

# Adam Smith, Justice, and the Moral Foundations of Economic Coordination

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## Abstract

Adam Smith is frequently portrayed as a theorist of market efficiency and self-interest. This interpretation understates the moral and institutional foundations that Smith regarded as necessary for markets to function. Drawing on *The Theory of Moral Sentiments*, *An Inquiry into the Nature and Causes of the Wealth of Nations*, and the *Lectures on Jurisprudence*, this article argues that Smith understood economic coordination to depend on justice expressed through general and enforceable rules. Markets function only when property is secure, contracts are enforced, and laws are impartially applied. Justice is therefore not an external support to markets but a necessary precondition for their operation. By clarifying the institutional role of justice and general rules, this article offers a more complete account of Smith's moral theory and situates his political economy within a broader tradition of rule-based governance.

**Keywords:** Adam Smith, justice, economic coordination, institutions, rule of law

## Introduction

Adam Smith is widely associated with the claim that markets coordinate economic activity through self-interest. In contemporary economic debates, the “invisible hand” is often interpreted as a mechanism through which decentralized incentives generate socially beneficial outcomes without centralized direction. While this interpretation captures part of Smith's insight, it risks separating economic exchange from the moral and legal framework within which Smith believed markets must operate (Fleischacker, 2013).

Smith's central concern was how social order is maintained while individuals pursue diverse and often competing interests. Markets require more than price signals. They require stable expectations of personal conduct. Individuals must be able to rely on others to respect property, honor agreements, and refrain from coercion. These conditions do not automatically follow from self-interest. They depend upon justice and a system of enforceable rules protecting persons and property (Smith, 1759/2002; Smith, 1776/1976).

Modern scholars increasingly recognize that Smith's view of political economy cannot be separated from his moral philosophy. Griswold (1999) and Hanley (2016), for example, argue that Smith's economic analysis presupposes moral judgment. Haakonssen (1981) situates Smith within a broader tradition of general law and institutional order, while Otteson (2002) emphasizes the importance of moral character and legal constraints within Smith's philosophy. Building on this literature, this article argues that justice, understood as a system of general and enforceable rules, functions as a necessary precondition for economic coordination. Markets are not autonomous mechanisms but institutional systems structured within the rule of law to limit discretion and stabilize expectations.

Rather than treating markets as autonomous mechanisms, this paper clarifies that markets themselves are institutions structured by law. Economic coordination emerges not simply from self-interest but from self-interest operating within predictable and impartial rules. By emphasizing the institutional role of justice and general rules, this article contributes to contemporary discussions of rule-based governance and the institutional foundations of economic coordination.

### **The “Adam Smith Problem” Reconsidered**

The relationship between *The Theory of Moral Sentiments* and *The Wealth of Nations* has often been described as the “Adam Smith Problem.” Early interpretations suggested that Smith presented two conflicting frameworks: a moral theory grounded in sympathy and an economic theory grounded in self-interest. Contemporary scholars largely reject this interpretation. Griswold (1999) argues that Smith’s economic analysis rests on the foundation of moral conduct, while Hanley (2016) highlights the importance of virtue and prudence in Smith’s broader philosophical system. Fleischacker (2013) similarly contends that Smith understood markets to function within moral standards rather than independently of them.

Smith’s well-known butcher, brewer, and baker passage illustrates this point (Smith, 1776/1976, I.ii.2). The passage is often cited as evidence that self-interest alone sustains economic exchange. However, the example presupposes legal security and moral restraint. Exchange functions because individuals expect contracts to be honored and property rights to be respected within a framework established by justice. Economic coordination, therefore, depends not simply on individual incentives but on institutional conditions that stabilize expectations. Justice functions as the bridge linking moral behavior and economic interaction.

### **Moral Judgment and the Enforcement of Justice**

In *The Theory of Moral Sentiments*, Smith explains moral judgment through the concept of the impartial spectator (Smith, 1759/2002, III.1.6). Individuals learn to evaluate their behavior by imagining how their conduct appears to an objective observer. Through this process, social norms and expectations develop, moderating individual behavior.

Smith distinguishes between generosity and justice. Generosity involves positive acts of kindness, while justice concerns the avoidance of harm and the protection of rights. Because violations of justice produce direct injury, they may be punished (Smith, 1759/2002, II.ii.3.3). Justice, therefore, carries an enforceable dimension that generosity lacks. Smith further recognized that justice must ultimately be supported by governing institutions capable of enforcing legal rules and maintaining order.

This distinction becomes especially significant in complex societies. Small communities may rely on social norms and personal relationships to maintain cooperation. Large commercial societies cannot depend solely on these mechanisms. As economic interactions expand, reliable legal protections become necessary. Justice thus establishes the institutional foundation that enables markets to function.

### **General Rules and Legal Order**

Smith’s *Lectures on Jurisprudence* clarify the institutional importance of general rules in governing. Laws must be general, stable, and impartially applied. Generality reduces favoritism, stability enables planning, and impartial enforcement strengthens trust (Smith, 1759/2002, III.4.12).

Haakonssen (1981) points out that Smith's understanding of jurisprudence is grounded in general and impersonal rules that protect property and enforce contracts. These rules limit arbitrary authority while creating predictable conditions for social interaction. North et al. (2009) later describe the historical transition from personal and discretionary authority to impersonal and rule-based institutions as a critical step in economic development.

Smith anticipated this insight. When governing relies on predictable law rather than discretionary decision-making, individuals can make long-term decisions with greater confidence. As markets expand and economic specialization deepens, the importance of stable and impartial rules increases. Economic coordination becomes possible when individuals expect rules to apply consistently across persons and circumstances.

### **Justice, Political Privilege, and Market Distortion**

Smith's critique of monopolies illustrates how departures from general rules weaken economic coordination. In *The Wealth of Nations*, he criticized policies that granted exclusive trading privileges to particular groups (Smith, 1776/1976, IV.iii.c.9). These privileges undermine the impartiality of law by allowing governments to favor particular interests.

When governing depart from general rules, incentives become distorted, and expectations become unstable. Political favoritism disrupts competition and reduces confidence in the fairness of governments and economic institutions.

Modern research supports Smith's concerns. North (1990) finds that stable institutions reduce uncertainty and encourage investment. Acemoglu and Robinson (2012) argue that inclusive institutions protect property rights broadly rather than selectively. Similarly, Rothstein and Teorell (2008) conclude that impartial public institutions strengthen trust and voluntary cooperation. Like markets, institutions depend on rules that apply equally to all.

### **Predictability, Planning, and Economic Coordination**

Economic coordination requires individuals to make forward-looking decisions. Investment and innovation depend on expectations about future legal conditions. Predictable rules reduce uncertainty and lengthen planning horizons.

Smith's critique of the "man of system" illustrates his skepticism toward attempts to redesign society through discretionary authority (Smith, 1759/2002, VI.ii.2.17). Even well-intentioned government interventions can disrupt social and economic cooperation if they undermine stable rules.

Justice, therefore, performs a coordinating role in commercial society. By reducing uncertainty and stabilizing expectations, general rules channel self-interest into productive exchange. Economic order emerges not from centralized direction but from rule-governed interaction among individuals pursuing their own purposes.

### **Justice as the Framework of Commercial Society**

Justice structures the institutional environment of economic life. Moral values encourage restraint, while legal rules establish enforceable boundaries that protect individuals from coercion. Together, they define the conditions under which voluntary exchange becomes possible.

Justice does not guarantee prosperity or equality. Instead, it establishes the institutional conditions that sustain cooperation and economic exchange. Markets are, therefore, embedded within legal orders that

define permissible conduct and limit arbitrary power.

### Contemporary Institutional Implications

Smith's analysis of justice and general rules remains relevant to modern discussions of governing and economic stability. Today's economies depend on complex institutional arrangements that regulate property, contracts, and financial exchange. These arrangements function effectively only when legal rules are applied consistently and predictably.

Institutional economists increasingly emphasize the importance of rule-bound governance in promoting economic development. Stable rules reduce uncertainty, encourage investment, and allow individuals and organizations to make long-term plans. Conversely, when laws are applied impartially and governing becomes discretionary or selective, uncertainty increases, and economic coordination weakens.

Smith's emphasis on general rules, therefore, speaks directly to contemporary debates about regulatory discretion, administrative authority, and the stability of economic institutions. While modern economies require complex regulatory systems, Smith suggests that effective governance must still operate through predictable and impartial rules rather than case-by-case intervention.

Understanding Smith in this institutional context clarifies that markets are not self-sustaining mechanisms but systems embedded within legal and political structures. Economic coordination depends not only on incentives but also on stable rules that protect property, enforce agreements, and limit arbitrary power.

### Conclusion

Economic institutions depend upon justice and a system of general and enforceable rules that protect persons and property. These rules do not create outcomes. Instead, they establish boundaries within which individuals engage in voluntary exchange and pursue their own interests.

Smith's insight is not that markets operate independently of governing, but that they operate within a predictable and impartial legal framework. Justice is therefore not a moral supplement to economic life but its structural foundation. When laws become discretionary, when privilege overrides generality, and when enforcement becomes selective, the conditions necessary for economic coordination weaken.

Recognizing the institutional character of Smith's beliefs clarifies the unity of his moral philosophy and political economy. It also situates Smith within a broader tradition of rule-based governing that views stable, impersonal law as the foundation of social order. Economic coordination depends upon general rules. Without them, markets cannot function. Smith's analysis, therefore, remains highly relevant to today's debates concerning institutional stability, rule-based governance, and the limits of discretionary authority.

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