The main elements of adam smith’s economic theory essay sample

Economics

Set out the main elements of Adam Smiths economic theory, and explain its strengths and weaknesses.

Adam Smith, who is well known as the father of capitalism, was born in Scotland in 1723. After turning fifteen, he went to Glasgow University, where he majored in moral philosophy. A short two years later he carried his education on to Balliol College, in Edinburgh. He later became a professor at Glasgow University. In 1776 he published his most important work, The Wealth of Nations which was his most important and lasting legacy and contained his most important work.

The following is an extract from Smiths The wealth of nations which attempts to explain his most important economic principle, the invisible hand.

“ 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 self-interest… [Every individual] intends only his own security, only his own gain. And he is in this 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 society more effectually than when he really intends to promote it.” In other words, the “ invisible hand” represents all the social good caused by individuals pursuing their own self-interest. A businessman who wants to turn a profit, must first come up with a product that is beneficial and desired by many customers. By pursuing his own greed, the millionaire also benefits society by providing a product or service.

The basis of this invisible hand theory is the market will sort itself out, meaning that prices will be kept to a market equilibrium because of competition between product providers and the fact that consumers will demand lower prices. The problem with Smiths argument, through no fault of his own since it was the circumstances of his time, is that huge corporations are no match for the individual consumer. It is essentially an unfair fight. In effect, large corporations can keep whole countries poor as a result of lack of opposing forces or competition to keep prices fair.

Another problem with his theory is that it does not account for the fact that the market, left alone to the forces of the invisible hand, will see booms and busts. These kinks in his theory were only later addressed by another famous economist John Maynard Keynes.

References: Economics: a view from the top. 1989. Todd Burns