

ADAM SMITH (1723 – 1790) & the Wealth of Nations (1776)

1750: Industrial Revolution

1776: American Revolution

1789 – 1799: French Revolution

The Scottish philosopher Adam Smith was a pioneer in the subject of political economy and is known today primarily for An Inquiry into the Nature and Causes of the Wealth of Nations (1776), which was one of the earliest attempts to systematically study the historical development of industry and commerce in Europe, as well as a sustained attack on the doctrines of **mercantilism**. Smith's work helped to create the modern academic discipline of economics and provided one of the best-known intellectual rationales for **free trade**, **capitalism**, and **libertarianism**.

BIOGRAPHY: What They Probably Told You on A&E

Smith was a son of the controller of the customs at Kirkcaldy, Fife, Scotland. At around the age of 4, he was **kidnapped** by a band of **Gypsies**, but he was quickly rescued by his uncle and returned to his mother. Smith's biographer, John Rae, commented wryly that he feared Smith would have made "a poor Gypsy."

EDUCATION & EARLY CAREER: "Adam Smith as the 'Professional Student' "

At the age of fourteen, Smith entered the **University of Glasgow**, where he studied moral philosophy under **Francis Hutcheson** and developed his strong passion for liberty, reason, and free speech. In 1748, Smith began delivering public lectures in Edinburgh and later took up the subject of "the progress of opulence." It was then, in his middle or late 20s, that he first expounded the economic philosophy of "the obvious and simple system of **natural liberty**" which he was later to proclaim to the world in his Wealth of Nations. Around 1750 he met the philosopher **David Hume** whose opinions and writings were closely aligned with his own regarding history, politics, philosophy, religion, & trade. In 1751 Smith was appointed chair of logic at the University of Glasgow, transferring in 1752 to the Chair of Moral Philosophy, once occupied by his famous teacher, Francis Hutcheson. Smith's lectures covered the fields of ethics, rhetoric, jurisprudence, political economy, and "police and revenue." In 1759, he published The Theory of Moral Sentiments. In the years that followed, Smith began to give more attention to jurisprudence and economics in his lectures and less attention to his theories of morals. The notes of his lectures taken down by a student in about 1763 have been published as "An Early Draft of Part of The Wealth of Nations."

MAJOR INFLUENCE: "The Tour de France?"

At the end of 1763, he obtained a lucrative offer from **Charles Townshend** (who had been introduced to Smith by David Hume), to tutor his stepson, the **young Duke of Buccleuch**. From 1764 to 1766, Smith travelled with his pupil, mostly in France, where he came to know intellectual leaders such as Turgot, Jean D'Alembert, André Morellet, Helvétius and, in particular, **Francois Quesnay**, the head of the **Physiocratic** school whose work he respected greatly. On returning home to Kirkcaldy, Smith devoted much of the next ten years to his magnum opus, the An Inquiry into the Nature and Causes of the Wealth of Nations, which was an instant best-seller and is still available on amazon.com today!

An Inquiry into the Nature and Causes of the Wealth of Nations

OVERVIEW of the Wealth of Nations

The Wealth of Nations was Smith's most influential work and is considered to be important in the creation of the field of economics. The work is also the first comprehensive defense of **free market** policies against **mercantilism** (the theory that large reserves of bullion are essential for economic success). In 1776, there was a strong sentiment for free trade in both Britain and America. However, at the time of publication, not everybody was immediately convinced of the advantages of free trade: the British public and Parliament still clung to mercantilism for many years to come.

The Wealth of Nations also rejected the Physiocratic school's emphasis on the importance of **land**; instead, Smith believed **labor** was paramount, and that a division of labor would effect a great increase in production.

The DIVISION OF LABOR

One example he used was the making of pins. One worker could probably make only twenty pins per day. But if ten people divided up the eighteen steps required to make a pin, they could make a combined amount of 48,000 pins in one day. However, it is less well known that Smith also concluded that excessive division of labor would lead man to his most ignorant state possible. (NOTE: Karl Marx & "alienation of workers")

FREE MARKETS & the "INVISIBLE HAND": "Can Self-interest serve the Public interest?"

One of the main points of the Wealth of Nations is that the free market, while appearing chaotic and unrestrained, is actually guided to produce the right amount and variety of goods by a so-called "**invisible hand**." If a product shortage occurs, for instance, its price rises, creating a profit margin that creates an incentive for others to enter production, eventually curing the shortage. If too many producers enter the market, the increased competition among manufacturers and increased supply would lower the price of the product to its production cost, the "natural price." Even as profits are zeroed out at the "natural price," there would be incentives to produce goods and services, as all costs of production, including compensation for the owner's labor, are also built into the price of the goods. If prices dip below a zero profit, producers would drop out of the market; if they were above a zero profit, producers would enter the market.

*"As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual value of society as great as he can. He generally, indeed, neither intends to promote the **public interest**, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an **invisible hand** to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his **own interest** he frequently promotes that of society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it."*

SELF-INTEREST: "Is the Path to Heaven is Paved with Bad Intentions?"

Smith believed that while human motives are often selfishness and greed, the competition in the free market would tend to benefit society as a whole by keeping prices low, while still building in an incentive for a wide variety of goods and services.

"It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages."

MARKET FAILURE & GOVERNMENT FAILURE

Adam Smith, on the one hand, was wary of cartel behavior (market failure) in the business sector.

*"People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a **conspiracy against the public**, or in some contrivance to **raise prices**. It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice."*

On the other hand, Smith believed that the government sector should not help create monopolies either.

"But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies; much less to render them necessary."

ROLE of GOVERNMENT in the ECONOMY

Adam Smith did advocate a role for the government in areas such as public education of poor adults, a judiciary, and a standing army. However, Smith vigorously attacked antiquated government regulations which he thought were hindering industrial expansion. In fact, he attacked most forms of government interference in the economic process, including tariffs by arguing that tariffs create inefficiency and high prices in the long run. This philosophy against government intervention in the markets has become known as "**laissez-faire**" – a notion that a free market of buyers and sellers should dictate what happens in the marketplace. This laissez-faire philosophy has influenced government legislation during the mid-19th century in England and again during the de-regulation of major industries in the early 1980's in England and the United States.

TAXATION: Progressive or Proportional?

Adam Smith may be credited by economists as one of the first advocates of a progressive tax system.

*"It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something **more in proportion.**"*

However, he might also be interpreted as being a proponent of a proportional tax system in the following way:

*"The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in **proportion** to their respective abilities; that is, **in proportion to the revenue which they respectively enjoy under the protection of the state.** The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation."*

INFLUENCE

The Wealth of Nations, one of the earliest attempts to study the rise of industry and commercial development in Europe, was a precursor to the modern academic discipline of economics. It provided one of the best-known intellectual rationales for free trade and capitalism, greatly influencing the writings of later economists.

FOOTNOTE:

There has been a controversy over the degree of Smith's originality in The Wealth of Nations. Some argue that the work added only modestly to ideas already established by thinkers such as **Anders Chydenius**, **David Hume**, and **Montesquieu**. Indeed, many of the theories Smith set out simply described historical trends away from mercantilism and towards free trade that had been developing for many decades and had already had significant influence on governmental policy. Nonetheless, Adam Smith's work organized many of the earlier ideas more comprehensively, and so remains one of the most influential and important books in the world today.

TRIVIA:

In Robert B. Downs' BOOKS THAT CHANGED THE WORLD: 16 Landmarks in the History of Ideas, Adam Smith's entry is listed as: "3. Patron Saint of Free Enterprise."