<u>Economist Adam Smith's Greatest Legacy is His Balanced Approach</u>

Christopher Ragan
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If Adam Smith were still alive, he would be having a birthday today, June 16. The man credited for founding the discipline of economics was a man of curiosity, vision and wisdom. Smith's insights about the functioning – and malfunctioning – of markets are still valid, and deserve to be repeated and celebrated.

Born in 1723 in Kirkcaldy, Scotland, he became a professor of moral philosophy and a leading figure of the Scottish Enlightenment. At the age of 36, he published *The Theory of Moral Sentiments*, a book that made him an academic superstar. Only then did he start to study economics and, in particular, the mechanics of national wealth creation.

For hundreds of years before Mr. Smith, technology had not changed significantly and patterns of production and consumption were relatively stable, determined mostly by tradition. But with the beginning of the Industrial Revolution in the mid-1700s, economies began changing quickly. As technological developments in some sectors outpaced those in others, and many new products were created, adjustments had to occur. Costs and prices bounced around, and so did wages. In response, labour and capital shifted across sectors and regions.

Adam Smith was both observant and curious, and he wondered why these changes were occurring and how the various pieces of the complex puzzle fit together. How were prices and wages determined, and by whom? Whose overall plan ensured that the products demanded by consumers were actually produced? How were all these decisions coordinated?

In 1776, Mr. Smith's insights came together in a book that changed the world, *The Wealth of Nations*. This masterpiece contains many ideas, but the central one is seeing the price system as an institution producing social order. At the core of a market economy is a set of prices that influence consumer and producer incentives. A rise in the scarcity of a product drives up its price, which induces buyers to economize on the product and also leads sellers to increase their supplies. Prices adjust to bring both sides of the market together.

His deepest insight was how thousands of decentralized and mostly self-interested consumers and producers, none of whom had a plan for the overall economy, interacted in markets to produce a remarkably coordinated overall outcome. Increases in the demand for one product generate the market forces that bring forth the supply; decreases have the opposite effect. His most famous metaphor to describe this co-ordination was the market's "invisible hand" of resource allocation.

Mr. Smith sought to understand the functioning of markets, and he was certainly impressed by what he observed. But he was not mesmerized by them, nor blind to their problems. He was suspicious of the collusive instincts of producers, and clearly saw the social benefits of competition. He recognized the failure of markets to provide goods such as public sanitation and national defence, and favoured government intervention when the benefits clearly outweighed the costs. He advocated progressive taxation and public education when those ideas were all but unknown. He was pragmatic rather than doctrinaire; he celebrated the wonders of free markets but also recognized the need for selected government intervention.

After studying and teaching economics for more than 30 years, only two things set me over the edge. The first is listening to people who think markets are everywhere and always perfect. They seem to have forgotten – or perhaps never learned – the many ways markets fail to produce the best outcomes for society, and the various ways well-designed policies can improve market outcomes.

The only thing worse is to listen to people who largely dismiss the value of markets and seem to deny that market-based incentives have been responsible for driving our rising living standards. They see market failures around every corner, and imagine a government always able to make things better, with policy that always works as intended.

In the social inquiry that is economics, balance is perhaps the greatest asset. We need to see markets as they really are, with their wonders and their warts. But we also need to see governments as they really are, with their ability to redress some market failures but also their capacity to waste resources, succumb to lobbying and get policy very wrong.

Adam Smith had this balance in spades, and deserves to be celebrated on the 292nd anniversary of his birthday. Canada and the world could use many more like him in our modern polarized policy debates.

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