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, adapted by Newsela
Spanning 300 years of history, from the dawn of the industrial age to modern times, three great thinkers changed economics. They developed their own groundbreaking theories on commerce, labor, and the global economy.
Economic thought vs. economic behavior

It is said that "economics is a study of mankind in the ordinary business of life." What choices do you face in the ordinary business of your life? You buy clothing, decide what to eat, look for a job. When you make these decisions, you probably consider your needs, the costs, and your various options. You are making economic decisions.

Imagine decisions like this happening all the time, all over the world. Modern society is formed by individual choices that form a complex network. The choices we make have local, national, and even global consequences.

The field of economics tries to analyze, interpret, and understand these decisions. Governments, businesses, and individuals use economics to understand how people produce and consume goods and services.

The three economists profiled in this article — Adam Smith, Karl Marx, and John Maynard Keynes — contributed to the development of economics as a science. Still, economic thinking was around long before these men. This type of thinking goes back to the beginning of humankind.

The economics of the hunt

Economics doesn’t have a beginning, or a founder. People have always thought about questions that we now consider part of economics.

Early humans, for example, spent a lot of time and energy hunting large game. The meat needed to be distributed to the group. Each individual had to decide whether to save the meat or use it right away.

From the earliest times, effective economic decision-making was crucial to survival.
As hunter-gatherer groups formed into more organized societies, decisions about distributing resources and designating jobs became more complex.

Hunter-gatherers lived in fairly egalitarian societies. Everyone was roughly equal and everyone worked together to survive. Today we are more individualistic.

But for many thousands of years, humans were neither egalitarian nor individualistic. People worked according to “custom” or “command.” Custom means people did work that was passed down from previous generations. Command means people worked to avoid violence or punishment.

The medieval European blacksmith. The Indian farmer. The pyramid-building Egyptian slave. None of these people worked for their own goals, dreams, or wealth.

Today it seems almost everyone wants to be rich. But earlier peoples had more complex attitudes toward wealth. Most people in the ancient civilizations of Egypt, Greece, Rome and Asia didn’t think about getting rich.

Those who worked with money (merchants, lenders, and even craftsmen with specialized skills) were often viewed suspiciously. Sometimes they were even punished for innovating within their trades. Consequently, skills and technology advanced gradually and similar jobs and standards extended across many generations.

Several major changes began around 1500. Overseas trade established new networks and boosted collective learning and commercialization. Globally traded currency created an easy way to trade goods and store wealth. Individual markets were once places to buy and sell physical goods. Now they began to merge into the market system. The market system can sustain and maintain an entire society.

By the 1600s and 1700s, both custom and command were weakening. Rather than survival, obedience, or tradition, people began to be motivated by obtaining personal wealth. It was in this era, on the verge of the Industrial Revolution, that Adam Smith lived and worked.

Adam Smith

Scotsman Adam Smith (1723 — 1790) was born as the industrial system was replacing the traditional one. Profit was becoming the main motivation, replacing command or custom.

The change in economic thought fit with a general intellectual shift in Europe. People at this time were interested in rationality, progress, liberty, and secularism. This time period is called the Enlightenment.

Smith studied in Glasgow, Scotland, and Oxford, England. He had many jobs: professor, 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.

Smith wrote this book at the dawn of the Industrial Revolution. It describes a world increasingly dominated by commerce and capitalism. Here, Smith gives his observations of a visit to a pin-making factory.

He describes the 18-step process to make the pins, which is split up. One man draws out the wire. Another man straightens the wire. A third man cuts the wire, and so on.

He observes that the process makes the factory more productive:

[An average factory of 10 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 helped. It allowed one man to be 4,800 times more productive than if he worked alone!

Smith also argued that people have a natural drive to improve their own lives. He suggested that this self-interest causes markets to satisfy individual demands by producing the goods and services people want. He called this the “invisible hand.” He explained: It is not from the kindness of the butcher or baker that we expect our dinner, but from their regard to their own interest.

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

The complex functions of society and economy emerge from the self-interested actions of each individual, Smith argued. 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 six 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.

Smith predicted many of the successes of industrial capitalism. But he didn’t live to see the worst effects of the Industrial Revolution. Several decades later, the world would have an economist whose criticisms of capitalism matched Smith’s optimism. That economist was Karl Marx.
Karl Marx

Karl Marx (1818–1883) was born in the midst of the Industrial Revolution. He came from a middle-class family in Prussia (in what is now 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 sloppy. He spent money freely, causing financial problems for his family. For most of his professional life, Marx was a writer for a variety of newspapers. He moved between Prussia, France, Belgium, and England because he was continually blacklisted or deported for his controversial 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 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 opus, Das Kapital, published in 1867.

Marx saw the history of all societies as the history of class struggle. Every society must have a system to produce goods. Marx believed these systems created classes: the rulers and the ruled.

Slavery was the most basic example of this principle. Then came feudalism, where poor peasants worked for a rich noble. Capitalism, where the owners paid the workers, was the next development. After capitalism, Marx believed, would come communism. He believed communism would bring about a classless society.

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 workers, or “proletariat,” owned nothing. All they had was the ability to work in exchange for wages.
Marx theorized that capitalists competing for profits would squeeze as much work as possible out of the workers while paying them as little as possible.

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

He was unsure about the new technology. New machines could add to unemployment by making human workers unnecessary. Machines could also make work dull, repetitive, and alienating for the people who still had jobs.

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. He predicted the workers would eventually overthrow the ruling class and 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. It 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. It inspired various revolutions and uprisings. 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. The U.S.S.R. collapsed in the early 1990s. China has shifted toward a market-friendly economy. Smaller communist countries that depended on Russia and China have adopted 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 found all around the world, Marx taught us to seriously examine and criticize capitalism when necessary.

Marx’s skepticism about capitalism started a conversation about its weaknesses and how it can be improved. Our third economist, John Maynard Keynes, was highly influential in confronting the issues 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. During his life he worked in academia, economic publishing, private financial advising, currency speculation, and as an official in the British Treasury.

Keynes made many contributions to economics, but he is most famous for his ideas about the Great Depression, the major economic crisis of the twentieth century. The worldwide Depression lasted roughly from the early 1930s to the mid-1940s. Unemployment in the United States increased from 3 to 25 percent during this time. The national income was cut in half.


Keynes argued that people saving too much could lead to economic ruin. In a weak economy, businesses wouldn’t hire as many people. Without jobs, people wouldn’t have money to buy things and support businesses. People would save more money, expecting tough times ahead. But their savings would run out after a long time without a job.

Rational decisions by individuals (saving in hard times) could lead to collective irrational results (an unbreakable cycle of economic decline).

Keynes believed only the government could break this cycle by spending money that consumers and businesses could not. He generally endorsed free-market capitalism, but felt the Depression’s unique challenges required unique solutions.
This approach was tested in the 1930s and '40s. President Franklin D. Roosevelt’s New Deal government relief programs were designed to improve the economy in the early 1930s. In the late '30s, federal budget cuts caused an immediate economic downturn. Government spending on World War II coincided with the end of the Depression.

While some Keynesian policies had mixed results, the overall picture seemed to confirm Keynes’s arguments. Until the 1970s, Keynesianism dominated American economics. "Great Society" domestic social programs — like Medicare and education funding — reflected Keynesian thinking. Institutions such as the International Monetary Fund and the World Bank also are based on the Keynesian model.

The 1980s and '90s saw a renewal of “classical” economic theories that went back to some of Adam Smith’s ideas. The “Great Recession” of the 2000s has presented a new opportunity to debate Keynes’s ideas.

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 fit into a larger system. Our decisions don’t just affect us. They affect our families, communities, countries, and even the world.

Economics is powerful because it can reveal the complex workings of society. As society moves about the ordinary business of life, economics is always there, in the background. It is observed by some, influenced by others, yet it affects everybody.
Sources


Image credits

An undated etching of Adam Smith, public domain

Karl Marx, January 1870 © adoc-photos/CORBIS

A studio portrait of John Maynard Keynes by Gorden Anthony, late 1930s © Hulton-Deutsch Collection/CORBIS

The New York Stock Exchange, 2009 ©Justin Guariglia/CORBIS
Articles leveled by Newsela have been adjusted along several dimensions of text complexity including sentence structure, vocabulary and organization. The number followed by L indicates the Lexile measure of the article. For more information on Lexile measures and how they correspond to grade levels: http://www.lexile.com/about-lexile/lexile-overview/

To learn more about Newsela, visit www.newsela.com/about.

The Lexile® Framework for Reading
The Lexile® Framework for Reading evaluates reading ability and text complexity on the same developmental scale. Unlike other measurement systems, the Lexile Framework determines reading ability based on actual assessments, rather than generalized age or grade levels. Recognized as the standard for matching readers with texts, tens of millions of students worldwide receive a Lexile measure that helps them find targeted readings from the more than 100 million articles, books and websites that have been measured. Lexile measures connect learners of all ages with resources at the right level of challenge and monitors their progress toward state and national proficiency standards. More information about the Lexile® Framework can be found at www.Lexile.com.