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Adam Smith: Why Decentralized Systems?

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Editorial

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The Adam Smith Review is a multidisciplinary annual review sponsored by the International Adam Smith Society. It provides a unique forum for vigorous debate and the highest standards of scholarship on all aspects of Adam Smith's works, his place in history and the significance of his writings for the modern world. *The Adam Smith Review* aims to facilitate interchange between scholars working within different disciplinary and theoretical perspectives, and to this end it is open to all areas of research relating to Adam Smith. The *Review* also hopes to broaden the field of English-language debate on Smith by occasionally including translations of scholarly works at present available only in languages other than English.

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should have sufficient respect for Smith the philosopher to assume that he isn't blind to his own critique of men of system (TMS VI.ii.2.7-18). We should thus pay close attention to his explicit indications of the natural limits of his own 'obvious and simple system'.

Smith was acutely aware of the problems facing the establishment of impartial justice and religious and economic liberty. This awareness makes it all the more necessary to explain and defend the advantages and to protect the achievements of these where they exist. Otteson and Smith are on the same side here, and that is the side of moderate liberalism. Smith is neither a traditionalist nor a libertarian. Liberalism is not well served by downplaying the difficulty of its realization by an overemphasis on unintended beneficial consequences. Once established, however, the advantage of a traditional prejudice in its favor is not to be lightly dismissed.

Adam Smith

Why decentralized systems?

Maria Pia Paganelli

'I have never known much good done by those who affected to trade for the public good'

(WN IV.ii.9)

James Otteson's book (2002) is a comprehensive and clear analysis of Smith's two works – *Wealth of Nations* and *The Theory of Moral Sentiments* – and their relation. Otteson's detailed analysis shows how, for Smith, market systems and moral systems are similar. Both are generated by individual decisions. And both generate unintended systemic social order. I think Otteson's analysis is correct. In this paper I develop one possible implication of Otteson's reading of Smith (that Otteson did not develop) aimed at justifying his Smith's position (as read by Otteson).

Smith describes human beings as imperfect and not perfectible. Given all their biases, delusions and mistakes, how can individuals live together, be virtuous, and prosper? In both TMS and WN, Smith answers that individuals do not know what is best for them and/or for society, but with a decentralized process of trial and error they develop successful rules of behaviour and/or institutions that allow them to achieve their goals as well as, unintentionally, social order. The question this paper asks is: was Smith accurate in describing how, aiming at something other than social order, individual decisions unintentionally and spontaneously generate social order?

The answer I offer is yes. Smith's implicit model of social order works because it focuses on how to minimize the consequences of mistakes and imperfections in society rather than on how to create the best social system.

I Why decentralized systems are preferred to centralized systems in theory and in practice

A decentralized system is a system in which there are many autonomous and independent decision centres, as many as the number of individuals (or groups of individuals) present in the system. Individual decision centres choose accordingly to individual costs and benefits. The well-being of the system may not be taken into account individually, and the decision centres

may not be coordinated. A centralized system is a system in which there is one (or few) decision centre(s), the decisions of which are for the entire system.

Borrowing the concept from robust statistics (Mosteller and Tukey 1977), a robust system is a system that minimizes catastrophic results under non-ideal conditions, even if it may not be the most efficient system under ideal conditions. It asks the questions: what is the worst that can happen? How is it avoidable? A fragile system is a system that collapses under non-ideal conditions, even if it may be the most efficient system under ideal conditions. It asks: what is the best that can happen? How is it achievable?

Decentralized systems tend to be robust. Decentralized systems minimize catastrophic results if there is a mistake, because of their very decentralized nature. Decisions are taken at the individual level, and their consequences remain at the local level. If a decision is incorrect and causes disasters, only the individual decision maker (or maybe his close surroundings) may face the catastrophe, but the rest of the system may remain unaffected.

Centralized systems tend to be fragile. With centralized decisions, consequences are global by definition. If an error is made with a centralized decision, the entire system is affected and likely to face disasters. Centralized systems that aim at achieving the best possible outcome expose themselves to catastrophic outcomes in case of mistakes.

Smith claims that decisions taken at the individual level – a decentralized system – generate social order both in the economic sphere³ and in the moral sphere. To understand why Smith described a decentralized system as able to generate social order, let us ask ourselves: what is the alternative? The alternative to a decentralized system as described by Smith is a centralized system. Smith does not design the best social order ever, but he describes a social order that is able to cope with human imperfections. The decentralized spontaneous orders he describes are robust systems.

Let us apply the two frameworks to analyze social systems.⁴

Assume angelic selfless, unbiased, and rational men – perfect human beings or at least perfectible. This assumption can be used on two levels. Either all individuals are selfless, unbiased, and rational, or a group of them is. If only a group of individuals is selfless, unbiased, and perfectly rational, or at least more so than the rest of the population, this group should be in charge of leading the rest to perfection. Perfect social harmony is achievable, even if with some effort, under the (central) direction of the privileged group. This is the description (and prescription) of a centralized system. Centralized decisions made by the best individuals to better the conditions of others generate the highest performance for the entire social system, as in model *A* of Figure 5. On the other hand, if the best group is not in charge of the rest of society because of the existence of a decentralized system (model *B*), society is not as well off ($B_1 < A_1$). But what if

all men are self-interested and self-centred? What if nobody is either perfect or perfectible? Using a centralized system under non-ideal conditions causes disasters (A_2). A decentralized system does not (B_2). Similarly, if all individuals are basically perfect, there is no need for leadership, as all, being perfect, know what is best to do. Perfect social harmony is achieved effortlessly. But what would happen to a social order designed for perfect individuals, if the individuals turn out to be imperfect and not perfectible?

Authority ... would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it.'
(WN IV.ii.10)

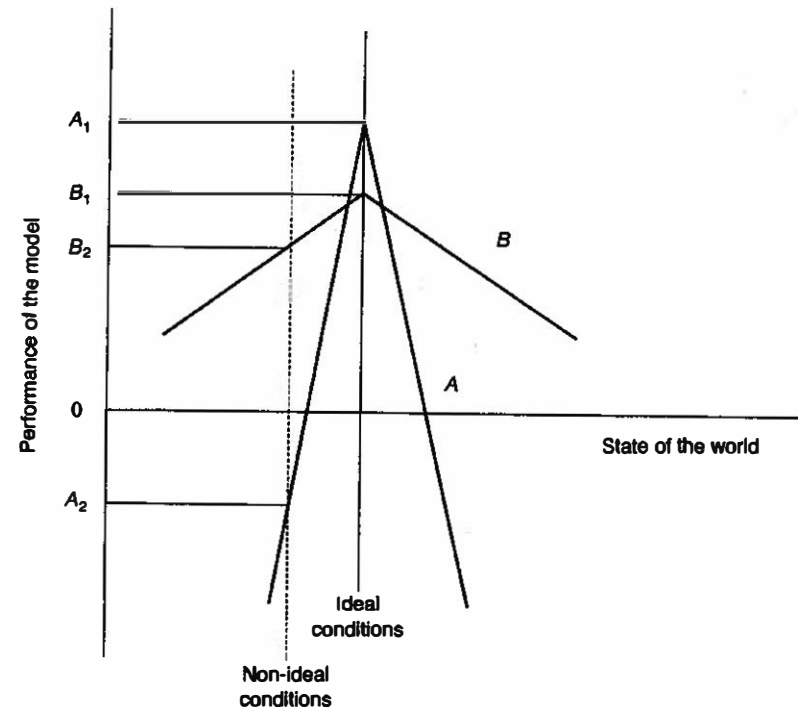


Figure 5⁵ Performance under centralized and decentralized systems

Now, assume (or observe) imperfect and not perfectible men, cursed with defects, vices, greed, biases, and delusions. A decentralized system (model *B*) performs well. The consequences of individual (inevitable) mistakes are minimized because they are localized, and a stable social order is possible.

Given the imperfection of human nature, a decentralized system is likelier to generate a social order suitable to the human condition. Given the imperfection of human nature, a centralized system, even if beautiful, is likelier to cause disasters because the consequences of decisions are global. In this sense, we can say with Smith, that a decentralized system of self-interested individuals (a system of natural liberty) is able to generate a spontaneous, unintended, and good social order, by localizing the potentially catastrophic consequences of human imperfections and frequent mistakes.

II Smith is right

Smith describes how a decentralized system allows for a social order that is able to cope with all sort of human imperfections: (1) at the individual level and (2) at the group level.

The analysis of the individual can have at least three starting points: (a) all individuals are perfect; (b) some individuals are better than others and can lead the others to better their conditions; (c) all individuals are imperfect and not perfectible. Smith describes all men as imperfect and not perfectible. Given his starting point, a decentralized system is the description of a system that works, at least better than a centralized one.

Smith rejects the idea of human perfection. TMS is an account of human imperfection and systematic mistakes. Man is limited by his physical conditions (TMS I.i.1.2). The use of imagination to relate to the rest of the world causes gross mistakes, all the time. We identify with the hero of a novel, even if it is not true. We feel sorry for the dead because they are cold and lonely when they are just dead (TMS I.i.1.13). The poor man's son believes that riches will make him happy, struggles all his life to achieve them, eventually to find out it is not true (TMS IV.1.8). Our impartial spectator, who is supposed to lead us on the right way, is in reality partial and self-centred. The achievement of impartiality is basically not possible in human life. We are constantly deluded (TMS III). We are driven by passions, and only after the fact we rationalize our actions so that we can either live with ourselves or feel good about it (in particular TMS III.4 and also WN V.i.f.26). We are envious, weak, vain, egotistic, narcissistic, and we struggle all our life to be someone we naturally are not so that others can praise us (TMS III.3.4).

Despite all this, societies do not often fall apart. There are at least two reasons for this, both related to polycentrism. An individual copes with his biases by multiplying the decision centres around him. If there is one decision centre (an individual in isolation), biases are overwhelming and deforming. But in a social context, when the centres are multiplied, multiple perspectives are available to dilute errors (TMS III.3.38–43). Similarly, a successful society copes with human biases and imperfections by having as many decision centres as possible, therefore trying not to impose

individual mistakes on others (for example WN V.i.g.7–9). On the other hand, when individuals are far from perfect, having a (beautiful) social order for perfect individuals will likely have catastrophic results (TMS VI.ii.2.17–18).

Smith also rejects the idea that some individuals are somehow better than others and therefore should be in charge of the others.⁶ Political leaders, philosophers, and teachers are just as limited, imperfect, and mistaken as everybody else. There are no reasons for them to try to generate a social order better than (or to correct) the one spontaneously emerging from a decentralized system. Actually, there are reasons for preventing them from trying. Political leaders are corrupt and easily corruptible. They give in to the flattery of those who surround them and allow the creation of socially dysfunctional monopolies. So:

[t]he statesman who should attempt to direct private people . . . would . . . assume an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who *had folly and presumption* enough to fancy himself fit to exercise it.

(WN IV.ii.10; emphasis added)

Philosophy is like any other employment, there is nothing special about it (WN I.i.9). Philosophers are like any other men, just vainer (WN I.ii.4), and wise men often simply 'fancied themselves such' (WN V.i.f.25). They believe things that turn out to be false ('History of Astronomy'). They think they can generate political and moral order, but 'notwithstanding . . . the very respectable authority of Plato, Aristotle and Polybius' we are left with violence, sanguinary factions, and immorality (WN V.i.f.40). Also educators are corrupted and incompetent:

If they [students] are not always properly educated, it is seldom from the want of expence laid out upon their education; but from the improper application of that expence. It is seldom from the want of *masters*; but from the negligence and incapacity of the masters who are to be had, and from the difficulty, rather the impossibility which there is, in the present state of things, of finding any *better*.

(WN V.i.f.52)

Any 'man of system' who tries to make decisions for others, disregarding (the imperfections of) human nature, is bound to fail.

A centralized decision-making system based on some superiority of certain individuals is 'folly'. Mistakes are unavoidable. The choice is between a system that *minimizes* their consequences and a system that globalizes them instead. Centralized systems are, had been, and will be present in human history. But they are not sustainable in the long run. Their

antidote is the multiplications of decision centres that disperse and minimize the consequences of errors. Decentralized systems are orderly systems that, even if imperfect, allow human society to exist, with all its defects, and without attempting unnatural improvements that result in disaster.

Smith describes a stable social order generating from a decentralized system also at the group level. He allows for 'deviant' group behaviour. Men are neither perfect nor perfectible, and they perceive differently. What is thought as right or wrong may vary in time and place, or even within the same time and place. It is possible that the sympathetic principle with which harmonic and 'good' moral systems are explained generates approbation and emulation for anti-social group behaviours. There are brutal political factions, bloody religious factions, and even societies of thieves. Their existence is not a problem for Smith. Deviant and anti-social behaviours at both the individual and group levels are not in contradiction to the social order generated by a decentralized system. The threat to society is not one form of deviant behaviour or another, but is the attempt to either eliminate it or to centralize such deviant and anti-social behaviour. 'That zeal must be altogether innocent where the society is divided into two or three hundreds, or perhaps into as many thousand small sects, of which no one could be considerable enough to disturb the public tranquillity' (WN V.i.g.8). Once again, Smith describes a stable social order which is able to minimize the effect of 'mistakes'. Given the imperfection of human nature, factions and deviant groups are inevitable. How to minimize the possible social damages of anti-social behaviour? Localize the area of effect as much as possible. The more decentralized the system is, the less danger it faces.

III Conclusion

Otteson's account of Smith is accurate. And Smith's account of the development of social order is accurate as well. Given the assumption, or the empirical observation, that human nature is imperfect and implies a large variety of mistakes, and given the choice between a centralized and a decentralized system, a decentralized system is preferred both in theory and in practice, because it is better able to cope with the non-ideal conditions that characterize human conditions. Decentralized systems unintentionally generate imperfect, yet stable orders both in economic and moral spheres. Centralized attempts to develop market and moral orders would less likely generate good orders because they are less likely to survive our inevitable mistakes.

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Adam Smith's theoretical endorsement of deception

Eric Schliesser

I Introduction

James Otteson's *Adam Smith's Marketplace of Life* offers a lucid, original, and insightful reconstruction of a fourfold template that underlies and unifies Smith's approach to all kinds of social phenomena (pp. 285–9). After resurrecting 'The Adam Smith Problem' (ASP), Otteson employs this account to bury it for good. Otteson is refreshingly honest that he is offering a reconstruction of Smith's 'general model of a market' (p. 102), even if there is no 'explicit textual evidence' that Smith intended it as the 'key' to understanding 'the development and maintenance of all large-scale human institutions' (p. 258). For the sake of argument, I accept the reconstruction (for misgivings see Schliesser 2003a). Like a true Smithian philosopher, Otteson explains the invisible structure that combines the 'most distant and similar' elements of Smith's written universe (cf. *Wealth of Nations* I.i.9).⁷ Yet, I argue that Smith's views on theorizing shows that ASP is generated by too-partial an understanding of the moral psychology of WN and that the position that Otteson attributes to Smith, as a 'transcendent' endorsement of the marketplace of life (pp. 252–7), is itself, according to Smith, a (beneficial) 'deception'! Smith's *commitment to philosophy* falls outside Otteson's framework.

II Wonder and admiration in *Wealth of Nations*

The crucial premise in Otteson's argument for reviving ASP is that in WN, Smith appeals 'only' to 'self-interest'; in WN there is no evidence that Smith thought that 'any motivation besides self-interest is active in human behavior' (p. 156). This is in stark contrast to the complex moral psychology presented in *The Theory of Moral Sentiments*. This is not a problem in consistency between the two books, for nowhere is it suggested that the focus on self-love, which for Smith is 'the governing principle in the intercourse of human society' (p. 154, n. 30), would rule out other sources of motivation; none of the passages, which Otteson cites from WN (p. 155), go quite that far. Yet, as a reading of WN, Otteson's position is incomplete.