

ADAM SMITH'S THEORY OF WAGES*

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In his monumental work «An Inquiry into the Nature and Causes of the Wealth of Nations» (1776) Adam Smith (1723-1790)¹ develops his theory of wages, which is of a great interest concerning the evolution of economic thought on wages. He examines economic phenomena from the point of view of the principle of naturalism² i.e. accepting the existence of natural laws which govern economy and which, without the intervention of men, succeeds in obtaining the rational order. Any disturbance of the economic equilibrium finally and in short time is restored by the invisible hand of the natural laws³. For this reason men must abstain of any

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1. A. Delatour : Adam Smith, sa Vie, ses Travaux, ses Doctrines, Paris 1868. W. Hasbach : Die allgemeinen philosophischen Grundlagen der von F. Quesnay und Adam Smith begründeten Politischen Oekonomie, 1890 und Untersuchungen über Adam Smith, 1891.-J. Rae : Life of Adam Smith, London, 1895.-F. Virgili : Adam Smith, Milano 1928.-W.R. Scott : Greek Influence on Adam Smith "Études dédiées à la Mémoire d'André Andréades", Athènes, 1940.-W.R. Scott : Adam Smith as Student and Professor, 1937.-H. M. Robertson : The Adam Smith tradition "University of Cape Town, Lecture Series No. 11" 1950.-A.W. Coats : The Classical Economists in English Classical Political Economy, London, 1953.-Adam Smith and the mercantile system in "Essays on Adam Smith", Oxford University Press, 1975.-S. Hollander: The Economics of Adam Smith, University of Toronto, 1973.-V. Foley : The division of Labor in Plato and Smith in "History of Political Economy," No. 2, 1974.-See also Paul J. McNulty : A note on the division of labor in Plato and Smith in "History of Political Economy" Vol. 6, p. 372 No. 3, 1975 and the reply by Vernard Foley in the same volume and No. 3 p. 379 entitled : Smith and the Greeks : a reply to Professor McNulty's comments - H. Mizuta : Moral Philosophy and Civil Society in "Essays on Adam Smith", Oxford University Press, 1975.-E. Roll : The Wealth of Nations 1776-1976 in "Loyd's Bank Review", No 119, 1976.

2. The same principle was supported also by the Physiocrats, while the difference between their School and that of the Classics is that the naturalism of the first is governed by evidence, while of the latter by necessity. The Mercantilists on the contrary accepted the principle of voluntarism according to which there does not exist a rational order and men must intervene in economic life to obtain it (A. Fanfani : Storia delle Dottrine Economiche, Milano-Messina, 1955, p. 129, 272, 335).

3. The commonest use of "natural" in Adam Smith means at first the instinct and here we find the influence of Mandeville's «Fable des Abeilles» (1751) upon him, as first the same happened

intervention into the ideal system of these laws given by God¹.

This naturalism was a consequence of the crisis of voluntarism, which began to appear from 1550, when the mercantilist Sir John Massone expressed his doubts about the influences of the State's intervention² and from the 17th century, when another mercantilist Nicholas Barbon supported that the market was the best referee for the price of goods and services³.

The cause of this change into the spirits of different authors in 17th century and after, from voluntarism towards naturalism, was the impact of the natural law expressed by Hugo Grotius (*Mare Liberum* 1609, *De Jure ac Pacis*, 1625) and Pufendorf (*De Statu Imperi Germanici* 1607, *De Jure Nature et Gentium* 1672)⁴. From the other hand the philosopher Bacon influenced with his mechanistic explanations simulating economic thought with natural sciences.

W. Petty (1623-1687) as physician and G. Montanari (1633-1687) as astronomer tried to find analogies between Economics and natural phenomena maintaining that natural forces must govern also Economy, ideas which will be expressed by Dudley North (1641-1691), John Locke (1632-1704), Boisguillebert (1646-1717), to his Professor Hutcheson (H. Mizuta : of cit. p. 117). Mizuta refers to an anonymous letter of Hutcheson "To Hibernicus" published in the "Dublin Journal" (4. February 1726) "A Collection of Letters and Essays on Several Subjects, lately Published in the «Dublin Journals» 2 Vols (1729) 1, 370-4.

Mandeville's book was an innovation in human thinking about the emerging bourgeois society and the human behavior "without distinction between vice and virtue" to use the words of Adam Smith (*Theory of Moral Sentiments*, 1759 2nd ed. Edinburgh, 1808 vol. 11, p. 290), as also of Physiocrats who founded the idea of laissez-faire on the notion of nature or with Smith on the "simple system of natural liberty" (A. Smith: *Wealth of Nations*, Vol. IV p. 311, ed. E. Seligman, New York, 1970 vol. I). Of course the predecessors Grotius, Hobbes and Locke, as also Hume, impacted upon Smith. Anyway "law", "rights", "rules", coincides in last analysis into the Smith's thought, who underlines that "all general rules are commonly denominated laws" (*Theory of Moral Sentiments*, vol. II, p. 283). The earliest use of the term "economic law" occurs, accordingly of Bonar, in Ricardo's "High Price of Bullion" (1810) (J. Bonar : *Philosophy and Political Economy*, London 1893 ed. 1922 impression 1967, p. 196). The invisible hand of the nature it is a cause of order and law in human actions (A. Smith : *Wealth of Nations*, p. 199), of course "every man is by nature first and principally recommended to his own care" (A. Smith : *Theory of Moral Sentiments*, vol. I, p. 181), but private interest coincides with public interest, when private action is left to function into the system of liberty (A. Smith : *Wealth of Nations*, IV p. 311). "Every man, therefore, is led by an invisible hand to promote an end, which was not part of his intention" (A. Smith, IV p. 311. For the invisible hand of natural laws see also in "Theory of Moral Sentiments,., p. 348-351).

1. God's creating the natural order does no longer intervene into it. He once created the harmony of the mechanism of the natural laws leaves to men to be adapted to them. (See also E. Heimann: *History of Economic Doctrines*, Oxford, 5th ed. 1951, p. 49.-A. Fanfani: op. cit. L. Houmanidis : *History of Economic Theories* (in Greek) Piraeus-Athens 1968-1969).-Malthus and Ricardo were afraid for the intervention to economic life and described the terrible results of it, for this reason Fanfani holds that these two classics are not right to be considered as pessimists (A. Fanfani : p. 76). The same idea has also J. Letiche : Adam Smith and David Ricardo on Economic Growth in "Theories of Economic Growth" (B. Hoselitz, New York 1965 p. 76). For Classics and their Economic Policy see also L. Robbins, op. cit. - A.W. Coats : op. cit.

2. E. Roll : *A History of Economic Thought*, London 1949, p. 65.

3. N. Barbon : *A Discourse of Trade*, 1690 ed. Baltimore 1903, p. 15-16.

4. L. Houmanidis: *History of Economic Theories* (in greek), Athens ed. 1976. p. 73 and ff.

Louis d'Argenson (1694-1757), David Hume (1711-1776), A. Genovesi (1713-1769), F. Galiani (1728-1787) and others, and the Physiocrat François Quesnay (1694-1774) and his followers. These new ideas opened the door to free trade.

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According to Smith «every man, as long as he does not violate the laws of Justice, is left perfectly free to pursue his own interest, his own way, and to bring both his industry and capital into competition with those of any other men or order of men». Freedom is the basis of progress; is of course the cause of social injustice but anyway individuals in a cheep-abundance economy have the same satisfactions, otherwise the rich consumes almost the same goods as the poor. Also we must have in mind that moral satisfactions have more importancè than the materialistic ones; mercantilists have not conceived the liberal order being governed by the idea of population-wealth-power obtained only with State intervention. From the other hand Physiocrats adopted first «laissez-faire, laissez passer le monde va de lui même» but were based on agriculture and not upon the labor which predominates for the production of wealth; because «the annual labor 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 of that labour, or in what is purchased with that produce from other nations»¹. This labour regards to its division as a consequence of human nature and of the transactions, which are developing with laizzez-faire. So Smith accepts the point of social efforts for abundance, which the division of labor cause, and to increase opulence², and here we have a difference regarding the subject as Plato accepted it supporting that the division of labor is spontaneous as a result of human nature³.

Man as homo oeconomicus tries to obtain his maximum of satisfaction. «It is his own advantage indeed-says Smith-and not that of society, which he has in view»⁴.

Of course with this mentality the desire for personal advancement may become vicious, moreover its effect is social because of reason and humanity. This is the universal perfect mechanism of contrasting interests created by God in order in «all times to produce the greatest possible quantity of happiness»⁵.

Thus free competition helps to succeed to distribute better the factors of productions and to diminish the cost of production at a state of an ideal equilibrium. Only with this ophelimistic behavior society can also profit.

This idea was first exposed by the mercantilist Misselden but was the road

1. A. Smith : Wealth of Nations, vol. I, p. 1.

2. A. Smith : Lectures, p. 161-8.

3. Plato: Republic : II, 369 B.

4,5. A. Smith : Theory of Moral Sentiments, II, p. 118

which was followed by Smith and his successors concerning the research on value and distribution and of course on wages.

Society is divided into three classes: Laborers, landlords and capitalists. Wages, is a form of revenue derived from labour, while that derived from the stock of capital is called profit and the revenue which proceeds altogether from land is called rent¹.

Wages and profits are original revenues as also the rent of land, while derived revenues are taxes, pensions etc., and the interest which goes to the owner of the stock².

The rate of wages and the rate of profit are two different rewards regarding the first the worker and the second the entrepreneur. Both are on dependence each other and are regulated by two forces «partly by the general circumstances of society their advancing, stationary or declining conditions; and partly by the particular nature of each employment»³. Rent is a revenue which derives «partly by the neighborhood in which the land is situated and partly by the natural or improved fertility of the land»⁴.

The phenomenon of fluctuating wages happens with other commodities as well, around the equilibrating level of the wage of subsistence which is the natural price of labor⁵.

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On the basis of the wages theory of Adam Smith we shall make an analysis in order to show the following:

- a. The significance of the thesis he takes in his distribution theory.
- b. His contribution regarding the theories on wages which followed.
- c. The vital analysis of this stationary and evolutionist conception.

Before examining the first I must inform the reader of this paper about that I mean with the terminology *cost of dependence or dependence effect*⁶. I define cost of dependence the psychological pain that gets a factor of production from another. Man is the supreme value of life created in freedom; he does not accept to depend on

1. 2. 3. 4. A. Smith: Wealth of Nations, vol. I, p. 46 ff.

5. "This price is the central price to which prices of labour and of all other commodities are continually gravitating. Different accidents may sometimes keep them suspended a good deal about it, and sometimes force them down even somewhat below it. But whatever may be the obstacles which may hinder them from settling in this center of repose and continuance, they are constantly tending towards it". (A. Smith, vol. I, p. 51).

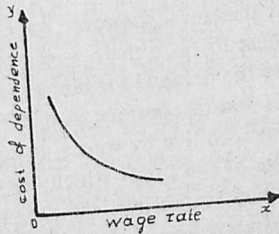
6. For cost of dependence or dependence effect see my book "The Theory of Wages from Classics until today" (in greek), Preface Amintore Fanfani, Athens, 1957, also my "History of Economic Theories" (in greek), Piraeus-Athens, 1968-1969, and "Comparative Economic Systems" (in greek), Athens, 1975. The term dependence effect was advised by Professor Anghel Rugina in his letter address to me, when I explained to him my theory of cost of dependence. Anyway cost of dependence is a philosophic and economic conception, is the reality of distribution concerning shares and its effect concerns to the impact of it in a social and economic structure. My proposal for a "Rational Economy" is to avoid any disturbance in economic equilibrium because of this effect (see my mentioned books).

somebody else. Thus examining wages I accept that there is a cost of dependence of the laborer from the entrepreneur and the higher the reward of the first from the second the lower the cost of dependence and vice-versa. A very high cost of dependence can create troubles in the economic and social equilibrium, and of course that happens when workers are not organized in Unions.

Smith examined this cost of dependence between the factors of production but did not conceive the deeper significance of it; so he failed to propose an economic system able to diminish it, except this of laissez faire, the same happened with the followers of Adam Smith, and only J.S. Mill from the classics economists accepted some socialist principles in order to obtain it.

Marx exposed his theory of surplus value as a result of dependence of the worker from the capitalist and considered that the social revolution was the only road to solve the problem of dependence with the establishment of a communist regime. But the cost of dependence is governed by a psychological law which always existed and will exist. For this reason we can diminish this cost but we cannot eliminate it completely, also with the change of the economic system.

Herebelow we have a figure showing the cost of dependence. The cost of dependence is a negative function of the wage rate and could be represented by the simple function $y = a - bx$, where x = the wage rate, y = the cost of dependence.



In case the wage rate tends to zero the cost of dependence will then tend to infinity and vice-versa.

a. Smith at first refers to the dependence effect saying: «The produce of labour constitutes the natural recompense or wages of labor. In that original state of things, which precedes both the appropriation of land and the accumulation of Stock, the whole produce of labor belongs to the laborer. He has neither landlord nor master to share with him. . . . But this original state of things, in which the laborer enjoyed the whole produce of his own labour, could not last beyond the first introduction of the appropriation of land and the accumulation of stock. . . . as soon as land becomes private property, the landlord demands a share of almost all the produce which the laborer can either raise, or collect for it. His rent makes the first deduction from the produce of the labour which is employed, upon land» . . . «the farmer who employs him and who would have no interest to employ him, unless he was to be replaced to him with a profit. This profit makes a second deduction from the produce of the labour which is employed upon land».

«The produce of almost all other labour is liable to the like deduction of profit. In all arts and manufactures the great part of the workmen stand in need of a master to advance them the materials of their work and their wages and maintenance will it be completed. He shares in the produce of their labour, or in the value which it adds to the materials upon which it is bestowed; and in this share consist his profit»¹.

Masters always try to avoid an increase of wages above their actual rate which equals to the level of labourer's subsistence. Also Masters enter into particular combinations to diminish wages below this rate. But such combinations «are frequently resisted by a contrary defensive combination of the workmen; who sometimes too, without any provocation of this kind, combine of their own accord to raise the price of their labour»².

The cost of dependence emerges between those two parties, whose interests are not the same. The masters try to give as little as possible and the workmen desire to get as much as possible. But «a man must live by his work and his wages must at least be sufficient to maintain him»³.

Masters are few in number but stronger and in a favorable position to combine in a better way having the assistance of the authorities and of the parliament⁴, so workmen depend on them. This dependence increases, when funds which are destined for the payment of wages are constant and the births are increasing at a higher rate⁵.

«There are certain circumstances, however, which sometimes give to labourers an advantage and enable them to raise their wages considerably above this rate». That happens if in a country the demand for labour is continuously increasing and the «workmen have no occasion to continue in order to raise their wages»⁶.

«The demand for those who live by wages, it is evident, cannot increase but in proportion to the increase of the funds which are destined for the payment of wages. These funds are of two kinds: first, the revenue which is over and above what is necessary for the maintenance; and secondly the stock which is over and above what is necessary for the employment of their masters». . . «the demand for those who live by wages, therefore, necessarily increases with the increase of the revenue and stock of every country, and cannot possibly increase without it. The increase of revenue and stock is the increase of national wealth. The demand for those who live by wages, therefore, naturally increases with the increase of national wealth and cannot possibly increase without it. It is not the actual greatness of national wealth, but its continual increase, which occasions a rise in the wages of labor. It is not, accordingly, in the richest countries, but in the most thriving, or in those which are growing rich the fastest. But the wages of labour are highest»⁷.

Smith argues also that variations from the subsistence wage depend partly upon the fluctuations in the supply of stock in progressive, in stationary and in

1.2. A. Smith : *Wealth of Nations*, vol. I, p. 57-58.

3. A. Smith, p. 60.

4. A. Smith, p. 59.

5. A. Smith, p. 60.

6.7. A. Smith, p. 61.

declining stages¹. With these thoughts Smith supersedes his subsistence theory in a way that it seems «toward the end of his book to have forgotten that he had ever held it»².

In a stationary state the labouring class can keep subsistence but not when the fund is «sensibly decaying»³. This fall of the wage fund which causes the reward of labourers to decline has some implications also on all other classes. In a declining country the conditions of the labourers are worst, because supply and demand for labour does not arrive at a balance as in a stationary stage. In the stationary state wages and profits of stock would make wages to be low, while in a declining state profits of stock increase because of lack of competition but wages are lowered⁴ because of the lack of funds.

In the advancing countries the increase of capital stock improves the conditions of labour and causes the raising of wages. Here we must mention that the subsistence theory of wages is realised by the costs of living which determine wages.

This supposition of Smith helps him to support that «The money price of labour is necessarily regulated by two circumstances : the demand of labour and the price of the necessaries and convenience of life. . . and the money price of labour is determined by what is required for purchasing this quality⁵». So if commodities which the labourer must buy in order to live are high, it follows that the wages must be high too so that the labourer can purchase the commodities. In other words the price of commodity necessary to maintain the labourer is following by wages.

These ideas of Smith concerning real wages have relation with his discussion concerning rent of land⁶. He declares that rent is the effect of price; a monopoly price; a component of price. Rent varies with fertility and situation of land. The price above wages and profits depends upon the demand and its increasing improves rent. Technology and other methods applied on land raise the rent.

Concerning bargaining between masters and labourers Adam Smith follows his thoughts regarding the dependence effect. Masters can reduce wages while labourers are in difficult position to bargain.

Smith does not conceive bilateral monopoly and the trade cycle escapes his thought, he does not examine wages and profits under recovery or depression and the resistance of workers with their Unions or with their parliamentary pressure for employment and not diminishing of wages, but Smith accepts that mobility of labour helps workers for better remunerations and he argues that this is possible only to a degree and under certain conditions. Anyway the tendency is the labourer

1. B.F. Catherwood : Basic Theories of Distribution, London, 1939, p. 30.

2. E. Cannan : A History of the Theories of Production and Distribution in English Political Economy from 1776 to 1898, London 1953, p. 237.

3. A. Smith, p. 75.

4. A. Smith, p. 26.

5. A. Smith, p. 87.

6. A. Smith, p. 137 ff.

to receive what he produces, while the entrepreneur combines labour and capital in a way the first to be highly productive.

If the productivity of labour is increased entrepreneurs will gain more profits while workers will be rewarded with higher wages. Classics and their leader Adam Smith examined economics from the point of view of free competition¹ considered in condition of general equilibrium at the level of full employment². For this reason Smith and his followers and above all Say with his law of markets, accepting production as static, examined the possibility of the production's forces. For this reason, when they were researching the problem of the economic development they were based upon the productivity concept. Smith and his followers have examined the impact of technology upon the productivity of labour and related it to wages.

Technology helps both masters and workers «more hands are occupied in investing the most proper machinery for executing the work of each, and it is therefore, more likely to be invented. There are many commodities, therefore which, in consequence of these improvements, come to be produced by so much less labour than before that the increase of its price is more than compensated by the diminution of its quantity»³.

1. Heimann very rightly says : "Indeed Smith develops two different price theories, one for competition, the other for monopoly. Only the former is a part of his system; the latter is a foreign body. . . Traditional economic theory is the system of competitive price theory" (E. Heimann : p. 65). Professor Anghel Rugina also writes : "Classical economists were not sufficiently aware of the fact that economic realities of their time were representing a mixed system, where monopoly was almost as strong as competition, if not even stronger at times. Since Adam Smith, classical economists have been dominated by the idea that as long as the government was not interfering to create new monopolistic privileges or to support old ones, the market forces of competition from inside and outside would remain the decisive economic factor pushing always toward stable equilibrium. The over-optimism supported the belief in natural laws in economics and gave the second characteristic, namely, that in the classical model competition was the rule and monopoly the exception (A. Rugina: American Capitalism: What kind of an economic system? The application of an Orientation Table of Sociology, Economics, Finance and Political Science, in "International Congress of Economic History and History of Economic Theories in Piraeus", 1975, p. 229 ed. The Piraeus Graduate School of Industrial Studies.

2. Here we must mention Say's law of markets or Walra's Law who considered the numeraire's price as equal to unity and so money as a medium of exchange. This means that the total supply of money as equal to the value of all commodities demanded or offered in exchange for money (M. Blaug : Economic Theory in Retrospect, London, p. 146). The Cambridge School although explains cash balances remained attached to the idea of money as medium of exchange and only Wicksell and especially Keynes confronted the meaning of money also as a store of value (V. Hegeland: The Quantity Theory of Money, Göttemberg 1951, L. Houmanidis : The Value of Money from Merchantilists until today (in greek) Athens 1965). Also J.R. Hicks in "Value and Capital", Oxford, 1939, tried to combine these two aspects of money. Samuelson writes for the Keynesian thesis in comparison with the naturalism of classics which governs markets "With respect to the level of total purchasing power and employment, Keynes denies that there is an invisible hand channeling the self-centered action of each individual to the social optimum. This is the sum and substance of his heresy" (P. Samuelson: "New Economics" (Samuel Harris), p. 151).

3. A. Smith, p. 61.

«The rise and fall of the profits of stock depend upon the same causes as wages, but these are affected differently. The increase of stock, raises wages but tends to lower profits»¹.

I think that the most important part of Smith's theory of wages is centered in the above mentioned paragraphs of his book. I shall discuss them in the following lines of my paper.

b. The ideas advanced by Adam Smith regarding wages, formed a separate theory in the course of the evolution of economic thought².

Adam Smith talks of a certain level below which wages may not fall as «man must always live by his work»; he actually refers to the theory of minimum level of subsistence³.

Also when for instance he maintains that «in that original state the whole produce of labor belongs to the laborer», he puts the foundations of the theory of productivity. When, again, Smith says that «The workmen desire to get as much, the masters to give as little as possible», he lends to the problem the aspect of a

1. A. Smith, p. 78.

2. About Smith's contribution to the latter theories of wages see E. Cannan : op. cit., p. 182-184 and J.L. Guglielmi: *Essai sur le développement de la théorie du salaire*, Paris, 1954, p. 53 ff.

3. The minimum of subsistence was developed by Physiocrats and especially by A.J.J. Turgot (*Lettres au contrôleur général (Abbé Terray) sur le commerce des grains (1770)* 5th letter in "Écrits Économiques" p.p. 307-309), according to whom the consumption or expenditure of the labourers is equal to the wage that they receive, but Petty was the predecessor of the theory (W. Petty : *A Treatise on Taxes and contribution*, 1667). Adam Smith examined subsistence according to the socio-economic evolution. In his "Lectures" he embodied a theory—as Aristotle did in ancient times and Friedrich List in modern—expressed in terms of four stages: hunting, pastorage, agriculture and commerce, each of which was based on a particular mode of subsistence (A.W.Coats: *Adam Smith and the Mercantile System*, in *Essays on Adam Smith*, Oxford University Press, 1975, p. 221). Ricardo was of course influenced by Smith saying that "wages equalled the amount of commodities necessary to feed and clothe the labourers and their families and enables the labourers to subsist and to perpetuate their race." (D. Ricardo : *Principles of Political Economy and Taxation*, 1817, p. 86). A. Gray says that this view of Ricardo may be formulated as man's minimum cost of production (A. Gray : *The Development of Economic Doctrines*, p. 183). The same view is expressed in Richard A. Lester's : *Economics of Labor*, New York 1946, p. 161. Any way according to the subsistence theory the satisfactions of the wants which are not indispensable to the labourer for his maintenance are left unsatisfied (L. Gangemi : *Svolgimento del Pensiero Economico*, Milano-, Roma, 1932, p. 204). The idea of the law of supply and demand concerning wages was also examined by Sant Thomas d'Aquinas (1226-1274), who for wages used the word *quasi pretium* and not *justum pretium* containing into the first more than the reward of the labour contribution (St. Thomas d'Aquinas : *Sum. Theol. P. II, 1, 29, 114 1 and ar. 2 and 105 ar.2, 6*). San Bernardino di Siena (1380-1444) supported that the market price can fluctuate and below the cost of production "secundum estimationem fori occurrentis" while wages must equalize the subsistence of the labourer (A. Fanfani, p. 96, R. de Roover, *La Doctrine Scolastique en Matière de Monopole et son Application à la Politique Économique des Communes Italiennes* in "Studi in Onore di Amintore Fanfani" vol. I, p. 154). Sant Antoninus (1389-1489) considers justum wages as the same justum pretium. He says : "Vel puum duis locat operas suas personales et altar eum conducit ad

tug-of-war and throws the seed from which grew up the theory of bilateral monopoly and the theory of games of the economists that followed. Even Smith's view regarding the relation existing between capital and labor with the former's purchase of the latter, furnishes us, be it remotely, with the basis of the wages fund theory¹, especially if we remember his dictum that the «demand for those who live by wages cannot increase but in proportion to the increase of the funds which are destined to the payment of wages». So Smith is going further than Cantillon². Finally, when he refers to the partial appropriation on the part of the entrepreneur of the laborer's work saying that «He shares in the produce of their labor or in the value which it adds to the materials upon which it is bestowed; and this share consists his profit» he views the problem from the standpoint of labor's exploitation³.

Thus in Smith's work we meet in embryonic form the theories that will follow in the course of the economic thought⁴.

Now, turning to the significance of A. Smith's term «fund» we can deduct that, although he means by it a «fund for the payment of wages», nevertheless he makes the further clarification that the demand for labor naturally increases with

laborandum totum est licitum dummodo justum pretium statuatur et frahs omnis tollatur" (Sum. Theol. Pars III 8, 2). Any way the subsistence theory was criticized vigorously by the Institutional School and others as today's writers J. Marchal, F. Menthon, J. Vibert, ISEA (L. Houmanidis : *The Theory of Wages from Classics until today* (in greek) Athens 1958, Preface by A. Fanfani and *History of Economic Theories*, p. 425 ff).

1. Also Demaria maintains that the wage fund theory of J.S. Mill was originated from Smith (G. Demaria: *Logica della produzione e della occupazione*, Milano, 1950, p. 321). It is true that Malthus and Ricardo also approached wages fund theory. Malthus conceives wages fund as maintenance fund and Ricardo as circulating capital (E. Heimann : *History of Economic Doctrines*, Oxford 1933, p. 120. -V. Graziani : *Storia delle Dottrine Economiche*, Napoli, 1940, p. 120).

2. Richard Cantillon (1674-1744) in his "Essai sur la Nature de Commerce en général" (1730-1734) had observed first that the price of labor is determined by its supply (population) and its demand (total national income), thus he maintained the notion of the absolute rate of wages.

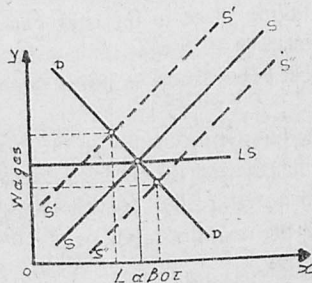
3. John Stuart Mill will write "the cause of profit is, that labour produces more than is required for its support...We thus see that profits arise, not from the incident of exchange but from the productive power of labor"(J.B. Mill, *Principles*, p.416). Marx underlines this paragraph as also of Smith saying that the whole produce of labor did not belong to the laborer in case the labor force is purchased into the market as commodity which produces surplus value. (K. Marx: *Capital*, Moscow, Vol. I, p.483 and *Theories of Surplus Value*, Moscow 1969 p. 78 ff). But this idea that the commodity buys more labor than it contains because of surplus value was exposed by Thomas Hodgskin (*Popular Political Economy*, 1827). Schumpeter is of the opinion that Smith was the first to touch upon the question of the workmen's not receiving the entire product of their labor or that they are subjected to deductions (J. Schumpeter : *A History of Economic Analysis*, p. 663). About deduction and surplus value difference see also M. Dobb : *Theories of Value and Distribution* since Adam Smith, Cambridge University Press 1973 p. 45 ff.

4. Edwin Cannan also tries to detect in Smith's work the embryonic form of the wage theories which were subsequently developed by the classics and the neoclassics (E. Cannan : *A History of the Theories of Production and Distribution in English Political Economy from 1776 to 1846*, p. 182-184). Also Jean L. Guglielmi : *Essai sur le Développement de la Théorie du Salaire*, Paris, 1945, p. 53.

any increase of the national wealth, explaining thus that wages are determined by stock, which is the result of labor, land and capital. When the supply of labor happens to be bigger than the capital which is offered by the national wealth then, wages will fall and if, instead, it is the capital which is larger, wages will rise.

c. Therefore, the greater the progress registered the higher wages will rise with a proportionate increase in savings, in the accumulation of capital, in employment and prosperity. It is for this reason that Adam Smith makes the remark that wages rise more in progressive countries. In a backward society the capital fund on disposal does not suffice to absorb the supply of labor as we have a continuously increasing population that seeks employment with a continuously steady fund of capital. In such circumstances, laborers will compete with each other to secure employment and the greater is the competition between them (as a result of a continuously increasing population, as compared with the fund of capital that does remain static), the larger will be the fall in wages until they will reach the limit of the workman's minimum level of subsistence, while as population increases wages tend to fall below the subsistence level¹.

If we have a constant demand for labour, while population increases or decreases the wage rate would be figures as following :



In progressive communities however, the number of workers increases as fast as capital, as the accumulated capital derived from commerce and industry encourages a still greater production. Incomes increase incessantly and so also do savings, which are destined to fill the requirements of production, the demand of labor increasing thus still further. And when the population increases as a consequence of an improvement in the workmen's standard of living, there is a further advancement in social progress, an increased consumption, improvement in business, in the division of labour and, therefore, an increased demand for it.

1. If the price offered for labour rose above what is necessary to maintain the supply of it, then the workers would have larger families and the supply of labour will increase. With an increased labour supply wages would fall below the subsistence level, because children would die off or never would be born. So supply in the next generation would be diminished while wages would rise again above the natural price (normal price) and equilibrium will be restored. Thus Smith, accepts finally the iron law of wages (See also M. Dobb : Wages, Cambridge, ed. 1947, p. 101-102 and M. Meier-R.E. Baldwin : Economic Development, New York, 19 3, p. 23).

In his examination of the changes in needs, resources and technology, Smith describes the historical evolution of the economy. And given that this historical evolution relates to his vital views on wealth acquired from increased income as a result of growth realized from investments, labor potential and the population increase, there is no doubt that on the matter of the evolutionary aspect of the economy, Smith is once again the basic theoretician among classical writers on the subject.

His views on the apportionment of labor is the starting point of economic development, especially when he emphasizes the importance of industry as opposed to agriculture, since he believes that industry allows and achieves a more complete apportionment of labor¹.

In addition, Smith observes that when technology is applied in agriculture the community will profit from it. For if thanks to technological progress an agrarian family can double its production, this means that, in the entire community, half of the population will feed the whole of the population. Consequently, the rest of the population will have to resort to other occupations which means that an economy of labor will be realized in favor of the country's economy². At this point Smith is influenced by the Physiocrats since he considers that the various bourgeois productive occupations depend on the agricultural surplus. However, as already stated, the developments taking place in industry can and do affect this surplus. And if the population increase is such that its rate becomes a pressure on living standards, then technological applications in industry can bring about an increase of agricultural production.

Smith's views described above are based on the foundations of his theoretical conception according to which the richer countries are essentially those which have achieved a great degree of progress rather than these which have abundant resources, and according to which the result of labor productivity is more slowly evident in agriculture than in industry.

It is true that Smith was too much under the influence of his environment to take into consideration that food price increases resulted in the increase of the landowners' income to the detriment of the businessman and of the workers whose wages barely covered their minimum of subsistence. When stating these ideas, Smith believed in the continued increase of working hands in England as a result of her high level of prosperity on a world scale. On the other hand, however, his theory ends on an optimistic note, in contrast with the pessimism of Malthus and Ricardo³, since Smith accepted that, through its achievements, progressive society

1. A. Smith : p. 401 ff. Y.S. Brenner : *Theories of Economic Development and Growth*, London, 1966, p. 30 ff.

2. A. Smith : p. 163, J.M. Letiche : *Adam Smith and David Ricardo on Economic Growth* in B.F. Hoselitz : *"Theories on Economic Growth"*, New York 1965, p. 67.

3. Professor Fanfani says, "it is a mistake to consider Malthus and Ricardo as pessimists" ... "In respect of these two writers attempts have been made to create the impression that they form the pessimist wing of the Smithsonian School, nevertheless because of the basic character of their

would be able to cope with the dangers arising from the population increase and the higher cost of land¹. Under these circumstances, Smith believed that rather than a downward trend of capital accumulation, we would experience an upward surge of such accumulation through investments that would enhance the broadening of markets and the development of the economy.

Smith did not base these ideas on the factor of technology only but also on that of the trading and industrial classes which ruled the economic arena.

The traders took these classes into serious consideration given the power of the State, but Physiocrats, who were loyal to the landed aristocracy emphasized the importance of the agrarian class as being the only one which was productive. It was Smith who based his entire theory mainly on the industrial class², also accepting the advantageous position of the landowners who, ever since land became an object of ownership, enjoyed the profits also of the natural produce of the land.

Smith represents with his rent theory a new form of income which appears as a monopoly price³, which also participated in the distribution of shares. So, not only the laborer is obliged to concede a part of the value which he creates but also the entrepreneur is obliged to pay rent to the landowner. Indirectly the rent of land influences wages and it represents a deduction from the produce which is due to labor⁴. This rent may be considered as the produce of those powers of nature, the use of which the landlord lends to the farmer. Any way the products of land must be cheap in order to increase «the demand for them and consequently for the

conception and of their confidence in the natural order, we have no hesitation in stating that Malthus and Ricardo are not only pessimists, but, on the contrary, they are ponderous searchers of Smith's conceptions"... "Malthus and Ricardo, by condemning outright state intervention, prove that they do so not in the intention of imparting a pessimist interpretation to their belief; on the contrary, they wish to express their absolute faith that, in a world of human beings, the natural order is the best course one may follow and, therefore, we cannot improve upon it by attempting to harness the action of natural laws" (A. Fanfani : *Storia delle Dottrine Economiche*, Milano-Messina, 1955, p. 350).

1. Besides Smith did not give any consideration to the law of the diminishing return of the soil, which was first formulated by Xenophon. It should be noted that the wrong notion according to which the first to formulate this law was Turgot, is derived from the ideas supported by Turgot in his "Sur la Mémoire de Saint-Peravy (1768). (Turgot: *Ecrits Économiques*, p. 209).

2. Profesor Mizuta says: "Locke's" effort to establish and justify the passions and actions of individuals in civil society also falls short in the field of moral philosophy. For example, his ambiguous and relativist concept of the law of opinion and reputation in far from strong enough to justify the activities of embryonic industrialists. The task of justifying their activities through an economic analysis of civil society was left to Adam Smith (H. Mizuta : *op. cit.* p. 115).

3. A. Smith : p. 145. Smith's views on land revenue were also adopted by Say, his popularizer. Say considers land as a kind of monopoly, given that both labor and capital can meet an increased demand, even under certain conditions, while it is impossible to have an increased supply of land and therefore the tenant must pay rent to the landowner even if it has to be done at great sacrifice (J.B. Say : *Traité d'Économie Politique*, p. 325 ff. and p. 365).

4. S. Hollander : *The Economics of Adam Smith*, University of Toronto Press 1973, p.

labor of those who produced them such a reduction in taxes upon raw materials would allow to laborers to work cheaper and the products of them to be sold in lower prices»¹.

Smith describes the income of the industrial class as the income of those who use or exploit capital². Increase of capital in a country of advancing wealth brings higher wages and tends to reduce profits³. This happens because of the competition among capitalists to obtain relatively scarce labor so long as capital increases faster than the population. Wages will therefore rise while profits will diminish. But when the population increases, profits too increase since wages will be lower. In a progressive economy wages will show an upward surge while profits will tend to be reduced so long as the population will not increase. In a declining state, however, capital will eventually decrease while wages will drop and profits will rise because there will not be a corresponding decline in the need for it»⁴. «It is not-says Smith-the actual greatness of national wealth but its continuous increase, which brings about a rise in the wages of labour. It is not accordingly, in the richest countries, but in the most thriving or in those which are growing the fastest, that the wages of labour are highest»⁵.

It is a fact that from his «Theory of Moral Sentiments» (1759) onwards, Smith never changed his views on the importance of self interest as a prime mover for economic progress⁶. According to him, the total of self-interests means, in the final analysis, a gain for the economy, which creates the terms and conditions of its development.

To encourage self interest and bring about the gains thereof, Smith believes, that it is necessary to have free trade. For only under free trade conditions, domestic as well as foreign, is expansion of economic transactions and promotion

1. S. Hollander, p. 159.

2. A. Smith, vol. 1. p. 54.

3. A. Smith vol. 1, p. 89.

4. A. Smith, vol. 1, p. 96 and E. McKinley : *The Theory of Economic Growth in the English Classical School* (in "Theories of Economic Growth," p. 97ff). The meaning of profit is confused with interest. Smith divides stock into two parts, one for immediate consumption and the other in the capital which is expected to afford revenue (A. Smith, p. 261). A compensation concerns to extraordinary losses and another to neat or clear profit (A. Smith, p. 98) the second is the interest and both the gross profit (B.F. Catherwood, p. 40). The first concerns to the entrepreneur, the second to one who lends the stock to another (A. Smith, vol. 1, Op. 46). The follower of Smith, Senior, more clearly explains profit as "the revenue obtained from the employment of capital after deducting ordinary interest on the capital, as the remuneration for the abstinence of the capitalist, ordinary wages, as the remuneration for his labour, and any extraordinary advantages which may have been the result of accident". He also subdivides capitalists into two classes, the inactive and the active; the first receiving more interest, the second obtaining profit (N. Senior : *An Outline of the Science of Political Economy*, 1836, ed. London 1872, p. 130, 133).

5. A. Smith, vol. 1, p. 61-62.

6. O. H. Taylor : *Economics and Liberalism*, Collected Papers, Harvard University Press, Cambridge, Mass. 1955, p. 73.

of economic resources possible. To achieve this, however, Smith did not exclude the State altogether. In fact, he admitted the necessity of State action, of public education, health, defence, public works, control of the monetary system and of currency circulation; he also believed in the necessity of import and export taxation as sources of income for the State and for economic progress¹. It is precisely in order to ensure economic progress that Smith insisted on the regularization of colonial relations. For although the American colonies and the opening up of the road to India through the Cape of Good Hope made economic expansion and the discovery of new resources possible, yet other rather unpleasant problems were created for the metropolises. Setting forth his ideas, Smith, finally proposed that England should avoid any expenditure for the security of the colonies and recommended that an agreement be reached between the metropolises and the colonies ensuring the freedom of trade².

While Smith then believed that the apportionment of labor strengthens economic development by enhancing productivity, he also believed that international trade is equally important in strengthening the domestic market.

Generally, Smith's work is remarkable for its optimistic structure and its provision for an expanded economy so long as the factor of progress governs economy through technology in the industrial society. Otherwise we must not forget that Smith developed his ideas during the Industrial Revolution. In this connection Smith observes that labor demand increases concurrently with the increase of the national wealth. Therefore, with greater progress we have higher wages above the level of minimum of subsistence, society makes larger savings, more capital is accumulated, employment is higher, and so is prosperity. That is why, Adam Smith observes, wages rise in the more progressive countries, not in the richer ones. In a stagnating or backward society, however, the capital available cannot absorb the labor force offered and one is confronted with a continually rising population asking employment from a more and more stagnating wealth. Wages are governed by the eternal law of supply and demand in the same neighborhood there was any employment evidently either more or less advantageous than the rest, so many people would crowd into it in the one case, and so many people would desert it in the other, that its advantages would soon return to the level of other employment³. In a situation like this, the workers compete with each other for work and the greater this competition becomes as a result of a steadily rising population and a stagnating economy, the lower do wages drop, often reaching minimum subsistence levels.

Yet in a progressive society the number of workers cannot increase as fast

1. A. Smith, pp. 101-102, 120-123, 350 ff. J.M. Letiche, op. cit. p. 70, and Lionel Robbins : The Theory of Economic Policy, London, 1972.

2. A. Smith, p. 603

3. A. Smith, Wealth of Nations, p. 939.

as capital. The capital accumulated from trade and industry promoted great production. Income increases steadily, and so do the savings which are channelled into production thus causing an increased demand for labor. And even when the population increases as a consequence of the workers' improved living standards, social progress is even further strengthened, consumption becomes more general, enterprises flourish and there is a still greater demand for working hands.

* * *

Summarizing we can say that Smith distinguishes three factors influencing wages. The first being the bargain between the master and the laborers whose number can force the wage rate to, or below, the level of present subsistence¹. The second relates to the increase of demand for labor, because of the affluence of the fund for the payment of wages, which forces the masters to compete among themselves for labor and raise the wages². The increase of this fund depends upon or is an increasing function of national wealth, which affects wages through an increase of revenue or stock³. Here we have an identity of the wages fund and of the maintenance fund⁴ although this identity cannot be a true one according to Smith's theory of wages. Any way Smith conceived it as a fund of material goods or «the real quantity of the necessaries and conveniences of life»⁵.

The third force as determinant of wages is the price of food and this aspect of Smith's analysis is the dominating one in his theory of wages. Consequently when the price of the goods consumed by the laborer is high the wages must be high in order that the laborer be able to purchase them and when prices are low wages will tend to be low. Any rise in wages when the cost of living is low will effect the latter in a way to neutralize the former⁶. The dependence effect in the above cases exist but cannot disturb the social equilibrium, because the economic equilibrium thanks to the invisible hand of the natural laws affects the former. Any way the cost of dependence is diminishing in progressive countries and is increasing in stationary or underdeveloped ones.

According to what we have mentioned above we can say that it was Smith who, besides W. Thompson (*An Inquiry into the Principle of the Distribution of Wealth*, 1827) and Thomas Hodgskin (*The Natural and Artificial Right of Property* Constated, 1832)⁷, conceived the dependence effect from the relations of

1. A. Smith, vol. 1, p. 60.

2. A. Smith, vol. 1, p. 70 and B.F. Catherwood, p. 34.

3. A. Smith, vol. 1, p. 71, B.F. Catherwood ib.

4. The maintenance fund was conceived as the base of wages not only by Malthus but also and by Senior.

5. A. Smith, vol. 1, p. 79.

6. B.S. Catherwood, p. 35.

7. See also W. Stark: *The Ideal Foundations of Economic Thought*, London, 1948, p. 93.

production and distribution of income. His views on the development of the system constitute the most concise statement of his times on the phenomena of capital accumulation, development, and technological progress and W.J. Baumol is therefore right when he describes the dynamics of the classics as «magnificent dynamics»¹. Smith's views on labor wages influenced other classic writers, among them John Stuart Mill, who represented both the rise and the decline of the School², but also the neoclassical Alfred Marshall who was exposed to the great Scotsman's wisdom through John Stuart Mill.

In general, for Smith the labor market is examined from the point of view of the increment of the number of workers and in a way so that a relation exists between national wealth and the active population. The progress of technology helps to avoid the consequences of the increase of population, while both provoke the division of the labor and that of the markets for a favorable attack on the problem in the industrial society governed by liberty.

So Adam Smith examined wages from two aspects³ :

a. According to a static analysis which concerns the value and the distribution and a dynamic analysis emerging from his conception regarding economic evolution.

b. A microeconomic analysis which concerns the value and a macroeconomic analysis from the point of view of the income distribution between the different classes.

Regarding the short-run explanation of Smith's theory of wages it is a consideration in the ratio between capital and population i.e. a wage fund theory, of course not Millian. The long run evolutionary explanation is based on population and thus appeared his theory of the minimum of subsistence.

* * *

The meaning and significance of the «Wealth of Nations» is much broader than a book of Economics. It presents a Philosophy, a Sociology and an Economic Doctrine, above all it is dominated by Ethics and for this reason value and distribution is the main subject of the Smithian thought.

His followers or adversaries will select specific interesting parts of his book which is the first anatomy of the Industrial economy and society.

1. W.J. Baumol : Economic Dynamics, New York, 1951, p. 6 ff. It is understood that the classics' dynamics is extra-structural and a dynamics of the facts and mechanisms but not of the structures or of the economic regime (A. Pietre : Pensée Économique et Théories Contemporaines, Paris 1965, p. 77).

2. Ch. Gide-Ch. Rist : Histoire des Doctrines Économiques depuis les Physiocrates jusqu'à nos jours, Paris 1926, p. 411.

3. L. Houmanidis : History of Economic Theories, Piraeus-Athens, p. 132. L. Stoleru : L'Équilibre et la Croissance Économique, Principes de Macroéconomie in Finance et Économie Appliquée, vol. 26, Paris, 1969, p. 396.

This society is governed by just price according to the Aristotelean conception of the exchange and of the medieval one of *justum pretium*, which was inherited to the naturalist Locke¹ and Smith of course was sensible to this idea. The cost of production is regarded as satisfying social justice (i.e. the minimization of the cost of dependence according to my theory) and the increase of social wealth through productivity which impact on wages. For this reason Smith confronted the problem, of the distribution in a «politico-economic or ethical discussion, particularly in regulation of prices»².

In a free society and in a free competition economy just price gives the possibility to any factor of production to be satisfied according to the best advantage, but there are two checks. The first is the intervention of government, which destroys the ideal mechanism of the natural laws, the second is that «the patrimony of a poor man lies in the strength and dexterity of his hands only»³ while rich people, the masters, «have the possibility to live without work having their stock already acquired»⁴. «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»⁵.

With these ideas Smith explains capitalist social structure with humanitarian views preparing the soil to Manchesterians and other naturalists in general, but also to social radicalism.

Smith is the Aristotle of Economics and caused misunderstanding, as the same happened with Scholastics who studied the Great Greek Philosopher⁶. His followers, optimists or pessimists, will adopt the idea of no intervention into the functioning of the perfect mechanism of natural laws in order to minimize the cost of dependence of the laborer from the entrepreneur. The adversaries on the other hand inspired by his subsistence theory will conceive the iron law of wages proving thus that it is impossible to minimize the cost of dependence in a capitalist society.

The philosopher Bergson supported that the value of a book depends from the discussions which it provokes and from this point of view Adam Smith's «Wealth of Nations» is a successful one.

1. C. Vaughn : John Locke and the morality of the market price in "International Congress of Economic History and History of Economic Theories in Piraeus", 1975, p. 74 ff.

2. M. Bowley : Studies in the History of Economic Theory before 1870, London 1973 p. 130.

3. A. Smith : Wealth of Nation, vol. 1, p. 110.

4. A. Smith, vol. 1, p. 59.

5. A. Smith, vol. 1, p. 59.

6. M. Bernard : Introduction à une Sociologie des Doctrines Économiques des Physiocrates à Sturt Mill, Paris, 1963.

ANNEX

Professor Douglas K. Adie of the Ohio University, discussant to my paper at the Chicago Congress of History of Economics among other things he analysed my views upon cost of dependence saying :

«According to Smith, because the owners are fewer in number than employees, have more wealth than employees, can collude more easily and have the advantage of the law on their side, they have a tendency to exploit workers. It is in this context that Professor Houmanidis introduces his "cost of dependence" or "dependence effect", which he defines as the psychological pain that gets a factor of production from another. Man does not enjoy being at the mercy of someone else and so Professor Houmanidis believes that society should be structured in such a way as to minimize the dependence effect. He says that the cost of dependence emerges between those two parties whose interests are not the same. For instance, the masters try to give as little as possible and the workerman to get as much as possible. Because the masters are stronger, Houmanidis says the workers depend on them.

This dependence increases, Professor Houmanidis says, when funds destined for the payment of wages are constant and the labor force is increasing. Houmanidis confesses that Smith's discussion of this effect is not as extensive as he would have liked in the light of its importance and suggests that it might have been an oversight. I would suggest with an equal deficiency of evidence that Smith did consider it but simply dropped it because it was of little practical value in explaining wage determination. After discussing the state of nature briefly and the bargaining theory he drops it and has no desire to return to precivilized society. For Smith it is impossible to return to the state of nature and any attempt to do so would be disastrous. Only in the state of nature would Professor Houmanidis' "dependence effect", as he understands it, be minimized. Smith, on the other hand proceeds to discuss how wages are determined in a world of private property where capital has been accumulated".

«There is a problem with Professor Houmanidis' position (if I understand it correctly) and his use of the "dependence effect". His goal of minimizing dependence seems to be inconsistent with his suggestion that we should foster a free, competitive society, where market prices lead to optimal resource allocation and fair remuneration of factors; and his desire to restrain government intervention from worsening the outcome. A policy of minimizing dependence as he understand it would seem to me to call for either a return to the state of nature or massive government intervention. However, what Professor Houmanidis refers to as the "dependence effect" might better be described as the exercise of non-price rationing techniques when actual wages deviate from their equilibrium levels. This area has been explored by Alchian, Demsetz and Coase. If the market wage is below the

equilibrium wage then there is an excess demand for labor; if the market wage is prevented from rising or rises slowly, there will be a period of time when firms are "dependent" on workers. If in the opposite situation the market wage is above the equilibrium wage, there is an excess supply; if the market wage is prevented from falling or falls slowly there will be a period of time when workers are dependent on firms. I would suggest that it is this non-equilibrium situation which produces the so-called "dependence" not any inherent power in the employers. Also I would suggest that this "dependence" can exist on either side of the market. Understood in this way minimizing dependence is consistent with a non-interventionist posture toward market phenomena».

«In his understanding of empirical phenomena he is just plain wrong when he says that dependence varies inversely with the wage. Rather dependence varies directly with the discrepancy between demand and supply at the market wage and can be on either side of the market».

I am obliged to add some more lines to my paper explaining my theory of cost of dependence as it was analysed by professor Adie.

Man is superior value of life born in freedom. Truth is born with man who for this reason is responsible to truth, which he must cultivate to find it in freedom. But because man is a product of freedom cannot accept dependence of another upon him. This is my basic psychological law.

I must explain also that I presented Smith's theory of wages as "Smithian" and not as "Alchianian" or "Demsetzian" or "Coasian".

From the other hand I must explain that when laborers are not organized in Labor Unions my theory of course is "one sided" but not in all cases, when workers are organized in Unions and have representatives in the Parliament.

The value of labor is determined by its cost and utility.

The cost is composed of two elements : The one is *material* and concerns the subsistence of the laborer and his family, including education and other expenses and the other is *psychical* and this is the sacrifice to which the laborer is submitted in his inferior position in the hierarchy of production and in his dependence on the employer. This is what I call cost of dependence.

The laborer not only compares repose with wages, but also he takes into account his dependence in production and the psychological effect on him of such inferiority, especially as regards his employer or he is an entrepreneur or the state, whom he is ready to avoid. The higher is the reward of the laborer the lesser is the *cost of dependence*. When, however, the entrepreneur seeks to reduce wages or to increase the working hours, then the cost of dependence rises and the reaction against the existing system of social production on the part of laborers, rises. For this purpose the regulative intervention of the state becomes indispensable in order to avoid monopolies, to come to the aid of small incomes, to supervise the just distribution of products and to create outlets for the prevention of unemployment etc.

The above cost of labor it appears as social estimation, which with the disposal stock of labor and its capacity determines supply. When, however, we talk of social cost we should have in mind the *marginal social cost* and this is the minimum cost of each working stratum (unskilled, skilled and highly skilled) below which the cost of dependence will be increased with a consequent active reaction of the laborers, given that we shall witness a displacement of laborers.

At the contrary if wages are high the cost of dependence will diminish to zero but never being equal to zero because of the basic psychological law of the disutility of dependence. These changes in the level of the wages are of the highest significance and prove the importance of the syndicates in their resistance against excessive displacements, the stabilization of the workers in the developed countries and the difficult posture of the workers in the under-developed ones, where there do not exist organized labor forces. The marginal social cost is the minimum level of wages which determines, the supply of labor, while the highest level is its marginal social utility, which determines the demand of it.

As regards, then, the utility of labor, it is social, indirectly estimated by society which buys the goods offered by the entrepreneur who obtains a profit of the goods he is selling.

In case of highly skilled labor mainly the demand will determine its price, while of the skilled labor the supply and demand and of the unskilled labor the supply will be effective in determining its price.

Competition, the sway of institutions and the resistance of Labor Unions obligate the entrepreneurs to continually increase their technical capital and to engage in rational ameliorations. But whilst the technical capital is increased at the expense of labor (preferred by the entrepreneur as being more disciplinary and effective) there is, on the other hand, an increase both in product and in profits.

Finally, and before I close my present paper, I believe it would be indispensable to refer to the tug-of-war during the various phases of the economic cycle, given that the strategy of the bargaining both of the laborers and the entrepreneurs as also their resistance and successes depend on cycle's phases¹.

In examining the ascending phase of the cycle we see that the increase of prices has usually as a result, to improve employment and, therefore, to increase the demand of labor with a consequent rise in wages, especially those nominal rather than real. In this case the laborers will press for higher wages and the employers will be obliged to submit to their demands, given that their business is going well and their expectations are optimistic. When on the other hand, prices fall, the position of labor becomes difficult, as the entrepreneurs will insist on a reduction of the nominal wages.

1. See also the book of Sir John Hicks «The Theory of Wages (1932) and the after Second World War interesting books of C. M. Stevens (On The Theory of Negotiation in «Quarterly Journal of Economics», 73 (1958), M. W. Reder (Job scarcity and the nature of Union Power in «Industrial Labor Relations Review», 13 (1959),

But when prices are going up the entrepreneurs, despite the pressure of the Labor Unions, enjoy a better reward from the product, proportionally to what labor gets, because this increase favors various combinations which, when they are carried out in sight of a quick rise in prices, extend the difference between cost and the price of the product will further. For the laborers, however, things are different because, although they receive higher wages than formerly, nevertheless their real wages do not follow the same rate of increment as nominal wages, and are thus unable to offset the rise in prices.

Besides, as during the period of departure from the state of depression to that of recovery in the cycle prices ascend slowly before their recovery receives an impetus, which increases at a faster pace commensurately with the oncoming prosperity, the entrepreneurs find themselves in a more privileged position than the laborers, as the symptoms of recovery are not so clear-cut, to urge the laborers to demand an increase in their wages.

Thus, generally employers in a period of prosperity find themselves in a more *ex post* privileged position, obtaining more profits because the product is sold at higher prices than it is possible for the laborers *ex ante* to do with their wages, given that employers are influenced by expectations and laborers by employment. When on the other hand, cycle is going down prices are falling then wages go down also, but not proportionately to the profits as the laborers, through their Unions, strive to keep wages, especially the nominal ones, at the former levels.

The fall in profits during depression is followed by a decrease in the rate of interest, which helps to create more hopeful provisions for the future, for a new recovery.

As however, a reduction in wages becomes difficult, as a result that everyone tries to keep his wage as formerly, Unions resist and now entrepreneur is the dependent part of the bargaining.

From what we have exposed hitherto we see that during recovery of the cycle, those who are in a more advantageous position are the employers, whereas when the opposite is the case the tables are turned and the profits of the entrepreneurs fall incessantly and in an analogy much more faster than wages.

The inclination to imitate those in the higher strata in society and the habits thus formed render well high impossible the regression of wages, if by such regression the laborer were to discontinue his old mode of living. Thus, the laborer and his family strive to keep their income the same as before, that is, analogous to their requirements in the prosperity period. For this reason the laborer's mode of living is subjected to two counter-opposing sways, the one tending to bring it down to its lowest possible limit cost of living and the other leading to richer and more complex requisites of life and this can be reached at through the highest level of labor's wage. Thus, social sways force laborers to react against any diminution.

in wants of curtailment in enjoyment and habits acquired during the prosperity period.

To solve the problem and the opposition between laborers and entrepreneurs, during depression, the State helps the latter to give employment to the former.

Of course, the supply of labor besides other factors, is not made independently of labor's existing conditions, in the productive procedure and, generally, of the customs and institutions in force and, in this trend of thought, one could point out that the wants of a Greek are different from those of an English. Also, the wants of the Asiatics are not similar to those of the Europeans, a fact which is of the utmost importance as far as the cost of labor and the possibilities of competition in the international market is concerned.