**Specialization and Wealth**
**By Dwight R. Lee**
Audio (9:15 minutes)

**Question for thought:** As you listen, determine how specialization, voluntary exchange and cooperation can lead to wealth accumulation.

A remarkable degree of social cooperation emerges through market communication. Now, let's consider some of the advantages we realize from that cooperation. At a general level these advantages are obvious. It simply makes sense that we can produce more if our actions are in harmony than if we are working at cross-purposes. But to really understand economics, we must consider the link between cooperation and productivity in detail.

Wealth seldom comes as manna from heaven. It has to be produced by applying human effort, intelligence, and patience to natural endowments that yield their bounty reluctantly. This should be obvious. But one measure of the success of the marketplace at improving our productive powers is that it has become all too easy for people to assume that wealth is part of the natural order of things. Academics and policy wonks consider the *distribution* of wealth to be the primary issue, while dismissing any concern that their policy prescriptions could hamper its production. They drone on and on about the causes of poverty (or the "improper" distribution of wealth), apparently unaware that determining the causes of wealth is the serious challenge. The success of capitalism has blinded a remarkable number of otherwise intelligent people to the simple truth that distribution comes *before* production only in the dictionary.

## Specialization's Special Role

When economics emerged as a separate academic discipline in the late eighteenth century, it was obvious what the economic problem was. Adam Smith titled his economics book *An Inquiry into the Nature and Causes of the Wealth of Nations*, and his concern with explaining wealth is apparent from the very first page.

Smith begins by observing: "The greatest improvement in the productive powers of labour . . . seem[s] to be the effects of the division of labour." He illustrates the importance of specialization, or the division of labor, by considering the advantage of having each worker in a pin factory concentrate on a particular step in production rather than producing a pin from beginning to end. Through specialization workers can become more skillful, use machinery that increases their productive powers, and avoid the loss of time from constantly changing activities. These advantages are rather obvious, but the increase in productivity is far greater than one would expect. According to Smith, ten pin-makers, by specializing in different tasks, can produce about forty-eight thousand pins a day. But if each attempted to perform every task in pin production, Smith doubted that they could each make twenty pins a day, or two hundred among them.

But it takes more than extra output to create a real increase in productivity. A specialist produces much more of a product, or part of a product, than he wishes to consume himself. Producing lots of output is not productive unless it ends up in the hands of those who value it. So the advantage of specialization can be realized only to the degree that people can cooperate, with each specializing in the production of something that others want in order to be able to acquire what he wants from the specialized production of others. The only way for this cooperation to occur, and thus the only way to realize the productivity of specialization, is through exchange.

Adam Smith recognized the crucial connection between exchange and productivity when he observed that “the extent of this division [of labor] must always be limited by . . . the extent of the market.” If you can exchange only with those in a small village, your ability to specialize productively is extremely limited. For example, how many could afford to pursue careers writing novels, painting landscapes, or mastering musical instruments, no matter how great their talents, with only a few people to appreciate and reward their accomplishments? In such settings, most people tend to become “a jack-of-all trades, but master of none.” The more limited the market, the more limited the productive potential of specialization.

**Expanding the Market**

The link between specialization and the size of the market provides another explanation of the importance of market cooperation based on private property and voluntary exchange. Cooperation is possible without markets, at least without markets as we normally think of them. Family members cooperate on the basis of intimate knowledge and shared concerns. Members of small firms can work cooperatively in response to a common objective and peer pressures. The same can be said for churches, clubs, and other relatively small social organizations. The cooperation within families, firms, and social organizations can be explained as the result of exchange relationships. (Gary Becker’s writings on the family and the depiction of the firm as a “nexus of contracts” are good examples of such explanations.) But such relationships, because they depend on personal association and common objectives, are limited to relatively small groups.

A key to the productivity of the market is that it greatly extends the range of cooperation, and therefore greatly increases our ability to specialize productively.

Obviously the expansion of markets has depended on improvements in transportation and communication networks. But without the information communicated through market prices, and the cooperation motivated by these prices, improvements in transportation and verbal and written communication would be insufficient to realize much of the advantage of specialization. Brazilians could communicate their desire for more denim clothing with a steady barrage of faxes, e-mails, and telephone calls to clothing manufacturers in every country in the world, with it being possible to ship the clothing to them overnight from anywhere on the globe. But without the information communicated by changes in relative market prices, Brazilians would be unable to motivate cotton growers, agricultural chemical producers, dye manufacturers, textile workers, truck drivers, airline pilots, merchants, and countless others to coordinate their specialized efforts to make sure that the denim clothing was made available in Brazil in the desired quantities and preferred styles.

**The Impersonal Market**

The market is often criticized as impersonal. It can be, but that's why it so greatly extends the range of cooperative specialization. People don't have to know, or care for, those they are cooperating with, or those whom their cooperative efforts are serving, when they respond to market prices.

The market does far more to foster multicultural cooperation and global harmony than can ever be achieved by the personal efforts of government diplomats. It is the cooperation and harmony of the marketplace, and the specialization that it allows, that explain the creation of wealth.

**Concluding question:** Now, can you explain why cooperation and voluntary exchange lead to the real increase in productivity resulting from specialization?

**Reference:**

Lee, Dwight R. "Specialization and Wealth," The Freeman: Ideas on Liberty - August 1998. Retrieved from the World Wide Web on 20 November 2014 at http://www.fee.org/publications/the-freeman/article.asp?aid=4110.