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Adam Smith and the Ethics of Contemporary Capitalism

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ABSTRACT. This paper presents a theoretical elaboration of the ethical framework of classical capitalism as formulated by Adam Smith in reaction to the dominant mercantilism of his day. It is seen that Smith's project was profoundly ethical and designed to emancipate the consumer from a producer and state dominated economy. Over time, however, the various dysfunctions of a capitalist economy — e.g., concentration of wealth, market power — became manifest and the utilitarian ethical basis of the system eroded. Contemporary capitalism, dominated as it is by large corporations, entrenched political interests and persistent social pathologies, bears little resemblance to the system which Smith envisioned would serve the common man. Most critiques of capitalism are launched from a Marxian-based perspective. We find, however, that by illustrating the wide gap between the reality of contemporary capitalism and the model of a *moral* political economy developed by Smith, the father of capitalism proves to be the most trenchant critic of the current order.

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Introduction

The end of the Cold War has been interpreted by many observers as the victory of democratic capitalism over totalitarian socialism. To some, this victory represents the "end of history" (Fujiyama, 1991); that is, the end of an epoch in which two fundamentally contradictory ideologies of political economy, capitalism and socialism, competed for the hearts and minds of people throughout the world. As Eastern Europe, the former Soviet Union and mainland China surge toward market-based economies and (in some cases) democratic political systems, the West is less and less inclined to critically examine the state of its own economic and political institutions. However, most Western nations are themselves characterized by increasing structural unemployment, increasing crime, rising inequality, political apathy, and generally declining living standards. The demise of the Stalinist political economy in the East says very little about the absolute virtue of Western institutions, only that the Western model is relatively superior in fulfilling individuals' economic and political aspirations.¹

The time has come for a critical examination of the political economy of democratic capitalism in order to better understand the effectiveness with which this institutional system "delivers the goods" — in terms of both material comforts and political liberties — to the average citizen. For unless we understand what the system is capable of delivering and compare this to what it is currently providing, how can we hope to improve its functioning (which we take to mean making the political system more accountable and the economic system more effective in raising the mean standard-of-living)?

While critiques of capitalism, whether in its classical or contemporary forms, most often origi-

nate from a Marxian, neo-Marxian, or at least quasi-Marxian perspective, we find the most effective critic of contemporary capitalism to be Adam Smith himself. Indeed, several of Marx's basic criticisms of capitalism can be found in the work of Smith, who well understood both the promise and pitfalls of the economic system he theorized. Before we draw upon Smith to critique the ethics of contemporary capitalism, however, it is first necessary to review the ethical nature of Smith's political economy in an explicit manner rather than through a cursory reference to the magic of the Invisible Hand. For Smith's concerns were *primarily* ethical, and the economic system he devised was the *means* to achieve a more moral, ethical, and just social order — not an end in itself, as is so often implicit in the works of contemporary proponents of capitalism (Lux, 1990).

Adam Smith, ethics and capitalism

Capitalism has been interpreted as constituting a moral, immoral, or amoral system by social and economic theorists of various ideological persuasions. For example, defenders of capitalism like Michael Novak stress the aspects of consumer sovereignty, individual choice and responsibility, material progress, and (in Novak's case) even theological virtuousness (Novak, 1982). Critics of capitalism, on the other hand, focus on such negative aspects as the exploitation of labor, hyper-materialism, waste and environmental degradation, and a chronically unequal distribution of resources (Bowled and Gintis, 1986). Other observers maintain that capitalism is simply one of a variety of ways of organizing a nation's economic affairs and that it should be judged simply on its ability (or inability) to allocate resources in such a way as to sustain and extend a comparatively high standard-of-living for the average citizen (Heilbroner, 1985).

Each of the preceding perspectives has its merits as well as its drawbacks, yet each also largely ignores the normative orientation of Adam Smith as he developed the framework for a capitalist economic system over two centuries ago. In order to ascertain the deeply moral nature of Smith's project, one needs to approach his work with an awareness of the historical context in which it was formulated.

The period in which Smith completed his opus,

The Wealth of Nations (Smith, 1776), was known as the Mercantilist Era. Mercantilism was an economic system geared to maximize the power of the nation-state (itself a relatively new institutional form arising from the end of the Hundred Years' War and the Treaty of Westphalia in 1648) relative to other nation-states through pursuit of autarky (i.e., self-sufficiency). The mercantilist state attempted to maximize its exports while minimizing its imports from other states with which it was competing. Colonial possessions supplied the mercantilist state with raw materials as well as markets for its finished goods. In its quest for autarky, mercantilist political economy required a high degree of administrative centralization; it was thus consistent with non-democratic political institutions as well as non-competitive (i.e., monopolistic) domestic economic structures. Mercantilism benefited producers and entrenched interests at the expense of consumers and the growing middle classes, who were forced to pay inflated prices for domestically produced goods which were shielded from foreign competition by various protectionist mechanisms. As Smith stated, "It cannot be very difficult to determine who have been the contrivers of this whole mercantile system; not the customers, we may believe, whose interest has been entirely neglected; but the producers, whose interest has been so carefully attended to" (1776: 626).

Smith developed his model of a market driven, consumer-based economic system as an alternative to the political economy of mercantilism. Whereas mercantilism involved consumers subsidizing producers in a system of centralized (and thus authoritarian) economic and political structures, Smith envisioned a production system organized according to the consumer's interests (expressed as demand). Further, this new economic system oriented to maximizing the welfare of the economic consumer by providing goods and services according to the market forces of supply and demand would be compatible with a democratic political system oriented to maximizing the welfare of the citizen as a political consumer.²

The political economy Smith was advocating was thus based on maximizing consumer/citizen choice in both economic and political spheres. Smith's paradigm shifted the institutional emphasis from centralized to decentralized structures, from author-

itarianism to representative democracy, from monopoly to competitive markets, from autarky to international interdependence through a spatially expanding division of labor, and from producer appropriation of the societal surplus to consumer sovereignty. His system, which would later be called “capitalism”, was as revolutionary a concept with respect to the dominant mercantilism of its day as Marx’s communism was to the capitalism of the mid-nineteenth century. As Thomas Sowell (1979) observes,

It is impossible to appreciate fully the thrust of Adam Smith’s arguments concerning *laissez-faire* until he is regarded as very much, and very self-consciously, a social critic of eighteenth-century society . . . The concepts of *laissez-faire* and consumer sovereignty had some quite radical implications in Smith’s time. I do not wish to portray Smith as a radical in any of the twentieth-century meanings of the term, but in eighteenth-century Britain these were distinctly radical ideas, with radical policy implications (p. 34).

Classical capitalism: Smith’s caveats

While Marx’s critique of classical economics has proved to be the most influential, Smith himself had envisioned the potential weaknesses of his model. In a recent article, James Wilson notes five moral problems Smith associated with capitalism: impoverishing the spirit of the workers and the work ethic more generally, creating cities in which anonymity facilitated price-fixing, expanding the ranks of the idle rich, inducing government to foster monopolies and selective privileges, and separating ownership and control as the scale and capital requirements of business firms increased (Wilson, 1989). Following Wilson, we now turn to discuss some of Smith’s most significant fears about the potential dysfunctions of his paradigm.

Perhaps the dysfunction Smith feared most was the concentration of economic resources by monopolistic joint-stock corporations. He wrote at length about the abuses of such monopolistic joint-stock companies as the East India Company, the Hudson’s Bay Company, and the South Sea Company (Wilson, 1989). As noted by Ginzberg (1979), “Smith’s concerns about the evils of monopoly went beyond the unjustified rewards that accrued to the man who was

able to rig the market. A still more untoward consequence of monopoly was the ineffective management that in Smith’s view was the likely concomitant of an entrepreneur’s being sheltered from the cold winds of competition” (p. 41).

Smith also expected that concentrated economic resources could be readily translated into political influence, which he considered similar to other commodities for which there was a supply and demand. Smith was particularly scathing with regard to the political powers exercised by economic interests. He warned that legislative proposals emanating from the business sector

ought always to be listened to with great precaution, and ought never be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. [Such legislation] comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it (1980: 359).

His advocacy of an economic system based on small producers, each lacking the ability to affect prices through the exercise of market power, thus had direct political implications. Competitive markets would ensure that no producer assumed a dominant position from which it could influence the market either directly (through price-fixing, predatory pricing, etc.) or indirectly (through privileges obtained from political influence).³

Smith also recognized the necessity of a strong work ethic to provide the twin dynamics for increasing productivity and accelerating capital accumulation.⁴ In this vein, he noted that “Capitals are increased by parsimony [frugality], and diminished by prodigality and misconduct” (1980: 437). As the worker became productive, better paid, and saw his standard-of-living rise, however, he demanded more leisure time and engaged in increasingly conspicuous consumption. This shift in emphasis from the virtues of productivity, frugality, and responsibility to leisure and consumption-related activities undermined the basic normative and behavioral foundations of classical capitalism.

This paradox, that a capitalist system might fall victim to its own material successes (and excesses) as the social emphasis shifted from production to con-

sumption and the values necessary to sustain labor productivity and capital accumulation lost their influence, was the focus of much significant work by Thorstein Veblen at the turn of the twentieth century (Veblen, 1963). Joseph Schumpeter also took up this issue a few decades later in *Capitalism, Socialism and Democracy* (Schumpeter, 1946), as did Mancor Olsen still later in *The Rise and Decline of Nations* (Olsen, 1982). It was Adam Smith, however, who first identified this paradox in his observation that "the principle which prompts to expense is the passion for present enjoyment" (1980: 441). He was particularly concerned that the industriousness of the middle and working classes would be undermined by their desire to emulate (through demonstration effects) the extravagant behavior of the rich and famous, whose virtues he was extremely dubious of (Wilson, 1989).

Smith also recognized the inevitability of market failure in the provisioning of public goods and the consequent need for government intervention to ensure that services that could not be rendered profitable (e.g., fire protection) because of free-rider problems would nonetheless be available to the public. As Rosenberg (1979) observes, "there is nothing in Smith that is inherently opposed to legislation of a protective nature or to restrictions upon the natural liberty of individuals, where such restrictions are likely to advance important social goals" (p. 27). Of course, the alternative to universal, publicly funded provisioning of essential services is selective, privatized provisioning of those services on an ability-to-pay basis. This exclusionary method of supplying what Smith would have defined normatively as universally essential services was (and is) contrary to the progressive nature of his paradigm.

Finally, Smith perceived the threat the ever increasing capitalist division of labor posed to the humanity of the working classes. The routinization of work and the progressive deskilling of the worker made possible by segmentation and specialization processes threatened to create a society of automata with few skills, interests, or objectives save the vulgar pursuit of the pleasure principle. Smith feared that the division of labor would drive most men to become

as stupid and ignorant as it is possible for a human creature to become. The torpor of his [the worker's]

mind renders him, not only incapable of relishing or bearing a part in any rational conversation, but in conceiving any generous, noble or tender sentiment, and consequently of forming any just judgement concerning many even of the ordinary duties of private life . . . [specialization] seems in this sense to be acquired at the expense of his intellectual, social, and martial virtues. But in every improved and civilized society this is the state into which the laboring poor, that is, the great body of the people, must necessarily fall, *unless government takes some pains to prevent this* (1976: 50; emphasis added).

To attenuate the dehumanization attendant with the capitalist division of labor, Smith advocated government investment in public education. Importantly, and consistent with Smith's larger moral project, an educated population was also a fundamental prerequisite for the functioning of a democratic political system.

Capitalism and democracy in contemporary America: a Smithian critique

Capitalism is an economic system based upon private property, production for profit, (mostly) wage labor, and a market mechanism to allocate a society's productive resources. Democracy is a political system founded on the basic principle that people should have a voice in the decisions which affect their lives. As explained above, capitalism and democracy are theoretically compatible in the sense that each system is organized to maximize individual choice and liberty. Capitalism maximizes the choices available to the consumer, whose spending patterns drive the resource allocation process in the economy (hence the concept of consumer sovereignty). Democracy maximizes the choices available to the voter, whose political interests and voting patterns result in government which is accountable to and representative of the body politic. The form of political economy formulated and advocated by Smith may thus be termed democratic capitalism (Friedman, 1962).

Unfortunately, much of the theoretical compatibility between capitalism and democracy, as well as the manner in which each system is supposed to operate, breaks down in reality. In the section above, we noted the various problematics that Smith identified over two centuries ago as potential dysfunc-

tions of a capitalist economic system. Here, we subject contemporary American "democratic capitalism" to a Smithian critique in order to determine whether, and to what extent, Smith's fears were justified.

History has shown quite clearly that capitalism leads to a massive concentration of economic resources in the hands of a tiny minority of firms and property holders. This point is not disputed even by the staunchest defenders of capitalism (cf., Wilson, 1989). In the United States today there exists around 12 million business firms, yet the fifty largest firms make almost half of all profits (U.S. Dept. of Commerce, 1990). According to UCLA sociologist Maurice Zeitlin, "the richest 1% of families own 31.5% of everything owned by all American families", while the bottom 50% of families retain only 3% of the national wealth (Zeitlin, 1989).

This incredible concentration of economic resources translates, however imperfectly, into political power and undermines the democratic process. This is so because in order for democracy to be viable, concentration of power must be avoided and all participants in the political system require adequate resources to engage fully in the democratic contest (Lindbloom, 1977). Herein lies the basic contradiction between capitalism and democracy as well as the manifestation of Smith's greatest fears.⁵

Smith would also likely be disturbed at the state of the work ethic in contemporary America. As the labor market segments into dual categories of secure high-skill/high-wage professionals and low-wage/low-skill service workers, with tremendous mobility barriers in between, the hegemony of the work ethic is undermined (Edwards, 1988). Indeed, the values which supported the work ethic have been largely supplanted by those supporting consumption-related activities (Jameson, 1990). Importantly, it is not only the working classes but the entire society which has been vulgarized by the hegemony of consumption and the commodification of human relations (Gorz, 1989).⁶

Expressions of the contemporary hegemony of consumption manifest at both the firm and individual levels. At the firm level, the functional emphasis has shifted from production to marketing and, finally, to finance-related activities (Reich, 1983). Increasingly, markets need to be created by marketing programs oriented to manipulating con-

sumers into needing products they were not even aware existed (Galbraith, 1976). At the individual level, status, personality and lifestyle are defined by consumption (e.g., what one wears, where one lives, the car one drives) rather than by production (i.e., what one does for a living) (Firat and Venkatesh, 1991). This shift in focus away from production and toward consumption threatens the productivity and accumulation mechanisms of such central importance to the capitalist system. The explosion of consumer, corporate and government debt over the past decade is another significant manifestation of the hegemony of consumption.

Finally, Smith's acknowledgement of the existence of market failures and the need for government to foster the provision of public goods has all but been forgotten. Instead of government investing in public education and infrastructure, essential services are increasingly being privatized and made available only to those with the resources to purchase them (Mattera, 1990). The notion that government intervention has been largely responsible for the progressive achievements of capitalism since the New Deal period has been discredited by New Right ideologies propounding the myth of the "free market". The withdrawal of government as a progressive influence on capitalism and the re-emergence of Social Darwinism and other reactionary tendencies is a direct result of increased reliance on unfettered market forces to dictate the organization of society (Mead, 1991).

Conclusion

In the United States today, we largely ignore Adam Smith's caveats on the pernicious aspects of capitalism. Instead, we theorize and teach economics and politics as though they are distinct areas unconnected by the common thread of resources pursuing interests. The massive concentration of economic power was noted above. The political implications of this economic concentration are hard to ignore. How else to explain the 1980s, when trillions of dollars of wealth were shifted upward through massive tax cuts for the wealthy, defense spending, and the savings and loan scandal (Phillips, 1990). Meanwhile, middle class incomes stagnated, investment in social programs (education, housing, welfare)

decreased, poverty increased, homelessness mushroomed, and prison populations doubled nationally. The minimum wage, although raised recently, still fails to lift a working person out of the poverty category (the very definition of which is set at ridiculously low levels). Taxes have become tremendously regressive, and the public expenditures middle and upper-class taxpayers do support are generally confined to increases in police budgets and prison construction to treat the symptoms whose basic causes can be traced to the increasingly unequal distribution of resources in American society.

In critiquing the ethical foundations of capitalism, Marx is often the first resort. In this essay, we have critiqued contemporary American capitalism from a Smithian perspective, which we feel is more effective than the admittedly incisive but ideologically stigmatized Marxian approach. Smith is the father of capitalism, yet he is also in many ways its most powerful critic. He identified many of the potential dysfunctions which have manifested themselves over the past two centuries in the United States and elsewhere. Smith's project was motivated by a deep ethical concern for the average citizen who was exploited by the mercantilism of his day. Smith theorized capitalism to liberate the consumer and foster a political economy which would be more democratic and responsive to the wants and needs of the individual. Capitalism has had many successes in terms of improving the material prosperity of some peoples and some nations. Yet, many of Smith's fears have come to fruition, calling into question the ethical basis of contemporary capitalism.

We conclude that the political economy of American capitalism is in deep crisis due to the concentration of economic and political power and the hegemony of consumption. The major effects of these developments include the de-politicization of the citizenry through widespread disillusionment with and withdrawal from politics, the abandonment of government's progressive influence on the economy and the imposition of a neo-Victorian socio-economic order, the undermining of the work ethic and other production-related activities, and the accelerating destruction of the physical environment. It remains an open question whether Adam Smith or Karl Marx would be more surprised and appalled at the current state of affairs in the Western World.

Notes

- ¹ The riots (or rebellion?) in Los Angeles evidence the persistence of social pathologies in the United States. In Western Europe, the electoral gains made by neo-fascist parties in recent French, German and Italian elections are indicative of deep cleavages in these societies.
- ² On Smith's political orientation, West (1979) observes that "Smith seems to have had much in common with the founding fathers of the American Constitution, which was a blend of republicanism and democracy. In a full democracy the will of the people reigns supreme. In a republic it is not the will of the people that predominates but a rational consensus, which is implicit in the term "consent." Such a republic, if ruled by wise men, can enjoy a liberty that is not threatened by tyrannical majorities" (pp. 140–141).
- ³ Smith's awareness of the dangers of large scale accumulation and market power would have placed him alongside Jefferson in the latter's debate with Hamilton over the direction of American economic development at the turn of the nineteenth century (Dolbeare, 1986).
- ⁴ In this recognition, Smith anticipated some of the insights of Max Weber (1958), whose work elaborated the historically significant linkages between the Protestant work ethic and classical capitalism.
- ⁵ Both Thomas Jefferson and Karl Marx also recognized the linkages between economic and political power and the antidemocratic implications of economic concentration.
- ⁶ The educational and media institutions play a crucial role here. Instead of fostering an informed populace (the foundation of a democratic political system), the ideas and values given mainstream legitimacy by these institutions are those which glorify consumption, individualism (expressed solely through consumption), private property (and capitalism more generally), super-patriotism, racism, and xenophobia (Kellner, 1990). Smith, Jefferson and many of their contemporaries would certainly be appalled at the average American's political obedience, ignorance, hyper-materialism, and unthinking acceptance of the status-quo.

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