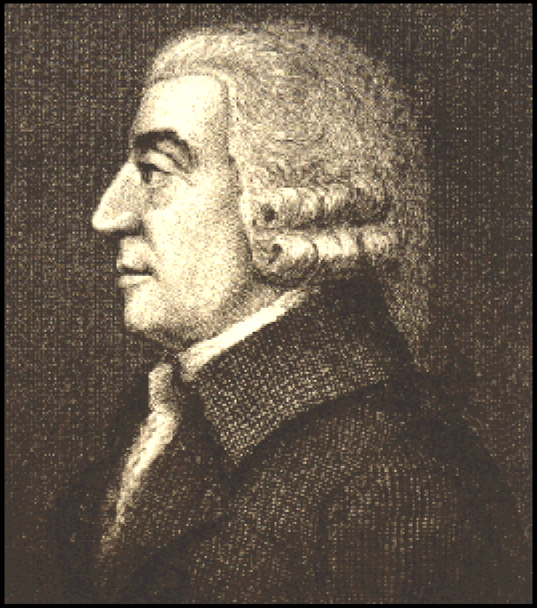
Adam Smith and *The Wealth of Nations.* *What Economic Liberalism means in the 21st century.*

Dr. Alan J. M. Haffa

Adam Smith (1723-1790)

- *Wealth of Nations* published in 1776
- Father was Controller of Customs in Scotland
- Influence of David Hume
- 1750s: Professor of Logic at Glasgow University
- 1760s: Tutor to a nobleman and travel in France; exposed to French economists
- 1778: Commissioner of Customs



Main Principles of Liberalism, Laissez-faire or Physiocracy

- Natural (Physiocracy)
- (Liberal) As little government interference as possible; low taxes lead to more productivity.
- Invisible Hand: people's individual economic choices naturally lead to the best possible economy
- Free Trade will lead to economic benefits for all parties

Means of Mercantile Control and Results of Mercantilism

- Tariffs on imports and protectionism of local products
- Restriction on the means of foreign trade; Gold and Silver Exchanges restricted (fees on the export of precious metals).
- Creation of Monopolies: Dutch East India Company, etc.

- Tariffs lead to retaliation and to higher prices; in effect, they are a tax on the consumer who must pay more than he otherwise would if there were free and open competition.
- Trade is hindered when Gold and Silver are restricted: Less Trade occurs and this results in less competition and higher prices.
- Monopolies can charge above the natural price for goods: Higher prices

Smith Opposed to Mercantilism

- Mercantilists sought to encourage Exports but discourage Imports: a positive Trade Balance was thought to be necessary; Trade Deficits to be avoided at all costs.
- Gold and Silver were thought to be the basis of all wealth, and therefore, security; The object of Foreign Trade was to bring more Gold and Silver into the country than went out.

Key Concepts of Liberalism introduced by Smith

- GDP is the true measure of a nation's wealth and power; not its Gold and Silver
- The wealth of the nation is reckoned as the GDP divided by the population: Average Productivity
- The Wealth of the Nation increases with the Division of Labor
- Disincentives to labor and to investment in manufacture lead to decline in productivity (Taxes and Tariffs)
- Free Trade Promotes Productivity: NAFTA and GATT and CAFTA

Prices: Rent, Labor, and Stock (capital investment)

- Natural Price: the cost to produce an item based upon the labor, rent (includes raw materials), and standard rate of return for the stock investment. What it really cost to bring it to market.
- Market Price: May be lower or higher depending upon supply/demand. Supply will naturally adjust to demand, arriving in time at the natural price; but, monopolies and other unnatural constraints can restrict this natural adjustment.

Division of Labor

- Example of Pin Maker: one person may make one pin a day; 10 people could make 48,000/day, 4,800/each; Pin making could involve as many as 18 different operations!
- Increase in productivity due to

1) Increase in skill
2) Time saved moving from task to task
3) Invention of machines to facilitate labor

Is anything lost by specialization?

Price of Labor

- Money conveys the power to purchase and command labor or the product of labor.
- But we do not calculate value by labor because it is difficult to calculate

1) Hardship
2) Ingenuity Exercised
3) Labor and Time Required to acquire skill or knowledge
4) Supply and Demand: “It is adjusted, however, not by any accurate measure, but by the higgling and bargaining of the market, according to that sort of rough equality which, though not exact, is sufficient for carrying on the business of common life.”

Productive Labor

- Productive labor adds value to the object of the labor.
- "The labor of a manufacturer adds, generally, to the value of the materials which he works upon…" A woven rug is more valuable than the plain wool. A nail is more valuable than the unforged steel.
- Unproductive labor does not add value: all service industries; teachers, public servants, military, churchmen, lawyers, physicians, scholars, entertainers, etc. "Like the declamation of the actor, the harangue of the orator, or the tune of the musician, the work of all of them perishes in the very instant of its production."
- All people, productive laborers, unproductive, and those who do no work at all, "are all equally maintained by the annual produce of the land and labor of the country."

Free Trade

- Free trade within the country and with other countries leads to greater productivity. It is good for all parties. The increase in English productivity due in part to the free movement of goods within England compared to Provincial Dues in France
- “It is of more consequence that the capital of the manufacturer should reside within the country. It necessarily adds greater quantity of productive labor, and adds a greater value to the annual produce of the land and labor of the society.”
- Also a useful way to disburse excess goods

Outsourcing and Mechanization

- David Broder, “The Bust within the boom,” quoting Rep. Barney Frank: “The ability of the private sector in this country to create wealth is now outstripping its ability to create jobs. The normal rule of thumb by which a certain increase in the gross domestic product would produce a concomitant increase in jobs does not appear to apply.”
- What is it about our modern economy and the practice of outsourcing that would undermine this economic law?

Difference between Free Trade and Outsourcing

- Smith was considering the situation where raw goods might be imported from another country and then fashioned. Rather than use native flax, for example, they import flax from the Baltic region. But while the rent of the land that produced the flax is lost, as well as the labor of harvesting the flax, the labor of producing the flaxen clothes is still retained, and that is the most profitable.
- When we outsource, we still gain the tax on the capital investment of the company (the companies profits; maybe), but we lose the value added by the labor and the tax upon that labor. There is no guarantee that the foreign employees will purchase other American goods and certainly they will not purchase as many American services as an American employee would.

On Monopolies

- A monopoly is when one company controls a particular market so much that they can essentially charge whatever they want.
- In healthy capitalism, companies compete for market and this creates a “natural” price for goods.
- “The monopolists, by keeping the market constantly under-stocked, but never fully supplying the effectual demand, sell their commodities much above the natural price…”
- Think Frito Lay.

Trade Associations and Politicians: Collusion

- Public ought to be suspicious of trade and manufacturing organizations
- “to widen the market and to narrow the competition, is always the interest of the dealers…The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution…It comes from an order of men, whose interest is never exactly the same with that of the public, who has generally an interest to deceive and even to oppress the public…”
- Corporate lobbyists

War and Economy

- “But had not those wars given this particular direction to so large a capital, the greater part of it would naturally have been employed in maintaining productive hands, whose labour would have replaced, with a profit, the whole value of their consumption. The value of the annual produce of the land and labour of the country, would have been considerably increased by it every year, and every year’s increase would have augmented still more that of the following year. More houses would have been built, more lands would have been improved, and those which had been improved before would have been better cultivated, more manufactures would have been established…and to what height the real wealth and revenue of the country might, by this time have been raised, it is not perhaps very easy even to imagine.” p. 328

Progressive Taxation

- 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." (p. 775)
- Why should taxation be progressive?

Conclusion

- Division of Labor promotes GDP
- Free Trade promotes GDP
- Free Trade is "natural" and is based on men freely pursuing their own economic interests
- "Invisible hand" produces the best outcome even though individuals all pursue their individual interests
- Monopolies undermine the GDP
- Taxes should be proportionate and progressive
- Manufacturing and Trade Organizations should not be trusted when they lobby for Business Laws.