and consumption will not result because of waste of resources. However efficiently the resources of each single corporation may be used within the corporation for the purposes of that corporation, the unseen hand will so direct the use of resources that they will not be most effectively used. Waste through the duplication of facilities was neatly brought out by former Secretary Ickes in speaking to a meeting of the Petroleum Institute. Earlier speakers had dwelt on the inefficiency of government. In defense Ickes pointed out that at least the government could not be accused of putting a post office on each of the four corners of a highway intersection. The wastes of competitive promotion, of forced style change, of concealed or controlled know-how must be great, and theory indicates that these wastes are inherent in a corporate economy which works on the basis of self-interest controlled only by market forces. To reduce some of these wastes, we have zoning laws, city planning, government-inspected meat, and many other limits on the freedom of enterprise. How far these wastes are due to the corporation is not clear. The

The efficiency of big enterprise undoubtedly reduces some wastes, but the big corporation creates others.

3) Justice Through the Equating of Contribution and Reward -- Even under conditions of sustained full employment, I believe it can be shown that a corporate economy operating solely on the basis of self-interest and market forces would be certain not to reward the individual producer in proportion to his contribution to production (in the more precise technical language of the economist, the individual would be certain not to be rewarded according to his marginal product). Again, in practice we have been forced by circumstance to recognize this fact by providing minimum wage laws and old age pensions, governmentally fostering labor organization, and introducing heavy income taxes on upper brackets. Yet, in spite of the tremendous gains in technology and income in the last half-century, and in spite of an extensive but incomplete system of social security, almost a third of our urban population did not have incomes sufficient to support a minimum level of living as defined by the Bureau of Labor Statistics (\$3,500 for a family of four), and more than 10 per cent had less than half this.

It would undoubtedly be possible to compile a longer list of discrepancies between the results to be expected from the theoretical working of Smith's atomistic economy and those to be expected from the working of a corporate economy under the comparable conditions of self-interest controlled only

by the unseen hand of market forces. The present list would seem to be sufficient to pose the basic problem.

Our actual economy does not run nearly as badly as the theory of self-interest controlled by market forces would imply for a corporate economy.

There would seem to be at least three major reasons for this:

- 1) We don't rely on the economic self-interest and the unseen hand to anything like the extent prescribed by Adam Smith.
- 2) Labor has become organized to a major extent, and
- 3) Public pressures not realized through market forces have modified the self-interest of corporate management.

But these adjustments to the actual results of corporate enterprise are pragmatic adjustments. We continue to justify the free enterprise system on the basis and with the arguments of Adam Smith's model, regarding the modern corporation as a private enterprise (just a unit of Smith's atomistic economy), treating the corporation before the law as a "person," and treating labor as a commodity. Each new issue of policy is likely to be argued in the frame of reference provided by Adam Smith and his classical followers.

The confusion which results is clearly brought out in a recent issue of Time in which the following item appears:

U. S. Steel Chairman Roger Blough offered another defense of uniform prices which would appeal to all lovers of Alice in Wonderland, and which seemed to defy the basic principle of a competitive economy. If all steel prices are the same, he contended, then the customer is free to buy from any producer he chooses. But if prices are different, then the buyer has no real freedom of choice because he must buy from the company that sells cheapest.<sup>1</sup>

If we are to introduce the qualifications in Adam Smith's analysis which are necessary in order to establish the conditions which could be expected to yield the maximum of Smith's freedom and justice in a corporate dominated economy, the following steps would seem to be called for:

- 1) Review the existing modifications of classical economics to discover: (a) how far the current body of neo-classical economic theory takes account of the effect of the modern corporation on economic functioning and (b) how far that neo-classical body of theory indicates that self-interest, the unseen hand of market forces, and the government measures now in operation and not contemplated by Smith's analysis could be expected to produce Smith's freedom and justice. If such an analysis finds that classical theory has been so modified as to take full account of the effects of the modern corporation, the main problem would be to establish what, if any, further modifications in government or private action would be needed (including possible reduction

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1. Time, November 13, 1957, p. 101

in government action) to achieve the maximum of Smith's freedom and justice consistent with the effect of scientific knowledge on production processes. If such an analysis finds that neo-classical theory does not take full account of the effects of the corporation, the following steps would be appropriate:

- 2) Clarify the behavior to be expected from the operation of self-interest and market forces in a pure corporate economy, both without and with the modifications in the role of government over that prescribed by Adam Smith. By a pure corporate economy, I have in mind one in which all production is carried on by big corporations. The object of the theoretical analysis would be not only to discover how such a model could be expected to work but also how far it could be expected to achieve Smith's freedom and justice.
- 3) To the extent that a pure corporate economy could not be expected to produce Smith's freedom and justice, work out theoretical ways to modify the drives of self-interest, modify the working of market forces, or modify the results so as to provide the maximum freedom and justice in theory. The practical ways in which we have departed from Adam Smith's model (full employment policy, progressive income tax, unemployment insurance, etc.) can give some guide to possible

modifications but only a thorough theoretical analysis seems likely to give a solid basis for appraising the full range of possibilities.

- 4) Clarify the behavior to be expected from a more complex economic model in which a major part of production is carried on by corporate enterprise, but also a large part by individual enterprises which fit Smith's atomistic model, another large part is carried on in factory enterprises (the Marxian model) and a fourth large part is carried on by government.
- 5) Reconsider the modifications which could be expected to produce the maximum of Smith's freedom and justice in a pure corporate model in the light of the more complex model and make any further modifications.
- 6) Appraise the above modifications in the light of their practicality and in the light of the increase in freedom and justice to be expected from such modifications in relation to their cost.

In the above analysis I have adhered to the objectives of freedom and justice as Smith conceived them. These also need reconsideration; and if other conceptions of freedom and justice are adopted, the six steps outlined above would have to take these alternative objectives into account.