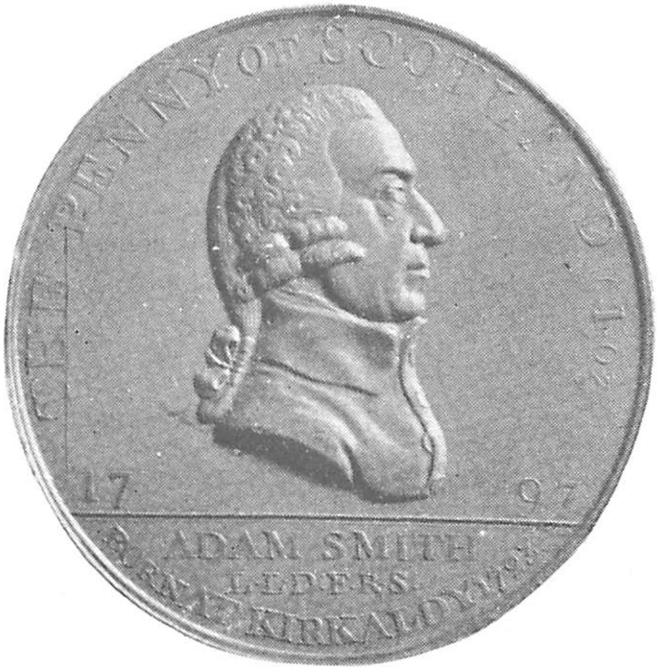


30 ADAM SMITH

1723-1790

Adam Smith, the leading figure in the development of economic theory, was born in 1723, in the town of Kirkcaldy, Scotland. As a young man, he studied at Oxford University, and from 1751 to 1764 he was a professor of philosophy at Glasgow University. While there, he published his first book, *Theory of Moral Sentiments*, which established his reputation in intellectual circles. However, his lasting fame rests primarily on his great work, *An Inquiry Into the Nature and Causes of the Wealth of Nations*, which was published in 1776. The book was an immediate success, and for the rest of his life Smith enjoyed fame and respect. He died in Kirkcaldy, in 1790. Smith had no children and never married.

Adam Smith was not the first person to devote himself to economic theory, and many of his best-known ideas were not original. But he was the first to present a comprehensive and systematic theory of economics that was sufficiently correct to serve as a foundation for future progress in the field. For this reason, it may fairly be said that *The Wealth of Nations* is the starting point of the modern study of political economy.

One of the book's great achievements was that it cleared away many past misconceptions. Smith argued against the older mercantilist theory, which stressed the importance of a state having large supplies of gold bullion. Similarly, his book rejected the view of the physiocrats that land was the principal source of value, and instead asserted the basic importance of labor. Smith heavily stressed the great increase in production that could be brought about through the division of labor, and he attacked the whole set of antiquated and arbitrary government restrictions that were hampering industrial expansion.

The central idea of *The Wealth of Nations* is that the seemingly chaotic free market is actually a self-regulating mechanism, which automatically tends to produce the type and quantity of goods that are most desired and needed by the community. For example, suppose some desirable product is in short supply. Naturally, its price will increase, and the higher price will lead to higher profits for those who manufacture it. Because of the high profits, other manufacturers will be eager to produce the article also. The resultant increase in production will alleviate the original shortage. Furthermore, the increased supply, in conjunction with competition between various manufacturers, will tend to reduce the price of the commodity to its "natural price," i.e., its production cost. No one has deliberately set out to help society by eliminating the shortage; nevertheless, the problem has been solved. Each person, in Smith's words, "intends only his own gain," but he is, as it were, "led by an invisible hand to promote an end which was no part of his intention...By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it" (*The Wealth of Nations*, Book IV, Chapter II).

The "invisible hand," however, cannot do the job properly if there are obstructions to free competition. Smith therefore believed in free trade and argued strongly against high tariffs. In fact, he strongly opposed most government interference with business and the free market. Such interference, he claimed, almost always decreases economic efficiency, and ultimately results in the public paying higher prices. (Smith did not invent the term "laissez faire," but he did more than any other man to promote the concept.)

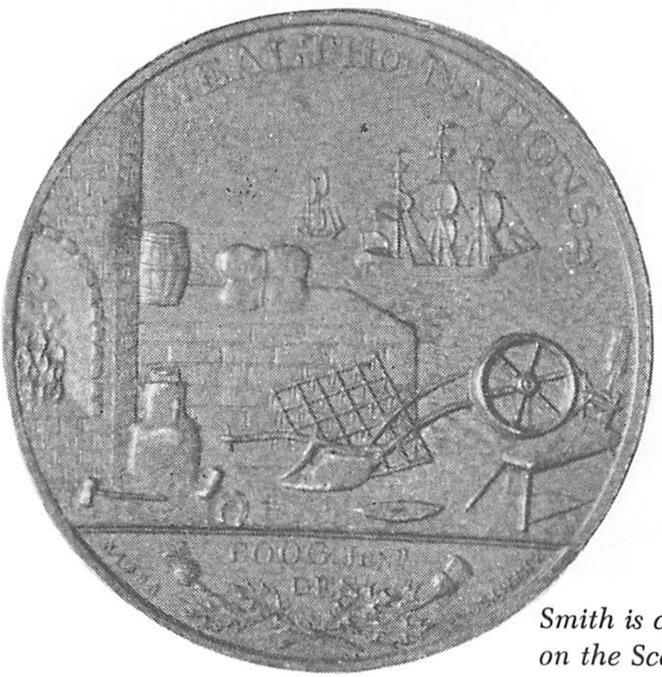
Some people have the impression that Adam Smith was a mere apologist for business interest, but such a view is incorrect. He repeatedly, and in the strongest terms, denounced monopolistic business practices and urged their elimination. Nor was Smith naive regarding actual business practices. Here is a typical observation from *The Wealth of Nations:* "People of the same trade seldom meet together but the conversation ends in a conspiracy against the public, or in some diversion to raise prices."

So well did Adam Smith organize and present his system of economic thought, that within a few decades the earlier schools of economic thought were abandoned. Virtually all of their good points had been incorporated into Smith's system, while he had systematically exposed their shortcomings. Smith's successors, including such important economists as Thomas Malthus and David Ricardo, elaborated and refined his system (without changing its basic outlines) into the structure that is today referred to as classical economics. Although modern economic theory has added new concepts and techniques, it is largely a natural outgrowth of classical economics.

In *The Wealth of Nations,* Smith partly anticipated the views of Malthus on overpopulation. However, while Ricardo and Karl Marx both insisted that population pressure would prevent wages from rising above the subsistence level (the so-called "iron law of wages"), Smith stated that under conditions of increasing production wages would be able to increase. Quite obviously, events have proved that Smith was correct on this point, while Ricardo and Marx were wrong.

Quite aside from any question of the correctness of Smith's views, or of his influence upon later theorists, is the matter of his influence upon legislation and government policies. *The Wealth of Nations* was written with great skill and clarity, and it was widely read. Smith's arguments against government interference in business and commercial affairs, and in favor of low tariffs and free trade, had a decided influence upon governmental policies during the entire nineteenth century. Indeed, his influence on such policies is still felt today.

Since economic theory has advanced greatly since Smith's day, and since some of his ideas have been superseded, it is easy to underrate Adam Smith's importance. The fact is, though, that he was the principal originator and founder of economic theory as a systematic study, and as such is a major figure in the history of human thought.



Smith is commemorated on the Scots penny.