|  |  |  |
| --- | --- | --- |
| Economist  | Adam Smith | Karl Marx |
| What book did the economist write? |  |  |
| What is their biographical background? |  |  |
| If they were observing a factory, what would they see? | Productivity:  | Alienation:  |
| What conclusions would they draw?  | The “invisible hand”Competition:  | Class Struggle:Economic Instability  |
| What was their impact on economics? | Economic liberalism | Revolution:  |
| What are some contemporary issues?CURE the article on the back and write a summary of it.  | Consumerism | Income Inequality |

|  |  |  |
| --- | --- | --- |
| Economist  | Adam Smith | Karl Marx |
| What book did the economist write? | *The Wealth of Nations* | *The Communist Manifesto**Das Kapital* |
| What is their biographical background? | He studied in Scotland and England and was part of the Enlightenment in trying to *rationally* understand the economy.  | He was born in Prussia and ended up in England after being deported for his radical views.  |
| If they were observing a factory, what would they see? | Productivity: Adam Smith saw how the division of labor in a factory would increase the efficiency of production, because specialization was more efficient than one person making a whole product, a pin.  | Alienation: Karl Marx was skeptical of the new technology because it made work dull, repetitive and alienating.  |
| What conclusions would they draw?  | The “invisible hand”Economic markets will satisfy the demands of people naturally because people in their self-interest will produce those goods in order to make money from it. Competition: In order for markets to work best there must be competition. Otherwise, it will not satisfy consumer needs nor remain innovatve. | Class Struggle:Injustice and inequality have been part of historical economic systems from slavery to feudalism and now capitalism. In capitalism, the capitalist owned the means of production—machines and property to make things—and ruled over proletariat who sold their labor for wages. Economic Instability Competition causes the failure of some companies increasing the instability of the market.  |
| What was their impact on economics? | Economic liberalismFree market capitalism has become the dominant and most successful economic system since.  | Revolution: Marx predicted that the proletariat would grow unhappy with the ruling class and attempt to create a more equal society. (Ultimately he thought we would move to a classless society.) |
| What are some contemporary issues?CURE the article on the back and write a summary of it.  | ConsumerismIncreased production of goods meant businesses needed to sell more goods, which led to the development of advertising. Society moved from consumption, just buying stuff, to consumerism, the habitual consumption of goods, which leads to wasted resources. We are now confronted with issues of sustainability.  | Income InequalityExtreme inequality of wealth has been a problem during the capitalist era. Inequality leads to various social problems like unrest, increasing divorce rates, unemployment and difficulty finding work, and less social mobility. Various solutions have been proposed to resolve the problem.  |

Great Economists: Adam Smith

When the Scotsman Adam Smith (1723–1790) was born, industrialization and a profit-driven market system were replacing custom and command-driven economic systems across Europe. These changes reflected an intellectual shift toward rationality, progress, liberty, and secularism — generally referred to as the Enlightenment.

Smith studied in Glasgow, Scotland, and Oxford, England. He had many jobs: professor and lecturer, private tutor to the children of European royalty, government economic adviser, and customs commissioner for Scotland. This gave him a comprehensive understanding of economics. His ideas are captured most powerfully in *An Inquiry Into the Nature and Causes of the Wealth of Nations*, usually known as *The Wealth of Nations*.

Composed at the dawn of the Industrial Revolution, *The Wealth of Nations* describes a world increasingly dominated by commerce and capitalism. Here, Smith gives his observations of a visit to a pin-making factory:

One man draws out the wire, another straights it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving the head; to make the head requires two or three distinct operations; to put it on is a peculiar business, to whiten the pins is another; it is even a trade by itself to put them into the paper; and the important business of making a pin is, in this manner, divided into about eighteen distinct operations.... [An average factory of ten workers] could make among them upwards of forty-eight thousand pins in a day. Each person, therefore...might be considered as making four thousand eight hundred pins in a day. But if they had all wrought separately and independently, and without any of them having been educated to this peculiar business, they certainly could not each of them have made twenty, perhaps not one pin in a day.

In other words, the division of labor allowed one man to be as much as 4,800 times more productive than if he worked alone! In addition, Smith argued that people have a natural drive to improve their own lives. This self-interest, he suggested, propels markets to satisfy individual demands by producing the goods and services people want. He called this the “invisible hand,” and wrote, “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.”

He suggested that competition between businesses ensures fair prices and quality products. Competition also drives innovation and satisfies consumer demand. In short, competition keeps everyone honest, because customers treated unfairly by one business can always go to another one instead.

Smith argued that the complex functions of society and economy emerged from the self-interested actions of each individual. This view must have been reassuring and liberating to a world undergoing a great transition. It was certainly popular: the first edition of *The Wealth of Nations* sold out within 6 months.

Smith’s remarkable insights not only captured his own time accurately. They also foresaw much of the economic future. Free-market capitalism has survived as the world’s foremost economic model for the last 200-plus years. Today, we call this arrangement “economic liberalism.” The liberalization of economies continues around the world.

Though Smith predicted many of the successes of industrial capitalism, he lived too early in the Industrial Revolution to see its worst side effects. It would take several more decades to produce a critic whose cynicism toward capitalism matched Smith’s optimism. That critic was Karl Marx.

From consumption to consumerism

By Gale, Cengage Learning, adapted by Newsela staff

Consumption is the way that we buy new things, use them for a while, and then throw them away when they are old. Consumption is similar to consumerism. Consumerism is when a country needs people to always keep buying more and more goods. It is necessary for people to keep buying things so that there are jobs and businesses.

But, always making new things and then throwing them away damages the environment. Some people believe the world should make things in a way that protects the planet. They say that would make the planet more sustainable.

# What Is Sustainability?

Sustainability is the idea that people should meet their needs without hurting the ability of future generations to meet their own needs. For example, people should make sure their habits do not use up too many natural resources or damage the environment.

That's where supporters of sustainability are coming from. They say consumption and consumerism encourage waste and that buying things becomes too important in people's lives. It can be unhealthy for people to focus so much on buying things to stay happy.

# Background

During the Great Depression of the 1930s, businesses suffered and many people lost their jobs and homes. Then during World War II (1939–1945), there was little food, so people had to wait in line sometimes to get it. After these tough times, Americans wanted to live more comfortable lives. Troops came back from the war and got jobs with better pay. People bought more homes and cars.

During this time people started buying more. They became consumers. What they bought was influenced by the advertising they saw. The advertising business became very powerful in the 1950s and 1960s. Back then, televisions were becoming more popular in homes. Many television commercials were aimed at children. Advertising to children is now on the Internet. It is even in some school cafeterias.

Since the mid-1900s, the world's population has consumed more goods and services than all previous generations of people combined.

But consumption has its bad sides. Some companies that make goods moved jobs to countries with few or no laws that protect workers, or pay them enough. This keeps prices of products low so that people in rich countries can keep buying the products. But it also takes advantage of workers in poorer countries. They are paid very little and work in dangerous conditions.

Rich societies that buy a lot also use more resources and hurt the environment more. The United States is one example. The country has 5 percent of the world’s population but creates half of the garbage in the world.

# Consumption And Sustainability

People must think about the future. Why? Because the Earth cannot keep up this consumption lifestyle forever. People must become aware of how their daily activities affect their world and the environment.

That’s why sustainable consumption is an important idea. Here is a definition of sustainable consumption: consuming goods and services that hurt the environment less and treats workers better. What would a sustainable society look like?

This type of society would provide all citizens of the world with basic necessities. Some of these basics include water, healthcare, food and shelter.

How do we get there? It is not easy. But it is possible. For society to choose sustainable consumption, it must educate its citizens. People should support laws that improve how we take care of the environment. Society must teach everyone to replace the values of consumption with values of sustainability.

Things are getting better in some ways. Awareness of the importance of sustainable consumption is growing. People are demanding products that last longer and are made in ways that cause less harm to the environment. They are also demanding manufacturing methods that are safer for workers.

# Consumption And Citizenship

What can people do to help change consumption habits for the better? The simple answer is this: take action and get involved. People can get involved by voting for politicians who make laws that encourage sustainability. People can also spend their money in a way that pressures companies to do business in more sustainable ways.

There are also organizations that can help people try to have a positive impact. One example is the Campaign for a Commercial-Free Childhood. The organization offers advice for families hoping to cut down on the number of things they use. It also gives them information about how they can push for better laws that encourage sustainability.

Great Economists: Karl Marx

Karl Marx (1818–1883) was born in the midst of the Industrial Revolution, into a middle-class family in Prussia (a former German kingdom straddling parts of present-day Germany and Poland). He led an eventful life: He was jailed for public drunkenness as a college student. His home and personal appearance were unkempt. He spent money frivolously, causing his family to frequently live on the brink of poverty. For most of his professional life, Marx was a writer for a variety of liberal, radical, and foreign newspapers. He moved between Prussia, France, Belgium, and England because he was continually blacklisted or deported for his radical views.

Marx’s attitude toward capitalism was extremely critical. The Industrial Revolution had created a factory system. Factory owners were the new ruling class. In this system, Marx saw injustice and inequality. He felt things were bound to change.

Marx and his frequent co-author, Friedrich Engels, were outraged at the hardships faced by the working classes of industrial European cities. They channeled this anger into two monumental written works that formed the basis of modern communism: The Communist Manifesto, published in 1848, and a four-volume, 2,500-page work, Das Kapital, published in 1867.

Marx saw the history of all societies as the history of class struggle. He regarded human history as a series of eras that was defined by systems for producing goods. These systems created classes: the rulers and the ruled. This process had already progressed from slavery to feudalism to capitalism and, in Marx’s view, would eventually lead to a classless society called communism.

Why did Marx object to capitalism? He saw two groups operating in capitalism: the owners and the workers. The “capitalists” owned the machines, property, and infrastructure used to make things [the means of production]. The workers, or “proletariat,” owned nothing but the right to sell their labor in exchange for wages.

Marx theorized that capitalists, competing for profits, would squeeze as much work as possible out of the workers, paying them as little as possible.

Furthermore, competition would cause some capitalists’ firms [or companies] to fail, increasing unemployment (and, thus, misery and poverty) among the proletariat.

He was skeptical of innovations in technology. New machines could add to unemployment by making human workers obsolete. Machines could also make work dull, repetitive, and alienating.

Still, Marx saw capitalism as a necessary stage for building a society’s standard of living. But he felt the proletariat would become unhappy under capitalism, and eventually overthrow the ruling class to create a more equal society.

The new, more equal society would at first be socialist — the state would control the economy and distribute resources more evenly. Then it would become purely communist — a stateless, classless, egalitarian society without private property or nationality.

Marx’s beliefs, theories, and predictions represent a school of thought called Marxism. Marxism is a theory of economics, politics, sociology, and ethics. For some, it is also a call to action.

As a call to action, Marxism was most influential in the twentieth century, when it inspired various brands of revolutionary activity. This includes the Russian Revolution in 1917 and the rise of communist governments in China, Vietnam, and Cuba, as well as in many Eastern European and African nations. It has since fizzled out, with the U.S.S.R. collapsing in the early 1990s, China shifting toward a market-friendly economy, and smaller communist countries that depended on them adopting more market-oriented systems.

As a theory, Marxism is more durable. Some believe that communism’s decline disproves Marx. Others have built on his approach of critiquing economic systems on social grounds. Even though capitalism is dominant around the world, Marx taught us to seriously examine and criticize capitalism when necessary. In other words, Marx’s skepticism about capitalism started a conversation about its weaknesses and how it can be improved.

Income inequality

By Bloomberg, adapted by Newsela staff

Income inequality is the gap between the rich and poor. It is getting wider and the world is concerned. The pope condemned it. U.S. Federal Reserve Chair Janet Yellen said she’s “greatly concerned” about it. The World Economic Forum talked much about the threat to the global economy at its annual meeting in Switzerland. Inequality has become a big issue in the U.S. presidential election. And a 700-page book about it by a French economist was a surprise best-seller.

Inequality has been getting worse in the United States and many other countries for a generation. The term is often used as a general description of different problems, including poverty. For some, it also means that it creates a system of classes, where people have different opportunities based on how much money they have. Yet, experts argue over how inequality affects people and whether it affects how wealthy a country becomes.

# The Situation

During the Great Depression in the 1930s, many people were out of a job. Between then and the 1970s, the income gap narrowed in the United States, but since then it has grown wider. From 1979 to 2011, income tripled for the top 1 percent, or 1 out of every 100 households. In the bottom fifth, income grew by just half. The world went into a recession in 2008, and many people lost jobs. In the first three years after the recession ended, the top 1 percent of earners received most of the gains. By 2013, the Federal Reserve found that the poorest half of U.S. households got nearly nothing. All economists agree that the income gap is getting worse, but they argue about how much.

The CIA World Fact Book ranks the United States 43rd out of 144 countries listed in order of unequal family income. Slovenia in Europe is the most equal and Lesotho in Africa is the least. Equality and prosperity can also be different. In the United States, the gap between rich and poor is growing, but poverty rates are falling. China’s income gap has grown wider than America’s, even as China's economy has grown and hundreds of millions of Chinese have been lifted out of poverty.

# The Background

Many factors cause the growing gap between rich and poor. Manufacturers have closed factories in the United States, causing many workers to lose their jobs. The companies reopened them in countries where labor is cheaper. In the United States, the banking and tech industries have grown much stronger and pay very well. Also, college has become much more important for finding a job, and also has become very expensive. In addition, wealthy people pay a lower proportion of their incomes in taxes to the government than they used to. This means they get to keep more of the money they earn and grow richer. Thomas Piketty is a French economist who wrote the best-selling book “Capital in the 21st Century.” Piketty said that generally throughout history as countries grow more rich, inequality gets worse. 

# The Argument

Many people think that there should not be such a big gap between rich and poor. They point to studies that show it creates big problems. Countries with a bigger gap have higher unemployment and are not as peaceful. One study found that households in areas with more inequality have more money problems. Their divorce rates are going up. They also have longer drives to work and are less able to pay their bills. More inequality is linked to less social mobility, or the ease with which people can find better jobs and make more money. In many countries, it is hard to become wealthy if your parents were not.

On the other side, people argue there is little proof these trends actually make inequality worse. Inequality can make people work harder to make more money. It can also prompt them to be more creative and take risks. These people point out that inequality isn’t a zero-sum game, in which some people get everything and others get nothing; during the recession, wealthy Americans also lost money. The recession briefly reduced inequality, but the poor did not get richer.

One proposal to lower inequality is increasing the minimum wage. This is the lowest amount of money by law that people can earn per hour. Other ideas include higher taxes on the rich, as well as higher taxes on inheritances and investments. Another idea is to limit the salaries of company leaders. Piketty suggested a global tax on capital, or wealth, to fight the social instability that he believes goes hand in hand with inequality.

# Capitalism

In everyday language, the word ‘capitalism’ is used in different ways, in part because people have strong feelings about it. In the language of economics, we use the term in a precise way because that helps us to communicate: we define capitalism as an economic system combining three institutions, each of which we need in turn to define.

‘Capitalism’ refers not to a specific economic system, but to a class of systems sharing these characteristics. How the institutions of capitalism—private property, markets, and firms—combine with each other and with families, governments, and other institutions differs greatly across countries.

|  |  |  |
| --- | --- | --- |
| PRIVATE PROPERTYThis means that you can:* enjoy your possessions in a way that you choose
* exclude others from their use if you wish
* dispose of them by gift or sale to someone else …
* … who becomes their owner
 | MARKETSMarkets are:* a way of connecting people who may mutually benefit
* by exchanging goods and services
* through a process of buying and selling
 | FIRMA firm is a way of organizing production with the following characteristics:* One or more individuals own a set of capital goods that are used in production.
* They pay wages and salaries to employees.
* They direct the employees (through the managers they also employ) in the production of goods and services.
* The goods and services are the property of the owners.
* The owners sell the goods and services on markets with the intention of making a profit.
 |

# GREAT ECONOMISTS

Adam Smith

Adam Smith Adam Smith (1723–1790) is considered by many to be the founder of modern economics. Raised by a widowed mother in Scotland, he went on to study philosophy at the University of Glasgow and later at Oxford, where he wrote: ‘the greater part of the … professors have … given up altogether even the pretence of teaching.’

He travelled throughout Europe, visiting Toulouse, France where he claimed to have ‘very little to do’ and thus began ‘to write a book in order to pass away the time.’ This was to become the most famous book in economics.

In *An Inquiry into the Nature and Causes of the Wealth of Nations*, published in 1776, Smith asked: how can society coordinate the independent activities of large numbers of economic actors—producers, transporters, sellers, consumers—often unknown to each other and widely scattered across the world? His radical claim was that coordination among all of these actors might spontaneously arise, without any person or institution consciously attempting to create or maintain it. This challenged previous notions of political and economic organization, in which rulers imposed order on their subjects.

Even more radical was his idea that this could take place as a result of individuals pursuing their self-interest: ‘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,’ he wrote.

Elsewhere in the *Wealth of Nations*, Smith introduced one of the most enduring metaphors in the history of economics, that of the invisible hand. The businessman, he wrote: ‘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. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.’

Among Smith’s insights is the idea that a significant source of prosperity is the division of labour or specialization, and that this in turn is constrained by the ‘extent of the market.’ Smith illustrated this idea in a famous passage on the pin factory by observing that ten men, each fully specialized in one or two of 18 distinct operations, could produce close to 50,000 pins a day. But ‘if they had all wrought [pins] separately and independently … they certainly could not each of them have made twenty, perhaps not one pin in a day.’

But such an enormous number of pins could only find buyers if they were sold far from their point of production. Hence specialization was fostered by the construction of navigable canals and the expansion of foreign trade. And the resulting prosperity itself expanded the ‘extent of the market’, in a virtuous cycle of economic expansion.

Smith did not think that people were guided entirely by self-interest. Seventeen years before The Wealth of Nations, he had published a book about ethical behaviour called *The Theory of Moral Sentiments*. (Smith, 1759)

He also understood that the market system had some failings, especially if sellers banded together so as to avoid competing with each other. ‘People in the same trade seldom meet together,’ he wrote, ‘even for merriment and diversion, but the conversation ends in a conspiracy against the public; or in some contrivance to raise prices.’

He specifically targeted monopolies that were protected by governments, such as the British East India Company that not only controlled trade between India and Britain, but also administered much of the British colony there.

He agreed with his contemporaries that a government should protect its nation from external enemies, and ensure justice through the police and the court system. He also advocated government investment in education, and in public works such as bridges, roads, and canals.

Smith is often associated with the idea that prosperity arises from the pursuit of self-interest under free market conditions. However, his thinking on these issues was far more nuanced than he is given credit for.

# GREAT ECONOMISTS

Karl Marx

Adam Smith, writing at the birth of capitalism in the eighteenth century, was to become its most famous advocate. Karl Marx (1818–1883), who watched capitalism mature in the industrial towns of England, was to become its most famous critic.

Born in Prussia (now part of Germany), he distinguished himself as a student at a Jesuit high school only by his rebelliousness. In 1842 he became a writer and editor for the Rheinische Zeitung, a liberal newspaper, which was then closed by the government, after which he moved to Paris and met Friedrich Engels, with whom he collaborated in writing The Communist Manifesto (1848). Marx then moved to London in 1849. At first, Marx and his wife Jenny lived in poverty. He earned money by writing about political events in Europe for the New York Tribune.

Marx saw capitalism as just the latest in a succession of economic arrangements in which people have lived since prehistory. Inequality was not unique to capitalism, he observed—slavery, feudalism, and most other economic systems had shared this feature—but capitalism also generated perpetual change and growth in output. (Marx, (1848) 2010)

He was the first economist to understand why the capitalist economy was the most dynamic in human history. Perpetual change arose, Marx observed, because capitalists could survive only by introducing new technologies and products, finding ways of lowering costs, and by reinvesting their profits into businesses that would perpetually grow.

This, he claimed, inevitably caused conflict between employers and workers. Buying and selling goods in an open market is a transaction between equals: nobody is in a position to order anyone else to buy or sell. In the labour market, in which owners of capital are buyers and workers are the sellers, the appearance of freedom and equality was, to Marx, an illusion.

Employers did not buy the employee’s work, because this cannot be purchased, as we have seen in this unit. Instead, the wage allowed the employer to rent the worker and to command workers inside the firm. Workers were not inclined to disobey because they might lose their jobs and join the ‘reserve army’ of the unemployed (the phrase that Marx used in his 1867 work, Capital). Marx thought that the power wielded by employers over workers was a core defect of capitalism. (Marx, Capital: A Critique of Political Economy, 1906)

Marx also had influential views on history, politics, and sociology. He thought that history was decisively shaped by the interactions between scarcity, technological progress, and economic institutions, and that political conflicts arose from conflicts about the distribution of income and the organization of these institutions. He thought that capitalism, by organizing production and allocation in anonymous markets, created atomized individuals instead of integrated communities.

In recent years, economists have returned to themes in Marx’s work to help explain economic crises. These themes include the firm as an arena of conflict and of the exercise of power (this unit), the role of technological progress (Unit 1 and Unit 2), and the problems created by inequality (Unit 19).