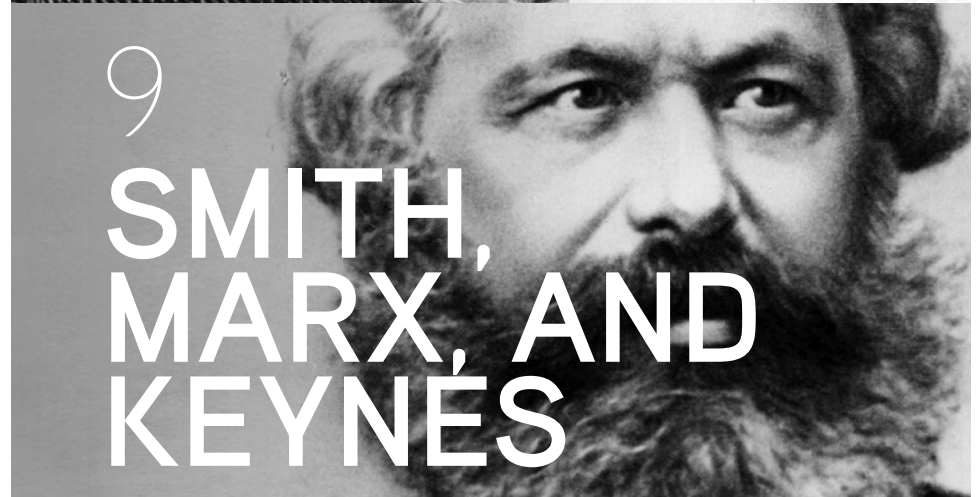
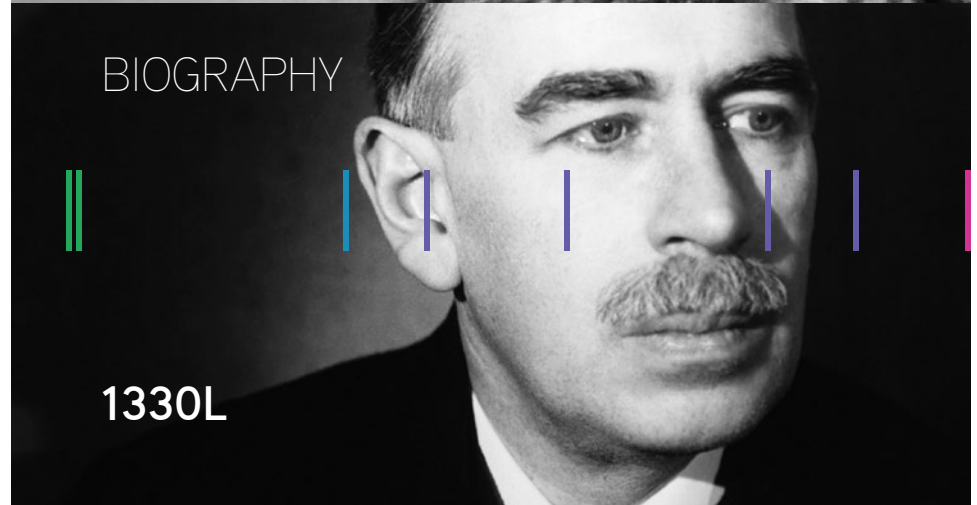




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SMITH,
MARX, AND
KEYNES



BIOGRAPHY



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SMITH, MARX, AND KEYNES

ECONOMIC MODELS
FOR THE MODERN WORLD

Adam Smith

Born
June 5, 1723
Kirkcaldy, Scotland

Died
July 17, 1790
Edinburgh, Scotland

Karl Marx

Born
May 5, 1818
Trier, Prussia

Died
March 14, 1883
London, England

John Maynard Keynes

Born
June 5, 1883
Cambridge, England

Died
April 21, 1946
Sussex, England

By Daniel Adler

Spanning three centuries of history, from the dawn of the industrial age to modern times, three diverse thinkers developed their own landmark theories on commerce, labor, and the global economy.

Economic thought vs. economic behavior

“Economics is a study of mankind in the ordinary business of life,” wrote nineteenth-century economist Alfred Marshall. What choices do you face in the ordinary business of your life? Buying clothing, deciding what to eat, or seeking a job — all involve considerations of cost, scarcity, and trade-offs with other options. Whether or not you think of them as such, these are economic decisions.

Now extend that idea to scales beyond your individual transactions. Modern society is woven together by a complex network of individual choices with local, national, and even global implications. Economics is the field of knowledge that seeks to systematically analyze, interpret, and understand these decisions. In practice, economics is a dynamic tool used by governments, businesses, and even individuals to observe, manage, and influence how people produce and consume goods and services.

The three economists profiled in this article — Adam Smith, Karl Marx, and John Maynard Keynes — contributed substantially to the development of economics as a science. Nevertheless, considerations of production, distribution, choice, scarcity, and alternate uses far predate these men, to the earliest days of humankind. Ages before there was economic thought, there was economic behavior.

The economics of the hunt

In the words of economic historian Roger Backhouse, “Economics does not have a beginning or a ‘founder’; people have always thought about questions that we now consider part of economics.” The earliest humans, for example, spent lots of energy to track and kill large game, which they would then need to distribute, and which each individual would decide to conserve or use. Even without developed cultural, commercial, or legal systems, effective economic decision-making was often imperative for survival.



The trading floor of the New York Stock Exchange, 2009

As hunter-gatherer groups coalesced into more organized societies, decisions about distributing resources and designating jobs became more complex. For many thousands of years, it was not the communal egalitarianism of hunter-gatherer times or by the individualism of today that drove such decisions. Rather, as twentieth-century economic historian Robert Heilbroner says, people worked according to “custom” (doing work that was passed down from previous generations) or “command” (working to avoid violence or other retribution). Not the blacksmith in medieval Europe, the farmer in India, nor the pyramid-building slave in Egypt worked to advance his or her own goals, dreams, or prosperity.

Early economies were also marked by an ambivalent attitude toward money and the pursuit of wealth for its own sake. Writes Heilbroner, “The idea of gain...was quite foreign to the great lower and middle strata of Egyptian, Greek, Roman, and medieval cultures, only scattered throughout Renaissance and Reformation times, and largely absent in the majority of Eastern civilizations” (Heilbroner, pp. 24 — 25). Those who worked with money (merchants, lenders, and even craftsmen with specialized skills) were often viewed suspiciously and sometimes even punished for innovating within their trades. Consequently, skills and technology advanced gradually and similar jobs and standards extended across many generations.

Around 1500, several drastic changes were set in motion. Overseas trade established new networks and boosted collective learning and commercialization. Globally traded currency created an easily recognizable and transferrable store of wealth and medium for exchange. Individual markets, once physical places for the simple exchange of goods, began merging to create the market system, which, according to Heilbroner, “is not just a means of exchanging goods; it is a mechanism for sustaining and maintaining an entire society” (Heilbroner, pp. 26 — 27). By the 1600s and 1700s, custom and command ceased to exert as much influence as the pursuit of wealth. Rather than survival, obedience, or tradition, it was “the lure of gain...[that] steered the great majority to his or her task” (Heilbroner, p. 21). It was in this era, on the verge of the Industrial Revolution, that Adam Smith lived and worked.

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 the intellectual shift toward rationality, progress, liberty, and secularism, generally referred to as the Enlightenment.

Smith studied in Glasgow, Scotland, and Oxford, England. As a professor and lecturer, private tutor to the children of European royalty, government economic adviser, and a customs commissioner for Scotland, Smith had a comprehensive understanding of economics, which was captured most powerfully in *An Inquiry Into the Nature and Causes of the Wealth of Nations*, better known (and referred to hereafter) 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 straightens 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. (*The Wealth of Nations*, p. 10)



An etching of Adam Smith

In other words, the division of labor enabled 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” (*The Wealth of Nations*, p. 20).

He suggested that competition between businesses prevents exploitation of consumers by ensuring fair prices and quality products, encouraging constant economic innovation, and satisfying consumer demand. In short, competition keeps everyone honest, because customers treated unfairly by one business can always patronize another instead.

Smith’s view that the complex functions of society and economy emerged, unintentionally yet effectively, from the self-interested actions of each individual must have been both reassuring and liberating to a world grasping for new means of economic, social, and political organization. It was certainly popular: the first edition of *The Wealth of Nations* sold out within six months.

Smith’s remarkable insights not only captured his own time accurately; they also foresaw much of the economic future, which is evident in the endurance of free-market capitalism as the world’s foremost economic model for the last 200-plus years. Today, we call this arrangement “economic liberalism” (different from the “liberal” political alignment in America) and the liberalization of economies continues around the world (Balaam and Veseth, pp. 48 – 49).

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

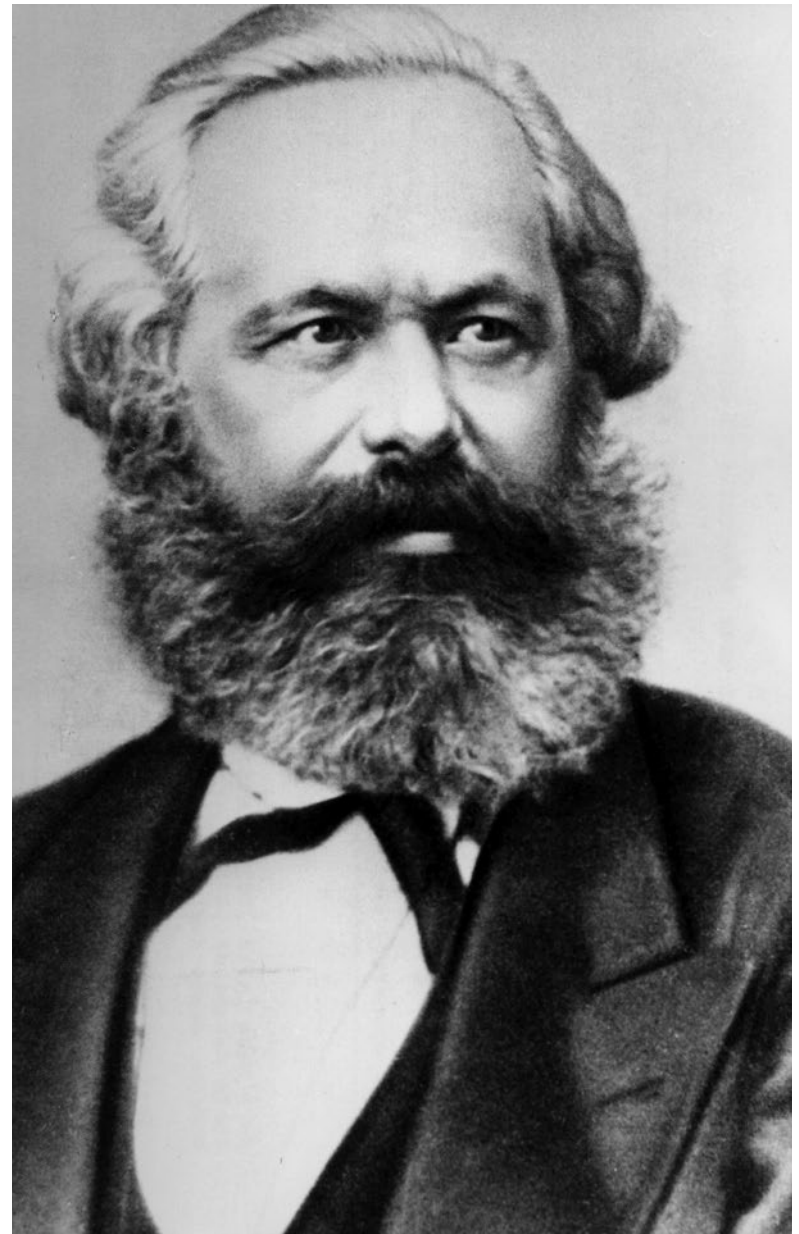
Karl Marx

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 a tumultuous life: he was jailed for public drunkenness as a college student; his home and personal appearance were unkempt; and he spent income 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, moving between Prussia, France, Belgium, and England because he was continually blacklisted or deported for his radical views.

Marx's attitude toward capitalism was scathing. In an age when "the Industrial Revolution had changed the process of production into a factory system and created a new ruling class of factory owners" (Bussing-Burks, p. 85), Marx perceived injustice, inequality, and the inevitability of change. Marx and his frequent coauthor, Friedrich Engels, were outraged at the hardships faced by the working classes of industrial European cities, and 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 opus, *Das Kapital*, published in 1867.

Marx's analysis sees the "history of all...societies [as] the history of class struggle." Marx interpreted human history as a series of eras, each defined by systems for producing goods, which created classes of 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 believed that "capitalists" (the owners of the machines, property, and infrastructure used to produce things) were a separate class from the workers, or "proletariat," who own nothing but the right to sell their labor in exchange for wages. Marx theorized that capitalists, in competition with each other for profits, would squeeze as much work as possible out of the proletariat at the lowest possible price. Furthermore, competition would cause some capitalists' firms to fail, increasing



Karl Marx, January 1870

unemployment (and thus misery and poverty) among the proletariat. Innovations in technology were not necessarily positive; new machines would add to unemployment (by rendering human labor increasingly inefficient and obsolete) while also making work dull, repetitive, and alienating.

Yet Marx was not altogether dismissive of capitalism, which he saw as a necessary stage for building a society's standard of living. But in his view, the proletariat's discontent would inevitably lead it to overthrow the ruling classes and create a more equitable society, at first socialist (wherein the state would control the economy and distribute resources more evenly) and then 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. International political economy professors David Balaam and Michael Veseth caution, however, that there is no definitive reading of Marx, and that "Marxism is at once a theory of economics, politics, sociology, and ethics. For some, it is also a call to action" (Balaam & Veseth, p. 73). As a call to action, Marxism was most influential in the twentieth century, when it inspired various brands of revolutionary activity, including 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 arguably more durable. While some believe that communism's decline disproves Marx, others draw upon his approach to critique economic phenomena on social grounds. Even as capitalism defines most of the world's economies, Marxism remains alive in "the idea that capitalism can undergo serious scrutiny and adaptation" (Bussing-Burks, p. 95). In other words, Marx's skepticism about capitalism initiated an ongoing conversation about its shortcomings and how it can be improved. While he was no Marxist, our third economist, John Maynard Keynes, was highly influential in confronting the dilemmas of capitalism in the early twentieth century.

John Maynard Keynes

John Maynard Keynes (1883–1946, last name rhymes with "rains") was born into an educated family, and during his life he worked in academia, economic publishing, private financial advising and management, currency speculation, and as an official in the British Treasury.

While his contributions to economics were extensive, Keynes is most famous for his ideas about the Great Depression, the major economic crisis of the twentieth century. The Depression's effects were felt worldwide from roughly the early 1930s to the mid-1940s. The United States saw unemployment increase from 3 to 25 percent, a halving of the national income, and a near cessation of residential construction (Buchholz, p. 210).

Keynes's analysis of the Great Depression focused on the role of savings. In his 1936 book *The General Theory of Employment, Interest and Money*, Keynes argued that excessive savings could lead to economic ruin. A weak economy made businesses hesitant or unable to make investments that created jobs. Without jobs, people had no income that, if spent, would have stimulated demand for more production. Savings increased in anticipation of economic hardship. But then savings dried up as joblessness persisted. Individual rationality (saving in hard times) led to collective irrationality (an unbreakable cycle of economic decline).

Keynes believed the government should support the economy. While Keynes generally endorsed free-market capitalism, the Depression's unique challenges required unique solutions. Keynes argued that only the government had the resources to spend the money that individual consumers and businesses could not, and so break the cycle.

This approach proved relevant in the 1930s and '40s. The New Deal government relief programs of President Franklin D. Roosevelt were designed to stimulate the economy in the early 1930s, while cuts to the federal budget in the late 1930s caused an immediate economic downturn. Extensive government spending to fund World War II coincided with the end of the Depression. While some Keynesian policies had mixed results, the overall picture



John Maynard Keynes, 1940

seemed to confirm Keynes's arguments, and until the 1970s, Keynesianism predominated American economics. The "Great Society" domestic social programs — including Medicare and education funding — reflected Keynesian thinking. So too did the establishment of many of the institutions that form the basis of international trade and finance, such as the International Monetary Fund and the World Bank. While the 1980s and '90s saw a resurgence in "classical" economic theories closer to Smith than to Keynes, the recent "recession" presents a new opportunity to debate whether Keynesian economics are still viable.

The power of economics

Let's return to our initial question: What choices do you face in the ordinary business of your life? Smith, Marx, and Keynes all explained how individual choices, conscious or otherwise, fit into a higher order, affecting not only those who make them but also their families, communities, countries, and even the world. Over time, many other thinkers have developed their own distinct models and agendas for explaining and managing economic activity.

The power of economics lies in its ability to reveal the complex workings of society. The idea that we are all touched by economics is perhaps best summarized in a quote from Keynes himself:

The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.

(The General Theory of Employment, Interest and Money, p. 383)

As society moves about the ordinary business of life, economics always hums along in the background; it is observed by some, influenced by others, yet it affects everybody.

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