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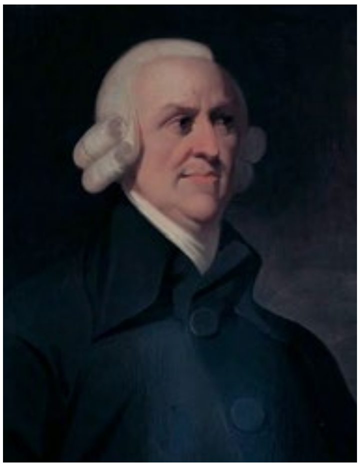
THE MYTHICAL ADAM SMITH

Few thinkers loom larger in the imagination of policy-makers and economists than Adam Smith. But the figure they venerate is a mythical creature, half man, half useful quotations.



"The disposition to admire, and almost to worship, the rich and the powerful, and to despise, or, at least, to neglect persons of poor and mean condition is the great and most universal cause of the corruption of our moral sentiments."

Adam Smith, still Tax Justice Network's most popular pinup.

Myths can be used to sustain and encourage governing projects. The shift to deregulation and limited government – 'neoliberalism' - in the English-speaking world after the election of Margaret Thatcher in 1979 and Ronald Reagan a year later depended partly on the creation of, and belief in, myths. One example of highly effective myth-making can be found in the notion that neoliberals like Thatcher and Reagan were the champions of the 'free market' first celebrated by Adam Smith.

Adam Smith and the Free Market

Chicago neoliberals like Milton Friedman and George Stigler interpreted classical political economy in general and Adam Smith in particular in a very specific way. They used his idea of an 'Invisible Hand' to argue that individuals merely had to pursue their individual self-interest and exclude other concerns for the market economy to function optimally. Like Keynes's ideas in the 1930s, this argument gave politicians a simple and plausible justification for the policies they wanted to pursue. During the Depression Keynes had argued for countercyclical investment to revive the economy. FDR used these arguments to provide intellectual ballast for the New Deal programmes, although Roosevelt himself was no economist and had little time for Keynes. Similarly, in the 1980s, Thatcher and Reagan cut taxes, fought unions and attacked the public sector on the back of neoliberal policy proposals. Neoliberal myths about the benefits of unfettered self-interest in market economies provided cover for another political project: the elevation of the profit motive as a cardinal virtue.

Adam Smith's account of commercial society in the *Wealth of Nations* (1776) does not provide a blueprint for a free market economy based on the selfish pursuit of profit. In his argument, the 'invisible hand', by which a market economy was sustained according to Smith, is shown to work by the actions of the educated and morally cultivated individuals to whom Smith refers in his *Theory of Moral Sentiments* (1759). Smith's conception of such individuals and their moral sympathy was a world apart from the sort of selfish greed encouraged by 1980s Conservative and Republican policymakers. Smith worried that "people's disposition to admire the rich and the great, and to despise or neglect persons of poor and mean condition", led to the "corruption of our moral sentiments". The main solution he proposed was publicly funded education. Government was also to provide the means for building and sustaining the necessary infrastructure for the successful functioning of the economy, something acknowledged by neoliberals like Hayek and Friedman themselves.

Despite the nuance and complexity of Adam Smith's actual positions, it suited both neoliberal thinkers and politicians to see themselves as part of a venerable lineage whether or not their ideas actually matched up with his. In their view, the "free market" was supposed to be the result of stripping away layers of government ownership and public expenditure. At the core of the myth was the idea that government was bad and business was good, a central narrative that helped to determine policy under both Thatcher and Reagan. When a myth is successful, as this one proved to be, then it can help to drive an agenda through by simplifying a government's message.

American Neoliberalism

In the case of the neoliberals, the Chicago theorists, along with their close associates in the Virginia School of Political Economy, led by James Buchanan and Gordon Tullock, were engaged in a radical new set of economic theories. The "free market" was rethought and repackaged as an idea. The Americans differed, not just from Adam Smith, but also from earlier European neoliberals based in Austria, Germany and Britain, who first emerged in the interwar years in response to war, depression and totalitarianism.

The earlier European neoliberals had as their main focus the conditions necessary for effective competition in the marketplace and they saw no incompatibility, even Friedrich Hayek in his famous *The Road to Serfdom* (1944), between free markets and the welfare state. The political project most closely associated with these early neoliberals, the Social Market economy of the German Economic Miracle in the 1950s, attempted successfully to institute just such an economy with vastly different results for the German economy than those achieved for Britain after the 1980s.

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The American model of neoliberal thought, in contrast, partly fostered by the very different conditions of rising prosperity and the Cold War, advocated a new role for the market from that proposed by either Adam Smith or the European neoliberals. They wanted to take a market-based approach to all kinds of hitherto untouched policy areas. What became known as "economics imperialism" saw methodological individualism, the focus on the rational actor pursuing his self-interest in the marketplace, being applied by scholars like Friedman, Stigler, Buchanan and Gary Becker in the realms of education, public administration, crime and even the family.

The Radicalisation of Neoliberalism

This expansion of free market radicalism born in Chicago and Virginia sharpened and clarified the neoliberal political message. But the idea that it rested on classical liberal foundations was a myth. What the Chicagoans and their political followers were engaged in was an entirely new kind of state-sponsored reform of the economy.

This reform drew on several further myths. The first of these was the idea that tax cuts would increase wealth that would trickle down into more jobs and rising incomes for all. In fact in both Britain and the United States we saw rising inequality, income stagnation as well as large numbers of unemployed among much of the population. The second was the myth that deregulation would free up important sectors and foster a more dynamic economy. Governing parties of all political stripes followed the deregulatory policies advocated by Stigler and others. The "dynamism" of self-interest led directly to the catastrophic financial crisis of 2008.

Finally the denouement arrived and Fed Chairman Alan Greenspan was forced to admit the "flaw" in neoliberal thought. The "free market" and its ability to adjust and correct itself was a myth (and not one created by Adam Smith, but rather by neoliberal economic theorists). It is not at all clear yet, however, that the political class has lost its appetite for myth. In both Europe and the United States, politicians are currently in thrall to another convenient myth: the idea that austerity can lead to economic growth. Until this myth is decisively rejected, the future of the world economy looks bleak indeed.

Daniel Stedman Jones is a barrister and author. Masters of the Universe: Hayek, Friedman and the Birth of Neoliberal Politics is published by Princeton University Press.