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Adam Smith and the Moral Foundations of Political Economy

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ABSTRACT

Adam Smith's political economy is best understood as part of a broader inquiry into human beings and society, rather than as a narrow theory of market self-regulation. This paper situates *The Wealth of Nations* within Smith's wider intellectual project, including his writings on moral philosophy, rhetoric, jurisprudence, and scientific method. It emphasizes the complementarity between self-interest and sympathy, the centrality of the division of labor to Smith's theory of economic development, and the role of institutions, justice, and public action in sustaining commercial society. The paper also revisits Smith's theories of value, prices, distribution, and competition, arguing against interpretations that assimilate Smith to modern general equilibrium theory or

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reduce the “invisible hand” to a doctrine of automatic market optimality. Smith emerges instead as a theorist of social interdependence, historical development, and institutional complexity.

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1. Life and writings[1]

Adam Smith was born in the small town of Kirkcaldy (population about 1,500 at the time), on the Eastern coast of Scotland, in 1723. The precise date of his birth is not known; we only know that it must have been a few weeks after the death of his father, a customs officer, which occurred in January, and before 5 July, the day of his christening. The young Smith had a placid childhood, raised by his mother Margaret with the help of relatives – a moderately well-to-do family of landowners – until 1737, when he moved to Glasgow in order to attend the local university. Among his teachers, his favourite was Francis Hutcheson.

At the time, fourteen was not an uncommon age to enter university, which was in fact a sort of upper secondary school. The young Adam had already studied some Latin in Kirkcaldy, and was immediately admitted to Greek lectures; he also took lessons in logic, which apparently followed the Aristotelian tradition but also included some recent developments (Descartes and Locke), in natural philosophy, in mathematics and physics (Euclid's *Elements* and Newton's *Principia Mathematica*) and in moral philosophy (with Francis Hutcheson).

In the Scottish educational system, at all levels, the students paid their teachers course by course. The total salary of the latter hence depended on their students' assessment of their teaching: a system that Smith himself would experience later as a professor, and would consider by far superior to that of the great English universities like Oxford, financed by public funds and private donations, where the professors, receiving a regular salary, had no incentive to put zeal into their profession.

It was in fact at Oxford, at Balliol College, that Smith continued his studies as from 1740, with a scholarship (the Snell scholarship) that guaranteed 40 pounds yearly for eleven years, as preparation for an ecclesiastical career. As we have seen, Smith did not take to the celebrated English university, traditionalist and authoritarian as it was. Learning by rote, reading summaries rather than original works, were the rule. Traditionally sanctioned topics – Aristotle over and again – were imposed on the students, but the workload was far from heavy; compulsory prayers dominated over compulsory lessons, and Smith had plenty of time to spend in the Bodleian library, following his own interests, 'perhaps in defiance of the Oxford guardians of orthodoxy' (Ross 1995, p. 78). For instance, the young Adam was punished when caught reading the *Treatise of Human Nature* (1739-40) by David Hume, a supporter of a vague theism and who would later become one of Smith's best friends. It may have been these readings that put Smith off the idea of embracing an ecclesiastical career.[2] Thus, after six difficult years, in 1746 Smith

[1] Cf. the biography painstakingly compiled by Ross (1995). Smith's first biographer was his pupil Dugald Stewart (1753-1828). Let us also mention at least West 1976.

[2] In Protestantism, which is declaredly his own religion, Smith 1977, pp. 67-8, appreciates above all 'the pretious right of private judgement for the sake of which our forefathers kicked out the Pope and the Pretender'. When teaching in Glasgow, Smith asked to be exempted from the traditional prayer at the beginning of the lessons, and it is said that his prayers were anyhow inspired by 'natural religion' (Ross 1955, p. 118).

decided to return to Scotland, to Kirkcaldy, where he spent two years studying on his own and writing some essays on literary and philosophical subjects.

For three years, from 1748 to 1751, Smith held public lectures in Edinburgh on rhetoric and English literature, with some success in terms of audience and finance (about a hundred people paid a guinea a year each to listen to the young lecturer, while the sponsors, including Lord Kames, paid the expenses). On the strength of the fame obtained with these lectures, in 1751 Smith became a professor at Glasgow university, first holding the chair of logic (but his lessons were essentially on rhetoric, like his Edinburgh lectures) and subsequently the moral philosophy chair.[3] This involved lecturing on natural theology, ethics, jurisprudence and, in the same set of lessons, politics and political economy.

From those years we have the notes on a course of lessons on rhetoric, taken by a student in 1762-63, found in 1958 and published in 1963 (Smith 1983), and the notes of two courses on 'jurisprudence' (taken in 1762-63 and in 1763-64, discovered respectively in 1958 and 1895 and published in 1978 and 1896: Smith 1978). These texts, apart from having considerable interest in themselves – for the study of human nature and the forms of communication, and for analysis of institutions and their development in the course of history – show that the author already, hence before coming in touch with the French physiocrats, had the main themes that would weave together into the *Wealth of Nations* clear in his mind.

In the same period Smith wrote and published his first book, *The Theory of Moral Sentiments* (1759); it met with success, and reached six editions before Smith's death. Among the readers of the book was Charles Townshend, step-father to the young Duke of Buccleuch, who invited Smith to act as tutor to the young nobleman, accompanying him on a tour on the continent. The proposal was an attractive one, not only because it meant a life annuity of £ 300, but also because of the prospect of coming into direct contact with the liveliest centres of cultural life of the time. Smith accepted and, at the beginning of 1764, resigned from his chair at Glasgow. The travels on the continent gave Smith the opportunity to meet Voltaire in Geneva, and in Paris d'Alembert, Quesnay and many others.[4]

Scotland had at the time a fair cultural life, relatively free (especially in comparison with the authoritarianism and conformism that prevailed in the English universities) and rich in solid good sense, especially in the field of the social sciences; but the real centre of European intellectual life was France, especially Paris. When Smith arrived there, Quesnay had published a few years earlier his *Tableau Économique* (1758-59), while Turgot had still to publish his *Réflexions*. The culture of the *Encyclopédie* (publication of which began in 1751), based on faith in reason and progress, was also felt in other European countries, but the liveliness of the celebrated Parisian salons was unique. The stay in Paris offered Smith stimuli that he would work upon in the following years.

[3] On Smith's experiences as a teacher and on his pupils, cf. Ross 1995, pp. 128-56.
[4] On Smith's travel on the continent and on his activities as a tutor, cf. Ross 1955, pp. 195-219.

At the end of his travels on the continent, thanks to the annuity of the Duke of Buccleuch, Smith was able to dedicate himself fully to the composition of the *Wealth of Nations*, in the tranquil environment of his native Kirkcaldy where he lived with his mother between 1767 and 1773. In 1773 he moved to London to follow the printing of his book, which however took three more years of work. Finally, on 9 March 1776, the most famous economics book of all times arrived in the bookshops, meeting with a warm reception from the public (the book went through five editions in twelve years). His great friend Hume wrote him an enthusiastic letter about it.

After a long illness, David Hume died in the same year. Smith wrote an account of the last months of his friend's life, stressing his stoic courage: published in 1777, it 'brought me ten times more abuse than the very violent attack I had made [in the *Wealth of Nations*] upon the whole commercial system of Great Britain' (as Smith himself wrote in a letter to Andreas Holt of October 1780).[5]

In 1778, consulted on the American situation, Smith wrote a memorandum in which he argues the case for adopting a uniform system of taxation for Great Britain, Ireland and the American colonies, accompanied by the election of representatives of these latter populations to Parliament (on the basis of the principle commonly summarised in the motto 'no taxation without representation'). Furthermore, Smith foresaw the loss of the American colonies (with the exception of Canada) and the gradual shift of the economic and political barycentre from England to America.[6]

In the same year of 1778 Smith was appointed Commissioner of customs for Scotland; he thus moved to Edinburgh, accompanied by his mother. There he lived quietly (though deeply saddened, in 1784, by his mother's death), attended scrupulously to his duties and meticulously edited the new editions of his books, until his death on 17 July 1790. Complying with his instructions, the executors of his will destroyed sixteen volumes of manuscripts.

2. Method

It would be a mistake to ignore Smith's 'minor' writings, including the notes on his lectures taken by students, and to concentrate solely on the *Wealth of Nations*, although this is what in the past generations of historians of economic thought have done. As we shall see in the next

[5] The loving account of the last months of Hume's life is written in the form of a letter to the publisher William Strahan (1715-1785), dated 9 November 1776 (Smith 1977, pp. 217-21), subsequently published, with Smith's consent, in a pamphlet (Hume 1777, pp. 37-62). The final lines of the letter show the high regard that Smith had for Hume: 'Upon the whole, I have always considered him, both in his lifetime and since his death, as approaching as nearly to the idea of a perfectly wise and virtuous man, as perhaps the nature of human frailty will permit'. On the subject cf. Ross 1995, pp. 288-304. The letter to Holt is in Smith 1977, pp. 249-53; the quotation is drawn from p. 251.

[6] Smith was since long a friend of Benjamin Franklin (1706-90), one of the protagonists of the independence of the United States, whom he had met in Glasgow in 1759 and with whom he had remained in touch through William Strahan. As his teacher Hutcheson and other intellectuals of the time had already done, Smith furthermore declares himself against the slave trade (cf. Ross 1995, p. 171).

section, *The Theory of Moral Sentiments* is in particular decisive for our understanding of the notion of 'self-interest' on which Smith relied in his more strictly economic analysis. Even the *Lectures on Rhetoric and Belles Lettres*, although apparently remote from economics in contents, are important, together with the *Essays on Philosophical Subjects*, for an understanding of some aspects of the method of enquiry adopted by Smith.

Our point of departure is in fact one of these essays, the *History of Astronomy* (the full title of which, significantly, is: *The Principles Which Lead and Direct Philosophical Enquiries; Illustrated by the History of Astronomy*). Schumpeter (1954, p. 182) singles out this among all Smith's works as the only one really deserving praise; and not solely for love of paradox since Schumpeter's 'liberal' methodology appears very similar to the Smithian approach.

Smith's point of departure in the field of epistemology, too, was based on analysis of the motivations for human action. In his view, our attitude towards scientific theories is explained by three 'sentiments': 'Wonder, Surprise and Admiration'. Wonder is excited by 'what is new and singular', surprise by 'what is unexpected', admiration by 'what is great or beautiful'.[7] 'Nature', Smith said, 'seems to abound with events which appear solitary and incoherent with all that go before them, which therefore disturb the easy movement of the imagination'; the task of philosophy (defined as 'the science of the connecting principles of nature') is 'to introduce order into this chaos of jarring and discordant appearances', 'by representing the invisible chains which bind together all these disjointed objects'.[8] In this way philosophy 'render[s] the theatre of nature a more coherent, and therefore a more magnificent spectacle'.[9]

In accomplishing this task of enquiring into nature, 'philosophical systems' are built (such as the two different cosmological views, Ptolemaic and Copernican) which – Smith stressed – are 'mere inventions of the imagination, to connect together the otherwise disjointed and discordant phaenomena of nature'.[10] In other words, the intellectual ('philosopher') who considers the world and tries to interpret its functioning has an active role, *creating* rather than *discovering* the theories. With this thesis, Smith opposed the Galilean idea (shared by Petty) according to which the task of the scientist consists in *revealing* (in the literal etymological meaning of taking away the veils which cover them) the 'laws of nature' which constitute the skeleton of the real world. All this should come as no surprise: after all, in this respect Smith is simply following in his great friend David Hume's footsteps.

In this way we may also interpret Smith's declared mistrust towards Petty's political arithmetic. It was not, as some commentators have maintained, a matter of doubting the statistical data which political arithmeticians construct with a notable effort of the imagination, in a situation where statistics collection was rudimentary. For Smith, it is rather a question of denying the idea

[7] Smith 1795, p. 33. The origin of Smith's notion of wonder as the source of the desire for knowledge is Aristotle's *Metaphysics* (I.2.982b); cf.Vivenza 1984, pp. 15 and 42.
[8] Ibid., p. 45.
[9] Ibid., p. 46.
[10] Ibid., p. 105.

of a mathematical structure of reality, which Hobbes and then Condillac's sensism had already extended to the human body, and which Petty and the political arithmeticians extended to the 'political body', namely society.[11]

The 'philosophical systems', though 'inventions of the imagination', may help us to get our bearings in the chaos of real events. However, it is clearly not possible to verify the theories by demonstrating their correspondence to supposed natural laws, unless we assume that such laws have a real existence independent of the theories themselves (unless, that is, such laws are inscribed, so to say, in the real world, and not a creation of our thought). Smith does not tackle this issue. Feyerabend and McCloskey propose to solve it by referring to 'honest discourse' and 'rhetoric'. It is, however, interesting to note that Smith himself, in the *Lectures on Rhetoric* (1983, p. 178), proposed the method of rhetoric, with particular reference to the model of legal proceedings, as the way to select the propositions to be accepted and those to be rejected.[12] This idea should, however, be understood (with a connection, typical of Smith, between ethics and theory of knowledge) in terms of the notion of the impartial spectator. As we shall see in the next section, to this spectator we may assign the role of the arbiter, in this case not of what is just and what unjust, but (provisionally, not absolutely) true and false.

Smith thus adopted a flexible methodology, which left room for a good degree of eclecticism. Moreover, abandonment of the idea of a mathematical structure intrinsic to reality corresponds to attributing men with a complex set of motivations, the balance of which is the object of the *Theory of Moral Sentiments*. These elements – diffidence towards the idea of laws of nature hard and fast in their objective reality, in the natural as in the human world, and systematic openness to recognising the complexity of the motivations of human action – were characteristic of the Scottish Enlightenment, the cultural environment in which Smith had grown up and to the development of which contributed with his writings.

3. The moral principle of sympathy

As we have already seen, the broad context of Smith's work was the debate on the different motivations for human action. In short, his contribution consisted in pointing out the complementarity between pursuing self-interests and attributing a central role to moral rules for the sound functioning of common life in society. This interpretation, upheld by the editors of the

[11] In many respects, this Smithian view resurfaces in Keynes.

[12] These ideas have a long history. Suffice it to recall the Sophists' opposition to Socrates' (and Plato's) thesis on the existence of Truth, discovery of which must be the aim of philosophical enquiry. The Sophists prescribed, rather, open debate on the elements in favour and against any and every thesis, believing no thesis to be true in an absolute sense. On the Smithian thesis of the rhetoric as an instrument of research, cf. Giuliani 1997. As Giuliani stresses (ibid., p. 205), 'Rhetoric is the method of enquiry into the domain of the opinion and the probable truth'. In this respect, too, we note a significant affinity between Smith's ideas and those of Keynes.

critical edition of Smith's works,[13] emerges from reading his two main works, *The Theory of Moral Sentiments* and *The Wealth of Nations*, as complementary rather than contradictory.

The thesis of a contradiction between the two works prevailed for a certain time, constituting what has been labelled *das Adam Smith Problem*. According to this thesis, defence of the free pursuit of self-interest within a market economy proposed by Smith in the *Wealth of Nations* would correspond to the mature position of the Scottish economist. Smith is taken to have reached it after rejecting the position he initially defended in *The Theory of Moral Sentiments*, according to which sympathetic behaviour among the members of a community is necessary for the very survival of the collective entity.[14] This thesis appears untenable when we recall that *The Theory of Moral Sentiments* was repeatedly reprinted, on all occasions under the control of the author, who took advantage of the opportunity offered by the reprint to introduce changes into the work, even after the publication of *The Wealth of Nations*. Smith should have had a schizophrenic personality had he simultaneously submitted to his readers two works contradicting each other! Moreover, in Smith's correspondence there is no hint that he himself or any of his correspondents saw even the slightest contradiction between the two works.

The mistake of those arguing a contradiction between the two works, and hence between self-interest and the ethics of sympathy, is a typical example of a reading misled by the theoretical (and cultural, in the broad sense of the term) tendencies prevailing in the period in which the interpreter lives. In our case, the prevalence of a mono-dimensional notion of man[15] led commentators to consider as contradictory the simultaneous presence of two motivations of human actions. We should rather recall that in the eigthteenth century the simultaneous presence of even conflicting passions and interests as the foundation for human action was considered a matter of fact with which to come to terms. Rather, the complementarity suggested by Smith between the moral principle of sympathy and self-interest constitutes both the basis for a richer and more complex notion of the human being than those proposed later and a theoretical contribution that remains highly relevant.

The Theory of Moral Sentiments is centred on the proposal of the 'moral principle of sympathy', the importance of which in driving human behaviour had already been maintained by Hume

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[13] The six volumes of the *Glasgow Edition of the Works and Correspondence of Adam Smith* (edited by D.D. Raphael and A.S. Skinner, Oxford University Press, Oxford 1976-1983; paperback anastatic reprint, Liberty Press, Indianapolis, 1981-1985) include *The Theory of Moral Sentiments*, edited by A.L. Macfie and D.D. Raphael; *The Wealth of Nations*, edited by R.H. Campbell and A.S. Skinner; *Essays on Philosophical Subjects*, edited by W.P.D. Wightman, *Lectures on Rhetoric and Belles Lettres*, edited by J.C. Bryce; *Lectures on Jurisprudence*, edited by R.L. Meek, D.D. Raphael and P.G. Stein; *Correspondence*, edited by E.C. Mossner and I.S. Ross.
The literature on Smith is huge, and keeps increasing; here we can mention Macfie 1967, Skinner and Wilson 1975, Wilson and Skinner 1976, Winch 1978, Pack 1991, Skinner and Jones 1992, Aspromourgos 2009. A radically different interpretation is offered by Hollander 1973b, who maintains the thesis – insistently repeated, but very rarely investigated: Hollander is an important exception, from this point of view – of Smith as a founder of the theory of general economic equilibrium; for a critique of such a thesis see below.

[14] This thesis was developed by a group of German scholars in the second half of the nineteenth century, first of all Carl Knies. For references to this literature, and for a detailed criticism of their thesis, cf. Raphael and Macfie 1976.

[15] This view can be connected to Benthamite utilitarianism and to the subsequent affirmation of the subjective theory of value within the framework of marginalism.

(1739-40).[16] According to Smith, 'the chief part of human happiness arises from the consciousness of being beloved'; sympathy, namely the ability to share the feelings of others, leads us to judge our actions on the basis of their effects on others in addition to their effects on ourselves. Thus the human being 'must … humble the arrogance of his self-love, and bring it down to something which other men can go along with. … In the race for wealth, and honours, and preferments, he may run as hard as he can, and strain every nerve and every muscle, in order to outstrip all his competitors. But if he should justle, or throw down any of them, the indulgence of the spectators is entirely at an end. It is a violation of fair play, which they cannot admit of'. This kind of moral attitude is a prerequisite for the very survival of human societies: 'Society … cannot subsist among those who are at all times ready to hurt and injure one another'. [17]

In other words, Smith's liberal views are based on a two-fold assumption, namely that commonly each person knows better than anybody else her or his own interests, and that among the interests of each there is the desire to be loved by the others and hence respect for the well-being of the others. The first assumption explains the rejection of a centralised management of the economy, even if by an enlightened prince; hence the preference for a market economy over a command economy. The second assumption constitutes, within the Smithian building, an essential precondition to ensure that the pursuit of self-interest on the part of a multitude of economic agents in competition among themselves leads to results conducive to the well-being of society. The distinction between private and public interest becomes opposition, irreconcilable conflict – Smith said in substance – only if the private interest is interpreted in a restrictive way, as selfishness rather than self-interest, the latter implying attention to one's own interests moderated by the recognition (or, better, 'sympathy') for the interests of the others.[18] In a civilized society, based on division of labour and commerce[19] – the declared object of Smith's analysis – this conflitcs is also countered by laws and regulations aimed at directing towards the common weal human behaviour driven by personal interest.

Another central element in *The theory of moral sentiments* is the notion of the 'impartial spectator'.[20] According to Smith, individuals evaluate their own actions by taking the viewpoint

[16] However, the meaning attributed to such a principle is somewhat different in the two authors: by the term sympathy Hume 'means the communication of feeling, and Smith means the psychological mechanism that provides an approach to mutuality of feelings' (Ross 1995, p. 183).
[17] Smith 1759, pp. 41, 83, 86: I.ii.5.1; II.ii.2.1; II.ii.3.6.
[18] In *The theory of moral sentiments* Smith criticises the 'licentious systems', in particular Mandeville's one: 'It is the great fallacy of Dr. Mandeville's book to represent every passion as wholly vicious, which is so in any degree and in any direction. It is thus that he treats every thing as vanity which has any reference, either to what are, or to what ought to be the sentiments of others: and it is by means of this sophistry, that he establishes his favourite conclusion, that private vices are public benefits' (Smith 1759, pp. 312-3: VII.ii.4.12).
An articulate view of self interest, not reducible to the monomania for the accumulation of wealth (or, in other terms, to a mono-dimensional maximising behaviour), is evident for instance in the following passage: 'What can be added to the happiness of the man who is in health, who is out of debt, and has a clear conscience? To one in this situation, all accessions of fortune may properly be said to be superfluous; and if he is much elevated on account of them, it must be the effect of the most frivolous levity' (Smith 1759, p. 45: I.iii.1.7).
[19] Cf. Smith 1776, p. 26: I.ii.2. The notion of a civilized commercial society is an Enlightenment commonplace, but goes back to Medieval juridical thought: Giuliani (1997, p. 84) recalls in this respect the notion of *honesta utilitas*.
[20] On the notion of the impartial spectator, and more generally on Smith's moral philosophy, cf. Raphael 2007.

of an impartial spectator who, endowed with the knowledge of all the elements they know, judges such actions as an average citizen.[21] Juridical institutions, the functioning of which is indispensable to guarantee the security of market exchange, find in this principle of moral behaviour the necessary concrete support. Thus the most famous Smithian statement, according to which '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', should not be considered in isolation. In the context it implies the assumption – vital for the functioning of a market economy – of a civilised society, grounded on the general acceptance of the moral principle of sympathy, and endowed with the administrative and juridical institutions necessary to deal with the instances in which the common morality is violated.[22]

What Smith attempted, following in the tradition of the Scottish sociological school, was a difficult task of definition of a third way for the theory of man and society, differing both from the Aristotelian tradition and from the natural law philosophers discussed above. Smith rejected the arbitrary absolutism that the social and political structure of his times inherited from feudalism, and which can be associated with the Aristotelian tradition. However, he equally rejected Hobbes's contractualism, in which a state, though enlightened and benevolent, dominates the life of its subjects. It is this statism, which the 'mercantile' theories are imbued with, that Smith was opposed to, more indeed than he was to the mercantile identification of wealth with money and the thesis of the preference for an active balance of payments, the latter being Smith's own interpretation of the history of economic thought preceding him, proposed in the fourth book of *The wealth of nations*, although in many respects it appears forced.

Smith proposed the line of a greater confidence in the self-governing capacity of individuals: 'Every man is, no doubt, by nature, first and principally recommended to his own care; and as he is fitter to take care of himself than of any other person, it is fit and right that it should be so'.[23]

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[21] Naturally this thesis presupposes the existence of a common cultural basis (in the broad sense) for the individuals belonging to a given social system. In this respect the reference to the nation-economy customary in the tradition of classical political economy implies relatively minor difficulties compared with modern reference to the world-economy.

[22] Smith 1776, pp. 26-7: I.ii.2. This passage, or variants of it, also occur in the *Lectures on jurisprudence* and in the *Early draft of parts of 'The wealth of nations'* (now reprinted in Smith 1978, pp. 562-81). Cf. Smith 1978, pp. 348: LJ-A, vi.45-46; 493: LJ-B, 219-20; 571-2: *Early draft*, 23. Smith's reference to benevolence is an implicit way of drawing attention to the thesis of his master Hutcheson, who attributed to it an important role as a guide to human action. It may be worth stressing that in a society in which merchants felt no compunction in selling adulterated food (and in which merchants who did so would not be sued by the state justice) production for self-consumption would grow, with regression in the division of labour and hence economic decline, upon which civic decline would inevitably follow.

[23] Smith 1759, p. 82: II.ii.1. The passage is repeated with nearly the same wording further on in the text (ibid., p. 219: VI.ii.1.1): 'Every man, as the Stoics used to say, is first and principally recommended to his own care; and every man is certainly, in every respect, fitter and abler to take care of himself than of any other person'. As we can see, Smith does not say that every man is fitter than anybody else to take care of himself, but that every man is fitter to take care of himself than he could of anybody else. The difference is not enormous; however, Smith's meticulousness and caution emerge on such occasions, qualifying his liberalism.
John Stuart Mill reproposes this thesis (without quoting Smith) in his famous essay *On Liberty* (Mill 1859, p. 76): Each person 'is the person most interested in his own well-being'.

However, the free pursuit of personal interest comes up against two limits: one external to the individual (the administration of justice, one of the fundamental functions that Smith attributes to the state), and one internal to him, 'sympathy' for his fellow human beings. The simultaneous recourse to these two elements shows how Smith, faithful in this to the Aristotelian tradition of hostility to extreme positions, had a positive but not idealised vision of human beings.[24]

Smith (1759, p. 77: II.i.5.10) was explicit in this respect:

We are not at present examining upon what principles a perfect being would approve of the punishment of bad actions; but upon what principles so weak and imperfect a creature as man actually and in fact approves of it. ... The very existence of society requires that unmerited and unprovoked malice should be restrained by proper punishments .... Though man, therefore, be naturally endowed with a desire of the welfare and preservation of society, yet the Author of nature has not entrusted it to his reason to find out that a certain application of punishments is the proper means of attaining this end; but has endowed him with an immediate and instinctive approbation of that very application which is most proper to attain it.

It is precisely from the non-idealised view of man and society that the various examples stem of state intervention that may be attributed to Smith.[25]

To sum up, in Smith's view various elements concur to guarantee the very survival and development of civilised societies: moral behaviour based on the sentiment of sympathy (hence grounded on a sentiment which is innate in man, not imposed from outside), the driving force of a well conceived personal interest, a set of juridical rules and customs, and public institutions designed among other things to guarantee the administration of justice. This is a view that appears as grounded on a solid good sense; at the same time, it is the fruit of refined theoretical elaboration involving the whole field of the social sciences and entailing, step by step, fine-tuned selection among the different cultural traditions and streams of thought contributing to the liveliness of the century of Enlightenment.

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[24] This view of the human nature constituted a central element for the Scottish Enlightenment, but was widespread. For instance, also Kant (a year younger than Smith) adopted a position similar to Smith's (one of his favourite readings, by the way: cf. Ross 1995, pp. 193-4; the German translation of *The Theory of Moral Sentiments* is dated 1770). Let us compare two passages: 'The coarse clay of which the bulk of mankind are formed, cannot be wrought up to such perfection' (Smith 1759, pp. 162-3: III.5.1); 'From a twisted wood, such as that of which man is made, nothing entirely straight can come out. Only the approximation to this idea is imposed on us by nature' (Kant 1784, p. 130). Before both Smith and Kant, the idea of a substantially benevolent human nature was maintained, for instance, by Hutcheson and Shaftesbury, who opposed it to the thesis of a substantially selfish human nature argued in particular by Hobbes and Mandeville.

[25] Viner (1927) recalls such examples in order to criticise the interpretations of Smith 'as a doctrinaire advocate of laissez-faire' (ibid., p. 112). The article by Viner, one of the most authoritative exponents of the first Chicago school, is an *ante litteram* critique of Stigler's motto at the bi-centennial celebrations of *The Wealth of Nations*: 'Smith is alive and well, and living in Chicago'. This motto joins together two different notions: political liberalism, mainly concerning political institutions, and economic liberism, focused on freedom of action within the economic field. The two notions may well coexist, as in Luigi Einaudi; but the distinction is important, as shown by the openings of neoliberists such as Friedman and Hayek towards Pinochet's bloody dictatorship in Chile.

4. The Wealth of Nations

Smith's contributions, as we have seen, concern many fields: rhetoric, moral philosophy, jurisprudence, political economy. This latter field is the one which Smith owes his fame to. However, it is important to stress that his reflections on this topic (and thus the book in which they are illustrated, *The Wealth of Nations*) are part of a wider research on human beings and society: two elements that, as his master Hutcheson held, actually constitute a single object of study.[26]

An Inquiry into the Nature and Causes of the Wealth of Nations (Smith, 1776) is subdivided into five books. The first concerns the division of labour (and thus technological progress), the theory of value and income distribution; the second deals with money and accumulation; the third is a brief, thought-provoking excursus in the history of institutions and the economy since the fall of the Roman empire; the fourth critically illustrates the mercantile doctrines and the physiocratic tenets; finally, the fifth concerns public expenses and receipts and, more generally, the role of the state in the economy.

The starting point of Smith's economic reflection is represented by the division of labour. His object is to explain the functioning of an economic system in which each person is engaged in a specific task and each firm produces a specific commodity.

The division of labour is not a new phenomenon, and Smith is not the first to draw attention to it. Schumpeter (1954, p. 56) called it 'this eternal commonplace of economics': authors from classical Greece such as Xenophon and Diodorus Siculus, Plato and Aristotle, had already discussed it, as well as authors of the previous century such as William Petty. Smith, however, was the first to bring the division of labour to the centre of analysis applied to explain which are the elements that determine the standard of living of a given country and its tendencies to progress or regress.

Smith's thesis may be summarised as follows. First of all, the wealth of nations is identified with what today we call per capita income, or in substance the standard of living of the citizens of the country under consideration.[27] This is an identification we now take for granted, but it was by no

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[26] In *The Wealth of Nations* and in other writings (especially the *Lectures on Jurisprudence*: Smith 1977) Smith adopted a theory of the stages of social development – hunting, stock-raising, agriculture, commerce – analogous to the one proposed, probably independently, by Turgot, under the influence of Montesquieu's *De l'Esprit des Lois* (1748, in particular book eighteen): cf. Meek 1977, pp. 18-32.

[27] These are the very first lines of the *Wealth of Nations* (Smith 1776, p. 10):

> The annual labour of every nation is the fund which originally supplies it with all the necessaries and conveniences of life which it annually consumes, and which consist always, either in the immediate produce of that labour, or in what is purchased with that produce from other nations.
>
> According therefore, as this produce, or what is purchased with it, bears a greater or smaller proportion to the number of those who are to consume it, the nation will be better or worse supplied with all the necessaries and conveniences for which it has occasion.

As a matter of fact, Smith's view is wider: in a civilised society material wealth, liberty, individual dignity and shared rules (laws and moral norms) all matter. A flourishing economy is important both in itself and as a

means so when Smith introduced it. Indeed, it ran counter the tendency of cameralist and mercantilist writers, counsellors to the prince in the previous decades, to take as the goal the maximisation of the total national income of a country as source of economic power and hence of military and political power (a view that would see Switzerland as less wealthy than India).

Secondly, let us recall that national income (Y) is equal to the quantity of product obtained on average by each worker (or labour productivity, π) multiplied by the number of workers employed in production (L):

$$Y = \pi L.$$

If we divide national income by population (N), we obtain per capita income; as a consequence, per capita income proves equal to labour productivity multiplied by the share of active workers over total population. In other terms: from $Y = \pi L$, dividing by N, we obtain

$$Y/N = \pi L/N.$$

Namely, the standard of living of the population depends on two factors: the share of citizens employed in productive labour and the productivity of their labour.

Here the division of labour comes into play. In fact, according to Smith, labour productivity depends mainly on the stage reached by the division of labour. In turn, this depends on the size of the markets. The first thesis – the positive effect of the division of labour on productivity – was illustrated by Smith (1776, pp. 14-5: I.i.3) with the well-known example of the pin factory, which was taken from the item *Épingle* in the *Encyclopédie* edited by d'Alembert and Diderot.[28] Smith identifies three circumstances that connect productivity to the division of labour: the improvement in the skills of the worker, when he regularly accomplishes a specific task rather than a multiplicity of tasks; the saving of labour time usually lost when shifting from one task to another; and technical progress induced by the possibility of focusing attention on one specific work task.[29]

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prerequisite for the development of letters and arts, and because of the civilising function attributed to commerce (the *doux commerce* thesis).
The idea of a 'common weal' concerning a country's citizens was already present earlier, among other things attributing importance to social inequalities: a theme also considered by Smith, especially in book V.

[28] The item *Épingle* (written by Alexandre Deleyre, known as the translator of Francis Bacon) is included in the fifth volume (1755) of the *Encyclopédie*, published between 1751 and 1772, and mentioned (with erroneous reference to the needle, 'aiguille') in the programmatic manifesto of the work, d'Alembert's *Discours Preliminaire* (1751, p. 141). The importance of the division of labour had, however, already been recognised by the Greek writers and, nearer to Smith, by authors such as William Petty, who uses as examples the fabrication of dresses, ships and clocks (Petty, 1690, pp. 260-1 and 1899 [1682], p. 473), and the anonymous author of the *Considerations on East India Trade*, who uses the same examples (Anonimous, 1701, pp. 590-2). Kindleberger (1976, p. 7) recalls that the example of pins had already been utilized by Carl (1723). The example of pins might have appeared suggestive to Smith because of the possibility, for himself and for the readers among his fellow citizens, of a direct comparison with the conditions in which the Scottish seamen produced the nails for their boats, as a subsidiary part of their fishing and smuggling activities (with the result of low productivity and bad quality of the product). The example of the needle was used by a medieval Muslim author, Ghazali (1058-1111): cf. Hosseini 1998, p. 673.

[29] Cf. Smith 1776, pp. 17-20.

The second thesis concerns the connection between growth of the market and development of the division of labour.[30] Let us recall that when a firm expands in order to realise an improved division of labour within itself, it will have to place on the market a product that has increased because both of the increase in the number of workers employed and the increase in their productivity. In Smith's example of the pin factory, rounding the numbers, a worker who does everything by himself produces around ten pins a day, while a small factory with ten workers produces about 50,000 pins a day. Production as a whole has increased by five thousand times, as a result of a tenfold increase in the number of workers and a five hundredfold increase in their productivity. Thus the market must also grow by five thousand times, in order to absorb the production of the small factory, compared with the size of the market sufficient for a single worker producing pins. Clearly, therefore, the size of the market constitutes the main constraint on the development of the division of labour. Hence Smith's economic liberalism: whatever is an obstacle to commerce, also constitutes an obstacle to the development of the division of labour, and so to increases in productivity and the increase in the welfare of the citizens, or in other words to the wealth of nations.

Smith considered a given fact that in the long run the increase in productivity would translate into an increase of the wealth of nations and not into a reduction of the area of productive labour.[31] Forerunning the so-called Say's law, Smith considered that what is saved tends to be entirely invested, in tranquil times.[32] In a progressive society, the workers' conditions are good, while their conditions are difficult in a stationary society, and miserable in a declining society. Thus, the workers' interests correspond to those of society, since wages are high when the economy grows; the same holds for rents, while the opposite holds for profits, notwithstanding the importance of their role for growth.[33]

Obviously, in analysing the division of labour we cannot stop at an aggregate notion such as that of the wealth of nations. Indeed, there are three connected but distinct aspects: the microeconomic division of labour, among the different workers within a same plant;[34] the social

[30] The Smithian connection between the size of the market and the division of labour has often been interpreted, in the terms of the traditional marginalist theory of the firm based on the U-shaped cost curves, as a thesis concerning increasing returns to scale. Cf. for instance Stigler 1951. In the context of the marginalist theory, however, the returns to scale concern static comparisons among alternatives equally available to the entrepreneur at a given instant of time, while in the Smithian framework the division of labour (more specifically, technological change) and the expansion of the market are dynamic processes that take place in time.

[31] See the wide treatment of the issue in book three of the *Wealth of Nations*, 'Of the different Progress of Opulence in different Nations'.

[32] 'In all countries where there is tolerable security, every man of common understanding will endeavour to employ whatever stock he can command in procuring either present enjoyment or future profit' (Smith 1776, pp. 284-5: II.i.30). Cf. Baumol 1977.

[33] Cf. Smith 1776, pp. 119, 251, 97: I.viii.43; I.xi.p.9-10; I.vi.8.

[34] The example of pins concerns the microeconomic division of labour, namely the division of labour within an individual productive unit (or firm). The expansion of the market may consist not only in an increase in the quantity of the product demanded by the buyers as a whole, but also in an increase in the market share of the individual firm through a process of industrial concentration. However, such a process implies a growing efficiency of the market. For instance, the number of firms producing pins in Great Britain may decrease if transport logistics allows the product of any firm to reach distant areas of the country. Smith, although not excluding it, does not refer so much to

division, among different jobs and professions; the macroeconomic division, among firms and sectors producing different commodities or groups of commodities.[35] It is therefore necessary to consider both the social stratification typical of such an economic system, and the relations that set in between the different productive sectors. On these aspects Smith went well beyond the economic thought preceding him, although he took a number of elements from it.

The political arithmeticians King and Davenant had illustrated the economic situation of England utilising a partition of the national economy into geographical areas: a choice we can understand for a time when commerce was greatly hindered by the difficulty of transportation. Subsequently, instead, the criterion gained ground of dividing society into social classes and productive sectors. In the wake of Cantillon and Quesnay, Smith considered a society divided into three classes. His tripartition – workers, capitalists and landlords (with the three corresponding kinds of income: wages, profits and rents) – is different from that of his predecessors (agricultural workers and farmers, artisans, nobility and clergy). The latter classification mirrors a society in transition from feudalism to capitalism, while Smith's classification mirrors a capitalist society (though nowadays landlords have lost practically all their importance, while the middle classes have expanded). Thus, in this respect too Smith marks the rise of the conceptual scheme that characterised subsequent economic science.

The notion of the rate of profits, though not new (it had already been utilised by Turgot and others), definitively acquires a central role: the expediency of alternative lines of activity is evaluated by looking at the ratio between profits and the value of capital advances, rather than at the difference between receipts and costs.

Because of the differences in bargaining power between capitalists and workers,[36] we may assume that the latter receive a wage just sufficient to maintain themselves and their families.

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the expansion of the market for the individual firm as to the market for a product as a whole. (It is only within the marginalist theory of the equilibrium of the firm that increasing returns, conceived in statical terms, enter into contradiction with the assumption of competition; here we limit ourselves to stressing the dynamic, not static, nature, of the Smithian analysis of the division of labour, and the absence in it of the marginalist notion of equilibrium.)

[35] Even if Smith did not explicitly discuss this connection (nor distinguish explicitly these different aspects of the division of labour), it is clear that the macroeconomic division of labour stems from the microeconomic division, through the externalisation of some areas of activity of a firm giving rise to new firms and new branches of activity. Cf. Corsi 1991.

[36] 'What are the common wages of labour depends every where upon the contract usually made between those two parties, whose interests are by no means the same. The workmen desire to get as much, the masters to give as little as possible. The former are disposed to combine in order to raise, the latter in order to lower the wages of labour. It is not, however, difficult to foresee which of the two parties must, upon all ordinary occasions, have the advantage in the dispute, and force the other into a compliance with their terms. The masters, being fewer in number, can combine much more easily; and the law, besides, authorises, or at least does not prohibit their combinations, while it prohibits those of the workmen. We have no acts of parliament against combining to lower the price of work; but many against combining to raise it. In all such disputes the masters can hold out much longer. ... In the long-run the workman may be as necessary to his master as his master is to him; but the necessity is not so immediate.' (Smith 1776, pp. 83-4: I.viii.12).

Smith maintained the thesis of a downward pressure on the wage towards the subsistence minimum (for the necessary consumption of the worker and his family) with arguments of an historico-institutional kind; changes such as the legalisation of the trade unions and the right to strike modify the situation and make it possible for wages to

The incomes of capitalists and landlords, namely profits and rents, may thus be considered equal in their total to the surplus obtained within the economy.

In the process of development, Smith added, rents increase, while the rate of profits tends to decrease due to the 'competition of capitals'. As a consequence, the interest of landowners accords in this respect with the general interest of society, while the opposite holds true for the capitalists.[37]

The surplus – a notion that Smith took over from Petty, Cantillon and Quesnay – is equal to that part of the product that exceeds what is necessary to reconstitute the initial inventories of means of production and means of subsistence for the workers employed in the productive process. This notion is the core of the classical representation of the functioning of the economy as a circular flow of production of commodities by means of commodities. Period after period, firms utilise the initial inventories of means of production (and the workers utilise the initial inventories of means of subsistence); at the end of the productive process, they obtain a product which is used first of all to reconstitute the initial inventories so as to be able to repeat the productive cycle; what is left after this, namely the surplus, may be utilised to increase the inventories of means of production and subsistence, increasing the number of workers employed in the productive process and hence the product, or for 'unproductive' consumption (which includes together with luxury consumption also the subsistence consumption of the unemployed or of those whose work does not give concrete results, that is does not give rise to commodities that can be sold in the market).

Smith attributed notable importance to the process of accumulation, or in other words to the productive utilisation of the surplus. Accumulation consists not only in investment in new means of production but also in the increase in the number of workers employed, and so in the wage advances for such workers, consisting in the use of part of the surplus as means of subsistence for the additional productive workers.

Here the problem arises of the distinction between productive and unproductive workers. In this respect, Smith appeared to oscillate between three different definitions. According to the first one, productive labour is that labour that gives rise to physical goods: labour in agriculture and manufacture, that is, but not labour in the services sector. The second definition identifies as productive that labour which recoups the funds employed in production and in addition generates a profit. According to the third definition, that labour is productive the wage for which is drawn

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be raised, even by a great deal, above the subsistence level, but do not detract from the validity of Smith's approach to the issue of distribution, seen as a problem of relative bargaining power. The same cannot be said for the 'iron law of wages' based on the Malthusian population principle.

[37] Cf. Smith 1776, pp. 264-7: I.xi.p.1-10. This does not mean that Smith's attitude be favourable to the landlords: they 'love to reap where they never sowed' (ibid., p. 67: I.vi.8), and rent 'is naturally a monopoly price' (ibid., p. 161: I.xi.a.5). But the attitude towards 'those who live by profits' is even harsher; not only is their interest opposed to economic development, it is also 'to narrow the competition' (ibid., pp. 266-7: I.xi.p.10).

from capital, while we are confronted with unproductive labour when the wage is drawn from the income of the master, as is the case for servants.[38]

As a matter of fact, these are not necessarily three alternative definitions. The last is useful for illustrative purposes, since it helps the reader to concretely understand Smith's reasoning, but as a theory it would imply a logical vicious circle.[39] The second and the first definition may coincide, if we assume that agriculture and manufacture correspond to the field of action of capitalistic enterprises. With such an assumption, we may credit Smith with an able compromise between the tradition that identifies productive labour with the production of durable goods (along a scale topped by precious metals and foreign trade, the latter being the means to obtain them) and the subsequent view, that will become dominant in Karl Marx' work, according to which the distinction between productive and unproductive labour, as far as the historical stage of capitalism is concerned, corresponds to the distinction between what comes within and what remains outside of the capitalistic area of the economy. In other words, Smith kept account of the traditional view but at the same time transformed it, throwing a bridge towards the less ambiguous Marxian definition.[40]

As for the theme of productive labour, again on the issue of the origin of the surplus Smith went beyond the traditional view of a hierarchy of productive sectors. In particular, the physiocratic idea that agriculture alone is capable of generating a surplus came under fire from Smith a few years after publication of the main works of the physiocrats.[41]

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[38] For the three definitions, cf. Smith 1776, respectively pp. 330-1, 332, 332-3: II.iii.2, 5, 6-7. It should be stressed that because of this notion of productive labour, Smith's notion of national income (Y in the equations above) is more restrictive than the current definition of income in modern national accounts. Nearer to Smith's (because of Marx's adoption of a variant of the Smithian concept of productive labour) was the notion of national income adopted in the national accounts of communist countries in the twentieth century.

[39] Indeed, when a capitalist hires a worker, we may say that the expense for the wage comes from his capital if the worker is a productive worker, while it comes from his income if the worker is unproductive: the distinction depends on what the worker does, not on the fact that his wage comes from one specific banking account rather than another. (Similarly, the purchase of a car on the part of an entrepreneur may today be classified as an investment or a consumption expenditure according to the use that is made of the car).

[40] The identification of productive labour with that which gives rise to material goods is the object of criticism on the part of Jean-Baptiste Say (1803), who defines services as 'immaterial products'. According to Say, we may define as productive any activity that gives rise to use values, namely to goods and services considered useful by the purchaser: a view that falls into the tradition of the subjective theory of value.
As far as unproductive labour is concerned, Smith suggested a distinction between useful and useless jobs (for instance, the physician and the buffoon; cf. Smith 1776, p. 331: II.iii.2). In essence, we may consider as useful that work which contributes indirectly to the functioning of the economic system, for instance by guaranteeing the observance of property rights; we may include in this field teachers and physicians, who contribute to the survival of the workers and to the development of their capabilities.

[41] Smith 1776, pp. 674-9: IV.ix.29-38. Here Smith explicitly also considered as productive the labour of the merchants, at the same level as that of agricultural workers, artisans and manufacturers, and in maintaining this thesis he again recalled the elements that characterise the three definitions of productive labour illustrated above. The arguments here used by Smith, however, mainly refer to the erroneousness of considering unproductive the manufacturing and the mercantile sectors, rather than the fact that in a system of productive interrelations, in which the different sectors depend one upon another for the provisioning of their means of production, it is nonsense to say that the surplus can only spring from the natural power of the land, and so only in the agricultural sector. Indeed, land has no autonomous role in the productive process, and would not yield anything if left uncultivated, if labour

In synthesis, according to Smith the wealth of nations, interpreted as per capita income (Y/N), depends on two factors: the productivity of the workers employed in the production of commodities (productive workers), π, and the share of productive workers in the total population, L/N. Labour productivity depends on the stage reached by the process of increasing division of labour, which in turn depends on the consumers' income (that is, on Y/N) and on the more or less liberist policies adopted by public authorities, in addition to improvements in transport. At the same time, the share of productive workers in the total population, L/N, depends on the stage reached by the process of accumulation, namely on available productive capacity, on institutional elements and on customs, such as laws on primary public education for all or child labour, or customs concerning women's employment. In turn, such factors are influenced by the political choices of the public authorities.

Using arrows to indicate cause and effect relations, we may represent the complex of relations as in Figure 1. As we can see from the scheme, the adoption of policies aiming at favouring free trade and the expansion of the markets may set in motion a virtuous spiral: the expansion of the markets favours an increasing division of labour, hence an increase in productivity that in turn gives rise to an increase in per capita income and, consequently, a further expansion of the markets. At the same time, these and similar policies favour an increase in per capita income thanks to their action in favour of an increase in the share of productive workers in the total population. These dynamic mechanisms, of a cumulative kind, constitute the essence of the Smithian theory of the wealth of nations.

(hence means of subsistence) and means of production had not been utilised together with it. Therefore the product cannot be attributed to a single element among the various elements employed in any individual productive process. Thus, since means of production at least in part come from other sectors (because of the division of labour, in agriculture manufacturing products are used, and vice versa), it is not possible to establish whether the surplus springs from one sector or from another, without first explaining how the exchange ratios are determined. Indeed, the surplus is a notion related to the economic system as a whole, not to an individual economic sector.

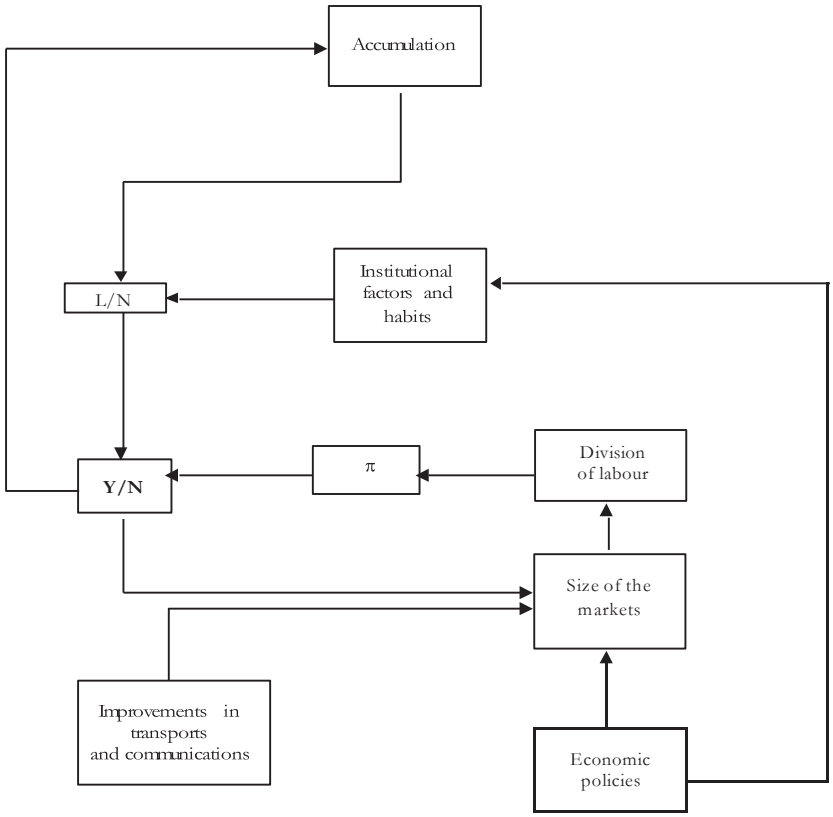
Accumulation
L/N
Institutional factors and habits
Y/N
π
Division of labour
Size of the markets
Improvements in transports and communications
Economic policies

Figure 1

5. Value and prices

One of the crucial conceptual distinctions for the development of classical political economy is that concerning value in use and value in exchange. This distinction is perfectly clear in Adam Smith:

> The word *value* ... has two different meanings, and sometimes expresses the utility of some particular object, and sometimes the power of purchasing other goods which the possession of that object conveys. The one may be called 'value in use'; the other, 'value in exchange'. The things which have the greatest value in use have frequently little or no value in exchange; and, on the contrary, those which have the greatest value in exchange have frequently little or no value in use. Nothing is more useful than water: but it will purchase scarce any thing; scarce any thing can be had in exchange for it. A diamond, on the contrary, has scarce any value in use; but a very great quantity of other goods may frequently be had in exchange for it.[42]

According to Smith and classical economists in general, value in use is a prerequisite of value in exchange: a good which has no use, and which is not desired by anybody, cannot have a positive value in exchange.[43] But once this condition is satisfied, the value in exchange of any commodity is determined on the basis of elements different from value in use: value in exchange depends on the conditions of reproduction of the economic system, not on the utility of the commodity under consideration. More precisely, the classical economists do not consider the value in use of a commodity as a measurable quantity. At most, like Smith in the passage quoted above, we may speak of a greater or lesser value in use, but in a rather generic way that certainly does not entitle us to think of a complete ordering of the preferences of economic agents. In any case, Smith himself explicitly rejected the idea that it is possible to explain the value in exchange of two commodities on the basis of their greater or lesser value in use. On the contrary, a connection between the two notions based on the representation of value in use as a mono-dimensional magnitude (either as a measurable magnitude, as in the cardinal utility approach, or as simply subject to comparison, as in the ordinal utility approach and in the theory of revealed preferences) was to be the basis for the marginalist theory of value.[44]

When they refer to the value of a commodity, the classical economists commonly mean value in exchange. However, the problem of value may assume different features, according to whether: i) the aim is to go back to the first principle – the 'source' – of value; ii) the focus is on the issue

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[42] Smith 1776, pp. 44-5: I.iv.13. The paradox of water and the diamonds is a commonplace in economic literature. Galiani, for instance, referred to it in order to stress the role of scarcity, alongside that of utility, in the determination of exchange values.

[43] For Smith, as for so many other authors before the marginalist revolution, utility has an objective sense as the capacity of a good to satisfy some need, rather than in the sense of subjective evaluation on the part of one or more individuals. These two aspects had already been distinguished – as *virtuositas* and *complacibilitas* – by Bernardine of Siena and Antoninus of Florence at the beginning of the fifteenth century.

[44] The idea of a connection between value in use and value in exchange was already present both in earlier authors and in Smith's times.

of the standard of value for inter-temporal comparisons or comparisons involving different countries; iii) the theoretical problem is tackled of determining exchange values.

It is understandable that, whatever specific problem came under consideration, the economists should initially have focused on labour. As we have already seen, theories of labour-value were already common among the natural law philosophers; labour reappears, side by side with land, among the elements that constitute the content in value of a commodity in the theories of Petty and Cantillon. As we have seen, however, labour-value theories assume different meanings in different authors. On the one hand, the natural law philosophers conceived labour-values as an index of the sacrifice made by people in order to obtain the desired commodity. On the other hand, authors like Petty and Cantillon were nearer to a theory of physical production costs; labour-values have for them the meaning of a simple matter of fact, devoid of the metaphysical features that characterise the idea of labour as sacrifice: that is, labour-values are nothing but a simplified way of expressing the relative difficulty of production of the commodity under consideration in relation to that of other commodities.

In Smith both features were simultaneously present; furthermore, the labour-value theory was proposed both as a theory of necessary labour (labour required for the production of the commodity: labour contained, in Marx's terminology) and as a theory of labour commanded. Let us consider this latter first:

Every man is rich or poor according to the degree in which he can afford to enjoy the necessaries, conveniences, and amusements of human life. But after the division of labour has once thoroughly taken place, it is but a very small part of these with which a man's own labour can supply him. The far greater part of them he must derive from the labour of other people, and he must be rich or poor according to the quantity of that labour which he can command, or which he can afford to purchase. The value of any commodity, therefore, to the person who possesses it, and who means not to use or consume it himself, but to exchange it for other commodities, is equal to the quantity of labour which it enables him to purchase or command. Labour, therefore, is the real measure of the exchangeable value of all commodities.[45]

In the passage quoted above Smith did not intend to point out the factors that determine exchange values, but simply to indicate the standard with which to measure them; he justified this choice by referring more generally to the central role of labour in the economy. Labour commanded moreover constitutes a standard particularly suited to comparison between different countries or different times within the same country,[46] and is thus appropriate for a dynamic theory of the wealth of nations such as that proposed by Smith. Moreover, according to Smith

[45] Smith 1776, p. 47: I.v.1.

[46] Even today the use of such a standard is frequent: a haircut 'commands' an hour of labour in one country, two hours of labour in another. The choice of the standard is here motivated not by a logical necessity internal to the theory, but by the particular role of the human being, and especially the worker, in the economists' eyes. Let us also observe that in Smith's times a theory of index numbers was not available, such as could have supplied an alternative instrument of measurement of the changes in economic magnitudes; moreover, even index numbers provide only approximate solutions to the measurement problem.

labour commanded is an appropriate measure for a society based on the division of labour. In fact, in such a society exchange between the products of different sectors is in substance an exchange that connects the workers of the different sectors: behind the act of exchange there is a relationship reciprocally connecting the workers of the different sectors, bringing them together in a single economic system, within which each person depends on the labour of the others. On the basis of work time we can thus express in quantitative terms the economic relations that hold together the different producers in a society based on the division of labour.

However, the problem of value remains open, at least in the sense it usually has in economic literature, namely that of identifying the factors which determine the value in exchange of the different commodities. In a society where the workers do not own their means of production (that is, in which they are mostly dependent workers), labour commanded gives the number of hours of labour required to earn a wage equal to the price of the commodity. Thus, for instance, we may say that two hours of labour 'acquire' (or 'command') a kilogram of meat. We may obtain the quantity of labour commanded by a given commodity by dividing its price by the wage rate, although this presupposes knowledge of both price and wage rate.

A solution to the problem of the determination of exchange values, already suggested in the passage quoted above, is provided by the necessary labour theory, according to which the exchange ratios between two commodities are proportional to the quantities of labour necessary to produce them. Smith, however, considered this theory valid only in an 'early and rude society':

In that early and rude state of society which precedes both the accumulation of stock and the appropriation of land, the proportion between the quantities of labour necessary for acquiring different objects seems to be the only circumstance which can afford any rule for exchanging them for one another. ... It is natural that what is usually the produce of two days or two hours labour, should be worth double of what is usually the produce of one day's or one hour's labour.[47]

However, Smith said, we can no longer utilise necessary labour to explain exchange values when we refer to a society in which workers are no longer the owners of the capital goods and land which they use in their work. In fact, necessary labour takes no account of the rents and profits that enter into the price of every commodity when capitalists and landlords constitute social classes distinct from the working class.

In such a society, exchange values correspond to the 'natural prices', which Smith defines in the following passage, distinguishing them from 'market prices': 'When the price of any commodity is neither more nor less than what is sufficient to pay the rent of the land, the wages of the

[47] Smith 1776, p. 65: I.vi.1. We must stress that Smith did not refer to any real primitive society, but to an ideal model of society in which economic agents (hunters and fishers) adopt the rational behaviour typical of a mercantile society, while the primitive character is given by the abstract hypothesis of absence of division into the social classes of workers, capitalists and landlords.

labour, and the profits of the stock employed in raising, preparing, and bringing it to market, according to their natural rates, the commodity is then sold for what may be called its natural price.'[48] In other words, the market price is the price we see looking at the actual acts of exchange; the natural price, instead, is the theoretical price that expresses the conditions of reproduction of the productive process. In a society divided into social classes, natural prices must cover production costs and guarantee, in addition, a return equal to that obtainable in other sectors for the capital invested in the productive activity.

Obviously reference to costs of production is in itself insufficient to build a theory of prices, since it would imply circular logical reasoning: if we need steel in order to produce coal, and coal in order to produce steel, we cannot determine the price of coal if we do not already know it. For this reason some economists, before and after Smith, had recourse to a first principle such as necessary labour (or labour-and-land, as in the case of Petty and Cantillon), which allowed them to explain prices without having to be explained in turn. However, as we have seen, Smith did not agree, since he considered necessary labour as an explanatory principle acceptable only for an 'early and rude society'.

Exchange values remain an open issue in Smith's analysis. An attempt at solving it is seen by some interpreters (for instance by Dobb 1973, pp. 44 ff.) in what has been called the 'adding-up-of-components-theory': namely, the idea that 'the price of every commodity finally resolves itself into some one or other, or all of those three parts', 'rent, labour, and profit'.[49] In other words, the price of a commodity corresponds to wages, profits and rents plus the costs borne for the means of production other than labour and land; such costs are in turn decomposed into wages, profits, rents and costs for the means of production; we thus proceed backwards until the costs for the means of production have disappeared or become insignificant. The value of a commodity thus depends on the technology and on the 'natural' rates for wage, rent and profit.

In this theory, however, there seems to be implicit an idea, which was to come under criticism from Ricardo, that an increase in the wage rate causes an increase in the price while leaving unchanged the rate of profits. As a matter of fact such criticism only holds if we assume – as Smith did not, at least not explicitly – that the three distributive variables are independent the one from the other. The adding-up-of-components-theory, however, does not constitute an adequate solution to the problem of exchange values, since the residual of means of production cannot in general be reduced to zero.[50] The theory thus represents rather re-proposal at the level of an individual commodity of a national accounting principle: the value of the national product corresponds to the value of national income, namely to the sum of the incomes of the different social classes. In fact, it is precisely this point which is stressed by Smith (1776, p. 69: I.vi.17).

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[48] Ibid., p. 72: I.vii.4.

[49] Ibid., p. 68: I.vi.10. The inclusion of profit in the price may be considered a step forward from Petty, Cantillon, Quesnay: cf. O'Donnell 1990, p. 54.

[50] Strictly speaking, 'complete reduction' is only possible when no commodity is directly or indirectly required for the production of itself: cf. Sraffa 1960, pp. 34 ff.

We can say, in conclusion, that Smith did not provide a fully adequate theory of exchange values; what he did provide, with the labour commanded theory, was more simply an indication of how to measure the prices of commodities that appears to be particularly useful for an economy based on the division of labour and in which continuous technological evolution takes place.[51] It was only with Ricardo that the theory of value, in its modern meaning of theory of relative prices, came to centre stage.

6. Natural prices and market prices

As we have already seen, the division of labour poses a problem of coordination among the different economic agents. Each firm produces a commodity or group of commodities and, in order to continue producing, it needs to dispose of part at least of what it has produced in exchange for the means of production required for the continuance of its activity. Similarly, the workers obtain a wage that they need to convert into their means of subsistence.

According to Smith , the market economy as a whole functions in a fairly satisfactory way: for each commodity, the flow of production coming out of the firms producing it more or less corresponds to the flow of the demand coming under normal conditions from the buyers. The market mechanisms guide the economy in such a way as to ensure the material welfare that is an indispensable precondition for a civilised life.

Let us consider the issue in some more detail. The exchanges between the different sectors, necessary for the continuous functioning of the economy, may be coordinated by a central authority with a plan for the repartition of the global product among the different sectors and the different productive units: such is the case of a command or planned economy. In a market economy, on the contrary, exchanges take place freely and the decisions on quantities to be produced, sold and acquired and on exchanges and prices are decentralised. It is the market that links up the productive units operating in the different sectors of the economy, in two distinct ways. First of all, through market exchanges each productive unit obtains from the others what it needs to continue its activity in exchange for its own product. Second, the market links up the productive units through the competition they conduct among themselves; it is from here that the mechanism derives ensuring the required coordination among the myriad of decentralised decisional centres, producers and buyers.

We may distinguish two kinds of competition, both taken into consideration by Smith. The first is competition within the market for each commodity. Each buyer seeks among the many sellers present in the market the one that sells the desired commodity at the lowest possible price; the seller who asks too high a price risks being left with unsold merchandise. Similarly, each seller seeks among the many buyers present in the market the one that is ready to pay the highest price

[51] Following similar lines, and showing how relevant the problem of measurement in spatial and intertemporal comparisons was to Smithian analysis, was the proposal to take corn as standard of measure: cf. Smith 1776, pp. 55-6: I.v.22. Sylos Labini 1976, illustrating the proposal, remarks that in Smith's opinion the production of corn is characterised by relative costs more or less stable over time, unlike, on the one hand, other agricultural products, characterised by increasing costs, and, on the other hand, manufactures, characterised by decreasing costs.

for the commodity on sale; the buyers offering too low a price risk being left empty handed. Under ideal conditions, when competition among the sellers and among the buyers does not meet with obstacles, the price of each commodity is one and the same for all the buyers and all the sellers. This is the so-called law of one price, emerging as a necessary outcome of competition.

There is then a second kind of competition, which Smith called the 'competition of capitals': namely, the competition among capitalists in search of the employment that offers the highest returns on their capital. When capitalists are free to move their capitals from one sector to another in search of the most fruitful employment (in Smith's 1776, p. 73: I.vii.6, terms, 'where there is perfect liberty'), there is free competition: its characteristic is precisely the absence of obstacles to the free movement of capital (or, as it is also put, the absence of barriers to entry into the different sectors of economic activity).[52]

When free competition rules, it is not possible for a sector to offer capitalists a return higher than that obtainable in other sectors for a long stretch of time, since otherwise new capitals would flow into it, with the consequence that production would increase, the market price would diminish, and with it also profits and the rate of return would decrease. In the same way, it is not possible for a sector to offer capitalists a return lower than that obtainable in other sectors, since otherwise there would be an outflow of capitals from that sector, causing a fall in production, with an ensuing rise in the market price and hence in profits and in the sector's rate of return. Therefore, under 'perfect liberty', namely generalised free competition, the return on capital – the rate of profits – tends to be equal in all sectors. In this way the competition of capitals links up in a single capitalistic market the different sectors of the economy. Here we see the central role of this kind of competition, which distinguishes the capitalistic system from a non-capitalistic market economy.[53]

As a result of the assumption of competition, the theoretical ('natural') price must be such as to allow reproduction over time of an economy based on the division of labour; hence the recovery of production costs and the possibility of earning a 'natural' profit. Its empirical counterpart is the market price: 'the actual price at which any commodity is commonly sold is called its market price. It may either be above, or below, or exactly the same with its natural price'. And Smith went on: 'The market price of every particular commodity is regulated by the proportion between the quantity which is actually brought to market and the demand of those who are willing to pay the natural price of the commodity'.[54]

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[52] For the comparison between this notion of competition and the neoclassical one, cf. Sylos Labini 1976.

[53] This element is lost sight of in the marginalist theories, which consider the capital market a market like all others, and the tendency to a uniform rate of profits as a specific instance of the law of one price. In this way the marginalist theories confuse the notion of competition within each individual market, based on the number of buyers and sellers, with the notion of the free competition of capitals, based on the freedom of entry into the various sectors of the economy.

[54] Ibid., p. 73: I.vii.7-8. Smith already discussed natural and market prices, and their relationship, in the *Lectures on Jurisprudence* (Smith 1978, pp. 356-66: vi.67-97); but these pages can only be considered as a rough first draft of the mature treatment of the issue in book 1, chapter 7, of the *Wealth of Nations*.

The counterposition between natural and market price may be considered not only as the distinction between a theoretical variable and its empirical correlate, but also as a subtle way in which Smith counterposed his own theory of exchange values, based on the analytical conditions defining the natural price, and the subjective theories of value, vaguely referring to scarcity and utility, to supply and demand, prevailing among Scholastic writers or in authors such as Galiani and Turgot. Focusing on the problem of reproduction over time of a society based on the division of labour, Smith, while apparently bringing into his exposition the elements on which the traditional subjective theories of value relied, confined such elements to the role of (irregular, non systematic) disturbances and by the very definition of natural price ruled them out of his own theory of exchange values.

Attempts at interpreting Smith so as to establish a connection between the objective elements on which the notion of natural price is based, and the subjective elements which are brought into the picture with respect to the market price, focus attention on the adjustment mechanism between market and natural price. This mechanism relies on the two kinds of competition illustrated above: when production of a commodity is in excess of the 'effectual' demand (i.e. the quantity that buyers are prepared to absorb at the natural price), then competition between sellers will push the market price below the natural price: the producers will be unable to obtain the natural profits, and an outflow of capitals from that sector will take place; production will decrease, and the excess supply will thus be absorbed. It was in connection with this adjustment mechanism that Smith used the famous gravitation analogy:

The natural price, therefore, is, as it were, the central price, to which the prices of all commodities are continually gravitating. … But though the market price of every particular commodity is in this manner continually gravitating, if one may say so, towards the natural price, yet sometimes particular accidents, sometimes natural causes, and sometimes particular regulations of police, may, in many commodities, keep up the market price, for a long time together, a good deal above the natural price.[55]

Some authors have interpreted the metaphor of gravitation as if it implied a theory of market price based on supply and demand. Specifically, market prices came to be interpreted as short run (Marshallian, market-clearing) equilibrium prices.[56] This idea is in fact totally alien to Smith's thinking, both because the market price, as we have seen, is not a theoretical variable for him, but an empirical correlate, and because the reference to gravitation itself, which seems to imply a precise theoretical structure, that of Newton's theory (in which the behaviour of the body that gravitates around another one is described by precise mathematical laws), is in fact

[55] Smith 1776, pp. 75 and 77: I.vii.15 and 20. Again in chapter 7 of book I of *The Wealth of Nations*, Smith states that the market price may prove higher than the natural price 'for many years together', 'for centuries', 'for ever', whenever the operation of competition is impeded by customs, regulations, laws, natural monopolies. The 'natural price' thus appears not only as a theoretical variable which expresses the conditions of reproduction of the economic system, but also as a norm corresponding to the full operation of competition.
[56] Cf. for instance Blaug 1962, p. 39.

quite vague.[57] This is testified among other things by the fact that in each of the two sentences in which the term 'gravitation' appears, it is accompanied by expressions ('as it were', 'if one may say so') which point to its use as an imprecise metaphor.

The interpretation of the market price as a theoretical variable determined by the confrontation between demand and supply according to general and precise rules makes its appearance only towards the end of the golden period of classical political economy, with John Stuart Mill and Thomas De Quincey, to be developed later by Alfred Marshall in the way that has become familiar through textbooks. In Smith's times, the terms 'demand' and 'supply' did not indicate curves, or more generally stable and well-identified functional relations connecting price and quantity of a commodity,[58] but a set of elements, possibly fortuitous or contingent, that cannot be reduced solely to technological (economies and diseconomies of scale) or psychological factors (consumers' preferences). Rather, reference to the role of demand and supply in the determination of price typically reflected, before Smith, a situation preceding the development of regular markets, with prices, as in village fairs or in sea-port cities, subjected to the influence of non-systematic events.

The modern interpretations of the market price in Smith, as determined by demand and supply, are commonly based on the second part of the definition of the market price quoted above: it 'is regulated by the proportion between the quantity which is actually brought to market, and the demand'. However, in this passage Smith spoke of the market price as 'regulated', not 'determined', by the proportion between demand and supply; nor can the expression 'proportion between the quantity … brought to market, and the demand' be taken as pointing to a precise mathematical relationship. This passage constitutes neither a definition of the market price, nor a theory to explain its determination. Smith did not then go on to illustrate laws concerning the way demand and supply react to a market price different from the natural price, nor laws on how the market price reacts to disequilibria between demand and supply and to fluctuations in these variables. In particular, there was no hint of the idea, common in modern theory but not at the time of the classical economists, of a market clearing mechanism determining the market price.[59]

What Smith suggested are only a few general rules. First, the market price will be above the natural price when for any reason supply proves lower than the effectual demand, and below it

[57] According to Deane 1989, pp. 61 and 68, the reference to Newton corresponds to the representation of the market economy as a self-regulating system. 'The essence of the Newtonian world-view was that it started from two axioms, two articles of faith about the real world in its social as well as its physical aspects: 1) that it was characterized by uniformities and constancies which were sufficiently regular to have the force of laws of nature; and 2) that it was designed and guided by an intelligent creator. ... there was a systematic, god-given harmony in the operations of the universe.' However, such an optimistic and simplistic view of the social world appears alien to the tradition of the Scottish Enlightenment and closer to the French Cartesian tradition.

[58] Demand curves appear in economic literature more than half a century later, with Cournot and Rau.

[59] As we have already seen, market clearing – namely the idea that the market has a position of equilibrium in which demand and supply are exactly equal – is characteristic of financial markets, not of the markets for industrial products; modern theory has had to resort to artificial constructions such as 'reserve prices' in order to extend such a notion to agricultural and manufactured products. Let us also stress that the notion of market clearing should not be confused with the much vaguer idea of market adjustment mechanisms.

when the opposite holds true. Second, deviation of the market price from the natural price will provoke reactions on the part of buyers and producers alike; with free competition such reactions tend to favour resolution of the disequilibrium situation. From the examples that Smith gave, it is clear that the concrete action of these general rules depends on circumstances, and it is not therefore possible to formulate precise reaction functions for the market prices to the disequilibria between demand and supply, and of these two latter variables to the prices.[60]

Thus, for Smith gravitation is nothing but a metaphor used to evoke the role of competition as a force making for the stabilisation of the market. This is also the role of the invisible hand metaphor, which moreover Smith uses only once in *The Wealth of Nations*, and in a specific context (the capitalists' preference for investing in the most profitable sectors of the national industry rather than in foreign countries, although motivated by personal interest, has a positive effect for society since it tends to increase the national income, as 'led by an invisible hand').[61] This is a long way from any theory based on market clearing mechanisms, supply and demand curves and the like. The difference may seem to represent progress at the level of the formal completeness of analysis, but it implies radical changes in the concepts utilised by the classical economists – so radical as to modify the theoretical context in a decidedly restrictive direction. We thus have a net loss as far as the conceptual representation of the economic system is concerned.[62] What, however, is certain is that both the notion of the market price as a theoretical variable and the idea of the 'invisible hand of the market' were totally alien to Smith.

7. The origin of the division of labour: Smith and Pownall

The issue of the origin of the division of labour is connected to various issues of social philosophy, and constitutes their unifying ground. As we shall now see by examining Smith's

[60] Let us add that, as shown by Egidi 1975 and Steedman 1984, these rules should be reformulated referring them to the sectoral rate of profit compared to the general rate; furthermore, Steedman shows that in the context of multi-sectoral analysis the sign of the deviation of the market price from the natural price is not necessarily the same as that of the deviation of the sectoral profit rate from the general rate, in contrast with Smith's supposition.

[61] Cf. Smith 1776, p. 456: IV.ii.9. The term 'invisible hand' is used only twice elsewhere by Smith, in different works and contexts (the *History of Astronomy*, III.2: Smith, 1795, p. 49; and *The Theory of Moral Sentiments*: Smith 1759, p. 184: IV.1.10) and, moreover, at least on the first of these occasions, in somewhat ironical tones. On the subject cf. Rotschild (1994; 2001, pp. 116-56), Gilibert (1998) and Roncaglia (2005). As Gilibert notes, neither Smith's contemporaries nor the students of his thought up to the middle of the twentieth century gave any attention to the theme of the invisible hand; it began to be propounded only after Arrow and Debreu had developed the axiomatic general economic equilibrium theory and the two so-called fundamental theorems of welfare economics according to which perfect competition ensures an optimal equilibrium and any optimal equilibrium may be interpreted as the outcome of a perfectly competitive market. In this way, by attributing to Smith the idea of the market as an invisible hand that leads to optimal equilibria modern theory has some claim to be seen as crowning the Smithian cultural design. In reality, however, the two views are quite different.

[62] Consider, on the one hand, the complexities of motivations of human action within the Smithian analytical framework in comparison to the mono-dimensional economic agent of modern theory, who only aims at maximising utility and, on the other hand, the disappearance of classical themes such as distributive conflicts and employment problems if it is held that the competitive market ensures optimal equilibria and the distributive variables (wage, rent, rate of profits) are considered, under competition, as equilibrium prices of the 'factors of production'.

views and the criticisms they received from Pownall,[63] the origin of the division of labour may be traced to the human propensity for social life, or to innate differences in abilities. The two theses have profoundly different implications on issues such as the foundations of social coexistence, the view of social stratification as a fact of nature and indeed the positive or negative evaluation of labour itself.

Smith tackled the issue of the origin of the division of labour in chapter 2 of book I of the *Wealth of Nations*:

This division of labour, from which so many advantages are derived, is not originally the effect of any human wisdom, which foresees and intends that general opulence to which it gives occasion. It is the necessary, though very slow and gradual consequence of a certain propensity in human nature which has in view no such extensive utility; the propensity to truck, barter, and exchange one thing for another.

Whether this propensity be one of those original principles in human nature, of which no further account can be given; or whether, as seems more probable, it be the necessary consequence of the faculties of reason and speech, it belongs not to our present subject to enquire. It is common to all men, and to be found in no other race of animals, which seem to know neither this nor any other species of contracts.[64]

Smith's thesis was, then, that division of labour originates in the tendency of men to enter into relations of reciprocal exchange, or in other words – we might say – in human sociability. To this characteristic Smith also attributed the origin of language; moreover, it distinguishes men from animals. In Smith's own words (1776, p. 26: I.ii.2):

No one ever saw a dog make a fair and deliberate exchange of one bone for another with another dog .... When an animal wants to obtain something either of a man or of another animal, it has no other means of persuasion but to gain the favour of those whose service it requires. ... Man sometimes uses the same arts with his brethren .... He has not time, however, to do this upon every occasion. In civilized society he stands at all times in need of the cooperation and assistance of great multitudes, while his whole life is scarce sufficient to gain the friendship of a few persons. In almost every other race of animals each individual, when it is grown to maturity, is intirely independent, and in its natural state has occasion for the assistance of no other living creature. 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. He will be more likely to prevail if he can interest their self-love in his favour, and shew them that it is for their own advantage to do for him what he requires of them.

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[63] Thomas Pownall (1722-1805) had been in 1757-59 governor of Massachusetts; from 1767 to 1780 he is member of Parliament.

[64] Smith 1776, p. 25: I.ii.1-2. This is a thesis that constitutes a fixed point in Smith's thought; he had already stated it, in virtually the same terms, in the university lectures and in the first draft of *The Wealth of Nations* (Smith 1978, p. 347: LJ-A, vi.44; pp. 492-3: LJ-B, 219; pp. 570-1: *Early draft*, 20-1).

This long quotation is useful because it brings to the fore an important logical step that Smith took perhaps too rapidly, from the propensity to barter as the basis for the division of labour to the role of self-interest for the sound functioning of a system based on the division of labour. This nexus implies that the propensity to barter may be seen as sociability only if we do not confuse the latter concept with the idea of altruism. On the other hand, as we saw in our illustration of *The Theory of Moral Sentiments*, Smith considered the market economy as based on self-interest rather than mere selfishness. It is this specification of the two terms, propensity to barter and self-interest, that allows for their immediate connection.

Let us now return to the propensity to barter, seen as the desire to come in touch with our fellow creatures, without, however, having to bear costs for this but, rather, looking for advantages. At first sight this idea might seem not to differ greatly from Pownall's thesis, according to which – as we shall now see – the division of labour originates in the desire to exploit the innate differences of labour abilities of the different individuals.

In fact, Pownall (1776, pp. 338-9) criticised Smith not because of mistakes in his statements, but because he had stopped his analysis too soon, without reaching the first principles:

I think you have stopped short in your analysis before you have arrived at the first natural cause and principle of the division of labour. ... Before a man can have the propensity to barter, he must have acquired somewhat, which he does not want himself, and must feel, that there is something which he does want, that another person has in his way acquired .... Nature has so formed us, as that the labour of each must take one special direction, in preference to, and to the exclusion of some other equally necessary line of labour .... Man's wants and desires require to be supplied through many channels; his labour will more than supply him in some one or more; but through the limitation and the defined direction of his capacities he cannot actuate them all. This limitation, however, of his capacities, and the extent of his wants, necessarily creates to each man an accumulation of some articles of supply, and a defect of others, and is the original principle of his nature, which creates, by a reciprocation of wants, the necessity of an intercommunion of mutual supplies; this is the forming cause, not only of the division of labour, but the efficient cause of that community, which is the basis and origin of civil government.

Pownall's position has two presuppositions that appear extraneous to Smith's view of the functioning of the society and the economic system. The first presupposition is that each individual knows what he wants and what the others can offer before coming in touch with them, and in particular before entering into relations of exchange. In modern terms, we might say that Pownall presupposes the knowledge on the part of each economic agent of his or her own abilities and preferences and of the goods that other economic agents make available, or better of their abilities and preferences; such knowledge should be innate, in order to constitute the origin of the division of labour and of exchanges. The second presupposition of Pownall's thesis is that there be original differences in abilities among the different individuals: such differences, apart

from constituting the original spring that determines the division of labour, are also seen as a natural presupposition of society's economic stratification.[65]

As far as the first aspect is concerned, the view of the individual as a logical *prius* with respect to society is opposed to the Smithian idea, typical of the whole tradition of the Scottish Enlightenment, of the human being as an intrinsically social being. As for the second aspect, namely the existence of a natural basis for economic and social differentiations, it was explicitly rejected by Smith. In fact, he affirmed that he considered the different working abilities as mostly acquired as a consequence of the division of labour:

The difference of natural talents in different men is, in reality, much less than we are aware of; and the very different genius which appears to distinguish men of different professions, when grown up to maturity, is not upon many occasions so much the cause, as the effect of the division of labour. The difference between the most dissimilar characters, between a philosopher and a common street porter, for example, seems to arise not so much from nature, as from habit, custom, and education.[66]

The contrast between the democratic content of the Smithian thesis and the conservative element in Pownall's thesis thus appears evident: a contrast worth stressing, both because it may help us in understanding the innovative and progressive nature of Smith's social philosophy, and because the contrast between the two views repeatedly manifested itself in the course of time.[67]

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[65] The doctrine of the intrinsic differences of abilities was already present (and dominant) in the Greek tradition and then in the Scholastic period. Around the middle of the eigtheenth century, this doctrine was taken up, in the framework of a subjective theory of value, by Galiani (1751, p. 49): 'By providence men are born to various crafts, but in unequal proportions of rarity, corresponding with wonderous sagacity to human needs.' This passage also indicates a crucial difficulty of the traditional view: if we maintain that the distribution of abilities among the individuals is innate, only the invisible hand of Providence can guarantee that the availability of abilities corresponds to the requirements of society, since any social mechanism of adjustment is ruled out by definition. Galiani (ibid., p. 50) was also aware of the implications of the doctrine of the innate differences of abilities for income distribution, conceived as just in so far as it mirrors the innate abilities of the individual: 'It will be seen that wealth does not go to any person otherwise that in payment for the just value of his works.'

[66] Smith 1776, pp. 28-9: I.ii.4. On analogous lines we find the Smithian view of the entrepreneur as a normal person, with at most the characteristics of a good *paterfamilias*, quite different from the heroic view of the entrepreneur that would subsequently be proposed by Marshall, and especially by Schumpeter. Actually Smith, with characteristic prudence, did not deny the existence of original individual differences or, as we would say today, differences due to genetic characteristics: what he maintained is the crucial importance of the elements of differentiation acquired through the vicissitudes of life, and in particular through working experience. Thus work acquires an additional dimension, as a formative factor, be it positive or negative. This thesis was foreshadowed when Smith (1776, pp. 21-2: I.i.9) remarks that 'In the progress of society, philosophy or speculation becomes, like every other employment, the principal or sole trade and occupation of a particular class of citizens. … it is subdivided into a great number of different branches …; and this subdivision of employment in philosophy, as well as in every other business, improves dexterity, and saves time. Each individual becomes more expert in his own particular branch'.

[67] The modern marginalist theory of wage differentials may be traced back to Pownall's position (innate differences among the different kinds of personal abilities) or to different capacities of accumulation and investment in personal capital, while Smith pointed rather to the importance of circumstances that determine the work role of each individual, largely connected to the pre-existing social placement, so that social stratification emerges as a mechanism endowed with self-reproducing capacity. Policy interventions in the field of education, such as those suggested by Smith in book V of *The Wealth of Nations*, thus have not only the function of a remedy to the perverse

8. Economic and political liberalism: Smith's fortune

To say that Smith was the founder of the economic science would be wrong: apart from the problems intrinsic to the notion of an individual founder of political economy, there is the fact that before him authors like Petty, Cantillon, Quesnay and many others had tackled analysis of specific economic issues or, more generally, of how a social system functions in terms of its material aspects. It was indeed on the many writings already existing on such issues that Smith largely relied in his work, drawing on them in many respects. Perhaps, in comparison with previous authors, Smith's distinctive characteristic was that of being an academician, dealing with the object of his analysis under the stimulus of political passion, too, but sufficiently detached from immediate problems and interests and, above all, dedicating great care and an enormous amount of time to the precise definition and accurate presentation of his ideas, with a great capacity to mediate between different views and theses while capturing the positive elements in each of them.

This Smithian subtlety, the refusal of clear-cut theses without qualifications and specifications, renders interpretation of his works difficult and interesting at the same time. In the next few pages we will discuss some examples of the interpretative issues that have attracted particular interest.

The first of these examples concerns Smith's liberalism. We should stress, in this respect, that Smith's was a progressive attitude to the major political themes of his time, such as the conflict over the independence of the American colonies. In pre- and post-revolutionary France *The Wealth of Nations* was viewed with favour by the progressive elements of the time, including Condorcet (1743-1794), who published a summary of it in 1791 (while after his death his widow, Madame de Grouchy, prepared a translation of *The Theory of Moral Sentiments*). In England, Smith became a reference point, in the years immediately following his death, for radical thinkers such as Thomas Paine (1737-1809) and Mary Wollstonecraft (1759-1797). Together with Hume, Smith was seen as a dangerous subversive by the conservative intellectuals of the time. The point is that all these thinkers, favourable or adverse to Smith's views, saw no difference in his thought between liberalism in the political field and economic liberalism, between the defence of political freedom and the defence of free trade.[68]

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effects that the division of labour has on human nature, but also the function of a democratic mechanism of fluidification of social stratification.

[68] The history of these early progressive readings of Smith, and of the subsequent conservative reinterpretation, is illustrated in an interesting artiche by Emma Rothschild (1992). According to her reconstruction, 'Freedom consists, for Smith, in not being interfered with by others: in any aspect of life, and by any outside forces (churches, parish overseers, corporations, customs inspectors, national governments, masters, proprietors)' (ibid., p. 94). Cf. also Rothschild 2001, pp. 52-71.
In this respect we may also recall an aspect of Smith's liberalism – his diffidence towards entrepreneurs taking on a direct political role – that appears relevant in contemporary politics, but that has a general validity:

> The interest of the dealers, however, in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the publick. ... The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to

The situation went through far-reaching change in the years immediately following. English public opinion showed a sharp negative reaction to the excesses of the French revolution (the Terror), which initially implied a growing diffidence towards Smithian liberalism. Soon however, thanks especially to Smith's first biographer, Dugald Stewart (1753-1828), reinterpretation of Smithian thought began with the aim of making it more acceptable, based precisely on the distinction between economic and political liberalism. With this fine-tuned reinterpretation, a politically progressive thesis bringing to the fore the need to fight concentrations of power of any kind was transformed into a conservative thesis – to leave maximum freedom of action to entrepreneurs, which in the stage of industrialisation went so far as to take on reactionary tones, serving to justify a total indifference of the new entrepreneurial class towards the heavy human costs of the new productive technologies and the widespread misery they brought: a far cry from the sensitivity repeatedly shown by the Scottish economist for human sufferings, and from his interest in the continuous improvement of living standards for the great mass of the population.[69]

For a better understanding of Smith's liberalism, we may refer to Books IV and V of the *Wealth of Nations*. Most of Book IV is devoted to critique of 'the commercial, or mercantile system', taken more as an array of interventions by the nation-state in the economy than as a theoretical system of political economy or, perhaps better, a set of ideas commonly collected under the label of 'mercantilism'.[70] Restraint on imports, support for exports, treaties establishing commercial preferences, colonies – all are examined in detail and subjected to specific criticism. A chapter on the physiocratic ('agricultural') system concludes the book, but here too the account consists of criticism of specific instances of active state intervention, and a plea for 'the obvious and simple system of natural liberty' (Smith 1776, p. 687: IV.ix.51).

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be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the publick, who have generally an interest to deceive and even to oppress the publick, and who accordingly have, upon many occasions, both deceived and oppressed it (Smith 1776, p. 267: I.xi.p.10).

[69] The conservative view of economic liberalism became decidedly dominant as from the beginning of the nineteenth century, and has since continued to take reference from Smith notwithstanding the interpretative twist illustrated above. In the last decades, for instance, the Chicago school has directly placed itself in a line from Smith, notwithstanding the caution originarily expressed by the most cultured of its exponents (cf. Viner, 1927). In Italy we may recall the ultra-liberism of Francesco Ferrara (1810-1900), editor of the first series of the important *Biblioteca Dell'Economista* (Cugini Pomba Editori-librai, Torino), the second volume of which (1851) offers readers an Italian translation of *The Wealth of Nations*.

[70] Book IV also contains a 'digression concerning banks of deposit' (Smith 1776, pp. 479-88: IV.iii.b), which, together with chapters 2 and 4 of Book II (ibid., pp. 286-329 and 350-9: II.ii and II.iv), constitutes the main references for Smith's treatment of monetary and financial issues. In very broad outline, Smith considered the interest rate to be determined by supply of and demand for loans, where demand is influenced by the perspective return, namely the prevailing rate of profits; usury laws, setting a maximum limit to the interest rate, are favourable to accumulation. Banks may be induced by 'prodigals and projectors' (ibid., p. 357: II.iv.15) to an over-issue of notes; the rule which banks should follow is the so-called real bills doctrine, which would dominate the field for more than a century, and which held that the issue of bank notes should be limited to the discount of sound commercial bills. Smith's ideas on money and banking have been the subject of a lively interpretative debate; cf. for instance Laidler 1981; Gherity 1994 reconstructs the development of Smith's thought on the issue.

'Natural liberty' means political and economic freedom, but within a set of rules supported by public intervention and public institutions. As a general rule (ibid., pp. 687-8: IV.ix.51):

According to the system of natural liberty, the sovereign has only three duties to attend to …: first, the duty of protecting the society from the violence and invasion of other independent societies; secondly, … an exact administration of justice; and, thirdly, the duty of erecting and maintaining certain publick works and certain publick institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because the profit could never repay the expence to any individual or small number of individuals, though it may frequently do much more than repay it to a great society.

Book V of the *Wealth of Nations* goes on to deal with 'the revenue of the sovereign or commonwealth': first the expenses for defence and justice, but also public works – mainly transport infrastructures: navigable canals, roads, bridges – and education, with a long section devoted to the latter, in striking contrast to the half-page devoted to 'the Expence of supporting the Dignity of the Sovereign',[71] and then public revenue. Smith preferred public expenditure to be financed by taxes rather than by public debt; and as for taxes, four principles which would become canonical were clearly set out and illustrated: proportional taxation, certainty, least inconvenience for the taxpayer, and low cost of collection.[72]

In sum, Smith was no dogmatic liberal, but a pragmatic one: strongly critical not only of feudal institutions and of policies characteristic of the absolutist state, but also of capitalistic concentrations of economic power, and diffident towards the inclination of 'the dealers' to establish monopoly.

Another interpretative issue[73] stems from comparison between Books I and IV of *The Wealth of Nations*, concerning the apparently contradictory position taken by Smith towards the division of labour. In Book I, the division of labour is extolled as the foundation for increases in productivity, hence for the well-being of population and for civic progress itself; in Book V, in an often quoted passage referred to as the precursor of the Marxian theory of alienation, but

[71] Ibid., p. 814: V.i.h. Specific discussion is devoted to the 'regulated companies for foreign commerce' and to the joint stock companies. Smith (1776, p. 731: V.i.e.2) recognised that 'some particular branches of commerce, which are carried on with barbarous and uncivilized nations, require extraordinary protection'; but his detailed discussion of the actual affairs of the South Sea Company, the East India Company and similar institutions then develops into a real indictment (ibid., pp. 731-56: V.i.e.1-34).

[72] 'I. The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. … II. The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. … III. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it. … IV. Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the publick treasury of the state' (Smith 1776, pp. 825-6: V.ii.b.3-6).

[73] On the history of this debate, which dates back to Marx, cf. Rosenberg 1965. The negative implications of the division of labour were widely recognised in the environment of the Scottish Enlightenment, for instance by Ferguson (1767, part 2, Chapter 4: 'Of the subordination consequent to the separation of arts and professions').

which rather points to the loss of civic virtues, Smith stressed the negative characteristics of fragmented labour, that can make a brute of man:

In the progress of the division of labour, the employment of the far greater part of those who live by labour, that is, of the great body of the people, comes to be confined to a few very simple operations; frequently to one or two. But the understandings of the greater part of men are necessarily formed by their ordinary employments. The man whose whole life is spent in performing a few simple operations, of which the effects too are, perhaps, always the same, or very nearly the same, has no occasion to exert his understanding, or to exercise his invention in finding out expedients for removing difficulties which never occur. He naturally loses, therefore, the habit of such exertion, and generally becomes as stupid and ignorant as it is possible for a human creature to become. The torpor of his mind renders him, not only incapable of relishing or bearing a part in any rational conversation, but of conceiving any generous, noble, or tender sentiment, and consequently of forming any just judgement concerning many even of the ordinary duties of private life. Of the great and extensive interests of his country, he is altogether incapable of judging'.[74]

However, the contradiction between Books I and IV of *The Wealth of Nations*, between optimistic and pessimistic views of the division of labour, is only apparent. We should not wonder if an author like Smith, so careful in capturing the different sides of any issue, attributed different effects, some of them positive and some negative, to a single cause. It is clear from the context that Smith considered as dominant the positive effects of the division of labour. Indeed, confronted with the concomitant negative effects, he did not hesitate an instant on the road to take, and far from raising doubts on the opportunity of pursuing the continuous deepening of the division of labour, he propounded recourse to elementary education as a counterweight.

There is in this respect an aspect that should be stressed, since it constitutes perhaps the main point of difference between Smith's social philosophy and that of Marx, and on which we may maintain that it was the Scottish philosopher who was right. Both Smith and Marx were fully conscious of the negative implications of the division of labour, and of the need for work (or 'compulsory labour') that accompanies them. Marx however held that the hard need of compulsory labour can be overcome in a communist society, in which it will be possible to reach the full development of the productive forces, that 'makes it possible for me to do one thing today and another tomorrow, to hunt in the morning, to fish in the afternoon, rear cattle in the evening, criticise after dinner, just as I have a mind, without ever becoming hunter, fisherman, sheperd, or critic'.[75] The possibility of reaching full freedom from compulsory labour morally justifies, and renders politically acceptable, the costs in blood and tears of the proletarian revolution and of the subsequent dictatorship of the proletariat, as necessary stages (together

[74] Smith 1776, pp. 781-2: V.i.f.50. Before Smith, we can trace the notion of alienation in the writings of the Swiss Jean-Jacques Rousseau (1712-1778), whom Smith was acquainted with through Hume. Differently from Smith, Rousseau is a radical critic of the market economy: cf. Colletti 1969b, pp. 195-292.
[75] Marx and Engels 1845-46, p. 265.

with capitalistic accumulation) for development of productive forces which constitutes the indispensable premise for reaching the final objective.

Smith, on the contrary, considered overcoming the division of labour clearly impossible. Increases in productivity and growing economic welfare made possible by the deepening of the division of labour are the presupposition for progress in human societies. This was however conceived as a continuous process, without there being in sight a way out of the set-up of market economies and an overcoming of their limits and defects, such as compulsory labour and the inequalities of social conditions. This Smithian view may perhaps be likened to the reformist theses present in the contemporary political debate, which oppose both the conservative streams of thought that consider as useless any intervention aimed at countering the situations of social malaise and, on the opposite side, the revolutionary hopes for social palingenesis.[76]

A substantive faith in the human being, though recognised as essentially imperfect, and in the possibilities of progress in human societies, constituted the common element for Smith and for eigtheenth-century Enlightenment culture. But it also and mainly constitutes the positive message that renders the work of the Scottish thinker a central point of reference for pondering over human beings and society.

[76] Cf. Roncaglia 1989 on Smith and 1995 on Marx; Roncaglia 2024, pp. 203-70 on conservative, revolutionary and reformist perspectives.

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[The year after the author's name indicates the original date of publication, except for pre-1500 writings. The original date of writing is occasionally indicated in square brakets. Page references in the text refer to the last of the editions quoted below not in brackets. When this is not an English edition, the translation of the passages quoted in the text is mine.]

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