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# Early Views on the Economic Role of the State

Over the centuries, various philosophers, political scientists, and, later, economists have theorized about what the role of governments, or more generally the state, should be in an economy. Their theorizing was inevitably influenced by the experiences that they had with the actual roles that governments had been playing, or had played, at times when governments had rarely been democratic.

The government roles, of course, depended on both the *intentions* of the policymakers, their views of the world, and the economic and political *reality* that the policymakers faced. That reality could prevent governments from pursuing some roles that they might have wished to pursue, but that may have been unrealistic, at those times. In those early years, the economic status of families was still largely based on traditional and largely inherited rights, and not on democratic principles or market performance.

Two centuries ago, Edmund Burke had written that: "one of the finest problems in legislature [is] to determine what the state ought to take upon itself to direct by the public wisdom and what it had to leave with as little influence as possible to individual exertion." A century later, in a lecture that he gave in Berlin, in 1926, Keynes would write that "perhaps the chief task of economists … is to distinguish … the Agenda of Government from Non-agenda, and the companion task of Politics is to devise forms of Government within" (Keynes, 1926, p. 40). The role of the state had been a long-term topic of debates, starting at least from the time of the Greek philosophers.

In the distant past, and until Adam Smith's time, *mercantilism* had been the most common policy that governments had adopted.



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The concept of mercantilism may be a bit vague to current economists, but a good description of it and of its functions can be found in Max Weber's (1923) *General Economic History*. Some detailed and broader description of the specific features of how mercantilism was applied in France in the seventeenth century can also be found in Solomon (1972). In France, in the seventeenth and much of the eighteenth century, mercantilism was promoted through government regulations. The French government imposed many and some rather unusual and extreme forms of regulations. For example, it regulated the height of buildings in Paris, the size of handkerchiefs that could be sold, and even assigned permits to beggars, permits that specified the street corner where a particular beggar could beg. Some other governments, as for example that of the Kingdom of Sardinia, specified the color in which doors of houses could be painted.

Governments regulated trade and other economic activities of individuals and enterprises. Britain followed some forms of mercantilism, as was indicated by Adam Smith, but it did it in a less rigid form than France. This difference can be seen by comparing Paris, with its architectural regularity, and London, with its lack of it.

In 1613, an economist from the then Kingdom of Naples, named Antonio Serra, published a book that provided a rather precise and detailed description of mercantilist policies related to trading activities. In his monumental *History of Economic Analysis*, Schumpeter (1954) would describe Serra's book as the very first book ever written that could claim to be an authentic *economics* book, in a modern sense, rather than just a philosophical treatise.

In Serra's time the wealth of a country was measured mainly by the quantity of gold and silver that the sovereign had available. This was the wealth that could be used for fighting wars, for supporting sovereigns, and for other national purposes. It was the kind of wealth that had made Spain rich and powerful at that time, due to the gold and silver coming from its American colonies.

In the absence of gold and silver mines in a country, or in conquered territories, such wealth could be accumulated mainly through trade, by limiting imports, through import duties and other government-imposed restrictions, while giving incentives and support to exporters. At that time payments for imports and receipts for exports were settled in gold and silver, which were the means of exchange. Therefore, the balance of payment largely determined the wealth, in gold and silver, that a country had available.

Some may recognize that Serra's policy was broadly the same one that was strongly recommended, in the 1950s and 1960s, to Argentina and other Latin American countries, by Raul Prebisch, then an influential Argentina economist. The declared objective of Prebisch, however, was not that of accumulating gold and silver for governments, but that of promoting industrial development in those countries, at a time when industrialization was seen by many economists as a necessary precondition for economic development. If a country wanted to develop into a developed country, it had to industrialize. One way to promote industrialization was to impose obstacles to the import of many products, in order to provide implicit subsidies to local producers, replacing the imported products with local production. That is how Argentina ended up producing, in those years, US-designed cars that had not been produced in the United States for many years. The view was that, with high enough import duties, a country could produce almost anything. Of course, the costs of production could become very high, making a country poor rather than rich.

In Max Weber's book, published in 1923, almost three centuries after Serra's book, he explained that mercantilism had been part of the formation of the "rational" state and that "modern capitalism" could flourish only in a "rational" state, a state that was capable of guarantying *consistent* policies to private enterprises. Modern states had come into existence only in relatively recent centuries, and in some countries, such as England and France, earlier than in others. They had not existed, as such, in the distant past. Mercantilism had been the first expression of a modern *capitalist* state and a road to it.

As Weber put it, mercantilism had

> consist[ed] in carrying the point of view of capitalistic industry in politics; the state [was] handled as if it consisted exclusively of capitalistic entrepreneurs. External economic policy rest[ed] on the principle of taking any advantage of the [foreign] opponent, importing at the lowest price and selling much higher. Hence mercantilism signifie[d] the development of the state as a political power, which [was] to be done by increasing the tax paying power of the population.
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> (Weber, 1923, pp. 255–256)

Weber added that: "England is distinctly the original home of Mercantilism. The first traces of the application of mercantilist principles are found [in England] in the year 1381" (Weber, 1923).

A century and a half after Serra, and at the very beginning of the Industrial Revolution, the Scottish economist Adam Smith (1776) would present a different and more utilitarian, or more modern, definition of the

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"wealth of the nations," in a book that would become the most influential and famous book in the history of economics, appropriately titled, *The Wealth of Nations*.

In what was then a novel and revolutionary view, Smith identified the wealth of nations not with the amount of gold and silver owned by a country but with the wellbeing of the individuals who lived and operated in it. The wealth was in the hands of the citizens and not in the hands of the state. There was, thus, an implicit acceptance, on the part of Adam Smith, that the wellbeing had to originate and to be found among the population, rather than being the gold and silver concentrated in the safes of the state and largely in the hands of the sovereigns.

Smith explained that the individuals of a community, acting in their own interest and without the need for any government to guide them, had incentives to produce what other members of the community needed and would want to buy. Each member had the incentive to sell to others and to buy from others, what he or she and others did not produce, but needed. Ricardo would later extend this concept to the trade between England and Portugal, introducing a global dimension to the principle (see Ricardo, 1817).

Smith added that an "invisible hand" would somehow coordinate the actions of the individuals, without any need for the government to play a direct role. For the first time, Adam Smith had proposed a philosophy of *laissez faire*, a philosophy that would become popular and would acquire many followers during the nineteenth century, especially among individuals who had some training in the new and developing field of economics. Economists would develop the theoretical underpinnings of the laissez faire economics that Smith had advanced. And laissez faire would play a fundamental and useful role during the industrial revolution.

The industrial revolution would significantly be promoted by laissez faire, even when governments would continue to interfere to varying degrees in some economic activities. Religion would also play a role in the economic developments in those years (see Friedman, 2021).

Perhaps it could be mentioned at this point that the industrial revolution would create many needs for new energy, which initially would come from running water and from the use of coal and later from oil and gas. These new energy sources would lead to great increases in average incomes over the years. In the long-term this would create the problem of global warming that has become increasingly problematic in recent times.

While laissez faire is often identified with Adam Smith's work, the term did not originate with him. Rather, it had a much earlier origin, in France, during the time when Jean Baptiste Colbert was the powerful finance minister of Louis XIV, the then king of France. At that time mercantilism was the prevalent economic philosophy that guided France and other countries.

One day Colbert invited several leading French merchants to discuss possible ways in which the state could help them in their commercial activities that would increase France's possessions of gold and silver, an increase that the country badly needed. During the discussion, and in response to Colbert's question on how the state could help them in their activities, one of the merchants present, by the name of Legendre, commented that the best help that the government could provide them was by simply staying out of their way and their activities. As he put it, in French, by *nous laissez faire*, by "letting us do our things." That was the origin of the term. As we saw earlier, the state had been interfering in many activities in which it had no legitimate business to intervene, and it was often allocating monopoly power on some activities to specific, favored merchants.

Adam Smith used the term "invisible hand" briefly and only in passing. However, that term would be often used, over the years by various commentators, as an argument that the government should have almost no role to play in the market, and that it should simply "stay out of the activities of private agents." These commentators still expected the government to perform its important role of protecting the private properties of citizens and the personal safety of individuals and, of course, of defending the country from invasion from other countries, and providing essential institutions and infrastructures. For all these activities governments would inevitably need some revenues through taxes. However, the payment of these was often resisted.

A careful reading of all of Adam Smith's writings, including his other important book, *The Theory of Moral Sentiments* (1759), conveys a more nuanced message than implied by the common view of laissez faire. Smith did not live in the abstract world of theoretical economics and he had his feet firmly placed on the ground (see Buchan, 2006). He was a keen observer of the reality that surrounded him and he was fully aware that market operators could try, and often did try, to take advantage of their customers, when they could. They did this by organizing "cartels" and by other means that allowed them to extract higher profits from their economic operations. He was also aware that there were some essential infrastructures and some services that later would be called public goods, that only governments could provide. When possible, the infrastructures

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could be built by private interests that could charge fees for their use, as was the case with turnpikes that significantly reduced the number of hours that it took to go to London from other major British cities.

Smith also realized that, in all communities, there are some individuals who, because of circumstances or personal handicaps, might not be able to produce and sell anything that others wanted, including their labor. These individuals might not have any income to support their essential needs. In the absence of some assistance, that might come from other members of large families, from charitable and religious institutions, or from the government, these individuals would be forced to become beggars or criminals or simply starve. These were prospects that a caring community would and should not accept and should not ignore.

As large families started to disappear and religious institutions reduced their role, the government would have to assume a larger role in filling this need. Since Elizabeth I, England had had some poor laws aimed at providing some assistance to very poor individuals who were not able to feed themselves. These laws had filled the role that in the past had been played by convents and other religious institutions before the religious separation from the Papacy.

In conclusion, while Adam Smith recognized the beneficial role that small and noninterfering governments could provide to the work of free markets, and to the welfare of its citizens, he also recognized the need for some regulatory function by the governments, and for some governmental assistance to individuals in need and not able to provide for themselves. He also elaborated some basic rules related to the imposition of taxes and was against the use of public debt by governments.

The limited functions of the state would be justified even in the largely laissez faire environment that was contemplated and favored by Adam Smith. This meant that equity could not be left out of the equation, and that if the market did not provide it, the government should. Smith was in favor of a free society, but of a society that was a decent and caring one. Such a society might not arise spontaneously in an extreme laissez faire environment, He wanted to create incentives for free individuals, not only for them to do better economically, but also to act better, reflecting some altruistic community notions. He gave significant importance to "empathy" (see Muller, 1993) for elaborations of these points, and especially the last chapter of Smith's *The Theory of Moral Sentiment*.

It should be added that Smith's theorizing was conditioned by the environment in which he lived, one then made up of inherited privileges and some mostly small economic activities. The market he referred to, with some exceptions, was then prevalently local, and the market exchanges that took place were mostly repeated exchanges, among individuals who knew one another and focused on material goods rather than services. Transparency could be assumed in this market and competitive prices were important in the exchanges.

This society would dramatically change over the next centuries and during the Industrial Revolution, when factories that could host thousands of workers under the same roof started to be built, leading to the obvious question of whether what might have been good in Smith's time would still be good in a different environment. When the weather changes, should one wear the same clothes or change clothes? This was and has remained the key question.