ACTIVITY 23.1

The Two Faces of Adam Smith

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In 1723, Adam Smith was born in a small village in Kirkcaldy, Scotland. His father was a customs agent. That is, Adam's dad inspected the different products, bags, and objects carried on the ships entering or leaving Kirkcaldy. Unfortunately, Adam's dad died before Adam was born, leaving his wife to raise Adam. Adam went on to learn about his dad's business. He often sat and watched ships enter the harbor with goods from other countries and leave port with exported goods from Scotland. Adam was fascinated with the work of the customs agents. He watched them carefully inspect the goods carried by the ships. The young Smith took special note of the ships leaving his country with goods produced in Scotland for people in other countries to consume.

Exported goods were considered good for the country. The people buying them paid in gold and silver, helping the country build wealth. By contrast, the goods imported into Scotland through Kirkcaldy were considered bad for the country because it was thought that they drained the mother country of its precious metals. This thinking was called **mercantilism**. This system based the wealth of Scotland and other countries like England on the amount of gold and silver held in each country's coffers. International trade was considered a positive to the exporting country but a negative to the importing one because the exporting country received gold and silver from the trade partner.

At 14, Adam entered college. Although his poor health had kept him from attending college when his classmates went at age 12, he was a good student and accepted a scholarship to the University of Glasgow. He later pursued graduate studies at Balliol College at Oxford. After that, he taught, researched, and traveled. Education benefited Adam greatly. It helped him broaden his world view and opened new opportunities to him.

In 1759, economics was not a subject unto itself. Adam Smith's first book, *The Theory of Moral Sentiments,* explained why and how people cooperate in a variety of settings. Smith believed people helped others by carefully managing their emotions, behaviors, actions, and interactions in ways that benefited them *and* others. Smith did not buy the notion that most people were selfish and greedy. Smith noticed that selfish and greedy people had a hard time getting others to cooperate, work with them, or help them in times of need. Why? People have a choice.

Activity 23.1, continued

People freely choose with whom to play, work, and do business, argued Smith. Selfish and greedy behaviors are not rewarded for long, even in the marketplace. People turn away from individuals who continuously lie, go back on their word, fail to do what they say they will, or cheat. People want to interact with honest, trustworthy, respectful, and honorable individuals.

Smith believed that a powerful authoritarian government was not needed to oversee business. Government's main role should be to protect the rights of individuals to pursue life, liberty, and happiness without harming others. Government was needed when individual rights were violated and justice was required.

In 1776, *The Wealth of Nations* was published. It showed how Smith's theories on morality applied to business. Today, many consider this book one of the first real economics books. Because of this book, Smith is sometimes called the "Father of Economics."

In *The Wealth of Nations*, Smith points out the weaknesses of mercantilism (government restricting imports to build up its purse of gold and silver). It focuses on how individuals' desires to cooperate and serve others lead to voluntary exchanges that make everyone better off—whether the trade is between individuals or countries. Contrary to popular belief at the time, Smith argued that wealth was not simply the amount of gold and silver piled up in a country's vaults. Wealth, Smith said, was increased by ordinary people being able to acquire the goods they valued through voluntary exchange.

Smith claimed that ordinary people benefit individually by pursuing their own interests. Individuals best serve their interests by helping and cooperating with others—even in markets. This voluntary exchange within a moral framework is how nations build wealth. Government control over production, consumption, or exchange is not required.

Individuals interacting in a free market choose what is best as they consider the different costs and rewards that their actions produce. As long as the benefits of an activity exceed its costs, people will continue doing it. They will stop when the costs exceed the benefits. As long as the additional benefits of an activity exceed the costs, wealth grows for everyone involved. Some wealth, like in the trading exercise, comes in the form of simply moving goods to those who value them most from those who value them least. Other types of wealth come from exchanges involving money, homes, buildings, education, computers, machines, stocks, bonds, and other assets.

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