

### **Brief biography of Adam Smith**

- Adam Smith was born on June 16th, 1723 in Kirkcaldy, Scotland
- He would die on July 17th, 1790, in Edinburgh
- He studied social philosophy at the University of Glasgow at the age of 14, and graduated in 1740
- He would later travel to the University of Oxford to undertake his postgraduate studies in philosophy
- He began a teaching career at the University of Edinburgh in 1748, and would later become a professor at the University of Glasgow, teaching moral philosophy and ethics
- He later became a professor at the University of Glasgow, and was quite respected, giving many lectures across Europe
- Adam Smith would later be known for his two most famous works, the Theory of Moral Sentiment (1759) and his magnum opus, The Wealth of Nations (1776)

### **The theory of the Invisible Hand**

- Smith came up with the theory of an “Invisible Hand”, which was the idea that there was an invisible hand that guided market
- Smith’s work mentions the idea of the “economic man”, someone who acts in their own self-interest, and how they are guided by an invisible hand
- Adam Smith’s quote “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 interest” explains the idea that when individuals act in their own self-interest, they bring about the best outcome for society
- “By pursuing his own interest he frequently promotes that of the society more effectively than when he really intends to promote it” shows the previous point
- The theory also promotes the idea that the market will regulate itself, through supply and demand
- Producers and consumers determine the price and quantity of goods and services, through their given incentives, to maximize profit and utility
- Given that the market regulates itself, Smith was of the belief that government regulation was to be limited in markets, and that the goal of governments was to provide laws that allow for the framework of markets to function, and also the provision of essential goods such as infrastructure and defense
- Smith’s ideas of market forces and their impact eventually led to the idea of supply and demand and were also instrumental to the push for free-market capitalism, and less government intervention

### **The division of labour**

- Smith’s famous example of the pin factory explores the concept of the benefits of division of labour and specialization
  - Ten workers could produce 48,000 pins per day if each of the eighteen specialized

tasks were assigned to particular workers, such that each of them specialized in two to three

- Therefore, each work would be producing 4,800 pins per day, something that they would not be able to do by themselves, if they were to do all the steps of production
- In the absence of the division of labor, a worker would be lucky to produce about 20 pins per day
- This idea promotes the most efficient use of factors of production, and is how large firms and corporations are able to utilize economies of scale to ramp up their production
- Through specialization, producers can enjoy significant productivity gains, as each worker is able to do one particular task very well, faster than someone doing all the tasks, and at a higher quality

### **Promotion of free trade**

- The standard at the time of Smith was the idea of Mercantilism, where a nation's wealth was based off the amount of gold and silver it possessed
- Countries would often aim to export more than they imported, so they could keep the amount of gold and silver they possessed and grow the countries wealth
- They would often do this by placing high tariffs on imported goods, foregoing free trade
- Smith proposed the idea that the value of a country came from the value of its goods and services, which would give rise to Gross Domestic Product as a means to measure the wealth of a country
- He also believed that free trade actually leads to a mutual benefit between the two parties that trade, rather than the exporter gaining and the importer losing
- The Scottish wine example shows that if a country has a comparative advantage over another, meaning that they have a lower opportunity cost to produce a certain good, they should specialize in its production, as it benefits both parties
- If a country can produce a product better and with fewer resources, then a country that is unable to do that can trade to get these goods rather than using its inefficient production to produce the good

### **Impact on Modern Economics**

- Smith's ideas on the invisible hand, division of labour, and ideas on free trade have been crucial to the development of modern economics
- Smith's ideas helped develop the classical school of economic thought, which later evolved into the neo-classical school
- Some of the key principles that still apply to modern economics include:
  - Free markets and competition
  - Limited government intervention (only to provide defense, infrastructure, and public goods)
  - Self-regulating markets