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Economic Liberty and the Constitution, Part 3

by Jacob G. Hornberger

Throughout the ages, governments have regulated the economic affairs of their citizenry. The common belief of mankind was that economic chaos would result if government did not plan and direct the economy. It was also widely believed that government management of the economy was necessary to help alleviate the plight of the poor.

When Adam Smith published his treatise *An Inquiry into the Nature and Causes of the Wealth of Nations* in 1776, people were living in what is called "the age of mercantilism." It was a period in which government regulations covered the most minute aspects of people's economic activities. Producers were governed by detailed sets of regulations, primar-ily because it was commonly be- lieved that if government did not direct production, essential items might not be produced, which would mean that the people would suffer.

There were extensive price controls that prohibited producers from selling their products for more than the legally established maximum price. There were anti-speculation laws that imposed severe punishments on people who bought low and sold high in the expectation of making a profit.

It was illegal to be a middleman, a person who facilitated trade between a buyer and seller. For example, when farmers transported their crops to sell at the village market, it was a criminal offense for someone to buy the crops on the outskirts of town with the intent of selling them at the market at a higher price.

Royal monopolies were often granted to producers, which meant that the law prohibited anyone from competing against them. The monopoly status enabled the producer to stay in business without fear of competition, thereby assuring the public of a continued supply of his product.

Subsidies were granted to important businesses to make sure that they survived. The government also provided poor relief or welfare to the poor.

The primary justification for all of these laws and regulations was that they were needed to combat poverty, which was deep and widespread during the mercantilist period. The standard of living of the average person was horrible, a fact reflected by the average life span, which was in the low 20s for both men and women. People lived in squalor and died at an early age from famine, malnutrition, or disease. In *The Wealth of Nations,* Smith told how families would have a dozen children, in the hope that a few would survive into adulthood.

Hardly anyone questioned the morality or usefulness of this extensive economic control. Most everyone believed that if government didn't manage the economy, the plight of the poor would be even worse than it already was. Perhaps most important, hardly anyone questioned the authority of the king to regulate people's economic affairs, because he was the ruler and they were his subjects. The common mindset was that rulers ruled and people obeyed.

Adam Smith and economic liberty

Then along came Adam Smith and turned the world upside down with one of the most revolutionary ideas in history. Smith said that the reason people had remained mired in poverty throughout the ages was that governments had waged war against poverty. If people would only prohibit government from waging war on poverty, Smith argued, the standard of living of people would soar. That was the key, he said, to the nature and causes of the wealth of nations.

Would there be chaos if governments were not managing the economy? No, because the "invisible hand" of the market would coordinate the economic affairs of the people. Would producers fail to provide essential items if government did not direct them to do so? No, because it would be in their self-interest to produce what other people were willing to buy.

Would the poor be gouged without price controls? No, because prices were simply market signals to producers and consumers. If prices were high, producers would produce more and consumers would consume less. If they were low, producers would produce less and consumers would consume more. The market would balance supply and demand.

Rather than subsidize inefficient businesses, Smith suggest-ed, the consumer, through his buying habits, should decide which producers and sellers remained in business.

Entrepreneurs and speculators provided a vitally important service, Smith suggested. Their role was to more quickly anticipate market conditions and to assume the risk of market changes, which resulted in more efficient use of resources. They also provided a degree of economic security for sellers. For example, by buying the farmer's crops on the outskirts of town, the middleman assumed the risk that the price would be lower by the time the items got to market.

When someone asked Adam Smith whether he would see the triumph of his free-market ideas in the near future, he responded that it would be a long time before the world would see the triumph of his philosophy. After all, not only had people been living in a managed economy for centuries, not only did they believe that it was beneficial to them, not only did they believe that the king had the sovereign right to regulate their affairs, but also multitudes of people both inside and outside government were dependent on the mercantilist system. It is not difficult to understand Smith's pessimism.

Yet within a relatively short period of time — some 50 years — Smith's economic philosophy of free enterprise prevailed. Virtually the entire mercantilist structure came crashing down, especially in Great Britain. Laws and regulations governing economic affairs were repealed. In England, this was primarily due to the political efforts of two Englishmen — Richard Cobden and John Bright, who traveled the nation explaining the benefits of free trade.

The triumph of economic liberty brought phenomenal, almost miraculous, results, especially for those at the bottom of the economic ladder. Despite all the bad things that have been said about the Industrial Revolution, the truth is, the standard of living of poor people throughout the 19th century soared. The mistake that critics of that period make is to compare living standards of the 19th century with those of the 20th, when the accurate comparison is between the 19th century and the centuries that came before it. Compared with the past, people during the Industrial Age were not only surviving, they were living longer and actually prospering.

Two revolutionary ideas

The most dramatic outcome of Smith's ideas took place in the United States. The confluence of two revolutionary ideas published in the same year — the Declaration of Independence and *The Wealth of Nations* — brought into existence the most unusual society in history, one that would do more to alleviate the suffering of the poor than anyone could have ever imagined.

The Declaration proclaimed the revolutionary idea that man's rights of life, liberty, and the pursuit of happiness came not from government but instead from Nature and Nature's God. The purpose of government was to ensure the exercise of such pre-existing rights by capturing, prosecuting, and punishing violent people who interfered with such rights. Since people's rights pre-exist government, government could not legitimately control them or take them away.

By the time 1787 came along, those two revolutionary ideas — one political and the other economic — had gripped the hearts and minds of the American people. Thus, when the Constitution called the federal government into existence that year, the Framers were primarily guided by the political philosophy expressed in the Declaration of Independence but, at the same time, were deeply influenced by the economic philosophy of Adam Smith.

Despite the tragic and ultimately costly exception of slav-ery, the result was the freest society in history. For most of the 19th century, there were no occupational licensure laws — that is, people were free to engage in any occupation without asking for government permission. Lawyers, doctors, farriers (people who shoed horses), gunsmiths, restaurant owners, alcohol and tobacco sellers, and everyone else could enter into business simply by opening up shop. This was what was once meant by the term "free enterprise." Through their buying and abstention from buying, the consumers, not the government, decided which businesses succeeded and which ones failed.

There were virtually no regulations on economic activity. People were free to enter into mutually beneficial economic transactions with one another, and it was none of the govern-ment's business. People believed that "liberty of contract" was a right, not a privilege. The practical consequence of liberty of contract confirmed a thesis set forth by Adam Smith — that through the simple act of exchange, the standard of living of people rises.

For example, suppose that one person had 10 apples and another person had 10 oranges and that they traded 3 apples for 3 oranges. Both of them gained from the trade because they had both improved their respective positions. Their standard of living had risen through the exchange. Thus, Americans figured out that to the extent government regulations interfere with mutually beneficial trades, people's standard of living is reduced.

There were no taxes on income. No withholding tax. No Internal Revenue Service. No income tax returns. People were free to accumulate unlimited amounts of wealth from the enterprises in which they were freely engaged and through the trades into which they were freely entering with others. And there was nothing the government could do about it, because the supreme law of the land — the Constitution — did not permit the federal government the power to impose a tax on people's income.

No welfare. No Social Security. No Medicare and Medicaid. No monopolies. Relatively few government subsidies (railroad grants being a notable exception). There also were no drug laws, virtually no public schooling, no immigration controls, and no travel restrictions, including passports.

That is what it once meant to be an American. That is what it once meant to be free. That was the concept of liberty that Americans once celebrated every year on the Fourth of July. It was not to last.

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