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# Is the System Rigged? Adam Smith on Crony Capitalism, Its Causes—and Cures

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## Abstract

*For Adam Smith, crony capitalism fails on two grounds: It is unjust, favoring a few at the expense of the many, and it is destructive of the desired end of political economy—economic growth. Smith's writings are of great use today in their capacity to properly frame this problem, its causes, as well as solutions for preventing or mitigating the corruption of free markets. For Smith, the tendencies to cronyism, which are anchored in human nature, can be tempered by: (1) limiting government to a few essential powers (defense, administration of impartial justice, and certain limited public works and institutions); and (2) educating the public concerning the "folly" of attempts to direct the economy by legislators. These approaches offer the best chance to limit crony capitalism, its corruption of natural liberty, and its consequent undermining of benefits of free markets.*

## Introduction

Adam Smith, the intellectual founder of modern free-market economics, famously called the economic system he advocated "the obvious and simple system of natural liberty."[1] The benefits he claimed for this system of natural liberty include the wealth of nations and an increase in the independence, liberty, and security of all members of society—but especially of the non-elite members. He particularly defended it on the grounds that robust economic growth offered the best opportunities for the less advantaged members of society:

> The liberal reward of labor, therefore, as it is the necessary effect, so it is the natural symptom of increasing national wealth. The scanty maintenance of the labouring[2] poor, on the other hand, is the natural symptom that things are at a stand, and their starving condition that they are going fast backward.[3]

Comparing our present situation to conditions when he wrote, we are compelled to admit that these benefits have been substantially realized by the system we now call free markets or capitalism.[4]

Yet despite this almost unbelievable acceleration of wealth and liberty in the countries that have adopted Smith's system, few would claim that this progress has been simple or uncontroversial—or that the benefits have accrued equally to all. Noted libertarian Charles Koch, writing in the *Washington Post*, argued that he agreed with one claim made by socialist Senator Bernie Sanders: *that the system is rigged in favor of the few.*[5] Is there something inherent

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in the system of natural liberty, or in human nature itself, that is systematically corrupting in ways that undermine its claims of universal benefits? Is Smith overly optimistic or naïve in his claims concerning the benefits of free markets? Standing at a distance from the minutiae of today's economic and policy arguments, Smith can help us take a step back to fundamental principles—and thus help us understand these current debates in a fresh (old) way.

For Smith, cronyism fails on two grounds: It is unjust, favoring a few at the expense of the many, and it is destructive of the desired end of political economy—economic growth.

Smith warned that natural liberty faces natural obstacles in the form of human nature, particularly the desire of especially "merchants and manufacturers" to "rig the system." They accomplish this self-enriching corruption of free markets by using the power of government to procure for themselves "systems either of preference or of restraint." In so doing, they impose an "absurd tax on the rest of their fellow-citizens." These preferences and restraints are what we today call crony capitalism.

For Smith, cronyism fails on two grounds: It is unjust, favoring a few at the expense of the many, and it is destructive of the desired end of political economy—economic growth. Smith's writings are of great use today in their capacity to properly frame the problem and its causes and to offer solutions for preventing or mitigating this corruption of free markets. For Smith, the inevitable tendencies to cronyism can be limited (1) by limiting government to a few essential powers (defense, administration of impartial justice, and certain limited public works and institutions), and (2) by educating the public concerning the "folly" of attempts to direct the economy by legislators who, even if well intentioned, inevitably lack sufficient knowledge of local conditions and thus are

1. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, R. H. Campbell and A. S. Skinner, eds. (Indianapolis: Liberty Classics, 1981), p. 687.
2. Various spellings throughout this paper (e.g., publick, labour, domestick) are from Smith's original work and reflect English spelling at the time *Wealth of Nations* was written.
3. Smith, *Wealth of Nations*, p. 91. Contrary to many in his day (and since), Smith had no doubt that this was a major achievement:

   > Is this improvement in the circumstances of the lower ranks of the people to be regarded as an advantage or as an inconveniency to the society? The answer seems at first sight abundantly plain. Servants, labourers and workmen of different kinds, make up the far greater part of every great political society. But what improves the circumstances of the greater part can never be regarded as an inconveniency to the whole. No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable. It is but equity, besides, that they who feed, cloath and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves tolerably well fed, cloathed and lodged.

   Ibid., p. 97. This result, he argues, can only be accomplished when society is experiencing continued, preferably increasing, economic growth.
4. "Two centuries ago, the average world income per human (in present-day prices) was about $3 a day. It had been so since we lived in caves. Now it is $33 a day—which is Brazil's current level and the level of the U.S. in 1940. Over the past 200 years, the average real income per person—including even such present-day tragedies as Chad and North Korea—has grown by a factor of 10. It is stunning. In countries that adopted trade and economic betterment wholeheartedly, like Japan, Sweden and the U.S., it is more like a factor of 30—even more stunning. And these figures don't take into account the radical improvement since 1800 in commonly available goods and services." Deirdre McCloskey, "How the West (and the Rest) Got Rich," *Wall Street Journal*, May 21, 2016, https://www.wsj.com/articles/why-the-west-and-the-rest-got-rich-1463754427 (accessed March 15, 2018). See also Deirdre McCloskey, *Bourgeois Equality: How Ideas, Not Capital or Institutions, Enriched the World* (University of Chicago Press: Chicago, 2016).
5. "The senator [Bernie Sanders] is upset with a political and economic system that is often rigged to help the privileged few at the expense of everyone else, particularly the least advantaged. He believes that we have a two-tiered society that increasingly dooms millions of our fellow citizens to lives of poverty and hopelessness. He thinks many corporations seek and benefit from corporate welfare while ordinary citizens are denied opportunities and a level playing field. I agree with him. Democrats and Republicans have too often favored policies and regulations that pick winners and losers. This helps perpetuate a cycle of control, dependency, cronyism and poverty in the United States. These are complicated issues, but it's not enough to say that government alone is to blame. Large portions of the business community have actively pushed for these policies." Charles Koch, "This Is the One Issue Where Bernie Sanders Is Right," *Washington Post*, February 18, 2016, https://www.washingtonpost.com/opinions/charles-koch-this-is-the-one-issue-where-bernie-sanders-is-right/2016/02/18/cdd2c228-d5c1-11e5-be55-2cc3c1e4b76b_story.html (accessed March 15, 2018).

incompetent to direct the economy to the ends they propose. These approaches offer the best chance to limit crony capitalism, its corruption of natural liberty, and its consequent undermining of benefits of free markets.

## Smith's Warning

Smith repeatedly warned about systematic tensions that he saw undermining or preventing the expected beneficial results of free markets. The optimistic Smith quote that opens this paper is part of a conditional sentence, a fact often overlooked both by Smith's supporters and opponents. The sentence in full reads: "All systems either of preference or of restraint, therefore, being thus completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord." What are the conditions for the establishment of natural liberty? What does he mean by systems of preference or restraint, and can we reasonably expect that they can be "taken away"?

If we are to continue to reap the very real benefits of natural liberty, we must be prepared for a constant political defense against cronyism.

While the concept of a free market may be obvious and simple, its achievement or perpetuation is not. Despite spending much of his book detailing the folly of preferences and restraints, Smith is not sanguine about "completely" removing them: "To expect, indeed, that the freedom of trade should ever be entirely restored in Great Britain, is as absurd as to expect that an Oceana or Utopia should ever be established in it."[6]

Free markets are neither self-establishing nor self-maintaining. If we are to continue to reap the very real benefits of natural liberty, we must be prepared for a constant political defense against cronyism. But constant vigilance against what or whom? Smith can help us here as well. He describes the obstacles to the full establishment of natural liberty as "the prejudices of the publick, but what is much more unconquerable, the private interests of many individuals."[7]

## Private Interests

Which private individuals? Smith discusses the three major segments of the population whose combined income represents the "whole annual produce" of every country:

- Those who receive rent from land (largely landowners from tenants working the land, but also landowners receiving rent from those extracting resources from the land, such as minerals or timber);
- Those who earn wages through productive labor; and
- Those who make a profit on their capital investment, i.e., merchants and manufacturers.

These are "the three great, original and constituent orders of every civilized society, from whose revenue that of every other order is ultimately derived."[8]

The interests of the first two of these orders tend to coincide with that of the society as a whole since their income rises with economic growth. The wages of labor in particular:

> are never so high as when the demand for labour is continually rising, or when the quantity employed is every year increasing considerably. When this real wealth of the society becomes stationary, his wages are soon reduced.... [T]here is no order that suffers so cruelly from its decline.[9]

Smith argues that both these orders, to the extent they understand their real interests (a significant

6. Smith, *Wealth of Nations*, p. 471.
7. Ibid.
8. There is no elaboration here of "every other order" who live at the expense of these three, since he is concerned here only with those who produce wealth. Smith does *not* ignore this category, and we will take up this issue below.
9. "The demand for those who live by wages, therefore, necessarily increases with the increase of the revenue and stock of every country and cannot possibly increase without it. The increase of revenue and stock is the increase of national wealth.... It is not the actual greatness of national wealth, but its continual increase, which occasions a rise in the wages of labor." See Smith, *Wealth of Nations*, p. 87.

qualification), have an interest in supporting policies that benefit the growth of society as a whole. But the same cannot be said of the third order: merchants and manufacturers.

> The interest of the dealers, however, in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the publick. *To widen the market and to narrow the competition, is always the interest of the dealers.* To widen the market may frequently be agreeable enough to the interests of the publick; but to narrow the competition must always be against it, and can serve only to enable the dealers, by raising their profits above what they naturally would be, to levy, for their own benefit, an absurd tax upon the rest of their fellow-citizens. The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution...and carefully examined...with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the publick, who have generally an interest to deceive and even to oppress the publick, and who accordingly have, upon many occasions, both deceived and oppressed it (emphasis added).[10]

The problem arises not from natural liberty or free markets *per se*, but from the effort of some to gain unfair advantage over their actual or potential competitors by using the power of government to interfere with or corrupt natural liberty and implement either preferences in their favor or restraints on competitors.[11] It is a question of earning one's money under conditions of free and fair competition—or of making money by obtaining special (and therefore unjust) consideration through political power.[12]

Efforts to "widen the market" are in most cases benign, even beneficial, to the public, since this usually extends competition. Examples include reductions in restraints on trade, cheaper transportation, or new technologies that make items more affordable or accessible, and thus increase the number of potential buyers. But widening the market through some kinds of government intervention is *not* benign. A contemporary example would be the government mandate to require a percentage of ethanol be mixed into gasoline. This requirement expands the market (primarily) for corn growers and processors. If ethanol were not more expensive, there would be no need to require it, and this requirement results in higher gas prices—and secondarily higher food prices.

A second example is the mandate to extend mortgages to borrowers with poor credit without fully accounting for the increased risk. This expands the market for the producers and dealers in housing; importance (and wealth) of the managers of federal housing agencies; and, for a time, the profits of banks that trade in securities based on these mortgages. These housing mandates require taxpayer guarantees of the loans, producing subprime loans that would not otherwise have been made, or if made, then only at higher interest rates. The result of this interference in the market was, in fact, the 2007–2008 housing bubble that collapsed with painful consequences for all—most painfully for many of the very people the advocates of the mandates claimed to be helping.[13]

10. Ibid., pp. 266–267.

11. The problem for Smith is not that free markets promote greed over morality, as some on both Left and Right have claimed. What Smith calls the "desire to better our condition" is not greed but an admirable prudence directed at self-improvement—at least as long as it operates within the bounds of justice. See ibid., p. 341.

12. "Most people think of entrepreneurship as being the 'productive' kind, as Baumol referred to it, where the companies that founders launch commercialize something new or better, benefiting society and themselves in the process. A sizable body of research establishes that these 'Schumpeterian' entrepreneurs, those that are 'creatively destroying' the old in favor of the new, are critical for breakthrough innovations and rapid advances in productivity and standards of living. [Note: The research in question can be found at David Audretsch, "Entrepreneurship: A Survey of the Literature," European Commission *Enterprise Paper* No. 14 (2003), https://www.researchgate.net/publication/246075618_Entrepreneurship_A_Survey_of_the_Literature (accessed March 15, 2018).] Baumol was worried, however, by a very different sort of entrepreneur: the "unproductive" ones, who exploit special relationships with the government to construct regulatory moats, secure public spending for their own benefit, or bend specific rules to their will, in the process stifling competition to create advantage for their firms. Economists call this "*rent-seeking behavior*." Robert E. Litan and Ian Hathaway, "Is America Encouraging the Wrong Kind of Entrepreneurship?" *Harvard Business Review*, June 13, 2017, http://www.startupsusa.org/entrepreneurship/is-america-encouraging-the-wrong-kind-of-entrepreneurship/ (accessed March 15, 2018) (emphasis in original).

13. Gretchen Morgenson and Joshua Rosner, *Reckless Endangerment: How Outsized Ambition, Greed, and Corruption Led to Economic Armageddon* (New York: Henry Holt and Co., 2011).

By requiring actions that would not occur without such regulations, these mandates distort the market in favor of a few and to the detriment of the public generally. Similar arguments could be made against subsidies for solar power, wind power, electric cars, many agricultural subsidies—and the list goes on.[14] Those originally promoting these subsidies run the gamut from naïve do-gooders to the corrupt beneficiaries of the subsidies. If cronyism was not the only motivation for the subsidies at the beginning, it almost always becomes the main source of continuing political support, as the example of ethanol—and, more generally, the entrenched corporate and governmental interests feeding off "green" subsidies—should make clear. When evaluating a proposal for any such subsidy, Smith argues that one should *assume* cronyism. Any such proposal "ought always to be listened to with great precaution…and carefully examined…with the most suspicious attention." Not only are these mandates unjust in the sense that they privilege a small group at the expense of the public generally, but they always divert capital investment from more productive to less productive uses, retarding economic growth.[15]

Smith's second type of cronyism, efforts to *narrow* the competition, is by definition anti-competitive. It allows some to "levy, for their own benefit, an absurd tax upon the rest of their fellow-citizens."[16] Many of the instances Smith cites seem like historical oddities today. We do not distribute royal patents to be the sole producer or supplier for some product or service or establish monopoly "corporations" or guilds that control apprenticeships and restrict entry into a craft or trade. But are these practices really foreign to our modern economies? What about the strenuous attacks on Uber and similar services—attacks which aim to protect the interests of entrenched taxi companies? Or the explosion of occupational licensing that protects more established or larger providers and restricts new entrants?[17] Or restrictions or outright prohibitions of charter schools and school vouchers that maintain the monopoly of the existing schools at the expense of students, parents, and taxpayers? Something similar can be said about most of the thousands (potentially *tens* of thousands) of new regulations promulgated every year by governments at all levels.

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As with the subsidies discussed above, these restraints may have originated in, or been defended as, necessary for some general good. Yet almost every regulation (a "restraint" in Smith's terms)

14. The examples cited here and throughout this paper are not meant to be an exhaustive or definitive discussion of these various issues. They are rather intended to be provocative and illustrative—to encourage thought about how Smith's principles might apply to some current debates familiar to a citizen who follows these sorts of questions with some attention.

15. The recent debate over income inequality is usually couched in terms of justice, but it might also be discussed in terms of crony capitalism and economic growth. A recent study suggests that inequality alone does not hurt growth, while inequality based on political favoritism does. This is understandable from Smith's analysis: Declining growth (due to the distortions of cronyism) depresses wages, while the beneficiaries of cronyism reap windfall profits. "We find that wealth inequality reduces economic growth, but when we control for the fact that some billionaires acquired wealth through political connections, the effect of politically connected wealth inequality is negative, while politically unconnected wealth inequality, income inequality, and initial poverty have no significant effect." Sutirtha Bagchi and Jan Svejnar, "Does Wealth Inequality Matter for Growth? The Effect of Billionaire Wealth, Income Distribution, and Poverty," IZA *Discussion Paper* No. 7733, Forschungsinstitut zur Zukunft der Arbeit (Institute for the Study of Labor), November 2013, http://ftp.iza.org/dp7733.pdf (accessed March 15, 2018).

16. Smith, *Wealth of Nations*, pp. 266–267.

17. "Licensing requirements impose up-front costs. The actual licensing fees are often just the tip of the iceberg; many aspiring professionals must spend time and money attending the required trade school courses. These burdens fall disproportionately on people from lower-income backgrounds. Licensing can act as a form of "opportunity hoarding," allowing those with resources and connections to benefit from the higher incomes flowing from these occupations, in part by preventing others from competing with them." Edward Rodrigue and Richard V. Reeves, "Four Ways Occupational Licensing Damages Social Mobility," February 24, 2016, https://www.brookings.edu/blog/social-mobility-memos/2016/02/24/four-ways-occupational-licensing-damages-social-mobility/ (accessed March 15, 2018). For more on the cost of regulations, see James Gattuso and Diane Katz, "Red Tape Rising 2016: Obama Regs Top $100 Billion Annually," *Heritage Foundation* Backgrounder No. 3127, May 23, 2016, https://www.heritage.org/government-regulation/report/red-tape-rising-2016-obama-regs-top-100-billion-annually.

falls unequally on smaller, newer, or alternative producers. It is more difficult for a small company or individual practitioner to understand and comply with numerous regulations than for a larger company to do so. Nothing here requires that all regulations be jettisoned. Nor would Smith claim that every regulation or restraint is solely for the purpose of suppressing competition. Some do so blatantly; some are subtler; and a few, perhaps, have no anti-competitive effect. Smith insists, however that all such proposals "be listened to with great precaution...and carefully examined...with the most suspicious attention."

When competition is reduced, new entrants are burdened or prohibited outright, and alternative sources or methods are restricted, the result is that entrenched interests unjustly levy a tax—in the form of higher prices—on the public for the producers' own benefit. This is the basis for his complaint above about private interests "who accordingly have, upon many occasions, both deceived and oppressed [the public]."[18]

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## "Public" Private Interests

The "oppressors of the public" are not limited to the obvious or subtle defenders of government-mandated subsidies or restraints and the resulting restrictions on competition. The collusion between the private individuals or interest groups and government officials (at all levels) is what we most readily think of as "crony capitalism." The first image in our minds, of the politician with his or her hand out for campaign contributions or other perks, is certainly not the only way cronyism occurs. For every law and legislator, there are vastly more regulations and government employees to administer them. This multitude of bureaucrats constitute their own private interest group or groups—and are a significant factor in the origin and entrenchment of market-distorting preferences and restraint. Taking into account all the various levels of government, they may represent a greater obstacle to free markets than any particular industry or trade group.

One might object that these are "public servants." However, it should be obvious that the mere fact of accepting employment in "public service" does not miraculously turn a self-interested private individual into a paragon of disinterested virtue. Government employees, whatever their political party, have a vested personal interest in their own job, perks, and power and thus in expanded government. In addition to the anti-competitive effects of most government actions and regulations and the incentives to corruption and graft that always accompany every government intervention, there is the mere fact of the size of government itself. Smith explains the danger of a state that grows too large:

> Great nations are never impoverished by private, though they sometimes are by publick prodigality and misconduct. The whole, or almost the whole publick revenue, is in most countries employed in maintaining unproductive hands.... Such people, as they themselves produce nothing, are all maintained by the produce of other men's labour.... When multiplied, therefore, to an unnecessary number...(t)hose unproductive hands, who should be maintained by a part only of the spare revenue of the people, may consume so great a share of their whole revenue, and thereby oblige so great a number to encroach upon their capitals, upon the funds destined for the maintenance of productive labour, that all the frugality and good conduct of individuals may not be able to compensate the waste and degradation of produce occasioned by this violent and forced encroachment.[19]

18. The restraint on competition from tariffs and other restraints on trade will be discussed below, under the heading "Free Trade?"
19. Smith, *Wealth of Nations*, p. 342.

Smith is obviously not a Keynesian. Government spending, in most cases, is not productive of real wealth for a country, however much we may require certain government functions. What is needed to increase wealth is the availability of more capital for investment. As Smith explains:

> The annual produce of the land and labour of any nation can be increased in its value by no other means, but by increasing either the number of its productive labourers, or the productive powers of those labourers who had before been employed.... In either case an additional capital is almost always required.[20]

Additional capital is the result of the amount of profit produced in the preceding cycle of production. This surplus is then available for additional investment in expanded employment or technological improvements. Part of this profit is taken away by taxes to provide the "publick revenue" of the above passage.[21] Smith asserts that an "unnecessary number" of non-productive individuals, all of whose support is a subtraction from the surplus available for investment in expanded production for the next cycle, may so reduce that surplus that no new investment, or even an absolute reduction of investment, may result. "The next year's produce, therefore, will be less than that of the foregoing, and if the same disorder should continue, that of the third will be still less than that of the second."[22]

While subsidies for particular industries distort investment by diverting capital to a less productive use than it would otherwise have found without the subsidy, government itself is the limit case of diverting capital from productive to non-productive uses. Any such diversion or distortion is a drag on the surplus available for investment—and thus a restraint on economic growth: the greater the diversion, the greater the drag. This economic growth argument is the ultimate basis for Smith's objections to "preference and...restraint," although the argument about fairness is certainly important.

A very large number of "private individuals" have been identified as having incentives to promote "preference or... restraint," which is to say cronyism or corruption—promoting the interest of an established few at the expense of the rest of society. They include those with an established interest that can be promoted by government action: mainly merchants, manufacturers, and professionals, as well as government itself—whose members always have a private interest in increasing their power and status, and in cases of explicit corruption, their wealth. This is the first part of Smith's account of the systematic obstacles to natural liberty.

## "Prejudices of the Publick"

The "prejudices of the publick," according to Smith, constitute the second obstacle to natural liberty. In particular, he was concerned with the opposition to free trade with other countries, which usually expresses itself in high tariffs on particular imports. A similar account might be given of public prejudices in favor of other "systems of preference or of restraint" that apply domestically, such as the energy, environmental, housing, health care, or other mandates discussed earlier. The question of free trade or restrictions thereon seems, both in Smith's time and ours, to be particularly problematic, and thus deserve some particular attention.

Smith is quite precise in his description of the sources of this "prejudice" and is harsh in his condemnation of it:

> Were the officers of the army to oppose with the same zeal and unanimity any reduction in the number of forces, with which master manufacturers set themselves against every law that is likely to increase the number of their rivals in the home market; were the former to animate their soldiers, in the same manner as the latter enflame their workmen, to attack with violence and outrage the proposers of any such regulation; to attempt to reduce the army would be as dangerous as it has now become to attempt to diminish in any respect the monopoly which our manufactures have obtained against us.[23]

20. Ibid., p. 343.

21. For this argument, taxes on wages can be thought of as a pass-through—ultimately a cost of production: If not for taxes, the wage could be lower while still providing the same (or a better) standard of living, and thus the surplus (profit) available for the next cycle greater. See ibid., p. 864.

22. Ibid., p. 342.

23. Ibid., p. 471. See also ibid., p. 267, note 12.

The "monopoly...against us" that he is referring to is the imposition of tariffs or even outright prohibitions against the import of foreign goods that compete with some domestic manufacturers. He argues that almost all public support, or "prejudice," for these preferences or restraints is the result of agitation by those who most directly benefit. The general public will see only higher prices due to tariffs and thus should have no reason to clamor for them. On the other hand, those domestic merchants and manufacturers who benefit from reduced foreign competition understand their immediate interest and promote it, often under the color of the "common good." They often successfully arouse among the general public an unreasonable "prejudice" against foreign competition.

In the normal course of things, an increased profit can be obtained either by expansion of the number of workers or by an increase in the productivity of those workers through improved technology. In other cases, the "master manufacturer" may find a quicker and easier route to increased profit by using government regulations to restrict competition or provide an outright subsidy. Since a naked plea for special treatment is unlikely to have broad appeal, either outright corruption of government or duplicity in argument is needed to succeed. Smith is highly attuned to the likelihood that such appeals to the general good can mask private interests.

Theories of political economy "first introduced by the private interests and prejudices of particular orders of men," eventually came to have "a considerable influence, not only upon the opinions of men of learning, but upon the public conduct of princes and sovereign states."[24] The dominant "prejudice" of his time was what Smith called the mercantile or commercial system. These theories argued that the wealth of a country depended on the amount of gold and silver it retained—and thus on a positive balance of trade in order to prevent the loss of those metals or "wealth." In general, mercantilism proposed various means of restricting imports and boosting exports, measures that were claimed to be necessary for retaining or increasing a nation's precious metals.[25]

In contrast, Smith argued that the wealth of a country depended on "the annual produce of its industry"—and that this annual produce is increased the most when capital can be invested where it can make the most return.[26] To the extent that "men of learning" or large parts of the public are persuaded by the self-serving arguments of those with private interests to promote, public opinion or "prejudice" can be enlisted to defend private privilege or cronyism.

## Free Trade and Its Limits

Smith has no use for the arguments defending domestic monopolies by restraints (duties, tariffs) on imports or subsidies for exports. He attributes them to bad faith on the part of their proponents. The first part of the passage below, with slight modifications, could pass for a description of our present situation:

> By such maxims as these, however, nations have been taught that their interest consisted in beggaring all their neighbours. Each nation has been made to look with an invidious eye upon the prosperity of all the nations with which it trades, and to consider their gain as its own loss. Commerce, which ought naturally to be, among nations, as among individuals, a bond of union and friendship, has become the most fertile source of discord and animosity. The capricious ambition of kings and ministers has not, during the present and the preceding century, been more fatal to the repose of Europe, than the impertinent jealousy of merchants and manufacturers. The violence and injustice of the rulers of mankind is an

24. Ibid., p. 11. One might think that Smith is a hypocrite here, since he, too, offers a system of political economy, his "system of natural liberty." But what particular private interest does natural liberty defend? Smith argues that under his system "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." Ibid., p. 687.

25. "The two principles being established, however, that wealth consisted in gold and silver, and that those metals could be brought into a country which had no mine only by the balance of trade, or by exporting to a greater value than it imported; it necessarily became the great object of political economy to diminish as much as possible the importations of foreign goods for home consumption, and to increase as much as possible the exportation of the produce of domestick industry. Its two great engines for enriching the country, therefore, were restraints upon importation, and encouragements to exportation." Ibid., p. 450. Monopoly of one kind or another, indeed, seems to be the sole engine of the mercantile system (WN 630).

26. Ibid., p. 451.

> ancient evil, for which, I am afraid, the nature of human affairs can scarce admit of a remedy. But the mean rapacity, the monopolizing spirit of merchants and manufacturers, who neither are, nor ought to be the rulers of mankind, though it cannot perhaps be corrected, may very easily be prevented from disturbing the tranquility of anybody but themselves. That it was the spirit of monopoly which originally both invented and propagated this doctrine, cannot be doubted; and they who first taught it were by no means such fools as they who believed it. In every country it always is and must be in the interest of the great body of the people to buy whatever they want of those who sell it cheapest. The proposition is so very manifest, that it seems ridiculous to take any pains to prove it; nor could it ever have been called in question, had not the interested sophistry of merchants and manufacturers confounded the common sense of mankind. Their interest is, in this respect, directly opposite to that of the great body of the people.[27]

**Smith's Exceptions.** Support for the general principle of free trade, to "buy whatever they want of those who sell it cheapest," seems clearly stated here and belongs to what Smith calls "the science of a legislator."[28] But Smith is well aware that the details of the situation of any given country at any given time may make it advisable to modify the general principle to some extent. His discussion of some examples may give us perspective on similar current debates.

The first exception to free trade is "when some particular sort of industry is necessary for the defense of the country."[29] His primary example is the military need for Great Britain to maintain "the number of its sailors and shipping," and thus he approves of measures to promote domestic shipping and penalize that of other countries. He admits that this raises domestic prices to some extent and reduces exports as well but concludes that "defence, however, is of much more importance than opulence."[30]

The second exception where he finds it advantageous "to lay some burden upon foreign for the encouragement of domestick industry, is when some tax is imposed at home upon the produce of the latter. In this case, it seems reasonable that an equal tax should be imposed upon the produce of the former" in order to put them "as nearly as possible upon the same footing."[31] He is generally critical, however, of domestic taxes, at least on the necessities of life. The question arises whether higher corporate taxes (in the U.S., for example), compared to the taxes in competitor nations, fall under this heading and further whether it would be better to impose tariffs to offset the higher domestic taxes or to reduce the domestic taxes. By passing the Tax Cuts and Jobs Act of 2017,[32] Congress seems to have decided for now on the latter approach. More onerous regulations domestically compared to the regulations to which a foreign competitor might be subject raise a similar question.

An analogous situation that Smith does not directly address would be when other countries subsidize their export industries to make their products cheaper than the domestic production of their competitors. The details may become complex in any of these cases, but the general principle is to attempt to maintain a level playing field. He addresses some of these nuances in his discussion of two other cases in which he explicitly contends that it "may sometimes be a matter of deliberation" whether to protect domestic industry.

He describes the first of these cases as "when some foreign nation restrains by high duties or prohibitions, the importation of some of our manufactures into their country. Revenge in this case naturally dictates retaliation, and that we should impose the like duties and prohibitions…Nations, accordingly seldom fail to retaliate in this manner."[33] He admits that "there may be good policy in retaliations of this kind, when there is a probability that

27. Ibid., p. 493.
28. Ibid., p. 468.
29. Ibid., p. 463.
30. Ibid., pp. 464–465.
31. Ibid., p. 465.
32. Tax Cuts and Jobs Act of 2017, Public Law 115–97.
33. Smith, *Wealth of Nations*, p. 467.

they will procure the repeal of the high duties or prohibitions complained of." A temporary inconvenience of paying more for some goods will be worth it if it results in "the recovery of a great foreign market."

On the other hand, unless such repeal is likely, "it seems a bad method of compensating the injury done to certain classes of our people, to do another injury to ourselves." A retaliatory tariff is usually on some other good that we normally import from the misbehaving competitor. While that may boost the profit and employment of some at home, who may expand their production of that good and also raise the price of that good in the home market, the owners and workers who previously produced the goods for export that now face the foreign duty or prohibition receive no benefit—and along with the rest of the country will have to pay more for some domestic goods no longer imported more cheaply. Smith concludes that "[e]very such law, therefore, imposes a real tax upon the whole country" without helping the particular workmen injured by the foreign prohibition.

The problem is how to determine if retaliation will produce repeal or lead to an escalation of the dispute. This is a judgment not of the "science of a legislator, whose deliberations ought to be governed by general principles" but rather relates to the "skill of that insidious and crafty animal, vulgarly called a statesman or politician, whose councils are directed by the momentary fluctuations of affairs."[34] Despite the harsh-sounding description, Smith is aware that prudential management of particular circumstances is a real virtue in politics—yet he is skeptical that such virtue will often prevail against "insidious" motives.

The second "matter of deliberation" concerns "how far or in what manner it is proper to restore the free importation of foreign goods, after it has been for some time interrupted."[35] The problem is that some domestic industry protected by the high duties may now "employ a great number of hands." Smith argues that

> humanity may in this case require that the freedom of trade should be restored only by slow gradations, and with a good deal of reserve and circumspection. Were those high duties and prohibitions taken away all at once, cheaper foreign goods of the same kind might be poured so fast into the home market, as to deprive all at once many thousands of our people of their ordinary employment and means of subsistence. The disorder which this would occasion might no doubt be very considerable.[36]

Smith is aware that prudential management of particular circumstances is a real virtue in politics—yet he is skeptical that such virtue will often prevail against "insidious" motives.

Yet Smith continues: "It [the disorder] would in all probability, however, be much less than is commonly imagined." This is because, as with other causes (such as technological change) for the fluctuation in the fortunes of various groups, many or most of the individuals affected make adjustments and find other employment. The example he offers is the demobilization of the army and navy after "the late war," which made unemployed a larger number than employed by the greatest manufacturers. He admits considerable inconvenience for many and some reduction in the standard of living of merchant seamen when a large number of navy seamen started competing for their jobs. But despite this large and sudden influx of newly unemployed, he concludes that there was "no great convulsion...no sensible disorder.... [T]he number of vagrants was scarce anywhere sensibly increased by it."[37] The persons most affected would be the manufacturers suddenly subject to cheaper foreign competition, whose plant and equipment might, depending on the details, suddenly lose much of their value. Smith concludes this section with the following admonition:

34. Ibid., p. 468.
35. Ibid.
36. Ibid., p. 469.
37. Ibid.

> The equitable regard, therefore, to his [the manufacturer's] interest requires that changes of this kind should never be introduced suddenly, but slowly, gradually, and after a very long warning. The legislature, were it possible that its deliberations could be always directed, not by the clamorous importunity of partial interests, but by an extensive view of the general good ought upon this very account, perhaps, *to be particularly careful neither to establish any new monopolies of this kind, nor to extend further those which are already established. Each such regulation introduces some degree of real disorder into the constitution of the state, which it will be difficult afterwards to cure without occasioning another disorder* (emphasis added).[38]

Finally, he adds another consideration to those that counsel against establishing a monopoly of the home market against foreign competition: "Taxes imposed with a view to prevent, or even to diminish importation, are evidently as destructive of the revenue of the customs as of the freedom of trade."[39] Such taxes, if successful in preventing those imports, obviously produce no revenue.

From this analysis, it is clear that Smith, despite his basic argument that protective tariffs are a prime example of cronyism, had a nuanced understanding of free trade. The details and circumstances matter—and may merit some adjustment of the general principle that free trade is most advantageous to economic growth. "The very bad policy of one country may thus render it in some measure dangerous and imprudent to establish what would otherwise be the best policy in another."[40] Unfortunately, bad policies in other countries have hardly been eliminated.

## Prescription: Limited Government

Smith shows that many groups or businesses have incentives to try to evade the discipline of the market by using government rules, tariffs, licensing, subsidies, and other forms of government intervention to give these themselves special privileges not available to their competitors, or to prevent competition entirely. Further, governments at all levels have a built-in bias towards expanding their power and perks, are constantly subject to undue influence or outright corruption by these special interests, and often use their powers for private gain. Smith has outlined a variety of these abuses under the rubric "systems of preference and of restraint," abuses that are in today's discourse often lumped under the phrases "crony capitalism," "corporate welfare," "rigging the system," or simply "corruption." What can be done to limit the damage and preserve the useful and necessary functions of government while nurturing the benefits of natural liberty?

We can hardly abolish all governments. Nor can we expect a sudden change in human nature either on the part of those seeking privileges or on the part of those granting them.

We can hardly abolish all governments. Nor can we expect a sudden change in human nature either on the part of those seeking privileges or on the part of those granting them. Smith is aware that the problem lies in human nature itself. The natural desire to "better our condition" motivates striving for a better life and is the motive which underlies the success of natural liberty. Yet this same natural desire, if not constrained, also leads to cronyism and corruption. Bettering our condition and "the mean rapacity, the monopolizing spirit of merchants and manufacturers," noted above, look a lot

38. Ibid., pp. 469–472.

39. Ibid., p. 472.

40. Ibid., p. 539. There are nearly as many positions on free trade as there are commentators. The following is a particularly clear recent example of a free trade absolutist by a generally very thoughtful and knowledgeable student of Smith: "[T]hose arguing against free trade and for protectionism are arguing in favor of higher prices and fewer choices for consumers, and therefore against a higher standard of living for America by prescribing a strong dose of economic poison for themselves, their families, and the nation.... You can make it unnecessarily complicated and try to justify protectionism with convoluted trade models, but that just needlessly hides and masks the simple insight from Adam Smith that it is in our own self-interest as individuals to buy whatever we want from those who sell it cheapest." Mark J. Perry, "Adam Smith Makes the Case for Free Trade and Warns Against the Sophistry of Domestic Producers Seeking Protectionism," May 17, 2017, American Enterprise Institute, https://www.aei.org/publication/adam-smith-makes-the-case-for-free-trade-and-warns-against-the-sophistry-of-domestic-producers-seeking-protectionism/ (accessed March 15, 2018). Nowhere in the article does he suggest that there might be, or that Smith might have acknowledged, any qualifications or exceptions.

alike in their sources in human nature. They differ mainly in the opportunities and constraints under which they operate.

Smith's thoughts on the proper role of government offer two interrelated approaches that provide some guidance in promoting salutary efforts at self-improvement while restraining corruption and cronyism. He can help us understand ways to *mitigate* these obstacles to the full realization of the benefits of free markets for the society as a whole: mitigate—as opposed to eliminate—because he has no expectation of changing human nature. Smith's first suggestion is a relatively clear outline of the proper and necessary, but limited, purposes of government. The second is a powerful critique of the possibility that any government has the requisite knowledge to predict the consequences of its actions with any accuracy, and thus a powerful argument for government restraint and humility. How these relate to the problems posed by human nature should become clear as the argument develops.

Smith outlines his view of the duties of government with admirable clarity:

> According to the system of natural liberty, the sovereign has only three duties to attend to; three duties of great importance indeed, but plain and intelligible to common understandings: first the duty of protecting the society from the violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and, thirdly, the duty of erecting and maintaining certain public works and public institutions.[41]

These three duties may be "plain and intelligible," but that does not mean that they are easily achieved. In particular, the recorded history of mankind suggests that the protection of all individuals from "injustice or oppression" has been noticeable mainly by its absence. That is a sobering fact, and we would do well to give some thought to the extent to which modern industrial democracies have escaped from the historical norm of injustice and oppression, to the conditions which allowed and maintain that escape, and to the ease with which even modern societies can lapse back into injustice and oppression. Whatever problems we still have, we have much for which we can and should be thankful.

It should be clear from this discussion that Smith is not a doctrinaire advocate of *laissez-faire* if that is understood to mean that "anything goes"—that the government has no responsibility to ensure justice or protect the least advantaged. That Smith includes justice as one of the few fundamental duties of government means that while he insists on limited government, he also insists on a government strong enough to enforce an "exact administration of justice" on all the individuals and groups that come under its jurisdiction. A limited government is not incompatible with a strong government, nor a strong government with a limited one. The system of natural liberty is challenged by equally natural tendencies toward corruption, tendencies that lead private interests and even government interests to push strongly against the free market. A strong, which is not to say extensive, government is needed to rein in such corruption and cronyism.[42]

If government were to be limited to its three basic duties, the opportunities for preference and restraint—for crony capitalism or rigging the system—would be fairly limited. Of course, any time government is raising revenue and spending it, even if limited to defense or public works, there is opportunity for graft and corruption. We might compare this version of the duties of government, even with

41. Smith, *Wealth of Nations*, p. 687.

42. Smith also saw a danger that the "common people" might suffer in their "intellectual, social and martial virtues" from their constant labor "unless the government takes some pains to prevent it." Smith, *Wealth of Nations*, p. 782. Smith was very careful in his specific suggestions to make sure that such government intervention did not create uncompetitive monopolies. For example, his suggestion that the government "impose on the whole body of the people the necessity of acquiring those most essential parts of education." He thought this could be accomplished by a combination of "parish" schools mandated by law and private "charity" schools. He cautioned that the "master" should not be "wholly paid by the publick [government]" since "if he was wholly, or even principally paid by it, he would soon learn to neglect his business." See ibid., pp. 785–786 and 759–762. For a more extended discussion of cases in which Smith looks favorably on government action, see N. Rosenberg, "Some Institutional Aspects of the *Wealth of Nations*," *Journal of Political Economy*, Vol. LXVII (1960), pp. 557–570, and Lauren Brubaker, "Adam Smith on Natural Liberty and Moral Corruption: The Wisdom of Nature and the Folly of Legislators," in *Enlightening Revolutions, Essays in Honor of Ralph Lerner*, Svetozar Minkov, ed. (Lanham, MD: Lexington Books, 2006).

a modicum of corruption, to the current situation in which government plays a large role in *every* aspect of our economy and society.

The system of natural liberty is challenged by equally natural tendencies toward corruption, tendencies that lead private interests and even government interests to push strongly against the free market.

Every expansion of the role of government, especially into matters of economic importance, is a temptation and opportunity for corruption—one might say an invitation to cronyism—and the greater the government role, the greater the temptation and opportunity. This is not to say that the people involved in commerce (or in government) are uniquely corrupt or anything but normal human beings with the normal mixture of motives. But if government is going to make laws and regulations that have a major impact on one's livelihood, one would be foolish not to pay attention and attempt to shape those laws and regulations to one's benefit. By contrast, if the free market is the context rather than government intervention, the opportunities for cronyism are largely eliminated.

The American Founders, arranging the Constitution at approximately the same time as Adam Smith was publishing his works, had a similarly sober view of the mixed motives of citizens, whether in private or public life.[43] That is why the Constitution that they proposed, and which was ultimately adopted, included what political scientists call the separation of powers and checks and balances, as well as enumerating the specific *limited* powers of the federal government. Most state constitutions of the period adopted similar restraints on government. As long as government intervenes in economic life, "crony capitalism" is a problem—and the more widespread the intervention, the more widespread the problem. Smith's insight is that a government of limited and enumerated powers offers the least opportunity for corruption. It at least circumscribes a problem that, given the need for government and our imperfect human nature, is perennial.

## Legislators' Folly

Governments at all levels sit above the societies they regulate and have only very limited knowledge of the details of any particular aspect of the society. Government is thus unlikely to be able to predict the consequences of its intervention with any accuracy. Under Smith's "system of natural liberty," every man, within the restraints of justice, is free to pursue his own interest without asking permission of government. Each person knows his own situation, the local economy, and, through the information conveyed by the free market, what goods and services are needed (potentially) worldwide. As a result:

> The sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of society.[44]

In addition to this general admonition, Smith makes the same argument in reference to many specific areas. A typical example concerns investment decisions:

> What is the species of domestick industry which his capital can employ, and of which the produce is likely to be of the greatest value, every individual, it is evident, can, in his local situation, judge much better than any statesman or lawgiver can do for him. The statesman, who should attempt to direct private people in what manner they ought to employ their capitals, would not only load himself with a most unnecessary attention, assumes an authority which could safely be entrusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so

43. "But what is government itself but the greatest of all reflections on human nature? If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary." James Madison, *The Federalist Papers*, No. 51, https://genius.com/James-madison-the-federalist-papers-federalist-no-51-annotated (accessed March 15, 2018).

44. Smith, *Wealth of Nations*, p. 687.

> dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it.[45]

By this standard, "folly and presumption" would seem to be the default description of government intervention in the economy.

**Inefficient investments, unintended negative consequences, increased cost for average citizens—these are just some of the effects of the "folly and presumption" of even well-intentioned intervention in the market.**

How is it possible that such decentralized decision-making by common citizens can produce better results for the society than the most well-intentioned and, for the sake of argument, intelligent and informed legislator or executive branch bureaucrat? Admitting that each person is closer to his local situation, how does his activity get integrated with all the other local situations? Who has the whole picture? Smith's answer? Nobody. The market—and not any individual—is the repository of the nearly infinite amount of information represented by all the individual decisions. It is a constant and efficient feedback mechanism for all those individual decisions. No one has to decide how many cars of what type need to be produced or has to account for the changes in consumer preferences due to changed fuel prices, changed economic situations, etc. Consumers make their decisions, and car producers have their answers—and adjust. Unless, of course, the folly and presumption of legislators intervene. Then, car producers may be forced by fuel-economy rules to produce cars they are unable to sell except at a loss or with a subsidy.

For example, by some estimates, subsidies for electric plug-in cars made by Tesla average $20,000 per car—and top $45,000 in California. The electricity needed to charge them is largely produced by fossil fuels, so the benefit is ambiguous (granting for the sake of argument the benefits of reduced carbon dioxide ($CO_2$)).[46] That per car money comes from the taxpayers, local and federal, and flows to those few persons purchasing the electric cars. It is unlikely that Tesla would be in business without these subsidies. Registrations of Tesla vehicles in Hong Kong dropped to zero in April 2017 after a large subsidy was removed.[47] Inefficient investments, unintended negative consequences, increased cost for average citizens—these are just some of the effects of the "folly and presumption" of even well-intentioned intervention in the market.

Smith chose as his example a government that directs investment for a reason. Whenever private decisions about where to invest are changed or directed (to assume the best case) by some idea of a social good to be achieved, the result is always less economic growth than would otherwise occur. It is "either a useless or a hurtful regulation." If the investment represents the best opportunity available, it will be made by private individuals without a mandate, and the mandate is useless. If it is not an investment that will provide the best rate of return, forcing capital into that less productive direction produces less value than would have been produced—and thus is hurtful to the economic growth of the society. "The industry of the country, therefore, is thus turned away from a more, to a less advantageous employment, and the exchangeable value of its annual produce, instead of being increased, according to the intention of the lawgiver, must necessarily be diminished by every such regulation."[48]

45. Ibid., p. 456.

46. Holman W. Jenkins Jr., "Voters Should Be Mad at Electric Cars," *Wall Street Journal*, March 12, 2016, https://www.wsj.com/articles/voters-should-be-mad-at-electric-cars-1457737805 (accessed March 15, 2018).

47. Tim Higgins and Charles Bollet, "Tesla Sales Fall to Zero in Hong Kong After Tax Break Is Slashed," *Wall Street Journal*, July 9, 2017, https://www.wsj.com/articles/teslas-hong-kong-sales-gutted-by-tax-change-1499598003 (accessed March 15, 2018). A further example: A recent study of the impact of the "Cash for Clunkers" program in 2009 found: "On net, Cash for Clunkers significantly reduced total new vehicle spending over the ten-month period," which is, of course, the opposite of the intended result. Mark Hoekstra, Steven L. Puller, and Jeremy West, "Cash for Corollas: When Stimulus Reduces Spending," *Bureau of Economic Research* Working Paper No. 20349, July 2014, https://www.nber.org/papers/w20349 (accessed March 15, 2018). Of course, it remains a speculative matter as to whether Tesla would even exist, or have a chance for success, absent federal subsidies, since they might have initially invested otherwise had they known no subsidies were forthcoming.

48. Smith, *Wealth of Nations*, pp. 456–457.

Governments lack the knowledge to regulate in a way that will produce the end they intend, even assuming only benign motives and no corruption. A classic recent example is the fact that the United States is the only country in the world to significantly reduce greenhouse gases from electricity generation over the past decade or so. This reduction is not the result of climate treaties or government policies or subsidies for alternative energy (although there have been many expensive examples of these) but rather almost entirely the result of coal-burning plants being replaced by plants burning the cheap natural gas produced by fracking.[49]

> According to data released recently by the Energy Information Administration (EIA), $CO_2$ emissions from America's electric power sector have dropped by more than 25% since 2007, reversing a multi-decade increase, and they fell last year to a 28-year low, dropping to the lowest level since 1988.... As we celebrate Earth Day 2017, it's important to remember that the hydraulic fracking technologies that were responsible for both the dramatic increases in shale gas production in the US and the resulting dramatic decreases in $CO_2$ emissions from electricity generation, were not part of any planned government energy or environment policy or treaty. Rather those promising developments that ended up being environmentally-beneficial happened primarily as a result of the efforts of private, risk-taking energy companies on private land using Made-in-the-USA technologies developed in America's private sector. In other words, those energy and environmental successes were more of a "free market triumph" as oilman Harold Hamm described it, than any deliberate effort by policymakers, politicians or energy bureaucrats to reduce $CO_2$ emissions by government fiat.[50]

What does all this have to do with preventing cronyism? Cronyism (when it is not outright or secret corruption) usually requires that the public believe that government can effectively intervene in the economy for some claimed general good. If the public thinks such intervention is likely to produce the result desired without huge extraneous costs, that appeal is much more likely to succeed than if the public understands the argument just described about the "folly and presumption" of legislators. All such government interventions face both the problem that directing investment to some purpose to which it would not normally go reduces economic growth and the problem that such direction often or usually fails to accomplish what it intended or has other expensive negative consequences. A public aware of these constraints is less likely to go along with specious new interventions—with their attendant cronyism and corruption.

In addition to the problem of misdirected investment, the consequent drag on economic growth, and the frequent negative unintended consequences, the mere existence of the ever-increasing number of regulations is an additional drag on the economy. The number of regulations and the cost to the country are disputed questions. While definitive answers are probably impossible, it is possible to make some estimates. The total cost of federal regulations is estimated to be as high as $2 trillion annually, the cost to companies in general around $10,000 per employee per year, and the cost to manufacturing companies around $20,000 per employee per year.

However, this cost does not fall equally on all companies. Small manufacturers (less than 50 employees) face an estimated cost of nearly $35,000 per employee, while large companies (greater than 100 employees) face a cost of "only" around $14,000 per employee.[51] Even if these numbers are not precise, the general picture is clear. The total drag on

49. To be sure, anti-coal and anti-nuclear biases drive up regulatory and other costs making both energy sources less competitive. For example, an energy company may determine that shutting down a perfectly good coal plant rather than upgrading it makes more sense given current fears over future $CO_2$ regulation, and nuclear plants face uncertainty over waste disposal due to the failure of Congress to act.

50. Mark J. Perry, "On Earth Day, We Can Celebrate Being One of the Only Countries to Reduce $CO_2$ Emissions—Thanks to Fracking," American Enterprise Institute, April 19, 2017, https://austrian.economicblogs.org/carpe-diem/2017/perry-earth-co2-emissions-fracking-2/ (accessed March 15, 2018).

51. National Association of Manufacturers, "The Cost of Federal Regulation to the U. S. Economy, Manufacturing, and Small Business," http://www.nam.org/Data-and-Reports/Cost-of-Federal-Regulations/Federal-Regulation-Executive-Summary.pdf (accessed March 15, 2018). See also Clyde Wayne Crews, "Ten Thousand Commandments," Competitive Enterprise Institute, 2017, https://cei.org/10kc2017 (accessed March 15, 2018).

the economy is enormous, and regulations fall disproportionately on new and smaller companies. Numerous theories have been offered for the sluggish recovery from the recent financial crisis—and more generally the sluggish growth this century (somewhere under 2 percent per year, as compared to 3.5 percent from 1950–2000). John Cochrane, a Senior Fellow at the Hoover Institution of Stanford University, surveyed several explanations for this dramatic slowdown, and contends that the

> U.S. economy is simply overrun by an out-of-control and increasingly politicized regulatory state. If it takes years to get the permits to start projects, and mountains of paper to hire people, if every step risks a new criminal investigation, people don't invest, hire or innovate. The U.S. needs simple, common-sense Adam Smith policies.[52]

If the costs of regulation in general, and of specific regulations, were better understood by the public, their susceptibility to the seductive call that "there ought to be a law" to fix this or that would be substantially lessened. This is important because in a democracy the ultimate check on cronyism is the opposition and disgust of the public expressed through elections.

## Conclusion

Adam Smith's reason for studying economics was to determine how best to provide for an increasing standard of living for the non-elite members of society. This was only possible, he argued, in an environment of increasing economic growth, and the best means of promoting this necessary growth was the "system of natural liberty."

Yet Smith was aware that natural liberty faced natural obstacles in the form of human nature and particularly the desire by "merchants and manufacturers" to use the power of government to procure for themselves "systems either of preference or of restraint" that distort the free market to their advantage. In so doing, they impose an "absurd tax on the rest of their fellow-citizens." Smith traces the effects of these preferences and restraints, or crony capitalism. He shows that they fail on two grounds: They are unjust, favoring a few at the expense of the many, and they are destructive of the desired end of political economy—economic growth.

A government limited to a few essential powers (defense, administration of impartial justice, and certain limited public works and institutions), combined with an awareness on the part of the public of "the folly and presumption of legislators," offers the best chance to limit or reduce crony capitalism and its corruption of natural liberty. Only then will the incredible benefits of free markets be available to all. He was well aware, however, that this solution is not simple and will always be opposed by the interests of many groups and individuals and the prejudices of parts of the public, usually encouraged by these very same interests.

In Smith's view, economics is not a dismal science, but a noble one:

> Political economy, considered as a branch of the science of a statesman or legislator, proposes two distinct objects; first, to provide a plentiful revenue or subsistence for the people, or more properly to enable them to provide such a revenue or subsistence for themselves; and secondly, to supply the state or commonwealth with a revenue sufficient for the publick services. It proposes to enrich both the people and the sovereign.[53]

This science can offer guidance, but no guarantees. General principles always have to be realized in the messy world of competing nations and domestic interests. The benefits of natural liberty can be attained and maintained only by constant political vigilance against the powerful and ineradicable tendencies endemic in human nature to "rig the system" through preferences and restraints to the benefit of a few and the detriment of the "great body of the people." A government of limited and enumerated powers based on checks and balances offers the best framework for natural liberty—but no guarantee against the corruption of crony capitalism.

If it is not possible to change human nature, our hope lies in informed and vigilant opposition to cronyism. Smith intended his writings to give

52. John H. Cochrane, "Ending America's Slow-Growth Tailspin," *Wall Street Journal*, May 3, 2016, https://www.wsj.com/articles/ending-americas-slow-growth-tailspin-1462230818 (accessed March 15, 2018).

53. Smith, *Wealth of Nations*, p. 428.

intellectual grounding for the constant political effort to stymie those private interests and to defend natural liberty—to "enrich both the people and the sovereign." To the extent that we have benefited from the great enrichment brought on by the adoption of natural liberty, we—in particular, the less privileged members of society—should give thanks to and learn from this great benefactor of mankind. How great and how widespread those benefits continue to be depends on our understanding of cronyism and its prejudices and our persistence in opposing it.

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