

# THE GENIUS OF ADAM SMITH

**Mark Skousen**  
**March 2026**

## About the author

**Mark Skousen**, PhD, is a presidential fellow at Chapman University, where he holds the Doti-Spogli Chair of Free Enterprise. He is also the Macroeconomist Strategist at the Oxford Club, and author of over 25 books, including *The Making of Modern Economics*, which makes Adam Smith the hero of modern economics. **Email: [mksousen@chapman.edu](mailto:mksousen@chapman.edu)**.

## About the IEA

Founded in 1955, the Institute of Economic Affairs is Britain's oldest free market think tank. Its mission is to improve understanding of the fundamental institutions of a free society by analysing and expounding the role of markets in solving economic and social problems.

The IEA is a registered educational charity. It is entirely independent of any political party or group and is wholly funded by voluntary donations from individuals, foundations, trusts and companies who support its mission.

It does no contract work and accepts no money from any government or government agency. The IEA retains full editorial control over all of its output.

The IEA holds no corporate position. The views in this publication are those of the authors alone, not those of the Institute, its managing trustees, Academic Advisory Council members or senior staff.

*This IEA Discussion Paper was published on 9 March 2026, in celebration of the 250th anniversary of the publication of Adam Smith's *The Wealth of Nations*. It is a revised version of a talk presented at the Panmure House in Edinburgh, Scotland, on 5 June 2023, in celebration of the 300th anniversary of the birth of Adam Smith, and Hillsdale College, Michigan on 5 November 2023.*

# Contents

Summary	4
The Adam Smith challenge	7
Imitating Newton	9
The three grand principles of Smith's system	11
How competition plays a critical role in moderating the passions	17
Mercantilism: How monopoly hurts the market system	20
The Adam Smith alternative to mercantilism	23
How economic growth feeds on itself	25
What should he call his model?	26
'The system of natural liberty'	27
The invisible hand at work	28
Smith's incredible prophecy	29
The Economic Freedom Index confirms Adam Smith's model	31
Conclusion	33
References	35

## Summary

- In *The Wealth of Nations*, Adam Smith argues that individuals pursuing their own self-interest can promote the public good when channelled through his ‘system of natural liberty.’
- Smith’s ‘system of natural liberty’ depends on three pillars—maximum individual liberty, tempered by justice (rule of law) and robust competition.
- Competition acts as a moral regulator by disciplining greed and channelling self-interest into socially beneficial outcomes.
- Smith strongly opposed mercantilism and government-granted monopolies, arguing that economic freedom and free trade generate greater prosperity.
- Modern evidence, such as the Economic Freedom Index, supports Smith’s prediction that societies with greater economic liberty achieve faster growth and higher living standards.
- The Scottish philosopher’s model achieves a hat trick: maximum liberty, individual improvement, and public benefit, all at the same time.

‘Adam Smith did for economics in many ways like what Charles Darwin did for biology ... a new framework’ – Wesley Mitchell (2021 [1934]: 13)

‘*The Wealth of Nations* ... is the most important book ever written about capitalism and its moral ramifications ... it was intended to make men better, not just better off’ – Jerry Z. Muller (2002: 51–2)

‘Adam Smith had one overwhelmingly important triumph: he put into the center of economics the systematic analysis of the behavior of individuals pursuing their self-interest under conditions of competition’ – George Stigler (1976: 1201)

‘When we read this work, we feel that previous to Smith there was no such thing as political economy’ – J.-B. Say (1827)<sup>1</sup>

---

1 J.-B. Say, letter to Louis Say in 1827; cited in Lai (2000: 81).

Adam Smith (1723–1790) has been labelled a multifaceted genius – for making the case for the specialisation and ‘division of labour’ as the key to economic growth and productivity ... for his devastating critique of protectionism that led to globalisation and free trade ... for revealing the counterproductive ‘unintended consequences’ of centralised planning under the mercantilist model ... and for popularising the term ‘the invisible hand’ to describe the market economy.

In this report, I’d like to follow up from my last lecture at Hillsdale College on the significance of the ‘invisible hand’ doctrine (Skousen 2012).

In *The Wealth of Nations*, Adam Smith undertook a bold and controversial course of action. He sought to find a way to transform the vice of private selfishness into a public virtue, and in doing so to build an economic model that could revolutionise human action – one that made people better, not just better off. He drew upon the assistance of contemporaries and past economic thinkers, but his own contribution deserves special praise. He was the first to ‘put it all together’. While the Scottish philosopher was far from perfect in the development of economic science, his unique achievement in perfecting this ‘invisible hand’ doctrine must be considered one of the greatest triumphs in modern history.<sup>2</sup>

---

2 My praise of Adam Smith is in sharp contrast to both Jesse Norman, who claimed that Smith was ‘no revolutionary’ (Norman 2018: introduction) and Murray Rothbard, who contended that Smith ‘originated nothing that was true, and that whatever he originated was wrong’ (Rothbard 1995: 435). Both failed to see the revolutionary and unique nature of Smith’s development of his ‘invisible hand’ doctrine.

# The Adam Smith challenge

In Adam Smith's day, giving citizens political democracy and economic freedom of choice was thought to be dangerous and could easily lead to chaos, anarchy and even violence. Hadn't such laissez-faire policies in the past led to social unrest, forcing the monarchy to impose order and the rule of law?

According to Benjamin Friedman,

*there was no presumption that people's pursuing their own self-interest, even if they perceived it correctly, would have any more broadly beneficial consequences. Quite the contrary – so much so that acting purely on one's individual self-interest was taken as a vice, and the standard adjective to such behavior was 'vicious'. Before then, the mercantilists of the seventeenth century had likewise been skeptical that individually motivated behavior could make a nation's economy better off; their approach was to run economic affairs from the top down.*

*(Friedman 2021: 30)*

According to the Scottish philosopher, humans could be honest, hard-working and fair in their commercial activities. At the same time they could be brutish, selfish, greedy, lustful, engage in commercial frauds and deception, and take advantage of government privilege to promote monopoly power, corruption and waste. In *The Wealth of Nations*, Smith warned that 'People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices' (Smith 1965 [1776]: 128).

At the end of Book I of *The Wealth of Nations*, Smith excoriated the wholesale traders:

*The interest of the dealers, however, in any particular branch of trade or manufacturers, is always in some respects different from, and even opposite to, that of the public. To widen the market and to narrow the competition, is always the interest of the dealers.*

(1965: 250)

Smith went further. He was suspicious of business people who seek to pass legislation in their favour:

*The proposal of any new law or regulation of commerce which comes from this order ... ought never to be adopted, till after having been long and carefully examined ... with the most suspicious attention. It comes from an order of men ... who have generally an interest to deceive and even oppress the public.*

(1965: 250)

How does one reconcile these statements from Adam Smith and his invisible hand doctrine that 'by pursuing his own interest he frequently promotes that of society' (Smith 1965: 423)?

Smith pondered his predicament: Was it possible to develop an economic model that would encourage the positive virtues of industry, thrift, prudence and benevolence and at the same time diminish the selfish passions of greed, selfishness and fraud? Smith's challenge was a tall order: How could individual decision-making lead to a self-regulating growing economy that would benefit all without taking away their freedom of choice?

# Imitating Newton

He was led to his discovery by studying and applying the principles developed by English scientist Sir Isaac Newton (1643–1727), who was famous for saying ‘If I have seen further, it is by standing on the shoulders of giants.’ For Adam Smith, Newton was one of those giants. Like most of his colleagues, he was deeply influenced by Newton’s discoveries of the laws of the physical universe, what Newton labelled the ‘system of natural philosophy’.

As Norris S. Hetherington states, ‘Adam Smith’s efforts to discover the general laws of economics were directly inspired and shaped by the example of Newton’s success in discovering the natural laws of motion’ (Hetherington 1983: 497).

Newton’s laws of motion explained an orderly and harmonious universe. Based on the three laws of motion, Newton could propose such universal laws as ‘gravitational pull is inversely proportional to the square of the object distant from the earth’.

By the same token, Adam Smith was inspired to create a Newtonian economics, where the economy, like Newton’s universe, was orderly and self-regulating, after observing some simple rules of human behaviour. And once this self-regulatory market mechanism was adopted, Smith insisted that it could catapult the world’s economies into ‘universal opulence that extends itself to the lowest ranks of the people’ (Smith 1965: 11).

You can even see in *The Wealth of Nations* how Smith tried to imitate Newton with the development of a market mechanism,

with numerous rules and laws of economic behaviour. In chapter III of Book I, Smith writes ‘that the division of labor is limited by the extent of the market’ (1965: 17). And in his discussion of the natural and market price, where supply and demand work together to create an equilibrating price, he writes in Book I,

*When the quantity brought to market is just sufficient to supply the effectual demand and no more, the market price naturally comes to ... the central price, to which the prices of all commodities are continually gravitating.*

*(1965: 57–8)*

# The three grand principles of Smith's system

What was the secret to Smith's system that allowed a free-market commercial society to function successfully in benefiting all and stabilising? Unfortunately, we don't find out his unique formula until p. 651 at the end of Book IV! After all his discussions of the division of labour, capital investment, wages and rents, the digression on silver and the tragic consequences of mercantilism, only then do we have a single sentence summarising the Adam Smith model.<sup>3</sup> But there it is, buried at the end of Book IV and as a way of introduction to government policy recommendations in Book V. Adam Smith finally describes his simple three-pronged formula this way in *The Wealth of Nations*:

*Every man, as long as he does not violate the laws of **justice**, is left perfectly **free** to pursue his own interest in his own way, and to bring both his industry and capital into **competition** with those of any other man, or order of men.*

*(1965: 651; emphasis added)*

You see from this quotation that Smith's model required three elements (emphasised) to work: justice, freedom and competition. Smith's basic model is one where economic freedom

---

3 Smith's tome is famous for being 'sprawling, inchoate and confused', to quote Rothbard (1995: 425). Consequently, like the Bible, *The Wealth of Nations* is subject to numerous interpretations. Every school of thought finds something useful in Smith's *magnum opus*.

is maximised under the conditions of dynamic competition and the proper rules of the game.

Let's see how Smith applied each element:

### **1: The need for justice and the rules of the game**

First, Smith saw a positive but limited role for government in the pursuit of justice. After introducing his model of prosperity, he argued for only three legitimate purposes of government: first, defence, as armed forces are necessary to protect society from invasion; second, policing and administering justice; and third, public works and certain institutions (such as public education).

His model calls for a strong rule of law. He was convinced that 'a tolerable administration of justice' is essential to a workable market economy. He favoured a legal system to protect liberty and property rights and an independent judiciary to enforce contracts and the payment of debts. In general, the Scottish professor supported a maximum degree of personal liberty in society, including a diversity of entertainment – as long as it was 'without scandal or indecency' (Smith 1965: 748). Smith was no pure libertarian.

In Book V, he immediately addressed the issue of taxation. He favoured 'easy taxes'. Excessive taxation and tariffs could lead to slow growth, black markets, bribes and corruption. He expressed sympathy to taxpayers 'continually exposed to the mortifying and vexatious visits of the tax-collectors' (Smith 1965: 880). After lambasting the complexity and inequality of the tax system, he prescribed tax cuts across the board, although he favoured rigid usury laws and some forms of progressive taxation.

To reduce the problem of smuggling, Smith advocated minimising the temptation to smuggle by cutting the duties on the most important classes of goods which were the subject of the smuggling trade, and cut them heavily. For instance, in the 1780s, the duty on tea amounted to 119% ad valorem, which more than doubled the price that the English consumer had to pay. Following Smith's policy, the prime minister William Pitt the Younger reduced the duty to 12%. The result was that smuggling became an unprofitable business so far as tea was concerned, and the great reduction of the rate of duty was followed by a considerable increase in the government's receipts from the duty. All the tea that had formerly been smuggled now passed through the customs, and the increase in the amount that went through was sufficiently great to offset the reduction of the duty by about ninefold (see Mitchell 2021: 79).

Smith's ideal society encouraged civility. It would be infused with virtue, mutual benevolence and civil laws prohibiting unjust and fraudulent business practices. Smith's 'impartial spectator' in *The Theory of Moral Sentiments* reflected the moral standards and judgement of the community (Smith 2000 [1759]: 217 passim). His economic man is cooperative and fair-minded without harming others. A good moral climate and legal system would benefit economic growth. Smith supported social institutions – the market, religious communities and the law – to foster self-control, self-discipline and benevolence (Muller 1995: 2). After all, Adam Smith was a professor of moral philosophy.

## **2: Free to pursue his own interest in his own way**

Second, Smith recognised that people were greatly motivated by self-interest. Self-love is a powerful ingrained drive, and to

reject it is to deny human nature. It is natural to look out for one's self and one's family above all interests. Humans will overcome almost any obstacle to improve their lot. Yes, Smith recognised the importance of sympathy towards his fellow man, but often self-preservation came first.

According to Mitchell, Smith believed that 'there was a Scotsman inside every man'. The Scotsman is famous for pursuing his self-interest, 'a person who was intent primarily upon pushing his own fortunes and who possessed a high degree of shrewdness in deciding what he could do best' (Mitchell 2021: 16).

To quote Smith directly: 'Every individual can, in his own situation, judge much better than any statesmen or lawgiver can do for him' (Smith 1965: 423).

Mitchell anticipates Hayek's argument in 'The Use of Knowledge in Society' when he states,

*The emphasis is on the fact that every man knows his own circumstances vastly better, in Adam Smith's language, in his local situation; he is a better judge as best to employ his capital than anyone in the distant capital of the country can.*

*(Mitchell 2021: 18; cf. Hayek 1945)*

According to Smith, ever the optimist,

*The natural effort of every individual to better his own condition ... is so powerful a principle, that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often incumbers its operations.*

*(1965: 508)*

Alan Greenspan rightly concludes,

*Adam Smith advanced a vision of a dynamic society in which wealth multiplied and opportunities abounded. In doing so, he performed a remarkable intellectual somersault. Until this point, people had generally regarded the pursuit of self-interest as, at best, unseemly, and at worst, sinful. Smith countered that, provided it took place within the constraints of law and morality, the purpose of self-interest boosts the well-being of the entire nation.*

*(Greenspan and Wooldridge 2018: 6)*

### ***3: The competitive marketplace***

But there was one vital missing piece in the search for an ideal society. For Smith, the deciding factor was the need for a robust competitive environment between sellers, buyers and workers.

Exchange of goods, services and money became the norm as citizens moved to the cities and nations engaged in more trade. But loving and caring for one's neighbour is also strong. The Judeo-Christian code, 'Love your neighbour as yourself' and 'Do unto others as you would have them do unto you' are constantly on their minds.

Smith wrote,

*But man has almost constant occasion for the help of his brethren, and it is in vain for him to expect it from their benevolence only. He will be more likely to prevail if he can interest their self-love in his favor, and shew them that it is for their own advantage to do him what he requires of them .... Give me that which I want, and you shall have this which you want, is the meaning of every such offer.*

*(1965: 14)*

As he declared in an earlier work, *The Theory of Moral Sentiments*: 'However selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others ...' (Smith 2000: 1).

According to Smith, the commercial society of production, consumption and exchange is mutually beneficial to both seller and buyer. The producer has the self-interest to maximise his gains, but in order to do so, he must respond to the needs of customers in trade. In a sense, commercial competition pushes people to be better citizens and to consider the needs of others. Those who focus best on the needs of others prospered the most.

According to Benjamin Friedman, the competitive marketplace pitted the passions of greed and money-seeking against one another in a way that directs 'the underlying energy to some worthwhile purpose' (Friedman 2021: 83).

# How competition plays a critical role in moderating the passions

Smith ultimately concluded that a vibrant competitive system would energise a commercially viable society. It might not abolish business deception and frauds, but it would moderate the passions, encourage self-discipline and reward customer loyalty. His new model was a self-governing system that would lead to peace and prosperity for all.

Competition is a powerful tool. The ability of customers and suppliers to move their business elsewhere is a huge incentive to encourage customer service. Smith himself wrote that it is his fear of losing customers 'which retrains his frauds and corrects his negligence' (1965: 129). In sum, a vibrant competition would channel the actions of greed and selfishness into a good outcome of satisfying customer needs and happy workers. As Benjamin Friedman explains, 'Fishmongers or butchers who gained a reputation for cheating their customers, or even just treating them rudely, would see their prospective trade move on to the next stall ... Surly or uncooperative workers would earn no wages' (2021: 82). In short, 'the dictates of the marketplace had a natural affinity for civil behavior' (2021: 82).

As Robert Heilbroner summarises,

*Self-interest ... drives men to action .... [But] a community activated only by self-interest would be a community of ruthless*

*profiteers. This regulator is competition, the socially beneficial consequence of the conflicting self-interests of all the members of society. For each man, out to do his best for himself with no thought of social cost, is faced with a flock of similarly motivated individuals who are in exactly the same boat .... A man who permits his self-interest to run away with him will find that competitors have slipped in ... will find himself without buyers in the one case and without employees in the other. Thus very much as in the Theory of Moral Sentiments, the selfish motives of men are transmuted by interaction to yield the most unexpected of results: social harmony .... The ... market is that it is its own guardian. If output or prices or certain kinds of remuneration stray away from their socially ordained levels, forces are set into motion to bring them back to the fold. It is a curious paradox which thus ensues: the market, which is the acme of individual economic freedom, is the strictest task master of all.*

*(Heilbroner 1995: 55–7)*

Smith followed the lead of Baron Charles Montesquieu, who taught commerce ‘cures destructive prejudices ... it polishes and softens barbarous mores .... The natural effect of commerce is to lead to peace’ (Montesquieu 1989 [1748]: 338). According to Montesquieu, Sir James Steuart and other *philosophes* of the era, the image of the merchant and moneymaker as a peaceful, dispassionate, innocent fellow was in sharp contrast with ‘the looting armies and murderous pirate of the time’ (Hirschman 1997: 63). Commerce improves the political order: ‘The spirit of commerce brings with it the spirit of frugality, of economy, of moderation, of work, of wisdom, of tranquility, of order, and of regularity’ (Hirschman 1997: 71). In short, it came very close to Newton’s universe of self-governing order.

Smith endorsed this progressive view of commerce. He taught that commerce encourages people to become educated,

industrious, punctual, dependable, self-disciplined and to defer gratification.

As a moral philosopher, Smith did not condone greed or selfishness. He would be uncomfortable with Ayn Rand's calling 'selfishness' a virtue or Walter Williams' labelling 'greed' a good thing. He accepted them as human frailties. However, Smith recognised that these base motives cannot be outlawed or prohibited, only that they could be discouraged and moderated in the commercial society, and could be channelled into positive action. As Dinesh D'Souza interprets Smith,

*Capitalism civilizes greed in much the same way that marriage civilizes lust. Greed, like lust, is part of our human nature; it would be futile to try to root it out. What capitalism does is to channel greed in such a way that it works to meet the wants and needs of society.*

(2005)

To sum it up, George Stigler said it best when he declared that the role of competition is the crown jewel of Adam Smith's contribution to economics: 'Adam Smith had one overwhelmingly important triumph: he put into the center of economics the systematic analysis of the behavior of individuals pursuing their self-interest under conditions of competition' (Stigler 1976: 1201).

## **Mercantilism: How monopoly hurts the market system**

Smith concluded that competition is absolutely essential to turning self-interest into benevolence and creating a self-regulating system. He preferred the cheaper 'natural price, or the price of free competition' to the high price of monopoly power and 'exclusive privileges' granted certain corporations and trading companies (such as the East India Company). Smith vehemently opposed the 'mean rapacity' and 'wretched spirit of monopoly' (1965: 428) that privileged businessmen were accustomed to: Competition means lower prices and more money to buy other goods, which in turn means more jobs and a higher standard of living.

According to Smith, monopoly power granted by the state created a political society, characterised by flattery, fawning and deceit (Muller 1995: 135). Monopoly fosters quick and easy profits and wasteful consumption (Smith 1965: 578). Today we would call it 'crony capitalism'. He was no apologist for merchants and special interests who sought privileges from the state. He sought to convince legislators to resist supporting the vested interests of business people and instead to act in favour of the common good.

Books IV and V were devoted to an attack of the commercial monopoly model known as mercantilism. During his lengthy research, Smith came to the conclusion that the contemporary system of mercantilism was a gigantic failure. One of the reasons Smith's book is so long is that he meticulously detailed

the extensive interference by the state into the economy. He spent much of the second volume (Books IV and V) lambasting government mismanagement of the economy, what he himself called ‘the very violent attack I had made upon the whole commercial system of Great Britain’ (quoted in Phillipson 2010: 247). As Wesley Mitchell noted, the government was wickedly engaged in a

*series of ingenious regulations concerning the terms on which goods might be imported from abroad or exported ... a very elaborate and detailed tariff policy ... the government should definitely encourage certain lines of manufacture by direct grants of bounties or monopoly privileges ... the government should determine the conditions for entrance to every trade ... it should adopt sufficient apprenticeship rules ... the government should lay down the terms of admission to any occupation ... the government should regulate or supervise the wages that were obtained. And so, for almost the whole of economic life; that the government should have a detailed economic policy which requires active intervention in the affairs of the community in a thousand and one ways, all with the great purpose of achieving exactly the aim Adam Smith wanted to achieve; the most rapid possible increase in the country’s wealth.*

*(Mitchell 2021: 16–17)*

As a result of the never-ending bureaucracy of the entrenched state system, controlled by the commercial interests and political powers, there was little progress over the centuries in England and Europe.

Given the lack of progress, the traditional view was that the world’s economy was stagnating and its wealth fixed, so that one nation grew at the expense of another. Some individuals, well positioned in the hall of government, could do well, while

the vast majority suffered. The economies of ancient and Middle Age civilisations were based on either slavery or different forms of serfdom. Under either system, wealth was acquired largely at the expense of others or through exploitation. As Bertrand de Jouvenel observed, 'Wealth was therefore based on seizure and exploitation' (1999: 100). Consequently, the state established government-authorised monopolies at home and supported colonialism abroad, sending agents and troops into poorer countries to seize gold and other precious commodities. As Smith wrote, 'The encouragement of exportation, and the discouragement of importation, are the two great engines by which the mercantilist system proposes to enrich every country .... The great affair is to get money' (Smith 1965: 398, 607).

# The Adam Smith alternative to mercantilism

Clearly Adam Smith was not happy with the contemporary system of mercantilism and top-down authoritarianism. The next question was that if mercantilism was a bad policy that led to little or no growth, what was the alternative? You can't get rid of a bad idea until you come up with a better one.

Adam Smith came up with a way to achieve real prosperity for all: Give people their maximum freedom under conditions of competition and the rule of law (justice). Within those boundaries, citizens and businesses would have the freedom to do what they wished without interference from the state. It meant the free movement of labour, capital, money and goods. Let them decide on their own what to do.

According to Mitchell, Smith came to the conclusion

*that the wealth of nations will increase most rapidly if every person is allowed the fullest opportunity to decide for his own individual self what is the best way to use his labor and whatever capital he possesses. In other words, the best policy for governments ... is to interfere as little as possible with the occupations and investments of its citizens.*

*(Mitchell 2021: 15–16)*

Smith even went so far as to insist it was a God-given natural right to be free to act. He wrote:

*To prohibit a great people from making all that they can of every part of their own produce, or from employing their stock and industry in the way that they judge most advantageous to themselves, is a manifest violation of the most sacred rights of mankind.*

(1965: 549)

It was an ingenious solution: To the extent possible, government should get out of the way and let individuals and entrepreneurs work their magic.

There is evidence that Smith favoured this small government formula as far back as 1755, when he famously said, 'Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice; all the rest being brought about by the natural course of things' (Smith 1982 [1795]: 322).

Even more interesting are his follow-up lines: 'All governments which thwart this natural course, which force things into another channel, or which endeavor to arrest the progress of society at a particular point, are unnatural, and to support themselves are obliged to be oppressive and tyrannical' (1982: 322).

# How economic growth feeds on itself

An advancing economy, where the wealth of nations increases, has multiple benefits, perhaps even beyond what Adam Smith or Charles Montesquieu envisioned. Benjamin Friedman makes this point when he states that economic growth through technological advances and new inventions does more than moderate the passions, and improves discipline and educational achievement under a commercial society. Higher incomes also improve the moral standards of society by encouraging social liberalisation, democratic institutions and more leisure time to pursue the arts and entertainment. 'Its crucial elements include openness of opportunity, tolerance, economic and social mobility, fairness, and democracy' (Friedman 2005: preface). Indeed, Friedman argues that economic growth, and not just a high standard of living, is necessary to achieve this higher moral standard and to avoid the 'wage slavery' problem that Adam Smith warned about: 'the gross ignorance and stupidity which ... seem so frequently to denumb the understandings of all the inferior ranks of people' (Smith 1965). As Friedman warns, 'Even the wealthiest of nations puts its democratic values at risk when income levels stand still' (Friedman 2005: back page).

## What should he call his model?

Adam Smith was well aware of the French physiocrats calling their small government approach 'laissez faire', having spent three years in France in the 1760s.

Why then did he pass on the term 'laissez faire' in *The Wealth of Nations*? Probably because 'laissez faire' was too representative of 'unfettered capitalism', to use a modern term. For Adam Smith, it was not enough for the legislature to benignly do nothing in response to citizens' requests to 'let us alone'. Laissez faire put no limits on the human passions and seemed like a defence of selfishness and the 'greed is good' attitude.

## ‘The system of natural liberty’

Besides, he wanted a term that was his own, since he believed he had created a new mechanism for enduring prosperity. I believe he deliberately chose to imitate Newton’s ‘system of natural philosophy’ (natural philosophy was what the physical sciences were called in the 18th century). Ultimately, he called his revolutionary model ‘the system of natural liberty’, which he mentioned twice in the final chapter of Book IV, where he summarises his three-pronged model combining justice, freedom and competition. He calls it ‘the obvious and simple system of natural liberty’ (1965: 651). Sometimes he called it ‘perfect liberty’. Smith uses the term ‘natural liberty’ ten times and ‘perfect liberty’ sixteen times in *The Wealth of Nations*.

According to Brad DeLong, Smith chooses ‘liberty because it leaves people free to do what they want with their labor and their possessions, “natural” because it confirms with human nature, “system” because it can be and is extended to the status of a general principle’. DeLong summarises Smith’s vision:

*Let people decide what they want to do with their things and their labor, and they arrange themselves in a large highly-productive societal division of labor. Self-interest focuses people on creating value. Competition curbs any distracting focus of self-interest on accomplishing exploitation.*

(DeLong 2019)

## The invisible hand at work

Smith also sparsely used the metaphor ‘the invisible hand’ to describe his model. He figured if individuals and businesses maximised their freedom within the bounds of competition and justice, everyone – the whole public – would benefit. His most famous line is that every individual ‘is led by an invisible hand to promote an end which was no part of his intention .... By pursuing his own interest he frequently promotes that of society’ (Smith 1965: 423).

In a lecture I gave several years ago on Adam Smith at Hillsdale College, I made the argument that although the term ‘invisible hand’ is used only once in *The Theory of Moral Sentiments* (1759) and only once in *The Wealth of Nations* (1776), it is not marginal in its intent. In both books, ‘invisible hand’ mysteriously appears in the exact middle of the book, suggesting its centrality as a doctrine. God is an invisible God, and so are the actions of most private individuals.

Moreover, only a robust development of the three parts of his model – justice, competition and freedom – would benefit all participants and minimise the vices of capitalism. In sum, Adam Smith ingeniously created a sieve or filter so that when commercial agents passed through his ‘system of natural liberty’, it converted their selfish interests into the public weal. By doing so, the private actions of individuals ‘frequently’ promoted that of society. His model did not eliminate business deceptions and frauds, but it minimised them and moderated the passions.

## Smith's incredible prophecy

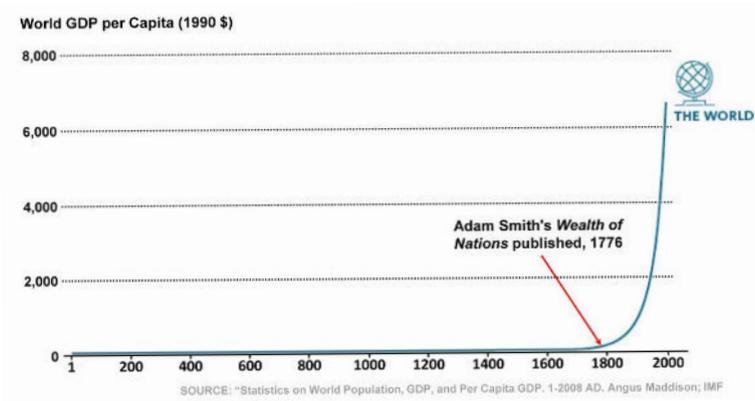
Adam Smith was excited about his new thesis. He promised that his three-pronged model would lead to 'universe opulence which extends itself to the lowest ranks of the people' (Smith 1965: 11). He led this promise for many years. As noted earlier, in 1755, he proclaimed, 'Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice; all the rest being brought about by the natural course of things' (Smith 1982: 322).

That was a huge promise, but it attracted the interest of not only the rich and the powerful but the common man. *The Wealth of Nations* offered a formula for emancipating the working man from the drudgery of a Hobbesian world. Now they would be liberated from 16-hour-a-day jobs, subsistence wages and a 40-year life span. Here was something that could capture the imagination and hope of not only the English worker but the French peasant, the German labourer, the Chinese dayworker and the American immigrant. The freedom to work or to start your own business could liberate everyone from the chains of daily chores.

Today we have several names close to it – laissez faire, free enterprise, the invisible hand and free-market capitalism. But Smith preferred 'the system of natural liberty'.

Indeed, his prediction proved to be prophetic, as Figure 1 demonstrates.

Figure 1: World GDP per capita (1990 \$)



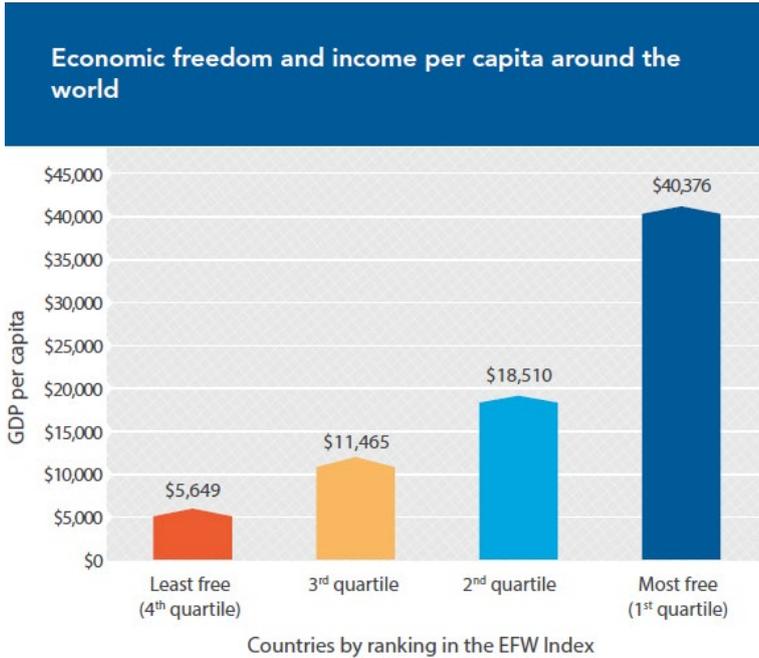
# The Economic Freedom Index confirms Adam Smith's model

In the early 1990s, under the direction of Michael Walker and the support of Milton and Rose Friedman, among others, the Fraser Institute developed an empirical model to reflect Adam Smith's model. They sought to determine to what extent economic freedom leads to a higher standard of living. The annual report constructs an index measuring the level of economic freedom for more than a hundred countries, based on five criteria:

1. Size of government
2. Property rights and legal structure
3. Sound money
4. Trade policy
5. Regulation

Then they compared the level of economic freedom with their growth rates, based on per capita income in purchasing power parity terms. Their studies confirm that greater economic freedom leads to higher standards of living, and the poor countries in particular are better off when they liberalise their economies (Figure 2).

Figure 2: Economic freedom and income per capita around the world



Sources: James Gwartney, Robert Lawson, and Joshua Hall, *Economic Freedom of the World: 2018 Annual Report*, Fraser Institute, 2018, p. 18. Income per capita is the 2016 GDP per capita measured at purchasing power parity in constant 2011 US dollars, from the World Bank's 2017 *World Development Indicators*.

Moreover, countries that adopt more liberalised economic policies tend to grow faster. 'Countries with low initial levels of income, in particular, are able to grow rapidly and move up the income ladder when their policies are supportive of economic freedom' (Gwartney, Lawson and Hall 2013: 38). In addition, the poorer 10% of the world's population earn more income when they adopt institutions favouring more economic freedom (2013: 22).

# Conclusion

For those pundits who claim that Adam Smith was no advocate of laissez faire, or that he was more a social egalitarian than libertarian, I'll end with the following observation:

What did Adam Smith call his model? He did not call it 'the system of social justice'. He did not call it 'the system of economic equality'. No, he called it 'the system of natural liberty'. Liberty was his greatest ideal.

If Adam Smith saw our world today he would be impressed with the dramatic rise in the standard of living, convinced that much of it was due to the influence of his policies, especially globalisation. He would not be surprised by American exceptionalism. After all, in 1776, he predicted that America would become 'one of the greatest and most formidable [countries] that ever was in the world' (Smith 1965: 588).

At the same time, he would no doubt have a violent reaction to the growth in the size and scope of government intervention, the massive national debt, complex and high tax rates, and would probably wonder if he was witnessing another round of mercantilism and a movement away from his ideal model of natural liberty.

Yet I suspect he would remain an optimist as he was in 1776 when he wrote:

*The uniform, constant, and uninterrupted effort of every man to better his condition ... is frequently powerful enough to maintain*

*the natural progress of things toward improvement, in spite both of the extravagance of government, and of the greatest errors of administration.*

(1965: 326)

## References

Danhert, C. E., ed. (1974). *Adam Smith, Man of Letters and Economist*. Exposition.

DeLong, B. (2019). Adam Smith: society & the 'system of natural liberty' ([www.bradford-delong.com](http://www.bradford-delong.com))

D'Souza, D. (2005). How capitalism civilizes greed. ([www.dineshsouza.com/articles/civilizinggreed.html](http://www.dineshsouza.com/articles/civilizinggreed.html))

Friedman, B. M. (2005). *The Moral Consequences of Economic Growth*. Random House.

Friedman, B. M. (2021). *Religion and the Rise of Capitalism*. Alfred Knopf.

Greenspan, A. and A. Wooldridge (2018). *Capitalism in America: A History*. Penguin Press.

Gwartney, J. D., R. A. Lawson and J. Hall (2013). *Economic Freedom of the World*. Fraser Institute.

Hayek, F. A. (1945). The use of knowledge in society. *American Economic Review*, September.

Heilbroner, R. L. (1995). *The Worldly Philosophers*. 7th ed. Simon & Schuster.

Hetherington, N. S. (1983). Isaac Newton's influence on Adam Smith's natural laws of economics. *Journal of the History of Ideas* 44(3): 497–505.

Hirschman, A. O. (1997). *The Passions and the Interests*, 2nd ed. Princeton University Press.

Jouvenal, B. de. (1999). *Economics and the Good Life: Essays on Political Economy*. Edited by Dennis Hale and Marc Landy. Transaction.

Lai, C.-C. (2000). *Adam Smith Across Nations: Translations and Receptions of The Wealth of Nations*. Oxford University Press.

Mitchell, W. C. (2021) [1934]. *Lecture Notes on Types of Economic Theory*. Hassell Street Press.

Montesquieu, C. (1989) [1748]. *The Spirit of the Laws*. Cambridge University Press.

Muller, J. Z. (1995). *Adam Smith in His Time and Ours*. Princeton University Press.

Muller, J. Z. (2002). *The Mind and the Market: Capitalism in Modern European Thought*. Knopf.

Norman, J. (2018). *Adam Smith, Father of Economics*. Basic Books.

Phillipson, N. (2010). *Adam Smith: An Enlightened Life*. Yale University Press.

Rothbard, M. N. (1995). *Economic Thought Before Adam Smith*. Edward Elgar.

Skousen, M. (2012). The centrality of the invisible hand. Lecture, Center for Constructive Alternatives, Hillsdale College, 31 January.

Skousen, M. (2022). *The Making of Modern Economics*. Routledge.

Smith, A. (2000) [1759]. *The Theory of Moral Sentiments*. Prometheus Books.

Smith, A. (1965) [1776]. *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. Edward Cannan. Modern Library.

Smith, A. (1982) [1795]. *Essays on Philosophical Subjects*. Liberty Fund.

Stigler, G.J. (1976). The successes and failures of Professor Smith. *Journal of Political Economy* 84(6): 1190–1213.

The Institute of Economic Affairs  
2 Lord North Street  
London SW1P 3LB  
Tel 020 7799 8900  
email [iea@iea.org.uk](mailto:iea@iea.org.uk)



**iea**  
Institute of  
Economic Affairs