

Adam Smith's theory of Growth



Part C

Stationary State

- ❖ Adam Smith was optimistic about economic growth in future
- ❖ In fact, he emphasised the cumulative and self propelling nature of development process
- ❖ However, he also pointed out that there is limit to the economic development which ultimately lands a free market in a stationary state
- ❖ In this condition capital accumulation ceases to take place and therefore there is no more growth of the economy

Why Stationary State?

- ❖ This happens because of two reasons:
- ❖ First, there is a limited amount of natural resources at the disposal of the economy and,
- ❖ After passing through a phase of growth a point is reached when they are fully utilised and do not permit further growth of output

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- ❖ The second factor responsible for occurrence of stationary state is fall in profits which reduces inducement to invest further
- ❖ Profits tend to fall as a result of competition among the capitalists i.e., investors
- ❖ This results in decrease in demand for more capital accumulation and hence declining in wages

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- ❖ Thus after a significant economic growth, stationary state of the economy is reached where
- ❖ Further capital accumulation ceases
- ❖ Profits fall to a low level and
- ❖ With the further increase in population, wages become equal to the subsistence level

Policy of Laissez Faire

- ❖ Adam Smith was a strong advocator of the policy of Laissez Faire as an instrument of economic development
- ❖ According to him, an individual was guided by self interest, hence each capable of promoting his own well being
- ❖ While promoting his own interests he promotes the welfare of the whole society in the process
- ❖ It is , therefore, according to Adam Smith, the production by individuals is led as if by the ‘invisible hand’ to promote social welfare

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- ❖ Thus, though individual capitalists produce goods to make profits for them but in doing so they promote social welfare
- ❖ Although social welfare was no part of their intention
- ❖ As a matter of policy, therefore Adam Smith advocated the removal of all restrictions on trade, choice of occupation and the use of property by individuals

Critical Evaluation of Adam Smith's Theory of Development

- ❖ Smith's model has the great merit of pointing out 'how economic growth came about and what factors and policies impede it
- ❖ In particular, he pointed out
- ❖ The importance of parsimony in saving and capital accumulation; Of improved technology, Division of labour and
- ❖ Expansion of market in production; And of the process of balanced growth in the interdependence of farmers, traders and producers

Criticism

- ❖ Despite these merits, it has certain weaknesses
- 1. Rigid division of Society: It assumes the existence of a rigid division of society between capitalists (Including land lords) and labourers but neglects the role of middle class
- 2. One sided saving base: According to Smith, Capitalists, landlords and money lenders save but the major source of savings in our advance society was the income receivers and not the capitalists and landlords

Criticism

1. Unrealistic assumption of perfect competition: Smith's whole model is based upon the unrealistic assumption of perfect competition. The laissez-faire policy of perfect competition is not to be found in any economy
2. Neglect of Entrepreneur: Smith neglects the role of entrepreneur in development. This is a serious defect as his theory
3. Unrealistic Assumption of Stationary State: Smith is of the view that the end result of a capitalist economy is the stationary state. It implies that there is change in such an economy but around a point of equilibrium

Thank You