

# ADAM SMITH ON THE “WRETCHED SPIRIT OF MONOPOLY” IN THE EAST INDIES TRADE

BY  
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*According to Adam Smith, the “wretched spirit of monopoly” dogged the East Indies trade. The regulations that governed the East Indies trade established legal barriers or restrictions to entry and sustained a mercantile community whose interests were “the opposite to that of the great body of the people” (WN IV, ch. iii, p. 494). The East Indies charter conferred a special privilege that shielded the English East India Company from all domestic competition in Asian trade. The East India Company was the complete incarnation of a mercantile system against which Smith had determined to launch “a very violent attack” in *Wealth of Nations* (Smith 1987, p. 251). Smith’s mistrust of trading bodies like the East India Company was compounded by its having assumed political powers commensurate with the sovereign while still in possession of its monopolistic franchise. Smith’s proposal was, first, to abolish the monopolistic franchise to rid society of “the unfortunate effects of all the regulations of the mercantile system” (WN IV, ch. vii, p. 606), and, second, to reform the East India Company’s administrative duties and functions in the Indian territories. The contention of this paper is that Smith’s call to abolish the East Indies monopoly was inseparable from his appeal for reform of the English East India Company.*

The East India charter is a charter to establish monopoly, and to create power. Political power and commercial monopoly are *not* the rights of men.

Edmund Burke, 1 December 1783

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Mark Donoghue: Independent scholar. I wish to express my gratitude to Tony Endres, Samuel Hollander, Vasuki Utravathy, Barry Weingast, the editor of the *Journal*, and particularly the referees for their invaluable comments and suggestions during the revision of this paper. Any remaining errors are solely my responsibility. Email: [mark.donoghue.nz@gmail.com](mailto:mark.donoghue.nz@gmail.com)

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## I. INTRODUCTION

Historians have largely overlooked Adam Smith's views on East India affairs. While earlier studies of Smith's economic ideas touched upon his opinions about the East Indies monopoly, the East Indies trade, and the English East India Company, there has been a lack of systematic exploration of the connection between historical events and contemporary concerns (see Winch 1965; Hollander 1973; Barber 1975; Ambirajan 1978). More recent Smith scholarship has sought to broaden the focus of his treatment of East India affairs (see Ortmann 1999; Collins 2019; Diatkine 2021; Ortmann and Walraevens 2022). These studies have been helpful in clarifying aspects of Smith's views on the consequences of "monopolies (protections) granted by princes in favour of particular interest groups ... or particular companies often in exchange for financial rewards" (Diatkine 2021, p. ix). However, this article presents a different perspective from those studies on Smith's discussions regarding the eastern commerce dominated by private chartered corporations.

What has escaped the attention of scholars is that Smith's attack on the East Indies monopoly was not only part of his broader criticism of the mercantile (or colonial) system but also central to his attempt to reform the English East India Company. Smith's criticisms did not merely focus on economic monopoly but targeted the incompatibility of economic *and* political powers in the same hands. Smith expressed the belief that such a combination "tends to make government subservient to the interest of monopoly" (*WN* IV, ch. vii, p. 638).<sup>1</sup>

The English East India Company was the complete incarnation of a mercantile system against which Smith was determined to launch "a very violent attack" in the *Wealth of Nations*.<sup>2</sup> According to John Dwyer (2005, p. 674), "Smith's supreme target in *Wealth of Nations* was the East India Company, whose monopolistic activities he condemned as economically and ethically disastrous for Great Britain." Smith believed the best way to correct the worst excesses of the East Indies trade was to abolish the East Indies monopoly and tighten parliamentary supervision of the East India Company's administration of the Indian dominions.

This article serves as a precursor to a previous publication of mine (Donoghue 2020), in which I examined Smith's views on the administrative duties and functions of the English East India Company after the termination of its monopoly franchises. Following this termination, the company transitioned into a delegate of the British state, responsible for providing public works (roads, canals, etc.) and public institutions (law and order, etc.). This study argues that Smith's critique of the East Indies monopoly was not only central to his proposals for dismantling the prevailing mercantile system but also inseparable from his call for reform of the East India Company. As Donoghue (2020) elaborated, this reform involved the company's assuming the responsibility of delivering public works and institutions in the Indian territories on behalf of the British state. However, the realization of this new phase in the company's governance in India was contingent upon the abolition of its monopoly franchise. Essentially, the abolition of the

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<sup>1</sup> All citations to *An Inquiry into the Nature and Causes of the Wealth of Nations* (denoted *WN*) refer to the Glasgow Edition (Smith [1776] 1976).

<sup>2</sup> Collins (2019, p. 380) makes a similar point: "The forced aggrandizement of the [East India] Company's lucre was the mercantile system distilled to its essence."

East Indies monopoly was a prerequisite for the subsequent reform of the East India Company's administration in India.

## II. EUROPEAN MERCANTILISM AND THE EAST INDIES TRADE

In Smith's time European states took very similar approaches to the long-distance maritime trade with the East Indies. Foreign trade between India and Europe was dominated by state-sponsored chartered monopoly companies that profited from limitations on overseas trade and exchange (Anderson and Tollison 1983, p. 550). The creation of the private corporation with joint stock was a remarkable innovation in institutional design that enabled European chartered companies to scale up operations and establish repetitive distant trade with Asia (Roy 2014, pp. 176–177, 187).

Smith, no ally of the chartered monopolies, argued that the concentration of economic power in the hands of a few very large mercantile companies in receipt of state trading monopolies posed a threat to the liberal trading order. Smith's account of the practice of European mercantilism emphasized what happened in colonies dominated by chartered companies when the colonial monopoly does not favor all the merchants from the metropole but only one particular company:

Some nations have given up the whole commerce of their colonies to an exclusive company, of whom the colonists were obliged to buy all such European goods as they wanted, and to whom they were obliged to sell the whole of their own surplus produce. It was the interest of the company, therefore, not only to sell the former as dear, and to buy the latter as cheap as possible, but to buy no more of the latter, even at this low price than what they could dispose of for a very high price in Europe. It was their interest, not only to degrade in all cases the value of the surplus produce of the colony, but in many cases to discourage and keep down the natural increase of its quantity. (*WN IV*, ch. vii, p. 575)

In the seventeenth and eighteenth centuries, a fierce rivalry among European chartered monopolies fueled the East Indies trade. The motive for the East Indies trade was, quite simply, earning high profits from “importing manufactures and expensive luxuries of richer countries” in Asia (*WN III*, ch. iii, pp. 406–407). To this end, European merchants purchased large quantities of Indian textiles that were sold across Europe (Gupta 2019, p. 807). Smith himself observed that “the muslins and other cotton goods of the East Indies were much esteemed in every part of Europe” (*WN IV*, ch. vii, p. 560).<sup>3</sup> Indeed, “the commerce of a great part of Europe,” as Smith pointed out, “consisted in the exchange of their own rude [produce] for the manufactured produce of more civilised nations” (*WN IV*, ch. vii, p. 560).<sup>4</sup> Smith emphasized the benefits of bilateral trade and commerce in the following passage: “By uniting, in some measure, the most distant parts

<sup>3</sup> Chaudhuri (1978, pp. 243–245); and Broadberry, Custodis, and Gupta (2015, p. 66) corroborate that in the eighteenth century, “cotton cloth was overwhelmingly India's main industrial export.”

<sup>4</sup> It is worth highlighting that European chartered companies primarily paid for Indian goods in silver. “In the cargoes,” noted Smith, “of the greater part of European ships which sail to India, silver has generally been one of the most valuable articles” (*WN I*, ch. xi, p. 225). Mercantilists considered the export of silver a drain of wealth from Europe to India, and were opposed to it. However, Smith diverged from these mercantilist policy prescriptions (see Paganelli 2022 for an in-depth discussion).

of the world, by enabling them to relieve one another's wants, to increase one another's enjoyments, and to encourage one another's industry, their general tendency would seem to be beneficial" (WN IV, ch. vii, p. 626).

By the mid-eighteenth century, the English East India Company had become the dominant European trader in the East Indies (Donoghue 2020, pp. 3, 9). The importance of long-distance maritime commerce with distant parts of the British empire was well understood by Smith, who expanded his treatment of the subject in the third (1784) edition of *Wealth of Nations*. According to Emma Rothschild (2012, p. 188), Smith's expositions of conquest, empire, and long-distance maritime commerce, particularly in relation to Asia, lie "at the very center of his concerns."<sup>5</sup> Smith's treatment of the long-distance commerce of the East India companies was an expression of the "intense [contemporary] interest in the political economy of colonies" (Rothschild 2012, p. 189). Smith saw clearly that the intersection between empire and maritime trade was reshaping the Indian Ocean order. Indeed, Prasannan Parthasarathi and Giorgio Riello (2014, p. 1) have argued that "the 1750s represented a shift from an Indian Ocean world that remained ... quintessentially Asian, to one that became colonial and came under the control of European empires, the most prominent of which was the British."

### III. THE ENGLISH EAST INDIA COMPANY

The English East India Company was established in 1600 to spearhead English maritime enterprise in the East Indies. To facilitate this mission, the company received a royal charter (monopoly trading rights), which shielded it from *domestic* competition in Asian trade.

Smith's treatment of monopoly encompasses the sole *right* to deal in specific products or trade with certain countries or territories. This legal privilege could be granted to individuals, companies, or nations, as exemplified by England's claiming the sole right to trade with its American colonies. The East Indies monopoly, for instance, bestowed the legal right to trade in spices, textiles, and other products through royal prerogative. The rationale behind regulating the East Indies trade via exclusive privileges was to foster British trade and commerce for the nation's benefit (Ortmann 1999, p. 300).

By the eighteenth century, public sentiment in Britain began to turn against the idea of a monopoly trading enterprise chartered by the British Crown that prioritized private interests over the general interest. Smith observed that,

in [the] process of time, when the principles of liberty were better understood, it became every day more and more doubtful how far a Royal Charter, not confirmed by Act of Parliament, could convey an exclusive privilege. Upon this question the decisions of the courts of justice were not uniform, but varied with the authority of government and the humours of the times. Interlopers multiplied upon them, and towards the end of the reign of Charles II, through the whole of that of James II and during a part of that of William III, reduced them to great distress. In 1698, a proposal was made to Parliament of

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<sup>5</sup> Paganelli (2022, pp. 531–532) has also contended that "Smith's attack against the policies of mercantilism" (as set out in the Digression on Silver) formed "the centrepiece of the *Wealth of Nations*."

advancing two millions to government at eight per cent, provided the subscribers were erected into a new East India Company with exclusive privileges. (*WN V*, ch. i, p. 747)<sup>6</sup>

The royal charter was a powerful instrument on several counts. First, it was the cornerstone of the East India Company's relationship with the Crown, without which the company's existence would be imperiled. Second, it exemplified how the Crown, through royal prerogative, could enlist a diverse group of individuals to serve the national interest. Third, the charter provided English merchants with the necessary incentive to establish a viable presence in the East Indies trade free from domestic competition.

Smith's evaluation of mercantilism drew a clear distinction between the monopolies of the East Indies trade and the American colony trade. "Monopoly is the great engine of both," Smith opined, "but it is a different sort of monopoly" (*WN IV*, ch. vii, p. 630). In Smith's time, British mercantilist or protectionist policies acted as a tethering device, intended to strengthen Britain's connection with its colonies. Smith recognized that "the trade to those two great continents [America and India] absorbs a greater quantity of stock than any other two branches of trade" (*WN IV*, ch. vii, p. 630).<sup>7</sup>

Smith's treatment of monopoly trade privileges differed in a logical and systematic way depending on whether the referent is North America or India. In the Atlantic trade, the thirteen English colonies were solely reliant on a single market—Great Britain—which permitted trade for "all the natives of the mother country" but imposed restrictions on foreign ships and European goods from other nations (*WN IV*, ch. vii, p. 575).<sup>8</sup> In contrast, in the East Indies, the British state confined "the whole commerce of their colonies to an exclusive company"—the English East India Company (*WN IV*, ch. vii, p. 575).<sup>9</sup> No other British subject was permitted to engage in the exclusive trade of the East Indies unless they were employed by the East India Company.

Despite Smith's general opposition to monopolies and state-granted privileges to specific companies, he acknowledged the need for differentiated treatment of capital in

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<sup>6</sup> In the early 1700s, the British government facilitated the merger of two rival East India companies, resulting in the establishment of the "United Company of Merchants of England Trading to the East Indies." Both the original East India Company and its newer competitor argued that they were being harmed by their rivalry as well as by private traders. Following the merger, the newly formed private corporation was granted an exclusive monopoly to trade east of the Cape of Good Hope. Smith highlighted a period of prosperity for the merged entity, noting that it, "being delivered from all competitors, and fully established in the monopoly of the English commerce to the East Indies, carried on a successful trade, and from their profits made annually a moderate dividend to the proprietors" (*WN V*, ch. i, p. 749).

<sup>7</sup> Smith evaluated the vast commercial opportunity in Asia in the following manner: "The trade to the East Indies, if it were altogether free, would probably ... offer a market both for the manufactures of Europe, and for the gold and silver, as well as for the several other productions of America, greater and more extensive than both Europe and America put together" (*WN IV*, ch. vii, p. 632).

<sup>8</sup> Smith explained that Britain leaves "the trade of their [American] colonies free to all their subjects who may carry it on from all the different ports of the mother country" (*WN IV*, ch. vii, p. 576).

<sup>9</sup> Ross (2010, p. 380) explains that "mercantilism had established a second form of monopoly [in] ... British India," which was difficult to escape due to the company's success in mobilizing a powerful lobby to secure legislative support for its proposals and privileges. "Such arguments," observed Smith, "convinced the people to whom they were addressed" (*WN IV*, ch. i, p. 434). "They were addressed," continued Smith, "by merchants to parliaments and to the councils of princes, to nobles and to country gentlemen, by those who were supposed to understand trade to those who were conscious to themselves that they knew nothing about the matter" (*WN IV*, ch. i, p. 434).

certain circumstances. Consequently, he introduced a qualification allowing for the possibility of *temporary* protection under very specific conditions.

This exception to Smith's opposition to monopolies arose in situations such as the establishment of new trading ventures with risky, uncertain commercial outcomes that were deemed a matter of potential national benefit. In the seventeenth and eighteenth centuries, the logistical challenge of establishing a presence in the East Indies trade involved significant "sea risk" and a considerable "chance of loss" of capital (*WNI*, ch. x, pp. 125–126). The accent on pervasive risk incentivized firms to seek exclusive trading rights before embarking upon such ventures (Roy 2014, p. 177).

Smith's advocacy for a temporary monopoly was closely tied to his treatment of the problem of capital formation in the *Wealth of Nations*. The purpose of granting a temporary monopoly was to attract English capital to ventures fraught with risk by providing a surety that limited uncertainty for participants. Therefore, a temporary monopoly can be seen as an incentive mechanism, "which afforded to industry, the only encouragement which it requires, some tolerable security that it shall enjoy the fruits of its own labour" (*WN I*, ch. xi, p. 256).

The inherent uncertainty and riskiness associated with "some branches of commerce ... carried on with barbarous and uncivilised nations" led Smith to the realization that some degree of "tolerable security" must be afforded to prospective traders and adventurers who "undertake, at their own risk and expense, to establish a new trade with some remote and barbarous nation" (*WN II*, ch. i, p. 285; *V*, ch. i, pp. 731, 754).

This qualification highlighted the unique requirements of a risky, emerging trade and emphasized the role of the Crown in granting provisional restrictions to nurture entrepreneurial efforts that served the national interest (Barber 1975, p. 97). Smith noted:

It may not be unreasonable to incorporate them into a joint-stock company and to grant them, in case of their success, a monopoly of the trade for a certain number of years. *It is the easiest and most natural way in which the state can recompense them for hazarding a dangerous and expensive experiment, of which the publick is afterwards to reap the benefit.* A temporary monopoly of this kind may be vindicated, upon the same principles upon which a like monopoly of a new machine is granted to its inventor, and that of a new book to its author. (*WN V*, ch. i, pp. 754–755; original emphasis)

Smith's approval of temporary legislative support for new trading ventures "hazarding their small capitals in so very distant and uncertain an adventure as the trade to the East Indies" was contingent upon public interest and financial viability (*WN IV*, ch. vii, p. 632). Legitimate government intervention, such as a temporary monopoly, aligned with the principles of restoring natural forms of liberty outlined in the *Wealth of Nations*. Commercial ventures involving high risk and substantial fixed capital investment warranted government assistance to ensure that the potential social benefits were realized.<sup>10</sup> However, as Samuel Hollander (2013, p. 29) has noted, the justification for a temporary monopoly was conditional upon the expectation of financial "success"

<sup>10</sup> Elsewhere, Smith wrote, "The returns of the fixed capital are in almost all cases much slower than those of the circulating capital; and such expenses, even when laid out with the greatest prudence and judgment, very seldom return to the undertaker till after a period of many years" (*WN II*, ch. ii, p. 307).

and broader social benefits.<sup>11</sup> Despite this, Smith made it clear that the prevailing state of insecurity, necessitating state support and protection, was untenable and outdated.

#### IV. MISGUIDED PRIVILEGES

Smith clearly indicates that the exclusive privileges safeguarding the English East India Company's dominance in the East Indies trade had reached their conclusion. Consequently, he embarked on a campaign to discredit and assail the East Indies monopoly while also challenging the legitimacy of corporate sovereignty rule in India.<sup>12</sup> "The government of an exclusive company of merchants is," Smith remarked, "the worst of all governments for any country whatever" (*WN IV*, ch. vii, p. 570).

One of the main theoretical devices Smith propounds to counter the mercantile system is the concept of the "natural progress of opulence" in Book III of *Wealth of Nations*.<sup>13</sup> Although it is not possible here to provide a full account of Smith's views on the concept, it might be helpful to provide a summary of it.<sup>14</sup> Briefly, Smith's concept of the "natural progress of opulence" was a product of European history (Diatkine 2021, p. 80). Smith's fundamental proposition was that "according to the natural course of things ... the greater part of capital of every growing society is, first, directed to agriculture, afterwards to manufactures, and last of all to foreign commerce" (*WN III*, ch. i, p. 380). The normative order that Smith establishes among the different employments of capital would improve the economic prospects of a nation.<sup>15</sup> According to Smith, however, the path of economic growth in Europe had been diverted from the "natural progress of opulence" by government regulations that, first, were responsible for the discouragement of agriculture and, second, provided special treatment to manufacturing and foreign trade. In view of this situation, the manufacturing towns naturally looked to foreign lands to exchange their goods (*WN III*, ch. iii, p. 405).

<sup>11</sup> The directors of the East India Company had originally proclaimed that the trade they conducted in the East Indies was a matter of national interest and importance (Mishra 2018, pp. 3–4). Thomas Mun, who served as a company director, contended that trade was "the very *touchstone* of the Kingdom's prosperity" (quoted in Mishra 2018, p. 3).

<sup>12</sup> As Collins (2019, p. 386) pointed out, "Smith's distrust of traders in the mercantile system thus commanded a far greater influence in informing his censure of the merchant-rulers of chartered trading companies in *Wealth of Nations*." At the same time, however, Smith recognized the legitimacy of the East India Company's landed possessions in India, and he concluded that such legitimacy was drawn from the authority of the British government (Collins 2019, p. 381). "The territorial acquisitions of the East India company," Smith remarked, were "the undoubted right of the crown, that is, of the state and people of Great Britain" (*WN V*, ch. iii, p. 945). The way out of this predicament is to remember that Smith was prepared to countenance the idea of permitting a delegate of the British state, such as a joint stock company without exclusive privileges, to administer the Indian territories provided the delegate was ultimately answerable to Parliament.

<sup>13</sup> According to Diatkine (2021, p. 167), "Smith sought above all to understand how monopolies prevented 'the natural progress of opulence.'"

<sup>14</sup> For a fuller treatment of Smith's natural hierarchy of investments, see Endres (1992).

<sup>15</sup> Smith supported this contention by examining labor productivity in each sector. He concluded that agriculture was the most productive: "no equal capital puts into motion a greater quantity of productive labour than that of the farmer" (*WN II*, ch. v, p. 363).

Smith explained how the prevailing mercantile system diverted more capital to the East Indies trade than it otherwise might have done. He pinpointed this aberration when he wrote:

No regulation of commerce can increase the quantity of industry in any society beyond what its capital can maintain. It can only divert a part of it into a direction into which it might not otherwise have gone; and it is by no means certain that this artificial direction is likely to be more advantageous to the society than that into which it would have gone of its own accord. (*WN IV*, ch. ii, p. 453)

Smith suggested that trading rights granted to exclusive companies in the East Indies trade had “the same effect as a secret in trade” in that “such enhancements of the market price [above the natural price] may continue for whole centuries together,” implying higher long-term costs for domestic consumers and producers alike (*WN I*, ch. vii, p. 78). As such, the East Indies monopoly was akin to a domestic tax that, Smith believed, will “derange more or less the natural distribution of the stock of the society” (*WN IV*, ch. vii, p. 631).<sup>16</sup> The “derangement of the natural distribution of stock,” calculated Smith, “is necessarily hurtful to the society in which it takes place” (*WN IV*, ch. vii, p. 632).

In reality, Smith never envisioned a commercial society entirely free from monopoly because “the private interests of many individuals, irresistibly oppose it” (*WN IV*, ch. ii p. 471).<sup>17</sup> Still, his ideal vision was to “break down the exclusive privileges of corporations” and restore “to all his Majesty’s subjects ... the natural liberty to exercise any trade,” since to do otherwise was a “manifest violation of the most sacred rights of mankind” (*WN IV*, ch. ii, p. 470; *IV*, ch. vii, p. 582). To this end, Smith joined the contemporary clamor condemning “systems either of preference or of restraint” that clashed with his “system of natural liberty and justice” (*WN IV*, ch. ix, p. 687).<sup>18</sup>

Smith opposed the mercantile system because it was a partial and thus unfair system that favored the interests of a small group of merchants and manufacturers at the expense of the general interest of society (*WN IV*, ch. iii, p. 494). According to Smith, the mercantile system was the outcome of a close alliance between merchants and manufacturers and the legislators (Diatkine 2021, p. 11). Smith believed that “our merchants and manufacturers may, perhaps, have extorted from the legislature these exemptions as well as the greater part of our other commercial regulations” (*WN IV*, ch. vii, p. 643, cf. p. 648). It was Smith’s considered view that the “connivance” forged between merchants and legislators “no doubt retards more or less ... the natural progress of a nation towards wealth and prosperity” (*WN IV*, ch. ix, p. 674).

This resulted in high profits from a close collusion between merchants and manufacturers seeking to defraud the public. Such behavior was rampant in the East Indies trade:

the interested sophistry of merchants and manufacturers ... is ... directly opposite to that of the great body of the people. As it is the interest of the freemen of a corporation to

<sup>16</sup> Scott (1912, p. 455) and Collins (2019, p. 380) put forward similar interpretations.

<sup>17</sup> Elsewhere, Smith writes: “to expect, indeed, that the freedom of trade should ever be entirely restored to Great Britain is as absurd as to expect an Oceana or Utopia should ever be established in it” (*WN IV*, ch. ii, p. 471).

<sup>18</sup> Greene (2013, pp. 137–142) and Collins (2019, pp. 382–383) offer concise overviews of the contemporary criticisms of the East Indies monopoly.

hinder the rest of the inhabitants from employing any workmen but themselves, so it is the interest of the merchants and manufacturers of every country to secure to themselves the monopoly of the home market. (*WN IV*, ch. iii, p. 494)<sup>19</sup>

Another criticism leveled against the East India Company by Smith was its disruption of market order in India through what he termed the “private trade” conducted by its servants (Barber 1975, p. 96).<sup>20</sup> In principle, Smith did not fundamentally oppose the private or carrying trade per se, referring to it as “a round-about foreign trade of consumption” (*WN II*, ch. v, p. 373). He acknowledged that “the trade which is carried on ... by British merchants between the different ports of India, make up, perhaps, the principal branch of what is properly the carrying trade of Great Britain” (*WN II*, ch. v, p. 373). The intention behind allowing individuals to engage in trade was to encourage their loyalty to the company and facilitate the purchase of Indian goods using their own capital to supplement the *legal* barriers to entry. Indeed, the company’s “factors” or employees stationed in India often “find it more for their advantage to employ their capitals in the most distant carrying trades of Asia” (*WN II*, ch. v, p. 375). The private trade was further facilitated and made more lucrative by the allocation of space on the company’s vessels to transport the employees’ goods to other foreign destinations.

The problem with the incentive scheme was that it was open to abuse. Employees were, in effect, free riding on the monopoly price established under the charter of the exclusive company. Tirthankar Roy (2014, p. 177) describes the company’s dilemma as follows: “this factor created a fundamental conflict of interest between principals and agents. The agents could abuse the privilege, or be seen to do so. The agents in their turn felt that they needed to fend for themselves in a hostile world that the principals did not understand.” Smith clearly understood the futility of resorting to legal restrictions on the private trade that company factors were engaged in because of the vast network of private traders and company employees complicit in it. “All the members of the administration,” Smith observed, “trade more or less upon their own account, and it is in vain to prohibit them from doing so” (*WN IV*, ch. vii, p. 636). This impulse for personal gain highlights, once more, the economic disorder induced by the “servants of the company [who] have upon several occasions attempted to establish in their own favour the monopoly of some of the most important branches, not only of the foreign, but of the inland trade of the country” (*WN IV*, ch. vii, p. 638). Smith’s unfavorable verdict on the private monopoly over inland trade prohibiting “all other people from trading in the articles in which they choose to deal” continued as follows: “They will employ the whole authority of government, and pervert the administration of justice, in order to harass and ruin those who interfere with them in any branch of commerce, which by means of agents, either concealed, or at least not publicly avowed, they may choose to carry on” (*WN IV*, ch. vii, p. 639).

Smith’s harsh verdict on the private monopoly conducted by the East India Company’s servants was in many respects more severe than his attack on the company’s

<sup>19</sup> Elsewhere, Smith wrote: “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices. It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice” (*WN I*, ch. x, p. 145).

<sup>20</sup> Marshall (1975, p. 32) explained that from the late seventeenth century, the East India Company “had ceased to make any real effort to control the private trade in Asia of its servants.”

public monopoly over foreign trade.<sup>21</sup> The size and scale of the private trade were potentially far larger than the company's exclusive trade because, explains Smith, "the public trade of the company extends no further than the trade with Europe," while "the private trade of the servants may extend to all the different branches both of its inland and foreign trade" (*WN IV*, ch. vii, p. 639). As a result the private trade "tends to stunt the natural growth of every part of the produce in which they choose to deal, of what is destined for home consumption, as well as of what is destined for exportation; and consequently, to degrade the cultivation of the whole country, and to reduce the number of its inhabitants" (*WN IV*, ch. vii, p. 639). Smith, who realized it was futile trying to constrain the private trade, concluded on a somber note with the observation that such servants of "exclusive companies, therefore, are nuisances in every respect; always more or less inconvenient to the countries in which they are established, and destructive to those which have the misfortune to fall under their government" (*WN IV*, ch. vii, p. 641).

## V. THE TURNING POINT

The East India Company's victory over the Nawab of Bengal at the Battle of Plassey in 1757 marked the beginning of British rule in India. Around this time, observed Smith, "the spirit of war and conquest seems to have taken possession of their servants in India," as the company became active "in the politics of the Indian princes" (*WN V*, ch. i, p. 749). From this point, the East India Company underwent an unusual political transition from monopoly trading enterprise to sovereign ruler.<sup>22</sup> Indeed, as William Barber (1975, p. 86) has remarked, "[i]n Bengal, in the 1760s, events had moved ahead of ideas." Even by the mid-1770s, a "conceptual scheme had not been formulated with a particular eye to East India affairs" (Barber 1975, p. 86). However, the changed realities of the East India Company's new frontiers shifted the focal point of Smith's treatment of East India affairs. In the third (1784) edition of the *Wealth of Nations*, Smith proposed a new framework for the administration of the Indian territories.<sup>23</sup> While there was nothing about the events of 1757 to suggest that the English company would emerge as the paramount power in India by the late eighteenth century, the fact remains that the growing acquisitiveness of the company in the decades after Plassey led to calls for greater legislative intervention in Indian affairs. Smith was among those who "sought to establish a measure of parliamentary control over the Company" (Ross 2010, p. 352).

Smith adjudged the East India Company "altogether unfit to govern" the Indian dominions, believing that "[a]s sovereigns, their interest is exactly the same with that of the country which they govern. As merchants their interest is directly opposite to that interest" (*WN V*, ch. i, p. 753; *IV*, ch. vii, p. 638). For Smith, the contradictory traits

<sup>21</sup> James Steuart also called for restraints on the private trade of the company's employees (see Barber 1975, p. 79, for further comment).

<sup>22</sup> The Treaty of Allahabad formally vested the East India Company with the power of *diwani*, or revenue administration, in Bengal, Bihar, and Orissa in August 1765 (Collins 2019, p. 370).

<sup>23</sup> As Diatkine (2021, p. 88) explained, "the transformation of the East India Company into a territorial power suggested to Smith that the change in the scale of operations meant that it was no longer sufficient to think in terms of a nation state, but of an empire that necessitated suitable reforms to meet the costs of running the colonies."

illuminated by this situation challenged the credibility of the East India Company's rule in India (Collins 2019, p. 370). He believed the distinction between private and public interests had to be removed because "no two characters seem more inconsistent than those of trader and sovereign" (*WN V*, ch. ii, p. 819).<sup>24</sup> For this solution to hold, Smith argued, the East Indies monopoly had first to be abolished because it underwrote "the mercantile company which oppresses and domineers in the East Indies" (*WN I*, ch. viii, p. 91). According to Smith, "the genius of exclusive companies is unfavourable ... to the growth of new colonies, and has probably been the principal cause of the little progress which they have made in the East Indies" (*WN IV*, ch. vii, pp. 634–635).<sup>25</sup>

As mentioned above, Smith assessed the mercantile system by considering how an impartial and just society should respond to a partial and thus unjust system that favors the special interests of certain merchants and manufacturers. Smith asked in what manner could the East Indies trade be reformed so that it was consistent with the system of natural liberty and justice he favored in economic affairs. Smith attached importance to this "project" because he wanted to understand "what institutions would make it possible to transform the (partial and hence unjust) mercantile system" into a "system of natural liberty (an impartial and hence just system)" (Diatkine 2021, p. xiii).

## VI. THE CROWN'S COMPROMISE

Under growing pressure from critics, the British government agreed to convene several parliamentary inquiries into Indian affairs in the 1760s and 1770s. The scandal of the East India Company's mismanagement prompted calls to place its internal government on a more regular basis (Vella 2000). Smith also believed that parliamentary intervention was essential if the company was to rebuild its tarnished reputation. However, in Smith's era, many British politicians were connected to the East India Company as shareholders, patrons, or directors (Bowen 2005, pp. 31–32). Such political patronage underscores the hidden relations of power that frustrated reform efforts when director-politicians were caught between their sworn parliamentary duty to hold the company accountable to Parliament while defending its commercial privileges and sanctioning its territorial ambitions (O'Brien 1998, p. 72).<sup>26</sup>

Smith emphasized the importance of fostering an impartial system of justice for societal prosperity (Irwin 2020, pp. 234, 237). Ensuring that "legislators be kept at the *right distance* from the merchants" was integral to achieving an impartial and just system (Diatkine 2021, p. 115). Smith underscored this by stating that such a system "can protect him [the impartial legislator] from the most infamous abuse and detraction, from personal insults, ... arising from the insolent outrage of furious and disappointed

<sup>24</sup> In this distinction between private and public interests, Smith was "deeply informed" by the critique of William Bolts (1738–1808), a Dutch merchant-adventurer who feared "the loss of political control over Bengal and the squandering of its wealth before it could be harnessed for the [British] nation" (see Vella 2000, pp. 279, 286, for further comment).

<sup>25</sup> See Coats (1975, p. 233) for further comment.

<sup>26</sup> Barber (1975, p. 101) highlighted this conflictual situation: "the position of thirteen of the Company's twenty-four directors as Members of Parliament between 1768 and 1774 had not ... escaped public attention."

monopolists” (WN IV, ch. ii, p. 471). Consequently, under this framework, the relationship between the merchant and the legislator would be adversarial since the special interests of the merchant would tend to conflict with the duty of the legislator to safeguard the wider public interest. Certainly, Smith urged legislators to exercise “great precaution” when evaluating “any new law or regulation” proposed by members of the merchant and manufacturer class, recognizing that these often reflected narrow prejudices. This sentiment was echoed in the conclusion of Book I of *Wealth of Nations*: “the interest of the dealers ... is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it” (WN I, ch. xi, p. 267). Impartial legislators, rather than political figures whose interests were aligned with the East India Company, were considered more likely to enact measures safeguarding the public interest (Diatkine 2021, p. 114).

Smith’s appeal for firm action on the East Indies monopoly went largely unheeded. Eventually, Parliament settled on a compromise: while overhauling the management of the East India Company’s Indian territories, it left the trading privileges intact while the charter was in force. Although Smith welcomed these legislative changes, he lamented the persistence of the East India monopoly, recognizing its potential to undermine parliamentary reforms intended to curb company abuse (Vella 2000, pp. 288–289; Collins 2019, pp. 383–384). The company’s success in thwarting efforts to abolish the monopoly led Smith to concede that “the regulations of 1773 ... did not put an end to the disorder of the company’s government in India” (WN V, ch. i, p. 753).

Nonetheless, Smith endorsed other judicial and administrative reforms designed to introduce a system that upheld legal order and property rights. The first important piece of legislation that followed parliamentary inquiries into Indian affairs in the early 1770s was Lord North’s Regulating Act of 1773.<sup>27</sup> This act established a Supreme Court in Calcutta, with a chief justice and three judges appointed by the British government. Smith noted that the courts “would be likely to act with more dignity and steadiness than they had usually done before” (WN V, ch. i, p. 752). Additionally, the 1773 Act stipulated the appointment of a governor general and an executive council of five advisors by the British government. Acceptance of these judicial appointments underscored the political importance Smith attributed to the idea of impartial judgment by the legislator in public affairs (cf. Diatkine 2021, pp. 114–116). Despite Smith’s considering these measures as “very important amendments ... in the constitution of their government,” company officials in London retained significant control over events in India (WN V, ch. i, p. 751).

While expressing concerns about the transformation of a private corporation into a territorial power, Smith neither advocated the nationalization of the East India Company nor endorsed the transfer of its territorial holdings to the Crown.<sup>28</sup> Building upon earlier work by Edwin West (1977) and Hollander (2013), Donoghue (2020) emphasizes Smith’s argument in favor of the transformation of the English East India Company

<sup>27</sup> Smith’s connection to Lord North had been established through John MacPherson, an MP who was deeply engaged in Indian affairs. MacPherson served initially as the “servant of the Nawab of Arcot,” later becoming the Nawab’s agent in England (Smith 1987, p. 236n1).

<sup>28</sup> Ambirajan (1978, pp. 30–31), Collins (2019, p. 389) and Shovlin (2021, p. 269) argue that Smith advocated replacing the company as the sovereign authority in Bengal with the Crown.

into a *de facto* sovereign ruler, carrying out duties and responsibilities in accordance with the system of natural liberty and justice he averred (cf. Ortmann and Walraevens 2022, p. 41).

Additionally, Donoghue (2020) argues that Smith envisioned a role for the East India Company providing public goods, such as roads and canals, in the Indian territories. This insight extends the previous discussion of West (1977) and Hollander (2013) regarding the involvement of joint-stock companies in public goods provision, a concept not uncommon in Smith's era, often supported by the sovereign through the granting of monopolies and special privileges.

Furthermore, Smith's thorough examination of joint-stock companies, especially the English East India Company, in Chapter 1, Book V, of the *Wealth of Nations*, titled "Of the Expenses of the Sovereign or Commonwealth," is crucial for understanding and providing strong support for his proposal to introduce legal instruments for utilizing new types of private enterprises "for facilitating the commerce of society" (WN V, ch. i, p. 724).<sup>29</sup>

In criticizing the existing mercantile system, Smith faced a dual challenge concerning East India trade, which he endeavored to address. First, he advocated the elimination of the East Indies monopoly. Second, he emphasized the necessity of reforming the East India Company's governance in the Indian territories. These objectives had to be pursued sequentially because it was incompatible for the East India Company to retain its sovereignty in India while also holding monopoly privileges. The central thesis of this paper is that, according to Smith, the fundamental precondition that had to be satisfied *before* the East India Company could assume a sovereign role was the abolition of the East Indies monopoly. Therefore, while acknowledging Smith's belief in the administrative potential of the East India Company, the argument presented here emphasizes the necessity of abolishing its monopoly rights for such a transition to be feasible. If this interpretation is accepted, Smith's proposal for the governance of overseas territories by a joint-stock company *without* exclusive privileges was novel, far-reaching, and ahead of its time (see Donoghue 2020, pp. 10–14).

In Smith's era it was common for the sovereign to delegate public works provision to private organizations (West 1977, p. 14; Donoghue 2020, p. 12).<sup>30</sup> As Stephen Vella (2000, p. 287) has noted, Smith criticized the East India Company for neglecting "to provide an adequate infrastructure in Bengal," contrasting this with former "sovereigns of Bengal" who were "extremely attentive to making and maintaining of good roads and navigable canals, in order to increase, as much as possible, both the quantity and value of every part of the produce of the land" (WN V, ch. ii, p. 838). Smith's critique of the East India Company's neglect of public infrastructure in Bengal contrasts sharply with his vision for the East India Company "as a medium of the British crown" *without* monopoly rights (Govind 2011, p. 188). According to Smith's vision, the reformed company would be accountable to Parliament, forfeit its monopolistic franchise in return for new revenue streams from land taxation and public works, and assume a broader range of public service responsibilities (WN IV, ch. vii, p. 637; V, ch. i, pp. 730–731, 756; V, ch. ii, pp. 838–839). This transformed role would encompass duties and tasks consistent with

<sup>29</sup> See West (1977, p. 6) and Donoghue (2020, pp. 12–13) for further discussion of this point.

<sup>30</sup> For a discussion of the duties and responsibilities of the East India Company in the provision of public works and institutions on behalf of the British state, see Donoghue (2020, pp. 11–14).

those of a sovereign. These operations would be backed by robust parliamentary regulations to ensure appropriate distance between citizens and legislators (Diatkine 2021, p. 116). However, Smith did not bring his ideas on the East India Company as an administrative, judicial, and tax-raising enterprise into sharper focus, leaving the specifics “to the wisdom of future statesmen and legislators to determine” (WN IV, ch. vii, p. 606).

While Smith welcomed the legislative efforts initiated by Lord North’s administration in 1773 to reform the governance structure of the East India Company in the Indian territories, it is essential to recognize that Smith’s objections to the company’s governance primarily centered on its monopoly charter, which bolstered its dominance in East Indies trade. The company’s territorial acquisitions were of subsidiary concern, as its exclusive privileges were not intended for colonization but rather to stifle economic competition and secure dominance in East Indies commerce (Marshall 1975).<sup>31</sup> Nevertheless, Smith regretted the sluggish pace of legislature reforms, attributing it to the company’s adept management of claims concerning foreign competition in British industry, which fueled the continuation of protectionist policies. This lack of progress highlighted the inability of substantive reforms to emerge from a process typically characterized by the expectation of conflictual negotiation between legislators and the company. Instead, incremental reforms often materialized from consensual arrangements, as numerous British politicians with connections to the East India Company as directors and shareholders prioritized the interests of the company over the broader public interest. As Smith observed: “The Member of Parliament who supports every proposal for strengthening this monopoly is sure to acquire not only the reputation of understanding trade, but great popularity and influence with an order of men whose numbers and wealth render them of great importance” (WN IV, ch. ii, p. 471). These pressures were more evident in the heightened interest in the *legal* processes governing Britain’s maritime trading system and the development of a commercial economy than in the “break down of exclusive privileges of corporations” (WN IV, ch. ii, p. 470).<sup>32</sup> Until the 1790s, there was little indication that public opinion in the metropole regarded the company’s role in India as anything other than commercial (Marshall 1975, p. 37).

## VII. CONCLUSION

Smith’s critique of the English East India Company in the *Wealth of Nations* revealed an individual deeply “preoccupied with the political difficulties of empire, [and] intensely conscious of the public dramas of the times in respect of the British, French, and Moghul empires” (Rothschild 2012, p. 185; cf. Ortmann and Walraevens 2022, pp. 6–7). Yet, what appears to concern Smith most is not merely the contemporary allegations against the company but rather the prospect of reshaping it into a new force in Asia based on

<sup>31</sup> Smith also noted that the company’s Indian territories were an important source of public revenue. In 1775, for instance, the East India Company paid a sum of two million pounds to the British government “as indemnification for their territorial acquisitions” (WN V, ch. iii, p. 923).

<sup>32</sup> Smith’s frustration with Parliament’s slow progress in repealing protective legislation underscores a point once made by Coase (1977, p. 319) that “government regulations will normally be much influenced by those who stand to benefit from them, with the result that they are not necessarily advantageous to society.”

different principles. He found the existing state of affairs untenable, famously remarking that “[n]o two characters seem more inconsistent than those of trader and sovereign. If the trading spirit of the English East India company renders them very bad sovereigns; the spirit of sovereignty seems to have rendered them equally bad traders” (*WN V*, ch. ii, p. 819). Therefore, Smith’s critique of monopoly was not merely theoretical but deeply grounded in the political realities of his time.

However, Smith recognized that simply terminating the East Indies monopoly would not fully resolve the conflicts of interest within the East India Company; in fact, it might intensify pressure for political support of the company, knowing that its profitability would be threatened by new competitors entering the market. Smith’s proposed solution was to abolish the East Indies monopoly *and* realign the priorities of the East India Company, with Parliament responsible for seeing this happened. While Smith never explicitly claimed that the English East India Company should assume responsibility for provision of public goods in India, the extensive discussion of joint-stock companies, public goods, and political reforms in Book V of the third (1784) edition of *Wealth of Nations* appears deliberate. Smith was known for carefully selecting new material for his work, making it unlikely that these topics were coincidental additions (Ortmann 1999; Ortmann and Walraevens 2022). Some scholars suggest that Smith’s revisions in the third edition aimed at an explicit formulation of public goods and infrastructure provision by a joint-stock entity under specific conditions (cf. West 1977; Hollander 2013; Donoghue 2020). Gregory Collins (2019, pp. 372–373) argues that Smith’s “thoughts on the East India Company grew into mature form in the 1770s and early 1780s,” and, “combined with his personal experiences relating to East India affairs, provided ample opportunity to fortify his criticism of the mercantile system.” Rothschild (2012, p. 184) rightly notes that the *Additions and Corrections* that Smith published separately in 1784 focus significantly on “overseas commerce,” especially the “East India companies,” suggesting Smith’s belief in the feasibility of the English East India Company functioning as a sovereign entity under specific conditions (cf. Rothschild and Sen 2006, pp. 351–352). While Smith did not provide specific details on the implementation of his plan, leaving such matters to the judgment of the wise legislator (*WN IV*, ch. vii, p. 606), Book V of *Wealth of Nations* includes concrete suggestions hinting at a potential solution for the East India Company’s “settlements in India,” which, it is crucial to note, were seen as “the undoubted right of the crown, that is, of the state and people of Great Britain” (*WN V*, ch. i, p. 751; *V*, ch. iii, p. 945).<sup>33</sup>

Smith’s writings on East India affairs served as a cautionary tale against the consolidation of monopoly power—both economic *and* political—in private hands. He rejected the idea that a chartered monopoly like the East India Company could ever act in the common interest. Smith’s advice to overhaul the commercial system stemmed from his desire to diminish the political influence wielded by the East India Company in Whitehall, where it had successfully shaped regulatory outcomes upholding barriers to entry.<sup>34</sup> However, at the heart of his critique against the prevailing mercantile system lay

<sup>33</sup> Collins (2019, pp. 381–382) summarizes Smith’s argument for the legitimacy of the company’s territories in India.

<sup>34</sup> Smith’s recommendation to overhaul the commercial system, driven by his aim to diminish the political influence of the East India Company in Whitehall, mirrors the modern concept in economics known as “regulatory capture.” This theory asserts that regulatory agencies may become controlled by the very interests

his long-standing opposition to the East Indies monopoly. “The monopoly has,” Smith observed, “upon many occasions intimidate[d] the legislature” (*WN IV*, ch. ii, p. 471).<sup>35</sup> The realization of his vision for the administration of the East India Company in the Indian territories could not be achieved until the mercantile system was reformed. This required, above all, the abolition of the East India Company’s monopoly rights. While the East India monopoly could be repealed by Act of Parliament, Smith cautioned that correcting the conduct of merchants and traders entrenched in “the wretched spirit of monopoly” would be a formidable task, given the challenge of altering “the nature of human affairs [which] can scarce admit of a remedy” (*WN IV*, ch. iii, p. 493).

## COMPETING INTERESTS

The author declares no competing interests exist.

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they are meant to regulate, rather than acting in the public interest. Smith’s analysis anticipates the essence of this principle.

<sup>35</sup> See Hanley and Paganelli (2014, p. 192) for a similar view.

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