

The ABC of Economic Literacy: 'A' for Adam Smith

The New Zealand Initiative | 06 March 2014

Few economists are more famous than the Scotsman commonly regarded as the founder of economics, Adam Smith (1723–1790). On one hand, this is understandable and much deserved. Smith's book, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), established economics as an academic discipline. *The Wealth of Nations* also contains many important insights into economic logic.

On the other hand, it is also a little bit odd for two reasons.

Before Smith appeared, there had already been centuries of economic discussions. And, Smith probably would not even have called himself an economist but a moral philosopher.

Smith did not start his intellectual life as an economist. To his contemporaries, he would have been better known as the author of *The Theory of Moral Sentiments* (1759). In this earlier work, Smith explained how society is held together by people caring for their neighbours. His vision was one shaped by virtues, conscience, moral rules, altruism and law.

The Wealth of Nations is the other side of the same coin in Smith's thinking. In it, he showed how self-interested behaviour fits into his moral philosophy. It fitted surprisingly well.

Smith's critical insight was that competition harnesses self-interest for the greater good of society. "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." It is as if 'an invisible hand' led people to do not just what is good for them but for their neighbours as well, he observed.

Smith's second-most important contribution to economics was understanding the division of labour. By observing how much more efficient a pin factory becomes if workers specialise on different tasks, Smith concluded that it is such specialisation which makes us more productive. This is true for companies, but also for countries – which is why he was an advocate of free trade.

Few ideas he presented in *The Wealth of Nations* were genuinely new, but it was Smith who collected the economic wisdom of his time, gave it a new framework, and firmly established economics as a social science.

Two hundred and thirty eight years after *The Wealth of Nations*, Smith's timeless ideas are still relevant and inspirational both for policymakers and for economists. Smith remains the best teacher for anyone aspiring to understand how altruism and self-interest belong together in society.

The New Zealand Initiative is a Wellington-based think tank formed by the merger of The New Zealand Business Roundtable and The New Zealand Institute. www.nzinitiative.org.nz. CEO Dr Hartwich is a regular speaker at PortfolioConstruction Forum programs.
