Adam smith wealth nations wealt of nations summary economics essay

In the first sentence of " Wealth of Nations, Smith explained his conception of the nature of the wealth of nations. In so doing, he separated his views from those of the mercantilists and physiocrats.

The annual labour of every nation is the fund which originally supplies it with all the necessaries and conveniences of life which it annually consumes, and which consists always either in the immediate produce of that labour, or in what is purchased with that produce from other nations.

In a number of places throughout Wealth of Nations, Smith berated the mercantilists for their concern with the accumulation of bullion and identification of bullion with the wealth of a nation. Smith believed, in fact, that most mercantilists were confused on this issue. For him, wealth was an annual flow of goods and services, not an accumulated fund of precious metals. He also revealed an understanding of a link between exports and imports, perceiving that a fundamental role of exports is to pay for imports. Furthermore, in his opening sentence he implied that the end purpose of economic activity is consumption, a position he developed more fully later in the book. This further distinguishes his economics from that of the mercantilists, who regarded production as an end in itself. Finally, in emphasizing labor as the source of the wealth of a nation, he differed from the physiocrats, who stressed land.

Smith went on to suggest that the wealth of nations be measured in per capita terms. Today when it is said, for example, that England is wealthier than China, it is understood that the comparison is based not on the total output or income of the two countries but on the per capita income of the population. In essence, Smith’s view has been carried forward to the present. In the same paragraph in which Smith stated that consumption is “ the sole end and purpose of all production,” he rebuked the. mercantilists because in their system “ the interest of the consumer is almost constantly sacrificed to that of the producer” and because they made “ production, and not consumption . .. the ultimate end and object of all industry and commerce.”

So much for the nature of the wealth of nations. The rest of Smith’s book is concerned with the causes of the wealth of nations, directly or indirectlyâ€” sometimes very indirectly. Book I deals with value theory, the division of labor, and the distribution of income; Book II with capital as a cause of the wealth of nations. Book III studies the economic history of several nations in order to illustrate the theories presented earlier. Book IV is a history of economic thought and practice that examines mercantilism and physiocracy. Book V covers what today would be called public finance.

Causes of the Wealth of Nations

Smith held that the wealth of a nation, what we today call the income of a nation, depends upon (1) the productivity of labor and (2) the proportion of laborers who are usefully or productively employed. Because he assumed that the economy will automatically achieve full employment of its resources, he examined only those forces that determine the capacity of the nation to produce goods and services.

Productivity of labor. What determines the productivity of the labor force? In Book I, Smith stated that the productivity of labor depends upon the division of labor. It is an observed fact that specialization and division of labor increase the productivity of labor. This had been recognized long before the publication of Wealth of Nations, but no writer emphasized the principle as Smith did. In our modern economyâ€” even in the academic worldâ€” division of labor is widely practiced, with notable influence on productivity. Smith illustrated the advantages of specialization and division of labor by borrowing from past literature an example that measured output per worker in a factory producing straight pins. When each worker performs every operation required to produce a pin, output per worker is very low; but if the production process is divided into a number of separate operations, with each worker specializing in one of these operations, a large increase in output per worker occurs. In Smith's example, when the process is divided into eighteen distinct operations, output per worker increases from twenty pins per day to forty-eight hundred.

It is interesting that although Smith recognized the economic benefits of specialization and division of labor, he also perceived some serious social costs. One social disadvantage of the division of labor is that workers are given repetitious tasks that soon become monotonous. Human beings become machines tied to a production process and are dehumanized by the simple, repetitive, boring tasks they perform. But Smith had no doubt that human welfare is, on balance, increased by the division of labor.

The division of labor, in turn, depends upon what Smith called the extent of the market and the accumulation of capital. The larger the market, the greater the volume that can be sold and the greater the opportunity for division of labor. A limited market, on the other hand, permits only limited division of labor. The division of labor is limited by the accumulation of capital because the production process is time-consuming: there is a time lag between the beginning of production and the final sale of the finished product.

In a simple economy in which each household produces all of its own consumption needs and the division of labor is slight, very little capital is required to maintain (feed, clothe, house) the laborers during the production process. As the division of labor is increased, laborers no longer produce goods for their own consumption, and a stock of consumer goods must exist to maintain the laborers during the time-consuming production process. This stock of goods comes from saving and is, in this context, what Smith called capital. A major function of the capitalist is to provide the means for bridging the gap between the time when production begins and the time when the final product is sold. Thus, the extent to which production processes requiring division of labor may be used is limited by the amount of capital accumulation available. Smith therefore concluded: " As the accumulation of stock must, in the nature of things, be previous to the division of labour, so labour can be more and more subdivided in proportion only as stock is previously more and more accumulated."

Productive and unproductive labor. The accumulation of capital, according to Smith, also determines the ratio between the number of laborers who are productively employed and those who are not so employed. Smith's attempt to distinguish between productive and unproductive labor became confused and reflected normative or value judgments on his part. However, it manifests an awareness of the problem of economic growth. Labor employed in producing a vendible commodity is productive labor, Smith held, whereas labor employed in producing a service is unproductive. As an advocate of the changing social and economic order, he postulated that the activities of the capitalists, which resulted in an increased output of real goods, were beneficial to economic growth and development, whereas the expenditures of the landowners for servants and other intangible goods were wasteful. " A man grows rich by employing a multitude of manufacturers: he grows poor by maintaining a multitude of menial servants." 10 According to Smith, what is true of the individual is true for the nation; thus, for the economy as a whole, the larger the share of the labor force involved in producing tangible real goods, the greater the wealth of the nation. Capital is required to support the productive labor force; therefore, the greater the capital accumulation, the larger the proportion of the total labor force involved in productive labor. " Capitals are increased by parsimony, and diminished by prodigality and misconduct."

This distinction between productive and unproductive labor also affected Smith's view of the role of the government in the economy. Just as the expenditures of the landowning class for servants and other forms of unproductive labor are detrimental to economic development, so is some part of government expenditures. " The sovereign, for example, with all the officers both of justice and war who serve under him, the whole army and navy, are unproductive labourers." 12 Smith insisted that the highest rates of economic growth would be achieved by distributing large incomes to the capitalists, who save and invest, and low incomes to the landlords, who spend for menial servants and " who leave nothing behind them in return for their consumption." 13 Furthermore, because economic growth is inhibited by government spending for unproductive labor, it is better to have less government and, consequently, lower taxes on the capitalists so that they may accumulate more capital.