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Wealth of Nations

When many folks hear the phrase "Wealth of Nations," they immediately think of Adam Smith's legendary socioeconomic work published in 1776 under the full title of *An Inquiry into the Nature and Causes of the Wealth of Nations.* The work was one of the first serious thought pieces regarding how wealth is created and the role of a market-based economy in that process. The book covers a number of broad-based economic concepts, such as the division of labor, productivity and the usefulness of free markets.

At times, the world's leaders have attacked the usefulness of free-market economic systems, declaring market-based systems uncaring and inhumane. While some would argue the truth of these sentiments, free-market economies have lifted up the vast majority of Western societies to levels of prosperity that were only dreams as little as 150 years ago. However, simply claiming an economic system to be market-based, rather than command-based, isn't enough to promote high levels of growth. *A focus on productivity is needed for strong, sustainable growth to occur and for society, as a whole, to prosper.*

Adam Smith, author of *An Inquiry into the Nature and Causes of the Wealth of Nations*

The purpose of this piece isn't to wave the free-market flag, but to simply address the question: "Why do some societies prosper, while others languish over long periods of time?" Additionally, the usefulness of this analysis goes beyond the simple philosophical argument of market-based vs. command-based economic systems. My goal is to apply this learned knowledge for investment purposes.

Why Productivity?

For the general purpose of this piece, I equate social "prospering" with economic productivity. Why not include the softer social goals in our analysis, such as the issue of income distribution, which is a current focus of some? Simply put, without raw economic growth, nobody prospers and income distribution becomes moot.

It is broadly believed, as a general economic tenet, that nominal GDP growth (total economic production) can be attributed to three factors:

1. The size of a country's labor force
2. The *productivity* of that labor force

3. Inflation

The larger the country's labor force, the larger the productive capacity of that country. Additionally, the more productive a labor force, the higher the macroeconomic growth of a society. Finally, inflation adds to growth by driving revenue higher for goods and services. The two factors that generate "real" (after-inflation) growth are labor force size and productivity.

The growth of a country's labor force, alone, over long periods does not raise the standard of living, as personal disposable income levels are not tied directly to the size of the labor force. Instead, the standard of living is directly tied to the productivity of each individual within that labor force.

Bluntly stated, the true wealth of a nation is tied to that nation's after-inflation, per-capita productivity level.

This is the measure I will examine: the rate of change of global and national after-inflation, per-capita productivity levels. I will outline why, over various periods of time, productivity trends accelerate in some countries, resulting in true wealth creation, and do not accelerate in others, with no resulting wealth creation.

From an economic standpoint, disposable income can be consumed or saved. If saved, investments occur. As investments occur, productivity over a period of time rises – assuming the investments are sound. As productivity rises, disposable income rises….you get the picture. A "circle of prosperity" occurs due to a rise in productivity.

Finally, some might wonder why true per-capita wealth creation is important. Why is it, from a broad-based social standpoint, important for individuals to have an opportunity to create wealth? The true answer goes well beyond greed.

Growth in productivity, in a macroeconomic sense, improves the quality of living of an entire society, along with the actual longevity of human life itself. Without growth in productivity (creating more output and, consequently, wealth than we consume), disposable income and savings would not be possible. A base economic concept is savings=investment. Without investment (building of new businesses, systems and innovations) the "human state" would not improve. Lifespans would not rapidly expand. Opportunity for all people to improve their lot would cease to occur. I believe an understanding of the base issue of per-capita, real productivity trends is one of the more important economic issues for us all to grasp.

I will continue the "Wealth of Nations" theme in future writings. Next, I will discuss global productivity trends from the time of Christ to the time of Lincoln, a daunting task with an outcome you may find surprising. I hope you will find this work of use, not only in your investment activities but also, in your daily business lives.

Just for Fun

Now that we have started our mini-series on productivity, I thought it would be fun to look at what some others have said about productivity.

The simple act of paying positive attention to people has a great deal to do with productivity.

Tom Peters

The reality is that business and investment spending are the true leading indicators of the economy and the stock market. If you want to know where the stock market is headed, forget *about consumer spending and retail sales figures. Look to business spending, price inflation, interest rates and productivity gains.*

Mark Skousen

Productivity and the growth of productivity must be the first economic consideration at all times, not the last. That is the source of technological innovation, jobs and wealth.

William E. Simon

We will be back next week.

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