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ARTICLE

ADAM SMITH AND THE NEO-LIBERAL PARADIGM: ON THE ESSENTIAL NATURE OF TRUST, AND REBALANCING CAPITAL

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Abstract
The key aim of this article is to reassess the societal consequences of the adoption of neo-liberal policies, post-1970, in the light of the writings of Adam Smith. We make two main points: First, the neo-liberal paradigm (NLP) and its characteristics are not the creation of Adam Smith as asserted by leading economists and, indeed, the contrary is very much the case. Second, given this, what does Adam Smith's work tell us about how we can fix modern-day capitalism broken by the NLP and bring it back in line with Smith's work?

Keywords: neo-liberalism; social capital; the market; the corporation; Adam Smith

1. Introduction

Since his seminal publications, the work of Adam Smith has been used by commentators on the right and the left of the political spectrum to justify entrenched views. This polarisation has perhaps come sharply into focus in the last 50 years or so with the development of the neo-liberal paradigm (NLP)—sometimes referred to as the 'Washington Consensus'—and its implementation by policymakers, particularly in the US and UK. Many proponents of this paradigm, such as Milton Friedman, use the work of Smith, and particularly the Wealth of Nations, to justify their radical agenda. The purpose of this article is to revisit the underlying tenets of the NLP against what Smith said across his various key writings.

In contrast to the Classical Liberalism of Smith, proponents of neo-liberalism, especially libertarians, denigrate the role of the state in the economy and emphasise free and unregulated markets and the privatisation of public utilities as spurs to economic growth and the efficient allocation of resources. In this view, all markets are viewed as homogeneous, with the ultimate role of the market to provide the commodification of practically all human activity. Central to the failure of the neo-liberal view is the dramatic implications it has had for societal trust and all the consequences that follow on from this, such as the rise in inequality and the impact on the environment to name but two.

In summary, and as we shall discuss in more detail in this article, the consequences of adopting the NLP in advanced economies are numerous and include: the loss of trust in the polity and the implications this has had for civic trust; the rise of a monopolistic–oligopolistic corporate sector; the development of capitalism into crony capitalism, a form of mercantilism, with rent-seeking and political lobbying at its heart; an over reliance on finance and the financial sector; the primacy and ascent of economic man, *homo economicus*; the market economy has morphed into the market society with the commodification of (almost) everything; corporate and market values have overwhelmed moral values and norms with the consequence this has for social and natural capital; the rise of inequality and the overreliance on profits as the objective of firms; the creation and exacerbation of key market failures, such as inequality, externalities, the principle agent issue, in the modern corporation, and moral hazard issues in the financial sector.

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The 2007 financial crisis highlighted the many fissures at the heart of neo-liberal policies and although the crisis surely marked the end of the adoption of neo-liberalism as the philosophy on which to base a modern-day society, its lasting consequences remain with us today in terms of the continued dominance of the financial sector and the implications of the financialisation for wider society along with the continued dominance of crony capitalism, the market society and the modern-day corporation and the implications of all of these in determining the values and norms in liberal democracies. COVID has perhaps dramatically heightened the dilemmas created by neo-liberalism and underscored the need to move away from the post-2008 financial crisis back to business as normal mentality.

For example, in its editorial, 3 April 2020, The Financial Times claimed that COVID-19 had laid bare the frailty of the social contract created by the application of neo-liberal policies and argued:

> Radical reforms—reversing the prevailing policy directions of the last four decades—will need to be put on the table. Government will have to accept a more active role in the economy. They must see public services as investments rather than liabilities and look for ways to make labour markets less insecure. Redistribution will be again on the agenda: the privileges of the elderly and the wealthy in question. Policies until recently considered eccentric, such as basic income and wealth taxes, will have to be in the mix.

Many consider the salient failures of the NLP, and the need for the kind of radical reform described in the Financial Times quote, as resulting from the central tenets of Adam Smith's view of laissez-faire capitalism (a term not in Smith's writing). The following quote from Norman (2018) amply captures this perspective:

> Today in a world yearning for genuine sources of intellectual authority, Adam Smith has been recruited to, or disparaged by, a vast range of different economic, political, or social viewpoints. But he remains little read, and that little reading has tended to focus on the Wealth of Nations. The result has been a series of caricatures: Smith as economic libertarian, Smith as apologist for *homo economicus,* Smith as high priest of capitalism.

Our main aim in this article is to consider some of the key elements and themes in the work of Adam Smith to make two main points. First, the NLP and its characteristics are not the creation of Smith and, indeed, very much the contrary is the case, despite assertions by leading economists such as Milton Friedman. Second, and given this, what does Smith's work tell us about how we can fix modern-day capitalism, broken by the NLP, and bring it back in line with his teaching and address the Financial Times quote?

To achieve this, it is important to take a holistic view of Smith's work to understand his view on key issues relating to the NLP, and this is particularly so in terms of his work on the creation of society's moral values and norms. Given the scope and magnitude of Smith's work in the Wealth of Nations (WN), the Theory of Moral Sentiments (TMS) and his Lectures on Jurisprudence (LJ), it is impossible to do justice to all his thoughts on pertinent issues discussed in this article. Our aim therefore in considering Smith's works is to extract his key thoughts on the issues relating to the NLP and we do this by building what we refer to as the Adam Smith Toolkit which focuses largely on the WN and TMS with relevant issues from LJ brought to bear as appropriate.

Furthermore, to understand why Smith has been viewed as an apologist for the NLP we will also have sections on the distinction between Classical Liberalism and Neo-Liberalism (since Smith was one of the leading developers of the former) and between Classical Economics and the economic model underpinning the NLP. This discussion is important since much of the NLP is underpinned by Neo-Classical Economics which developed from the Classical Economics of Smith and his successors, but the two schools use very different methods and have very different predictions. We then apply our toolkit, along with some more specific discussions of Smith's work contained in other sections, to analyse the

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deficiencies of the NLP and provide some thoughts on how some of the key issues raised by the NLP can be addressed.

As a backdrop to our thinking about the economics of Smith it is worth noting here what the three key foundational factors of an economic system are, regardless of time and place institutions, technology, and geography. Modern-day economists have debated which of these three factors is key to a nation's economic progress and well-being but as Sachs (2020) forcefully argues such debate is misguided since the three foundations are mutually dependent: 'These three domains are interdependent; we cannot understand economic history and economic change without taking all three into account'.[1] Interestingly, however, there is evidence that institutions dominate either geography or international trade in explaining economic growth (see, e.g. Rodrick *et al.*, 2004).

Given the brilliance of Smith's work, it is no surprise that all three of these foundational elements of economic prosperity are to be found in his writings and indeed Tajima (2007) convincingly argues that one of Smith's major contributions is that he introduced the idea of institutions into economics through his discussions of collective action in the TMS and this is something we consider in detail below. In this view, institutions are taken to be a set of formal or informal rules of conduct that can be conceptualised as implying standards of conducts that are based on explicit or implicit consensus between individuals. From a Smithian perspective, it is in large part the failure of neo-liberals to appropriately recognise the interplay between these key foundational factors, and particularly the importance of institutions, that have led to many of the ills our modern-day societies currently face.

Another theme of this article is that the adoption of neo-liberal policies has resulted in a move towards an overreliance on finance and the financial sector to the detriment of other key capital inputs to the production process, such as human, social and natural capital and this tendency has been exacerbated by the principal-agent problem that exists in the modern-day corporation (discussed in some detail below). Although these other forms of capital were not well defined in Smith's day, as we shall nonetheless see, key elements of these forms of capital were identified by Smith and he fully recognised that they were crucial to his thinking on the smooth running of his Commercial Society, the forerunner of modern-day capitalism. The failure of neo-liberals to recognise these key components of a country's capital stock goes a long way in explaining many of current-day societal ills, such as inequality and the climate crisis. As we shall also see, Smith was also aware of the potentially damaging effects that the principal-agent problem could have on the joint stock company of his day, the forerunner of the modern corporation, and effectively how this could further exacerbate the depletion of social and natural capital.

Central to the concept of social capital is societal trust and one of the key themes of this article is that at the centre of Adam Smith's thoughts on the development of society from hunter-gatherer communities through to his Commercial Society, with its emphasis on the marketplace, is the concept of trust. This in essence means that for a market-based economy to work as Smith predicted it must be embedded in the fundamental norms and values of a society rather than a disembodied artifice. For example, in entering a market transaction, the key question an individual faces is to what extent can we trust the integrity of the other individual(s) involved in a potential market exchange; if trust is low then the transaction costs associated with protecting oneself from the risk of immoral or unethical behaviour rise and, conversely, transactions costs are minimised in a high trust society. Progress from the hunter-gatherer society to the commercial society and beyond depends on trust and for Smith, without it, there can be no progress.

In Smith's view government has a key role in establishing a system of positive laws, and the institutions to enforce these laws and related incentives, and provide a platform on which trust societal trust can be built, but this system is insufficient to create market trust. As Evensky (2011) notes Smith's thinking goes much further than this in the sense that: 'the degree to which socialisation of individuals

[1]Following Sachs (2020), geography involves at least six major factors, including climate, biodiversity, disease incidence transmission, and prevalence, physical topography and primary resource availability. Tajima (2007) argues that institutions are usually regarded as a set of formal or informal rules of conduct and can include habits, customs, traditions, conventions, laws, ethical codes, authoritative relations and organisational and political rules of daily life. Technology refers to methods, systems and devices which are the result of scientific knowledge being used for practical purposes.

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inculcates a sense of duty (*Theory of Moral Sentiments*) to the set of civic duties in these positive laws, individuals can be trusted to police their own behaviour and the policing role of government, and thus the cost of community-based reinforcement is reduced.' This is a very important insight in challenging the neo-liberal view that small government can simply be achieved by a brutal cost-cutting agenda.

It is in essence the breakdown in trust in government and key institutions, with the implications this has had on underlying societal norms and values resulting from the adoption of neo-liberal policies, that has created many of the ills we see in society today; from inequality, the rise in rent-seeking, crony capitalism, the acceleration of the depreciation of human, social and natural capital, with all of the implications this has had for human well-being, productivity, the environment and beyond.

In sum, the central argument of this article is that neo-liberal policies have led to the corruption of the values and norms that are central to the creation of a well-functioning close-knit society and have created a new social order where societal trust is broken, and avarice and ambition prevail. In other words, neo-liberalism has led to a corruption of Adam Smith's moral sentiments and to address the many ills in our society it is clear we need to return to a social order that is underpinned by norms and values that restore societal trust.

The outline of the remainder of the article is as follows. In the next section, we build what we refer to as the Adam Smith Toolkit using material from the WN and the TMS combined with references from the JP and secondary material from Smithian scholars. We then go on in Section 3 to consider the central tenets of Classical Liberalism and contrast these with the central tenets of Neo-Liberalism. In Section 4, we consider the development of the so-called Classical Economic model, of which Smith was the founding father, and the development of that model into Neo-Classical economics and the economics of Neo-Liberalism. With the fore-noted sections as background we then go on in Section 5 to consider the NLP and the consequences of adopting neo-liberal policies. In so doing we consider several of the crucial issues that have stemmed from neo-liberal policies, including the governance of the modern corporation, the emergence of the market society, the development of Crony Capitalism and the impact neo-liberal policies have had on crony capitalism, social and natural capital, and social norms and values. Section 6 concludes.

2. An Adam Smith toolkit

In trying to understand what Adam Smith's take would have been on the central tenets of the NLP, and its consequences, in this section, we argue that a holistic view of Smith's work is needed rather than a narrow focus on parts of the Wealth of Nations, as has often been the case (see, for example, Berry, 2018; Norman, 2018 on this point). We refer to this holistic view as the Adam Smith toolkit and this seeks to convey the essential message of Smith's work for our purposes, by drawing primarily on the Wealth of Nations (WN) (Smith, 1976a), the Theory of Moral Sentiments (TMS) (Smith, 1976b) and Smith's lectures on Jurisprudence (LJ) (Smith, 1976b). That said, we also demonstrate that there is much more in the WN that portrays Smith's thinking in a way that is much more consistent with the TMS than conventional wisdom of the WN supposes. As noted in the Introduction, Smith is often caricatured as the high priest of modern capitalism as in the NLP. Underlying this view is:

> …what really matters is economics: Culture is irrelevant……alongside this has sat the idea that much of politics, sociology, anthropology and the like are ultimately derivative and reducible to economics (Norman, 2018).

However, 'culture', which essentially encompasses several non-economic disciplines, is central to Smith's framework and what in sum the toolkit shows is that there is more to humankind than *homo economicus.* Although it is certainly true that for Smith liberty enables the commerce that underpins an economy, and very significant economic benefits flow from his 'natural system of liberty', it is also the case that Smith is equally interested in the opposite phenomenon of how commerce sustains liberty and

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the values of liberty for all: specifically, what is the nature of commercial society and how does it shape human norms and human personality?

2.1. Some key points themes from the Wealth of Nations

2.1.1. Mercantilism versus the Commercial Society

In essence, the WN is a collection of books about economic processes and economic development and the key themes in the different books are: Book I addresses the sources of wealth, which Smith refers to as Opulence which it is important to note he argues should be *universal* in its reach; Book II focuses on the nature and uses of capital; Book III is on the causes of a country's progress and development; Book IV addresses trade policy; and the last book, V, deals with Government revenue, taxation and other domestic policy issues.

At the heart of the WN is a critique of the then prevailing economic theory of mercantilism (and the physiocratic view that land is the source of wealth). Mercantilists viewed national wealth as determined by a country's stock of gold and silver and they saw trade (both intra and inter-country) as only benefiting the seller and not the buyer. Such wealth is accumulated by running trade surpluses which are inherently seen as a 'good' thing and in this view of international trade, one country gets richer while another gets poorer. A key policy recommendation of mercantilism therefore entails the discouragement of imports, because precious metals had to be shipped to pay for them, while exports are encouraged, *ceteris paribus*, because they will increase the stock of a country's trade surplus.

To achieve the 'correct' mix of net exports, proponents of mercantilism favoured an edifice of controls, such as taxes and tariffs, to restrict imports, and subsidies were used to encourage exports. In sum, mercantilism is a model of protectionism of home industries, and the restriction of competition within a country in favour of monopoly provision. Furthermore, manufacturing was favoured over other forms of production, such as agriculture, and commerce was looked on with suspicion.

Mercantilists were a powerful and wealthy group at the time Smith wrote the WN and used their immense lobbying power to oppose laws that would undermine their control of the market by intimidating the legislature. Smith had a very dim view of the political class who comprised the legislature and argued that they were not genuinely motivated by public interest and virtue and likened their skill to an 'insidious and crafty animal' and they took on their role for opportunistic reasons and the prestige that their position accorded them. This meant that they were unable to stand up to the mercantilist class to ensure the wider public good and this had important consequences, as we shall see below, for the development of civic society. Smith's view has a strong resonance with the lobbying process that takes place today under so-called crony capitalism, a modern-day form of mercantilism, with anti-competitive objectives and rent-seeking at its heart.

In contrast to the mercantilist view, for Smith national income is the key metric of the wealth of a nation and the governing principle of the Smithian economic system is 'natural liberty', or non-intervention, which 'allows every man, as long as he does not violate the laws of justice, to pursue his own interest in his own way to bring his industry and capital into competition with those of any other man or order of men'. As a corollary of this, and in contrast to mercantilism, government is discharged from 'a duty…. of superintending the industry of private people and of directing it towards the employment most suitable to the interest of society'.

As Berry (2018) notes, this restriction on the role of government avoids a key fault in the mercantilist model, namely that it assumes that governments have a form of superior knowledge to direct the economy. The restriction in Smith's view is because of his conviction that everyone seeks to better their own condition which leads people to save and build up capital which he views as key to the dynamic process of stimulating growth and creating economic prosperity. However, as we shall argue below there is an important caveat with respect to this interpretation of government since it depends crucially on the relevant institutional structure being in place to create societal trust. It was Smith's view that individuals are always seeking to make the best use of their acquired resources or capital and it is in the context of the

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use of capital that the only reference to the much-cited 'invisible hand' makes an appearance in the WN where Smith predicts that the owner of capital seeks his or her own interest and 'as in many other cases is led by an invisible hand to promote an end which has no part in his intention'.

Although the invisible hand is often portrayed as the key contribution of the WN and a key component of how a free-market economy operates, it appears, as Berry (2018) notes, that Smith did not consider the working of the invisible hand as always producing a benign outcome. Smith hedges his use of the invisible hand with qualifications such as '…this pursuit of self-interest can be to the detriment of society and will not always rebound to society's benefit'. So even in one of Smith's fundamental contributions to the working of the commercial society, he is cautious not to overplay its significance. It is perhaps unfortunate that those who cite Smith for some extreme view of how modern capitalism works are not also more circumspect in their statements.

In Smith's alternative view of the economy to that of mercantilism—the Commercial Society—the division of labour is central, and this is illustrated using his experience of a Kirkcaldy pin factory. The specialisation created in this way is seen to raise productivity by improving skills, reducing disruptions, and creating scope for the use of dedicated machinery with the upshot that the process can generate surpluses used to pay for new Investment which, in turn, can lead to further specialisation and productivity gains—a virtuous production system described as the 'natural progress of opulence' by Smith, which he developed in the second book of WN. According to this theory, the extent of the market depends on the amount of labour employed and the investment made by capitalists in agriculture, manufacturing, and commerce and if capitalists invest their money in that order employment will be maximised and if workers apply themselves industriously the wealth of a nation will be maximised.

This of course raises the question as to why workers should be industrious, rather than lazy, and why capitalists should be frugal and invest their money rather than engage in avarice. Smith answers these questions by arguing that the virtue of prudence is the driving force of economic man which implies that workers are assumed to always be diligent and to work as hard as possible in the WN and capitalists are always assumed to be frugal and invest their saved money (Tajima, 2007). In our discussion of the TMS, we demonstrate that workers and capitalists will behave in this way because their behaviour has been institutionalised by being guided by prudence as a norm of conduct. This point highlights the interplay between institutions and social capital as defined in this article and discussed in more detail below.

It is worth noting at this juncture that Smith did not place any great emphasis on the accumulation of wealth as an end in itself. In the WN he noted: 'All for ourselves and nothing for other people seems, in every age of the world, to have been the vile maxim of the masters of mankind'. As we shall see below, Smith was an egalitarian and in his Lectures on Jurisprudence he is extremely critical of institutions that allow the consolidation of property, such as inheritance laws, primogeniture, and their implications for inequality.

The market is central to the Wealth of Nations as goods are sold in markets and the division of labour is limited by the extent of the market—the larger the market the higher the likelihood of the above virtuous circle occurring. In contrast to mercantilism, therefore, Smith favoured free trade both within a country and between countries, rather than forced trade as in mercantilism, as this further widens the market and reinforces and magnifies the virtuous circle of the division of labour. Free trade also provides incentives to improve infrastructure, property rights and other public goods so that the gains from trade can be maximised which, in turn, leads to capital accumulation. It is the dynamic long-term gains from free trade that spur the progress of commercial society. This in a nutshell is Smith's vision of 'development': with capital being the *sine qua non* of commercial progress.

As our discussion of the TMS will note, and as further emphasised in our discussion of neo-classical economics, markets for Smith are not some disembodied mathematical construct but are rather are "…living institutions, embedded in culture, practice, traditions and trust of their day" (Carney, 2021). Additionally, Smith clearly recognised various ways in which the market would not function to produce an optimal societal outcome. These so-called market failures range from the principal-agent problem and moral hazard through to externalities and informational asymmetries and we consider Smith's take on these issues in the sections on neo-liberalism.

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One of Smith's key contributions in the WN is his thoughts on the sources of value and how these interplay with the concept of natural capital which is at the heart of today's climate debate and which we consider in further detail below. Although it was for David Ricardo to provide a fully fleshed-out labour theory of value, it was Smith's insights that kick-started the Classical Economics theory of value. In contrast to Quesnay and the physiocratic school, who argued that it was farmers and the land they worked that created value, Smith argued that it was manufacturing labour that was the main source of value and the total value creation was in proportion to the amount of time spent by workers in production:

> The value of any commodity, therefore, to the person who possesses it, and who means not to use or consume it himself, but to exchange it for other commodities, is equal to the quantity of labour which enables him to purchase or command. Labour, therefore, is the real measure of the exchangeable value of all commodities (WN).

Smith distinguished between the use-value of a good and its exchange-value and recognised that some commodities may have an exchange-value but no use-value, such as diamonds, while a commodity with a very high use-value may have a very low exchange-value, such as water. Smith also recognised that a country's national Income was based not only on the income produced by the labour of a country's inhabitants', in the form of wages, but also in terms of the income from land, such as rent, and capital in terms of interest or profit.

In his theory of value, Smith also distinguished between the real and nominal prices of goods since the real price, in contrast to the nominal price, of a good is Smith's key measure of societal welfare as it enables a comparison of different purchasing powers in different times and places. For this reason, Schliesser (2017) argues that the real price, in contrast to the nominal price, of a good is Smith's key measure of societal welfare as it enables a comparison of purchasing powers in different times and places. We return to Smith's egalitarian views of society in Section 5.4.

For Smith, productive labour was the true source of income, while capital was the main organising force, boosting labour's productivity and inducing growth, but he also crucially recognised the importance of land in supporting the productive process and the provision of the natural environment. Indeed, climate is mentioned 18 times in the WN, (including the introductory page of the WN) usually along with soil, as a factor affecting agriculture and the working conditions of people and the following quote, from book II of WN, underlines Smith's awareness of the concept of natural capital:

> In agriculture ….Nature labours along with man; and though her labour costs no expense its produce has value as well as that of the most expensive workmen.

This is also a theme we return to in Section 4.

2.1.2. The role of government in the Commercial Society

That Smith in the WN is not referring to unadulterated, laissez faire (a term not used in the WN), is underscored by his view that the successful operation of a market economy depends fundamentally on an appropriate institutional structure being in place with a framework of rules provided by government. These rules stemmed from what Smith viewed as the three duties of government, namely: the maintenance of public works, the protection from external foes and an exact administration of justice.

'Justice', in Smith's terminology, has the state charged with the roles of instituting, updating and enforcing and it is crucial in allowing individuals to have 'natural liberty' and to pursue their own objectives. One of the key aspects of justice in the Smithian system is the establishment of property rights, along with contracts for enforcement, and the ability of individual citizens to buy, sell and invest freely in a market economy through the relevant institutions that minimise the risk of trade and investment with

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strangers. This needed to be supported by an appropriate legal apparatus that included a system of independent courts, lawyers and state police powers to enforce judgments against private parties.

Smith argued that the role of government goes well beyond the minimal nightwatchman state of the 19th and 20th century caricature in that government can have a positive role, even if this impinges on personal liberty, especially if it improves the liberty of society. For example, although the division of labour, discussed above, can bring greater universal opulence to a society it can also come at the cost of the workers involved in the process having their 'intellectual, social and martial virtues' corrupted. This is a clear case of a negative externality and for Smith, the remedy here is for government intervention to provide the (partial) public funding of parish schools with a national curriculum (see Berry, 2018 for a fuller summary of Smith's views on education). Smith was also in favour of the provision of other public goods, such as a publicly funded army, public health (see, e.g. Schliesser, 2017) and argued that government should intervene to prevent the development of monopolistic power. Smith also saw a role for government in designing institutional regimes that maintain public works, such as canals, roads, postal services and education. And as Schliesser (2017) notes Smith was also keenly aware of how economic and other incentives could produce unintended consequences of legislation, such as 'principle-agent' problems, 'regulatory capture' rent-seeking and financial control of state functionaries by private firms. In sum, Smith requires government to be 'strong' in 'umpiring' the 'great game of the market economy' as he calls it.

In that regard, as Evensky (2011) notes, government had a crucial role in creating societal trust which Smith regarded as essential for the workings of his dynamic view of the economy. It is, first, crucial in terms of the reach of the market—with weak societal trust the greater are the transaction costs of trade and the more constrained the market becomes. Second, trust is essential to the accumulation of capital since there will be no incentive to accumulate capital if there is a risk of confiscation of such by individuals and institutions. Smith emphasised two forms of capital, namely fixed and circulating capital, and although both suffer from the same general risks—a building may burn down, or a ship may sink—circulating capital suffers from the additional risk of trust in the sense that the control over that part of capital may lie with a third party. The example of money brings this aspect of trust into sharp relief. When gold and silver emerged as a medium of exchange, Smith noted that there was an important role of government to establish:

> Some expedients to ascertain with accuracy both weight and fitness. Coinage most effectively secures both these, the public finding how much would tend to facilitate commerce put a stamp upon certain pieces that whoever saw them might have the public faith {that is, trust} that they were of a certain weight and fitness, and this would be what was at first marked up on the coin as being of most importance (LJ) {author added}.

The emergence of credit creates other layers of trust that need to be addressed, namely the credibility of the banks and their customers:

> A private man who lends out his money to perhaps half a dozen or a dozen of debtors, may, either by himself, or his agents observe, and enquire both constantly and carefully into the conduct and situation of each of them. But a banking company, which lends money to perhaps five hundred different people, and of which the attention is continually occupied by objects of a very different kind, can have no regular information concerning the conduct and circumstances of the greater part of its debtors beyond what its own books afford it (WN).

In terms of bank trust, Smith was satisfied that the then banking practice of requiring 'frequent and regular' payments from the banks' customers was sufficient to determine solvency. In terms of the trustworthiness of banks and their issuance of bank notes, Smith recognised the potential of note issuance to improve the productivity of a country but also that this came with potentially significant risks:

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> The Commerce and Industry of the country, however, it must be acknowledged, though they may be somewhat augmented, cannot be altogether so secure, when they are as thus, as it were, suspended upon the Daedalian wings of paper money, as when they travel about upon the solid ground of gold and silver (WN).

Smith was very clear that to address this risk bank regulation was required and this required an act of Parliament and that although such regulations placed a restriction on natural liberty, they were necessary for the greater good:

> Such regulations may no doubt be considered as in some respect a violation of natural liberty. But those exertions of the natural liberty of a few individuals, which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments: of the most free, as well as of the most despotical. The obligation of building party walls to prevent the communication of fire, is a violation of natural liberty, exactly the same kind with the regulations of the banking trade which are here proposed (WN).

Smith's position on the regulation of banking was greatly influenced by the Scottish banking crisis of 1771, and particularly the collapse of the Ayr Bank, which represented a classic banking crisis of loans turning sour and the banks having inadequate access to liquidity and capital resulting in significant losses to the owners of the banks.

However, while Smith regarded government intervention as essential, particularly with respect to establishing trust in a society, he also recognised that government could be captured by a faction in society whose goal is not that of building a constructive society but rather their own competitive advantage (effectively the followers of mercantilism). As Evensky (2011) notes: "This faction advocated, with 'the passionate confidence of interested falsehood' for policies that were normally designed to increase the wealth of the nation but were in fact intended to monopolise the channels of trade to the advantage of the very merchants and manufacturers who are advising the government on the nature and causes of the wealth of nations". The resultant increased returns were devoted to oppositional voices and so a vicious circle of corruption was created. To quote Smith from the WN:

> Of the greater part of the regulations concerning the colony trade the merchants who carry it on it must be observed have been the principal advisers. We must not wonder therefore if in the greater part of them their interest has been more considered than either that of the colonies or that of the mother country.

Smith argued that the interest of the merchant faction "is never exactly the same with that of the public, who generally have an interest to deceive and even oppress the public and who accordingly have, upon many occasions, both deceived and oppressed it" (WN).

In fact, Smith believed that the merchant faction could potentially destroy the British system of free markets and liberty, and this had crucial implications for Smith's virtual production system, discussed below, and the productivity of the economy since it led to a diversion of capital from the many enterprises to which it would naturally be invested into the few most easily monopolised areas of trade. "The risk and the expense of maintaining this monopoly were borne not be the beneficiaries of the monopoly but society as a whole" (Evensky, 2011). To address this issue strong and wise leadership was needed from the governing party. This leadership should 're-establish and improve the constitution and …assume the greatest and noblest of all characters, that of the reformer and legislator of a great state' (TMS). For Smith, such incorruptible leadership was essential to the development of the civic process since it would produce confidence in the political process and justice for all.

One key way in which Smith saw government having a role in decreasing the role of a faction and increasing the likelihood that citizens will be diligent and constructive in their civic participation, and as a result of collective action, is public education:

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> An instructed and intelligent people….are always more decent and orderly than an ignorant and stupid one…. They are more disposed to examine, and more capable of seeing through, the interested complaints of faction and sedition, and they are, upon that account, less apt to be misled into any wanton or unnecessary opposition to the measures of government. In free countries, where the safety of government depends very much upon the favourable judgment which the people may form of its conduct, it must surely be of the highest importance that they should not be disposed to judge rashly or capriciously concerning it (WN).

As we shall see when we turn to the TMS and its moral sentiments, Smith's arguments in the WN, of the role of government in setting the formal rules of conduct, creates confidence in society to allow informal rules of conduct, such as norms of conduct, to flourish and produce a common collective commitment to civic ethics, thereby creating trust. Evensky (2011) summarises this crucial aspect of Smith's work thus:

> When citizens have this confidence society can flourish under such a constitution. Individual citizens feel that the system of justice is just to them and thus warrants their individual acceptance and adherence. This common commitment to civic ethics increases common trust and reduces the role of government both of which release energy and creativity in an expanding market engagement. Absent this confidence in the justice of institutions there is no buy in by individuals, there is no common civic ethics to which to commit this lack of confidence in government increases the cost of maintaining social stability and decreases the productivity of society.

2.1.3. The market, free trade and the joint stock company

As we noted above, the division of labour is limited by the extent of the market and Smith clearly recognised the role of geography in determining the reach of the market and this has been emphasised by several scholars, including, *inter alia,* Dockes (1969), Ionannou and Wocjcik (2022) and Ponsard (1983). For example, Ionannou and Wocjcik (2022) note that: "At the analytical level a distinction that permeates the whole of the Wealth of Nations, and thus underpins his geographical approach, is that between the town and the country. Related market forces for Smith always operate within specific sub-national geographies" And as Dockes (1969) notes: "Market equilibria—to the extent that they can be achieved—are spatially bounded such that notable discrepancies can systematically occur in wages, profits, rents and prices across different regions, cities, villages or even parts of a city".

Dockes (1969) also notes that Smith emphasises the relationship between the size of cities and townships and the scale of the market with the latter being measured in terms of urban population. Smith also writes about specific types of employment, seen as the offspring of the division of labour, that only exist in large towns and that Smith relates urban scale to other economic phenomena, "including the determination of profit and prices; the space it opens for wealth accumulation and speculation; favourable conditions it creates for business lobbying and networking; and the centripetal and centrifugal forces in urban development" (Ionannou and Wocjcik, 2022).

A further important aspect of Smith's recognition of the importance of geography in his economic analysis of trade, contained in chapter 3 of book 1 of the WN, is the importance of having locations which are close to the sea, a navigable river or canal since this can lower transportation costs enabling a town to enhance the scale of the market and deepen its division of labour. This was something that Smith would be keenly aware of when he lived and worked in Glasgow witnessing the flourishing trade generated by the cotton and tobacco industries.

Another aspect of the interplay between geography and trade for Smith was that trade could also play its part in alleviating inequalities arising from extending the geographic reach of the market. On this, although Smith envisaged free trade as generating greater wealth for nations that held the balance of power in trade, he also recognised that it could have deleterious implications for nations that were more

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backward and not so powerful, creating inequality between nations. The example he gave was in terms of the discovery of the sea routes linking Europe with the Americas and to the East Indies in Asia which Smith regarded as 'the two greatest and most important events recorded in the history of mankind…… By uniting in some sense the most distant parts of the world, by enabling them to relieve one another's wants, to increase one another's enjoyments and to encourage one another's industry their general tendency would seem to be beneficial'.[2]

However, the impact of colonialism meant that it was Europe that reaped the benefit of this development while the inhabitants of both the East and West Indies suffered: '…the superiority of force happened to be so great on the side of the Europeans that they were enabled to commit with impunity every sort of injustice in those remote countries'. Smith looked forward to a fairer world in which the inhabitants of the East and West Indies 'may grow stronger, or those of Europe may grow weaker' and he envisaged global trade as bringing about this equality of force through mutual communication of knowledge and eventually cause the rebalancing of power' and 'some sort of respect for the rights of one another'. For Smith, the market, rather than creating inequality could have a crucial countervailing egalitarian effect.

Smith envisaged markets working competitively to bring about a natural balance between the supply and demand for goods driven by the two great dynamics of human behaviour: first, 'the propensity to truck, barter and exchange one thing for another', which is distinct to the human species and relates to his concept of sympathy and the capacity of humans to empathise with others desires and values; and, second, 'the desire of bettering our condition' which is 'universal, continual and uninterrupted'.

If a person has more goods than she needs she will try to better her condition by exchanging some of these goods with someone who has goods which she lacks—this results in trade and it is mutually beneficial when it is freely and voluntarily undertaken. It is self-interest or self-love that sustains this mutual economic dependence as the famous quote from the WN makes clear: 'It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own self-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'. But the key point here is that these 'selfs' are tempered by the human characteristics of sympathy and empathy for others. The concept of sympathy, and more generally the creation of moral values and associated norms are discussed at some length in the Theory of Moral Sentiments, which we turn to in the next section.

Although the corporation did not exist in Smith's time it is important from the perspective of our discussion of the NLP to illustrate his thinking on the forerunner of the modern corporation, namely the joint stock company. Smith's insight into how shareholders owned companies is as relevant, if not more so, today than it was in his day. Indeed, this is a much-underplayed element of Smith's work, especially considering how the modern-day corporation has impacted on the well-being of today's society. Smith's discussion of the joint stock company is contained in the fourth book of the Wealth of Nations.

Smith viewed the joint stock company with considerable suspicion and saw it as an institution that was inimical to economic prosperity. Specifically, the extent to which the joint stock company was discussed by him was to highlight the numerous conflicts of interest that existed within the company to the point that: 'negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company'. Although Smith discussed this issue, which is today referred to as the 'principal agent' problem, for several joint stock companies, his most widespread discussion of the issue was for the East India Company whose shares, just like the modern corporation, could be traded and which had many passive shareholders who did not take a direct interest in the company.

Although, as in the modern corporation, the directors of the joint stock company were supposed to be merely non-self-interested agents of the shareholders, the reality was somewhat different. '…being the managers of other people's money than of their own, it cannot well be expected that they should watch

[2]Sachs (2020) labels this period as the Ocean Age of globalisation in contradistinction to the global order of the 21st century which he labels the Digital Age.

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over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own'. As we shall see in Section 4, this key insight of Smith regarding the divorce of ownership or control of the modern corporation, referred to today as the principal-agent problem, has created some of the key issues that have arisen because of the adoption of the neo-liberal model (see Anderson and Tollison, 1982 for an alternative interpretation of Smith's view of the joint stock company).

Although taking the WN as a separate entity from his other work often leads to the conclusion that Smith is the father of a laissez-faire view of the economy, what we hope to have demonstrated in this section is that this is in fact far from the case and that view is reinforced as we now turn to Smith's other great work the Theory of Moral Sentiments.

2.2. The Adam Smith toolkit: The Theory of Moral Sentiments

If the workings of the Smithian model in the WN is underpinned by an 'invisible hand' and if the model is to work in a fair way, which is central to Smith's overarching thesis, then that hand must be guided by a moral compass (Rayner, 2023) and that is clearly stated at the opening of the Theory of Moral Sentiments:

> However selfish man may be supposed, there are evidently some principles in his nature, which interest him in the fortunes of others, and render their happiness necessary to him, though they derive nothing from it except the pleasure of seeing it.

As we shall see below, one of these principles is 'sympathy' for others and for Smith the reason we can sympathise with others' actions and emotions is because an individual's moral sentiments have 'an immediate reference' to others' sentiments. Therefore, to fully understand the economics of Smith we must understand how he deals with the source of moral values and the behaviour that underpins his commercial society. In essence, the TMS, which is essentially a treatise on social psychology and sociology, seeks to address the key issue of what it means to be a human being and to attempt to explain how moral feelings arise from human sociability. For Smith 'Man naturally desires, not only to be loved, but to be lovely; or to be that thing which is the natural and proper object of love'.

The now-established consensus on the relationship between the WN and TMS is that the self-seeking behaviour that underpins the WN is conditioned by the virtue of prudence, referred to in Section 2.1.1, which, in turn, is one of the derivative virtues from the sympathy theory of Smith as outlined in the TMS. As the editors of the Glasgow edition of the TMS conclude: 'the prudent man of TMS. V1.i is the frugal man of WN.II.iii' (Raphael and Macfie, 1976). To understand this relationship further, we follow Tajima (2007) in taking an institutional perspective on the TMS as this is a useful way of understanding the importance of collective sociability in Smith's work and as a result brings into sharp relief the major flaw in the neo-classical economic model and as a result the NLP.

> One of Smith's major contributions is that he introduced the idea of institutions into economics, although he used it to signify morality in TMS. If virtues imply institutions, TMS may be considered an attempt to demonstrate how institutions are formed through sympathy and how they control human behaviour. Smith's theory of institutions and collective action consists of two parts: the first part focuses on the emergence of institutions from sympathy theory while the second deals with the deviation of actions from institutions (Tajima, 2007).

As we have noted, institutions can generally be regarded as a set of formal or informal rules of conduct and can be conceptualised as implying standards of conducts that are based on explicit or implicit consensus between individuals.

Furubotn and Richter (2000) argue that standards of conduct in turn comprise both rules, such as legal or administrative rules, laws and regulations, and norms of conduct which imply informal and implicit consents, such as traditions, customs, conventions, and ethics. As we discussed in the last section, the latter are predicated on the government establishing a set of formal rules which are seen as

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'incorruptible' within which societies informal rules of conduct, as contained in societal norms, can lead to a common commitment to civic ethics thereby increasing common trust. It is the latter component of the standards of conduct which is key to understanding the difference between the economics of Smith and the economics of the NLP—in forming our own moral views the opinions and behaviour of those we interact with are key. It is this socialisation that is key to understanding the TMS.

Although institutions impose impartial constraints on an individuals' choice behaviour, and shape them in conformity with a group collective action (Gauthier, 1986), such collective action may nonetheless be defined as individual actions if they obey the standards of conduct. All the individuals who are bound by a set of standards of conduct are considered as forming a group and their relationships within the group are termed social relationships. A social order arises when such social relationships are continuously maintained through the collective action of the members of the group. This order is referred to as a public good (Taylor, 1976) or a collective good (Hardin, 1993). The standards of conduct can be enforced either through the external enforcement of the rules of conduct and the norms of conduct can be enforced by the disapproval or censure of the wider group (Tajima, 2007).

Social norms therefore are crucial in influencing our identity and attitude formation. In this, Smith follows Hutcheson and David Hume in emphasising 'sympathy' for others: 'our fellow feeling with any passion whatsoever'. But his account differs from theirs in that for Smith imagination plays a key role in the creation of sympathy. Specifically, the Smithian view as elaborated in the TMS is that moral self-awareness emanates from outside a person and, crucially, this is not from consulting religious texts or self-reasoning but from an interaction between what he refers to as actors and spectators. In Smith's view, sympathy is stronger with respect to those close by compared to incidents that affect strangers in a distant location.

Smith's definition of sympathy is based on two fundamental principles. The first is that an individual has three types of passions: selfishness, with a focus on private interests, social passions—friendship, generosity, humanity, kindness, and compassion—and unsocial passions, such as anger, resentment and hatred. The second principle of human nature is that a person has fellow feelings. Smith's development of human emotions is experiential in that humans learn from experience. To quote Berry (2018): "They learn which situations typically generate what sort of emotions and how these emotions are typically expressed. Hence sadness follows parental death and that is felt more intense intensely than, say, disappointment that one's orchard has failed to flower. Where is this learned? For an empiricist like Smith the only sources from the experience of everyday life in society. *This sociality is decisive*" {emphasis added}. Indeed, Smith likens society to a mirror since "if someone grew up in isolation from society they would not know if they were beautiful or ugly and, equally they would not have any idea if they were acting morally or not" (Berry, 2018).

Sympathy effectively works by acting as a mental faculty through which we can approve or disapprove our own and others actions and sentiments, which in turn determines our moral sentiments in terms of a sense of proprietry and a sense of merit and it is the role of Smith's 'impartial spectator', who effectively bears the character of the conscience (Raphael and Macfie, 1976), to judge whether an action driven by our underlying passions can be approved morally. For Smith, it is the sympathy of the impartial spectator that decides whether his general rules of morality, consisting of the virtues of beneficence, justice and prudence are indeed virtuous and this leads him to conclude that 'the origin of our moral sentiments [result] from sympathy' (TMS). As morally guided individuals we sympathise with others' actions and emotions which create mutual and direct relationships between individuals, and this can be seen as creating a social externality which has non-pecuniary and intangible effects on others (see, e.g. Binmore, 2000; Sen, 1982).

Tajima (2007) argues that the general rules of morality can be regarded as institutions since they imply interpersonal relations regarding how an individual should behave and that Smith's virtues are institutions and constituents of standards of conduct which leads to the emergence of a social order which takes the form of 'the general rules of conduct' (Skinner, 1990). In sum, "Smith's TMS, thus, shows that morality is an institution and the institution shapes individuals' rules of choice behaviour. The development of the general rules of morality from the sympathy theory in TMS can be understood as a process of deducing one of the simplest forms of institutions namely the standards of conduct" (Tajima, 2007).

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Returning now to the issue raised in Section 2.1 of how the wealth of a nation is maximised by investors always investing their capital in a frugal way and by workers always acting in an industrious manner Smith argued that this will arise in the commercial society because the virture of prudence is the key driving force of economic man. To quote Smith on prudence:

> In the steadiness of his industry and frugality, in his steadily sacrificing the ease and enjoyment of the present moment for the probable expectation of the still greater ease and enjoyment of a more distant but lasting period of time, the prudent man is always both supported and rewarded by the entire approbation of the impartial spectator, and of the representative of the impartial spectator, the man within the breast (TMS).

and on the rules of conduct:

> The pursuit of the objects of private interest, in all common, little and ordinary cases, ought to flow rather from a regard to the general rules which prescribe such conduct than from any passion for the objects themselves (TMS).

In other words, the frugality of capitalists and the industriousness of workers are not the outcome of individual actions but rather they are collective decisions institutionalised and guided by prudence as a norm of conduct. It is important to note that on a number of occasions in the TMS Smith discussed how individual conduct may divert from the norms of conduct due to individuals having sympathy with joy instead of prudence and he referred to this as the 'corruption of moral sentiments'. In terms of the standards of conduct, corruption for Smith arises due to individuals deviating from the collective informal norms rather than a breach of formal legal laws (which would simply be regarded as illegality). "If an increasingly large number of members of the group follow this path that some members have taken, a different collective action will emerge with the result of the emergence of a new social order which differs from the social order that is formed from the pursuit of self-interest complying with the rules of morality" (Tajima, 2007). This is a point we return to when considering the neo-classical economic model and the NLP.

In sum, Smith demonstrates in the TMS that morality is inseparable from sociality:

> To live in society is to take part in a network of communication, to receive and send information about how to behave in different situations from the message received from others, I learn that some of my actions are approved, and some disapproved. Since I want to do what pleases and avoid what causes me pain, I am motivated to repeat the former and avoid the latter. In this way I react to the communicative signal sent. I acquire knowledge of what behaviour is condoned or condemned in given situations. This acquisition in other words gives us our moral compass (TMS).

Viewing Smith's virtues in the TMS as institutions clearly demonstrates how individual actions are shaped into collective action by accepted values and norms and this process produces trust which as we have argued is central to underpinning a well-functioning, close-knit society. As we have argued above government has an important role to play in this process by establishing the formal rules of conduct.

The themes discussed in this section are neatly brought together by the following two quotes:

> Smith's view of markets therefore is one in which markets are sustained not just by incentives of gain or loss, but by laws, institutions, norms and identities and without these things cannot be adequately understood (Norman, 2018).

> In a constructive society, trust and security are based on mutual respect among citizens and between the citizen and the State. It is the maturation of the citizen and of the state together that makes the emergence of a commercial free market society possible. It is the trust engendered by this maturation of civic ethics and institutions that makes it possible for individuals to enter the market

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system with confidence that the competition will be a game played by just rules. When trust is shaken individuals pull back and the system contracts. Where trust grows individual energy and creativity are unleashed and the system grows. In Smith's vision of humankind's progress, trust is the central theme (Evensky, 2011).

3. Classical Liberalism versus Neo-Liberalism

This section will elaborate the basic tenets and key features of the Classical and Neo-Liberal models as they relate to the main themes of this article. One of the sharp dividing lines here is in terms of the extent of state intervention and the trade-off between an individual's 'personal responsibility', to make their own decisions with respect to how they live their lives, and how much state intervention there should be. Some liberals (especially neo-liberals) cite the moral hazard aspect of state intervention. To quote Fukuyama (2022): "if the state pays people not to work, they will work less; if it insures people against too many risks then they will take unwise risks. Underlying many liberal concerns about excessive state intervention was a moral concern that excessive dependency on the state would weaken people's ability to take care of themselves".

3.1. Classical Liberalism

Gray (1986) outlines the main broad themes that define liberalism and that are common to all variants of the liberal tradition. First, liberalism is individualist in that emphasises the moral primacy of the person against the claims of any social collectively, although as noted in the previous section an collective action can be consistent with individual actions if they obey the standards of conduct. Second, it is egalitarian in so far as it confers on human beings the same moral status and denies the relevance to legal or political order of differences in moral worth among human beings. Third, it is universalist in affirming the moral unity of the human species and accords a secondary importance to specific historic associations and cultural forms. Fourth, it is melioristic in form given that proponents of liberalism believe human action can lead to an improvement of all social institutions and political arrangements. Grey notes that although there are many variants of the classical liberal model—'It is this conception of man and society which gives liberalism a definite identity which transcends its vast internal variety and complexity'.

As we have seen in the previous section, it is this link between people and society that is at the heart of Smith's overall thinking and specifically how the norms created in a liberal society underpin the greater good through trust. Indeed, it is the crushing of the social norms that underpinned Smith's view of the commercial society by neo-liberal doctrine and policies that have led to the extreme polarisation we see today in many previously stable liberal democracies.

As Fukuyama (2022) notes, liberal societies confer rights on individuals, the most fundamental of which is the right to autonomy; that is the ability to make choices about belief, speech association, and ultimately political life. Included within the right to autonomy is the right to own property and to undertake economic transactions. Although the term liberal democracy is often used for the doctrine adopted in many countries since the end of the Second World War, liberalism and democracy are separate entities although it is noteworthy that in the post-war period the pairing of democracy with liberalism: 'tempered the inequalities created by market competition, and general prosperity enabled democratically elected legislatures to create redistributive welfare states. Inequality was kept under control and made tolerable because people could see their material conditions were improving' (Fukuyama, 2022). It was as we shall see below the failure of this pairing in recent times that has led to the rise of the NLP and a focus on identity politics.

There are essentially three justifications for liberal societies over the centuries (Fukuyama, 2022). The first is pragmatic and rational in that liberalism is a way of regulating violence and allowing diverse populations to live peacefully with one another. The second aspect is moral—liberalism protects basic human dignity and in particular human autonomy and the ability of everyone to make choices. The final

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justification is that economic liberalism promotes economic growth and all the good things that come from growth, by protecting property rights and the freedom to transact.

For Adam Smith, and other 19th century liberals, the most important form of autonomy was the right to own property and to undertake economic transactions: the ability to buy, sell and invest freely in a market economy. Property rights were central to the classical economic liberal agenda, along with contracts for enforcement through the relevant institutions that minimised the risk of trade and investment with strangers. Property rights needed to be supported by an appropriate legal apparatus that included a system of independent courts, lawyers, and state police powers to enforce judgments against private parties.

The first two European countries to establish strong property rights were England and the Netherlands, both of which developed an entrepreneurial commercial class, and this resulted in very rapid economic growth and such growth was replicated in many other countries that adopted liberal regimes. Indeed, McCloskey (2021) notes that between 1800 and the present the average person on the planet has been enriched in real terms by a factor of 3,000 to about 10,000 and these gains have been felt across the income spectrum with ordinary workers in liberal democracies having levels of health, longevity, and consumption that only privileged elites in earlier ages enjoyed. McCloskey (2021) refers to this dramatic rise in prosperity as the Great Enrichment and it represents the largest economic and social change since the invention of agriculture. McCloskey goes on to argue that this period of enrichment cannot be attributed to 'capital accumulation, or hierarchical exploitation, or trade expansion or class struggle' or indeed to institutions. Rather McCloskey argues that the explanation for the Great Enrichment was: 'the first, modest moves toward social and economic and political *liberalism,* Adam Smith's obvious and simple plan of natural liberty' and 'Neither capital accumulation nor institutions, which were secondary and dependent initiated our riches. It was the articulated idea of human equality that did it'.

However, Sachs (2020) notes that the period of the Great Enrichment, particularly in the neo-liberal era, has also led to intense and increasing inequalities of wealth and income and has 'violated planetary boundaries with human-induced climate change, loss of biodiversity, and pervasive pollution that threaten the well-being of billions of people and the survival of the species'. Sachs goes on to argue that the key to well-being does not just lie in the pursuit of wealth but in a combination of prosperity, lower levels of inequality, and environmental sustainability. The core argument of this article is that it is this combination that is central to the economics of Adam Smith and that this can only be achieved by recognising Smith's central contributions which of course include his plan of natural liberty but go far beyond this.

It is also interesting to note that the founding father of the US Constitution, President James Madison, writing in the 18th century argued that social classes and inequality would inevitably result from the necessary protection of property rights, and this has resulted in liberalism going in and out of fashion over the centuries. Certainly, the issue of inequality has been hugely exacerbated over the last 40 years and has led many again to question the classical liberal model. However, during that period the Classical model has morphed into the neo-liberal variant, and it is this that is the source of the huge inequalities that have arisen in our societies. We now turn to a brief discussion of the neo-liberal model.

3.2. Neo-Liberalism

In the late 20th century liberalism's key principles have been polarised by advocates on both the right and left of the political divide. Specifically, the idea of the protection of individual autonomy has been pushed to extremes by the right, in terms of the right to buy and sell freely without interference from the state. On the political left, autonomy has come to mean personal autonomy about lifestyles, choices and values and resistance to the social norms, discussed above, that are imposed by the wider society, an interpretation that has evolved into modern identity politics.

Liberal ideas have also been taken to extremes in terms of economic thought that have been rebranded as neo-liberalism. The latter form of economic thought is usually associated with the University of

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Chicago and the so-called Austrian School of economics and economists such as Gary Becker, Friedrich Hayek, Milton Friedman, George Stigler and Ludwig von Mises. This stream of economic thought was developed at a time when the post-World War 2 liberal democratic mixed economy was facing severe questions in the 1970s and was absorbed into mainstream economic policy by Margert Thatcher's government in the UK and Ronald Reagan's in the US. Their polices, continued by succeeding centre-left politicians in the UK (Tony Blair) and the US (Bill Clinton), placed an emphasis on anti-state policies of deregulation and privatisation, particularly of natural monopolies.

As we saw in our discussion of the Adam Smith toolkit, Smith favoured free trade since it extended the size and scope of the market enabling the virtuous cycle created by the division of labour. However, as more and more countries signed up to the free trade model in the 20th century this created very real problems for the first countries to industrialise, such as the US and the UK. Specifically, the fact that not every individual in every country benefited from free trade was underplayed by many supporters of the NLP. For example, low-skilled workers in countries such as the UK and US lost jobs and opportunities to similarly skilled workers in poorer countries as multinational companies offshored their facilities. Although in the US the Clinton administration sought to ameliorate opposition to, for example, NAFTA by offering new programs, these were insufficient to prevent the inevitable consequences of the agreement. Similarly, the neo-liberal support for open immigration may well have been well-intentioned in its objective of increasing labour mobility but as Fukuyama (2022) notes in so doing neo-liberals paid insufficient attention to the distributional consequences of such a policy and the inevitable backlash it created in both the UK and US.

As we noted in our discussion of the toolkit, Smith was realistic about government intervention, especially as it relates to the creating of trust in government and the consequences that has for building civic trust in wider civic society. However, the NLP's focus on the deregulation of markets, including financial markets, and its allowance of the worst traits of mercantilism, including political lobbying for anti-competitive policies, would inevitably lead to the breakdown of trust in neo-liberal societies with all the consequences this has had as we shall see in Section 5 and especially the corruption of social values and norms.

In sum, the key tenets of neo-liberalism are: extreme hostility to the state and a belief in the sanctity of human freedom and opposition of state action in social matters; the privatisation of natural monopolies; the deregulation of markets with all markets treated as homogeneous; free trade is taken to extreme with low skilled workers in high-income countries losing their jobs with severe distributional and migratory consequences; it is highly critical of state policies that seek to address distributional issues and inequality; a focus on supply-side polices. In the next section, we take a more detailed look at the development of the economics of the neo-liberal model.

4. Adam Smith and the transition from Classical Economics to the economics of Neo-Liberalism

Our discussion of the AS toolkit, and particularly Smith's version of political economy, can be further teased out by considering the development of so-called Classical Economics[3] and the transformation of Classical Economics into Neo-Classical Economics and the modern variant of the model that underpins neo-liberalism. Our discussion here parallels the distinction between Classical Liberalism and Neo-Liberalism since it is essentially a variant of the Neo-Classical Economic model that underpins the NLP rather than the former. Therefore, to understand where the NLP has gone wrong it is important for our discussions to distinguish between the economics of Smith and the economic model underpinning the NLP.

The key point here is that with the development of the Neo-Classical model the economics of Smith shifts from a political economy perspective (i.e. one which is multidisciplinary with a focus on the

[3]In addition to Smith, the main proponents of the Classical School are: David Ricardo, John Stuart Mill, Jean-Baptiste Say, Thomas Malthus and Karl Marx.

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interrelationships among individuals, governments, and public policy) where the individual is embedded in society and guided by cultural norms to one in which economics develops into a supposedly value-free subject with economic man at its centre, maximising his own utility with no regard for the utility of others and rationally processing a 'full information' set.

It should be noted at the outset of our discussion, and as Norman (2018) persuasively argues, that there is a distinction between Smith's approach to political economy and that of David Ricardo and other Classical economists. As we saw in our discussion of the toolkit, Smith in his writing and analysis took a cautious, empirical and qualified approach to many of his key contributions including his system of natural liberty. In contrast, Ricardo thought more in terms of categorical laws of political economy and for him Smith's Commercial Society becomes transformed into a system of perfectly free commerce. Furthermore, John Stuart Mill took Ricardo's position a dramatic step further and argued that Smith's view of political economy had become 'obsolete' and that the discipline should be narrowed down to what was in essence a focus on economic man—'The whole of man's nature….is concerned with him solely as a being who desires to possess wealth and who is capable of judging of the comparative efficacy of means for obtaining that end'.

Another difference between Smith and the other Classical economists was in terms of their theory of value. As we noted, although Smith argued that labour was the key generator of the wealth of a nation, he also clearly recognised the importance of other inputs into the production process, namely capital and land and he explicitly mentioned the role of climate and the soil in terms of the production process. In contrast, Ricardo argued that the final value of a commodity is the sum of the hours of labour time equivalent to the time contained in the wage and the labour time used up in material inputs in the production process. What Ricardo referred to as surplus labour, and Marx referred to as surplus value, was the difference between the use-value of labour power and the value contained in the bread of the worker.

The development of the neo-classical model has at its heart the development of the economic man described in the writing of Mill and had important staging posts on that journey. These include the marginalist revolution of the 19th century, the work of Jevons and Walras in mathematizing the discipline, the development of game theory culminating in the seminal Arrow-Debreu general equilibrium result that a general equilibrium could exist in a competitive market in the sense that there is a set of prices at which the quantities supplied and demanded would be simultaneously equal across all markets.[4] Although many economists (see Arrow and Hahn, 1971) have interpreted the Arrow-Debreu result as the scientific expression of Smith's view that the combination of self-interest and freely functioning markets, along with what was essentially perfect competition, could produce an economically efficient outcome for a society. However, such an interpretation is not entirely clear from what we said in Section 2 and as we shall see further below.

Three key assumptions underpin the neo-classical model. First, agents (typically households) are assumed to act independently with access to full and all relevant information and have rational preferences between outcomes that can be identified and associated with value; decision-making is made at the margin. Second, the individual's key objective is to maximise their own utility where an individual's utility does not depend on the utility of others and there is no societal link for the individual apart from that contained in contracts. Third, a firms' sole objective is the maximisation of profits and not to any wider stakeholders nor does it have obligations to wider society to take account of the external effects of its activities.

Using these three key assumptions, neo-classical economists have built a structure to understand the allocation of scarce resources among alternative ends. For example, the derivation of demand curves for consumer goods comes from the utility maximisation assumption as does the derivation of labour supply curves and the assumption of profit maximisation underpins the neo-classical theory of the firm. In contrast to the classical theory of value price, in the neo-classical model, this is determined by the intersection of demand and supply curves.

[4]See Norman (2018) for a good non-technical overview of the development of the neo-classical model.

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In contrast to the Classical model in the Neo Classical model, the value of a good is not determined by inputs into the production process but by differences in the utility to the consumer. In this view, value is subjective and depends on a person's judgement and value occurs at the margin.[5] This combined with a belief that markets always yield optimal outcomes given idealised conditions "promotes a view that all market outcomes equal value creation, and with them the growth of the wealth and welfare of nations" (Carney, 2021). This result is formalised in the First Theorem of Welfare economics, which is sometimes seen as the analytical confirmation of Adam Smith's invisible hand (Arrow, 1951), and states that with complete markets, complete information, and perfect competition that the resulting equilibrium will be Pareto optimal, in the sense no individual can be made better off without making someone else worse off.

The development of modern economics has deviated from its traditional focus on the production, consumption and distribution of material goods that incorporates human interaction in general and the basic principles by which individuals make decisions. In the NLP a key principle is how people respond to incentives. Indeed, for many the role of incentives has become so pervasive it has come to define the discipline, and as Sandel (2012) notes this does more than extend the reach of markets into everyday life it also gives the economist an activist role to fix issues by devising new incentives.

To quote Levitt and Dubell (2005): 'The typical economist believes the world has not yet invented a problem he cannot fix if given a free hand to design the proper incentive scheme. His solution may not always be pretty—it may involve coercion or exorbitant penalties or the violation of civil liberties—but the original problem rest assured will be fixed. An incentive is a bullet, a lever, a key: an often-tiny object with astonishing power to change a situation'. The word incentive does not appear in the writings of Adam Smith or in the other Classical economists and the role of incentives in modern economics is a long way from Smith's image of the market underpinned by an invisible hand. As Sandel notes 'Once incentives become the cornerstone of modern life the market appears as a heavy hand and a manipulative one', as we shall see in Section 5.

A couple of other strands in the development of the economic model underpinning the NLP are worth noting here since they also contrast with Smith's thinking. The first is an emphasis on how markets always get prices right in the sense that they are efficient, and the market mechanism ensures the absence of riskless profits. Such a view is epitomised in the so-called Efficient Markets Hypothesis (EMH), developed to understand the behaviour of financial asset prices, which has its roots in the writing of Bachelier (1900) and fully fleshed out by Fama (1970). In this view, with fully rational agents endowed with a full information set, asset prices change only because new information hits the market, since any previously available relevant information will already have been incorporated into the price. Prices in this view follow a so-called random walk or martingale process.

This view, which has had a profound effect on the development of Finance, is controversial since if markets always reflect all available information, it raises the important question of what incentive investors will have to collect information since effectively over time it is impossible to beat the market. Paralleling the use of the EMH in financial markets is the so-called rational expectations hypothesis which imposes similar behaviour on agents trading in a wide range of markets. The rational expectations hypothesis developed by Muth (1961) takes the concept of rational optimising *homo economicus* to its extreme by assuming he or she uses all current available information and expected information over an infinite future forecasting horizon. Specifically, Muth argued rational individuals use all available information to make unbiased, informed predictions about the future. This, in turn, implies that individuals do not make systematic errors in their predictions about price and that their predictions are not biased by past errors.[6]

[5]The combination of the neo-classical model and Keynesian economics yielded the so-called neo-classical synthesis which dominated mainstream economics from the 1950s to the 1970s.

[6]Muth's paper also discusses the implications of rational expectations for economic theory and one key implication of this is that government policies, such as changes in monetary or fiscal policy, may not be as effective if individuals' expectations are not considered.

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An important extension of the rational expectations hypothesis, and particularly for the neoliberal focus on supply side economics, was Sargeant and Wallace (1973). In the context of a rational expectations model, Sargent and Wallace argued that rational expectations can help explain fluctuations in key economic variables, such as the real interest rate and the natural rate of employment. The latter concept suggests that there is a trade-off between unemployment and inflation in the short run, but that in the long run, the economy will return to the natural rate of unemployment, which is determined by structural, or supply side, factors, such as the skills of the labour force and the efficiency of the labour market. In other words, the extension of the rational expectations hypothesis developed by Sargent gives a further important theoretical justification for the neoliberal anti-government interventionist position and a focus on supply side issues.

In essence, the rational expectation assumption ensures that all markets are essentially to be treated in the same way as financial markets—they are all forward-looking and exhibit the same propensity to include all available information with prices adjusting rapidly to produce a market clearing price. As we shall see below this position is at considerable variance with Adam Smith's view of the working of markets.

Referring to our toolkit, we see the key differences between the political economy of Smith, and the modern economics that underpin the neo-liberal model, are that Smith, and indeed other classical economists, relied on an empirical based approach and sought to explain the commercial society and its evolution into the capitalist system of production through social and historical analysis. Smith's empirical approach, although different to the statistical-based empirical modelling of modern Economics used today, was nonetheless grounded in the living laboratory that Smith observed during his time living in Glasgow and other Scottish towns.

Before closing this section, it is worth contrasting the modern-day inputs into the production process with how the process was represented in Smith's Day. In the standard interpretation of Smith's writing, as discussed above, there are essentially three inputs in the production process, namely labour, capital and land. Land was still an important input into the production process in Smith's Day because of the importance of the agricultural sector. But with the industrial revolution economists began to downplay the role of land and indeed as the neo-classical model developed the role of land was excluded from many models of the economy, with the production process depending solely on capital and labour, and capital was narrowly defined in terms of financial and material capital.

Many now see the absence of an explicit recognition of land in the NLP economic model as one of the key failings of the model which has, for example, exacerbated climate change especially given the behaviour of the modern-day corporation which we discuss in detail below. Indeed, a key reaction to the NLP is to reconsider the definition of capital of the modern corporation to include land, a key component of natural capital, and other forms of capital that have been ignored in the NLP. The capital of the modern-day corporation has five key components (Mayer, 2018), namely human capital (employees, employers, suppliers and purchasers) intellectual capital (knowledge and understanding), material capital (buildings and machinery), natural capital (environment, land and nature), social capital (trust, social infrastructure and public infrastructure) and financial capital (equity and debt). It is noteworthy in this context that according to the 2014 UNESCO Inclusive Wealth Report that just 32 per cent of the world's wealth is attributable to financial capital, 55 per cent, is accountable by human capital and 13 per cent by natural capital.

One of our key arguments about the brilliance of Smith's work, which is often overlooked, is that his production process more closely mirrors this richer modern view of the production process which has been lost in the development of the economics of the NLP and is in essence why the many ills of modern-day society exist. And as we discussed in our elaboration of the toolkit, Smith's production process implicitly includes key elements of social capital, particularly trust, which he argued was crucial for a productive and healthy society. We return to the concept of social capital below.

We summarise the sharp distinction between the economics of Smith and Neo-Classical economics (NCE) by returning to the Adam Smith toolkit. In that, we saw Smith did not work with the set

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assumptions underpinning the modern economic model and we will consider some specific examples of this below. Also, Smith's use of the invisible hand seems to be much more guarded than its latter-day interpretation of always ensuring an efficient allocation of resources. Furthermore, Smith's basic assumption regarding the genesis of institutions is that there exists a relationship between individuals in society and effectively institutions emerge from the relationships between individuals. In contrast, the neo-classical view of the emergence of institutions is that they arise from market failures and in this view, institutions complement a market in terms of economic efficiency.

Individuals in the NCE are sole entities and lack any social relationships, other than that of contracts, and that "collective entities 'such as 'society', 'firm', 'state' and 'organisations' are derived from and explained by an individual's utility-maximising behaviour and their rational choices. Due to their individualism, the neo-classical economists come to consider society not as a collective of social relations but as the aggregate of individuals" (Tajima, 2007). It follows from this that proponents of the NCE would interpret the pursuit of private interests driven by passions such as avarice and ambition as legitimate if they abide by the rules of conduct—such as legal and regulatory rules.

However, as Tajima (2007) stresses the social order that results from such behaviour will be very different to the Smithian social order which is underpinned by the rules of morality in addition to the rules of conduct. In essence, the neo-classical model is one which is geared towards providing social orders which are underpinned by the corruption of Smith's moral sentiments. We now turn to the factors that have led to the corruption of societal values and norms resulting from neo-liberal policies and the resulting new social order this has created. Additionally, we outline various ways in which society could move from this corrupted social order to one in which a set of values consistent with the creation of a social order which restores society to a stable and sustainable path.

5. Smith and the NLP

We now bring the foregoing discussions to bear on the consequences of the Neo-Liberal Paradigm. In discussing the implications of neo-liberal policies it is important to contrast the Commercial Society of Smith with the modern capitalist model, which of course did not exist in his day. As in Smith's model, the market is central to the modern capitalist model as Norman (2018) notes: "…markets are the greatest tool of economic development, wealth creation and social advance ever known. They enable the owners of intellectual financial or human capital to earn a profit through the exercise of their property rights as a reward for putting that capital to use". The other key component of the capitalist model consists of the pooling of capital, risk and knowledge made possible by the emergence of the modern corporation, which in contrast to Smith's Commercial Society, takes on a role that is as important as the market and, as we shall see, the market has developed in a different way to what Smith discussed. The corporation has in many ways developed in a way that Smith predicted it would based on the joint stock company of his day with the divorce of ownership and control at its heart and the associated principal-agent issue distorting its societal purpose. Both developments are at the heart of the breakdown of trust in modern societies and the source of some of the key societal ills that have arisen because of the addiction to neo-liberalism.

5.1. The market

At the centre of Smith's view of the creation of wealth is as we have seen the market and the extent of the market. The concept of the market and its function and scope have changed dramatically since Smith's time. For example, a key element of the neo-liberal narrative is a reliance on free and unfettered markets with government intervention kept to an absolute minimum, if it exists at all. However, there are probably no entirely free markets in today's world and Smith certainly did not view markets as entirely freely functioning even in his day. At a minimum, markets, and as Classical economists starting with Smith recognised, need property rights and an institutional system that can enforce these rights. But often, especially in liberal democracies, the restrictions placed on markets go way beyond the baseline of

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property rights and include, for example, the licencing of certain products, regulations on qualifications, rules on product safety and so on.

In this section, we look at several different aspects of the market and its role today and how especially the market economy has become the market society. The latter differs from the market economy by implying that capitalist market economics influences not just the exchange of goods and services in a society, but also directly impacts on, and helps shape, the personal attitudes, lifestyles, and political views of its people. In other words, the market affects and undermines the norms and values that are so central to the well-ordered function of Smith's Commercial Society and leads to a corruption of moral values and the creation of a different social order.

5.1.1. The market economy and the market society

As Sandel (2012) notes, the years leading up to the financial crisis of 2008 were 'a heady time of market faith and deregulation—an era of market triumphalism' and, as we noted in Section 2, this era began in the early 1980s when Ronald Reagan and Margaret Thatcher indicated that it was markets and not government that held the key to prosperity and freedom. Crucially, Sandel goes on to note that the financial crisis not only cast doubt on the ability of markets to allocate risk efficiently, as predicted by the EMH, it also 'prompted a widespread sense that markets have become detached from morals and that we need somehow to reconnect them'. …'the reach of markets, and market-orientated thinking into aspects of life traditionally governed by non-market *norms is one of the most significant developments of our time*' (Emphasis added).

Specifically, over the last 50 years, the market has been used to allocate a whole range of social goods from health, education, public safety through to recreation and procreation issues. We now live in a world where everything, or almost everything, has a price and can be traded. But this raises serious moral issues and questions since different aspects of life and death—the buying and selling of vital organs, for example—are subject to corporate and market values that tend to overwhelm other values and norms such as those discussed by Smith in the TMS.

The move from a market economy to a market society matters for several reasons in the context of Smith. First, there is the issue of the inequality it potentially raises, discussed in more detail below. If everything is for sale in a society then it is unlikely that poor and even middle-class families can have access to good quality health and social care and quality schooling and as we have argued, and will argue further below, at heart Smith was an egalitarian. As Sandel (2012) puts it: 'the commodification of everything has sharpened the sting of inequality by making money matter more'. The second issue is the corrupting tendency of the market in that market values can crowd out non-market values that people care about—such as solidarity, fairness and responsibility—and which as we saw were highlighted by Smith as key elements in the workings of a balanced commercial society by creating a collective action and a social order bound by trust. As discussed below Smith was highly critical of the existence of inequality and the corrupting influence of markets and corporations on society's norms.

Sandel (2012) argues that to decide where the market belongs, society must decide how to value social goods such as health and education but also wider issues such as family life, nature, art and civic duties. In other words what are the moral limits of markets and the pivotal role of incentives in modern economics: the more we see markets extending their reach into non-economic spheres of life the more they become mixed up with moral questions.

Although Smith was a strong supporter and defender of the Commercial Society, he nonetheless well understood how a commercial society could be corrupting. On the one hand, for example, he describes the 'mean rapacity' and 'monopolising spirit' of the merchants who populated the commercial society and in a section of his Lectures on Jurisprudence, he concludes: 'these are the disadvantages of a commercial spirit. The minds of men are contracted and rendered incapable of elevation, education is despised, or at least neglected and heroic spirit is almost utterly extinguished'. Smith also emphasises the coercive effects which commerce can have on education which is clearly elaborated in the WN when people must perform endlessly repetitive manufacturing tasks within the division of labour. In Smith's

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view such mind-numbing tasks could affect a person's creativity and the ability of the person to 'exercise his invention' and as we noted in Section 2 he viewed education as the antidote to this corrupting influence.

As Norman (2018) puts it, to look at people's lives in purely market terms or even in terms of economics more widely is, therefore, to miss another and larger part of what makes lives meaningful—not merely less market-oriented work or work such as caring for others, that the market arguably does not value enough, but the non-market activities of socialising and volunteering and playing and giving. "These can be economically valuable and they too are shaped by norms including market norms, of course, and they shape those norms in terms of norms of friendship and reciprocity and trust".

In sum, values such as solidarity, fairness, responsibility and compassion get downplayed and undervalued, if not totally ignored, in the market society and the development of the market in this way is therefore hugely at variance with the central tenets of Smith's work and the central plan of his creation of norms.

5.1.2. The efficiency and homogeneity of markets

The financial crisis of 2008 challenged a central tenet of neo-liberalism that all markets—land, labour, capital and financial markets—behave in the same way and that all markets are subject to a stable, self-regulating mechanism. This can be illustrated by the dramatic fall in the US of the consumption of housing in 2008, which fell by a massive 60 per cent while the consumption of non-durable goods declined by only 1.7 per cent (Norman, 2018). Adam Smith was in fact aware of the differences between markets and he demonstrates this with his detailed examination of several markets, including corn, labour and bills of exchange. Smith was also very much interested in the dynamics of markets, rather than the static solutions of modern economics, and goes to great lengths to understand market differences in such markets with their evolution being influenced by, for example, government intervention, changes in taste and technology, fashion and social norms.

Although for Smith the core driver of market behaviour was the competitive behaviour of human calculation this can be dampened by human passion for the 'trinkets of frivolous utility' and the amassment of wealth for its own sake which could lead to individuals engaging in conspicuous consumption and disorderly conduct of markets not purely driven by orderly behaviour with the ramifications this could have for wider society. As Norman (2018) argues, a Smithian perspective on markets "can give us a different and deeper understanding of what went wrong in the economic crisis of 2008 and it is arguable that if the leading players had known and absorbed what Smith actually believed, at least some of the crisis could have been averted or softened in its impact for one major reason: why the crisis occurred is that asset markets—and, in particular, the market for credit and housing—did not behave as almost all the economists and regulators expected".

Financial markets are very different to the markets for non-durable goods and services, on which most of the private expenditure in developed liberal democracies is spent and since their focus is on items that are made, sold and used and once sold disappear from the market they are much closer to the markets Smith was used to and where the invisible hand was more likely to bring supply and demand to a competitive equilibrium. There is evidence to suggest that such markets are highly efficient in allocating resources in an effective way and highly generate the kind of economic welfare and wealth that underpinned Smith's thinking in the WN (Norman, 2018). The big difference between such markets and asset markets—taken to include markets for credit, real estate, securities, foreign exchange and derivatives—is that the latter are traded and re-traded and the market mechanism for these markets involves a bid–ask spread rather a single selling price.

The durability and intertemporal nature of asset markets means that these markets are in practice much more forward-looking than other markets and it is therefore crucially important that investors who trade in these markets recognise this in their trading decisions. The consequence of this is that asset markets behave in a very different fashion to other markets and the key issue in the determination of these prices is whether traders push prices to a fundamentals-based equilibrium, based on quantitative

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statistical methods, or, alternatively, to what is referred to as a 'will o' the wisp' or 'sunspot' equilibria. The latter can reflect the general sentiment of the herd through to a whole range of methods from the use of simple momentum techniques through to sophisticated so-called chartist methods. In crisis periods, asset markets are far from being stable and self-regulating and are inherently unstable and can for long periods of time deviate from the underlying equilibrium price due to herd behaviour. Such instability can lead to self-reinforcing cycles of boom and bust and speculative bubbles with all the implications this can have for the wider economy.

The financial deregulation of the Washington consensus was certainly a break with the past leading to what was thought to be a new paradigm in the behaviour of stock and real estate markets around the world, with the great moderation ushering in an apparent settled age of prosperity and with the associated recent phase of globalisation reaching unprecedented levels. However, towards the end of the great moderation, it was clear that speculative bubbles were emerging in a range of asset markets, and although at the time many thought this was a new never-ending paradigm, the reality was that these positive bubbles emerged due to an overly rosy sentiment, against a background of weak or non-existent regulation, with herd behaviour pushing prices ever higher. However, the view of the herd changed very quickly in 2007 with a rapid revision of asset values triggered by the collapse in the housing market which spread from the US and UK to the wider global economy: the upswing mania was burst.

Finally, central to market behaviour in the neo-liberal model is the assumption that citizens are rational utility maximisation individuals. However, this central assumption is challenged by various scholars using behavioural experimental methods such as Kahneman (2012). The latter's behavioural experiments found that his subject's behaviour could not be adequately explained by the assumption of utility maximising alone but instead was greatly influenced by specific norms of reciprocity and fairness with habit persistence and the preservation of reputation also being important. This finding clearly strongly resonates with our discussion of Smith's TMS. "In other words, the people…[in behavioural studies]…. inhabited the real world, which blends norms of cooperation with trust and competition and rivalry……For Adam Smith there is no such thing as an economics hermetically sealed from history, sociology or philosophical reflection" (Norman, 2018) [added by author].

5.1.3. The market, free trade and the infant industry case

Adam Smith deplored the tendencies of monopoly and colonial exploitation and the anti-competitive effects of trade restrictions, privileges, tariffs and subsidies as they distorted trade, and this was at the heart of his critique of the mercantilist model. Indeed, contrary to popular belief, even for Western capitalist economies, reasonably free market policies have largely been the exception and not the rule in the 200 or so years following Smith's death. Although the repeal of the Corn Laws in Britain in 1846 is often cited as the time Britain moved from a mercantilist tariff-bound economy to one of free trade, the reality was that at that time Britain still had over 1,100 items subject to tariffs, many of which were high and it was not until 1860 that Britain became a truly free trading nation, with less than 50 items subject to tariffs.

The US and several other countries also adopted the protectionist policies of Britain to protect their industries in the early years of industrialisation but then moved to a free trade position when their industries were sufficiently mature enough to weather competition. This temporary protectionism has become known as the infant industry model and has been used in the post-war period by several Asian countries including China. Given Smith's critique of mercantilism what would he have made of the infant industry argument given its importance for many countries as a transitional model to full free trade?

In book 4 of the WN, Smith suggests that retaliatory tariffs might be temporarily necessary, provided their goals are to induce another nation to drop its tariffs, but this is different to using tariffs for infant industry purposes. Perhaps the best answer to the infant industry question may be found in book 2 of the WN where Smith considers how countries with limited access to capital should best employ the capital they have. He argues that rather than spreading their capital too freely amongst different sectors, there

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should be prioritisation in the use of capital with agriculture being favoured over manufacturing and manufacturing over trade. This approach was seen to promote 'the quantity of productive labour or which it puts into motion within the country' and 'the value which its employment adds to the annual produce of land and labour of the society'. The upshot of Smith's argument here is that for a developing economy, it is permissible for them to prioritise one sector over another to promote the greatest value added for the country.

5.2. The role of the modern corporation and its objectives

As we have demonstrated, for Smith the market and the specialisation of labour were the key drivers of a country's national income and wealth. However, the modern-day business school elevates the corporation to a pedestal on par with Smith's market, as the following quote exemplifies:

> The corporation is the creator of wealth, the source of employment, the deliverer of new technologies, the provider of our needs, the satisfier of our desires, and the means to our ends. It clothes, feeds, and houses us. It employs us and invests our savings. It is the source of economic prosperity and the growth of nations around the world (Mayer, 2018).

In the toolkit section, we demonstrated that Smith viewed the joint stock company, the forerunner of the corporation, with considerable suspicion and saw it as an institution that was inimical to economic prosperity. Specifically, he highlighted the numerous conflicts of interest that existed within the corporation to the point that: 'negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company'.

Can these two apparently contrasting views be reconciled? Mayer (2018) argues that they can and notes that the flip side of the success of the corporation is its numerous failings in terms of being the 'source of inequality, deprivation and environmental degradation and the problems are getting worse'. The root cause of these ills is in a nutshell due to the failure to have an effective model of governance in place for the corporation, something that Smith clearly recognised in his work. In Smith's time, though, the issue was perhaps not seen as pressing as it is today, since the corporation then was still a public instrument of parliament.

The issue of corporate governance is much more of an issue today than it was in Smith's Day as a result of large measure of the forces unleashed by the NLP. A key element of the Washington Consensus concerns the governance of corporations and how the leaders of these corporations should behave and what would justify their actions. In terms of the NLP the governance issue was settled by Milton Friedman (1970) who argued that: 'there is one and only one social responsibility of business: to use resource and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud'. This became known as the Friedman doctrine. As Acemoglu and Johnson (2003) note: "…the impact of the Friedman doctrine is hard to exaggerate. At one fell swoop it crystallised a new vision in which big business that made money were heroes, not the villains … It also gave business executives a clear mandate: raise profits".

The Friedman doctrine was amended and effectively strengthened by Jensen and Meckling (1976) who argued that managers of publicly listed corporations were not sufficiently committed to their shareholders and were instead engaged in the pursuit of their own objectives which could be wasteful or involve self-serving projects. To avoid this Jensen and Meckling recommended that managers' compensation had to be tied to the value they created for shareholders and this in turn meant giving managers bonuses tied to shareholder value and issuing them with stock options. The result of this 'shareholder value revolution' where managers were to strive to maximise market value had several serious implications.

First, it produced short-termism on the part of managers since they had an incentive to pump up share prices by buying the shares of the company with retained profits rather than investing these profits

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in productive investment. Second, the issuing of stock options to managers motivated some business leaders to venture into grey areas of activity that turned out to be fraudulent. For example, "….in 2001 it was revealed that much of Enron's financial success was in large part a result of systematic misreporting and fraud which boosted the company's stock market performance (and made hundreds of thousands of dollars for its executives). Although Enron was the culprit that is most keenly remembered today, many other corporations and executives were involved in similar shenanigans and several more scandals were revealed in the early 2000s" (Acemoglu and Johnson, 2023).

The Friedmanite doctrine also altered the balance of power between managers and workers in that in an age where trade unions had lost power, mainly because of the neo-liberal polices in the UK at least, managers no longer saw the need to pay workers high wages since their social responsibility was solely to shareholders. The latter would be anathema to Smith who viewed high wages as one of the outcomes of a properly functioning market economy.

As Mayer (2018) notes, the Friedmanite doctrine has become like a law of nature with nearly every MBA course starting 'with the premise that the purpose of business is to maximise shareholder value and everything, and the rest of the course follows on from that'. Mayer goes on to note: 'that few social science theories are both so significant and misconceived as to threaten our existence but that is precisely what the Friedman doctrine is doing in the 21st century…and as long as we continue to believe in it (as a law) the greater will be the damage it inflicts on our societies, the natural environment and ourselves'.

The Friedmanite doctrine arose because Friedman, who regarded himself as firmly in the Classical liberal tradition of Smith, argued that the separation of ownership and control in the modern corporation meant that the institution had become a social institution seen as a law unto itself with executives who do not have the best interests of the stockholders at heart. For Friedman, this represented a step away from the individualistic liberal society towards a corporate state. Friedman sought to correct this disconnect by making the purpose of business to unequivocally make money for the owners of the business within the confines of the law. The separation of ownership and control of the firm seems to be more in tune with Smith's thinking on how best to govern the firm as noted above and in and of itself is not the real issue with respect to governance. Rather, and as we have argued, for Smith the norms that should govern economic behaviour are not derived from simple and naive mechanistic rules that fail to understand what motivates people and they come from a wider political economy interpretation of how people behave. As Mayer (2018) puts it:

> But in a world of creation rather than consumption where companies and individuals are innovating not just implementing then this mechanistic view of institutions and of individuals as automatons guided by unobservable forces cannot apply.

And

> The assets of the firm had been accumulated on the back of the investments of virtually every segment of society—employees, suppliers, communities, nations and nature—on the basis of extensive privileges and protection deriving from incorporation and limited liability. Shareholders do not and should not have rights to do with their companies what they please, even while staying within the law of social norms. They have roles and responsibilities as well as rights and rewards deriving from their dependence on obligations to the society in which they operate.

In other words, the purpose of the company cannot only be about the maximisation of financial capital given the wider range of stakeholders involved in the company's existence and the fact that the firm uses a whole range of different types of capital, as we saw above, including social and natural capital. With its sole objective stemming from the Friedmanite dictum of shareholder value, the corporation has no responsibility to ensure that key assets used in its production process, including natural and social capital, are not depleted. In sum, what the modern corporation needs is the alignment of its fiduciary duty to shareholders with its public obligations to its customers and the communities in which it operates

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which, in turn, means recognising the implications the firm has on the whole capital mix, including especially social and natural capital. Carney (2021) also argues that although profits are essential for the modern-day corporation, they should be generated in a way that creates shared value for all stakeholders not just shareholders and he views the key purpose of the modern-day corporation: '…to provide solutions, in a profitable manner, and contribute in its own way to the betterment of society'.

Mayer argues that the 2008 financial crisis not only eroded trust in financial institutions, but this erosion spread across the corporate landscape, and he argues that restoring trust in corporations is one of the most important issues of our age. "[Trust] is the essence of our survival as citizens and communities in a world of intense uncertainty where we rely on others not only to keep their word but also to have deep empathy and interest in our wellbeing…Restoring trust in corporations is urgent because without it our economic systems will continue to collapse, our financial systems to fail and our environment to degrade". Carney (2021) also forcefully argues that rebuilding purposeful companies, grounded in the objectives of all its stakeholders with ethical leadership in place is critical to the rebuilding of trust in society.

In other words, the corporation is, along with modern-day markets, a key source of the corruption of moral sentiments and in particular its focus on shareholder value underpinned by the neo-classical model has created a new social order based on the corruption of societal values and norms.

Currently, the alignment of the fiduciary responsibilities of the corporation with its wider responsibility can only take place through regulation but as Mayer (2018) notes the interests of regulators in promoting customer, investor and community interests are in direct conflict with those of utilities and banks in seeking to maximise shareholder value and therefore they do anything they can to circumvent regulation and create barriers to entry to their industries. So how can the issue of governance of the corporation be resolved to enable the alignment of the company's intentions and actions? Mayer (2018) convincingly argues that the governance issue can only be finally addressed by 'reformulating company law to require companies to articulate their purposes, to redefine the fiduciary responsibility of boards of directors to the delivery of their stated purpose, to produce accounts that measure their performance in relation to them…. and their license conditions to operate should be incorporated into their articles of association'. This process would require companies to balance their production and usage of all the different types of capital entering their production process including social and natural capital, rather than a sole scrutiny of financial capital.

Mayer's proposal for addressing the principal-agent problem feeds into the Environmental, Social and Governance (ESG) agenda. As a result of the corporation's effects on society, particularly as a result of the adoption of the Friedmanite rule, the issue of corporate sustainability has become a growing concern among investors who seek not only economic profit but also social good and this has resulted in the development of the ESG agenda which has as its heart the three pillars of corporate sustainability and has a strong resonance with taking a holistic balance sheet view of the firm as noted by Mayer above. Companies can improve their environmental sustainability by, for example, reducing their carbon footprint or wasteful practices.

The social responsibility pillar represents practices that benefit the company's employees, consumers, and the wider community and could be achieved by adopting a stakeholder model, a model which has proved popular and successful in several countries such as Germany, Italy, and Japan (Fukuyama, 1999). The governance pillar refers to maintaining honest and transparent accounting practices and regulatory compliance. Although there are many supporters of the ESG agenda there remains a lingering doubt for many that if compliance with the agenda is voluntary it will not be sufficient in and of itself to align the interests of the corporation with those of wider society. Indeed, many companies attempts to comply with the environmental pillar have been described as 'greenwashing'.

It is for this reason that Carney (2021) argues that to assess the value creation of the corporation it is crucial that ESG factors 'must be fully integrated and internalised into governance, strategy, operations, and performance management rather than segmented and *de facto* subordinated as matters of corporate social responsibility. Every board committee should have the relevant ESG factors integrated into their work, and the full board should be informed on how ESG issues affect the company's risk management'.

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Carney also argues that a company's purpose may need to be enshrined in its corporate structure to be effective and notes that there is compelling evidence (from a 2015 meta-analysis of over 2,000 studies) that purpose and commitment to values will help and not hurt a company's financial performance.

5.3. Crony capitalism: Political lobbying, rent-seeking and excessive remuneration

Without doubt, the emergence of so-called crony capitalism has been one of the most abhorrent implications of the adoption of neo-liberal policies, and as the quote at the beginning of the article suggests, many attribute the development of crony capitalism back to Adam Smith. Of course, capitalism as such did not exist in Smith's time but many consider the key elements of the workings of his Commercial Society as the forerunner of the capitalist model.

Crony capitalism, which is closely related to our previous topic, contains several elements, such as the large amount of funds corporations devote to political lobbying to create anti-competitive legislation, the pursuit of rent extraction rather than productive activity, the very high pay and renumeration of the leaders of large corporations and of those working in the financial sector, and growing inequality. Crony capitalism has two key features, namely that business activity loses any relationship to, and often clashes with, the wider public interest, and second, business performance is separated from business reward and as a result, a culture is created in which underlying values of decency, modesty and respect are disregarded and are replaced with avarice for money and ambition for power as the new norms of conduct and are part of the process leading to the neo-liberal social order.

Political lobbying has resulted in the emergence of global corporations through takeovers and mergers who thrive in oligopolistic markets in sectors such as pharmaceuticals, semiconductors, and brewing, creating barriers to entry with which they stifle the competition which was so central to Smith's commercial society. This is reflected in, for example, average prices being 67 per cent over marginal cost in 2004 compared to 18 per cent in the 1980s with a huge consequent increase in profitability (Norman, 2018).

Some of the worst excesses of crony capitalism can be seen in the financial sector, which started to dominate the economies of countries that have adopted NLP policies. There is little doubt that bank lobbying in the post-1970s period resulted in laxer credit standards, faster growth in mortgage and portfolio loans. This, as a result, encouraged lenders to take on extra risk since the banks and other financial institutions are now regarded as too big to fail. For example, since the adoption of NLP in the 1970s the share of GDP in manufacturing in the UK fell from 30 per cent of total value added to 10 per cent in 2014, at the same time as finance and insurance rose from less than 5 per cent in the 1970s to over 8 per cent in 2014 (MacDonald, 2021). Financial services' share of profits rose dramatically during this period mirroring the shift in the sectoral shares.

In the United States financial corporations' profits as a share of total corporate profits, which had been stable at 10–15 per cent from 1945 to 1980 rose steadily to a peak of 40 per cent at the start of this century. In addition to the expanding size of the financial sector in the UK and US, the sector also became greatly diversified with one sector being particularly important, namely asset management. For example, in the US the asset management industry grew dramatically from $3.1 billion in 1951 to some $17 trillion in 2015. In the UK asset management accounted for £5.7 trillion of financial funds by the end of 2015 which was more than three times the size of GDP in the same year (MacDonald, 2021). One of the key drivers of this growth sector has not been to channel savings into productive activities but rather to feed the beast of the rent-seeking created by Friedman's shareholder maxim and the avarice for money is perhaps at its clearest in the financial sector. As a result, the over financialisaton of the UK and US economies and the anti-competitive practices discussed above, has been associated with low rates of industrial investment, the malaise of poor productivity growth and rising inequality of income.

This expansion of the financial sector was originally welcomed by politicians of nearly all hues in the UK and US as it was predicted to providing a huge productivity boost to their economies and be a key replacement for the declining manufacturing sector. However, the reality as Mazzucato (2019) and other

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commentators have pointed out, is that both the financial institutions and the asset managers driving the financial revolution were effectively rent-seekers[7] working largely for the benefit of managers and shareholders, with the ordinary customers often only getting mediocre returns. Indeed, Norman (2018) notes the findings of a 2009 study which found as much as half of the unexpectedly high wages accruing to the US financial sector since the late 1990s could be accounted for by rents even when controlling for such factors as the risk of unemployment, wage volatility and education. Norman also notes that political lobbying is not just confined to the banking and financial sector with US corporate spending on lobbying amounting to $3.2billion in 2008, and an investment index based on the intensity of lobbying by US firms was reported in 2016 to have beaten the S and P 500 benchmark for the eighteenth successive year.

Doubtless, if the transformation of the financial sector in the UK economy had been used to channel the huge pool of financial capital it has created into productive uses rather than rent-seeking, we would undoubtedly have witnessed a very different growth and productivity record towards the end of the 20th century and the start of the 21st century. For example, in the UK only around 10 per cent of bank lending goes towards company and enterprise investment out with commercial property.

As we saw in our discussion of the Smithian toolkit, Smith and other Classical economists were highly critical of the mercantilism model, exemplified by the East India Company, which was in fact the forerunner of crony capitalism. At its heart mercantilism exhibited all the classic traits of modern-day crony capitalism, such as political lobbying, grossly excessive financial returns, and growing inequality. Indeed, as Norman (2018) notes "Smith appears as the first person to present a comprehensive analysis of what Crony Capitalism amounts to, and why it is damaging to business and government alike".

Although Smith did not provide a theory of economic rent he took a very dim view of the use of non-competitive means, such as political lobbying, subsidies or exemptions and monopoly power, to sustain excess returns. Second, as we noted in the toolkit Smith did not always see the invisible hand producing an optimal outcome and one important reason for this is that he recognised that there were important asymmetries of information and power between different agents in the marketplace which in turn allowed market players to exploit and obtain unfair advantage from others.

For example, Smith highlighted the fact that merchants' meetings often ended in 'a conspiracy against the public or in some contrivances to raise prices'. Third, Smith raised the principal-agent problem that arises for the joint stock company that we discussed in the previous section and argued that this could lead to an inferior performance of the joint stock company relative to that of a privately run company: '… being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own'.

The following quote from Norman (2018) encapsulates Smith's view of crony capitalism:

> Smith's idealistic vision of an economy according to the 'natural progress of liberty' ……specifically inhibits people from amassing large concentrations of wealth, profits are competed away; wages are high; land is widely distributed; inheritances are shared and taxes actively applied can in principle be onerous. Meanwhile government acts to support education, improve public works and prevent market-manipulation and rent extraction. This is not crony capitalism in any of its many varieties but its antidote.

In essence, crony capitalism represents a classic case of the corruption of moral values that Smith recognised could undermine his Commercial Society, and its spread during the neo-liberal era has played a key role in the breakdown of pre-neo-liberal norms and values and the creation of the current social order.

[7] Rent is unearned income over and above the returns generated in competitive markets.

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5.4. Inequality

The modern-day capitalist model has undoubtedly created unprecedented wealth leading to the great enrichment of many, with people having access to goods and services only kings, queens and the aristocracy could have dreamt of in the past. However, the model has also created unprecedented inequalities of income and wealth. Diamond (2019) argues that inequality in the form of the "enormous differences in standard of living between the world's peoples destabilising our globalised existence" is one of the four "existential threats" facing mankind today (the others being nuclear war, climate change and the unsustainable use of essential resources).

In the UK in 2022, households in the bottom 20 per cent of the population had disposable income of £13,218, whilst the top 20 per cent had £83,687 while the richest fifth had an income more than 12 times the amount earned by the poorest fifth. Further, since 1980, the share of income earned by the top 1 per cent in the UK has generally been rising, peaking at 14.7 per cent in 2007 before the financial crisis. For the whole world, the top 1 per cent earn 20 per cent of the total income.[3] Depending on the method calculation, the top 1 per cent's share of net household income rose to a new high in 2019 and continued to increase.[8]

Wealth in the UK is even more unequally divided than income. In 2020, the ONS calculated that the richest 10 per cent of households hold 43 per cent of all wealth. The poorest 50 per cent, by contrast, own just 9 per cent. Additionally for the UK, the top 0.1 per cent saw their share of total wealth double between 1984 and 2013, reaching 9 per cent. Worldwide, the top 0.01 per cent of the population owned 11 per cent of the global wealth by 2021, part explained by the growth in the super rich billionaire class.

There is little doubt from his writings that Smith was of a strongly egalitarian disposition and found income and wealth inequalities morally and economically indefensible since, for example, they prevented the poor from having a better chance to compete through education. As we have noted in our discussion of the toolkit the key thread in the WN is that of *Universal* Opulence with the emphasis being as much on the Universal, if not more so. As Norman (2018) notes regarding Smith's views on inequality: 'When the interests of the rich and poor clash, his instincts and arguments are almost without exception on the side of the poor. It is the poor, not the rich, who suffer from the restrictions on movement which he condemns. It is the worker and not the master who suffers from Parliament's decision to set an upper limit and not a lower limit on wages.'

Smith's egalitarian tendencies are confirmed in the following quote by Thomas Malthus:

> The professed object of Dr Adam Smith's inquiry is the nature and causes of the wealth of nations. There is another inquiry, however, perhaps still more interesting, which he occasionally mixes with it. I mean an inquiry into the causes which affect the happiness and comfort of the lower orders of society, which is the most numerous class in every nation (Malthus, 1992).

As we noted in Section 2.1.1 in Smith's theory of value he focuses on the real price of goods as the best measure of social welfare and his proxy for the real price was the price of corn as a proxy for his real price and one of his key reasons for so doing was because 'Corn, besides, or whatever else is the common favourite vegetable food of the people, constitutes in every civilised society, the principle part of the subsistence of the labourer' (WN). In Smith's time since the working poor made up the vast majority of the population the price of corn could be taken as a measure of societal welfare and:

> What improves the circumstances of the greater part can never be regarded as an inconvenience to the whole. No society can surely be flourishing and happy, of which the far greater part of the numbers are poor and miserable. It is but equity, besides, that they who feed, clothe, and lodge the whole body of the people, should should have such a share of the produce of their own labour as to be themselves tolerably well fed, clothed, and lodged (WN).

[8]The inequality numbers here are taken from the equality trust https://equalitytrust.org.uk/scale-economic-inequality-uk.

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Smith's egalitarian position can be further illustrated by his views on wealth accumulation and taxation. Smith did not place any great emphasis on the accumulation of wealth. In the WN, for example, he noted 'All for ourselves and nothing for other people seems, in every age of the world, to have been the vile maxim of the masters of mankind' and as we noted in his Lectures on Jurisprudence he is extremely critical of institutions that allow the consolidation of property, such as inheritance laws, primogeniture and entails and he sees the rich in every age as having a tendency to dissipate their fortunes through vanity and self-love. In our discussion of the TMS, we noted that Smith did not defer to the rich and powerful and despise the poor.

Smith's view of inequality can also be inferred from his views on taxation, of which fairness was at the forefront. In this regard, Smith stressed proportionality and the ability to pay with respect to taxation and there is also evidence that he favoured progressivity with respect to some taxes, such as land taxes. 'A tax upon house-rents, therefore, would in general fall heaviest on the rich; and in this sort of inequality there would not, perhaps, be anything unreasonable. It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than that proportion' (WN).[9] Smith was also in favour of inheritance taxes that encouraged wider, fairer, and more productive ownership of a nations' wealth.

5.5. Natural capital

Natural capital 'is the world's stock of natural resources, which includes geology, soils, air, water and all living organisms. Some natural capital assets provide people with free goods and services, often called ecosystem services. All of these underpin our economy and society, and thus make human life possible' (Wikipedia). As we have noted, for Smith land played an important role in the production process as a provider of food and he also emphasised the importance of property rights in minerals and in fishing and he recognised the importance of natural capital as the following quote from the WN demonstrates:

> In agriculture…Nature labours along with man: and though her labour costs no expense to produce has its value as well (WN).

That said, given environmental issues were not an issue in Smith's day and that throughout history nature has delivered its bounty it is perhaps understandable that Smith did not explicitly include natural capital in his theory of value and, as we saw in Section 2.1.1, neither did David Ricardo in his development of the theory of value. As Desai (2021) notes, it was for the last of the Classical Economists, Karl Marx, to explicitly recognise the importance of nature and the natural environment alongside labour in the value chain:

> Labour is not the source of all wealth. Nature is just as much the source of use values (and it is surely of such that material wealth consists) as labour, which is itself is only the manifestation of a force of nature, human labour power……And insofar as man from the beginning behaves towards nature, the primary source of all instruments and subjects of labour as an owner, treats her as belonging to him, his labour becomes the source of use values, therefore also of wealth (Marx, 1875).

Parts of natural capital, land, for example, are privately owned and as Smith recognised private land bears a return in terms of rent. However, large parts of natural capital are regarded as natural property and effectively belong to everyone and, crucially, as such are effectively free inputs into the production process and are priced in the production process and therefore represent a classic case of an externality. Helm (2015) argues the complexity and heterogeneity of natural capital means that the classic economic

[9] For a wider discussion of Smith's progressive views on taxation see, for example, Schliesser (2017).

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solution to the externality issue, in terms of the Pigovian adjustment of market prices to reflect the true social costs, including the use and depreciation of nature, would not be straightforward.

As we noted in Section 5.2, the modern corporation's focus on shareholder value has greatly exacerbated the depletion of natural capital and we argued there that one key way in which this externality issue could be addressed would be by repurposing the objectives of the company to include all forms of capital, including natural capital, in the firms' balance sheet. Helm (2015) argues that to ensure that the aggregate level of natural capital in a society does not decline, natural capital should be incorporated into national accounts in addition to its inclusion in corporate accounts. Given Smith's view of the corporation, and his recognition of the potentially damaging implications of not addressing externalities, we believe he would be in favour of Helm's proposal. Additionally given that Smith in his critique of mercantilism was against the subsidies and tariffs that underpinned their model, it would seem likely that he would be against the direct subsidies the fossil fuel industry achieves each year, which the IMF calculates as $300bn. The IMF also calculates that the fossil fuel industry gains a further subsidy to the tune of $5 trillion due to the external costs of the pollution and global warming resulting from the excessive use of fossil fuel (Pitt-Watson, 2021).

Carney (2021) argues that to address the depletion of natural capital and the impact of that on the environment that the mandatory reporting of climate-related risks is instituted in accounting practices. Carney sees the emergence of ESG measurement and investing as the most positive contribution to address the depletion of natural capital and more generally the creator of stakeholder value. Carney emphasises the broad range of ESG investment possibilities that now exists in the financial sector, from 'finance first' strategies, that seek to generate competitive financial returns, to impact first strategies, which accept below-market returns, at the other end of the spectrum.

A further way to maintain and rebuild natural capital is by rebuilding social capital, to which we now turn.

5.6 Social capital

As we have argued, it is clear from Smith's writings that markets, and indeed society, are generally sustained by trust and confidence and that the trust-building process must start with the government and other institutions such as the modern-day corporation. The central role of trust in creating a well-balanced and productive economy has been lost in the development of the neo-liberal economic model, in large part because of its focus on economic man in isolation from the society in which he operates. However, the importance of trust in the smooth working of the modern capitalist economy has been emphasised by several modern-day commentators such as Fukuyama (1999) and is central to the concept of social capital. The rebuilding of social capital is central to addressing the above-noted ills generated by the neo-liberal policies pursued post-1970.

Social capital is a relatively modern concept, attributable to the initial paper by Hanifan (1916), but it is one which has a strong relationship to the writings of Smith. Social capital means different things to different people and there is no single widely accepted definition, but there is a commonality of the relevant factors and concepts that underpin the various interpretations and particularly the focus on trust.

For example, social capital has been described as 'an instantiated set of informal values or norms shared among members of a group that permits them to cooperate with one another. If members of the group come to expect that others will behave reliably and honestly, then they will come to *trust* one another' and "…a nation's well-being, as well as its ability to compete, is conditioned by a single, pervasive cultural characteristic: the level of *trust* inherent in that society" (Fukuyama, 1999). Similarly, it is argued that social capital 'generally refers to *trust*, concern for one's associates, a willingness to live by the norms of one's community and to punish those who do not' (Bowles and Ginitis, 2002). For others, 'social capital refers to connections among individuals—social networks and the norms of reciprocity and *trustworthiness* that arise from them' (Putnam, 2000). The Office of National Statistics refers to

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social capital "as a term used to describe the extent and nature of our connections with others and the collective attitudes and behaviours between people that support a well-functioning, close-knit society". Clearly all these definitions of social capital have a strong association with Smith's arguments in the TMS and particularly in underpinning the values and norms-based element of the standards of conduct discussed in Section 2.2.

Trust is the key word that captures the central element of what social capital is about and the literature demonstrates that mutual trust underwrites our interactions, whether they are private, social, economic or political in nature. From an economic perspective, firms can benefit from the cooperative trust embodied in various types of networks, since this can reduce transaction and monitoring costs, and help to facilitate an efficient allocation of resources. In contrast, society wastes resources when people distrust each other and are dishonest. For example, management may have to introduce complex monitoring and surveillance systems in the workplace to ensure staff to fulfil their work time obligations. At the macroeconomic level, it has been demonstrated that inter-personal trust is strongly linked to GDP growth (Knack and Keefer, 1997) and it has also been shown that 'trust-based cooperative relations' between different organisations have contributed to the competitive advantage of manufacturing enterprises in Germany and Japan, as well as in parts of Italy (Humphrey and Schmitz, 1998).

Putnam (2000) used a meta-analysis to track the development of social capital in the United States over time and found "For the first two-thirds of the twentieth century a powerful tide bore Americans into ever deeper engagement in the life of their communities, but a few decades ago—silently, without warning—that tide reversed, and we were overtaken by a treacherous rip current". Thus, social capital increased in the US until the start of the neo-liberal period and then suddenly decreased right up to the present. Putnam found that this theme is consistent across seven separate measures of social capital, including: political participation, civic participation, religious participation, workplace networks, informal networks, mutual trust, and altruism. Given the importance of Social Capital, Putnam's findings have led to the US Congress Joint Committee setting up a Social Capital Project which confirms and reinforces Putnam's findings at US State level.

The US Congress Joint Committee report (2021), stemming from its Social Capital Project documents long-term declines in the health of American associational life along a number of dimensions, including membership of a church or synagogue; union membership has plummeted; social interaction with neighbours and co-workers has declined; rich, middle class, and poor are less likely to live alongside each other; trust and confidence in our fellow man has eroded, along with government, policymakers, the media, banks, newspapers, big business, organised labour and the medical system. In short, the report concludes that "our institutions of civil society have weakened and withered, and our relationships have become more circumscribed".

In the UK the ONS collects data on various measures of social capital, including a measure of trust, and the most recent data on this, collected in March 2021 and published in 2022, shows a long-term decrease since 2014–2015 in the percentages of people agreeing that others in their neighbourhood can be trusted (a fall of 8.0 percentage points) and that people in their local area are willing to help their neighbours (a fall of 7.2 percentage points). MacDonald (2021) noted that the ONS survey of social capital published in 2020 which included data up to the end of 2019 showed a dramatic decline in the general public's trust in national government from 2017 to 2019, falling from 32 to 21 per cent. MacDonald predicted that this percentage was likely to worsen during the COVID period given the way in which COVID had been handled with the various government scandals that arose. It is interesting to note that the latest ONS survey, noted above, no longer contains data on governmental trust.

The latest data for the development of social capital in Scotland was published in February 2020. The Scottish social capital measure was stable at the 100 mark between 2013 and 2017 but fell in the two subsequent years, to 93 points by 2019. The change between 2017 and 2019 has been driven by the decrease in the social capital themes of 'empowerment', 'networks' and 'participation' (volunteering).

How can social capital be rebuilt in the post neo-liberalism era to facilitate the kind of balance that existed in Smith's Commerce Society between economics and society? First, comparisons have been

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made between the end of the so-called 'Gilded Age' in the United States (1870–1900) and the current period in terms of persistent inequality, polarisation and cultural self-absorption (Putnam, 2022). In reaction to the large inequalities in the Gilded Age, a diverse group of progressive reformists became prominent in civil society. These reformers created a huge range of groups, such as the Rotary Club and other societies with a community-based focus on socialising, service, and mutual aid. This movement created a vast store of social capital, which helped to foster widespread support for legislation to address such issues as labour reform, the monopoly power of corporations and inequality. To achieve a comparable reform today, policymakers may need to follow the lead of the progressive reformers of the Gilded Age and engage in an 'immense collaboration' (Putnam, 2022). Perhaps post-pandemic, other pressing concerns such as climate change or global inequality will be the galvanising focus that creates such collaboration, with the internet and social media playing a supporting role.

In its recommendations for rebuilding US civil society, the US Congress Social Capital Report argues fundamental change in policymaking will be needed and, specifically, devolved policies that promote localism since a key element of devolution or subsidiarity is: "that if something can be more effectively done at a smaller, more local, and less centralized level than at a larger, more distant, and more centralized level, it should be". This advice has a strong resonance in a UK context where it is widely accepted that political decision-making in the UK and Scotland is over-centralised. As a result, in many communities, the level of perceived influence over local decision-making has been consistently low in recent years. Decentralisation of decision-making could therefore give people in local communities a greater incentive to get involved in local governance, building stronger local-level social networks in doing so and the US report notes how this could come about:

> Subsidiarity leverages local expertise and relationships rather than relying on far-off and impersonal bureaucracies. It allows a diversity of solutions to respond to a diversity of situations across the country instead of relying on one-size-fits-all approaches handed down from the federal government. By giving more responsibility to local residents and institutions, it provides valuable roles to community members they might otherwise lack. Further, by encouraging participation in local groups, subsidiarity provides us with firmly rooted identities, nurturing self-worth. That reduces the likelihood that people will cement their identities to non-local groups based on ideology or ethnicity that reinforce social and political polarization. … Finally, it forces local residents to interact to govern themselves, which then creates communal benefits. These benefits constitute social capital enjoyed by the whole community—strong institutions, dense and active social networks, and norms that encourage reciprocity and promote opportunity.

The report recommends five key policy areas to bring about a rebuilding of social capital: rebuilding civil society; making it more affordable to raise a family; increasing family stability; connecting more people to work and improving the effectiveness of investments in youth and young adults.

Other initiatives to boost social capital could include fiscal support, in the form of tax relief, for families that encourages or facilitates more parental involvement in the lives of children. These policies could work alongside government support for voluntary initiatives on the 'demand-side', with measures that encourage funding of organisations that make effective use of volunteers. There could also be 'supply-side' measures that encourage employers to offer time off for some sorts of community activity (OECD, 2000).

Carney (2021) persuasively argues that for markets to be dynamic and create value for all—the Universal Opulence of Smith—they need purpose and must reflect shared understanding and redeveloped trust-creating values. In this regard having strong institutions supporting fair and effective markets are the foundations for opportunity for all. Carney also emphasises that for formal institutions to be effective they have to be supported by the informal constraints—the informal rules of conduct—that we discussed in Section 2.2, and he argues that not only are underlying values and norms fundamental to the health of institutions they are institutions.

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Carney (2021) goes on to argue that to rebuild the social capital deficits that have accumulated over the years both firms and individuals must rediscover their sense of responsibility for the system. “More broadly, by rebasing valuation on society’s values, we can create platforms of prosperity for all that focus on solving our biggest problems….through shared understanding and values, we can channel the dynamism of markets for all” (Carney, 2021). Carney goes on to list what he sees as the core values required to build a healthy society—solidarity, fairness, responsibility, resilience, sustainability, dynamism and humility—and has an extensive discussion and a number of concrete examples of how to live and grow these values to everyone’s benefit. In the spirit of Smith, we would add compassion to Carney’s proposed set of societal values.

The OECD (2000) has argued that policies that support the greater use of information and communications technology could be used to help connect people with their local neighbourhoods, as well as more distant communities. Electronic networks can also serve to communicate information and ease market transactions, especially where matching information is lacking (OECD, 2000). There are undoubtedly inequalities in the ability to access technology, for example, high-speed broadband, and policy should therefore recognise the special need to target disadvantaged groups.

6. Concluding comments

The adoption of neo-liberal policies in the 1970s unleashed forces that have led to the polarisation of societies, including the UK and US. The consequences of neo-liberal policies litter the socio-economic landscape and include dramatic wealth and income inequalities, an overreliance on the financial sector and the associated rent-seeking, rather than productive activity, of those working in that sector, the re-emergence of crony capitalism, with political lobbying and anti-competitive objectives at its heart, the creation of monopolies in key sectors of the economy, and the depreciation of social and natural capital.

One of the main themes of this article has been that the use of neo-liberal policies, particularly with respect to corporate governance and the reinforcement of the market society, has led to the corruption of the norms and values that were central to Adam Smith’s view for the orderly functioning of his Commercial Society and by inference the modern capitalist economy. Relatedly, a further overarching theme in this article has been to demonstrate that the rational utility maximising *homo economicus* at the heart of the variant economic model underpinning neo-liberal polices is nowhere to be found in the writings of Smith and indeed, as we have demonstrated, his view of how individual citizens behave with the appropriate institutional structures in place is diametrically opposite to the neo-liberal position. In this concluding section, we summarise some of the key themes discussed in the article and conclude by noting some potential solutions inferred from Smith’s writing for the many ills created of neo-liberal policies.

As we saw in the discussion of the Adam Smith toolkit, the Smithian view of how the economy works is one in which economics is embedded in a multidisciplinary view of society, incorporating moral anthropology, philosophy, sociology and politics, in other words, political economy. Although Smith is regarded as the founding father of modern economics his view of economics is radically different to the modern economic paradigm and indeed to others in the Classical Economics tradition. The guiding principle of the Smithian system is that of natural liberty and, crucially, although for Smith such liberty enables the commerce that underpins an economy, it is also the case that Smith is equally interested in the opposite phenomenon of how commerce sustains liberty and the values of liberty for all: specifically, what is the nature of Commercial Society and how does it shape human norms and human personality? Much of the WN is an attack on the mercantilist system that prevailed in Smith’s time, and he regarded mercantilism as a form of what we refer to today as crony capitalism, with wealthy merchants using their power and wealth to lobby a weak legislature into implementing anti-competitive practices which resulted in the diversion of capital from its most productive means and emphasised rent-seeking. Deja vu?

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Although today the invisible hand is often touted by neo-liberals as a central contribution of Smith's work, and a *sine qua non* underpinning the efficient functioning of markets, we noted that this term appears only once in the Wealth of Nations and, even then, Smith did not refer to it in unqualified terms in the sense that his hand always produced an optimal outcome. Smith was also clear that markets were not homogenous in nature and had to be treated in different ways. As an empiricist, the concepts of efficient markets and rational expectations hypotheses governing the behaviour of markets would be completely alien to Smith. He was very clear, for example, that the financial markets of his day had to be closely regulated by the government to ensure trust in the system since the avoidance of systemic bank failures and panics was critical given the important implications this could have for the wider economy. Smith clearly recognised key issues of market failure, including the principal-agent issue, heterogeneity of information between markets and externalities. One of the key negative externalities that appears in the WN is in terms of the potentially corrupting influence of the division of labour on workers' intellectual and social virtues and Smith argued that this should be addressed by a government-funded education system. Smith also favoured the public funding of so-called public goods such as education, defence, and public health and for there to be limits placed on the ability of merchants to create monopolies.

Another feature of the neo-liberal model that we have noted in this article, and the variant of the neo-classical model that underpins it, is its focus on a very limited range of inputs into the production process, namely labour and capital, and the latter was circumscribed to include only physical and financial capital. However, the Smithian production process, although not defined by a neat equation, is clearly far richer and radically different than the neo-liberal view since it includes land, a key component of natural capital which has been completely overlooked in the development of the neo-classical model with all the implications this has had for the sustainability of the natural environment. The role of incentives has become so pervasive in the NLP that it has come to define the economics discipline, and once this happens the invisible hand is replaced by a manipulative 'heavy hand' (Sandel, 2012).

Additionally, Smith's view of capital included a key component of modern-day social capital, namely trust, which was created in a manner like that of several proponents of social capital, and Smith saw this central to the functioning of a healthy and productive society. And he also recognised the importance of natural capital. Although he was writing on the cusp of the industrial revolution, he would have clearly recognised that the principal agent issue in the joint stock company would have the potential to create unpleasant negative externalities for the natural environment. Given Smith's criticism of the mercantilists support for subsidies and tariffs he would have surely been against the massive fossil fuel subsidies which exist today, doubtless in large part due to the political lobbying of the oil industry.

A fundamental point contained in the WN regarding the role of government is in setting 'incorruptible' formal rules of conduct which Smith argued created the confidence in society to allow informal rules of conduct, such as norms of conduct, to flourish and produce a common collective commitment to civic ethics, thereby creating societal trust. This critical part of Smith's thinking is often overlooked and dovetails strongly with Smith's discussion of societal norms and values in the TMS. As we have noted, a key argument in the TMS is that 'our moral values and actions are a product of our very nature as social creatures': in forming our own moral views, the opinions and behaviour of those we interact with are key —it is this socialisation that is key to the creation of Smithian values and norms. In other words, it is social norms that influence our identity and attitude formation.

As we have argued, since institutions can generally be regarded as a set of formal or informal rules of conduct and can be conceptualised as implying standards of conduct that are based on explicit or implicit consensus between individuals, we have taken an institutional interpretation of part of the TMS and one that emphasises standards of conduct. The latter comprise both formal rules, such as legal or administrative rules, laws and regulations, and norms of conduct which imply informal and implicit consents, such as traditions, customs, conventions, and ethics. Informal rules of conduct, as contained in societal norms, can lead to a common collective commitment to civic ethics, and a social order based on trust. A social order arises when such social relationships are continuously maintained through the collective

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action of the members of the group, and it can be demonstrated that this collective action is consistent with the individualism of Classical Liberalism.

In contrast, the economic model underpinning the NLP is based on a different type of individualism, one in which if individuals abide by the formal rules of conduct, as contained in contract law, say, but the models' assumptions imply a lack of any social relationships, contracts aside, and therefore they do not need to abide by any informal norms or values that may exist in society. Neo-classical economists therefore come to consider society not as a collective of social relations but as the aggregate of individualistic actions missing all of the richness of Smiths central thesis. The social order that results from such behaviour will be very different to the Smithian social order which is underpinned by the rules of morality in addition to the rules of conduct. In essence, the neo-classical model is one which is geared towards providing social orders which are underpinned by the corruption of Smith's moral sentiments in terms of, for example, avarice and selfish ambition and that has been the consequence of neo-liberal policies.

How then can Smith's views be used to fix the ills created by the application of post-liberal policies? The first and most important would be the rebuilding of social capital and the reestablishment of societal trust to make markets work as Smith initially intended. As Smith clearly recognised, this must start at the highest level of government given the lobbying process along with the worst aspects of crony capitalism that exists in both the US and UK today. Given the importance of the corporation in the modern capitalist model strong and morally sound corporate leadership will also be required to support and reinforce government leadership. This will involve the creation or recreation of institutions that can achieve this. Only when such strong leadership is put in place can more widespread trust be created in civic society and societies values and norms can emerge. We have also argued that there are several other ways that Smith would have recognised as being crucial to rebuilding and revaluing societal norms and values.

Smith's views on the joint stock company are an important aspect of his thinking which is often overlooked but which gives a critically important insight into the operation and governance of the modern corporation, the successor to the joint stock company. The key issue for Smith was the divorce of ownership between the shareholders and directors of the company with the latter having their own interest at heart often to the detriment of the shareholder and the wider economy. As we have extensively argued, this key insight of Smith regarding the divorce of ownership or control of the modern corporation has created some of the key issues that have arisen because of adoption of the neo-liberal model.

The second key fix to restore trust and rebuild values and norms therefore would be in terms of addressing the governance issue of the modern corporation and we have highlighted two key proposals in this article. One is that of Mayer (2018) which involves resolving the governance issue by reformulating company law to require companies to articulate their purposes and to redefine the fiduciary responsibility along with a responsibility of companies to balance their production and usage of all the different types of capital entering their production process including social and natural capital, rather than a sole scrutiny of financial capital.

Carney (2021) argues that a company's purpose may need to be enshrined in its corporate structure to be effective and he notes that there is compelling evidence that purpose and commitment to values will help and not hurt a company's financial performance. Additionally, he argues that to assess the value creation of the corporation it is crucial that ESG factors are fully integrated and internalised into the governance, strategy, operations, and performance management of the corporation.

The third key area would be reversing the morphing of the market economy of Smith into the market society where capitalist market economics influences not just the exchange of goods and services in a society, but also directly impacts on, and helps shape, the personal attitudes, lifestyles, and political views of its people. In other words, in the market society, the market affects and undermines and corrupts the norms and values—such as solidarity, fairness, responsibility, and compassion—that are so central to the well-ordered functioning of a modern-day capitalist society. The market society has played its part in the creation of the neo-liberal social order with avarice and selfish ambition as its core values. It represents a corruption of moral sentiments. It is therefore for society to decide what the moral limits

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of markets and the pivotal role of incentives in modern economics should be since the more markets extend their reach into non-economic spheres of life the more they become mixed up with moral questions.

In conclusion, Adam Smith's views of how to create prosperous and equitable society are the key to addressing the issues raised in the Financial Times quote contained in the introduction. Given the main themes of this article, we would argue that Smith would not disagree with the views in the quote that government will have to accept a more active role in the economy and one key way it can do this is to kick start the trust building that is so desperately needed to rebuild societal social capital which has been so depleted during the neo-liberal period. As we have seen, Smith recognised the importance of strong and incorruptible government in achieving this. Such leadership along with other policy initiatives discussed in this article could help to rebuild a civic underpinned by values and norms that would produce a social order in which liberty, equity and prosperity were all given their rightful place. As we noted, Smith also favoured progressive taxation to achieve such an outcome and legislation to limit the vast inequalities of wealth that have arisen during the neo-liberal period. In sum, our society needs to move away from a version of capitalism that leads to the corruption of our moral sentiments, values and norms to one in which such corruption is extinguished. Three hundred years after Adam Smith's birth the central arguments laid out in the Wealth of Nations, The Theory of Moral Sentiments and in his Lectures on Jurisprudence are as relevant today as in his day in achieving such an outcome.

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