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# Why did economic systems begin to shift during the Industrial Revolution?

## What is economics?

Every society has access to resources, however, these resources are limited. There is a limited amount of water. There is a limited amount of fertile land. There is a limited amount of human labor. Economics is the study of how people **make choices** about how they use their limited resources to meet their wants and needs. Essentially, all nations must answer the question of scarcity of resources.

## What is an economic system?

An economic system is the method used by a society to produce and distribute good and services.

Through an economic system, each society answers three important questions:

What to produce?	How to produce?	For whom to produce?
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## Why do economic systems change over time?

Until the modern age, people focused largely on land and agriculture. However, as nations began to trade and industrialize, new economic systems were needed to make sense of how they should make choices about how they use their limited resources to meet their wants and needs.

The economic system that was most widely supported from the 1500s and until the 1700s was **mercantilism**. Mercantilism was a system of wealth accumulation and trade for profit. Mercantilists believed that there was a fixed amount of wealth and the job of a nation was to accumulate and extract as much wealth as possible. This system emerged around the the period of the Age of Exploration when new colonies were being established and many European nations believed that through trade, the accumulations of gold and the control of colonies would bring the most wealth.

As new technologies were developed and Great Britain began to industrialize during the Industrial Revolution, ideas around wealth changed. Economic theorists like Adam Smith argued that there was not a fixed amount of wealth. Rather, he argued, wealth could be created. A new economic system we now know as **capitalism** emerged. In industrializing Great Britain, the focus began to shift from accumulating wealth to finding more effective ways to create wealth through factory systems that used the latest technology, complex division of labor, free trade, etc.

Capitalism evolved from mercantilism and while both economic systems are geared towards profit, these systems have differences in the way this is achieved.

**Which turning point shifted European ideas around economic systems?**

**What is the one commonality between capitalism and mercantilism?**

	<b>Mercantilism (1500s-1700s)</b>	<b>Capitalism (mid 1700s-present)</b>
<b>Main goal</b>	Profit	Profit
<b>How should we attain wealth?</b>	Wealth <b>Accumulation</b> : Mercantilist believe there is a <i>fixed</i> amount of wealth, therefore mercantilist will <b>increase their overseas colonies and accumulate as much gold and silver as possible.</b>	Wealth <b>Creation</b> : Capitalist believe that wealth can <i>grow</i> , therefore capitalist competition and innovation will increase efficiency and grow wealth
<b>How are prices set?</b>	<b>Monopoly</b> : There is no competition. Instead, there is complete control of a product or business by one person or group who set the prices. In mercantalism, industries are protected by the government.	<b>Competition</b> : Producers compete for consumer money by lowering their prices or introducing new products.
<b>How are products traded?</b>	<b>Favorable Balance of Trade</b> : Mercantilists export more than import and heavily tax the import of foreign goods	<b>Free Trade</b> : Capitalists support free trade with anyone and do not heavily tax the import of foreign goods.
<b>How involved is the government in the economy?</b>	Heavy involved	Not involved
<b>What are the individual freedoms in this system?</b>	Individuals do not have freedom to make economic decisions. Instead, there is	Individuals have freedom and opportunity to create wealth by making

	heavy regulation.	choices based on <b>self-interest</b> .
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**What similarities and differences do you notice between these economic systems?**

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## What ideas explain the economic transformations during the Industrial Revolution?

**Directions:** Read the excerpt below and respond to the questions.

### Who is Adam Smith?

Adam Smith (1723-1790) was a Scottish economist and philosopher. He was a key figure in the Scottish Enlightenment. The Scottish Enlightenment of the 18th century was a period of intellectual and scientific accomplishments. Adam Smith participated in the Select Society which was an intellectual society where the members discussed new ideas and innovations.

Which key historical intellectual movement did Adam Smith participate in?

### Why is Adam Smith an important historical figure?

In 1776, Smith published what is considered the "bible of capitalism," called *An Inquiry into the Nature and Causes of the Wealth of Nations* (usually shortened to *The Wealth of Nations*). It is one of the world's first collected descriptions of what builds a nation's wealth.

Why is Adam Smith an important historical figure?

### How did Adam Smith produce *The Wealth of Nations*?

*The Wealth of Nations* was produced using seventeen years of notes, observations and conversations with economists during the beginnings of the Industrial Revolution.

Where did the information in *The Wealth of Nations* come from?

### Why did he write *The Wealth of Nations*?

The Industrial Revolution was a time of progress and innovation. Smith wanted to offer insight into the new changes he saw in the economy and he wanted to offer practical guidelines that could replace less relevant mercantilist economic ideas. He felt that the government interference and taxation under mercantilism prevented wealth. He proposed a freer economy without government interference. Through *The Wealth of Nations*, he hoped to explain strategies and methods for gaining wealth.

Why did Adam Smith write *The Wealth of Nations*?

**An Inquiry into the Nature and Causes of the Wealth of Nations, by Adam Smith (1776)**  
**Book I, Chapter I: *Of the Division of Labor***

**Pre-Reading Prediction:** The title of the chapter excerpted below is *Of the Division of Labor*. What might the phrase “division of labor” mean? \_\_\_\_\_

**Purpose for Reading:** What is **division of labor**? How does it generate wealth?

1 To take an example [...] the trade of the pin-maker; a workman not educated to this business [...] nor  
2 acquainted [aware or knowledgeable] with the use of the machinery [...] could [...] make one pin in a  
3 day, and certainly could not make twenty. But in the way in which this business is now carried on, [...] it  
4 is divided into a number of branches [...] One man draws out the wire, another straightens it, a third cuts  
5 it, a fourth points it, a fifth grinds it at the top for receiving the head [...] [T]he important business of  
6 making a pin is [...] divided into about eighteen [...] operations [...] Those ten persons, therefore, could  
7 make among them upwards of forty-eight thousand pins in a day. [...] But if they had all wrought  
8 separately and independently [...] they certainly could not each of them have made twenty, perhaps not  
9 one pin in a day ...

Source: <http://www.econlib.org/library/Smith/smWN1.html#B.I., Ch. 1, Of the Division of Labor>

1. According to Adam Smith, what is **division of labor**?

Denis Diderot was a French philosopher and writer. He was a prominent figure during the Enlightenment and is best known for serving as co-founder of the *Encyclopédie*. Diderot wanted to incorporate all of the world's knowledge into the *Encyclopédie* and hoped that the text could share all this information to the public.

2a. Why did Diderot create the *Encyclopédie*? How does this exemplify Enlightenment principles?

2b. Based upon the introduction on 2, how are Diderot's aims of sharing information similar to Adam Smith's aims?

## **What is the “invisible hand”, *laissez faire* and the free market? How do these systems generate wealth?**

**Directions:** Read the text below and respond to the questions.

**What is self-interest? What is the “invisible hand?”**

Adam Smith believed that individuals should be free to pursue their own economic **self-interest** [things that will bring you personal gain or benefit]. Through pursuing their own self interest, Smith believed that all of society would benefit. Smith argued that people would make things that feed their self-interests of

increasing their **wealth** and **profit** such as a coat maker who makes coats. Even though he is making coats out of self-interest or a selfish desire for profit, Smith argued that this would still benefit the rest of society because people need coats and are willing to pay for them. Smith believed an economy like this should work smoothly and efficiently without any government interference, as if guided and organized by an **invisible hand**. The invisible hand is a metaphor for a self-regulating economy where people get what they need by pursuing their own self-interests.

11. According to Adam Smith, how does allowing people to freely pursue their **self-interest** benefit society?

12. What does the metaphor of the **invisible hand** mean?

### What is *laissez faire*?

The invisible hand metaphor is connected to Smith's belief in a ***laissez faire* economy**. In a *laissez faire* economy, the government does not interfere in the economy by imposing regulations like taxes or restrictions on those who could trade. People are free to make their own decisions. *Laissez faire* is French for, "leave it alone" or "let go."

15a. What is **laissez faire economics**?

15b. Draw an image below that represents **laissez faire economics**?

### 16. **Laissez Faire Economics**




In country A, several factories produce different types of sneakers. Factories pay very few taxes, and they are allowed to sell to anyone.

In country B, several factories produce different types of sneakers. The government heavily taxes the factories and prevents imports of sneakers from other countries.

Which country practices *laissez faire* economics? Explain.

**What is a market economy or the free market?**

Laissez faire is based on the belief in a **market economy** or a **free market**. A free market or market economy is an **economic system** where people are free to make economic decisions without government interference. There are three key elements or “natural laws” of a free market.

Supply and Demand	Self-Interest	Competition for Consumer Money
 <p>I WANT ...      YOU HAVE...</p> <p>I sell      I buy</p> <p>DEMAND      SUPPLY</p>		
<p><b>Producers</b> are people who make things. <b>Consumers</b> are people who buy things. The amount of a good that a producer makes is called its <b>supply</b>, the amount that is available. How much consumers want something is called <b>demand</b>. The price of something is determined through the <b>law of supply and demand</b>. Producers try to sell their supply for the highest price possible, but this is limited by how much consumers demand it.</p>	<p>There is <b>self-interest</b> so producers and consumers only think about their selfish needs when making decisions.</p>	<p>There is <b>competition</b> where producers compete for consumer money by lowering their prices or introducing new products.</p>

Smith believed that consumers can get what they needed, people could generate wealth, and prices would set themselves all without government interference. Smith warned that if **entrepreneurs** do not have the **profit incentive** to take risks and innovate and if **buyers** can't buy from whomever they want and if sellers can't set their own prices, then the economy won't work "right." He advocated that that producers and consumer be left free to make their own decisions. This idea of the free market is now known as **capitalism**. Under capitalism, the **means of production** (such as factories) are owned by individuals and goods and services are produced for profit.

17. What are the three elements of a **free market**?

Smith thought that while the government should not interfere with the economy, he recognized that the government had a role. According to Smith, the government has only three functions: to protect society from invasion, to defend its citizens from injustice, and to keep up public works projects like roads and canals. Other than these three functions, Smith believed that the government should have minimal government involvement in the economy.

18. Under **laissez faire economics**, what are the three responsibilities of the government?

**An Inquiry into the Nature and Causes of the Wealth of Nations, by Adam Smith (1776)**  
**Book I, Chapter II: *Of the Principle which gives Occasion to the Division of Labor***  
**Book IV, Chapter 2: *Of Systems of Political Economy: Of Restraints upon the Importation***

But man has almost constant occasion for the help of his brethren, and it is in vain for him to expect it from their benevolence only. [...] Give me that which I want, and you shall have this which you want [...] and it is in this manner that we obtain from one another the far greater part of those good offices which we stand in need of. It is not from the benevolence [good will or kindness] of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.

[...]

But it is only for the sake of **profit** that any man [uses] **capital** in the support of **industry**;

[...]

[H]e is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.[...] By pursuing his own interest, he frequently promotes that of the society more effectually than when he really intends to promote it.

20. Smith writes, “Give me that which I want, and you shall have this which you want”. How is this sentence related to **self-interest**?

21. What does the phrase, “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” mean?

22. Why do men produce goods?