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Introduction

Adam Smith's most famous book, *The Wealth of Nations* (1776), was an economic declaration of independence with its call for trade liberalization and free markets, but the book he wrote that was his personal favorite was a treatise on ethics and psychology titled *A Theory of Moral Sentiments* (1759). Both books address the problem of poverty and will be used here to investigate the role of markets, charity and government for assisting the poor.

Free Markets and Trade?

In *The Wealth of Nations*, Smith argued that free trade (domestic and international) would increase the general "opulence" or wealth of society (as measured by the amount of goods and services produced and available for consumption) because it allowed for a division of labor that tended to increase worker productivity and therefore income. Smith believed the benefits of economic growth due to specialization and trade would be dispersed widely across socioeconomic classes so that even the poorest members of the working class in a free market society would attain a level of consumption superior to that of the wealthiest king in a society where trade and the division of labor remained rudimentary. Adam Smith's name is almost synonymous with a "free market" approach to creating wealth and reducing poverty, but he also advocated a variety of government interventions for improving both the economy and society including subsidies for education and investments in economic infrastructure such as transportation. Nevertheless, Smith's idea of an "Invisible Hand" whereby individual pursuit of self-interest leads to widespread economic benefits inclusive of the poor was revolutionary in 1776 and continues to influence public policy today.

How effective is free trade in reducing poverty? A recent study focusing on the effect of international trade on poverty examined over twenty less developed (comparatively poor) countries where free trade policies have been enacted and international trade constituted a substantially growing portion of economic activity from the mid 1970s to the mid 1990s [Dollar and Kraay (2004)]. Designating these countries "globalizers," the authors found that income growth among "globalizers" was substantially higher than "nonglobalizers." Moreover, the authors found that the poor (defined as the bottom fifth of the nation's population in terms of income) residing in globalizing nations on average benefited proportionately from national income growth.

These results provide support for the "free market" strategy for assisting the poor and the adage that "a rising tide lifts all boats." However, upon closer inspection, the link between poverty reduction and an expanding market economy is not as simple as it might appear. To illustrate, consider the case of China, a country that has experienced dramatic economic growth since introducing free market reforms in the late 1970s. During the 1980s and 1990s, China's annual rate of per capita income growth averaged 5.4%, but for the poorest fifth of the population the average rate of growth was only 3.8%, making them worse off relative to the rest of society. Why be concerned about a decline in relative income if the absolute income of the poor is rising on average? One reason is that increased income inequality may indicate people further removed from the social and economic mainstream whose capabilities remain untapped, as in the case of a family whose income is rising but is unable to gain access to electricity or who cannot afford housing where a job opportunity exists. According to the "capabilities" approach pioneered by Nobel Prize winning economist Amartya Sen, poverty should measure a failure to provide resources and opportunities necessary for social participation, not simply measure deficiencies of income.

Also accompanying China's free market reforms has been a phasing out of its social safety net, exposing certain groups to a greater risk of becoming or remaining poor. If average income is growing, but specific groups such as the elderly or children experience reductions in economic well-being or opportunities for self-development due to the removal of government subsidized housing, health care, education and other social support services, how confident are we that poverty is being reduced? This concern, like the "capabilities" approach, focuses on the failure to provide specific resources that enable people to attain their potential (income earning or otherwise) or attain social norms of decency. Turning to the United States for a moment, if a single parent's income rises as a result of taking a job, but the quality of child care declines (compromising the child's education or health), is the family or nation richer or poorer? This issue is particularly relevant to the United States since earning more income can result in substantial declines in government assistance (for example, health care) for low income earners. The "benefit-reduction" experienced by low income earners amounts to a tax rate that often exceeds the income tax rates paid by those in the middle or upper class.

Private Charity?

What about private charity—that is, voluntary donations of time, money, goods and services—to assist the poor who because of unemployment, child care responsibilities, disability or illness are not part of a rising tide of income growth? In *A Theory of Moral Sentiments*, Smith asserted that individuals naturally tend to approve of wealth because of the pleasurable feelings associated with it, but poverty triggers social disapprobation because of the feelings of pain and discomfort associated with it. The result is that there is a tendency for the poor to conceal their condition (out of shame due to the disapprobation assigned to poverty) and for wealthier people to distance themselves from the poor and their problems. This creates what might be called an "Invisible Poor" problem because of social, psychological and geographic segregation between the "haves" and "have nots." If we are isolated from the poor and their problems, how can we effectively address their needs? Free markets may create wealth as if by an invisible hand, but charity markets are hindered by invisibility on the demand side. Smith's theory also suggests that potential donors (the supply side of the charity market) might favor donating to causes with pleasing associations or which bring the donor more social acclaim than assisting the poor.

An aversion to the poor and their problems might be overcome by cultivating what Smith called "fellow-feeling" or adopting the perspective of an "impartial spectator" whose judgment is not influenced by self-promotion prejudicial to the poor. But how is this moral development to occur, particularly in a society where pursuit of self-interest (not altruism) is presumed to solve the problem of poverty? Also, developing empathy for the poor partly depends on sharing their experiences of hardship, something that historical patterns of social, economic and geographic segregation may prevent. It is also worth noting that the social disapprobation and shame associated with being poor depends on relative as well as absolute income. The inability to purchase the latest mainstream product of the consumer culture (cellphone or laptop) may reduce an individual's opportunities for social interaction and contribute to social isolation and neglect.

Government?

Because of moral or market failure, is there a collective responsibility to assist the poor through governmental institutions and policies? One case for government intervention rests on the fact that poverty rates are highly correlated with unemployment. Unemployment is a problem that arises within market economies due to a variety of factors, including dislocations caused by technological change and new patterns of international trade. Unemployment also comes about when, as during the Great Depression, total employment and production fell drastically. Government policies that provide education and retraining opportunities for the jobless can reduce the incidence of poverty as can tax cuts or increases in government spending to stimulate the overall economy. Probably the single most effective protection against poverty in a market economy is providing employment for those able to work, but government intervention may be required.

Another case for government assistance to the poor stems from the fact that reducing poverty has the characteristics of a "public good." Unlike a "private good" where the benefits are confined to the individual using or receiving it (like eating an apple), the benefits of a public good are "nonexcludable," meaning that society at large shares in the benefits of a public good once it is provided. National defense is an example of a public good provided by government, but reducing poverty also has public good characteristics. For example, large numbers of people may benefit from a transfer of income to the poor because they naturally approve of acts of generosity that exhibit kindness and reduce hardship. Providing specific goods such as education and health care to the poor also benefits society at large when it reduces crime and increases the population of workers who pay taxes. However, if helping the poor has spillover benefits to society, then local communities (and individual taxpayers and potential donors) have an incentive to wait until someone else provides services to the poor and receive a "free ride" from another community's (or individual's) assistance. Local and state communities may fear a migration of poor into their communities if they provide assistance and recognize that they do not reap all the benefits from those they might assist. Because of the costs of being a magnet and the difficulty of appropriating all the returns of their investment in the poor, local and state governments are likely to collectively underinvest. A possible remedy for this problem is to make welfare programs for the poor a federal responsibility, but, ironically, the trend of recent welfare reform has been to reduce the federal role in favor of state and local responsibility. One device used by local and state communities to restrict eligibility for welfare programs is to impose residency requirements, a policy Adam Smith opposed in the eighteenth century because it inhibited the mobility of the poor and made finding employment more difficult.

Conclusion

Assisting the poor is a difficult and complex problem that mirrors the difficulties and challenges of being poor. The precise combination of markets, charity and government intervention that best assists the poor is an issue that deserves further exploration. Looking at the issue through the lens of Adam Smith's writings and modern economic theory, my recommendation is to clarify the problems of the poor and make them more visible, then give a helping hand to the invisible hand of the marketplace.

References

Adam Smith's principal books are *An Inquiry Into the Nature and Causes of the Wealth of Nations*, edited by R.H. Campbell, A.S. Skiller, and W.B. Todd, Oxford University Press (1776) 1978 and *The Theory of Moral Sentiments*, edited by D.D. Raphael and P.G. Stein, Oxford University Press (1759) 1976.

For research on the link between globalization and poverty, see the article by David Dollar and Aart Kraay "Trade, Growth, and Poverty" (*The Economic Journal*, February 2004, Volume 114, pp. F22-F49.

A recent book that discusses the "capabilities" approach to studying poverty is *Poverty and Inequality* (2006) edited by David B. Grusky and Ravi Kanbur (Standford University Press).

For more on Adam Smith's ethical system and theory of charity, see my article "An Analysis of Adam Smith's Theory of Charity and the Problems of the Poor" (*Eastern Economic Journal*, Winter 1998, Volume 24, Number 1, pp. 25-41.