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ADAM SMITH, THE FATHER OF THE INDUSTRIAL SYSTEM

by ·

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From the 17th to the 19th century we have great technological change, which reached its high point between 1760 and 1830, the period of the Industrial Revolution, and was assisted by the progress and the domination, through the ideas concerning freedom of the new method of the production of material wealth, industry, so that the new ideas and the new technology transformed the world and brought into being economic liberalism, which the classics heralded¹.

The success of industry is basically due to three reasons: economic, political and technological. The development of commerce, the division of labor, the increase of the volume of demand, the multiplications of needs, the increase of populations, the political developments on the American and European continents etc., overthrew the suppositions which formerly dominated human life. Production was reshaped toward mass production. In addition, during the XVII century positivism took precedence in philosophy through Locke and the contribution of Newton to the physical sciences all added to the progress in technology. So that while, during Mercantilism, industry basically aimed at the satisfaction of the needs of the national market, with the passage of time this gathered strength and spread from the national market to the

1. B.S. Catherwood: *Basic Theories of Distribution*, London, 1933. A. Whitaker: *History and Critics of the Labor Party in English Political Economy*, New York, 1924. L. Price: *A Short History of Political Economy in England*, London, 1903. L. Haney: *Value and Distribution*, New York, 1939. *A History of the Theories of Production and Distribution in English Political Economy, from 1776 to 1848*, (by E. Cannan), London, 1953. N. Anagnos: *The Contribution of the Classical School in the Development of Economic Thought*, in "Review of Economic and Political Sciences". Vol. XVI, 1961, pp. 157-192. P. O'Brien: *The Classical Economists*, Clarendon Press, 1975. G. Zapatero: *La Economica Classica un los Economistas Espanoles en les Siglos XIX-XX*, in "Historia del Pensamiento Economico en Espana" in "Revista de Economia" (Ministero de Comercio), Num. 517, 1976.

world-wide one and labor was continually replaced by the machine. For this there was a demand for more machines, capital, credit, insurance and the risk-taking personality of the businessman in combination with his organizational spirit successfully competing against his opponents in the expanded market. This presented a broadened margin for the absorption of products which flowed not to a determined number of persons but to an anonymous crowd seeking standardized products until the cost of production came down.

Adam Smith first undertook and systematized this analysis of the economic function of the industrial mode of production, distribution and consumption of products.

The naturalism of the Physiocrats and especially the book of Cantillon² contributed to this, so that their influence was accepted with that of Hume and Hutscheson's student, the Scottish moral philosopher, Adam Smith³.

2. Richard Cantillon (1674-1744) in his "Essai sur la Nature du Commerce en général" (1730-1734) influenced by the perception of Bernard de Mandeville proceeded with observations concerning the individualism and automatism of economic forces. According to him, this automatism is due to the instinctual human behavior based on individual interest, which is the fundamental natural law. Thus, the aim of man, after the discovery of the laws which move him, is to come to terms with and adjust himself to these laws. When this is achieved, then we will have insured the just price of goods (cost of production) in the market; any price above or below this level cannot be maintained for a long time but will automatically return because of the reaction of these natural laws at this level. The "Essai" of Cantillon, Professor Fanfani says, is the first manual in which the economist is not alienated from the philosophical and scientific currents of the time and discovers and opens a way through which economic science will acquire presuppositions, rules and love for the systematic observation of unknowns in Voluntarism, which became characteristic of economic naturalism. "It was proved that through this new method we were better able to explain economic reality and that we were able to learn how to exploit it, adapting ourselves and reaching conclusions less artificial and more human concerning man's possibilities to achieve prosperity". (A. Fanfani: *Storia delle Dottrine Economiche*, p. 337). Cantillon also conceived the non-flow of metal money from country A when it is the debtor of B and the creditor of C by the same amount, when the off-setting of the debts automatically comes about between countries A, B, C, with C being the creditor of country B having to same debt with that between A and B. Cantillon emphasized the significance of international trade and freedom of exchanges. And the abbot Etienne Bonnot de Condillac (1715-1780) with his work *Le Commerce et le Gouvernement considérés relativement l'un a l'autre* (1776), however, contributed to the appearance of the new conception particularly in France. See the following: A. Lebeau: *Condillac l'Économiste*, Paris, 1903. R. Renoir: *Condillac*, Paris, 1924. A.D. Sideris: *O philosophos Abbé de Condillac ek ton idryton tis Economikis Epistimis* (in geek) in "Epetirida tis ASOEE", Athens, 1960. Introduction à une Sociologie des Doctrines Économiques, Paris 1963.

3. M. Bernard: Chapter II *Adam Smith* and A. Delatour: *Adam Smith, sa Vie, ses Travaux ses Doctrines*, Paris, 1886. P. Virgili: *Adamo Smith*, Milano, 1928. W.R. Scott: *Greek Influence on Adam Smith*, Études Dediées à la Mémoire d' André Andriades", Athens, 1940, p. 79ff. Also by him: *Adam Smith as Student and Professor*, 1937. J. Rae: *Life of Adam Smith*, London, 1895. 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, 1973. *Adam Smith and the Self-Interest Axiom*, "Journal of Law and Economics" April 1977. S. Hollander: *The Economics of Adam Smith*, University of Toronto, 1973. Carl Uhr: *Anders Chydenius (1729-1803) a Finnish Predecessor of Adam Smith*, in "Meddelanden Fran Nationalekonomiska Institutionen vid Handelshogskolen vid Abo Akademi", No. 26. 1963. V. Foley: *The Division of Labor in Plato and Smith*, in "History of Political Economy", Vol. 6, No. 2, 1975. Also Paul MaNulty: *A Note on the Division of*

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Adam Smith was born in 1723 and received his elementary education in Kirkcaldy, Scotland. His higher education was undertaken at Glasgow college where Hutcheson was a professor at the time. His higher education was completed during a six year period at Balliol College, Oxford, where he concerned himself with moral and political science. Returning to Edinburgh he became friends with the philosopher Hume. Then appointed to Glasgow, he took over the chair of the late Craigie, teaching ethics, theology, philosophy, constitutional law, and economics. His teachings he later published under the title, *Theory of Moral Sentiments* which appeared in 1759. During the years 1764-1766 accompanying the young Duke of Buccleugh, Adam Smith visited London, Geneva, Paris and Toulouse, where he began the writing of his great work, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776). In France, he became acquainted with the physiocratic theory of François Quesnay⁴, the economic ideas of Turgot and Condillac and the liberal ideas⁵ which were then being developed by the Encyclopediasts. In 1767 he went to live near his mother in Edinburgh, where he finished the above-mentioned work and where he dies in 1790.

Cannan published (1896) the rest of Smith's studies as *Lectures on Justice, Police and Revenue and Arms*, all brimming with correct judgments and indications of compositional labor and true creativity. Smith was thought to have followed the line carved out by the German Ludwig Carl (1687-1748) in his work which was published anonymously in French between 1722-1723 but Jenny Criziotti-Kretschman took opposition to this view, and was supported by A. Tautscher⁶ who maintained that Smith's work was developed under a different environment and

Labor in Plato and Smith, *ibid.*, Vol. 6, No. 2, p. 372 1975 and the answer of V. Foley to him in No. 3 p. 319 under the title, *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 "Lloyd's" Bank Review, No. 119, 1976. L. Calabi: *L' Uomo Mercante di Adam Smith*, in "Angelus Novus", No. 19, 1970. H.G. Johnson: *The Man Who Turned Economics Into Common Sense*, in "Times" (9-3-1976). L. Th. Houmanidis: *Adam Smith's Theory of Wages* in "Spoudai", VOL. KST, No. 4, 1976. R.D.C. Black: *Smith's Contribution to Historical Perspective*, in "Essays in Honor of Adam Smith", ed. T. Wilson - A.S. Skinner, Oxford, 1976, p42ff. T.W. Hutchinson: *Adam Smith and the Wealth of Nations*, in "The Journal of Law and Economics" Vol. XIX (3), 1976, p507ff. S. Hollander: *Adam Smith and the self-interest axiom* in "The journal of Law and Economics, Vol. XX, 1 1977.

4. His admiration for the Physiocrats and their conception that the yearly reproduction becomes the maximum possible under a regime of complete freedom he underlines in *The Wealth of Nations* (A. Smith, Chapter IX, p. 307).

5. *Ibid.*

6. A. Tautscher: *Ernst Ludwig Carl und Adam Smith (fur Neusichtungung des Smith Problems)*, in "Weltwirtschaftliches Archiv", Band II, 1941.

related to various ideas, which constituted the molding of economic science⁷.

Smith, as Bernard says, is the Aristotle of economics: from his work arose most of the contradictory points of view, but we cannot condemn him, just as we cannot condemn Aristotle because the Scholastics interpreted him on the basis of his words.

François Quesnay, Bernard de Mandeville and D' Alembert exercised their influence on Smith. He was, however, more under the influence of David Hume, with a religious feeling for life. He goes even further to the love of God, the only source of truth which is what unites men through invisible bonds. Men are his children under the great good of freedom and when they accept un-free coercion, they create barriers among themselves.

Interventionism is part of this barrier. The State is wrong to intervene, the commercial policy must be the same as the one sought by D' Argonson . . . "as free as the air and the water". This is not contradictory to the nature of man because his psychology is ruled by freedom. "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 man or order of man". Freedom is a term of progress, it is certainly the cause of social inequality but despite this individuals enjoy nearly the same satisfactions. The rich man, Smith says, spends on food about the same as the poor man and moreover, moral satisfactions have greater significance than material ones⁸. Consequently, let people be free. This is the only correct password. In his own interest man will again come upon the truth, this humble motive brings man next to God, because it does not result only from egotistical motives, but from love toward himself and his neighbor because respect for self is respect for the freedom of the neighbor. Furthermore, civilization requires this, the social life of man progresses and the division of labor demands this manner of human living together. What one produces the other one does not produce. Liberalism creates precisely these presuppositions through which is established the not only necessary but imperative requirement of international solidarity the just exchanges between states within a free society without protective barriers but through the emancipation of trade. As their economic position improves people's aspiration leads to a higher degree of social life. In no way did the mercantilists realize this, so they did not seek the domination of the liberal class through free trade. Man was moved toward this through biological development, because for Smith there was no historicity, there was no law moving history, but there was biological development in accordance with the will of God, on the basis of which societies continually developed toward progress.

In the environment of the developing English industrial capitalism, it was very

7. Jenny Griziotti-Kretschman: *Il Post di Ernst Carl e di Adamo Smith nella Storia delle Dottrine Economiche*, in ed. "Istituto Lombardo di Scienze Lettere" reprinted in "Rendiconti", No. 1, Vol. LXXVII, 194445.

8. A. Smith: *Theory of Moral Sentiments* Vol. 1.

natural for Smith to be supported on factors which his predecessors had not taken into account. Agriculture is not the only source of wealth. That is why he is considered to be the father of the industrial economical system but he agrees that the intervention of the State is disastrous and on that slogan raised the flag of free trade⁹. Later on, Smith's adherents, the Manchester School, came along and accepted the light of the moral and economic teachings of the great son of Scotland.

Though the Physiocrats gave primary importance to agriculture for this progress, Smith considered that labor is the thing which acts on nature¹⁰. Thus Smith certainly accepted the contribution of land to the production of wealth, but he elevated the significance of labor. The annual labor of one nation is, according to him, that which produces the commodities which are necessary for its perpetuation. However, this labor occurs through its division, the highest manner of social labor and the creation of utility.

The view of Smith concerning the division of labor, influenced by Hume, also took on a more catholic character. Because this division is not only national but universal as well, free trade strengthens the international division of works and each production branch is developed where the conditions are the most favorable for it.

The division of labor, according to Smith, is the result of human nature and exchange. The various products represent particular human capabilities. Professions are sub-divided into other subprofessions, levels of labor of one and the same product are distributed among the workers according to speciality, and industries for various products are subdivided into smaller enterprises, dividing up the labor of the large one. Technological progress strengthened the possibilities of man to produce more within this division, organizing the economic system of exchange of various labors.

On the question of these labors, Smith separated them into those labors which refer to the production of commodities required beforehand for the accumulation of capital, those which contribute to the increase of surplus for future investment, and those which are only useful (doctors, lawyers, actors, etc) which do not contribute to the production of the social product¹¹. Thus, Smith considers only those labors which are joined with capital as being related to production¹².

The followers of Smith in England, Thomas Robert Malthus (1776-1834), David Ricardo (1772-1823), Naussau Senior (1790-1864), John Stuart Mill (1806-1873), J.R. Cairnes (1823-1875), etc., his adherents in France John Baptiste Say (1767-1832), Frederic Bastiat (1801-1850), Michel Chevalier (1806-1879), Joseph Carnier (1813-1882), etc, Francesco Ferrara (1810-1900) in Italy and Heinrich von Thünen

9. Marx also accepts this while Engels calls him the Luther of economy (McLellan: p. 233).

10. M. Bernard: Chapter II. See my analysis of the work of Bernard in "Archeion Economikon kai Koinonikon Epistimon", 1968, No. 48. p. 547ff.

11. A. Smith: *Wealth of Nations*, p. 352.

12. This point of view is the dominant one in Smith, though he does speak of wealth, including in this all the "necessities and conveniences" which the various services have collectively.

(1783-1850), Wilhelm Hermann (1795-1868), K.H. Rau (1792-1870) etc, in Germany and G.H. Jovellanos (1744-1811) and A.F. Estrada (1766-1853) in Spain, also formulated systems ruled by natural laws functioning toward the establishment of rational order. This coincides with free exchange, free international trade, free production of commodities and free competition of commodities, along with individual political freedom and the rights of ownership and inheritance.

Smithian teaching, infused with the work of Mandeville (*The Fable of the Bees*, 1714) maintained that due to the instincts of man, individual faults, when added up give a sum expressing the happiness of the whole, conceived of an ideal type of man, homo oeconomicus. He finds his greatest advantage in managing to seek his own personal interest, "as is". However, for this greatest benefit of homo oeconomicus to succeed there must be free competition, allowing the best disposal of the factors of production, avoidance of superfluous expenditures because of the competition, and in consequence the lowering of cost, so that the most ideal equilibrium is achieved.

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In his monumental work *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776) Adam Smith developed his theories on value and distribution. Smith divided value into *value in use* and *value in exchange*¹³. The former is the property of the commodities, the latter is the capability of the products due to their value. In addition, Smith accepted in principle that the real measure of the value in exchange of commodities was labor¹⁴ and, in continuation, for the developed societies it was the cost of production¹⁵. The prices would fluctuate, because of the game of supply and demand, above or below the cost of production or the natural price without, however, any barriers being imposed so that even though the prices would move away from this center of equilibrium, they would have a ceaseless tendency toward it¹⁶. Because an increase of the price above the cost will cause the supply to increase so that the prices will return to the level of cost and if the prices go below the cost then the supply will be reduced until the prices are in equilibrium with the cost. The question arises, however, why Smith did not investigate this game and look, for the interpretation of the phenomenon of value.

The market price, according to Smith, is changed directly because of demand and

13. Aristotle was the first to make this distinction but Quesnay distinguished two kinds of value, the *valeur usuelle* and the *valeur venale* or *commerciale* which is determined by the production expenditures, about the level of which these prices, which tend to coincide with it, are fluctuating. O'Brien underlines that the chapter about value in A. Smith is of such importance that no writer has been able to present it. (P. O'Brien: *The Classical Economists*, Clarendon Press, 1975, p. 82).

14. A. Smith: Chapter V

15. A. Smith: Chapter VI.

16. A. Smith: Chapter VII

conversely supply. If supply and demand change the prices, the prices change supply and demand. The law of supply and demand explains the change of value but not this value itself so that Smith proceeded to the division of value of commodities into *natural* and *market*. And this holds true for all the classics. Also Smith through the paradox of value touched on the subject of scarcity. Thus, he says: "There is hardly any value in use in a diamond but we are often able to exchange it for a host of goods".

He did not proceed further to examine the phenomenon as utility within the unit of quantity¹⁷.

The subject of prices under monopolistic competition did not get the necessary attention from Smith¹⁸.

Despite that, Smith observed that there was yield of monopolistic character from discoveries, advantages, etc. This yield, however, disappeared with time and tended to come into equilibrium with the average of labor, profit and land yield. The exclusive privileges, the laws which limit competition to certain professions, etc., are a kind of monopoly so that the market value will be kept higher than the natural value¹⁹.

In accordance with everything we have developed about value and prices we can observe the following in relation to Smith: the satisfaction of needs presupposes the supply of commodities and this the covering of the cost of production; the demand, in order to be satisfied has to pay an increasing cost. Thus, the momentary disturbance of the economic equilibrium between supply and demand is immediately restored through the automatic rising and lowering of these two quantities.

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Adam Smith also developed his theory of wages, which is of great interest concerning the evolution of economic thought on wages. He examines economic phenomena, as we have already seen, from the point of view of the principle of naturalism²⁰, 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

17. A. Smith: Chapter: V.

18. Heiman says that the prices of free competition constitute a natural part of the system while the monopolistic ones are foreign to it. And he ends: "The traditional economic theory relates to the system of prices of free competition". (E. Heiman: p. 65).

19. A. Smith: Chapter VIII.

20. The same principle was also supported 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 that 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, pp. 129, 272, 335).

invisible hand of the natural laws²¹. For this reason men must abstain from any intervention into the ideal system of these laws given by God²².

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 States intervention²³ and from the 17th century, when another mercantilist Nicholas Barbon supported that market was the best referee for the price of goods and services²⁴.

The cause of this change in the spirits of different authors in the 17th century and after, from voluntarism toward 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 et Gentium*, 1772)²⁵. On the other hand the philosopher Bacon influenced with his mechanistic explanations simulating economic thought with natural sciences.

21. The commonest use of "natural" in Adam Smith means at first the instinct and here we find the influence of Mandeville upon him, as first the same happened to his Professor Hutcheson (H. Mizuta: op. 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 Journal" 2 Vol. (1729), 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. II, p. 290) as also the 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 well as Hume, had an impact on Smith. Anyway, "law", "rights", "rules" coincide in the final analysis with 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, according to 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 nature is the 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 within 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 in natural laws see also, *Theory of Moral Sentiments*, pp. 348-351).

22. God created the natural order but no longer intervenes in it. He once created the harmony of the mechanism of the natural laws leaving it to men to be adapted to them. (See 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 of intervention in economic life and described the terrible results of it, for this reason Fanfani holds that these two classes should not be considered as pessimists (A. Fanfani: p. 76) The same idea in J. Letiche: *Adam Smith and David Ricardo on Economic Growth* in "Theories of Economic Growth" (B. Hoselitz, New York, 1965, p. 76. For the Classics and their economic policy see also L. Robbins, op. cit. A. W. Coats: op. cit.

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

24. N. Barbon: *A Discourse of Trade*, 1696ed. Baltimore, 1903, pp. 15-16.

25. L. Houmanidis: *History of Economic Theories* (in Greek), Athens, ed. 1976, pp. 73ff.

W. Petty (1623-1687) a physician and G. Montanari (1633-1687) an astronomer tried to find analogies between economics and natural phenomena maintaining that natural forces must also govern economy, ideas which will be expressed by Dudley North (1641-1691), John Locke (1632-1704), Boisguillebert (1646-1717), 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.

Freedom is the basis of progress; it is of course the cause of social injustice but anyway individuals in a cheap-abundance economy have the same satisfactions, and besides the rich man consumes about the same goods as the poor one. Also, we must keep in mind that moral satisfactions have more importance than the materialistic ones; mercantilists did not conceive of the liberal order being governed by the idea of population - wealth - power obtained only with State intervention. On the other hand the physiocrats first adopted "laissez faire, laissez passer le monde va de lui meme" but were based on agriculture and not on 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 labor, or in what is purchased with that produce of that labor, or in what is purchased with that produce from other nations".²⁶ This labour regards to its division as a consequence of human nature and of the transactions, which are developing with laissez faire. So Smith accepts the point of social efforts for abundance, which the division of labour causes, and the increase of opulence²⁷ and here we have a difference regarding the subject as Plato accepted it supporting that the division of labour is spontaneous as a result of human nature²⁸.

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".²⁹

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".³⁰

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Thus free competition helps to better distribute the factors of production and to diminish the cost of production at a state of an ideal equilibrium. Only with this

26. A. Smith: *Wealth of Nations*, Vol. I, p. 1

27. A. Smith: *Lectures*, pp. 161-8.

28. Plato: *Republic*: II, 369B

29, 30 A. Smith: *Theory of Moral Sentiments*, II, p. 118

ophelimitic behavior can society also profit.

This idea was first espoused by the mercantilist Misselden but was the road 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 are a form of revenue derived from labor, while that derived from the stock of capital is called profit and the revenue which proceeds altogether from land is called rent³¹.

Wages and profits are original revenues as is also the rent of land, while derived revenues are taxes, pensions, etc., and the interest which goes to the owner of the stock³².

The rate of wages and the rate of profit are two different rewards the former relating to the worker and the latter to the entrepreneur. Both are dependent on 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"³³ Rent is revenue which derives "partly by the neighborhoods in which the land is situated and partly by the natural or improved fertility of the land"³⁴.

The phenomenon of fluctuating wages happens with other commodities as well, around the equilibrium level of the wage of subsistence which is the natural price of labor³⁵.

Before examining distribution I must inform the reader of this paper of what I mean by the term *cost of dependence or dependence effect*³⁶. 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 anybody 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 dependen-

31. 32. 33. 34. Smith: *Wealth of Nations*, Vol. I. p46ff.

35. "This price is the central price to which prices of labor 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 toward it". (A. Smith, Vol. I. p. 51).

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

ce 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 that of *laissez faire*; the same thing happened with the followers of Adam Smith and only J.S. Mill from the classic economists accepted some socialist principles in order to obtain it.

Marx espoused his theory of surplus value as a result of the dependence of the worker on the capitalist and considered that the social revolution was the only way 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 has always existed and will always exist. For this reason we can diminish this cost but we cannot eliminate it completely, even with the change of the economic system.

Smith at first refers to the dependence effect saying: "The produce of labour constitutes the natural recompense or wages of labor. In the original state of things, which precedes both the appropriation of land and the accumulation of stock, the whole produce of labor belongs to the labourer. He has neither landlord nor master to share with him . . . But this original state of things, in which the labourer 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 labourer 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 the land".

"The produce of almost all other labour is liable to the like deduction of profit. In all arts and manufacturers 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".³⁷

Masters always try to avoid an increase of wages above their actual rate which equals the level of the laborer'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"³⁸.

The cost of dependence emerges between these two parties, whose interests are not the same. The masters try to give as little as possible and the workmen desire to

37. A. Smith: *Wealth of Nations*, Vol. I, pp. 57-58.

get as much as possible. But "a man must live by his work and his wages must at least be sufficient to maintain him"³⁹.

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 parliament⁴⁰, 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 rate⁴¹.

"There are certain circumstances, however, which sometimes give to laborers 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"⁴².

"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 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"⁴³.

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 declining stages⁴⁴. 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 even held it"⁴⁵.

In a stationary state the laboring class can keep at subsistence but not when the fund is "sensibly decaying"⁴⁶. This fall of the wage fund which causes the reward of laborers to decline has some implications also on all other classes. In a declining country the conditions of the laborer are worst, because supply and demand for labor does not arrive at a balance as in a stationary stage. In the stationary state

39. A. Smith p. 60.

40. A. Smith p. 59.

41. A. Smith p. 60.

42. A. Smith p. 61.

44. B.F. Caherwood: *Basic Theories of Distribution*, London, 1939, p. 30.

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

46. A. Smith: p. 75.

wages and profits of stock would make wages low, while in a declining state profits of stock increase because of lack of competition but wages are lowered⁴⁷ because of the lack of funds.

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

This supposition of Smith helps him to support that "The money price of labor is necessarily regulated by two circumstances: the demand of labour and the price of necessaries and convenience of life . . . and the money price of labour is determined by what is required for purchasing this quantity"⁴⁸. So if the commodities which the laborer must buy in order to live are high, it follows that the wages must be high too so that the laborer can purchase the commodities. In other words, the price of a commodity necessary to maintain the laborer is followed by wages.

These ideas of Smith concerning real wages have a relation to his discussion concerning rent of land⁴⁹. 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 factors applied on land raise the rent.

Concerning bargaining between masters and laborers Adam Smith follows his thoughts regarding the dependence effect. Masters can reduce wages while laborers are in a 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 the nondiminishing of wages, but Smith accepts that mobility of labor helps workers get better remuneration and he argues that this is possible only to a degree and under certain conditions. Anyway the tendency is the laborer to receive what he produces, while the entrepreneur combines labor and capital in a way first to be highly productive.

If the productivity of labor 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 competition⁵⁰ considered in con-

47. A Smith p. 26.

48. A Smith p. 87.

49. A Smith p. 137ff.

50. 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

dition of general equilibrium at the level of full employment⁵¹. 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 economic development they were based upon the productivity concept. Smith and his followers examined the impact of technology upon the productivity of labor and related to it 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 if 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 diminuation of its quantity"⁵²

"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"⁵³.

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The ideas advanced by Adam Smith regarding wages, formed a separate theory in the course of the evolution of economic thought⁵⁴.

Adam Smith talks of a certain level below which wages may not fall as "man

economic factor always pushing 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.

51. Here we must mention Say's law of markets or Walras' 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 is 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 it 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*, Göttenburg, 1951. L. Houmanidis: *The Value of Money from the Mercantilists till Today* (in Greek), Athens, 1965). Also J.R. Hicks in *Value and Capital*, tried to combine these two aspects of money. Samuelson writes for the Keynesian thesis in comparison with the naturalism of the 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).

52. A. Smith: p. 61

53. A. Smith, p. 78.

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

must always live by his work"; he actually refers to the theory of the minimum level of subsistence⁵⁵.

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 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 theory⁵⁶, 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 pay-

55. The minimum of subsistence was developed by the Physiocrats and especially by A.J.J. Turgot ("Letter au controleur (Abbe Terray) sur le commerce des grains" (1770) 5th letter in "Ecrits Économiques" pp. 307-309), according to whom the consumption or expenditure of the laborers 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 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. Lesters's: *Economics of Labor*, New York, 1946, p. 161. Anyway, according to the subsistence theory the satisfaction of the wants which are not indispensable to the laborer 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 Saint Thomas Aquinas (1226-1274) who for wages used the word quasi pretium and justum pretium containing in the first more than the reward of the labor contribution (St. Thomas d' Aquinas: *Sum. Theol.* P. II. 1. 29. 114 1 and ar 2 and 105 ar 2, 6). San Bernadino 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 laborer (A. Fanfani: p. 96. R. de Roover: *La Doctrine Scolastique en Matière du Monopole et son Application à la Politique Économique des Communes Italiennes*, in "Studi in Onore di Amintore Fanfani" Vol. I, p. 154). Saint Antonins (1389-1489) considers justum wages as the same justum pretium. He says: "Vel pium dui locat operas suas personales et altar eum conducit ad laborandum totum est licitum dummodo justum pretium statuatur et frahs omnis tollatur" (*Sum Theol.*, pars III 8. 2). Anyway, the subsistence theory was criticized virgorously by the Institutional School and others such as the modern writers J. Marchal, F. Menthon, J. Vibert. ISEA (L. Houmanidis: *History of Economic Theories*, p. 425ff)

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

ment of wages". So Smith is going further than Cantillon⁵⁷. 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 exploitation⁵⁸.

Thus in Smith's work we meet in embryonic form the theories that will follow in the course of the economic thought⁵⁹.

Now, turning to the significance of Adam Smith's term "fund" we can deduce 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 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.

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 remains static), the larger will be the fall in wages until they will reach the limit of the workman's minimum level of

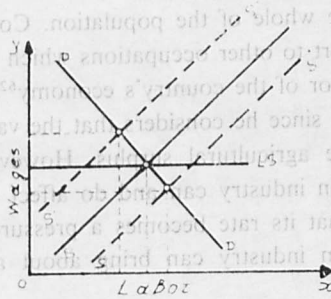
57. Richard Cantillon (1674-1744) in his "Essai sur la Nature du Commerce en général" (1730-1734) had observed first that the price of labor is determined by its supply (population) and its demand (total national income), thus he maintained the notion of the absolute rate of wages.

58. John Stuart Mill will write: "the cause of profit is that labor 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.S. 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 a commodity which produces surplus value (K. Marx: *Capital*, Moscow, Vol. I, p. 483 and *Theories of Surplus Value*, Moscow, 1969, p. 78ff). But this idea that the commodity buys more labor than it contains because of surplus value was espoused by Thomas Hodgskin (*Popular Political Economy*, 1827). Schumpeter is of the opinion that Smith was the first to touch upon the question of the workman not receiving the entire product of his labor or that he is 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. 45ff.

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

subsistence, while as the population increases wages tend to fall below the subsistence level⁶⁰.

If we have a constant demand for labor, while the population increases or decreases the wage rate would be figured as follows:



In progressive communities, however, the number of workers increases as fast 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 labor and, therefore, an increased demand for it.

covered the minimum of subsistence. When the demand for labor increases as a result of her high level of 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 Ricardo, since Smith

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 that matter of the evolutionary aspect of the economy, Smith is once again the basic theoretician among the 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

60. If the price offered for labor rose above what is necessary to maintain the supply of it, then the workers would have larger families and the supply of labor will increase. With an increased labor 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 would be restored. Thus Smith, accepts finally the iron law of wages (See also M. Dobb: *Wages*, Cambridge, ed. 1947, pp. 101-102 and M. Meier-R.E. Baldwin: *Economic Development*, New York, 1963, p. 23).

to agriculture since he believes that industry allows and achieves a more complete apportionment of labor⁶¹.

In addition, Smith observes that when technology is applied in agriculture the community will profit from it. For it 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 economy⁶². 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 those 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 the food price increase resulted in the increase of the landowners' income to the detriment of the businessman and of the workers whose wages barely covered the 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 Ricardo⁶³ since Smith accepted that, through its achievements, progressive society would be able to cope

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

62. 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.

63. Professor Fanfani says, "it is a mistake to consider Malthus and Ricardo as pessimists" . . . "In respect to 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 conception and of their confidence in the natural order, we have no hesitation in stating that Malthus and Ricardo are not only not 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 not have 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).

with the dangers arising from the population increase and the higher cost of land⁶⁴. 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 area.

The traders took these classes into serious consideration given the power of the State, but the 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 class⁶⁵, 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 price⁶⁶ 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 represents a deduction from the produce which is due to labor⁶⁷. This rent may be considered as the produce of those powers of nature, the use of which the landlord lends to the farmer. Anyway, the products of land must be cheap in order to increase "the demand for them and consequently for the 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 at lower prices"⁶⁸.

Smith describes the income of the industrial class as the income of those who use or exploit capital⁶⁹. Increase of capital in a country of advancing wealth brings

64. Besides Smith did not give any consideration to the law of 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 Memoire de Saint-Peravy* (1768) (Turgot: *Ecrits Économiques*, p. 209).

65. Professor 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 is 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).

66. A. Smith: p. 145. Smith's views on land revenue were also adopted by Say, his popularizer Say considers land as 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*, 325ff and p. 365).

67. S. Hollander: *The Economics of Adam Smith*, University of Toronto Press, 1973, p. 149.

68. S. Hollander, p. 159.

69. A. Smith, Vol. i. p. 54.

higher wages and tends to reduce profits⁷⁰. 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 it⁷¹. "It is not — Smith says — 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 the highest"⁷².

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 progress⁷³. According to him, the total of self-interests means, in the final analysis, a gain for the economy which creates the terms and conditions for 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 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, defense, public works, control of the monetary system and of currency circulation; he also believed in the necessity import and export taxation as sources of income for the State and for economic progress⁷⁴. It is precisely in order to insure

70. A. Smith p. 89.

71. A. Smith, Vol. I, 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 extraordinary losses and another 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 the entrepreneur and the second the one who lends the stock to another (A. Smith, Vol. I, p. 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 an 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, pp. 130, 133).

72. A. Smith, Vol. I, pp 61-62.

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

74. A. Smith, pp. 101-102, 350ff. J.N. Letiche, op cit, p. 70, and Lionel Robbins: *The Theory of Economic Policy*, London, 1972.

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 trade⁷⁵.

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.

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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 the minimum for 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 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 employment⁷⁶. 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, the lower do wages drop, often reaching minimum subsistence levels.

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

75. A. Smith, p. 603.

76. A. Smith, *Wealth of Nations*, p. 939.

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 for present subsistence⁷⁷. 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 wages⁷⁸. The increase of this fund depends upon or is an increasing function of national wealth, which affects wages through an increase of revenue or stock⁷⁹. Here we have an identity of the wages fund and of the maintenance fund⁸⁰ although this identity cannot be a true one according to Smith's theory of wages. Anyway, Smith conceived it as a fund of material goods or "the real quantity of the necessaries and conveniences of life"⁸¹.

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 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 former⁸². The dependence effect in the above cases exists but cannot disturb the social equilibrium, because the economic equilibrium thanks to the invisible hand of the natural laws affects the former. Anyway, the cost of dependence is diminishing in progressive countries and is increasing in stationary or under developed 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 Con- stated*, 1832)⁸³ conceived the dependence effect from the relations of 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"⁸⁴. Smith's views on

77. A. Smith Vol. I. p. 60.

78. A. Smith p. 70 and B.F. Catherwood, p. 34.

79. A. Smith p. 71 and Catherwood: *ibid.*

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

81. A. Smith Vol. I. p. 79.

82. B.S. Catherwood: p. 35.

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

84. W.J. Baumol: *Economic Dynamics*, New York, 1951, p. 6ff. It is understood that the classics'

labor wages influenced other classic writers, among them John Stuart Mill, who represented both the rise and the decline of the School⁸⁵ 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 labor and that of the markets for a favorable attack on the problem in the industrial society governed by liberty.

So Adam Smith examined economies from two aspects:⁸⁶

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.

Smith's theory concerning value was extended to money. Since the value of the commodities, as we saw, determines their cost of production, for Smith the value of money is determined in accordance with the contained amount of precious metal in the monetary units, whose value-cost of production must necessarily be equal to the cost of production of the commodity, the value of which it expresses.

Consequently, the value of the monetary unit must be equivalent to the value of the commercial unit. Because of this, Smith accepted that the value of the aggregate volume of money which the country has need of, must have a corresponding value in the quantity of commodities. Thus, Adam Smith maintained that in free exchange the quantity of money is determined according to the level of prices, so that for a certain quantity of commodities there circulates a certain quantity of money. As for the additional money, that will always go out of the country due to free trade, always restoring the equilibrium. Adam Smith left out the element of the circulation velocity of money and considered the quantity of circulating money as a passive factor,

dynamics is extra-structural and a dynamics of the facts and mechanisms but not of the structures or of the economic regime. (A. Piettre: *Pensée Économique et Théories Contemporaines*, Paris, 1965, p. 77).

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

86. L. Houtmanidis: *History of Economic Theories*, Piraeus-Athens, p. 132. L. Stoleru: *L'Équilibre et la Croissance Économique, Principes de Macroeconomie en Finance et Économie Appliquée*, Vol. 26, Paris, 1969, p. 396.

depending on the cost of production.

But the differentiation which arose between the industrial and the agricultural countries due to free trade as well as the concentration of business which obliterated the small producers and the monopoly of labor at the beginning of the 19th century also showed the trends opposed to economic liberalism: the criticism of the anarchists, socialists and the followers of protectionism.

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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 interesting parts of his book which is the first anatomy of the Industrial economy and society.

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 by the naturalist Locke⁸⁷ 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 with an impact on wages. For this reason Smith confronted the problem of the distribution in a "politico-economic or ethical discussion, particularly in the regulation of prices"⁸⁸.

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 only⁸⁹ while rich people, the masters "have the possibility to live without work having their stock already acquired"⁹⁰. The masters being fewer in number can combine more easily; and the law besides authorizes, or at least does not prohibit, their combinations, while it prohibits these of the workmen. We have no acts of Parliament against combining to lower the price of work; but man against combining to raise it"⁹¹.

With these ideas Smith explains capitalist social structure with humanitarians view preparing the soil of course for the Manchesterians and other liberalists in

87. C. Vaughan; *John Locke and the Morality of the Market Price* in "International Congress and Economic History of Economic Theories in Piraeus", 1975, pp 74ff.

88. M. Bowley; *Studies in the History of Economic Theory before 1870*, London, 1973, p. 130.

89. A. Smith; *Wealth of Nations*, Vol. I, p. 110

90, 91. A Smith p. 59.

general, but also for social radicalism.

Smith is the Aristotle of Economics and caused misunderstanding, as the same happened with the Scholastics who studied the Great Greek Philosopher⁹². His followers, optimists and 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.

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Introduction

One of the more interesting questions for inflation theorists is whether the aggregate rate of change of prices depends on market structure. The debate has a long history. Means (1932) first coined the term 'administered prices' during the Great Depression. Administered prices were defined as prices "set by administrative action and held constant for a period of time," whereas market prices were said to be "market prices" which are the result of the interaction of buyers and sellers. Though there are difficulties in identifying administered prices, since the line between setting a price through "administered action" as opposed to the interaction of buyers and sellers is unclear, the phenomenon of administered prices has become associated with the firm having some degree of market power. The most useful empirical tests of the hypothesis have involved looking at the relationship between concentration (the measure of market power) and price change, for a sample of industries when allowance has been made for unit cost or demand change. (See e.g. Cagan (1972), Dalton (1973), Luskatten (1974), Philips (1971) and Weiss (1966)).

The empirical tests have been employed for a number of countries (with the notable exception of the UK which has received little attention) and are broadly favourable to the hypothesis that a significant characteristic of inflationary movements is that price increases in relation to costs tend to vary according to the degree of industry concentration.

Price change is in part a function of unit cost change so as well as the direct influence a second manner by which market structure can influence the rate of inflation is via unit cost. In particular it has been suggested that monopolistic firms pay higher wages than competitive firms (see e.g. Garbarrino (1950), Galbraith (1957) and

92. M. Bernard: *Introduction à une Sociologie des Doctrines Économiques des Physiocrates à Stuart Mill*, Paris, 1963.

93. See also the book of Sir John Hicks, *The Theory of Wages* (1932) and the interesting books after the Second World War by 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).