
PAST LEARNINGS

Commercial Society and its Internal Enemies A Smithian Synopsis

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The Past Learning series of papers is predicated on the twin propositions that the great bulk of valuable knowledge about the principles of political economy is to be found in past research and that much of this knowledge is forgotten or ‘written off’ in consequence of an undue preoccupation with the particular issues and thinking of the day. Whilst the search for new incremental knowledge is admirable, the amnesia is not, because it implies a shrinking base to which the increments can be added. In consequence the total value of the associated, collective human capital applied to economic policy problems progresses more slowly than it could and is also prone to significant periods of regression. The contrast with the physical sciences in this regard is stark.

The aim of the series is to provide a mild corrective to the amnesia by re-presenting some of the older wisdoms and drawing attention to their direct and immediate value in application to today’s policy challenges.

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Abstract/Summary

Repeated public attitude surveys indicate that politicians are the least trusted of professionals. In their speech and in their conduct they are consistently judged to be untrustworthy. Immediate questions that arise include: Why do these patterns of conduct persist? Are they an unavoidable feature of democratic systems, or are they open to remediation? If the latter, what are the obstacles to remediation that seem to account for their persistence?

To explore aspects of these questions, this short paper in the Past Learnings series examines how the founding fathers of political economy, and Adam Smith in particular, approached the relevant issues in their own time. That was a quarter of a millenium ago, when the economic system was less complex than now and government was much smaller in size and scope. Nevertheless, much of that first-take analysis resonates strongly in contemporary contexts, perhaps because the problems have themselves been so persistent. The underlying issue identified is the use and abuse of the extreme monopoly powers that are afforded to government leaders. When leading politicians assume power, they immediately acquire a monopolistic position and tend to pick up all the dysfunctional behavioural characteristics that tend to be associated with monopolies, including lack of enterprise. In a nutshell, it can be said that enterprise is a necessity for survival in competitive markets, whereas, while political monopolists can, potentially, be enterprising, for them it is a discretionary choice. Just as commercial monopolists can come to be seen as ‘enemies’ of consumers, so leaders of government can come to be seen as ‘enemies’ of a well-functioning social and economic system. A final comments section of the paper notes one major factor that has changed since the 18th century, the expansion of managerial bureaucracy, and draws attention to previous Regulatory Policy work on how the observed dysfunctions in governance might, at least partially, be remediated.

Commercial society and its internal enemies: a Smithian synopsis

Introduction

Commercial society is the name given, by those of the 18th century Scottish literati interested in political economy, to the type of society in which they lived. Unlike, say, the words capitalism and socialism, it has a relatively precise definition. It is a society in which the great majority of its members rely very heavily on everyday exchange transactions with others for securing what is referred to in the *Wealth of Nations* as the ‘necessities, conveniences and amusements of human life’. The extent to which a society is commercial in this sense is largely a matter of empirics, a matter of fact finding, not a matter for ideological dispute.

Adam Smith put the matter as follows, at the opening of Chapter 4 of the *Wealth of Nations*:

“When the division of labour has been once thoroughly established, it is but a very small part of a man’s wants which the produce of his own labour can supply. He supplies the far greater part of them by exchanging that surplus part of the produce of his own labour, which is over and above his own consumption, for such parts of the produce of other men’s labour as he has occasion for. Every man thus lives by exchanging, or becomes, in some measure, a merchant, and the society itself grows to be what is properly a commercial society.”

The relevant exchange transactions themselves involve a strong form of reciprocity – a ‘this’ is exchanged for a ‘that’ -- and it is a form of economic organisation that tends to go alongside a general, social expectation that embodies a general, moral tenet of ancient lineage. As St Luke recorded it: *“For unto whomsoever much is given, of him shall be much required: and to whom men have committed much, of him they will ask the more.”*

Today it might be characterised as ‘proportionate reciprocity’.

The twin institutional pillars

Commercial society has two, principal, closely inter-related institutional pillars: ‘markets’ and ‘money’. Each has evolved to serve the function/purpose of reducing the costs of effecting exchange transactions, i.e., of buying and selling.

These transactions can be said to be ‘horizontal’ in nature: they require only the matching of willing buyers and willing sellers. No hierarchical institutional arrangements need to be engaged in determining the detail of the actual exchanges of goods, services and property rights that take place.

Lowering exchange transactions costs can be expected to increase the volume of exchanges that take place by expanding the potential gains from trading, including by rendering beneficial exchanges that were, at a previously higher cost of transacting, not judged beneficial. In that sense, the institutions serve to ‘grow the economy’, to increase the ‘wealth of the nation’. Exchange transactions costs can be viewed as ‘barriers to trade’, and ‘markets’ and ‘money’ can be viewed as evolved, institutional developments that serve to reduce those barriers.

A side effect of this is that both higher gains from trading and the associated broadening of the scope of transactional activity made feasible by lower costs provide greater incentives for enterprise, by which here is meant an ordinary, dictionary definition of that word: *“initiative*

and resourcefulness". In a high-functioning commercial society enterprise is ubiquitous – not restricted to a particular type or category of person or organisation. In this more developed state of economy and society, enterprise arguably becomes the key driver of improved economic performance. By analogy with physical science, it might be said to provide the continuing momentum required for productivity growth.

Viewed institutionally, i.e. as sets of rules or established patterns of social conduct that structure social interactions, markets are simply shared rules or patterns of human conduct that function to make buying and selling easier and less costly. In a fundamental sense, and as all institutions do, they regularise or regulate the conduct of their participants (and participation is voluntary, not coerced). They are distinguishable from other economic institutions chiefly by their specific, dedicated function or purpose. The nowadays commonplace, binary distinction between 'markets' and 'regulation' is therefore misleading: markets are themselves a form of regulation of human conduct.

Considered as a means of exchange, the institution of money shares the same function/purpose (reducing the cost of effecting exchange transactions) as markets. Markets and money can therefore be viewed as complementary institutions. It is possible to imagine a primitive market developing simply as a collective expectation that people will meet together at a certain place and certain time in order to exchange commodities by barter. Addition of the social convention of accepting some standardised token or other as a quid pro quo greatly simplifies (and thereby reduces the cost of) the transactional process.

The significance of the two institutional pillars for the well-functioning of a commercial society should be obvious from the above remarks, particularly given their roles in providing a seed-bed for enterprise. For current purposes, therefore, the 'enemies of commercial society' of interest can be identified, in a broad-brush way, as those sources of influence that serve to degrade the effectiveness of one or both of the two institutions. Some of the more significant of these sources of influence heave into view rather easily, but, since they all engage with the use and abuse of monopoly power, it will be helpful to say a few words about monopoly first.

Monopolies

Monopolies were anathema to classical liberals, whose critiques of them were multi-dimensional and richer in content than those of today's economics textbooks. Although the latter teach (correctly) that monopoly tends to restrict the volume of transactional activity in a market, and hence that it leads to economic inefficiency, they usually do so by means of static modelling frameworks wherein nothing changes from period to period.

The classicists, in contrast, were much more interested in the evolving dynamic effects, in the implications of this type of market structure for economic progress (the term used back then for productivity growth). And perhaps the most important point to make about the dynamics is that, while competitive markets can be said to be a seed bed for the development of enterprise, monopolies are much stonier ground.

There is no *necessity* for a monopoly supplier to be enterprising, to take innovative initiatives and be resourceful, in order to find willing buyers when buyers have no good alternative available to them: such suppliers can survive, and indeed oft times prosper, without being enterprising. On the other side of the market, there is less call for buyers to exercise initiative and resourcefulness in seeking out better deals when there is only one supplier in town.

Smith summarised the position this way : “*Monopoly, besides, is a great enemy to good management, which can never be universally established but in consequence of that free and universal competition which forces everybody to have recourse to it for the sake of self-defence.*”

Around 70 years later, J.S. Mill, in his *Principles of Political Economy*, expanded the point a little: “*When relieved from the immediate stimulus of competition, producers and dealers grow indifferent to the dictates of their ultimate pecuniary interest; preferring to the most hopeful prospects, the present ease of adhering to routine. A person who is already thriving, seldom puts himself out of his way to commence even a lucrative improvement, unless urged by the additional motive of fear lest some rival should supplant him by getting possession of it before him.*”

But, quite apart from the more specifically economic analysis of monopolised markets, Smith and other classical liberals were intensely interested in another aspect of monopoly, to do with the *distribution of power* (hence the genesis of the term *political economy*). A functioning State, whatever its shape, lays claim to a monopoly of physical coercion. How it conducts itself in the use of that monopoly power was their chief concern.

The State’s monopoly power encompasses not only the capacity to supply goods and services to the public (for example health, educational and transport services), but also the capacity to make laws and regulations that govern all commercial activity. In a very immediate and direct sense therefore, use of its monopoly power is systemic in its effects.

Smith’s analysis

The *Wealth of Nations* is notable for being the first, holistic, evolutionary analysis of an entire economic system and it leads up to a very radical critique of the 18th century British State’s use of its monopoly powers in regard to commercial/transactional activities. A central theme is the tendency of Government and Parliament to yield to the inducements of partial (meaning partisan) interest groups by legislating and regulating in ways that favoured those interests, even though the effect of doing so might be damaging to the wider public, by degrading the performance of the economic system as a whole.

The degradation occurs chiefly as a result of markets and money being re-purposed to serve functions other than their primary function. In consequence, because of the trade-offs this introduces, the simple, primary purpose/function of the twin institutions, the reduction of exchange transactions costs, is served less well. For example, the ‘rule-book’ of a particular market might be adjusted to tilt the likely *outcomes* of transactional activity in favour of some or other importuning partial interest; or a government might increase the supply of money, not to meet an increased demand for it in consequence of higher transactional activity, but rather in order to fund expenditures that are favourable to particular interest groups.

The tenor of the critique – which may surprise those familiar only with the cardboard cut-out version of Smith’s thinking that tends to predominate today – can most easily be captured by a few citations.

On freedom of trade:

“To expect, indeed, that the freedom of trade should ever be entirely restored in Great Britain, is as absurd as to expect that an Oceana¹ or Utopia should ever be established in it. Not only the prejudices of the public, but, what is much more unconquerable, the private interests of many individuals, irresistibly oppose it.”

On the political conduct of major commercial businesses:

“... like an overgrown standing army, they have become formidable to the government, and, upon many occasions, intimidate the legislature. 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. If he opposes them, on the contrary, and still more, if he has authority enough to be able to thwart them, neither the most acknowledged probity, nor the highest rank, nor the greatest public services, can protect him from the most infamous abuse and detraction, from personal insults, nor sometimes from real danger, arising from the insolent outrage of furious and disappointed monopolists.”²

On ideological³ obstacles to good regulation:

“The laws concerning corn may everywhere be compared to the laws concerning religion. The people feel themselves so much interested in what relates either to their subsistence in this life, or to their happiness in a life to come, that government must yield to their prejudices, and, in order to preserve the public tranquillity, establish that system which they approve of. It is upon this account, perhaps, that we so seldom find a reasonable system established with regard to either of those two capital objects.”

On the importance of always having a general view of things firmly in mind:

“The legislature, were it possible that its deliberations could be always directed, not by the clamorous importunity of partial interests, but by an extensive view of the general good, ought, upon this very account, perhaps, to be particularly careful, neither to establish any new monopolies of this kind, nor to extend further those which are already established. Every such regulation introduces some degree of real disorder into the constitution of the state, which it will be difficult afterwards to cure without occasioning another disorder.”

On the Mercantile System:

“Monopoly of one kind or another, indeed, seems to be the sole engine of the mercantile system.”

“It is the industry which is carried on for the benefit of the rich and the powerful, that is principally encouraged by our mercantile system. That which is carried on for the benefit of the poor and the indigent is too often either neglected or oppressed.”⁴

¹ This is a reference to *The Commonwealth of Oceana* by James Harrington (published in 1656, five years after Hobbes's *Leviathan*), an exposition of how the then Commonwealth might be ordered. It was initially suppressed by Cromwell, but later allowed to be published.

² Smith uses the term monopoly rather loosely in this passage. He does not, I think, mean to imply that individual merchants and manufacturers are monopolists in their own markets. The point is that they tend to act together, in a cartel-like way, when it comes to seeking to influence laws and regulations.

³ Taking ideology to mean a belief or system of beliefs that carries direct, prescriptive implications for social action which are largely immune to contra-indicative evidence or convincing reasoning.

⁴ Today, it might be more appropriate to refer to ‘commercial enterprise’, rather than ‘industry’.

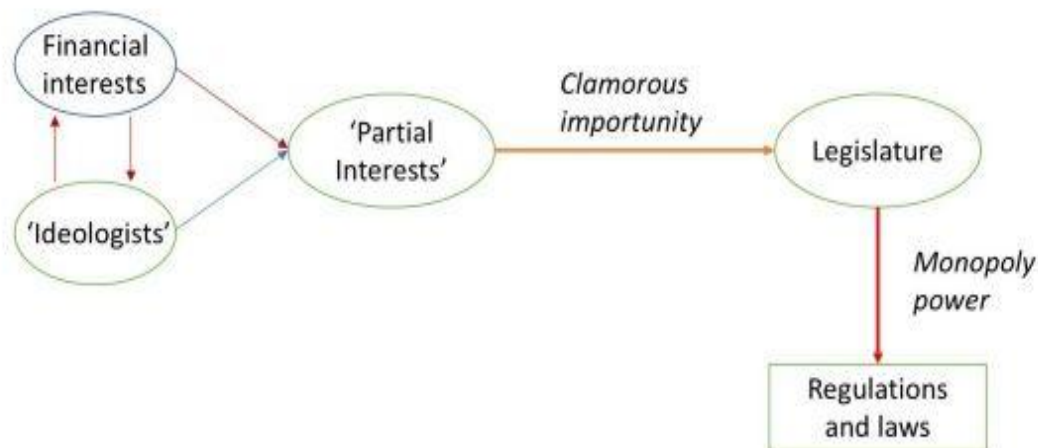
“It cannot be very difficult to determine who have been the contrivers of this whole mercantile system; not the consumers, we may believe, whose interest has been entirely neglected; but the producers, whose interest has been so carefully attended to; ...”

“A single, and as, I thought, a very harmless Sheet of paper, which I happened to Write concerning the death of our late friend Mr Hume, brought upon me ten times more abuse than the very violent attack I had made upon the whole commercial system of Great Britain.”⁵

On money:

“By means of those operations [debasement of the coinage/currency], the princes and sovereign states which performed them were enabled, in appearance, to pay their debts and fulfil their engagements with a smaller quantity of silver than would otherwise have been requisite. It was indeed in appearance only; for their creditors were really defrauded of a part of what was due to them. All other debtors in the state were allowed the same privilege, and might pay with the same nominal sum of the new and debased coin whatever they had borrowed in the old. Such operations, therefore, have always proved favourable to the debtor, and ruinous to the creditor, and have sometimes produced a greater and more universal revolution in the fortunes of private persons, than could have been occasioned by a very great public calamity.”

Pulling the various threads together, the laws/regulations generating process can be summarised schematically in the following diagram.



The bi-directional arrows in the diagram reflect a symbiosis between the two sources of influence. Thus Mercantilism was the doctrine/ideology promulgated by the merchants and major manufacturers, in support of their own pecuniary interests, a doctrine which Smith excoriated in the *Wealth of Nations*. And, even when an ideology is first developed without major influence by established financial institutions, it is rare to find that there is no support

⁵ From a letter to Andreas Holt, a Danish customs official. David Hume was damned by Scottish religious authorities as an ‘atheist’, so this can be read as a piece of evidence for the passionate intensity with which ‘ideological’ beliefs can often be held.

for its further development emanating from those who would derive personal benefits of one kind or another from its acceptance. Smith's analysis therefore contains seeds of perspectives that would be later given much more emphasis by later social theorists (see Marx on bourgeois ideologies and Nietzsche on the priestly caste).

Comments

It is important to recognise that, in all this, Smith was not attacking the functions performed by the leading merchants or by the emerging 'great manufacturers'. Far from it: these groups are the source of the enterprise that was driving economic progress at the time. What he was attacking were aspects of their conduct, particularly their use of wealth and influence afforded by commercial success to induce politicians to use their own, extensive monopoly powers to legislate and regulate in ways that are inimical to the general success of a commercial society (though favourable to the importuners).

Similarly, Smith is not questioning the right, in a representative democracy, of different interest groups, including those of an ideological nature, to make known their views and opinions to politicians. The indictment of them is that in doing so, those with potentially high influence do so without giving due consideration of the wider effects of their proposals on others. Their conduct on this count is to be judged as *irresponsible*.

Nor should the expressed sympathy with and concern with the "*poor and indigent*" be taken as a call for a social-democratic, large-scale transfer of income to that group. That sort of income transfer would be quite compatible with a mercantile system, and it is the mercantile system and its re-purposing of markets that Smith is attacking, on the ground that it depresses the wealth/wellbeing of the nation. Take that system away and the poor and indigent will benefit from a redirection of enterprise is the message, for example via a lower price of corn, which increases their collective spending power, which stimulates enterprise in satisfying their wants and needs.

Smith also expresses some sympathy for politicians in the face of the clamorous importunity, and sometimes passionate intensity (particularly when of an ideological nature), of partial interests, but, in the end, it is politicians that face the greatest indictment. Theirs is a tough job, full of many distractions that tend to be afforded the privilege of immediate attention, but it is to them that the coercive, monopoly powers of the state are entrusted. We are back to St Luke: much power is given to them (much more than is possessed by any other partial interest), ergo much is expected from them in the way they use that power. When they fall short of a general expectation that the extreme powers afforded will command extreme vigilance in defence of foundational institutions of a commercial society, they too can properly be described as *irresponsible* and they arguably become the greatest enemies of that society, precisely because of their systemic power.

The *Wealth of Nations* was written a quarter of a millenium ago, in an age when the economic system was much less complex and government much smaller in scale than it is now. While the schematic diagram of Smith's analysis resonates with the contemporary position in many respects, it doesn't, for example, encompass the later widespread emergence of the hierarchical structures of what can be called managerial bureaucracy, in both the public and private sectors.

These hierarchical structures operate according to principles of their own. They are heavily focused on processes and procedures and have proclivities to expand their own sizes and

budgets. They can be classified as ‘partial interests’ on that basis, but at least for those of them in the public sector, they have much stronger connections with the politicians. Other interests compete among themselves for the attention and favours of those elected to office (hence the references to “*clamorous importunity*”): the civil service doesn’t, and therein lies a contemporary problem awaiting a response. Inter alia, bureaucracy, with its focus on process and routine, is an area of activity that, like monopoly more generally, is stony ground for enterprise (initiative and resourcefulness).

As a provisional step forward, the oval in the diagram designated ‘Legislature’ (reflecting Smith) might be changed to ‘Government’, to encompass all the bodies engaged in exercising state power. The question then becomes: how effective is this conglomeration of entities in its vigilance in defending and, more optimistically, improving the functionality of the commercial system as a whole?

The performance standard for government was specified by Smith. It is that government “*be always directed, not by the clamorous importunity of partial interests, but by an extensive view of the general good*”, and it can be noted that this resonates with one of the criteria that Keynes set down as necessary to be judged a master economist: he/she “*must contemplate the particular in terms of the general*”.

It is a matter of everyday observation that government falls far short of that standard. Political bandwidth is overwhelmingly allocated to considerations of particulars, and ‘the general’ is subject to severe neglect and left ‘out of mind’ for most of the time. In previous Regulatory Policy Institute publications, it has been argued that this is linked to structural defects in the organisation of government, and that these defects can be brought to light by way of comparisons with the information-processing and decision-making structures of human and other animal brains. These have evolved in ways that keep the general picture (of the animal’s environment) under continuous surveillance at all times, even as attention is given to the particulars (e.g. grabbing some food). That is, there is simultaneous (parallel) processing of information concerning the particular and the general.

The case for viewing the conduct of politicians as the greatest enemy of commercial society is therefore a strong one. By virtue of state monopoly, politicians in government have the power/capacity to change the structure of the system within which they operate so that the general is always kept firmly ‘in mind’, but, like cognitively lazy, unenterprising monopolists more generally, they prefer the ease of “*adhering to routine*” (Mill), to the familiar (even if that involves seemingly never-ending frenzy), to business as usual, even in the face of system decay. It’s a choice for which they alone are responsible, and they can, and should, be properly held accountable for it.