Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

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Adam Smith 250 years later

Next year will mark the 250th anniversary of the ratification of the Declaration of Independence, the founding document of the United States.

But another foundational document, fundamental to our understanding of economics, will reach the same milestone in 2026: Adam Smith's The Wealth of Nations.

At a time of rapid economic and structural transformation, its insights are worth revisiting.

Two stand out. One is that the "invisible hand" of markets efficiently allocates resources, as long as certain conditions – including a stable currency, a degree of trust and moral rectitude among economic actors, and credible property rights – are in place.

Externalities (the unpriced impact of an entity's activities on others) and informational gaps and asymmetries diminish the invisible hand's efficiency and performance.

The second, arguably more important insight is that an economy's efficiency and productivity are enhanced by the "division of labor," known today as "specialization."

A specialized economy is powered by various pockets of knowledge and expertise, which take advantage of economies of scale, learning, and enhanced incentives for innovation.

Since specialization does not work in the absence of a reasonably efficient method of exchange, it depends on Smith's invisible hand. As specialization advances, so does the economy's complexity.

As Smith noted, however, specialization is limited by the "extent of the market": a small market cannot create enough demand to sustain a wide variety of specialized businesses.

That is why improvements in transportation and communication linkages, which lower the cost of addressing an expanding market, have enabled greater specialization.

After World War II, specialization went global

Another important potential constraint on specialization is the risk it inevitably generates.

Since an economy's patterns of specialization are structural, they take time to change.

So, if the trading system is disrupted, or certain skills or industries are rendered obsolete (such as by technological innovations or shifting demand patterns), individuals, firms, and even entire economies must undergo a transition, which may prove difficult and prolonged.

In the nineteenth and early twentieth centuries, as economies became more specialized, various policies, institutions, and conditions – from antitrust to social safety nets to the maintenance of macroeconomic and monetary stability – gradually emerged to mitigate the associated risks.

But these were largely national-level solutions, and, after World War II, specialization went global.

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Colonial empires were abandoned, along with their asymmetric economic structures, and mercantilism gave way to free trade.

Add to that advances in transportation and communications technology, accelerated by the digital revolution, and the first constraint on specialization – the "extent of the market" – was radically loosened.

For developing economies, this was a game-

changer. Given their low per capita GDP, they could not generate sufficient domestic demand to benefit from the efficiency and productivity gains of specialization.

But once they gained access to foreign markets and technologies, they capitalized on their comparative advantages and achieved rapid GDP growth.

Increasing specialization was thus accompanied by a geographic shift in economic activity.

The structural disruptions

The resulting structural disruptions outpaced the evolution of governance structures capable of mitigating the proliferating risks.

For a while, this did not seem to matter much: the advanced economies, especially the US, still underwrote international economic governance, making the rules and sponsoring the institutions that kept the system running.

But, eventually, the shift in global economic power reached a tipping point: the demand constraint on specialization was loosened to the point that the risk constraint was kicking in.

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As the structural disruptions grew more pronounced, popular frustration deepened across the advanced economies, fueling a social and political backlash.

Then, a proliferating series of shocks – escalating climate impacts, the COVID-19 pandemic, the wars in Ukraine and Gaza, and rising geopolitical tensions – reinforced this shift.

Donald Trump's return to the White House, with his "America first" foreign policy and preference for bilateral dealmaking, cemented it.

The potential consequences

As a result, many countries now view economic security as inextricably linked to national security: while specialization remains intact within economies, it is being partly reversed at the international level.

Although it is impossible to know precisely where this process will lead, one can expect adverse consequences for productivity and growth – in effect the price of increased resilience and reduced risk.

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Countries with less capacity to generate domestic demand – whether because of low per capita GDP or small population size – will suffer the most, with the extent of their losses depending on how much access to global markets they retain.

But Smith's model of specialization may soon face an even more fundamental shift. Recall that it is based on the creation of pockets of specific knowledge and expertise that are not easily acquired or transferred.

But generative AI models, among their many effects, now appear to be on course to deliver expertise in almost any area, to anyone who wants it, at very low cost.

The potential consequences are far-reaching. If expertise becomes less scarce, the price it commands will fall.

Only knowledge and skills that remain difficult to transfer – say, because they cannot easily be described or documented – will increase in value.

In other words, a significant share of human capital might not be worth nearly as much at some point in the future as it was in the past 250 years, but another share could be worth much more. A question that must now be investigated is how big each of these shares will be.

Nearly 250 years after Smith introduced the concept of specialization, it remains a key feature of our economies. But it has also changed profoundly.

It is in partial retreat in the global economy, as the perceived risks of interdependence rise.

Artificial intelligence will probably not reduce specialization, but by altering the knowledge-transfer equation, it may change the relative prices of the human capital associated with various types of specialized knowledge.

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