I. Theory of Free Market

A. “Discovery”

1. free market

a. natural phenomenon: progress

b. autonomous sphere

i. governed by laws of cause and effect

ii. analogous to physical universe

iii. self-regulating

"A freely competitive economy will regulate itself by the "invisible hand of the market place."

c. lead to individual wealth

d. wealth to society

. “. . . a mechanism for maintaining and sustaining an entire society”

2. economists

a. scientists

b. discover and explain laws that govern market

c.. Adam Smith *An Inquiry into the Nature and Causes of the Wealth of Nations*(1776) (status of “Bible”)

**II. Smith’s Theory of the Free Market**

**A. Assumptions**

**1. “truth” about human nature**

**a. psychology: human beings are greedy**

**b. individuals motivated by self-interest**

**c. self-interest = pursuit of profit and wealth**

**2. free market creates conditions to maximize pursuit of profit**

**a. private property**

**b. competition**

**c. governed by laws therefore predictable results**

**“a certain type of behavior (self-interest) will in a certain social framework (capitalism) bring about perfectly foreseeable results (fulfillment of individual and social needs) “**

**B. Laws of the Market Place**

**1. First law: supply and demand**

**a. needs create market place demands**

**b. market responds by creating supply**

**i. individuals (entrepreneurs) create products and services to meet demand**

**ii. guarantees competition**

**c. competition guarantees**

**i. consumer demands will be met**

**ii. high quality**

**iii. low price**

**iv. rewards individuals**

**innovative**

**highly motivated**

**efficient**

**risk taking**

**v. monopolies a threat**

**d. competition guarantees that social needs will be**

**met**

**e. competition progress**

**2. Second law: accumulation of profits**

**a. capitalist will accumulate wealth**

**b. competition guarantees reinvestment**

**i. means of production**

**ii. increasing division of labor**

**c. increasing national wealth=social progress**

**3. Third Law: good for the capitalist is good for the worker**

**a. free labor**

**b. competition between capitalists forces employer to keep wages up**

**c. wages will necessarily be above subsistence**

**4. Fourth law: laissez-faire or no government intervention**

**a. disrupt laws of market place**

**b. negatively affect incentive**

**c. reward losers**

**C. Role of government: limited but necessary**

**1. financial infrastructure**

**2. physical infrastructure**

**3. security: Police**

**4. Civil Courts: contracts**

**5. public education**

**6. no tariffs, no government protection of industry**

**G. Smith’s criticisms of capitalism**

**1. capitalists: “mean rapacity”**

**2. negative effects on workers**

**3. little hope for newly emerging phenomenon “corporations”**