

## **Adam Smith – The Wealth of Nations**

In 1776 Adam Smith, a Scottish philosopher published his famous work on economics, “The Wealth of Nations.” Smith's writing is the foundation for laissez-faire (*French for “let it be”*) economics, such as minimizing the role of government intervention and taxation in the free markets, and the idea that an “invisible hand” guides supply and demand.

### **Self Interest is the motivator of economic activity.**

Why do you go to work? Why do you go to school? There may be many reasons, but at their core you probably go to work and school because you are self-interested. To be self-interested simply means that you seek your own personal gain. You go to work because you want to get paid so you can buy the things you want. You go to school so you can get a better job someday and earn more money to buy the things you want. In fact, most of the economic activity we see around us is the result of self-interested behavior. Adam Smith described it this way in his book, *The Wealth of Nations*:

“It is not from the benevolence (kindness) of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.”

So why does the baker choose to bake? The answer is self-interest. The baker wants to earn enough money to feed his family and buy the things he wants, and the most effective way he has found to do that is to bake bread for you. In fact, his bread has to be good enough and the service friendly enough that you are willing to give up your money freely in exchange for his bread. The baker while serving his self-interest has produced a good that is very valuable to you. The miracle of a market system is that self-interest produces behavior that benefits others.

Is being self-interested greedy? Is it immoral? While the term self-interest has negative connotations, it does not necessarily imply greedy or immoral behavior. Self-interest just means that you seek your goals. In fact, your self-interest might lead you to study hard for your math test, give money to your favorite charity or volunteer at a local school.

### **Competition is the regulator of economic activity.**

Doesn't self-interest lead to price gouging, corruption and cheating? Sometimes it does, but most often it is held in check by competition. Because other self-interested people are competing in the marketplace, my self-interest is held in check. For example, if I were a baker, the only way I would be able to earn your dollars is to produce bread that is better, cheaper or more convenient than the bread produced by the other bakers in town. If I were to increase my price too much, you would likely buy bread from my competitors. If I were to treat you poorly when you enter my store, you would likely buy from my competitors. If my bread were moldy or inferior in any way, you will likely buy from my competitors. In order to earn your money I must provide a high quality good or service at a reasonable price. You will notice that this assumes I have competitors. If I were the only baker in 100 miles, I might be able to charge a high price, sell inferior products, or treat my customers rudely - but even in that case, another self-interested person might see an opportunity to earn a profit and open a competing bakery in town. Thus, competition is the regulator, a check on self-interest because it restrains my ability to take advantage of my customers.

### **The Invisible Hand**

Adam Smith described the opposing, but complementary forces of self-interest and competition as the invisible hand. While producers and consumers are not acting with the intent of serving the needs of others or society, they do. When you work, your goal is to earn money, but in the process, you provide a valuable good or service that benefits others and society. The amazing part of this process is that there is very little government control. The bread you buy at the store arrived as the result of hundreds of self-interested people cooperating without a government bread agency managing production at each step along the way. The farmer grew the grain, the mill prepared the flour, the bakery produced the bread, the truck driver delivered the bread to the grocery store, the grocer stocked the shelves and sold the loaf to the consumer all without a Government Secretary of Bread

Production telling any of them what, where, when, or how much to produce. It's as if they were being guided by an invisible hand that guided resources to their most valued use. In the words of Adam Smith, "by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention."

## **Karl Marx – Das Kapital**

Karl Marx published *Das Kapital* in 1867, almost one hundred years after Adam Smith's work. At the time capitalism was still a relatively new concept, brought about by industrialization. Economic life in England, the front runner in industrialization and where Marx was living at the time, was the basis for his critique. The major industry in England was the wool and textile industry and the conditions in the factories were abysmal. Marx wrote in terms of a struggle between opposites, as the historical process which brought change. His view of a struggle between classes is called dialectical materialism.

In any particular era, it was said, there was a dominant, ruling class and an oppressed class. As economic circumstances changed, a new ruling class emerged and a new oppressed class was created. As an example, in the traditional period (pre-industrial revolution), the ruling class was the aristocracy and the oppressed class was the peasantry. In the modern period, the new ruling class were the capitalists, or bourgeoisie, and the new oppressed class were the working class, or the proletariat.

Marx saw the enormous productivity of capitalism, but also looked at its evils:

- 1.) Competition drove the less successful into bankruptcy, while those who survived became ever more powerful and wealthier.
- 2.) Workers were powerless to protect themselves against a system which demeaned the value of labor, reducing it to a commodity, rather than recognizing labor as the true measure of value.
- 3.) Workers were exploited. The details of this exploitation were described, in detail, by his close friend and colleague, Friedrich Engels.

Marx predicted the collapse of capitalism through its inherent contradictions: ruthless competition among capitalists would destroy capitalism. Its own decadence would invite the proletarian revolution to overthrow the capitalist state.

The state was defined by Marx as the instrument by which one class dominates another. The liberal goals of the bourgeois (liberal) revolution were dismissed as meaningless, because only the capitalist class benefited. The capitalist state would be replaced by the proletarian state which he called the dictatorship of the proletariat. The proletarian state would create a socialist economy and a classless society. Once that was accomplished, the state would no longer have a purpose, and would wither away. The result would be the communist society, in which the great productive capacity of the new economy, evenly distributed according to need, would enable people to perform work for self-fulfillment rather than for monetary value.

Marxism was never realized by any government in the 19th century, but because some governments in the 20th century have claimed to be Marxist, it is important to understand its appeal. The "Achilles heel" of pure capitalism is the fact that, without government intervention in the private market, countries suffer from terrible inequality. The lower class live lives of desperation, while surrounded by others who have wealth and live in luxury. This inherent injustice will always give the Marxist vision a magnetic appeal, even if that vision cannot be realized.

## **Answer these questions on a separate sheet of paper**

1. What do people who follow "laissez-faire" economics believe?
2. What does "self-interest" mean? How does it get people to work?
3. How is self-interest different from selfishness?
4. How does competition keep self-interest under control?

5. What did Smith mean by the “invisible hand?”
6. What is “dialectical materialism?”
7. What were Marx’s criticisms of capitalism?
8. What did Marx think would cause capitalism to collapse?
9. What did Marx mean by the “dictatorship of the proletariat?”
10. How would you summarize each of these writers’ main ideas?

*<https://www.stlouisfed.org/education/economic-lowdown-podcast-series/episode-3-the-role-of-self-interest-and-competition-in-a-market-economy>*