

Adam Smith's theory of Growth



Part B

Capital Accumulation

- ❖ Adam Smith gave an important place to savings and accumulation of capital
- ❖ Capital stock consists of:
 - (a) Goods for the maintenance of productive workers.
 - (b) Goods for helping the workers in their productive activities.

Vicious Circle

- ❖ Productivity of people is low because the capital stock is small
- ❖ Capital stock is small because savings of the people are small and;
- ❖ Savings are low because incomes of the people are small due to their low productivity
- ❖ The way out of this vicious circle, according to Smith, is if capitalist class save most of their profits and invest in capital accumulation for accelerating economic growth

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- ❖ Thus according to Adam Smith, saving of the society is increased by 'parsimony' (i.e., habit of frugality of the capitalists)
- ❖ In fact, Adam Smith assumed that capitalist class behaves in such a manner and save a very large proportion of their profits

Development Process is Cumulative

- ❖ According to Adam Smith, once development process started it gathers momentum and becomes cumulative,
- ❖ This happens in the following ways:
- ❖ First, increase in saving causes more accumulation of capital which in turn facilitates a great degree of division of labour and thereby raising productivity of labour and levels of incomes of the people

Development Process is Cumulative

- ❖ Second, the higher incomes due to the capital accumulation and a higher degree of division of labour leads to the increase in the size of market or demand for goods
- ❖ Third, the increase in size of market and availability of capital induces improvement in technology

Development Process is Cumulative

- ❖ The cumulative process of development provides a cheerful note for the developing countries;
- ❖ Hence, if they start the development process in right earnest they can be sure of further and rapid economic development
- ❖ Also they can catch up with the presently advanced developed countries

Sequence of Development

- ❖ According to Adam Smith, the natural course of development is first agriculture, then industry and finally commerce
- ❖ Agriculture creates a surplus and increases the purchasing power of the people which generates demand for industrial products
- ❖ It also supplies raw materials for industries
- ❖ Agricultural growth thus provides a base for industrial development

To be continued...

Thank You