

# Adam smith's contribution to classical political economy



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## Assess the contribution of Adam Smith to the tradition of Classical Political Economy

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Quality of research and analysis(Clarity and depth of argument, scope of argument, originality of approach, range of sources used, critical use of sources)

Evidence of key skills (Structure, clarity of expression, proper referencing and accompanying bibliography, formatting, evidence of sustained research)

Potential areas for improvement (How could a future submission be enhanced?)

## Assess the contribution of Adam Smith to the tradition of Classical Political Economy

### Introduction

Adam Smith's contribution to the tradition of classical political economy was hugely influential. This essay will discuss two of his major theories outlined in the *Wealth of Nations*; the *division of labour* and then the *invisible hand*, whilst briefly touching upon Smith's view on the role of the state and the free-market. Smith was a moral philosopher from the late 18<sup>th</sup> Century and wrote; "*An Inquiry into the Nature and Causes of the Wealth of Nations*" in 1776, to critique the political-economic system of the time; mercantilism. This was an economic theory and practice that encouraged imperialism and state intervention into the allocation of scarce resources. Smith was writing at the outset of the Industrial Revolution when the world was changing.

In the *Wealth of Nations*, Smith proposed many revolutionary economic theories including; the *division of labour*, the *labour theory of value*, the *role of the state in an economy* and the *invisible hand* among others, which he thought would build a nation's wealth. Classical political economy is a group of theories that developed in the 17<sup>th</sup> – 19<sup>th</sup> Century to try and understand society on the basis of its economic foundation. Smith viewed

political economy as a branch of science of statesmen, aimed at providing its citizens with plentiful revenue or subsistence and sufficient revenue for state for public service. It proposed to enrich both the people and the sovereign. (Smith, 2008, p. 275; Burnham, P., 2014, A). Smith believed that society should be market-based, which he believed were characterised by the three factors of production; land, labour and capital. These factors of production produce three classes within society: landowners, capital owners and labour. Each class receives revenue, and all are independent of each other. Smith's main point in *the Wealth of Nations* was that all classes could gain from an increase in the scope of the market; anything that impedes the free-market is a problem (Burnham, P., 2014, B).

### Discussion

One of Smith's key theories, proposed in the *Wealth of Nations*, was that of the division of labour. This refers to the separation of different parts of the production process according to the worker's ability and/or the worker's equipment. Smith believed that the benefits were clear; it enhanced the production process leading to a more efficient use of scarce resources as well as lowering the cost of production (Smith, 2008, Book I, ch. 1).

Furthermore, Smith strongly believed that the division of labour greatly increased the quantity a worker and/or firm could produce. The results of dividing labour are; the increase in the skill of the worker; reduced time loss upon switching production process, and the invention of machines which aids workers and enables one man to do the work of many. By reducing the worker's part of the production process to one, simpler operation performed solely by the worker, this increases the worker's skill and performance. As no

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worker needs to change task, more time can be dedicated to the production process. The specialisation of workers would enable firms to employ machinery, thus producing more goods more efficiently compared to human capital, reducing the number of workers required to make a certain quantity of goods, and therefore reducing the cost of production (Smith, 2008, pp. 15-17). In the 18<sup>th</sup> Century when *The Wealth of Nations* was published, factory owners adopted his principle of people specialising in particular jobs as shown in his example of the pin-maker. This principle of specialisation has continued to modern industrial occupations, such as car manufacturing.

However, Smith believed that the division of labour was limited by the extent of the market. For example, if the market is so small that a worker cannot sell their produce of labour efficiently, the worker will make losses, and so, on this basis, may work in an industry for which they are not skilled in. Smith argued that division of labour will only take place when the population is large, that will create enough demand for specialised services (Smith, 2008, Book I, ch. 3). Karl Marx disagreed with Smith's theory, as he believed that specialisation would lead to the alienation of workers as the work becomes repetitive and reduces the value of the worker from a human being to that of a machine (Marx, 1988, p. 72). In addition when work becomes more specialised, less training is required for each job, and so, the individual workers become less skilled than if one worker performed the whole task (Marx, 1999, p. 119). Smith also critiques the division of labour; he believed that if a worker devoted their life to performing one or a few simple operations of which the effects are similar or the same, the worker has no occasion to discover methods for removing difficulties that never occur.

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Smith argues that because of this, the worker would generally become as stupid and ignorant as is possible for a human to be (Smith, 2008, pp. 429 – 430).

Another one of Smith's most prominent ideas was the concept of the 'Invisible Hand' and the idea of a free-market (Smith, 2008, Book IV, ch. 2). What Smith actually meant by 'Invisible Hand' is still a contested idea between economists, but it is widely believed that it is a metaphor to describe the guide of the allocation of scarce resources in a free-market. A free-market is a market free from government intervention and so the market price of goods are determined by the interaction between supply and demand. Smith stated that all actors, buyers and sellers, act in their own self-interest (Burnham, P., 2014, B). Smith claimed that, due to the absence of government intervention, buyers are free to choose where to buy goods from and seller are free to choose which goods they want to supply and at what price and quantity.

Smith believed that this method would benefit society as buyers, acting in their own self-interest, would buy goods from the cheapest sellers. This would mean that firms would compete against each other, trying to gain as many customers as possible to maximise their own self-interest; profit. This would lead to firms cutting their prices in order to gain buyers. In turn, the inefficient firms with higher costs and whose use of resources are inefficient, will not be able to cut their prices, so are forced out of the market. An obvious example of this is budget airlines competing against each other, Laker Airways became bankrupt in 1982 trying to compete. This inevitably leads to a more efficient use of resources, with buyers getting their goods at <https://assignbuster.com/adam-smiths-contribution-to-classical-political-economy/>

a cheaper price and/or higher quality; improving their utility whilst the efficient firms reap the benefits of increased profits. Smith believed that because of this, the free-market is the best way to allocate scarce resources and that individuals trying to maximise their utility would in turn increase the utility of society (Smith, 2006, p. 316). The most obvious example of the free-market theory in practice today is America - whether or not it is successful in allocating resources efficiently or lowering prices is debatable.

A common misconception is that Smith wanted no state intervention whatsoever. However, although he wanted a small state, he saw four main roles for the state to play: to uphold the rule of law, to protect society from people who are against the market, to maintain public infrastructure, and to foster "justice" (Burnham, P. 2014 B).

Not everyone agrees with Smith's theory of the invisible hand and that the free-market benefits society. The free-market does not work efficiently when externalities exist. An externality is an action of an individual that has an impact on others, which the individual does not pay for/the other individual is not compensated for, so therefore, the market price does not reflect the true cost to society (Mankiw & Taylor, 2014 p. 189). Marx argued that the capital class, that is those who own the modes of production, do not work and therefore exploit the workers. He also believes that capitalists would eventually accumulate more and more capital, further exploiting the working class (Marx, 1999, Vol. 7). More recently, Joseph Stiglitz identifies that markets are too short-term driven, and are unlikely to invest in research and development, which historically has been done by the government. As well as this, Stiglitz believes that due to asymmetric information and individuals

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pursuing their own personal interest, the free-market will inevitably lead to those with the information to benefit at the expense of others, therefore, markets will not be efficient (Stiglitz, 2004). This can be seen in George Akerlof's example of a used car salesman, who has more information than the customer, and so can gain at the expense of the customer (Akerlof, 1970).

### Conclusion

Adam Smith was immensely influential and made a huge contribution to the tradition of classical political economy. He produced the building blocks for basic liberal economics - that of the free-market - and many of his theories are still used in some way today. Smith's works influenced many prominent economically liberal academics of the 20<sup>th</sup> Century, including Milton Friedman and Friedrich Hayek. Smith's theories have been adopted by governments, most notably Margaret Thatcher's and Ronald Reagan's, and have been adapted to suit the different situation of modern society. With hindsight, and through criticisms from prominent academics, such as Karl Marx, we now know that there are faults with some of Smith's key theories, such as asymmetric information and externalities in a market. However, in the 18<sup>th</sup> Century, Smith's theories were revolutionary and helped change the political-economic system of Britain from that of mercantilism to classical political economy. Smith's theories also helped to kick-start Britain's Industrial Revolution in the 18<sup>th</sup> Century, which aided Britain's ascension to be the most powerful and wealthy country in the world (Hudson, 2011). Therefore, it could be argued that his contribution was immense and nearly

two hundred and fifty years later, he continues to influence political and economic thinking.

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