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## Commercial Relations: From Adam Smith to Field Experiments

Maria Pia Paganelli

Trinity University, [mpaganel@trinity.edu](mailto:mpaganel@trinity.edu)

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## CHAPTER 16

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## COMMERCIAL RELATIONS: FROM ADAM SMITH TO FIELD EXPERIMENTS<sup>1</sup>

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MARIA PIA PAGANELLI

ADAM Smith is often referred to as the father of economics and as a promoter of free markets. In what follows, I let the first claim stand and concentrate on the second: that Adam Smith is a promoter of free markets. In particular, I take for granted, with all the necessary caveats, that Smith is a promoter of free markets (but cf. e.g. Fleischacker 2004; McLean 2006) and concentrate on how Smith promotes free markets. Smith promotes free markets for at least two reasons: efficiency and morality. There is already a vast and detailed literature on the economic efficiency of the markets Smith describes. Here I focus on the claim that Smith promotes free markets on moral grounds and argues that markets can foster morality just as much as morality can foster markets.

The analysis bears on current debates in at least three ways. First, moral constraints in market transactions tend to reduce transaction costs. Morality is a cheaper means to enforce contracts than formal enforcement mechanisms. A better understanding of the relations between markets and morals may allow us better to understand some of the dynamics of economic growth today. Secondly, analysing both costs and benefits of markets may help us debunk useless yet common stereotypes. The approach Smith uses may integrate some of the contemporary analysis and help us see more clearly some of the consequences of the presence of markets today. Thirdly, we may increase (or develop) our appreciation for the depth and breadth of the eighteenth-century scholarship, and Smith's place in it, as well as for its relevance in today's discourse.

<sup>1</sup> Thanks to the Earhart Foundation, Trinity University, and The University of Glasgow for supporting this research. Thanks to the participants of the 2011 conference 'Markets and Happiness' for comments on an earlier draft of this chapter. Thanks also to Tyler Cowen, Christopher Berry, and Craig Smith for comments and encouragement as well as the participants of NYU colloquium, in particular to Sandy Ikeda.

The chapter starts with Smith's analysis of how markets may foster some aspects of morality. For Smith, markets generate wealth which supports life for an increasing number of people. Markets generate institutions which support liberty. And markets generate the social conditions which facilitate moral impartiality. If life, liberty, and impartial judgments are considered values, as they are in Smith, then for Smith markets support these aspects of virtuous behaviour. A section showing how in Smith morality fosters markets follows. If economic actors, such as the greedy great merchants and manufacturers, are not moral agents, then, Smith tells us, markets are impaired and may collapse, or at least they have negative consequences for the majority of the people. Additionally, as Smith is not a one-sided thinker, he sees the negative consequences of markets for some other aspects of morality. For Smith, wars, interest groups, ignorance, and irresponsibility are all morally corrupting results of markets, as described in the following section. The final section presents Smith's claims as testable hypotheses. Findings from experimental economics seem to support Smith's ideas that markets and some aspects of morality are dependent on each other, and in particular some results seem to bring to light that the causal effects of the relationship goes from markets to morality. My conclusions are therefore that Smith, while seeing both costs and benefits of markets, is a promoter of free markets not only on efficiency grounds but also on moral grounds. Morality is a necessary, but not sufficient, condition for markets. And markets are a fertile ground upon which some aspects of morality can develop. Given some experimental results, both from the field and from the laboratory, Smith may be correct.

## MARKETS FOSTERING MORALITY

Adam Smith argues in at least three ways commerce may foster some aspects of morality. Commerce fosters some moral behaviours by offering the means to behave morally, by offering the institutional environment in which we can behave morally, and by offering the social environment in which behave morally.

The *Wealth of Nations* (WN) opens with the claim that commercial societies foster certain aspects of moral conducts. If the preservation and the support of life are virtuous values, commerce facilitates their presence, because commerce generates wealth. For Smith, commerce allows poverty-stuck people to improve their material conditions. This is good because poverty is the cradle of heinous crimes (Young 1992). In Smith's account, poverty forces people to kill young children, the old, and the sick, either directly or indirectly. Smith indeed tells us that when a country is poor, 'from mere want, they are frequently reduced, or at least they think they are reduced, to the necessity sometimes of directly destroying, and sometimes of abandoning their infants, their old people, and those afflicted with lingering diseases, to perish with hunger, or to be devoured by wild beasts' (WN introduction 4: 10). The horrid practice of infanticide, Smith repeats later on, is a direct consequence of poverty.

The poverty of the lower ranks of people in China far surpasses that of the most beggarly nations in Europe. In the neighbourhood of Canton many hundred, it is commonly said, many thousand families have no habitation on the land, but live constantly in little fishing boats upon the rivers and canals. The subsistence which they find there is so scanty that they are eager to fish up the nastiest garbage thrown overboard from any European ship. Any carrion, the carcase of a dead dog or cat, for example, though half putrid and stinking, is as welcome to them as the most wholesome food to the people of other countries. Marriage is encouraged in China, not by the profitableness of children, but by the liberty of destroying them. In all great towns several are every night exposed in the street, or drowned like puppies in the water. (WN I.viii.24: 89–90)

In *The Theory of Moral Sentiments* (TMS) Smith repeats the claim that poverty induces immoral and actually unnatural behaviour such as infanticide. Poverty kills and makes people kill (TMS V.2.15: 209–10 cf. Rousseau and Smith's review of Rousseau in EPS. For a full discussion see Hont and Ignatieff 1983).

For Smith, commerce, on the other hand, lets people live. Commerce allows people to be more humane and less brutal because it generates wealth to support life. For Smith supporting life is moral and, to use contemporary economist's parlance, it is a normal good subject to an income effect. The wealthier one is, or a society is, the cheaper it is, in relative terms, to be engaged in some moral behaviours, such as supporting life. According to Smith, in commercial societies, infanticide is abandoned and looked upon with horror. In commercial societies, one is rich enough to afford children and avoid morally repulsive actions dictated by exigency. In his 'Introduction and Plan of the Work' Smith argues that in commercial societies:

though a great number of people do not labour at all ... yet the produce of the whole labour of the society is so great, that all are often abundantly supplied, and a workman, even of the lowest and poorest order, if he is frugal and industrious, may enjoy a greater share of the necessaries and conveniences of life than it is possible for any savage to acquire. (WN introduction.4: 10)

Smith repeats the same point at the end of the first chapter of WN, where he compares an African King, a European prince and a European peasant. The conveniences of life, which support the life of a European peasant are not much less than the ones enjoyed by a European prince, but they far exceed those of an African king (WN I.i.11: 24). With the exception of ancient Greeks, whom Smith characterizes as having 'the most unjust and unreasonable conduct' because they keep following the ancient barbaric custom incongruent with their more refined status (TMS V.2.15: 210), commerce prevents 'so dreadful a violation of humanity' (TMS V.2.15: 210) as infanticide. Commerce provides resources to maintain children and the sick and infirm, and the preservation and multiplication of life is morally good. Smith promotes commerce on moral grounds because some morally desirable outcomes, such as the preservation and support of life, are a result of commerce (see Otteson 2002).

Smith offers us a moral defence of commerce because commerce allows morality the space to flourish. Commerce lets people live. But this is not enough. An increasing

number of people alive and enslaved seems to be better than a decreasing number of people alive and enslaved. But an increasing number of people alive and free is even better. And, Smith argues, this is what commerce does. Not only is commerce conducive to morality because it lets more people live, but it is conducive to morality because it allows more people to live freely, through a set of institutions which foster liberty.

Non-commercial societies are characterized by personal relationships. For Smith personal relationships can imply dependence and therefore servitude. Indeed, personal relationships can easily be tyrannical. Commercial societies are characterized by impersonal relationships. In Smith, impersonal relationships imply independence and therefore freedom.<sup>2</sup> The African king, who is worse off than the European peasant, is also ‘the absolute master of the lives and liberties of ten thousand naked savages’ (WN I.i.11: 24). The European peasant is instead a free man, living under the protection of the rule of law.

Smith describes in detail how commerce brings about individual as well as institutional liberty in Book III of WN. There, Smith analyzes the fall of feudalism and the advent of commercial societies. He claims that ‘the least observed [yet] *by far the most important* of all [the] effects’ of commerce is the development and fostering of liberty (WN III.iv.4: 412, emphasis added). Indeed, ‘Commerce and manufacturers gradually introduced order and good government, and with them the liberty and security of individuals, among the inhabitants of the country, who had before lived almost in a continual state of war with their neighbours, and of servile dependency upon their superiors’ (WN III.iv.4: 412). Commerce therefore generates the ‘regular administration of justice’, institutionalizing rules of cooperation, fostering commercial prosperity and liberty (Rosenberg 1990; Prasch 1991; Rasmussen 2006; Smith 2010).

In feudal societies, for Smith, where commerce is effectively absent, the great landowners can spend the products of their land only on ‘rustick hospitality at home’ (WN III.iv.5: 413). This means they support hundreds or thousands of men, as there is nothing else on which they can use their produce. ‘[A great proprietor] is at all times, therefore, surrounded by a multitude of retainers and dependants, who having no equivalent to give in return for their maintenance, but being fed entirely by his bounty, must obey him, for the same reason that soldiers must obey the prince who pays them’ (WN III.iv.5: 413). Lack of commerce, for Smith, implies servility.

When commercial societies are slowly introduced the ‘masters of mankind’ find something different on which to spend their rents. Rather than sharing their rents with their dependants, they can now spend them all on themselves, buying ‘trinkets and baubles’. And they do. ‘For a pair of diamond buckles perhaps, or for something as frivolous and useless’ feudal lords trade away their power and authority, *de facto* freeing their dependants from servitude (WN III.iv.10: 418–19). Commerce requires monetized transactions. And monetized transactions are impersonal transactions; they break the

<sup>2</sup> Smith presents also other kinds of relationships such as friendship and familiar relations, but these tend to remain relatively stable in the different stages of development. Thanks to Christopher Berry for pointing this out to me.

personal ties between masters and servant. Smith tells us that masters are now customers, and servants are now tradesmen and artificers. It is true that the former master still feeds the former servants, but it is also true that the former servants 'are more or less independent of him, because generally they can all be maintained without him' (WN III.iv.11: 420). Smith provides here another moral justification for commerce: commerce generates freedom. Indeed, tradesmen and artificers now have not one but a thousand masters, which means they are 'not absolutely dependent upon any one of them' (WN III.iv.12: 420).

Smith's moral justifications of commerce, as we saw, are that commerce generates the resources to be more moral and it generates the freedom to be more moral. The third Smithian moral justification of commerce is that commerce fosters some aspects of moral development, perhaps most importantly, through facilitating the development of impartiality (Paganelli 2010). One can think of moral development as an enhanced capacity to exercise impartiality in our judgments. Moral actions are based on moral judgment and a moral judgment is an impartial judgment of what is appropriate in specific situations (see Fricke in this volume).

In Part III of TMS, Smith explains that impartiality is what allows us to be virtuous and therefore moral. Impartiality is not innate, but acquired. We are born with the potential of becoming impartial, but we become impartial only through a long process of practice. Smith explains the development of impartiality by explaining how we learn to perceive distance (TMS III.iii: 134–56). The perception of distance is not innate, but learned. What is innate is the capability of perception of distance. It is only with experience that we then learn to perceive distances correctly (Levy 1995).

So Smith tells us:

In my present situation an immense landscape of lawns, and woods, and distant mountains, seems to do no more than cover the little window which I write by, and to be out of all proportion less than the chamber in which I am sitting. I can form a just comparison between those great objects and the little objects around me, in no other way, than by transporting myself, at least in fancy, to a different station, from hence I can survey both at nearly equal distances, and thereby form some judgment of their real proportions. Habit and experience have taught me to do this so easily and so readily, that I am scarce sensible that I do it. (TMS III.3.2: 135)

The perception of distance is therefore learned.

Just like we need to put two objects at the appropriate distance from each other to compare dimensions, to see an object clearly, we need to put it at the right distance, that is, not too close and not too far away from our eyes. According to Smith, something that is close to our eyes appears much bigger than it is. Something that is far away from our eyes appears much smaller than it is. That is to say, the perception of something that is too close to us is biased. The object appears deformed in its 'bigness'. On the other hand, the perception of something that is too far away is also biased. The object appears deformed in its 'smallness'. Something big may look small simply because it is far away. Something small looks big simply because it is very close.

Smith argues what is true for a physical object is also true for passions. According to Smith, ‘as to the eye of the body, objects appear great or small, not so much according to their real dimensions, as according to the nearness or distance of their situation; so do they likewise to what may be called the natural eye of the mind’ (TMS III.3.2: 134–5). So, if something happens close to us, we give it much more importance than if the same thing happens far away from us. And the closer to us, the more importance we give it, and vice-versa. Something close to us seems big. Something far away from us seems small. This implies that a small personal trouble will appear to our eyes much more tragic, much bigger, than a large catastrophe far away from us. Or that a small personal success gives us more joy than a distant immense positive event (TMS III.3.3: 135).

Following Smith, this natural propensity is a problem for moral judgment and consequently for moral behaviour. If I perceive what is close to me to be much bigger than it actually is, a harm done to me will be seen as much more damaging than if the same harm is done to someone I do not know. Similarly, a good deed towards me is perceived as much more deserving than if done to an unknown stranger (see also Hume 2002: 219). So, I think that everything that happens to me is much more significant than it actually is. So much so that if I know I will lose my little finger tomorrow, tonight I would not be able to sleep. While if I know the entire population of China will die in an earthquake tomorrow, I will snore placidly through the night (TMS III.3.4: 136). But Smith explains that this is not the whole story. Humans are not only born with some vision problems due to their self-love, but also with corrective glasses (see also Hobbes [1651] 1991: 129). Just like we are able to learn that the moon is bigger than the thumb which covers it, we are also able to learn that someone’s problems or joys may be bigger and more relevant than ours, and that behaving thinking otherwise may not be good (TMS III.3.4–7: 136–9).

For Smith, as social animals, we are equipped with the ability to put ourselves in the place of another and to imagine how we would feel if we were them. We are also equipped with the desire to be loved and not hated. According to Smith, when I meet you, I see your aversion to my ego-centrism. I do not want you to dislike me. To the contrary, I want you to like me and approve of me. To do so, I learn that I have to ‘adjust the pitch of my passions’ to make them more acceptable to you. How do I know? Because that is the lesson of my exposure to the actions and reactions of my fellows. When I see you reacting to something that happens to you, I may think your passions are excessive, out of proportion. This is why I do not approve of them. If I were you, Smith tells us, I would be aware of the effect of my actions on others and not react that strongly. This then reciprocally makes me realize that this is why you do not approve of me when you see me reacting to a specific situation. So, in anticipation, I adjust the pitch of my passions so that you will approve of me, just as you adjust the pitch of your passions to appeal to me (TMS I.i.1–4: 9–23).

For Smith, therefore, the presence of others allows us to understand that our judgment towards ourselves is biased because we are too close to ourselves. The presence of others, given our ability to put ourselves in the place of others and see how we would react if we were them looking at ourselves, helps us overcome our biases and try to

develop a more socially acceptable behaviour. Thanks to the presence of others we learn the appropriate behaviour in a specific situation. According to Smith, this is the first step towards the development of impartiality and morality.

The second step towards the development of impartiality and morality, according to Smith, is the kind of others with whom we are interacting. Smith explains not all others are created equal in the process of our moral development. The closer the other is to us the less effective the other is in our development of impartiality (see also Hume 2002: 350). Family members or close friends are too close to us. They are more likely to let us indulge in our passions. People on the other side of the planet, similarly, are too far away for us to care. We are still left indulging in our passions. The strength of our passions is not proper, given the circumstances. Strangers whom we meet face to face, though, are the right kind of others for our moral development. For Smith, strangers are far enough from us to be unbiased in their judgment and are close enough for us to care (TMS III.3.38–41: 153–4).

Say we suffer a great personal tragedy. If we meet a family member or a friend, Smith tells us, we will let out the intensity of our passions. With them, our distress is big because it is close to us. And our relatives or close friends are, well, close. So they also see this event as big (even if smaller than we do). They will let us indulge in our passions. On the other hand, for Smith, we would unlikely display our feelings with the same intensity with a stranger. They would think it would be quite bizarre if we did it. And we know it. So if we have to meet a stranger, we control our passions. And even if this is fake at the beginning, eventually we will feel better than if we stayed all day in the solitude of our room. According to Smith, we have adjusted the pitch of our passions to appeal to others and made ourselves morally stronger (TMS I.i.4.9: 22–3, VI.iii: 237–64). These are some of Smith's words describing this process. Their power is worth citing:

In solitude, we are apt to feel too strongly whatever relates to ourselves: we are apt to over-rate the good offices we may have done, and the injuries we may have suffered: we are apt to be too much elated by our own good, and too much dejected by our own bad fortune. The conversation of a friend brings us to a better, that of a stranger to a still better temper. . . . Are you in adversity? Do not mourn in the darkness of solitude, do not regulate your sorrow according to the indulgent sympathy of your intimate friends; return, as soon as possible, to the day-light of the world and of society. Live with strangers, with those who know nothing, or care nothing about your misfortune (TMS III.3.38–9: 153–4).

This adjustment of the pitch of our passions is our learning the size of our fortunes and misfortunes. And, for Smith, our best teachers are strangers. The disapproval of others, of strangers in particular, to our reactions teaches us that our passions are too big because we are too close. If we see what happened to us from their point of view, from some distance, we would see that it is not that big. If we see ourselves as a stranger sees us, we see how bias our judgment is. If we see ourselves from the distance others see us, we would be able to be more impartial in our judgment towards ourselves. We would be able to see the right size. For Smith, the continuous interaction with strangers is a continuous

training for our self-command and therefore our impartiality. By practising adjusting our passions to the appropriate pitch, we eventually more easily adjust them. Eventually we will be able to moderate the pitch of our ego-centric passions to what an impartial spectator would judge as appropriate even in the physical absence of others. We become so accustomed to see ourselves with the eyes of another, that we do not need the physical other any longer to do it. In Smith's account, with our imagination, trained by practice, we split ourselves into two and become at the same time the actor and the spectator of our actions. When this happens we are able to be impartial in our judgment of ourselves regarding the propriety of our passions. When this happens we act morally (TMS III, 1–2: 109–34).

The others that matter the most for our development of impartiality, according to Smith, are strangers. Commercial societies are the societies in which one most often interacts with strangers. Commercial societies are societies of strangers (TMS I.i.4.9: 23; see also Seabright 2004) and so they seem to be the most effective locus to develop impartiality. Morality can therefore be seen as flourishing with the presence of commerce, that is, Smith, yet again, promotes commerce on a moral ground.

What Smith says and whether Smith is correct or not are two separate questions. A discussion of whether Smith may be correct in his analysis is in the last section of the paper. For now let us see how the dependence of markets and morals is reciprocal and how, for Smith, not only markets foster some aspects of morality but morals foster some aspects of commercial societies.

## MORALITY FOSTERING MARKETS

Adam Smith sees some positive moral effects coming from commerce, but he also sees that commerce requires some aspects of morality to develop and to grow. Evidence of this can be found in at least two places. One is in his analysis of the role of justice. The other is in his analysis of the consequences of the absence of morality in commerce: when agents do not behave morally, a commercial society is transformed into a deleterious and impoverishing mercantile system.

The role of justice in commerce (and in society in general) is straightforward. Smith claims that human societies cannot but be characterized by the presence of justice. A society without justice collapses. 'Justice... is the main pillar that upholds the whole edifice. If it is removed, the great, the immense fabric of human society... must in a moment crumble into atoms' (TMS II.ii.3.4: 86). Justice, Smith continues explaining, is a natural feature of human beings and therefore of human society. A society without justice is not a human society. Individuals would be 'like wild beasts... and a man would enter an assembly of men as he enters a den of lions' (TMS II.ii.3.4: 86; see also TMS II.ii.2.1: 83).

The analysis of how some aspects of morality foster markets by looking at the consequences of their absence is more complex and depends on our innate desire to receive approbation (Paganelli 2009a).

In Smith, approbation stems from two different sources: appropriate moral conduct and the social status associated with the possession and parade of wealth. The approbation generated from appropriate moral conduct generally gives us incentives to behave morally. The approbation generated from the parade of wealth gives us incentives to accumulate wealth (TMS I.iii.2.1: 50–1). But in contrast to our virtuous behaviours, wealth is visible and an easily recognizable sign of distinction. Thus, given the high recognizability of wealth and the difficulties with which virtue is distinguished from morally questionable behaviours, we tend to rely more on wealth than on virtue when we give approbation to others (TMS Vi.ii.1.20: 225–6). Similarly, for Smith, we rely more on wealth than on virtue when we seek approbation from others (see Tegos in this volume and Hont and Ignatieff 1983).

The more wealth one has, the more attention one attracts, and the more approbation one gains (TMS i.iii.3.4: 62–3).<sup>3</sup> For Smith, one admires the wealthy and aspires to become like them. But the great admiration for men of fortune may induce individuals to take great moral risks (TMS i.iii.3.8: 64–6). If the results of the morally questionable actions are positive, they gain the approbation from the easily recognizable higher level of wealth, and their difficult to recognize immoral misbehaviours will most likely be ignored. For Smith, reproachable behaviours generate great admiration when the resulting gains are great, while they generate contempt if the gains are ‘petty’ as the increase in wealth is not enough to compensate for the decrease in approbation due to the immoral behaviour (TMS Vi.i.16: 217). What Smith is telling us, then, is that we are willing to trade approbation from moral behaviours for approbation from parading wealth. We are willing to give up approbation from moral behaviours if we think that we can gain a lot of approbation from material possessions. The higher is the gain in approbation from material possessions, the more likely one is willing to behave in morally dubious ways to achieve it (Levy 1999).

Following Smith, when the possibilities to gain approbation from wealth are large enough, they may incentivize more morally questionable actions and generate potentially disastrous consequences. And indeed, in commercial societies big merchants and manufacturers, given their desire to improve their image in the eyes of others, have opportunities to do so. The wealth generated by commerce is unprecedented and can be concentrated in their hands, if only the government grants them monopolies. Smith tells us that merchants and manufacturers are willing to give up moral behaviours, using the coercive powers of the state, to increase their fortune and status at the expense of the rest of society. They are willing to elbow their way over their competitors, even if these are reproachable behaviours, because with monopoly powers, they will gain much wealth and approbation. The increase in personal wealth brings an increase in social approbation sufficient to outweigh any possible disapprobation for the methods used to achieve it. But, Smith also tells us, society will be deeply hurt and ‘both deceived and oppressed’ (WN I.xi.10: 267).

<sup>3</sup> Smith (2013) presents a number of exceptions. The man of fashion need not be the wealthiest. The coxcomb might appear rich but not be. The noble might be admired but not be wealthy, the *nouveau riche* might be scorned.

So if we have markets with immoral behaviours, the consequences are potentially devastating for society. A commercial society is reshaped into a mercantile system. Smith believes mercantilist policies deform, distort, and impoverish society. These are strong words:

In her present condition, Great Britain resembles one of those unwholesome bodies in which some of the vital parts are overgrown, and which, upon that account, are liable to many dangerous disorders scarce incident to those in which all the parts are more proportioned. A small stop in that great blood-vessel, which has been artificially swelled beyond its natural dimensions, and through which an unnatural proportion of the industry and commerce of the country has been forced to circulate is very likely to bring on the most dangerous disorder upon the whole body politick. . . . The blood of which the circulation is stopt . . . in any of the greater vessels, convulsions, apoplexy, or death are the immediate and unavoidable consequences. (WN IV.viii.c.43: 604–5)

Only commerce within its moral framework, not poverty nor the immoral mercantile system, brings about life. And therefore, life being a virtue to support, Smith highlights once again the positive link between commerce and some aspects of morality.

Smith goes on to explain the consequences of a broken link between commerce and morals. The system of justice that commerce generates becomes a system of brute injustice when morality is ignored. Smith indeed tells us that ‘sometimes the interest of particular orders of men who tyrannize the government, warp the positive law of the country from what natural justice would prescribe’ (TMS VII. iv.36: 340–1), and that ‘[t]o hurt in any degree the interest of any one order of citizens, for no other purpose but to promote that of some other, is evidently contrary to that justice and equality of treatment which the sovereign owes to all the different orders of his subjects’ (WN IV.viii.30: 654). And in Smith, this is exactly what some great merchants and manufacturers do when there are large profit opportunities generated by government granted monopolies. Merchants and manufacturers become a threat to that system of justice through their ability to extort ferocious laws in favour of their own interests (WN IV.iii.c.10: 493–4 and WN IV.viii.53: 661 among others). Mercantilist laws are far from just; indeed Smith likens them to the laws of Draco that ‘may be said to be all written in blood’ (WN IV.viii.17: 648).

According to Smith, Britain faces these negative forces from mercantile interests groups which use government’s coercion to extract benefits from themselves. Yet, her commerce is so strongly rooted that, despite such selfish and misguided legislation, the country is able to maintain a decent standard of living (WN IV.vii.c.47: 607–8 and WN IV.vii.c.50: 609). But, for Smith, the situation is not as fortunate where the mercantile system takes over a country where commerce does not have such deep roots. Bengal is the example Smith gives us. In Bengal

many would not be able to find employment even upon . . . hard terms, but would either starve, or be driven to seek subsistence either by begging, or by the perpetration perhaps of the greatest enormities. Want famine, and mortality would immediately prevail . . . till the number of inhabitants in the country was reduced to what could

easily be maintained by the revenue and stock which remained in it, and which had escaped either the tyranny or calamity which had destroyed the rest. In [that] fertile country [of Bengal] which had before been much depopulated, three or four hundred thousand people die of hunger in one year. (WN I.viii.26: 91)

Bengal is in such dismal state because of the ‘mercantile company which oppresses and domineers in the East Indies’ (WN I.viii.26: 91). Commerce, given the correct moral framework that can develop along with it, generates and sustains life. Mercantilism, a degenerated form of commerce where the moral framework succumbs to avarice and venality, generates the death of both individuals and society. Commerce requires morality; mercantilism subverts it.

## NEGATIVE CONSEQUENCES OF MARKETS ON MORALITY

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Adam Smith is not a one-handed economist. He sees the potential negative effects of commerce as well as the positive ones. Smith is eloquent in describing how the introduction of commerce may bring individuals to debauchery and to seek comfort from loneliness in vicious political or religious factions (WN V.i.g.12: 795–6; see Levy and Peart 2009), to which he suggests as remedies the ‘study of science and philosophy’ (WN V.i.g.14: 796) and ‘publick diversions’ (WN V.i.g.15: 796). He is eloquent in describing how commerce decreases the martial spirit of soldiers (WN V.i.f.50,59/782, 787; LJB 331/540) and numbs the mind of some specialized workers (WN V.i.f.50: 782) to which he suggests as remedies basic education (WN V.i.f.51–61: 782–8). Tegos, Pack, and Rasmussen, in this volume presents a full account of the corruption of commerce on certain aspects of morality. Here I add a couple of further considerations Smith makes, indirectly, on the negative moral effects of commerce.

Despite subscribing to the idea, later called *doux commerce*, that commerce increases humanity, Smith does not believe commerce brings peace. On the contrary, Smith tells us the number and the length of unjust wars increases with the increase in the wealth brought about by commerce. The great merchants and manufacturers want to open new markets and are now willing and able to bring a country into war ‘for the sake of that little enhancement of price’ (WN IV.viii.53: 661). Their fellow-citizens, ‘who live in the capital, and in the provinces remote from the scene of action ... enjoy, at their ease, the amusement of reading in the newspapers the exploits of their own fleets and armies’, enjoying their dreams of empire (WN V.iii.37: 920). And the ability to debt financing, which comes only with the wealth of commercial societies, allows the sovereign, the great merchants and manufactures, and the fellow-citizens to disregard the high expenses of war. They will not directly and immediately have to pay them, differently from when a war is financed by taxation when its expense is immediately and directly faced.

Smith also analyses how the wealth of commerce brings about a sovereign's morally irresponsible spending. Smith explains that the sovereign will squander his revenues of frivolous trinkets (WN V.iii.2–3: 908) during times of peace. When war comes, debt will be incurred, which 'will in the long run probably ruin all the great nations of Europe' (WN V.iii.10: 911). Smith is not too preoccupied by the presence of public debt though, because 'if [commerce] commonly brings along with it the necessity of borrowing, it likewise brings along with it the facility of doing so' (WN V.iii.5–6: 910). Yet, the possibilities created by commerce include the irresponsible and immoral frivolous spending of the sovereign and the possible ruin of society.

## A TESTABLE HYPOTHESIS

Adam Smith can be read as taking part in a larger conversation on the effects of commerce on aspects of morality. In the eighteenth century the studies of the effects of commerce on human character and moral systems abounded. Albert Hirschman (1977) refers to as the *doux commerce* the idea that the introduction of commerce changes the character and disposition of men, making them less violent and more sociable, as, among others, Montesquieu ([1748] 1989) and David Hume ([1752] 1985) suggest. Whether markets affect some moral systems and how they do so is not a question first asked in the eighteenth century. The relations between markets and moral systems have been analysed since antiquity. Typically it was believed markets affect morality, and they do it in a negative way. Merchants in classical Greece were typically not citizens. Commerce though necessary was liable to corrupt virtue, as a 'means' became an 'end'. Up to the eighteenth century, the general attitude did not change much: market behaviour is a threat to some moral orders. But with the spread of commerce and the development of commercial societies, markets are seen also as promoting all sorts of betterments, from material to moral, as Adam Smith testifies. Since the seventeenth–eighteenth century, markets have been seen as both promoters of the development of some moral systems or promoters of the degeneration of some other moral systems (Berry 1994; Clark 2007). But no consensus is present on whether the overall effect is positive or negative. Today we still face similar questions and generally we face similar disagreements (McCloskey 2006; Zak 2008). Probably this lack of consensus comes, among other things, from the method of inquiry—speculation and anecdotal analysis.

Yet, in recent years we have been able to present the question of whether markets have a positive or negative effect at least on specific aspects of morality as a testable hypothesis. The development and growth of experimental economics allows us to test it both in the field and in the laboratory. The results remain mixed, mostly because of the difficulty of designing a feasible experiment which captures the problem. So far, we have results showing that formal institutions such as markets may have an adverse effect on informal institutions and social norms (Frey 1997; Deci et al. 1999; Falk and Kosfeld 2006; Reeson and Tisdell 2010), but in other laboratory studies, Herrmann

et al. (2008) find that cooperation is enhanced by exposure to markets. Using macro data, Zak and Knack (2001) find a strong relationship between the incidence of markets and formal institutions and generalized trust.

The experimental designs which most closely address the question of how markets affect specific aspects of morals come from Joseph Henrich et al. (2004, 2010). Their work suggests that exposure to markets increases altruism. In particular in their cross-cultural experiments, they show that giving in Ultimatum Games and Dictator Games is positively correlated with market integration, that is, to how much subjects are exposed to markets. In fact, exposure to markets is the strongest explanatory variable for their results. Exposure to markets is positively correlated to cooperative behaviours often associated to moral behaviour.

An Ultimatum Game is a game where there are two human players. As in all economics experiments, subjects voluntarily come to the experiments and are paid in local currency the amount they earn by playing the experimental game. For each experiment, the number of participants is chosen so that the experimenter has enough observations to statistically analyse the results. In the standard Ultimatum Game, players' anonymity is strictly preserved. Player 1 (Sender) receives an amount of money and is asked to send any amount of it to Player 2 (Receiver). Should the Receiver accept the Sender's offer, the money is divided according to the terms of the offer. If the Receiver rejects the offer, both the Receiver and the Sender do not earn anything. In industrialized societies, subjects consistently tend to split the amount 50/50 and tend to reject offers that are less than 50 per cent (Guth and Tietz 1990; Roth et al. 1991; Camerer and Thaler 1995). A Dictator Game is a modified Ultimatum Game. In the Dictator Game, the Sender (Dictator) faces the same choice as in the Ultimatum Game: choose how much of the money given to her/him to send to her/his anonymously paired Receiver. But here, the Receiver cannot reject the offer of the Sender. The Receiver must take what the Dictator sends without any possibility of rejection. Here, the possibility that the choice of the Sender could be motivated by strategic behaviour intended to decrease the risk of rejection is eliminated by design. If a Sender sends a positive amount to the Receiver, s/he would be motivated only by other-regarding preferences. In industrialized countries, consistently 20–30 per cent of the Senders give 50 per cent, while 30 per cent of the Senders take the whole pot (Roth et al. 1991; Forsythe et al. 1994; Henrich et al. 2004). The average giving is around 30 per cent.

In 2000, Joseph Henrich started a series of field experiments across the globe using members of small-scale societies with a broad variety of economic and cultural conditions as subjects. His results, and the results of his colleagues, are different from the homogeneous results of industrialized countries (Henrich et al. 2004). Fairness seems to vary cross-culturally. The modal Ultimatum Game offers from the sample of the 15 foraging societies studied ranged from 15 to 50 per cent. Rejection rates are much lower than those observed in industrialized countries. Trying to control for possible explanatory variables, Henrich et al. found that two variables account for a significant part (47 per cent) of the variation between groups. These variables are 'market integration' (that is, do people engage frequently in market exchange?) and 'cooperation in production'

(that is, what are the potential benefits to cooperative as opposed to solitary or family based productive activities?). The higher the level of market integration, the higher the level of cooperation and sharing in the experimental games. It seems that market promotes cooperation and fairness. Intrigued by these ‘counterintuitive’ results, Henrich et al. (2010) went in the field again, and using another set of 15 small-scale societies explicitly tests the previous results again. The original findings are confirmed and reinforced. Market integration is the most powerful explanatory variable for changes in the amount given in both games. Adam Smith’s claim that some aspects of moral behaviour are a result of markets seems to have an empirical support.

Additionally, Omar Al-Ubaydli et al. (forthcoming 2013), using randomized control laboratory experiments, shows that market exposure has a positive and significant effect on trust and a positive yet negligible effect on trustworthiness. Al-Ubaydli and his colleagues use the Trust Game and the psychology technique of priming. In a Trust (or ‘gift exchange’) Game, Player 1 can either keep a fixed sum of money or send part of it to Player 2, who will receive the amount sent multiplied by a predetermined factor. Player 2 can then take all of what s/he received and leave Player 1 with whatever s/he did not send, or send back some of the money to Player 1. The observed ‘returns to trust’ tend to be positive (Fehr, Kirchsteiger, and Reidl 1993; Berg, Dickhaut, and McCabe 1995). With Al-Ubaydli’s design, subjects are randomly and unconsciously primed to think about markets and trade. They are then asked to play a Trust Game involving an anonymous stranger. The behaviour of these individuals is compared with that of a group who are not primed to think about anything in particular. Al-Ubaydli’s finding is that priming for market participation affects positively the beliefs about the trustworthiness of anonymous strangers, increasing trust. Again Adam Smith seems to have found empirical support for his justifications of markets on a moral ground.

Another way of seeing this is that when the hypothesis that markets have positive effects on morals is tested, and the closer is the design of the experiment to the hypothesis, there seems to be an increasing amount of evidence to support it. The question that is not tested or answered yet in the current experimental literature is *how* markets generate this positive effect on at least some aspects of morals. This is where the eighteenth-century scholarship and of Adam Smith in particular become relevant.

The way Smith explains our moral development can explain why subjects in Ultimatum and Dictator Games are willing to share as much as they do with an unknown other. The way Smith explains our moral development in relation with commerce can also explain why subjects exposed to markets generally give more in Ultimatum and Dictator Games than subjects who are not as much exposed to markets (Paganelli 2009b).

Additionally, according to Smith, as we start dealing with strangers, we start needing rules to govern our interactions. The institutionalization of rules of just conduct reinforces the cooperation among individuals providing a beneficial feedback loop (see also Ostrom 1998). The opportunity to trade with strangers allows individuals to learn more easily how to interact with others in a fairer way, without being exclusively motivated by fear of retaliation. The opportunity to trade with strangers also allows for the generation of institutions that facilitate cooperation, which in their turn facilitate the internalization of cooperation.

Indeed, in the absence of markets, interactions with strangers ('outsiders') are characterized by danger, exploitation, and mistrust (Henrich et al. 2010), and are therefore avoided. Commerce breaks the boundaries of small and closed communities. Commercial societies allow for fruitful exchanges with strangers and strangers begin to be associated with positive outcomes thanks also to the development of institutions which facilitate these exchanges (North 1990 and Ostrom 1998). The result is the weakening of a set of moral values and the strengthening of a different set of moral values. Some moral behaviours are enhanced even in the settings where there is no threat of punishment for devious behaviour. Commerce therefore reduces the cost of the development of impartiality and increases how relevant cooperation with anonymous strangers is in our life, and it may allow us to make that leap of faith required to trust strangers as trustworthy. The strong positive correlation between growth and trust Zak and Knack (2001) find may be part of this story.

As trust may increase economic growth, economic growth may increase trust. Adam Smith suggests indeed the more one trades the more honest one becomes, a *doux commerce* argument. The incentives to cheat decrease since one realizes of the potential long-term gains of honesty (LJB 205: 487; WN III.iv.3: 411; see Young 2001). Similarly, as his contemporary and friend David Hume claims, countries where commerce is introduced and sustained grow honesty and extinguish corruption. Hume's evidence? Poland: 'a country where venality and corruption ... prevail. The nobles seem to have preserved their crown elective for no other purpose, than regularly sell it to the highest bidder. This is almost the only species of commerce, with which that people are acquainted' (Hume [1752] 1985: 276).

It seems therefore, for Smith, 'ethical maturation is an ongoing process because the ideal is a limit—we can forever refine our values as we approach it, but we can never achieve it' (Evensky 2005: 47). Jerry Evensky indeed describes Smith as telling the story of the co-evolution of individuals and social norms of ethics, a story in which not only change but progress occurs. 'In this story, human nature is constant (we are not "better" than our predecessor), but human character evolves along with human institutions, and these have the capacity to mature toward the ideal' (56). The presence of commerce would indeed generate that moral environment that would fit in the story of co-evolution and maturity towards the ideal. This story fits our experimental results. Henrich (2004, 2010) and his team open the door to empirical cross-cultural studies where the variable with the highest explanatory power is market integration; Al-Ubaydli (forthcoming 2013) and his colleagues open the door to randomized control where trust and trustworthiness increase with market exposure; and Smith and other eighteenth-century scholars may provide the theoretical explanations for these results.

## CONCLUSION

Adam Smith favours commerce on grounds of both morality and efficiency. Commerce is intertwined with morals, it supports moral development and at the same time it is supported by it. Commerce requires morals for its functioning and gives the conditions

under which people can live, can live freely, and can live morally. The wealth generated by commerce may not only support life, but also endanger it. It may generate incentives to lobby for the establishment of monopolies which benefit a few at the expense of the many, it may generate incentives to cause and prolong wars, it may generate incentives to weaken a country martial spirit, and to numb the mind of some workers. Smith recognizes both positive and negative effects commerce on morals. Yet, on balance, he recognizes the positive effects outweigh the negative. Today there is increasing empirical support for the positive effects of markets on morals, coming from the laboratory and the field. And there is a coherent explanation for why that may be the case which comes from Adam Smith.

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