The Laissez-Faire State, and Thomas Philippon's 'The Great Reversal'

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"Since the 'father' of modern economics, Adam Smith, developed his theory of free market exchange, the question of the role of the government in protecting or interfering with the free market has kept economists busy. Jennifer Waters contributes to this debate in an analysis of EU and US governmental attitudes towards corporate influence in policy making. In contrasting the union versus state organisations, Waters gives insight into how different free-market interpretations lead to stark disparities in spending and power of corporations at the legislative level."

Introduction

In this essay I will argue against Thomas Philippon's conclusion in *The Great Reversal: How America Gave Up on the Free Market* and instead affirm America did not 'give up' on the free market but became a full-fledged laissez-faire state - with all the anti-competitive consequences it entails (2019). I will argue that a laissez-faire state is placed in an impossible position, to be both hands-off, as well as ensure that appropriate conditions of competition remain in place. I hold that the American laissez-faire state cannot appeal to independent standards of competition despite being required to perpetuate the invisible hand, making corporate lobbying and campaign finance the only way to legitimise its economic interventions. This then blurs the distinction between state and market and reveals the susceptibility of corporate influence consequently undermining the values of a laissez-faire state philosophy by its own criteria.

The Laissez-Faire Philosophy

Adam Smith's *Theory of Moral Sentiments* claimed that human morality is consequential to social interaction. Smith claimed that, humans are social creatures and that our tendencies for self-preservation work in conjunction with sympathy – what we would now consider 'empathy'- towards others. Smith claimed that human 'self-interest' was sympathetic in nature and that our judgements and assessments of values incorporate the standards of 'justice' and 'conscience' we attain from social interaction. Because human self-interest assumes sympathy, our interactions and decisions inherently consider other people's conditions, making our decisions and values 'beneficent.' (Smith, 1759).

Smith's view of 'beneficence' and sympathetic self-interest characterise his perspective towards market exchange, as well as the market competition underlying his invisible hand thesis made in his book on political economy, *Wealth of Nations*. The invisible hand thesis states;

> 'Every individual necessarily labours to render the annual revenue of the society as great as he can… he intends only his own gain, and he is in this… led by an invisible hand to promote an end which was not part of his intention.' (Smith, 1776)

The values of two individuals engaged in an exchange, acting in their own self-interest, would promote the beneficence of society by nature of their own self-interest. The integrity of that exchange, however, rests on it being uninterrupted by outside forces - like governmental restrictions. For Smith, exchanges on an individual scale ensured a mutually beneficial interaction, and the understanding of value was not through money, but through labour. Smith distinguished between real and nominal value, claiming that money was only a speculative price, where labour was the root purpose of money. While silver and gold varied,

> 'Labour alone, therefore, never varying in its own value, is alone the ultimate and real standard by which the value of all commodities can at all times and places be estimated and compared. It is their real price.' (ibid)

Labour, although the true value of commodities, had no metric, making any exchange highly relative and highly individualised in value, demanding unrestricted decision-making processes between both parties in order to retain its being 'mutually beneficial.' The integrity of exchange between corporation and customer was considered axiomatic in nature. Market competition in this sense would be dictated by what is mutually beneficial for society. Any dominance of a particular corporation would be by its own merit and the benefits it provides to individuals and, therefore, society as a whole.

In this way, corporate decisions could be considered representative of their customers. Discipline to corporations was disavowed as the actual nature of a corporation was considered to be composed of the needs of its customers and adjusted to accommodate new needs. Outlined by Smith; 'the real and effectual discipline which is exercised over a workman is not that of his corporation, but that of his customers.' (ibid). Further, any advantage a corporation had in the marketplace was because of the value it provided for its customers.

Smith's invisible hand and its assumptions of 'exchange' and 'competition' epitomises Smith's underlying philosophy about humanity's social nature and moral character. Patterns of exchange in a broader, social scale by this interpretation can be seen as the manifestation of social convention borne from beneficial social values. In this way un-patterned distributions can be defended due to the axiomatic integrity of 'exchange' and governmental intervention can be seen as disrupting not just the merits behind competitive advantage in the marketplace, but social values and social norms.

Laissez-Faire Legitimacy

Smith's invisible hand thesis and the market's symbolic value of citizens made the state's legitimacy contingent on its non-interference of exchange and competition, the 'hands-off' laissez-faire state. The social removal of the state from the exchanges themselves meant a state's management and restrictions of the localised transfer of money was detached from the ultimate understanding of value: sympathy. Despite the marketplace being considered the manifestation of social values, it could only be so when its emergence is regarded as having axiomatic integrity, namely the beneficence of sympathetic exchange – to regulate the market was to regulate the values of citizens. Any efforts for the state to ultimately regulate labour in Smith's morally derived economic system would be 'a manifest violation of that natural liberty which it is the proper business of law not to infringe but to support. Such regulations may, no doubt, be considered as... a violation of natural liberty.' (ibid).

Now a legitimate state could only be defined through its preservation of its market, as it could only legitimately 'support' the 'effort of every man to better his condition... powerful enough to maintain the natural progress of things towards improvement' (ibid). However, for a laissez-faire state to legitimately 'support' an invisible hand mechanism and 'maintain' the natural progress, it must be put into a conflicting position. Inherent to supporting the invisible hand is perpetuating an emergent phenomenon - the state cannot be 'hands off' and 'maintain.'

It is because of Smith's views on human nature and sympathy underlying market exchange and corporate competition that his politico-economic ideology conflicts. To ensure there is an evolution of competition guided by the invisible hand, the healthy entry and exit of new and old businesses must be held to a standard of efficiency and dictated by the popularity derived from the benefits of its consumers. The government must intervene on companies acquiring too much market power or even monopolistic tendencies. However, by doing so, it risks its legitimacy as a distinct laissez-faire state. For the laissez-faire state to do its duty, the state would be required to abstain from doing its duty.

The Solution and its Consequences

How then could a laissez-faire state legitimately perpetuate the invisible hand? The only way it seems for a laissez-faire state to do its duty and perpetuate an invisible hand mechanism would be for the distinction between a political entity and economic entity to blur. In other words, the state must incorporate lobbying and campaign financing.

The state cannot appeal to any standards of its own to justify intervening in the marketplace. Therefore, the only way a laissez-faire state could properly support the free-market and legitimately take action to preserve the invisible hand's integrity is to intervene by the standards set by the marketplace and encourage incumbent corporations who have competitive advantage. Competitive advantage in the invisible hand model is symbolic of the social value that corporations provide. If the laissez-faire state's standards are absorbed into the needs and values of large corporations, any intervention justified by the demands of corporations cannot be considered a transgression against the personal liberty of their consumers.

Lobbying is essentially corporate petitioning to inform economic regulations and governmental policies on issues they consider to be of interest. Inherent to the interests of the corporations, adhering to Smith's philosophy, is the values of the consumers. Frequent discussions of lobbying pertain to the revision of existing laws or policies, taxation, and addressing whether a particular industry is subject to economic 'shocks' and requires protection through tariffs or subsidies. Lobbying provides corporations direct influence over the state and in turn, legitimises a laissez-faire state's interference with the market.

Campaign finance is an indirect way corporations can influence the state and its policies. By funding particular candidates, corporations ensure that their voices are heard, and taken into consideration in the debate surrounding new policies being drafted, or current policies being enforced.

Although lobbying and campaign finance enable the laissez-faire state to do its duty, their political influence may provide them the opportunity to stifle competition and work against the interests of their consumers. Rather than corporations modifying and enhancing their practices and products to best suit the needs and demands of society and consumers, they can instead focus their efforts towards preventing competitive pressures from arising. They can promote the political establishment of higher barriers for entry for new corporations; increase their profits by way of tax breaks rather than efficiency; and stifle competition by merging with potential companies they consider to be threatening.

If a corporation leverages their political influence to circumvent fair competition, the nature or philosophy underlying the value of a laissez-faire state in the first place is threatened by the very thing Smith reviled - monopolies. Put another way, the laissez-faire state's legitimate intervention leaves it susceptible to its own subversion.

The 'Reversal'

Thomas Philippon in his book *The Great Reversal: How America Gave Up on the Free Market,* provided evidence that in the past 50 years, corporations in America were using their political influence to circumvent and stifle fair competition, concluding that America 'gave up' on the free market (2019). The shift of corporate priorities is evidenced by the proportion of corporate expenditures designated to lobbying, and the current concentration of marketplace power. Philippon found,

> 'Lobbying expenditures are three times more concentrated than revenues, which are themselves already fairly concentrated. This means that large firms play an even more outsized role in the political system than they do in the economy itself.'(ibid)

Philippon is wrong in describing the end of the free market in America. Instead, America became a truly laissez-faire state. Corporate political influence in America is not a rejection of the invisible hand ideology. The state is incorporated into the market and a political free market emerges. This incorporation, however, entails ideologically conflicting consequences.

State versus Union

The following sections will analyse Philippon's comparative analysis between lobbying in the United States and the European Union. These entities are examples of laissez-faire *states* and laissez-faire *unions*, respectively. The disparity between lobbying in the EU and the US can be traced to the differing standards governments are able to appeal to and justify economic intervention. Laissez-faire *states* are bound to the standards dictated by the market to retain legitimacy, as their regulation agencies must be centralised and federal. Whereas a laissez-faire *union* can appeal to independent standards of ideal competition and remain legitimate, as its regulation agencies can be decentralised and independent from its member states. Philippon argues that the EU is less corrupted by the political interference of corporations because its regulating agencies are supranational and independent. Following this logic while investigating the structure that makes independent standards of competition possible for legitimate intervention, the variable we need to consider is not how 'free' the free-market is, but how the structure of government seeks to 'maintain' competition. A laissez-faire *union* makes regulation agencies less dependent on corporate lobbying and campaign finance to justify economic intervention, which then leads me to disagree with Philippon that the degree of freeness does not change between the EU and the US, but the EU upholds competitive standards differently as a result of its *union* organisation. America 'giving up' implies the state could make the choice. Philippon attributes this shift in competition to an agency the state does not, and cannot, possess when adhering to Smith's politico-economic ideology.

The European Union is a union between 27 Member States. One of the main priorities of the EU was to establish the Single Market, or a free trade agreement between the 27 Member States, as well as Iceland, Lichtenstein, Norway, and Switzerland. The Single Market eliminated border tariffs and facilitated the unrestricted movement of goods and services between the participating members. The presence of the Single Market establishes a broader domestic market with more diverse resources in each state, and consequently forces each of its member states to relinquish a portion of their 'sovereignty' when regulating imports and exports. This means that within the EU, corporate and industry regulation is not undertaken at a state, or federal level, but at an independent, supranational level. The political independence of regulatory agencies seeks to limit partisanships - tax breaks, corporate influence, favourable policy, etc. - between other member states with the regulation agency. The result of this non-partisanship is that MEPs in any Member State have a far reduced influence on the investigations of the regulation agencies.

Philippon's comparison between US and EU lobbying can be considered to follow a 'follow the money,' quantitative approach. Regarding US lobbying, Philippon (2019: 169) finds, 'total lobbying expenditures for only twenty states in the US (which account for 58 percent of US GDP) totalled $1.43 billion in 2016—nearly as much as total lobbying to the EU.' Upon further investigation, Philippon (2019: 173) argued that lobbying did in fact carry heavy impact on industry and economic regulation, favouring corporations. He found that; 'If our estimates are correct, increases in lobbying can thus account for most of the decrease in enforcement in the US.'

Regarding the condonement of the corporation's political influence in the US, Philippon mentions the 2010 case of Citizens United vs Federal Election Commission (FEC). This case symbolises the tensions inherent to a laissez-faire *state* with respect to Smith's moral and political philosophy. The Supreme Court referenced the free-speech clause of the First Amendment in order to claim that restricting expenditures of non-profit, for-profit, labour unions, and other associations for political endorsements and partisan advertisements was a transgression against business communications, therefore the *individual liberty* of free-speech. The case was controversial, winning 5-4 in the Supreme Court. As said by Philippon (2019), 'for its proponents, [the Citizens United case] was a defence of the First Amendment. For its critics, it basically legalised corruption'.

This ruling is not an early indicator of 'reversal,' or 'giving up,' by the requirements of a laissez-faire *state*, it is the continuance of Smith's philosophical criteria. Smith's state is charged with 'maintaining' competition itself, meaning the US's regulation agencies are federal. The Federal Trade Commission, or FTC is a commission composed of political appointees from both the Republican and Democratic party which monitors business practices and settles disputes involving corporate mergers, acquisitions, and cases accusing corporations of anti-competitive behaviour. The FTC's position in a laissez-faire *state* means it is subject to the wills of elected officials who are influenced by the corporations it is investigating. Elected officials, whose campaigns were financed by corporations, can strongly encourage the FTC to stop investigations into corporations (Philippon mentioned Google). This lays bare the consequences of involving corporations in the regulatory process as implied by Smith's work.

When comparing campaign finance in the US and the EU, Philippon (2019) found, 'If differences in lobbying expenditures between the US and the EU are large (a factor of two, or three for corporate lobbying, as we saw in Chapter 9), differences in campaign contributions are staggering'. Comparing legislation in the EU, Philippon (2019) highlighted that the EU prohibited corporate contributions to campaigns and enacted lower spending costs per parliamentary candidate, reducing campaign spending from 22,00 euros to 10,000 euros.

His evidence left him this graph:

194 · POLITICAL ECONOMY

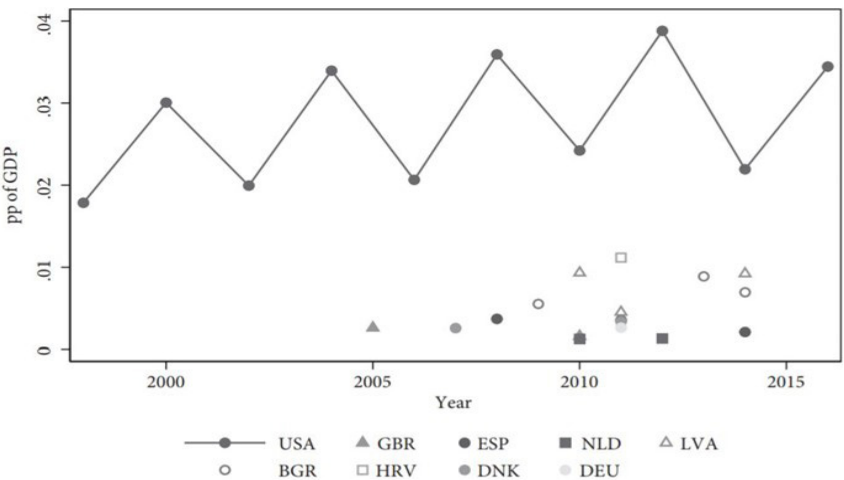

FIGURE 10.5 Total campaign expenditures divided by GDP. *Data sources*: US, Center for Responsive Politics; EU, EU Parliament (2015). For Germany, see Bundestags-Drucksache (2013).

Source: Philippon (2019)

Concluding Remarks

The philosophy behind Smith's invisible hand thesis, the mechanism of a free-market, and the extent of his faith in that mechanism is grounded in his belief that acting in mutual beneficence is inherent to human's social nature. For Smith's economic beliefs to fail, his philosophy on human nature would fail also. I must also emphasise that Adam Smith was far more pragmatic about state intervention in *Wealth of Nations* than is commonly understood, providing a 'long list of exceptions' for a laissez-faire *state's* intervention, while retaining his philosophy of the state's legitimacy (Reisman, 1998). Whether these exceptions are considered or not, however, I maintain my position that America is *truly* laissez-faire *state*.

References

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