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## Adam Smith and the Economic Model of State-Individual Relation: Design, Impact, Prevalence

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LEONARDO S. MILANI, AUG 2 2012

In the colourful spectrum of the 18<sup>th</sup> century Enlightenment's multi-dimensional project (or as in the Enlightenment literature terminology, 'progress') of constructing various types of descriptive /prescriptive man-centric theories of modernity aimed at enhancing the overall state of mankind, the quest for a systemic socio-political theory of progressive 'organic' nation-state, a theoretical blueprint for dissecting and perfecting the laws and processes of interactive relation(s) between the society's micro-component (i.e. individual), medium-component (i.e. social institutions) and macro-component (i.e. institution of power, state), was one of the central concerns in the grand intellectual endeavour of the architects of the Age of Reason. In retrospective, the emergence of the early forms of modern social sciences (e.g. political science, sociology, anthropology, economics) during the 17<sup>th</sup> and 18<sup>th</sup> centuries Enlightenment was perhaps catalysed by the aforementioned intellectual quest of the major thinkers to discover or devise an answer to the so-called 'problem of order' in the Western thought, the problem of determining the extent of societal order via achieving a most stable equilibrium between freedom and control, between hierarchy and quality.[1] The Enlightenment's most formidable minds with their distinct and iconic theoretical and teleological perspectives responded to the challenge by developing a wide range of theories: from Thomas Hobbes and his realism, pessimistic theory of human nature and justification of ever-authoritative state, to John Locke and his classical liberalism, individualism and enduring concept of social contract, to Rousseau and his classical republicanism, Athenian-like direct democracy and his model of organic nation-state.

Yet, perhaps none was as effective as Adam Smith (1723-1790) and his socio-economic model of neo-classical liberalism and theory of political economy in providing the most positive solution to 'the problem of order', a solution so influential that evolved to integrate with the very foundations of the modern Western civilization. Symbolizing the pinnacle of Scottish Enlightenment along with David Hume, Adam Smith is considered as the founder of modern economics and one of the premier philosophers of modern West.[2] Smith's moral and economic system, as outlined in his magnum opus *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776) and his other equally important book *The Theory of Moral Sentiments* (1759), establishes an unprecedented model of interdependency between individual psychology, collective behaviour and economic operation by placing the notion of economy at the centre of his philosophical system. But how did the Smithian perspective influence the nature and direction of the emerging Western civilization? As Smith's analysis of the mechanism of micro-economics and his theory of human nature penetrated the deepest levels of the emerging industrial market economy of his time, was it merely a theoretical justification of the status quo or a contribution to the process of civilizational transformation? Do Smith and his legacy still reside in the corridors of our modern civilization or they are lost in the shadowy galleries of a forgotten past? The answers to these questions are, perhaps, answers to the question of the genealogy of Western liberal-capitalism, the world as we know it.

This essay is an attempt to analyze the intellectual impact of Adam Smith's capitalist system, especially his theory of political economy, on the societal and intellectual trends in the Western world. Adopting an analytical approach, the essay will respectively analyze the two core operational concepts of Smithian doctrinal system (i.e. a) materialist conjectural history and b) conjoint theory of human behaviour and free-market), each theory followed by an analysis of its impact(s), if any. Through the implementation of such economy-centric model of analysis, designed to avoid entanglement with perhaps marginal fields, a realistic assessment of Smith's influence on the intellectual and social

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foundations of the modern West can be made.

The first component of Smith's multi-layered system, the basis for his socio-economic theory, is his distinct model of conjectural history, describing an economy-centric, materialist evolutionary pattern of human society from the most primitive forms of community with primitive methods of production and consumption towards more abstract forms. An alternative to the Rousseau's model of conjectural history, Smith's version, also known as 'the four-stage theory of development', focuses, however implicitly, on the role of economy in enhancing the state of mankind and his intellectual abilities through four stages of societal development.[3] The first stage and the most primitive of all, Smith observes, is the age of hunters. At this stage, there are no methods of production as men solely rely upon the art of hunting and random gathering of resources for survival. In the absence of means of organized production, chase would be the only profession, thus no significant intellectual skills or observations required. Yet, with increase in the population of the primitive communities of the first stage, the transition to the second stage, the age of shepherds, occurs. At the second stage, while men develop rather primitive techniques for maintaining the flock as the more reliable resource, a method of production is invented as a response to the increasing consumption rate. In comparison to the first stage, an advancement in human faculties is evident. With further increase of population and the growth of demand, the need for inventing new methods of supply triggers the third stage, the age of agriculture. In this age, mankind resort to the significantly more complex science of agriculture, a science requiring technical arrangements to maintain the crop as well as methodical observation of the growth process, hence another progress in the level of human intellectual capacity. With the rise of production rate, a critical development occurs: limited accumulation of goods by individuals. Strategic to Smith's conjectural history, the consequence of such however minimal accumulation is the exercise of exchange among the owners of surpluses. This triggers the final stage of social development, the age of commerce, in which the method of production and consumption are most abstract: the trade of goods and superfluous products between individuals, communities and states, hence a shift in the production-consumption culture. As the logic of commerce requires a wide range of innovations (e.g. methods of communication, monetary order, sophisticated banking system, means of transportation, science of calculus, etc) the fourth stage is in fact the final stage of historical development, both in social organization and human faculties. [4] It worth mentioning that, as will be discussed later and as the subsequent layers of Smith's system elaborate further, it is by the vertical advancement of the age of commerce that the inter-connected notions of civil society, individualism, liberalism, limited government and capitalism emerge.

The presence of Adam Smith's four-stage theory, as the base layer of Smith's system, can be detected in the doctrinal frameworks of two major theories: Marxist political sociology and neo-liberal theory of history. As for the impact on Marxism, the influence of Smithian conjectural history is most visible in the Karl Marx's and Friedrich Engels' theory of historical and dialectical materialism. In spite of the Marxist literature's emphasis on the Hegelian origins of the dialectical materialism,[5] it could be argued that Marx's theory of the exclusive material nature of those forces underlying historical developments, and the economic nature of those factors determining social structure and change, is in fact a reformulation of Smith's model of conjectural history. Similar to the centrality of the variable of economy to the Smith's theory of social and intellectual development, Marx's dialectical materialism systematically rely upon the function of production-consumption-accumulation to construct its framework of communist political sociology. Such a doctrinal connection between Marx's economic theory and Smith's model of conjectural history is successfully proven by a series of recent comparative studies.[6] It is perhaps one of the greatest ironies in the Western intellectual history that the core doctrine of communist socialism is almost a replication of the inner-most theory of the economic system of capitalism's main architect.

In contrast to the much discussed Smithian-Marxist connection, the existing literature on Adam Smith's legacy seems to ignore the enormous impact of his conjectural history model on one of the most celebrated, and most debated, theories of the last decade of the 20<sup>th</sup> century: Francis Fukuyama's neo-liberal theory of 'end of history'. [7] Reviewing Fukuyama's hypothesis regarding the direction of humanity's socio-cultural evolution towards an eventual unified model of free-market capitalism and liberalism, the argument could be made, with a degree of scholarly flexibility, that Fukuyama's methodology for developing his hypothesis is an expansion of Smith's four-stage theory of development to the level of international political economy (IPE). Similar to Smith's argument that the age of commerce constitutes the final stage of human progress, Fukuyama's theory also emphasizes a fully elaborated age of global commerce to be the final stage of our overall evolution.

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The second component of Smith's system is his theory of political economy, a conjoint theory of market-based behaviour, consisting of four inter-related sub-theories of a) human behaviour, b) market operation and c) the function of free-market and private industry, and d) government's function in the age of commerce. This second layer of Smith's philosophical system is his grand socio-economic theory that provides an astonishingly concise yet inclusive analysis of human nature, moral dimension of economic activity and standard government operation. It is essential to note that the theory requires 'the age of commerce' as its contextual pre-requisite. Compatible with the tradition of the Enlightenment method of social theorization, Smith theory is a methodical expansion of the psychological analysis of individual (micro-level analysis) to investigate the most optimized organizational forms of society and government (macro-level analysis/policy recommendation). The first sub-theory, theory of human behaviour, is based upon Smith's view of human nature as expressed in the *Wealth of Nations*: for our philosopher, the most fundamental characteristic of mankind is self-interest.[8] All affairs of man, including his economic affairs such as trade, are conducted according to the intrinsic motivation of self-love: for instance, the logic of our strategic decision-making in exchanging goods with a trade counterpart demands manipulating his sense of self-interest rather than resorting to our own dire need. While self-interest may manifest itself in various ways, its prime form of psychological realization is man's desire of bettering his general condition.[9] This last notion of bettering oneself that concludes the first sub-theory is strategic for linking Smith's theory of human behaviour to the second sub-theory, moral dimension of market operation.

The second sub-theory establishes moral grounds for the two notions of individualism and capitalism. Smith argues that the most common tactic to better one's condition, as a fulfilment of the moral requirement, is 'augmentation of fortune', the increase and accumulation of capital through parsimony and disciplined saving of revenue. While the accumulated capital generates an individual-level 'opulence' that empowers man to enhance his faculties and level of social grace, the implementation of such practice in a social set will transform a selfishly-motivated individual's economic operation, aimed at achieving self-grandeur, to collective opulence: with the rise of each individual's capital, the total sum of a society's capital increases exponentially and quantitatively, an increase that according to the first sub-theory leads to a qualitative increase in individual and social level of behavioural perfection, that being Smith's material version of morality.[10] Resembling a mathematical model, the operation of the set's members determines the overall performance of the set itself. Within such economy-centric organic social system, the notion of production-consumption gain further complexity as the expenditure of capital by any individual must be in compliance with the larger strategy of systematic increase of nation's net capital: as principle of frugality accumulates capital, strategic thinking dictates a share of capital to be employed in domestic industries to increase the rate of one's own capital, but indirectly, and perhaps unintentionally, maintain the pace of the overall growth of the set's capital.[11] This leads to the third sub-theory, the establishment of the utilitarian function of private industry and free-market through a discourse of production-accumulation.

According to the fundamental logic of self-interest (i.e. pursue of maximum profit), the employment of private capital in industry is solely and exclusively in line with the individual investor's selfish interests. Therefore, he will endeavour to employ his capital in support of those 'domestic' industries that offer an economic prospect of maximum benefit and minimum loss of capital. Echoing Smith's strong opposition to the contemporary British system of mercantilism, he emphatically emphasizes on the domestic nature of these industries: obviously, if large share of private capitals are to be transferred to foreign markets, the integrity and coherence of the national economic system would be disturbed as the set's net capital decreases. In regard to domestic industry, Smith also recommends a 'division of labour' in the process of industrial production: a key principle in Smith's economic model, division of labour is the dividing of one large task assigned to one worker to smaller tasks distributed among several workers. Smith argues that division of labour leads to quantitative rise in production, qualitative enhancement of industrial performance, and even spontaneous micro-invention as each worker seeks to hasten his now far more concentrated labour.

At this stage, after establishing notions of individualism and capitalism, Smith's theory outlines its reasons for the necessity of absolute freedom of market and economic liberalism: as argued before, private owners of capital seek maximum profit when investing it in domestic industries. Evidently, every individual has a much better insight regarding the prospect of his local industry than 'any statesman or lawgiver'; in addition, there is an 'invisible hand' in the market-network, a self-regulating mechanism that translates individual ambitions to social benefit while directing private actor towards utmost profit.[12] In this context, the maximum production of individual and national capital

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requires an absolute independence of market from government intervention and its regulatory policies, either as policies of encouragement or restraint. According to our philosopher, government's duties are to be solely confined to three domains: a) enforcing just laws b) maintaining domestic societal security and c) ensuring nation's security against foreign threats in international arena. Government is utterly discharged from the task of directing the industry of individuals or devising instructions in regard to the mechanism of expenditure of private capital. This constitutes Smith's system of natural liberty, his solution to 'the problem of order': individual freedom produces capital; capital enhances the overall condition of individual and society, both; social security (or control) is observed by the economic necessity itself since security of trade is paramount to proper function of market; and as the entire system begin to operate, and material opulence and moral quality simultaneously increase, government (i.e. institution of power) is eliminated from this complex self-sustaining socio-economic organism.

Smith's philosophical/utilitarian system of free-market capitalism influenced the Western thought and civilization in various ways and levels, yet the major doctrinal impact can be detected in three categories: a) science of economics and discipline of political economy, b) social theory, and c) theory of political systems. As for his influence on economics, while Adam Smith is widely considered as the founder of modern economics, the extent and nature of his impact is being debated between the two opposing camps of orthodox neo-classical economist and their counterpart who belong to Chicago school. In the camp of neo-classical economists, an orthodox interpretation of Smith's political economy dominates the discourse. Smith's theoretical analysis of the relationship between capital accumulation and social structure, also referred to as 'Smithian theme', was expanded by a legion of disciples into various directions and fields to form the general notion of the 'neo-classical political economy'.<sup>[13]</sup> The sociological and demographic dimension of Smithian neo-classicism and its model of production-accumulation heavily influenced the works of most notable economists of the 19<sup>th</sup> century, especially David Ricardo (1772-1823) and Robert Malthus (1766-1834). Ricardo's discussion on the nature of those socio-economic mechanisms that would lead a nation to reach its greatest potentials is a standard example of Smithian neo-classical perspective.<sup>[14]</sup> In the case of Malthus, Smith's account of the direct relation between population growth and social progress is employed by Malthus as the theoretical platform for constructing his own independent social theory, a theory that soon separates itself from Smithian theme.<sup>[15]</sup> In a more recent timeframe, neo-classical economists of the 20<sup>th</sup> century adopted the general framework of Smith's theory of free-market as a theoretical toolbox for analyzing the financial state of global economy. Apart of Joseph Schumpeter and his categorical refutation of Smith's significance,<sup>[16]</sup> Adam Smith's political economy is the central pillar in the perspective of the neo-classicists. An interesting example of Smith's omnipresence is Paul Samuelson's seminal attempt to devise a mathematical model based on Smith's model of liberal capitalism to accommodate a range of new growth theories into Smith's system.<sup>[17]</sup>

In contrast to the exclusively economy-oriented influence of Smith on orthodox neo-classicists, his influence on Chicago school has contributed to the formation of the Chicago 'public choice theory'. Effective in locating the causes of administrative corruption, public choice theory attempts to explain those mechanisms that influence the process and politics of economic legislation and determine the behaviour of economic agencies. As one of the most important theories of the 20<sup>th</sup> century in the field of political economy, Chicago public choice theory is an extension of Smith's analysis of the relationship between the self-interest-based model of micro-economic operation and the macro-level (i.e. collective) economic behaviour. The critical significance of this theory is in its reliable guidelines for stabilizing the progress of development in developing nations and maintaining the administrative transparency in modern developed nation-states, as elaborated by the prominent Chicago economist George Stigler.<sup>[18]</sup> In addition to these direct influences, a quick reference to some 'indirect' impacts may be useful in demonstrating the significance of Adam Smith to the modern economics: the celebrated 'theory of games', designed by John F. Nash is in fact a reaction to Adam Smith's behavioural sub-theory. In this respect, the bulk of Nash's successful theory is his attempt to refute a sub-theory of our Scottish philosopher.<sup>[19]</sup>

In the field of social theory, Adam Smith's influence on Karl Marx's theory of alienation is most visible. Marx's sociological criticism of the capitalist system is focused upon the negative effect of free-market economy and private property capitalism on the worker. It cannot be denied that Smith's model of political economy and system of capitalism greatly contributed to the industrial revolution of the 19<sup>th</sup> century in Britain, a revolution associated with great afflictions of working class.<sup>[20]</sup> According to Marx's observation, the structure of industrial production in a capitalist society perceives 'labour' only as paid toil in public sphere while in Marxist terminology labour is defined as

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a method of actualization of human potentials, an intentionally-organized practice to transform the environment to satisfy mankind's needs. In the general framework of capitalism, it is the 'division of labour' that plays the most significant part in eliminating the creative aspect of work: the division of labour confines the activity of the worker to an excessively limited performance that associates with repetition of a singular task within an infinite timeframe; such practice is in stark contrast with the aforementioned Marxist definition of labour. Therefore, since capitalism and division of labour eliminates the constructive aspect of labour from the process of industrial production, it degrades and dehumanizes the worker, reducing labour to a method of survival, hence the Marxian 'alienation' of man/worker. [21] This theory is heavily influenced not only by Smith's principle of 'division of labour', but also by Adam Smith's own criticism of the negative consequences of the implementation of 'division of labour' policy.[22] Yet, it seems that Smith's sincere critique of his own theory and his influence of founder of communist socialism is much neglected.

Finally, Smith's influence on the field of theory of political systems signifies the Scottish philosopher's phenomenal contribution to the emergence of the modern Western civilization. As discussed before, Smith's capitalistic model of political economy requires three correlated features: a) accumulation of private capital, b) establishment of an organic free-market and c) non-interventionist government. The dynamics of each of these fundamental components of the capitalist system produced a set of socio-political developments and consequences that evolved to become the existential characteristics of the modern Western liberal democracy. The systemic consequences of the first two characteristics were democratic institutions and individualism. Smithian policy of capital accumulation generated a relative state of private opulence that within a collective context developed the foundations of civil society. In addition, the increase in private capital leads to the horizontal growth of the society's middle-class, a class with a strong tendency towards active participation in social and political domain. The gradual increase of middle-class and its rate of socio-political activity strengthen the civil society, producing a politically active and relatively informed public sphere that constitutes a dynamic democratic institution. Therefore, the first step towards the establishment of democratic institutions is private capitalism. The gradual expansion of the capitalist culture causes a structural chain reaction that will eventually lead to a fertile ground for democracy. In this regard, Smith's view of private ownership of capital did contribute to the rise of the modern notion of Western democracy. In addition, establishment of an organic free-market, the second characteristic, further empowered the notion of individualism. From the perspective of organizational psychology and political sociology, individualism is critical in the process of democratization as individuality is incompatible with authoritarianism. The results of the first two fundamental components of Smith's political economy are capitalism, democratic institutions and individualism. The current state of Western civilization is closely associated with these three concepts.

The third component of Smith's model of capitalism, governmental policy of economic non-interventionism, adds the final and perhaps most significant socio-political feature of the Western civilization: liberalism. With the exclusion of government from the fiscal and economic policy cycle, the overall capacity of the state to project its power in the public sphere is critically reduced. Such reduction of state control does not cause any kind of chaos as the self-interest-based market depends on and operate according to the principle of mutual self-interest. Therefore, as all members of the society are entangled in the web of domestic market, and the security of trade is a fundamental requirement of commerce, reducing state control will only lead to further economic prosperity and greater accumulation of capital. In this regard, liberalism is a systemic outcome of the operation of Smithian political economy that constitutes another fundamental notion of Western civilization. As liberalism was economically institutionalized in the Western societies, it also affected other dimensions of social life, such as culture. It could be concluded, then, that Adam Smith's model of political economy did contribute to the emergence of the modern West, a civilization based on capitalism, individualism, free-market and liberalism.

In conclusion, the essay attempted to analyze the impact of Adam Smith's model of political economy and his system of capitalism on the intellectual and social trends of the West. The essay divided the major components of Smith's theory into two categories of a) Smith's version of conjectural history and b) his conjoint theory of human behaviour and laws of free-market, discussing their influence on relevant fields and/or thinker respectively. As for the first theoretical component, Smithian materialist conjectural history, the essay detected a pattern of influence on the Marx's theory of dialectical materialism and Fukuyama's theory of 'end of history'. As for the second theoretical component that constitutes the essence of Adam Smith's theory of political economy, the essay analyzed the domain and extent of its influence in three categories: first, in the field of economics and political economy. In this field, it was

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argued that while Adam Smith is widely considered as the founder of modern economics, his theoretical perspective has heavily influenced the current discourse of the two major camps of modern economic thought, orthodox neo-classicism and moderate neo-classicism of Chicago school. In the second category, the essay analyzed Smith's influence in the field of social theory. In this field, the essay focused on the direct impact of Smith's notion of 'division of labour' on Marx's theory of alienation and his critique of capitalism. In the third category, the essay discussed the influence of Adam Smith on the theory of political systems. It was argued that the emergence of the four core characteristics of the modern Western civilization (i.e. capitalism, democratic institutions, individualism and liberalism) are greatly affected by Adam Smith's model of liberal economics. To sum up the entire analysis, it can be concluded that while the economy-centric philosophical system of Adam Smith had a considerable impact on the Western social and economic thought, his greatest legacy is in his theory's contribution to the development of the fundamental civilizational factors that formed the modern West.

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[1] For a detailed discussion on 'the problem of order' with a strong socio-economic perspective, see: Joseph J. Spengler, 'Hierarchy vs. Equality', *Kyklos*, 21 (1968), 217-36.

[2] Warren J. Samuels, 'The Political Economy of Adam Smith', *Ethics*, 87.3 (1977), 189-207.

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[4] Adam Smith, *Lectures on Jurisprudence*, ed. R. L. Meek and D. D. Raphael (London: Clarendon Press, 1978), p. 58-60

[5] See, for example: Henri Lefebvre, *Dialectical Materialism*, trans. by J. Sturrock (Minneapolis: University of Minnesota Press, 2009), pp. 68-77.

[6] For an excellent example of such studies, see: Ronald Meek, 'Scottish Contribution to Marxist Sociology', in *Economics and Ideology and Other Essays*, ed. by R. Meek (London: Chapman and Hall, 1967), pp. 41-9.

[7] Francis Fukuyama, *The End of History and the Last Man* (New York: Free Press, 1992), pp. 51-8.

[8] This view is expressed in the *Wealth of Nations*; however, in *The Theory of Moral Sentiments* he adopts an entirely opposite position and considers man to be characterised by altruism. This inconsistency has caused much debate among economists.

[9] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. by E. Cannan (New York: University of Chicago Press, 1977), p. 362.

[10] A. M. C. Waterman, 'Economics as Theology: Adam Smith's Wealth of Nations', *Southern Economic Journal*, 68.4 (2002), 907-921.

[11] Smith, *The Wealth of Nations*, p.366.

[12] Ibid, p. 477-8.

[13] Knud Haakonssen and Donald Wind, 'The Legacy of Adam Smith', in *The Cambridge Companion to Adam Smith*, ed. by K. Haakonssen (New York: Cambridge University Press, 2006), pp. 372-3.

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[16] Joseph Schumpeter, *History of Economic Analysis* (London: Oxford University Press, 1963), pp. 189.

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[17] For Samuelson's excellent mathematical interpretation of Smith's theory see: Paul Samuelson, 'The Canonical Classical Model of Political Economy', *Journal of Economic Literature*, 16 (1978), 1415-34.

[18] George J. Stigler, 'Smith's Travels on the Ship of State', in *Essays on Adam Smith*, ed. by A. S. Skinner and T. Wilson (Oxford: Oxford University Press, 1976), p.232-48.

[19] For the premises of Nash's Game Theory and his references to Adam Smith, see: John F. Nash, *Essays on Game Theory* (Princeton: Edward Elgar Pub, 1997), pp. 5-11.

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Written by: Leonardo S. Milani  
Written at: University of Waikato  
Written for: Dr. Rowland Weston  
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