

## The Classical Theory of Economic Growth



### Adam Smith's Theory

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Adam Smith is known as the father of political economy. In his magnum opus "An Enquiry into the Nature and Causes of the Wealth of Nations", he was pioneer to understand the process of economic progress in general and causes of capitalistic development in particular. The main points of the theory are as under:

#### ① Capital Accumulation

The problem before the classical economist was to increase wealth of a country.

Wealth → prosperity — to produce more = needs huge amount of capital → save more — on the basis of capital accumulation.

= In other words, we should sacrifice the present consumption or enjoyment for the sake of future enjoyment.

= More production needs more capital and more capital is the integral part of capitalistic development of an economy. Capital accumulation is the central point of the classical theory of economic development.

#### ② Division of Labour

Adam Smith emphasized on division of labour in the process of economic development.

= Greater division of labour and specialization leads to:

- (a) An increase in dexterity among workers
- (b) Reduction in the time
- (c) Invention of better machines and equipment.



By division of labour, worker acquires more skill and efficiency which are needed for raising the level of output,

✓ | Division of labour → Exchange of Goods → Importance of trade → widens the market → Economic development.

### ③ Natural Law:

Adam Smith was a champion of liberty. He advocated the philosophy of free and independent action. Every individual member of the society be left free to pursue his economic activities which will maximise his output to render the services in the society. For this he advocated the operation of Natural Law. Natural Law is superior to the law of a State. Man-made law can never be perfect and beneficial for the society. = Nature teaches man the lesson of lesson of morality and honesty.

④ Laissez Faire - ~~The~~ Adam Smith's Theory is based on the principle of laissez faire which tells that state intervention is detrimental to the economic development. Let people be free to choose their own occupation. Laissez faire was considered a driving force for promoting saving and investment.

⑤ Free Trade: The principle of laissez faire should not be applied in the case of an individual only but it should be extended to trade also. If free trading is not allowed, division of labour would be less profitable and economy as a whole would stand to lose.

⑥ Trade cycle: Adam Smith has an idea of a cumulative growth, the idea that development starts and proceeds in a cumulative manner.

In upswing phase of trade cycle, every growth variables more in the upward direction i.e. saving, capital accumulation, employment, wages, income and demand rise, — market expands and absorbs the increased production.