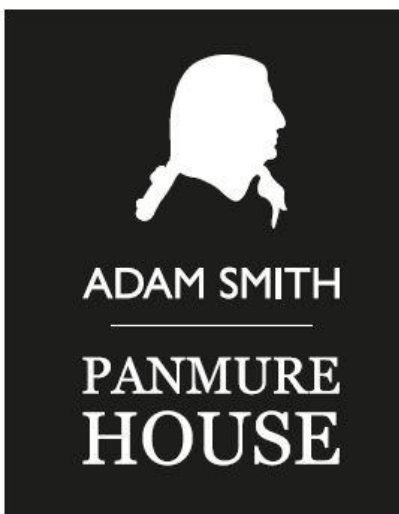


THE NEW ENLIGHTENMENT: Reshaping Capitalism and the Global Order in a Neo-Mercantilist World

A call to arms to be held at Panmure House,
Adam Smith's home in Edinburgh¹

July 1–2, 2019



Panmure House: “A place for economic debate and where people will meet together to solve the big problems of the world as they did in the 1790s.”

– Professor Heather McGregor, Executive Dean, Edinburgh Business School, Heriot-Watt University, 2018²

“The market system from which global prosperity has emerged over two centuries is now under attack from all sides, its basic legitimacy assailed from the right by critics of unfair competition and crony capitalism, from the left by campaigners against inequality and “market fundamentalism”. More than any other, the Scottish political economist and philosopher Adam Smith stands at the centre of this ideological battlefield, while around him clash competing views of economics, markets and societies.”

– Jesse Norman³

I. Background

Edinburgh was a “hotbed of geniuses” during the second half of the eighteenth century, and Adam Smith and his friend David Hume were key figures in the Scottish enlightenment. “THE NEW ENLIGHTENMENT: Reshaping Capitalism and the Global Order in an Neo-Mercantilist World” will provide a forum to bring together action-oriented scholars, policy makers, and practitioners who are concerned about mercantilism, favor a systems view of economics, and see Smith’s insights in *The Theory of Moral Sentiments* (TMS) as being as critical to the long-term success of the economic system as those laid out in *The Wealth of Nations* (WN).

This conference will be a call to arms and the first major event in Adam Smith’s home since his passing in 1790. It aims to draw together leading scholars and practitioners who care deeply about the balanced, long-term performance of the economic system and the survival and advancement of liberal democracies. There is concern in some quarters that unless liberal democracies continue to out-innovate and outgrow autocracies, economic and political freedom will be at risk at home and abroad. There is concern in other quarters that new technologies could be harnessed to favor tyranny.

Smith made the case for free trade, for enlightened self-interest, limited government, a reliable currency, and relatively unfettered markets and the absence of beggar-thy-neighbor trade policies. He railed against mercantilism and saw wealth creation as flowing from production and commerce, not from amassing large quantities of gold and silver. Perhaps he didn’t highlight entrepreneurship and innovation quite enough. Nevertheless, it is time to revisit his key themes and build on his enduring insights.

II. *The Wealth of Nations* (1776)

Historically, decentralized market systems have out-performed planned economies because, as Friedrich Hayek (building on Adam Smith) observed, “If we can agree that the economic problem of society is mainly one of rapid adaptation to changes in the particular circumstances of time and place, it would seem to follow that the ultimate decisions must be left to the people who are familiar with these circumstances, who know directly of the relevant changes and of the resources immediately available to meet them.”⁴

Since Adam Smith’s time, decentralized systems have out-innovated and transformed more rapidly than centralized economies. Indeed, in the twentieth century, decentralized decision-making aided by government support of science and technology allowed liberal democracies to outperform authoritarian socialist economies, helping to end the cold war and deliver affluence to many, both domestically and internationally.⁵ They continue to do so, but the performance gap is narrowing.⁶

It is important to remember that it is the ability to innovate that is the hallmark of the market system. Richard Nelson notes that “from Smith on, economists have recognized that discovery or invention of new ways of doing things and new things to be doing was the driving force of economic progress.”⁷ However, if administrative parsimony, responsiveness, and innovativeness are the hallmarks of the enterprise form of economic organizations, they have no basis in mainstream microeconomic theory. Neoclassical economists must accordingly

abandon much of their theoretical apparatus and embrace the study of innovation, institutions, and firm-level (dynamic) capabilities if they are to contribute usefully to current policy debate.⁸

While new technology is critical to economic growth, it has not always been harnessed for the common good. There is now concern that information technology will soon tilt the balance in favor of centralization so that repressive authoritarian regimes—because of technology-enabled ease of surveillance and control over data—will offset the economic handicaps traditionally associated with central control. Perhaps it is time to recognize that the battle between authoritarianism and democracy is undergirded by rapidly advancing information processing and storage technologies that can be used to both undermine and support democracies.

Absent leadership in technologies that allow the democracies to outflank autocracies in other ways, the very survival of democracy and liberty may be at issue.⁹ In short, the internet and related technologies, which many have hoped might be a panacea to excessive government control, may now be poised to make central control much easier, favoring tyranny over democracy.

New technology is not the only force impacting people and economic organizations and reshaping the role of markets. Smith explained the required moral foundations for a well-functioning market system. While he put markets at the center of the economic system, their proper functioning required the adoption of certain moral standards and the rule of law.

III. *The Theory of Moral Sentiments* (1759)

Smith was a wise and subtle thinker.¹⁰ He made it clear that markets are not faceless. They are living institutions mediated by norms and trust, and are always evolving and quite dynamic. He emphasized both self-interest and morality. He favored natural liberty, but in both TMS and WN was emphatic with respect to the importance of self-control and of the need for government to advance the role of law, provide security, and invest in basic infrastructure. The “invisible hand” of the market requires societal infrastructure including legal rules, domestically and internationally. This was certainly implicit and sometimes explicit in Smith. In TMS, Smith rebutted Bernard Mandeville’s “The Fable of the Bees” (1714), in which immoral and selfish bees nevertheless create a happy society. Self-interest and selfishness are not one and the same in Smith.

Self-interest also conveys the need for “sympathy” for others and advancing civic values. Smith favored rigorous self-scrutiny. He believed that we must always scrutinize our own behavior and supplement our observational and self-reflective capabilities with the observations and reflections of others in our community. Calvinistic doctrine may well be behind Smith’s “spectator” mechanism for moral judgement, commonly regarded as one of his major philosophical contributions.

In short, Smith was no proponent of the “law of the jungle,” and he recognized tendencies of greed, corruption, and the abuse of power by some businessmen who “love to reap where they never sowed.” He recognized that in an economic system, there is a critical linkage between the moral, legal, and economic elements of development. He saw the ethical,

economic, and jurisprudence as interrelated parts of a system. To the extent that current corporate law is viewed as imposing a legal duty to maximize (short-term) shareholder value, then it is inconsistent with Smith's view of sustainable forms of capitalism.

The imperative is now stronger than ever to read TMS and WN together. While some scholars see these as separate and contradictory theories, it's hard to imagine that Smith himself saw it that way. Both treatises have in common deep and prescient observations of society and the behavior of individuals. TMS, in particular, anticipates modern work in behavioral economics.¹¹

Business firms, investment funds, and banks are at the center of wealth creation and capture today. Creating value and capturing long-term value for shareholders has always depended on being conscious of other stakeholders. The sustainability (in terms of survival, growth, and profitability) of the business enterprise and the market system depends more than ever on commitment to a mission broader than maximizing short-term shareholder value.

We will explore how to resolve the perceived tension between stakeholder and shareholder theory. While these tensions are real in the microeconomics model of firm behavior, they fade away in models of strategic management, which focus on long-run value creation and capture. In particular, the Dynamic Capabilities framework sees long-run evolutionary fitness as requiring attention to a changing kaleidoscope of constituencies and stakeholders that are important to building and maintaining competitive advantage.¹² It is astute investment, private and public, in technological and organization innovation which animates economic development and growth.

We will also explore the resurgence of mercantilism in the twenty-first century. The liberal, merit-based global system of wealth creation Smith favored is upset, if not overturned, when nation-states sanction asymmetric market access, espionage, technology theft, and cyber-attacks. In regimes of weak appropriability, governments can move to shift the distribution of the gains from innovation away from (foreign) innovators and toward (domestic) firms by denying innovators ownership of specialized assets. The foreign firm will be left with the option of selling its intangible assets in the market for knowhow *at a deep discount* if both trade and investment are foreclosed by government policy.¹³

Such malfeasance is enabled by a weak rule of law and by political forces that discourage individuals and companies from pressing suits against infringers and misappropriators, coupled with an unspoken expectation of extrajudicial repercussions in the form of regulatory intrusions. *The Economist* notes that the World Trade Organization has not stopped nation-states from "flaunting the spirit, if not always to the letter, of its rules by shaking down foreign investors for technologies it fancies and giving under-the-table assistance to [their] own industries."¹⁴

While there is still great value in churning over what Smith said (or didn't say) in TMS or WN, there is greater value in carrying forward Smith's systems perspectives¹⁵ to help us understand better the foundations of the wealth of nations in a connected global world.

IV. Conclusion

In the West, identity politics often consume much of the energy of both the left and the right in contemporary discourse. Assertive authoritarian regimes appear less distracted and seem willing to invest in developing, acquiring, and harnessing advanced technologies, from robotics to artificial intelligence to gene editing. By doing so, one will soon be able to challenge the economic prowess of the liberal democracies, many of whom face aging infrastructure and a fragile mandate for long-term investment, whether in technologies of the future or in the job-creating infrastructure of today.

Smith's wisdom can be employed to gain a better understanding of the business enterprise and its governance, and of the required behavior of investment managers and other actors in the global economic system. In particular, it is time to reexamine how public policy and the individual actions of investment managers, executives, and government officials can be guided by moral principles, deep awareness of one's place in society at large, and the geopolitical consequences of a failure to innovate and invest in the future.¹⁶ Perhaps, together, we can initiate the development of a plan of action to preserve democracy and advance the many innovative and beneficial elements of the private market-based enterprise system.

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Berkeley, CA
October 2018

PANMURE HOUSE



¹ The elegantly restored Panmure House is owned today by the Edinburgh Business School, Heriot-Watt University. This conference is organized by Tusher Professor of Global Business David J. Teece and the Institute for Business Innovation, UC Berkeley, in cooperation with the Edinburgh Business School and Panmure House

² Anne McElvoy, "The Economist asks: Who was Adam Smith?" podcast (16 August 2018), available at: <http://radio.economist.com/>

³ Jesse Norman, "How Adam Smith Would Fix Capitalism," *Financial Times* (21 June 2018), available at: <https://www.ft.com/content/6795a1a0-7476-11e8-b6ad-3823e4384287>

⁴ Friedrich August von Hayek, "The Use of Knowledge in Society," *American Economic Review* (1945): 524.

⁵ N. Rosenberg and L.E. Birdzell, *How the West Grew Rich: The Economic Transformation of the Industrial World* New York: Basic Books (1986).

⁶ Many developed economies suffer from weak growth and low private sector investment, and there is evidence that the latter is related to the growing financialization of the corporate sector. Wages and salaries no longer reflect the marginal productivity of workers, if they ever did. Economic results show large firms' effects.

⁷ R. Nelson, "Assessing Private Enterprise: An Exegesis of Tangled Doctrine," *The Bell Journal of Economics* 12(1) (1981): 93–111.

⁸ There are better theories and understandings of firms in the work of Polanyi, Schumpeter, Rosenberg, Dosi, Nelson and others.

⁹ In short, the internet and blockchain, which many saw as a panacea to excessive government control, may now be poised to make central control much easier.

¹⁰ "Judged by the standards of analytical competence, Smith is not the greatest eighteenth century economist. But for an acute insight into the nature of the economic process, it would be difficult to find Smith's equal." Mark Blaug, *Economic Theory in Retrospect*, London (1962), p. 57.

¹¹ N. Ashraf, C. Camerer, and G. Loewenstein, "Adam Smith, Behavioral Economist," *The Journal of Economic Perspectives* 19:3 (Summer 2005): 131–145.

¹² D.J. Teece, "The Foundations of Enterprise Performance: Dynamic and Ordinary Capabilities in an (Economic) Theory of Firms," *Academy of Management Perspectives* 28(4) (2014): 328–352; D.J. Teece, "Dynamic capabilities and entrepreneurial management in large organizations: Toward a theory of the (entrepreneurial) firm," *European Economic Review* 86 (2016): 202–216; D.J. Teece, "Towards a capability theory of (innovating) firms: implications for management and policy," *Cambridge Journal of Economics* 41(3) (2017): 693; D.J. Teece, "A capability theory of the firm: an economics and (Strategic) management perspective," *New Zealand Economic Papers* (2017): 1–43.

¹³ Licensing may then appear profitable, but only because access to market-specific complementary assets is blocked by government. Thus, when an innovating firm generating profits needs to access complementary assets abroad, host governments, by limiting access, can sometimes milk the innovators for a share of the profits. (D. Teece, "Profiting from Innovation," *Research Policy* (December 1986): 303).

¹⁴ M. Ball, "Peter Navarro Used to Be a Democrat. Today He's the Architect of President Trump's Trade War," *Time* (2018): 47.

¹⁵ Adam Smith very much had a systems view of the economy and society. He did not compartmentalize his analysis. Many scholars do so today, adhering to disciplinary boundaries that didn't exist in Smith's time. See D.J. Teece, "Dynamic capabilities as (workable) management systems theory," *Journal of Management and Organization* 24(3) (2018): 359–368; and D.J. Teece (with Neil Kay and Sohvi Leih), "The role of emergence in dynamic capabilities: a restatement of the framework and some possibilities for future research," *Industrial and Corporate Change* (forthcoming 2018).

¹⁶ As Milton Friedman once noted, "The nineteenth century liberal was a radical, both in the etymological sense of going to the root of the matter, and in the political sense of favoring major changes in social institutions. So too must his modern heir." (Friedman, M. and Friedman, R. D., *Capitalism and freedom*. Chicago: University of Chicago Press, 2002, p.6.