

# THE ECONOMIC LIBERALISM AND THE EVOLUTION OF ITS CONTENT

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## Abstract

The concept of liberalism underwent many changes with respect to both temporal and geographical circumstances and its fundamental characteristics gradually evolved. The goal of this paper is to illustrate the inception and groundwork of the European understanding of the concept in 18th and 19th centuries and also the European development, which led to the general adoption of some measures that are designed to protect the weaker party but at the same time preserve the market system as such. In contrast to that stands the development of the American branch of liberalism, which acquired a different meaning following the 1920's and today stands for an interventionist public policy and criticism of capitalism. As a consequence, contemporary American authors use the term libertarianism or classical liberalism for the original European branch. The paper demonstrates its theses on the examples of basic ideas of the main proponents of the tradition. These are “Theory of Moral Sentiments” (1759) and “An Inquiry into the Nature and Causes of the Wealth of Nations” (1776) by Adam Smith, which explains the conflict of selfish and altruistic motives in human behaviour, (i.e. "Adam Smith Problem"), “Groundwork of the Metaphysics of Morals” (1785) and “Metaphysics of Morals” (1797) by Immanuel Kant, which provides insight into his idea of the moral imperatives, “Utilitarianism” (1863) and “The Principles of Political Economy” (1848) by J. S. Mill, which explain the idea of the utility principle. Finally summary is provided with regards to the laissez faire ideas of Physiocrats and J. B. Say. The contrasting American branch is demonstrated using the work of J. Dewey.

**Key words:** classical liberalism; J. Locke; A. Smith; J. Dewey

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## Introduction

The term "economic liberalism" is one of the very common terms in discussions and articles by economists, philosophers and social scientists. Yet it has no uniform definitional content.

The aim of this paper is to find the original foundations of the different understanding of the concept of economic liberalism in Europe and in the USA, based on the analysis and methodological comparison of the ideas and theoretical works of the so-called "fathers of liberalism" of the 18th and 19th centuries on the European continent and in the USA in the first half of the 20th century. In addition to the original works, the article draws on the seminal synthetic literature. From the historical general literature, the original work on liberalism is L. T. Hobhouse's 1911 (1919). Among contemporary authors, various approaches and definitions are given by Duncan Bell (2014), and a modern analysis of European economic liberalism according to the various "fathers of liberalism" has been made by Helen Rosenblatt of the City University of New York (2018, 2019). Studies on individual figures abound. Keith Tribe (2008) has drawn attention to the debate among German social scientists in the 1850s–1890s over the work of A. Smith. In terms of American roots, Roberto Frega (2017) analyzed Dawey's social philosophy and the influence of J. Bentham and J. St. Mill on the one hand and the Frankfurt School on the other.

Liberalism *per se* is also the starting platform for other political and legal considerations (e.g. Buchanan, 2001; Hayek, 1948, pp. 107-118). Here, the sphere of the individual and the sphere of society meet and the legitimacy of state economic activity and public intervention is justified on the basis of a democratic legal order.

## 1 European Roots

There is no universally "codified manifesto of liberalism" that provides a clear and unifying starting point for this tradition of thought. However, it is generally agreed (e.g. Bell, 2014, pp. 682-715) that the first 'father of liberalism' was John Locke (1632–1704). He was a typical representative of the natural-rights tradition of liberal thought. A fundamental postulate of Locke's philosophy and political theory is the assumption that men are born naturally free, equal in rights and duties, and independent (Locke, 1924, p. 164). In terms of economic liberalism, the key chapter in the second part of his "Two Treatises of Civil Government" [1689] is Chapter Five, "Of Property". Here he extensively analyzed the nature of private property, its acquisition and protection, and the discovery and use of money (1924, p. 129ff). Interestingly, Locke did not use the term "liberalism" for the socio-economic concept he was describing, but called it by the contemporary progressive name "civil goverment" (Locke, 1924, p. 118).

A major turning point in the history of liberal thought happens with the work of Adam Smith (1723–1790). Key works of A. Smith are “The Theory of Moral Sentiments” [1759] (2005) and “An Inquiry into the Nature and Causes of the Wealth of Nations” [1776] (2001). If one proceeds only from the “An Inquiry into the Nature and Origin of the Wealth of Nations” with the central idea of the so-called invisible hand of the market, which guides the (selfish) actions of individuals to a socially optimal outcome, regardless of the primary motive of the individual's actions (Smith 2011, p. 398), one gets into the so-called “the Adam Smith Problem”. It is the question of whether, according to Smith, a person is selfish or, on the contrary, sympathetic and sensitive towards other people (Tribe, 2008; Teichgraeber, 1981). It is a mistake to consider only Smith's economic text in “The Wealth of Nations” and to ignore “The Theory of Moral Sentiments”. On the contrary, the basic methodological work that generically determines the interpretation of Smith's other ideas is the book “The Theory of Moral Sentiments”. Indeed, human action is subject to a double test in Smith's teachings. First, the selected action is judged by the criterion of justice, which is elementary and serves to ensure the functioning of human society (Smith, 2005, pp. 94-99). The second stage is morally good human conduct. This must be just too, but in addition also must have other virtues depending on the action in question, e.g. friendship, charity, generosity, etc. (Smith, 2005, p. 20 ff). A just action can be enforced on any individual; a morally good action must be a reflection of the individual's free will and is unenforceable. This also means, therefore, that the individual must be left room for the expression of his free will if he is to be allowed to be a morally good person, so he must be guaranteed a certain sphere of personal autonomy, which is bounded by the limit of just action (Smith, 2005, p. 143). Even such an action that is driven by self-interest (self-love) can serve the interests of society as a whole if it meets the criteria of justice (Smith, 2005, p. 143, 334). This is also why Smith chose the title “The Wealth of Nations” for his next book, because individual – just and morally good – action leads to the wealth of the whole society. In “The Wealth of Nations” he deals with the relationship of the state to the economic system. According to A. Smith: *“The third and last duty of the sovereign or commonwealth is that of erecting and maintaining those public institutions and those public works, which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature that the profit could never repay the expense to any individual or small number of individuals should erect or maintain.”* ... *“the order works and institutions of kind are chiefly those for facilitating the commerce of the society, and those for promoting the instruction of the people. The institutions for the*

*instruction are of two kinds: those for education of youth, and those for the instruction of people for ages.*” (2001, p. 641-2).

Among facilities that facilitate trade Smith included transportation infrastructure (roads, bridges, canals, and canals) and the costs of foreign trade (for ambassadors and allowances for naval forts and the granting of temporary exclusive licenses to trading corporations). This, among other things, gave A. Smith the answer to whether, and how, the state should be involved in a country's economy (Smith, 2001, pp. 642-674).

Although Smith's contemporary, the moral philosopher Immanuel Kant (1724–1804), is not much remembered by economists, it should be noted that he also shaped the continental philosophical tradition of economic liberalism. Kant places as the cornerstone of his moral philosophy the idea, that man is endowed with free will, reason and the ability to control his actions. The reference point of human action is the so-called *categorical imperative*. He complemented the autonomy of the individual with the problem of a set of rights and duties of man embedded in a social (rather republican) system which is established by social contract and where there is a division of power into legislative, executive and judicial (Kant, 1996, p. 91). He defined the commonwealth with principles of the civil state as: 1. the freedom of each member of society as a human being; 2. the equality of each with all others as a subject; 3. the autonomy of each member of the political community as a citizen. At the same time, in the spirit of the time, he excluded women and children from the active civil community on the grounds of nature, and the landless and the poor on the grounds of property – they are only passive citizens (Kant, 1996, p. 92).

John Stuart Mill (1806–1873), a representative of the classical English political economy of the mid-19th century, understood the individual (like J. Locke, A. Smith and I. Kant) as a being endowed with free will and capable of acting on the basis of a range of motives. Unlike them, John Stuart Mill did not base his conception of liberalism on notions of natural law or the innate nature of human freedom. He builds it on Benthamite utilitarianism, that is, on the utilitarian motive that guides human action. The principle of maximum utility or happiness for maximum persons forms the backbone of his moral system. Although Mill's work is not entirely consistent (Hobhouse 1919, p. 107), and some of his ideas have also become the source of socialist and collectivist doctrines, on a practical level his doctrine nevertheless leads to conclusions similar to those reached by the authors of the natural law tradition mentioned above. For the first time in Mill's work there is an emphasis on individual freedom (including for women) as a means of serving the social good through the process of

discovery. The principle of the spontaneous process of discovery in economic reality was picked up less than 100 years later by Hayek (1948, p. 111 and p. 270) and other representatives of the Austrian School.

## **2 Liberal Theory Versus Practical Implementation**

After the Great French Revolution and the revolutionary year of 1848, the question of how to practically organize and legally ground the social order as to conform to the theoretical considerations of the "fathers of liberalism", i.e., to support, in the first place, the freedom and autonomy of each individual so defined, comes to the fore in the second half of the 19th century. There has never been perfect agreement among individual thinkers or politicians as to where exactly the boundary lies between the sphere of autonomy and the sphere of coercion by public power.

On the one hand, there has been a desire to put into practice the pure principle of *laissez faire*, that is, to abandon state-directed economic policy and instead let economic processes run their natural course. This was recommended by the Physiocrats in the mid-18th century as a reaction to the negatives of the activist mercantilist state policy of 17th century France. They were among the first to come up with the concept of the economy as a system that naturally tends towards balance and harmony, with interference with the course of this system leading to its disturbance and inefficiency. The role of the public authorities in the economic sphere is therefore limited to the minimum necessary sphere, i.e. the provision of internal and external defence and justice services (in particular the enforcement of contracts and protection against fraudulent practices). Further justification for *laissez faire* policies was provided in the early 19th century by Jean-Baptiste Say (1767–1832), who argued that an economy without state regulation tends to macroeconomic equilibrium and harmony in the long run ("Say's Law of Markets").

The implementation of *laissez faire* principles in their pure form never happened. Adam Smith was not a doctrinaire advocate of *laissez faire*. As noted earlier, he explicitly allows for public authority to be active in providing desirable goods or services that the market for some reason cannot provide (Smith, 2001, p. 641). In addition, Smith advocates other measures that are incompatible with pure *laissez faire*, such as the legal capping of interest rates in credit or loan contracts (Smith, 2001, p. 312). Similarly, one cannot attribute pure *laissez faire* to Immanuel Kant when he explicitly allows for the possibility of taxing wealthy individuals in order to ensure the security of those who for some reason cannot

provide for themselves (Kant, 1996, p. 101). Similarly, J. S. Mill allowed for a number of cases where public action is desirable, for example in education. He also allowed for the regulation of natural monopolies and network industries to serve the general good (Mill, 1900, pp. 602, 617).

European liberalism, then, did not exclusively imply an economic order along the lines of a pure application of laissez faire. The ideal liberal economic order was based on the legal establishment of the free functioning of the market mechanism and on private property. Restrictions on property rights, or outright expropriation, were always only an exception to this rule and had to be carried out on the basis of law and in return for compensation. Prices are naturally formed in a competitive market mechanism and there is a tendency for the market system to reach a long-term macroeconomic equilibrium. The basis of economic relations are the actions and responsibilities of the individual. Public power may have some economic functions, but always only complementary and never dominant.

### **3 American Liberalism**

Liberal thought in the United States has undergone a different development compared to Europe, which in turn has led to significant differences in the content of the concept of "liberalism". And this difference persists to this day.

American liberals did draw from the European tradition, particularly the work of John Locke, whose work served in part as the philosophical basis for the Declaration of Independence and the very conception of the US constitutional system. However, they began to address issues of a primarily social nature. In the first third of the 20th century, American authors began to draw on indigenous American sources, especially the economic so-called Institutional School, which was formed around the economist Thorstein Veblen (1857–1929). The latter criticised the neoclassical school of economics, its ahistoricism, the laissez faire principle and the concept of the invisible hand of the market. He advocated a different approach to economics that emphasised the role of social institutions (customs, established practices and non-economic, mainly psychological motivations of market actors). He criticized the capitalist conditions of the time and advocated the obligation of the state to actively support good institutions ('industry') and regulate and suppress bad institutions ('business'). A typical representative of this American "new liberalism" was John Dewey (1859–1952), who is otherwise known as a theorist of the so-called pragmatism. Dewey's ideas had many similarities with Veblen's theory. Both were among the founding members of

"The New School for Social Research", which was founded in 1919 in New York City and from the beginning was conceived as a research and educational center for American thinkers of the progressive liberal thought.

In addition to the philosophical treatises that later made him famous, Dewey did not shy away from analyzing social issues. The question of the nature of the economic order itself was an important one. In his treatise "Liberalism and Social Action" (1935), Dewey traced the development of American liberal thought from its first inspiration by John Locke to the time when the liberal movement split between traditional (original) advocates of restrained public policy and progressive writers. Progressive writers advocated active public (state) policy aimed at improving the material status of the most disadvantaged members of society. This distinguished British and American liberalism: „*American liberalism as illustrated in the political progressivism of the early present century has so little in common with British liberalism of the first part of the last century that it stands in opposition to it.*“ (Dewey, 2000, p. 30-31). Progressive American writers retained the label "liberalism" and still consider themselves legitimate continuators of the liberal tradition.

Dewey understood the concept of freedom as historically relative, with the sources of perceived oppression changing over time, and liberalism, he argued, must respond to these changes by adapting its programme. *“If we employ the conception of the historical relativity, nothing is clearer than the conception of the liberty is always relative to forces that at a given and place are increasingly felt to be oppressive. Liberty in the concrete signifies release from the impact of particular oppressive forces; emancipation from something once taken as normal part of human life, but now experienced as bondage.”* (Dewey, 2000, p. 54). At the same time, Dewey understood freedom primarily as a means to self-realization and the related leading of a morally and emotionally valuable life of the individual (2000, p. 57).

Dewey was a critic of the capitalist establishment and saw the logical outcome of the liberal program as an economic order with socialized factors of production that is consciously constructed to ensure the development of each individual and thus of society as a whole. Dewey explicitly stated: *“But the cause of liberalism will be lost for a considerable period if it is not prepared to go further and socialize the forces of production, now at hand, so that the liberty of individuals will be supported by the very structure of economic organization.”* (Dewey, 2000, p. 88). This strand of liberalism became so popular in the US that liberals in the original (European) sense of the word began to use the term "libertarian" to refer to their

views and orientation, and left the label "liberal" to be used in American discourse precisely for this sort of activist and progressive public policy.

## **Conclusion**

The term "liberal" has taken on different content in different historical stages and in different socio-political contexts. The concept of 'liberalism' has changed both over time (18th to 20th centuries) and depending on the territory, and its fundamental characteristics have gradually been refined. In the 18th century, the theoretical cornerstone was the natural-law philosophy and the ideas of J. Locke, and in economic liberalism especially the ideas of A. Smith. Economic liberalism in this mainstream form was not reduced to a primitive rejection of public power in the economy. Fundamental to a practical understanding of the concept of liberalism are the two revolutions that ended the eighteenth century and changed the political map of the world at the time: the American War of Independence (1775–1783) and the Great French Revolution (1789–1799). They shared the same basic ideas of the assertion of individual liberty, the abolition of feudal privileges, the gradual democratization of the aristocratic character of the social order, and the separation of church and state. These events resulted in a politically turbulent time, during which the first political movements and parties, that promoted the ideas of freedom and equality, were formed. Along with the formation of liberal political parties came the formulation of their political programs, which became the political and economic doctrine of liberalism and were usually described as right-wing. Their common denominators were, in particular, individual liberty and responsibility, constitutional representative government, freedom of speech and association, and the possibility of free enterprise, although there were disagreements between the various authors and parties about the form of their implementation, disagreements about how to achieve these goals, and the definition of the range of citizens involved in government and decision-making (electoral procedures, how the property census would be applied, the nature and protection of property rights, whether and how women or people of non-European descent could engage in business, etc.). The mainstream of liberal philosophy of the 19th century always allowed for some state intervention in the economy and economic life, but there always existed disagreement among liberal theorists and practitioners about the practical application of these theories.

Further developments in the European environment have led to the adoption of certain powers of public authority to intervene to protect the weaker party, but still within the framework of the market economy system. The market economy remained the basic desired



'liberal model' of economic organisation, supplemented only by elements of public regulation and social security. In the USA, from the first half of the 20th century onwards, the new socially progressive order became the desired 'liberal model', and when a European and an American nowadays speak of liberalism in general, they usually mean a very different set of ideas and policies.

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