



On the Elusive Search for Social Justice Under Democratic Capitalism Since Adam Smith

by

Syed Nawab Haider Naqvi



“Civil government, so far as it is instituted for the security of property, is in reality instituted for the defence of the rich against the poor, or of those who have some property against those who have none at all.”

Adam Smith

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About the Author

Prof. Dr. Syed Nawab Haider Naqvi is one of the most renowned scholar, academician and noted economist of Pakistan. Dr. Naqvi for his distinguished services in Economics received highest academic excellence award 'Sitara-i-Imtiaz' from Government of Pakistan in 1991. His work was cited in Who's Who in the World, 5th Edition (1980-81), while other credits include him receiving ECO Award for outstanding performance in the field of Economics in 1992 and HEC Life-Time Academic Achievement Award in the year 2009. Dr. Nawab for his literary contribution received award of book of the year award for The Evolution of Development policy (Oxford) November 1, 2016. Prof. Naqvi was also nominated in the list of the Outstanding People of the 20th Century in 1999 and in 2000 Outstanding Intellectuals of the 20th Century in the year 2000.

Prof. Naqvi has authored more than 35 books and monographs and published more than 80 research articles in journals of national and international repute. He has the membership and association of more than 25 societies and boards and remained the Editor/Board of Editors for more than 10 national and international journals. Dr. Nawab has also delivered more than 60 lectures at national and international seminars/conferences and universities in the field of his interest and expertise which includes development economics, international economics, agricultural economics, comparative economic systems, econometric model-building and Islamic economics.

Prof. Dr. Syed Nawab Haider Naqvi has served in different capacities at both inside and outside Pakistan. He remained allied with Global Issues Initiative, Virginia Tech University as Associate Faculty, Federal Urdu University, Islamabad, Campus as HEC Distinguished National Professor and Director General, Institute of Development Research, Islamabad as President, Nepra, Government of Pakistan as Economic Adviser, and, MCB as Economic Adviser. Dr. Naqvi served as Director, Pakistan Institute of Development Economics, Islamabad and was placed in Article 16 of the Warrant of Precedence for Pakistan with the equivalent status as of a Federal Secretary during 1979-1995 and as Chief, Economic Affairs Division, Government of Pakistan during 1971-72. He also served as Visiting Professor at Heidelberg University, West Germany and in the Faculty of Administrative Science, the Middle East Technical University, Ankara.

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*“How selfish so ever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it. Of this kind is pity or compassion, the emotion which we feel for the misery of others when we either see it or are made to conceive it in a very lively manner. That we often derive sorrow from the sorrow of others is a matter of fact too obvious to require any instances to prove it; for this sentiment like all the other original passions of human nature is not confined to virtuous and humane though they perhaps may feel it with the most exquisite sensibility. The greatest ruffian, the most hardened violator of the laws of the society, is not altogether without it (Adam Smith, the opening paragraphs of *The Theory of Moral Sentiments*, 1759 p.3).”*

➤ **Introduction**

The topic of this essay covers a wide field the problems related to achieving social justice in a democratic market society, one that is based on democracy and debate. As Forrester (2019) has pointed out political philosophy in the English speaking world today is largely concerned with a set of liberal ideas about justice, equality and the obligation of individual citizens in capitalist welfare states. These ideas got a new life in the post-Second World War with the publication of John Rawls a *Theory of Justice* (1972), which “for a generation of social philosophers it was a justification for social democracy, aimed at reducing inequality and fostering reciprocal relations between citizens” (p.105). A just society in his account was based on a property owning democracy where inequalities were heavily circumscribed and everyone had a stake. It contained an implicit repudiation of the market only oriented society with a minimally interventionist state’ and an explicit commitment to public democratic institutions and to improving the lot of the least well-off. It offered a robust defense of a welfare state. Such a society by harnessing the motivational forces that sustain

it would build a humane and efficient economic system at a time when inequalities are exploding and environmental decadence has reached dangerous limits. It would allow man to hang on to hope of a better future while being unrealistic. Hirschman (1977) traces the long history of the evolution of the central ideas of capitalism to show that it basically exalts the acquisitive instinct of man to acquire wealth for personal gain, indeed, it provides the basic economic argument for the untrammelled pursuit of self interest and that in a roundabout way it contributes to social welfare as well. Adam Smith's account of capitalism with which this essay is concerned supersedes the preceding debate about passions and interests by emphasizing the gains that this acquisitive pursuit brings. He shifted analytical focus to the proposition that material welfare is best served by letting each member of the society to pursue his own material self interest. In this pursuit, democratic capitalism has proved to be the survivor system when all others seem to have failed. This is not to deny its failures, but to show that none other has succeeded more since Adam Smith invented it more than 200 years ago and since the Industrial Revolution showed humankind that poverty is manmade and can only be cured by economic growth which holds the key to economic prosperity for all, rich and poor. Yet the possibilities for growth are not open ended, there are definite limits to it set by the environmental catastrophes it can cause; however, it is important to understand many elements of this motivational dynamism. One important such element is the central role of government which acts as a catalyzing force for change by creating a reliable framework of laws and institutions within which market forces must work. Put it the other way. Democratic capitalism contrary to what the neo-liberalists would have us believe is not laissez faire in which the role of the government is minimized or is considered harmful. What we need is intelligent and selective interventionism guided by a commitment to build a society based on compassion and respect. When these things are understood and implemented properly this system has proved stable in the sense of John Rawls (*A Theory of Justice*): that individuals in the society generally uphold and safeguard the broader values on which it is based and that it gratifies human desire for autonomy and contributes to human prosperity.

Yet there are tensions within the system which if not recognized can lead to defeating the broad purposes of such a system. Thus for instance, there is a tendency for the self-interest of the main players in the capitalistic society to overwhelm their interest for the society; which aggravates social injustices the share of labor in total income declines while that of capital rises. Rising inequality and capitalist's excesses have put strains on the system, and the needs of those

left behind in the race to development remain unrecognized and unremedied. If nothing is done to rectify these problems, then, as Piketty (2014) has shown, the Marxian apocalyptic vision may become a fact, overturning the apple cart of the democratic order. The Western societies saw this danger coming and met it by welfare states coexisting with capitalism so as to continue with the dynamism of the latter with the desire to keep social injustices in check. But, as Corneo (2017) maintains there seems to be an in-built tendency for capitalism not to accommodate a welfare state, which is the reason why welfare states have been cut down in scope and intent, which is one of the development problems faced by every country rich and poor. These difficulties have to be met at the political level by reasoned debate and by the commitment of the democratic parties not to forget their commitment to the poor when they gain power.

➤ **Adam Smith's Vision**

This essay takes its cue from Adam Smith (born June 5, 1723) to give an historical perspective to the story it tells of the evolution of the capitalist system, and its relationship with the public interest and with its capacity to grow economically, culturally and even morally, partly under its own momentum but always with the helping hand of a government committed to providing social good. Indeed, it is in the context of a well functioning government that the case for the competitive markets system is the strongest. With all the controversies surrounding it the fact is that capitalism, as outlined with a broad brush by Smith, has come out as a winner system, notwithstanding its many costs like selfishness, isolation, anxiety and alienation. As Milanovic (2019) has convincingly shown democratic capitalism now stands alone as an economic system in the sense that the entire globe now operates according to the same economic principle: production is organized for profit using legally money wage labor and mostly privately owned capital, with decentralized coordination, with the inherent property to expand geographically, which is globalization. In terms of its influence on social values it is that money-making within limits is accepted now as an economically and morally sound activity. This understanding has hard wired the acquisitive and competitive spirit into capitalism without which income declines and poverty increases and technological advancement slows. So it is not surprising that in an opinion taken in 2005, 61 per cent of the inhabitants of our planet considered a free market system within a democratic polity as the best system as a basis of our future (cited in Nobel Laureate Tirole (2017)). So Adam Smith's expansive vision of a capitalist society that works both for the rich and

the poor remains a valid basis for thought and discussion even today. He was especially concerned with the quality of human life at a time when extreme poverty prevailed in some countries but when some were emerging from it, though very slowly. He had watched that countries which adopted pro inclusive growth policies benefited the very poor a lot. So he wished to understand the public institutions which help in alleviating human condition. He saw democratic capitalism as based on natural liberty supported by a limited but a responsive government that ensures among other things the maintenance of social justice and which intervenes selectively on behalf of the underdogs. He had the analytical power to see the bottom of things in the 17th century and to indulge in an unflinching confrontation with human condition and to make it better. Like Karl Marx his project involved deep concern with human emancipation and freedom from poverty and wants. Although some of his ideas were reflected in the writings of the earlier thinkers, but his originality lay in the fact that, “What in the writings of earlier scholars was either scattered or inconsequential became in his own great work a well-knit whole of great effectiveness” [Edwin Seligman (2017 edition)].

It is a tribute to the sagacity, humanity and foresight of Adam Smith, who by common consent is both the father and the smith of economics which bears the stamp of his work that he foresaw some of these problems for the first time, practically invalidating the economic and philosophical consensus at the time. He saw capitalism as a system of “natural liberty” leaving no doubt that the socio-economic system he envisaged is essentially democratic not totalitarian based on central command. His model of the market is also freely competitive and self regulating but has little room for the emergence of the monopolies. Indeed, it can be safely stated that, as Agnar Sandmo (2016) points out: “that Smith’s minimum requirement for the market to work in the public interest is the absence of monopoly” (p.235) And, as opposed to the Physiocrats of France who gave a starring role to agriculture and land development, he features manufacturing and trading as the real contributors to the wealth of the nations and its continued growth. Also, as Ross (2016) points out “his theories were a direct challenge to the theories of intrinsic human selfishness advanced by Hobbes and Mandeville” (p.xxv). While emphasizing the dynamic qualities of capitalism (a term which he never used) he was wise enough to pinpoint the moral problems of a commercial society. He emphasized that economic, political and moral checks are required to keep a capitalistic society working for all the people, rich and poor. In this context, contrary to common perception, Adam Smith envisaged a large though selective role for the government, which he regarded as the most impor-

tant institution on which a commercial society depends because the authority and security provided by it is necessary for the flourishing of “liberty, reason and happiness of mankind”. In particular, he emphasized an intrusive role for the government to provide universal and free education as well as humane poverty relief to the least privileged in the society. He had an abiding faith in humankind’s ability to make progress and move in stages to the ideal goal of “the liberal plan of equality, liberty and justice” (Wealth of Nations, 1V; 1x; 3). He was quite clear that the benefits of a commercial society would need a large government charged with such basic functions as national defense, justice security under the law and infrastructure and also making adequate social expenditures. A proactive government when social goals demand is a necessary precondition for a market economy to create “universal opulence which extends to the lowest ranks of the people”. Milanovic (2019) points out, surprisingly prophetic is Adam Smith’s, predication in his all time classic. The Wealth of Nations that capitalism standing alone as a Western creation will eventually lead to an internal schism into liberal meritocratic capitalism led by the West (that is one in which careers are open to talent) and political capitalism (that is communistic or socialistic) led by Asia (really China). This convergence in terms of economic rebalancing at the global level would be led by what is known as the ICT (information and communication technologies) revolution just as the Industrial Revolution of 1776 led to the divergence between the West and the East (or the North and the South). Also, as Sen (2016) has comprehensively shown Smith’s prescriptions as given in the Wealth of Nations are relevant for those faced by the developing countries partly because when was writing the economies of Britain and France were roughly at the same stage of development.

By no means a narrowly focused economist on free markets and their mysterious capability to bring order to an apparently chaotic economic universe via the celebrated Invisible Hand, Adam Smith was no less concerned about the broader social commitments to virtue, justice and equality and freedom. His multifaceted perceptions about the potentialities and problems of a commercial society (read capitalistic society) as brought out in Hanley’s edited volume (2016) are still relevant because of their evergreen quality and because they are based on social values that are more or less universal now. They are rooted in the 18th century Enlightenment, which roughly began with the Glorious Revolution of 1688 in England and ended with the French Revolution a century later. This period by virtue of its belief in the educability of humankind, aimed at creating a society of emancipated individuals and enlightened classes. These ideas for all their apparent conservatism (as they emphasized the incremental rather

than a revolutionary nature of social change) were imbued with a deep sense of helping the poorest in the society. His was a firm commitment to the equality and dignity of all the people regardless of their race and color and cultural and national backgrounds. He is then the first economist to put democratic capitalism at the center of his analysis of a well functioning society at the time when the economy still had an agricultural bias (and the Industrial Revolution had not yet fully spread its wing). While he understood that “it is well that nature thanks to our self interest rouses and keeps in motion the industry of mankind”, yet, as he clarifies in the quote above, self interest here includes the interests of the society because it is also part of our nature to be happy on the well being of others and to feel bad at their misfortunes. There is no confusion here because Smith considers an individual to be an inseparable part of the social system. It is thus that capitalism works well for the poor and not just for the rich. Thus we should be grateful to Adam Smith for lifting the cloud of confusion hanging around the idea of a capitalist society as being both eco-nomically and ethically beneficent as well as benevolent.

His greatness lies in combining the economist’s understanding of the market system with the ethicist’s appreciation of the moral challenges that such a society faces. This vision is laid out in two essentially complementary timeless classics: *The Theory of Moral Sentiments* and *The Wealth of Nations*, both of which he kept revising till his death in 1790. In *The Theory of Moral Sentiments*, which is his first and last book Smith offers a reasoned explanation of the manner in which we form moral judgments’ the way in which we arrive at canons of virtue and criteria of vice based on the belief that these are based on education and social experience. He was convinced, as Phillipson (2016) points out “the source of our cognitive powers lay in the imagination, the passions and the customs and habits we acquire in the course of common life” (p.108). It, in the words of Nobel Laureate Amartya Sen, it is “a modern day global manifesto of profound significance to the interdependent world in which we live of his other masterpiece the *Wealth of Nations*, which successfully explained the origins of wealth and how it is constituted, Thomas Malthus (1766–1834), author of the 1798 *Essay on the Principle of Population*, went so far as to claim that Smith’s *WN* “has done for political economy, what the *Principia* of Newton did for physics” (1986: 257). Later on, so great an economist as Alfred Marshall said that what he has said “it is all in Adam Smith”; it still stands alone as a work of uncommon erudition and keen observation. Being an empiricist, Smith attempted in it to accomplish the daunting task of laying bare the mechanism by which a democratic capitalist society hangs together. Here by contrast, the dominant determi-

nant of human motivation is self interest though it is not naked self interest but one that is subject to well known moral and just rules of conduct, as Nobel Laureate Vernon Smith and Bart Wilson (2019) have convincingly shown. The butcher baker brewer example in the second quote above from the *Wealth of Nation* properly interpreted is not the standard bearer of an invisible hand guided by unalloyed selfishness; it rather denotes the limited reach of benevolence as an explanation of the working of economic universe). It also tells the history of how the system of “natural liberty” came into being and how it worked his task, in which he succeeded superbly was to discover in the welter of apparent disorder a unifying mysterious chord so that when he was done what looked like a chaotic set of events became an orderly progression and the apparent tumult of the real world resolved into a chord. Indeed, as Heilbroner (2003) noted, this book had a wider canvas of thought: it reflected the 18th century optimistic vision in the inevitable triumph of rationality over arbitrariness and chaos. It is also consistent with the Darwinian thesis of the evolution of human societies (Incidentally, Darwin claimed that he gained considerably from Adam Smith’s ideas). There is a great deal of turbulence and variation at the micro level, but the decentralized actions and interactions of individuals give rise to a relatively orderly system at the macro level. This macro level order is relatively stable, recognizable, and scientifically describable, though it is still subject to change over time, at least at the margins, as a result of individuals’ changing circumstances, purposes, and experiences. Indeed, as Hanley (2019) points out the Invisible Hand is a metaphor and specifically a metaphor for what Smith himself has called a system of natural liberty. Smith’s genius lies in making visible the many resemblances between the discrete parts of the system that appear invisible at first glance (p.138). It may be fruitful here to conclude this section by re-emphasizing why Smith’s two classics must be read together, keeping them so to speak side by side on the reading table. The reason is that he considers the process of acquiring wealth, which is essential for bettering the lives of the poor as well as satisfying the vanities of the rich, yields fruits that are both sweet and bitter. It fundamentally depends on the state of one’s mind. Smith emphatically states: “Happiness and misery which reside altogether in the mind must necessarily depend more upon healthful and unhealthful, the mutilated or the entire state of mind, then upon that of body”. The main point is that happiness is much less the result of our physical conditions than our psychological condition. Thus as an author of the *Theory of Moral Sentiments*, he emphasizes that the rat race to keep running “enchanted with the distant idea of this felicity”(of a poor man’s efforts to become the equal to the rich to merit same attention as the latter does)

may end up by making a man unhappy. But as also the author of the *Wealth of Nations* he knows that this striving for betterment of one's condition is the power that makes possible economic growth as well as alleviation of poverty. It may be noted here that he was most concerned about reduction of poverty because poor persons remain "out of the sight of mankind" and are overlooked for that reason. Thus poverty must be removed for material reasons (to keep the body and soul together) but also to enable the poor to get the recognition and respect that everyone rich and the poor equally want but which only the rich get. This was the main reason why Smith regarded commercial society as essential for humankind. There is another connection here that links the material pursuits of a commercial society to the ethical goals that a man of "perfect virtue" must strive for. It is that the man whom we revere and love the most is he who joins to the most perfect command of his own original and selfish feelings the most exquisite sensibility both to the original and sympathetic feelings for our others. With such striving in the society man through the agency of the mutual sympathy and the "impartial spectator" also contributes to the betterment of the society. Here he explicitly states that the perfection of the self contributes directly to the perfection of the society of which man is a part. In other words, the perfection of the self and that of the society are not zero-sum or either or ventures they very much complement and reinforce each other. Thus it is the single life that we are aiming at to achieve: where self perfection and social perfection join each other. Such a person is both wise and virtuous and is the peak figure for his ethics. Smith states this point emphatically at different places: "By acting according to the dictates of our moral faculties we necessarily pursue the most effectual means for promoting the happiness of mankind" and this is the link that joins the subject matter of his two classics. It is really at a deeper level the condition of the success of the capitalistic society to perform both the material and ethical aspects of human calling a condition that capitalist societies are far from satisfying, as we will see.

➤ **The Integrated Nature of Adam Smith's Vision of Human Society**

It may be of interest now to look at Adam Smith vision of an efficient and humane democratic capitalism, in some more detail. As noted above this vision is laid out in the two books he wrote.

1. The Theory of Moral Sentiments (1759/1790)

In 1759 he wrote his first classic *The Theory of Moral Sentiments*, which contains a unique analysis of the nature of virtue and what it takes us to act vir-

tuously. As Ross (2010) points out its achievement is to produce a definition of virtuous action that comprehends what is truly lovable such as benevolence. Since it was extensively revised a year before his death in 1790, the present edition should be regarded as his last book as well. It lays down that men be other-regarding, the dominant human motivation being benevolence. He pointedly states that “while prudence was of all virtues that which are most helpful humanity, justice, generosity and public spirit are the qualities most useful to others”. Indeed, he makes a stronger claim: namely, that man must act accordingly to create circumstances that make life good for us as well as for others; “Man was made for action and to promote by the exertions his faculties such changes in external circumstances of both himself and others as may seem most favorable to the happiness of all.” As Hanley (2019) points out, Smith would not consider it enough if one merely wishes well for others unless these wishes are followed by appropriate actions to realize those wishes in the real world. But that requires hard work “it will call forth the whole vigor of his soul and strain every nerve”. He in fact warns that living such life is not for the faint of heart. The difficulty arises because each individual is endowed with the faculty of caring for oneself he is blessed with the equally strong desire to help other and that these faculties pull in opposite directions. The great challenge then lies in living a full life that is caring for oneself as well as caring for others, both of which are innate. To make space for such behavior it is necessary “to make changes in the external circumstances of both himself and for others”. Also these changes must be such as are for the happiness of all. Here we see Smith’ ethical instincts and his understanding of a commercial (capitalistic) mixing together into a powerful argument for a workable democratic capitalist society.

The book presents an original theory of moral judgement, the cornerstone of which is sympathy the sentiment that helps us feel in some what others feel about us and which is part of human nature. Sympathy is in turn assisted by another mechanism. This comes about through the agency of a vicarious “Impartial Spectator” which is supposed to be an ideal judge whose thinking is unclouded by undistorting feelings and who can deliberate coolly and calmly what is right and what is wrong. It is not however as some mysterious character, but it is rather the amalgamation of a life time of experiences of judgements. The working of the impartial spectator could not be described without reference to a real-life society without which we cannot even think of our own character any more than we can assess the ugliness or the beauty of our own faces. The society acts as a mirror in which we can see these things. Over time it is through our social interactions that we construct a set of principles upon which we rely to judge

both ourselves and others. As we mature, this set of principles gradually coalesces into an increasingly coherent picture of virtue and vice, of propriety and impropriety. It becomes the standard against which we judge human behavior; when we use it to judge our own conduct; it constitutes what we call our conscience. The fully morally mature person, Smith thinks, will judge himself by this imaginary and idealized perspective, which will give us more reliable guidance than the often biased actual spectators around us will. Through its agency “we place ourselves in the situation of another man, and view it as it were with his eyes and from his station”. The impartial spectator so defined enables us to see ourselves from certain distance to rule out the influence of vested interests and the impact of traditions and customs with a view to achieving a modicum of objectivity in a reasoned discourse. However, there is a problem which Smith saw clearly it is that the impartial spectator’ vision can be beclouded by what is regarded as self conceit, which he regards as “the fatal weakness of mankind” and “is the source of half of its disorders” and which would make it a little too partial in as judges of our character. An yet In case of a manifest injustice the impartial spectator would also allow us to subject our sense of victimhood to critical scrutiny to determine whether there does or doesn’t exist a case for sustained condemnation of injustice. [Sen (2009) p.45]. At work here is the force of “mutual sympathy” which heightens our pleasures; “enlivens joy and alleviates grief”. The desire for mutual sympathy, and the pleasure it affords when it is achieved, is, for Smith, the glue that holds human society together. Without it, we would have no community, and thus no morality; with it, both community and shared moral standards are enabled. It also provides much of the foundation for the ideas in his later works, (most notably in *The Wealth of Nations*). In it, Smith expresses his general system of morals, exploring the propriety of action, reward and punishment, sense of duty, and the effect of numerous factors on moral sentiment. In so doing, Smith devised innovative theories on virtues, conscience, and moral judgment that are still relevant and accessible today. Though it is somewhat surprising to find a philosopher of Smith’s abilities discussing aspects such as luck and sympathy and how they affect self image or relationships, “*The Theory of Moral Sentiments*” never loses its critical excellence in its good natured understanding of the human exploration for the meaning of being good. Its opening line, cited above lay down the basic principles of human conduct, including his economic activities: “How selfish so ever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, thought he derives nothing from it except the pleasure of seeing it” (p.3). The most important point he made in the book is that, as

Nobel Laureate Vernon Smith and Bart Wilson (2019) point out that contrary to common misconception, Adam Smith did not regard self interest alone as the guiding principle of human action. He does not use self love in the sense of naked selfishness; it is rather one's "own love" as long as other persons can go along with. Though self love is at the core of our being yet it is that of a responsible person whose personal maturation is shaped by mutual other regarding fellow feelings, we feel happy out of mutual sympathy which implies a resonant relationship with fellow men that teaches us to learn context dependent rules of conduct so that we can live in harmony with others. It also leads him to lay down some key principles on intentional acts of beneficence and injustice which provoke corresponding feelings of gratitude and anger. It may be noted here that Smith's model is a total repudiation of the Max (U) Arrow-Debreu model which is mistakenly proffered as a faithful description of all human decision making and which is devoid of any practical significance as it mistakes the heavily conditional (based on assumptions) propositions for the real world behavior of individuals. As Nobel Laureate Amartya Sen (2009) points out "Smith's analyses and explorations are of crucial significance for any society of a world in which issues of moral, politics and economics receive attention, Indeed, Theory of Moral Sentiments may be regarded a global manifesto of profound significance to the interdependent world in which we live". It in fact, it shows how Smith, a student of the soul as well as of a commercial society, sets forth a vision that is uniquely suited for us today as helping us to understand what makes for a good life [Hanley (2019)].

2. The Wealth of Nations (1776)

We now come to Adam Smith's earth shaking book The Wealth of Nations which totally changed the face and context of economics as was prevalent before his time. The greatness of the book lies in its ability to mix expectations of social progress with a sobering recognition of capability to deal with them. Essentially it encloses the discussion of economics in a historical framework. It spells out in encyclopaedical details the principles upon which modern capitalism is based and the processes by which wealth creation occurs. Even though he did not use the word capitalism in the book, he presented in it an astute analysis of the key factors responsible for capitalistic activity. He also praised the enhanced public liberty that came with the capitalistic process of barter, truck and exchange. Even more, rejecting the current religious orthodoxy, he regarded the promotion of national wealth through the markets a desirable goal worthy of the attention of the social philosophers, because it promoted cooperative modes of behavior and

because it makes men more self-controlled. It is however, also the book which has led to grave misunderstandings about what he meant by say the invisible hand of the market and correspondingly the minimal role of the government in managing a commercial society. There is another aspect of the book which is that it traces the establishment of a commercial society as a result of an ineluctable historical process that gradually replaced feudalism and its follies by a system of natural liberty. This progression from feudalism to a commercial (read capitalistic) society is pushed forward by two related aspects of the later: one is its self-regulating nature and the other is the capacity of such a system to generate growth, financed by saving and investment and the division of labor. However, this self-regulating nature of the capitalistic system does not minimize the role of an active government which is supposed to do three things: defense, provision of law and order and the provision of infrastructure. Fulfilling these preconditions would prevent a society of natural liberty to start down a slippery slope. What he argued against was the pretension of the government that it knows better than the market as to how to regulate it. This system of perfect liberty that capitalism provides makes sure that the wealth it generates is for both the rich and the poor. There is another aspect of the capitalistic system which is negative and that is that excessive division of labor and specialization dulls the creative capacity in the laborer and he can become “as stupid and ignorant as it is possible for a human creature to become, unless the government takes some pains to prevent it”. This is done by the state providing free public schools to educate the children of the poor to enable them to do more specialized jobs a progressive capitalist system requires.

Both errors of interpretations flow from the tendency so to speak to consider the main theses of his two books as unrelated, as if there are two Adam Smiths. This is all the more surprising because he kept on revising his first book even after the publication of the *Wealth of Nations* until 1790. Indeed, the fifth and the last edition of the *Theory of Moral Sentiments* appeared in the same year when he died and came after five years of the publication of the *Wealth of Nations* and incorporated a lot of what he said in the later. For instance, the first quote above has been the source of a total misunderstanding of the meaning and significance of self love as main a driver of human activities. Indeed, by appealing to the self love of the baker, butcher and brewer Smith means as he makes clear “allowing each man to pursue his own interest his own way is made conditional upon the liberal plan of equality, liberty the laws of justice”; and again “every man as long as he does not violate the laws of justice” should be allowed to pursue his own interests his own way. It also means that benevolence though

an admirable human characteristic is of limited significance as a principle of man's economic endeavor when dealing with persons with whom one is not familiar. Indeed, he maintained it would be "morally demeaning" to depend on the benevolence of a person without appealing to his self interest. Only a beggar would do that. Also Smith assigned important tasks to the government to run a society based on the principles of justice, equality and liberty. He clearly saw that the growth of the market and the corresponding division of labor are the source of much that is good in a civilized society but they were also the source of intrinsic dangers which it was the duty of the legislator to obviate.

➤ **The Invisible Hand Not One but Two!**

As noted above one of the key misunderstandings of the Wealth of Nations relates to the attribution to it of the centrality of the invisible hand principle which keeps a real world economy on an even keel without any steersman. Most surprising thing however is that this misunderstanding has been caused by no less a person than 'The Nobel Laureate Kenneth Arrow' who is indisputably the greatest of all modern economists. At the start of the influential book General Competitive Analysis which he wrote with Frank Hahn, it is stated:

"There is by now a long and fairly imposing line of economists from Adam Smith to the present who have sought to show that a decentralized economy motivated by self-interest and guided by the price signals would be compatible with a coherent disposition of economic resources. Thus it can be maintained that Smith was a creator of the general economic theory." [cited in Norman (2018)]. Such an attribution on the basis of which one of the most mathematically beautiful Invisible Hand theorem that perfect competition is Pareto optimal and a Pareto optimal solution leads to perfect competition was proved and for which he and Debreu were awarded Nobel Prize. The irony however is that this eye-catching theorem is based on a misunderstanding namely that Smith never mentioned the invisible hand in this sense. Indeed, this term appears only once in the wealth of Nations and one more time in the Theory of Moral Sentiments but in different contexts as explained below! The relevant passage in the Wealth of Nations runs as follows:

by preferring the support of the domestick to that of foreign industry y, [the domestic investor] intends only his own security and he in this, as in many other cases led by an invisible hand to promote an end that was no part of his intention. Nor is it always the worse for the society that it was no part of it" [p. 456].

It is thus clear that there is no mystery about the invisible hand, indeed, in the context that it is stated it is plain common sense. However, there is another fundamental principle in which all social science is based that is, to prove that there may be have unintended consequences of public policy. It is interesting to note however that there is another Invisible Hand which makes its appearance in the Theory of Moral Sentiments. Here it is not that ghostly character that brings order to the apparent disorder of the mercantilist society, it in fact denotes an indirect intervention of the Deity in human life. Here It appears as one that brings order and stability in society without which an economic successful economy cannot function. Here is a theme that runs through the Theory of Moral Sentiment. It is the means by which the author of the Universe has assured that Man will achieve the purpose for which he is created despite the frailty of his reasoning powers. Here we find the link between the Wealth of Nations and the Theory of Moral Sentiments, and the ambitious reach of the Adam Smith's project. There are two aspects of the Invisible Hand that make The theory of Moral Sentiments the foundations of the Wealth of Nations. The first describes the "passion" (not the "reason" he emphasized) that is put in our heart by the Deity to acquire wealth. Through its agency the unsocial actions of acquisitiveness undertaken for private gain get transmuted into the social act of creating wealth that will benefit all. So by virtue of the inborn capacity to doing good that "the rich are led by an invisible hand to make nearly the same distribution of the necessities of life which would have been made had the earth been divided into equal proportions among all its inhabitants and thus without knowing it and intending it, advance the advance the interests of the society, and afford means to the multiplication of the species" [cited in Heilbroner (1986, p.61)]. Thus the accumulation of wealth undertaken by private motive eventuate a socially useful outcome; here is a shining example of the unintended social consequences of private actions and also the benevolent force of nature. Here we find also the moral basis of the market without which a capitalistic society would not find the motives necessary for its existence that human kind does seek wealth and accept a modicum of inequality, something that Adam Smith traces to the elemental forces of human psyche. The Invisible Hand is in fact a metaphor for a system of "natural liberty" as he calls it. He recognized too that this system is extremely complex machine that coordinates the activities of the untold parts. Smith showed these parts hang together, to make visible the many resemblances that seem invisible at first glance. The same thing holds for his moral philosophy. However, it needs to be understood that while the term invisible hand occurs only once or twice as noted above, that is not minimize its importance in Smith's plan of thinking. The genius,

and the power, of Smith's Invisible Hand argument it offers a path for channeling the individual's limited knowledge and self interested concerns into benefit, even inadvertent benefit, to others. It is also a bridge between his two books. What he accomplished more than 200 hundred years ago was nothing less than what appeared to most like the Sphinx Riddle.

I now pass on to the second element of this essay which is the crisis of democratic capitalism which Adam Smith first envisioned.

➤ **The Existentialist Crisis of Democratic Capitalism**

I now come to the second part of this essay: that is, the crisis of democratic capitalism the inner working of which Adam Smith wished to reveal, The fact is that for all its munificence as unrivalled creator of wealth and the guarantor of personal freedom, capitalism seems to have lost its way as modern corporation has fallen prey to crony capitalism which seems to have thrived on the enormous profitability of lobbying. Indeed, Tepper and Hearn (2019) and Stiglitz (2019) point out that capitalism is no more than a myth now, as it no longer rest on market competition but on monopolies and oligopolies. The net result of this process is to depress the worker's wages and raise the profits of the capitalist. The tragedy is in the US for instance, the workers have little bargaining power to negotiate for a raise in wages. In particular, Most capitalists enjoy monopsony power in the labor market namely, they are the only buyers of labor in the market. To make matters worse, the labor are increasingly unable to bring law suits against their employers because of the clauses hidden in their employment contracts. Democratic Capitalism is also being stymied now by a combination of social polarization and income inequality and widespread dissatisfaction with democratic institutions. In advanced countries slightly over one in three persons express satisfaction in their governments [Boix (2019)]. The situation is worse in the developing countries, where democratic institutions rest on rickety foundations. The long term trend has been procapital and anti labor raising the Marxian specter of Infinite accumulation of power and wealth in the hands of a handful of capitalist and the gradual euthanasia of labor. Globalization has made matters worse, because while capital is free to move the same is not the case with labor whose mobility is severely limited. Again the net result is to raise profits in relation to wages; it is interesting that Adam Smith has foretold the evil consequences of monopolies: he warned that "people of the same trade seldom meet together but the conversation ends in a conspiracy against the public or in some diversion to raise prices."

As a result, the inequalities of income and wealth have risen and there is no sign yet that the trend would reverse any time soon, if ever. As things stand now these trends will deepen due to technological innovation that are mostly labor saving, unless corrective steps are taken to make them labor friendly. The fear is that so much inequalities of income are inconsistent with free-market capitalism that aims to deliver growth and welfare states. There is also an escalating concern about the legitimacy and the stability of our economic and political systems and about whether they are serving public interest. It is questioned whether the air of triumphalism about its unquestioned merits that dominated the public debate like the Fukuyama thesis about the End of History in the wake of the fall of the Berlin Wall in 1989 was justified. Productivity is falling and growth faltering, in fact the financial capitalism precipitated the 2007-08 financial crash and wiped out vast amount of economic value is now cited as proof of its egregious follies. The problem is that capitalism is now represented by modern corporations which have become externalizing machines adept at pushing costs onto others, suppressing wages and erecting barriers to new entry. They often seem to bring escalating inequalities and a coarsening of moral norms and values. Another more serious problem with it is what is referred to as “crony capitalism”, which is defined as a situation when business activity loses any connection with wider social interest and business merit is separated from business reward. This situation is worsened by the toxic combination of political lobbying, anti competitive legislation egregious executive pay escalating inequalities and loss of public trust. Lobbying has become an extraordinarily profitable business itself: An OECD study estimates that a typical lobbying group generates 1.2 billion US dollars government contracts and assistance to its clients for every for just 11 million dollars in fees: that is, a return of 100 dollars for every one dollar spent. As a result, capitalism itself begets corruption and greed. Furthermore, a study by the US Council of Economic Advisors showed a significant increase in market power: In 2014 a typical US firm charged 67 per cent over marginal cost as compared to 18 per cent in 1980. These trends also help explain low rates of investment despite low interest rates sluggish investment and rising inequality of income. Robert Solow shows that as a result of these trends, the tacit understanding that governed the relationship between labor and capital is under threat, not least from capture by the management itself. If that is the case then it is a sure sign that capitalism is itself struggling. Reich (2016) also warns that the threat to capitalism comes not from fascism or communism, but from the declining trust that modern societies need for growth and stability.

What should then be done? As Norman (2018) has eloquently argued we need a new master narrative with better understanding, better explanations, better shared identities, to come to terms with the existential problems that capitalism is facing now. The task before us is to reform it, even to civilize it, so that it becomes acceptable to the people and be relevant to society. The fact is that capitalism is by its nature polarizing, and if steps are not taken to encase it in appropriate laws and institutions (like anti monopoly and bankruptcy laws for, example) it can become predatory and inefficient. Another problem that is eating into the vitals of the capitalist system is that while the power to bias the system to their benefit has increased in the hands of the top hierarchy (the CEO's) who set their own pay and their rewards are not proportional to their contribution to productivity, the countervailing power of the working class (the labor unions, small investors etc.) has withered. Ominously, the numbers of the non-working rich and the working poor have risen. As a result, the bargaining strength of the former has declined and that of the latter risen.

Adam Smith had the foresight to point out that the capitalism will function properly if the economic actors follow the laws of justice in pursuing economic activity and that this should happen in a market economy based on free competition, not one riddled by oligopolies and monopolies, which tend to hurt the consumers and benefit the capitalist. The reason being that as he noted "to widen the market and narrow the competition is always in the interest of the dealer [capitalist], who generally have an interest to deceive and even to oppress the public" (p.267 and health etc.)

That being the overarching vision of a capitalistic society (or rather of a commercial society, as he put it) that fulfills its potential of working for the greater good of the people of all the people, it is not surprising why this vision has not fully translated yet into well functioning system as Adam Smith saw it. If the capitalistic market economies are malfunctioning, it is because they are lacking in all the respects that Adam Smith emphasized. They are not competitive and not organized on the universal principles of justice and fair play or to put in other words, it is not a balanced system which reflects its economic and ethical aspects. Indeed, it is feared if these trends are not reversed then it will not be possible for the present day democracies to deliver growth and welfare states the way they did in much of the 20th century western democracies under the influence of the Keynesian Revolution, and the inequalities of income and wealth might as they actually have risen even in the otherwise well-functioning market economies. As Noble Laureate, Joseph Stiglitz (2019) has noted the US capitalistic system is not living up to its promise of providing reasonable stan-

dards of living for the majority of its population. The reason being that the redistributive channels are badly clogged so that most money goes to the top one per cent and only a small part to the lower and the middle classes. Indeed, Fukuyama's triumphalist vision of democratic capitalism having provided the answer to man's economic and problems has crashed to the ground. The 2008 Great Recession showed that capitalism, without the safeguards specified long ago by Adam Smith, is neither efficient nor stable. Indeed, much of the theoretical work done shows that for markets to work on their own a host of conditions must be satisfied, there has to be robust competition, information has to be perfect and that actions of one individual or firm cannot impose harm on others. Unfortunately, these conditions are seldom if ever fully satisfied, He has warned that free markets by themselves do not function in the interest of the society; and thanks to the externalities involved in social welfare projects like mass education and universal health and guaranteed employment to the sick and the weak, these needs will remain unmet or not adequately met. Also economic policies have worried more about increasing the size of the cake (GDP) than on distributing it fairly. As it is, the two are inter related. A rise in the size of inequality reduces both the quality and durability of growth [Ostray Loungani and Berg (2019)]. Experience has shown that to succeed in working for the greater good of the society governments must actively pursue the welfare state ideals that have helped Scandinavian countries to achieve growth with social justice by spending massively on infrastructure, education, and social protection like free education.

➤ **The Types of Capitalism**

1. The Liberal Meritocratic Capitalism

As noted above capitalism is the only survivor economic system we have in the sense that the entire standing its undeniable merits has led to rising income inequality, as Adam Smith first pointed out mainly because capital income tends to rise in the long run and that capital is concentrated in the hands of the rich capitalists. Capitalism has changed some of its feature since his time, however, as predicated earlier, the belief that capitalism has reached its destination is not true either: such claim has been disproved by the financial and the political dysfunction of the western world. An important element of this change is that as Milanovic (2019) has shown capitalism is now a plurality as we now have are mainly of two broad types: the liberal meritocratic capitalism that is typical of the US in the 21st century and political capitalism that is typical of China. Sur-

prisingly this development was also foreseen by Adam Smith, as Milanovic has noted. Both types are competing for influence in the world and it is difficult to predict which one will triumph if at all over the other. In this section we follow Milanovic briefly. Let us first note some of the distributional characteristic of the liberal meritocratic type. The most important is that it leads to rising inequality of income via a rising share of capital in the total national product, because the rich mostly derive their income from physical capital and human capital. What is new now, and was not the case under the classical type of capitalism that prevailed in the UK (in Adam Smith's time), and not even in the social democratic type of capitalism that prevailed in Western Europe after World War II. The share of income from capital tends to rise unless it is moderated by high income taxation and generous social security expenditure by the government. The fact to note is that insofar as both labor and capital are received by top one per cent (or more accurately, top 0.1 per cent), capitalism lends to strengthen its dequalizing effect. This can be referred to as the systemic characteristic of capitalism. Added to it are the non-systemic factors like the skill premium paid to educated labor.

2. Political Capitalism

As opposed to the liberal capitalism, there is the political capitalism which is practiced with some variations in eleven countries in Asia and Africa. Led by China, Vietnam, Singapore, Malaysia; all these countries have single party system which has remained unchanged over long periods of time. Just as the liberalist type is shown as led by USA the political variety is typified by China being the largest component of this group. The common characteristic is the political motivation of the system is that it is run by highly efficient bureaucracy the duty of which is to realize in the high growth rate and implement this by the best possible means available. Secondly, there is no rule of law as in the West (that is, no one is above the law) the bureaucracy thus makes decisions applying laws selectively. The government and the Communist Party has the broad oversight role, leaving enough room for the private initiative as long as it does not challenge the ultimate authority of the Party. The private sector is seen as a bird in the cage which should be allowed sufficient room for maneuver. The government is generally helpful to the growth of private sector, but to think that anyone "without the support of the government or from a position of opposition to the state one can become a capitalist is an absurd presumption." [cited Milanovic (p.116)]. That said, it is important to note that the role of the private sector has increased steadily over the years. Taking the case of China, the share of industrial

output produced by State Owned Enterprises (SOE's) has fallen from 100 per cent in 1978 to 20 per cent or so. The same is the case with rural areas where And the prices are mostly market determined. Yet the autonomy of the state is the common characteristic, another characteristic is that the same political party has ruled the country for a long time (led by 73 years in Vietnam, and 69 years in China). What makes this type of capitalism attractive for the developing world is that (1) growth rates of per capita GDP in these countries have generally been significantly higher than in the countries where liberal capitalism has prevailed, China being the star performer growing at the rate of 8.5 per cent per annum between 1991 and 2016. (2) As a result, their collective share in world output has increased from just 5.5 per cent in 1990 to 21 per cent. (3) These countries together contain 24.5 per cent of world population in 2016. However, as opposed to these attractive features what makes it unattractive is, as Milanovic points out the endemic corruption of the society which comes from absoluteness of the political power and no less that inequality in China has risen faster than in the USA: While US disposable income inequality has risen by increased by 4 Gini points between 1980 to 2013, it increased by 20 Gini points in China during the same period. It has increased mainly because of rapidity with which urbanization has come about mainly due to structural factors: that it has come about with explosive growth rates fed by the Kuznetsian mechanism. As one would expect the share of income from capital has increased steadily which has led to a high concentration of wealth in the hands of the rich: private wealth has increased from 100 per cent of national income in 1980 to 450 per cent in 2105. [Milanovic (p.104)]. The question is its relative attractiveness for the developing countries; Milanovic thinks that high level of corruption is inherent in it mainly because it is almost impossible to separate economics from politics. But I think its attractiveness lies in its ability to foster high rates of inclusive growth, which has helped to pull out millions from absolute poverty, and since rising inequality has arisen from a very sectoral transfer of labor and capital from rural to urban areas as noted above. Keeping this corruption thing aside partly because it is no less in other countries and what counts is whether there are effective checks to keep it within acceptable levels. The more important thing is that China generally does not interfere with the country's politics. As opposed to the what Schumpeter refers to as the ethical imperialism of the US, with the desire for regime change, which makes the Western type of capitalism unattractive. What makes the Chinese capitalism attractive is due to two very powerful forces, one is BRI (Belt and Road Initiative) for the less developed countries by helping to improve the infrastructure of these countries; and the Second is the Asian Infrastructure Bank.

Both of them are development oriented with no ideological excess baggage. On balance one would perhaps be attractive to the Smithian model in which reforms are gradual and the state plays a largely helpful role of upgrading the division of labor the huge expansion of education the subordination of the capitalist interest to the national interest and the active encouragement of inter-capitalist competition. This is the liberal meritocratic capitalism as it prevails before 1914 especially in the UK; however there is a deeper crisis that amoral capitalism faces, it is that as Economist (October, 2019) without the liberal values like honesty, and the duty to put the welfare of others (and of the Society) ahead of one's own, which sustained western liberal capitalism in Smith's time and later it may reach its dead end. Partly for this reason and many others the society needs to move towards more ethically just societies, those which are more equal and in which the needs of those left behind in the march to economic prosperity are given priority. However, since the time of Adam Smith we have understood that the largesse that capitalism showers on the society depends on one fundamental factor. And it is competition: As Philippon (2019) shows if we compare two states of the economy: one with more competition and the other with less than the former will generally be better than the latter because it would have lower prices, higher production and higher wages and higher employment and higher investment. Taking all factors into consideration, competition increases our standard of living. It tends to increase growth by pushing prices down. It also decreases inequality by reducing the profit margins, higher output and higher prices. Basically, competition creates efficiencies and these efficiencies are redistributed among the members of a society. However, there are downsides of competition, it is that its benefits are widespread but vested interests are concentrated and can nullify at least some of the overall benefits through lobbying. This is what Olson (1971) long ago showed in his classic the Logic of Collective action, this explains why competition is beneficial but is fragile because people don't rush to save it if the system goes off the rails mainly because of the activities of the rent-seekers.

➤ **Towards More Equal Societies**

It is often mentioned that equality of income and liberty cannot be attained at the same time, but this idea is a relic of the Cold War era when the US gave up its commitment to equality. For instance, slavery provided an instance when both were denied, and equality could be enjoyed only with liberty. The leading intellectuals of the time, like L.T. Hobhouse, believed liberty depended in all its

domains on equality, equality before law, equality of opportunity equality between the parties to contract etc. Indeed, it is easily forgotten that that there is an unstoppable historical current trend towards greater equality. “it runs like a river of human progress from the first constitutional limitations on the divine rights of the Kings and continues to flow on through the slow development of democratic institutions. It picked up pace with the development of free education and health services and systems of minimum income maintenance during periods of unemployment”(p.260). As noted above, a lot of depends on political will to make societies equal rather than to just reduce inequalities. The direction of change that the politics should take should be based on the conviction that “the greater equality is the material foundation on which better social relations are built” (p. 265).

Lindert and Williamson (2016) in their review of growth and inequality in the US since 1700 also reject any efficiency equity trade off. Indeed, they do not find the existence of such a trade off in American history. The reason is that US history does not record any correlation (negative or positive) between income equalization and economic growth either in the US history over the past 360 years or world history over the past 150 years. Also, they did not find any significant adverse growth effect of equalizing income; nor have they found any adverse effect of progressive taxation nor of greater tax based social spending on growth. They reach the very important result “no country has used up all its political opportunities for levelling income without harming economic growth” (p.262). Improving public education, taxing large inheritances, and taming financial instability with regulatory vigilance offer clear opportunities to achieve greater equality and strong growth. These results support the argument that egalitarian investment in human capital is good for equity and growth. Reich (2015) has pointed out, “to many sided problems we face in the US is still is to have an activist government, that raises taxes on the rich, invests the proceeds in excellent schools and other means people need to get ahead and redistributes to the needy (p., XIII).

➤ **The Ultimate Economic Frontier: The Welfare State**

A welfare state, also referred to a Social Democracy and progressive capitalism is broadly defined as one in which the state plays a key role in the protection and promotion of the economic and social well being of its citizens. Corneo (2017) refers, it as Market economy plus welfare state; he considers it as the best of many alternative economic system”. It embodies the basic principles of equal-

ity of income and wealth; It has shown in concrete terms that it is possible to lay the foundations of a strongly growing welfare state with a capitalistic market economy provided that conscious efforts are made through progressive taxation of income and wealth to pay for greater social spending. A welfare state basically makes room for individuals to realize their full potential. Historically, these ideas were an extension of Keynesian thinking that governments must play an active role to save capitalism. He warned that without it “existing order of society will become so discredited that wild and foolish and destructive changes will become inevitable” [cited in Frieden (2006), p.239]. Scandinavian Social Democrats who were credited with practicing Keynesian before Keynes himself had decided to make capitalism work better by introducing welfare programs. It is interesting to note that Adam Smith seems to have endorsed welfare state experiment which came into existence after his death. Ian Simpson Ross in his definitive biography of Adam Smith (2010) endorses this point of view: “it seems to me that the would esteem the idea emanating from Ludwig Erhard and others in the post- World War Two era about nations endorsing the social market based on free and fair competition going along with responsible provision of a social safety net for health care, pensions and unemployment insurance” (p.xix). In the US the New Dealers under President Roosevelt stated the soundness of our democratic on the determination of our government to give employment to idle men a much early example of the legislative effort required to ensure justice with growth is the Anti-Socialist Law of 1878 passed by Chancellor Bismarck of Germany, which laid the foundations of a welfare state in which the government (and not the market) provided basic social services to the needy and the unemployed and old people. It was copied by President Roosevelt’s New Deal and later by President Johnson’s Great Society program in the US. As noted above, Sweden, surviving a turbulent past decided to establish a classless society, in which all share the fruits of economic progress. Denmark gradually took the welfare state model to new heights by making a competitive vibrant market economy compatible with a plentiful provision of social services from cradle to grave within a democratic dispensation. It has made it not only materially prosperous but also happy (it ranks high on the list of the UN Index of Happiness) as people are relieved of the daily worries about how to live a respectable and reasonable life in which social trust is promoted as well.

The Welfare state experiment has made capitalism efficient, just and humane when it is pursued single mindedly knowing the hurdles in the way. The underlying idea is that such a system if sustained over a sufficiently long period of time builds a sense of altruism in humankind, away from crass selfishness and

greed. Living in such a society people try to pay back to the society what they get from a generous economic system. More specifically, it infuses a sense of voluntarism which minimizes the cost of policing the system and keeps the free-riders in check. As a result, an average man in Sweden is willing to bear progressive taxes to finance social expenditures and to keep low the inequalities of income and wealth, which are the natural result of the working of a capitalistic system. The common argument I have heard during my visits to Sweden from even low income tax payer is that they could not build roads and hospitals and free public schools they daily need, so it would be cheaper and more efficient to give the government the money to let it do it for them. The same is true of other Scandinavian countries like Denmark and Germany. The point here is that average tax payers should be able to see literally the benefits they get in return for their payments to the state, a sort of quid pro quo.

It has been noted that the foundation of strongly growing economies of East Asia has also been raised on an egalitarian distribution of income and wealth. Their success in achieving this is that their governments have succeeded in stitching up a policy package of which the main contributing factors are universal free education and health services to all people, rich or poor and sweeping land reforms. It is interesting to note that welfare states are rising in relatively poor Af-rica as well.

➤ **Is Welfare State and Capitalism an Unstable Combination?**

Lest our recommendation to aim at establish a welfare state should be regarded as rosy-spectacled romanticism, let us add a few words about its feasibility. It is noted that capitalism has an inbuilt tendency to repel a welfare state. So, for them to go together it takes conscious legislative effort to institutionalize it and wide ranging reforms will be required to make this experiment a success. The most important such reform relates to the creation of a civil society and a responsible, transparent, and sensitive polity in which politicians don't lose touch with the electorate once they are in power. Their voters are the working class defined as persons whose incomes are based on their own labor and do not diverge from the median income. This is important because if the children of the rich who are voted into power by the working class follow in the footsteps of their parents and don't mingle with the poor children, then the society will lose the social mobility which is an essential feature of a progressive democratic society. In particular, the politicians should not become one of those who don't want to bear the burden of progressive taxation.

However, what we see in the real world in both the developed and the developing countries is a persistent retreat from the Welfare state ideals by lowering the tax rates on the rich (on capital income) and raising the taxation of labor income and on consumer spending, which are regressive. The quality of social services has also declined, even in the vital health and education sectors. We see a proliferation of high priced and low quality English schools and private hospitals. It is difficult to have progressive taxation because of the safe tax havens and the ease with which money can be taken to lower taxed countries or regions, a tendency made difficult by globalization. Another problem that darkens the prospect of a welfare state is its alleged financial nonviability. Indeed, this fear (mostly unjustified) led to the contraction of welfare states even in Sweden, where inequality has increased mainly because of changes in the taxation structure that favor the rich and social benefits are now less generous. The provision for the unemployed has declined and pension schemes have become less generous, and the trade unions are losing strong bargaining power and so on. Another problem is the rising gap between the lowest paid worker and the CEO's. Wilkinson and Pickett (2010) provide the following estimates of the ratios of the workers and the production workers in manufacturing: 16:1 Japan, 21:1 Sweden, 31:1 in the UK, and 44:1 in the US. Interestingly these ratios correspond very closely to the differences between the highest 20 per cent and lowest 20 per cent: these differences are the least in Japan and most in the USA (only Singapore is below it) (p.17). The point to note is that it should not be impossible to undo at least some of these deequalizing forces to revert to the pre-existing better world given strong and enlightened political will

➤ **Can Developing Countries Afford a Welfare State?**

An important matter relates to the feasibility of doing the welfare state experiment in the developing countries. Piketty (2014) thinks welfare state institutions are very much a Western phenomenon. In the West, the rights to education, health and pensions have come to be recognized gradually as the percentage of national income collected as taxes which was in the region of 10 per cent or so in 1900-1910 rose to 30 and 55 per cent in 2000 to 2010. It is only now that the rich countries can finance a welfare state. Earlier with 10 per cent or so the government could hardly finance anything beyond its "regalian" functions. He feels that the situation in the developing countries is similar to that of

Europe in the past in that they collect no more than 10 to 15 per cent of national income in taxes. He feels that the history of economic development is also a matter of political and cultural development.

The caveats Piketty adds are well taken. But there is no reason why developing countries cannot raise their taxable capacity to finance social expenditures on health and education that the population in these countries need and move gradually towards the welfare state ideal. It is too unrealistic to argue that they have exhausted their capacity to raise enough money to finance a modest welfare state. Not long ago, public sector financed education and health facilities were available to the common man in developing countries, including Pakistan. Now fees even in the public sector universities and hospitals have increased beyond the capacity of the common man. The historical evidence cited above should give hope that given the political will to do it developing countries welfare state can also do it. The financial resources can be found once it becomes a political priority. After all, so much money is being wasted on grandiose projects which bring little or no social or economic benefits. Also they lowered their taxable capacity. The externally forced privatization has tied the hands of the public sector, while enriching the private sector, the tax rates have been reduced without doing much to expand tax base. Agricultural sector, especially in Pakistan is exempt from income taxation which is hard to justify and inheritance taxes which could yield revenue without hurting growth have been abolished. This can and should change. It is difficult to accept that there is something missing with the culture of the poorer countries to foster a commitment to a higher and more equal society. To that end, gradually, conscious efforts should be made to increase tax revenues and provide social services, especially those relating to education and health. These considerations point to the difficulty of running a welfare state. But the rewards of a successful experiment are very great. Should it then not be a matter of priority for all responsible and compassionate governments to see their citizens happy, and spiritually elevated? That is what is needed for the common man to have confidence in the justice of the economic and social system that they live in. It may be noted that among the emerging economies the East Asian economies particularly are witnessing a greater emphasis on more generous welfare systems. This suggests that there is a vital connection between strong (catch-up) growth and the provision of generous social services. On the other hand, modest and successful welfare state experiments in Africa show that even relatively poor countries can make a head start along their lines. The Economist magazine (February-March 2019) reported that in Tanzania welfare system (known as PSSN, Social Security net though not generous is quite effective

and has expanded quickly. The recipients are paid the equivalent of \$ 13 per month. In Senegal they receive \$ 43 every three months. As for its effectiveness these cash transfers have gone to the poorest, who live below the poverty line and who spend this additional income wisely. This is partly funded by the World Bank, the Swedish and the British government. These African governments has generally tried to reduce poverty by promoting growth by building infrastructure etc., but the best way to tackle deep poverty is to start at the bottom, with the poor people themselves. What his shows is that welfare states can be modest but effective in alleviating extreme poverty.

However, there is another problem relating to the optimal financing of the welfare state as Saez and Zucman (2019) point out in their book. It is that the present system of funding the welfare state's three pillars (namely retirement, education and health care by mostly such taxes as VAT poll taxes which are generally regressive and basically fall on labor income but not on capital income. They therefore suggest the imposition of a national income tax which would supplement progressive income tax. The former would instead replace the current system of taxes including private insurance (as in the US) which are regressive and fall mostly on the middle and low income but spare the top 1 per cent and 0.01 per cent. But that is an ideal solution even for the Western countries. But the basic point is clear since both labor and capital benefit from welfare systems both should bear the tax burden to finance it.

➤ **The Challenge of Economic Development**

We noted above that Adam Smith has thrown light on the problems of the developing countries or more accurately of development economics. It may be of interest to dwell on these issues in some detail, in the light of Sen's excellent essay referred to above. This is of interest not only to understand the breadth of Smith's economic, political and social vision but also to get a better hold on the problems relating to development economics. Even more, he was very much concerned with the reasons that drove Western countries later on to create welfare states and the forces that tended to undercut its growth would pose development challenges as we will discuss Much confusion has been created by neo liberalist thinking which minimizes the role of the government, arguing that it causes distortions in a free market economy. This does not make sense because a free market economy cannot exist outside umbrella of an efficient and humane government. Adam Smith, contrary to the general notion that he argued for the minimum government, he indeed stated that the role of the government is es-

entially transformative and that it gets bigger as the market economy gets richer and gets more involved in alleviating the problems of poverty and social justice. And in this context, it is essential it also worries about the moral aspects of the functioning of the markets. Adam Smith was well placed to combine his economic prescriptions based on his path breaking *Wealth of Nations* with his ethicist's vision as an author of the equally influential *Theory of moral Sentiments* which got him a professorship in moral philosophy while he was still in his twenties. A very important point which is of universal concern is to have a balanced view of a capitalistic society, eschewing its populist condemnation. To him we owe that positive vision of the dynamism of wealth creation at a time when as he pointed out that it is so important as to warrant the full time occupation of a moral philosopher on the ground that economic growth helped by division of labor and specialization and foreign trade leads to a reduction of poverty and to the development of institutions to help solve such difficult problems. He understood clearly that the market mechanism is not by itself efficacious to handle the problems of the least privileged in the society. Even more fundamental was his concern for the insufficiency of the market mechanism to provide universal and free education to help skill formation and raise productivity. Indeed, this is a lesson that the tiger economies of Asia beginning with Japan learned early on. No less fundamental was Smith's understanding of the harm social harm done by the capitalists (whom he called pejoratively as prodigals and projectors, those who indulge in the activity of profit making at the expense of the society. He warned that capital should be kept out of the hands of such people who would most likely "waste and destroy it". Furthermore, no less fundamental is his understanding of the forces that motivate profit seeking activities and his emphasis that self-interest is not the sole motivation. Indeed, his novel theory laid out in the *Theory of Moral Sentiments* makes it clear that self-interest is enlightened self interest that is other regarding no less (as the quote at the beginning of this essay points out). More important for his analysis are such motives as "Sympathy", supported by "public spirit" and "generosity". One more important point that distinguishes him from practically most modern development economists who ascribe the relative success of the people from Western countries as opposed to those from the Asian and African countries. He saw all human beings irrespective race or color in symmetrical terms. He stated: "there is not a negro from the coast of Africa who does not, in this respect (that white man is innately superior to black Africans) possess a degree of magnanimity which the soul of his sordid master is too often scarce capable of conceiving" (*Theory of Moral Sentiments*). The performance of the tiger economies (all

being Asians) Including China proves this in no uncertain terms. In this respect he was much ahead of his time and to some extent even the present times in his stubborn rejection of racism, imperial prejudice ethnic snobbery and intellectual arrogance of all kinds.

And contrary to the common misunderstanding that he was a prophet of self interest driven market economy, he argued strongly for state intervention with a view to bridging the gap between self interest and the interest of the society by counteracting the doings of the “projectors and prodigals” as he called the private investors hell bent of maximizing their profits to the detriment of the society. He condemned them for deceiving with public with schemes which mingled folly with knavery. And so on.

A recent book by the IMF experts [Ostry, Loungani and Berg (2019)] referred to above in this essay makes three important point which have a bearing on the growth inequality redistribution debate. It presents large amount of empirical evidence to prove fairly convincingly that: (1) Inequality causes economic harm by lowering growth and making it less durable, (2) Benefits of most economic policies are not equally shared and many lose out by policies that are good on average, (3) and lowering inequality by redistribution, if not excessive is not bad for growth. These three findings are really of fundamental importance and are based on rejection of many a textbook argument. They deny that existing inequalities are good in that they reflect just reward commensurate with productivity and therefore a redistribution of income from the rich to the poor will be counter productive. However, it needs to be kept in view that some inequalities are integral to the working of the economy so a policy of extreme redistribution would be counter productive. The authors argue that some pre distribution policies need to be pursued so that extreme inequalities don't arise in the first place. Thus providing equal access to education and health promote mobility by generating equality of opportunity for children of the poor. As argued below, these social expenditures need to be financed by taxing the rich. However, one has to be careful when one talks about inequality. As Nobel Laureate Deaton (2013) shows inequality can both hinder as well as help growth. So we talk of growth and inequality together. Yet as he points out when inequality is a handmaiden of progress it is a mistake to look only at the averages because some gain while others lose when progress is made. Noble Laureate Tirole points out that it is important to make a distinction between inequality that is caused by the creation of value to the society from that which involves just the creation of rents. For instance, an empire built by scoundrels and thieves is to be distinguished from the one created by innovator like Steve Jobs and Bill Gates who

promoted innovation. So the fiscal system aimed at redistribution must make a distinction between these two types, even though it is difficult to make these distinctions in practice.

Wilkinson and Pickett (2009) in their well researched book *The Spirit Level* have argued with the help of lots of real life data drawn mostly from developed countries, that equality makes societies stronger. A common factor that links the happiest and healthiest societies is the equality among its members. On the other hand, inequality undermines the trust, solidarity and mutuality on which responsibilities of citizenship depend, and that greater inequality is bad for everyone, the rich and the middle class and the poor. Equalization of income across income classes within the societies is also essential for promoting a more caring world order in which the rich countries adopt a sympathetic attitude towards the problems of the emerging countries. It appears that the way people treat inequalities within their own societies instills in them values and norms that predispose them to look askance at the inequalities that exist between rich and poor nations. It is from the prism of equality that higher standards of living and achievements are attained. With the benefit of hindsight one can hope that since inequalities have risen dramatically in the rich countries including Sweden where these were the lowest, they can also be reduced with determined reformative action in other countries. They show that a sustainable economy itself leads to egalitarian outcomes; also, it is important to note that greater equality can be achieved in more than one way. It can be done as we know by redistributive measures like progressive taxation and higher social expenditures, but it can also be attained by achieving equality before taxes and benefits such as has been done in Japan, so that redistributive effort need to be lesser that is, the social security expenditure would then be a smaller proportion of GDP than say in the US. There is a vital trade-off between using social expenditure to cope with the social harm that high inequality does or to pay for real social benefits when it is low than when it gets high. The key to resolving this trade-off is the political will to achieve greater equality as a primary objective of public policy. As a matter of history, given that there are many ways in which more egalitarian outcomes can be secured, governments have usually adopted such policies when they realized that their very existence depended on them. In East Asian countries where greater equality of income and wealth underpinned high economic growth, one of the factors that encouraged them to be egalitarian was that they had to face the challenge of political legitimacy. The same sequence to achieve equality happened in Britain which became more equal in the aftermath of the first and Second World Wars. Richard Titmus observed “if the cooperation of the masses was thought to be es-

essential for the war effort then inequalities had to be reduced and the pyramid of social stratification had to be flattened". Even in Sweden, it was to curb the labor revolt started by police firing on labor violence that the three time Prime Minister Albin Hanson during Swedish rearmament and the war pledged that he would, make Sweden the classless society and people's home. And he did translate that lofty promise into reality within the limits of financial and political feasibility. The history of land reforms in China, Japan, Korea and elsewhere involved considerable state coercion. Wilkinson and Pickett advocate that there must be a widespread movement to make society a more equal place to live.

➤ **For whom should the Bell Toll?**

There seems to be consensus now that the neo liberal recommendation to leave it to the market and reduce the government to a Lilliputian size because as they say the government is part of the problem rather than a solution of the many problems that democratic governments face (including that of inequality and social injustice is bogus; it is high time to bury this idea in deep grave that it can be resurrected from. John Maynard Keynes was the first to point out the need for active government policy to cure big systemic failure of Western democracies like the one that the Great Depression had occasioned. These ideas were given a formal shape in John Rawls, A Theory of justice, which, as noted at the outset. In addition to providing an objective a theoretical basis for the welfare state, it sought to deal with the impasse of welfare economics, that is of going beyond the efficiency oriented Pareto optimality principle and integrate ethics in economics, a job that Sen had successfully undertaken and which Rawls broadly accepted. It would be useful to conclude this discussion with Adam Smith, because as noted above market fundamentalism has been misattributed to him. He wrong headedly has been shown as champion of some sort caricatured capitalism based on unalloyed self interest; as noted above the fable of the invisible hand in the sense of the market forces being enough to run a capitalistic society has been the source of a lot of mistakes in as noted above, Adam Smith strongly pleaded for a capitalistic system in which the government would ensure social justice and in particular, would not pander "to the importunity of partial interests". As Sen has pointed out in his introduction to the Theory of Moral Sentiments, Adam rejected "market excluding interventions but not the market-including interventions aimed at doing those things that the market tends to leave undone." He is particularly worried that lobbying by particular organized interests that seek to protect their rents by restricting competition. In today's language,

he asked for Democratic Capitalism which endeavors to meet the vital needs of the society. And to this end he devoted hundreds of pages of the *Wealth of Nations* to analyzing the functions of the government and how to pay for them. He regarded government as the most important institution on which the commercial society depends. He held that by providing for defense, justice and infrastructure, the government (and only a government) would create the pre conditions for a market economy and for “universal opulence which extends itself to the lowest ranks of the people” [Cited in Muller (1993), p.148]. A rather unexpected reason for the government intervention was to serve as an antidote to the mental degradation caused by the division of labor by providing for universal public schooling largely at government so that even the poor people can acquire the skill for reading, writing and arithmetic. Thus the visible hand of the state would counteract the potentially stultifying effects of the invisible hand of the market. A proof of the high regard in which he held a public office was his acceptance (indeed, he actively sought it) the position of the Commissioner of Customs in 1778 in recognition of his great expertise on taxation and Public Finance that he exhibited in *Wealth of Nations*.

More than 200 years after his death (in 1790) these issues are still important for capitalist societies. It would be of interest therefore to enquire whether the capitalist societies that Adam Smith wanted to see established do actually exist. The answer is probably it depends on the willingness of the governments in both the developing and the developed countries to provide social services to the poor and the needy. It may be useful to repeat his oft quoted passage noted above:” 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 forth his industry and capital into competition with those of any other man or order of man. We have noted that modern capitalism does not satisfy this condition in that it has given rise to oligopolies and rising inequalities of income and wealth which Adam Smith considered both immoral and inefficient. He considered them immoral because essentially he points out “difference of natural talents in different men are much less than we are aware of”. Such differences in income and wealth between men as exist “are not so much from nature and as from habit, custom and education”. These differences should therefore be obviated by conscious government efforts. Perhaps, modern day Scandinavian states come close to Smith’s ideals in that they have achieved a modicum of social justice with the inherent dynamism of a capitalist society which even Karl Marx recognized. Indeed, this should be the ostina to of well functioning society raised on the principle of social justice. But to achieve and run such a society, we need public spirited politi-

cians who when they become politically powerful remember the problems they faced when they were not powerful. There is the stirring example of the Democratic leader Gustav Moller whose mother the widow of a blacksmith died of tuberculosis because she could not afford the medical expenses and because there was not public pensions to cover such expenses. When Moller became a minister recalling his personal experience he pressed for social reforms to prevent the occurrence of fates like my mothers. [cited in Frieden (2006); p. 232].

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