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THE CONCEPT OF ABSTRACT LABOUR IN ADAM SMITH'S SYSTEM OF THOUGHT.

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The Concept of Abstract Labour in Adam Smith's System of Thought[+]

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Abstract

The starting point of this paper is Kenneth Arrow's recognition that Adam Smith did not suppose the phenomenon of division of labour to derive from innate individual differences among people (an idea that underpins neoclassical economics); Smith, on the contrary (as indeed dictated by his purpose of elucidating the process of growth) envisaged labour as essentially homogeneous or 'abstract' (Marx's term). The paper goes on to argue that Smith, rather than attributing productivity gains from specialisation to the exploitation of differing individual capabilities, understands such gains to result from economies of scale as growing markets permit increasing degrees of specialisation, thus yielding lower unit costs in production. Furthermore, Smith recognises that to maintain the 'natural balance' of industries in a growing economy – which is essential to ensure the continuance of growth - two things are necessary: (1) that the price mechanism, working through the profit motive, guides the allocation of resources, and (2) that productive resources are fully flexible – adaptable to the changing requirements of an evolving industrial economy, or, in other words, that resources (essentially labour) are potentially homogeneous or abstract. Finally, this discussion leads on to an unconventional reading of Smith's famous statement about the 'invisible hand', interpreting the virtue of the invisible hand not in the usual subjectivist terms of consumer satisfaction, but in terms of its making possible a process of on-going growth by ensuring the maintenance of the proper ('natural') balance of industries.

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1. ***Introduction***

Commenting on the special role that the division of labour plays in the *Wealth of Nations*, Kenneth Arrow observes that Adam Smith's idea that people benefit by specialising in particular tasks or trades and exchanging their services or goods with each other 'has been the basis of the most significant strand in the development of economics in the ensuing two hundred years.' In this context he refers to Ricardo's theory of comparative advantage according to which countries with different natural endowments benefit from trade by specialising in doing what they do best. 'The Ricardo viewpoint', he observes, 'extended from foreign trade to the domestic market, has been predominant in subsequent economic theory [founded by Alfred Marshal, Leon Walras and Stanley Jevons]. *Like differences in natural resources, the differences in individual talents are the basis of [specialisation] and trade.'* Arrow also notes that this view departs from Smith's formulation in which *'people are very much alike, but they have chosen to specialise in different ways because they can do better to be a specialist.'* (Arrow 1979:154-55, italics added) In other words, Smith rejects the notion that the utilisation of comparative advantages of different individuals is the basis of division of labour in society. Specialisation rests on something other than intrinsic differences between individuals. Arrow does not follow up on this observation; nor does he say anything on the place that this idea has in Smith's system of thought. This observation of Arrow's provides the starting point of the present discussion. It will be argued that the conception of labour as 'abstract' labour, that is, as a productive resource which is characterised not by the possession of particular abilities and skills but as flexible and adaptable as circumstances may require, occupies a fundamental place in Smith's thinking. Given the objective that he had set for his work he could not have gone the other way.

2. ***The philosopher and the common street porter***

It will be useful for our purpose to see how Smith is led to making the observation regarding the similarity of ability and talents among different people. After having, in the first chapter of his book (Smith 1976), identified the kind of economy that is the subject of his analysis – one that is characterised by a fairly advanced degree of division of labour – and division of labour as the principle cause of the wealth of nations, Adam Smith, in the following chapter, raises the question of the 'principle which gives occasion' to this phenomenon. In every civilised society (he tells us) man stands at all times in need of the cooperation and assistance of his fellowmen. This creates conditions for the emergence of exchange, a pre-condition for division of labour to come into existence. Since exchange takes place only when people are producing different things, he raises the question as to why one person chooses to specialise in one particular product and another in some thing else. Is it because of their different intrinsic abilities and comparative advantage in the production of different things? The manner in which Smith proceeds to deal with this question is interesting. He writes (Smith 1976, Book I. Chapter ii: 27-28):

> In a tribe of hunters or shepherds a particular person makes bows and arrows, for example, with more readiness and dexterity than any other. He frequently exchanges them for cattle or venison with his companions, and he finds at last that he can in this manner get more cattle and venison, than if he himself went to the field to catch them. From a regard to his own interest, therefore, the making of bows and arrows grows to be his chief business, and he becomes a sort of armourer. Another excels in making the frames and covers of their little huts or moveable houses…..

And so on. In this way different people come to 'dedicate' themselves to particular activities and we have the emergence of a community of specialist producers.

Smith, presumably tracing the historical origins of specialisation, seems to be leaning towards the comparative advantage view, a view whose provenance can be traced back to Plato.[1] It was expressed by a contemporary of Smith in the clearest possible terms: 'Men are endued with various talents and propensities, which naturally dispose and fit them for different occupations; and are… under a necessity of betaking themselves to particular arts and employments, from their inability of otherwise acquiring all the necessaries they want, with ease and comfort. This creates a dependence of one man upon another, and naturally unites men into societies.'[2]

Having apparently gone in this direction, Smith immediately distances himself from this viewpoint and comes down firmly, though in his characteristic cautious manner, on the opposite side. He writes (Smith 1976, I. ii: 28-29):

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

He goes on in this vein and concludes that in the absence of division of labour 'All must have had the same duties to perform, and the same work to do, and there could have been no such difference of employment as could alone give occasion to any great difference of talents' (Smith 1976, I. ii: 29). This view is reinforced later in Book V where, discussing the deleterious effects of the division of labour (within the plant), he tells his readers that the 'understandings' of men 'are necessarily formed' by the kind of work they perform. (V. i.: 781-82). Thus, abilities, skills and 'understandings' are acquired through education, training and experience; they are not the result of natural endowments.

[1] Plato (1953: 212): '… we are not all alike; there are diversities of natures among us which are adapted to different occupations.' Again (on the same page): 'We must infer that all things are produced more plentifully and easily and of a better quality when one man does one thing which is natural to him...').
[2] Smith 1976: I. ii: 28. (Editors' footnote quoting J. Harris, author of *An Essay upon Money and Coins*, London, 1757).

There can be little doubt that Smith actually subscribed to the doctrine of the 'natural equality of all men' (and, presumably, women) generally held by his Enlightenment contemporaries.[3] But to follow Smith's general line of thinking, and, indeed even to accept it, we do not need to adopt the view that all human beings are, as it were, born with a 'clean slate', nor should we allow ourselves to be sidetracked into the nature-versus-nurture debate. The position adopted in this paper may be summed up as follows. Smith does not require for his analysis as strong an assumption as the one he is making here. Without departing from the essentials of Smith's argument in the *Wealth of Nations* we may allow that, although individuals may have different potentials, these differences are such that they can be neglected for the purpose of discussing the problem in hand. The problem of course is to understand the nature and causes of the growth of an economy in which the phenomenon of the social division of labour has come firmly to be established. In the context of a dynamic, evolving system it is appropriate to suppose that labour skills and abilities are not given and unchanging, but that they are acquired in response to the changing needs of the economy. Thus, to follow Smith we can do without the 'clean slate' assumption. All that is needed is to view the economy as one in which labour is seen as a resource that is reproducible (Ricardo) or conceptualised in abstract terms (Marx)[4] - one that is to say in which the character of the labour supply will naturally adjust to the needs of the time. It is not denied that for the investigation of a different kind of problem in a different theoretical framework it may be quite appropriate to assume that 'men are endued with various talents that dispose and fit them for different occupations'.

3. *Rationale of division of labour*

Smith's adoption of the standpoint noted above raises an important question. What is the rationale of division of labour if we reject the principle of innate comparative advantages? That is, what does Smith put in place of the ' innate differences' principle?

We may start to answer this question by considering the famous example of the deer and beaver hunters (I. vi). This is the situation – 'that early and rude state of society which precedes both the accumulation of stock and the appropriation of land' – in which (according to Smith) the labour-quantity principle is the only rule that can provide the basis of exchange. If it costs twice the labour to kill a beaver which it does to kill a deer, one beaver should 'naturally' exchange for two deer. (p.65) Note that it is 'natural' that the two should exchange in this ratio only because Smith is assuming that labour is potentially homogeneous or is seen in abstract terms. That is, if they exchange on the basis of the labour quantity principle the concrete forms in which their labour appears must be neglected. If that were not the case – if hunters' skills were inborn rather than acquired – there would be no basis for the labour-quantity principle to be applicable. So the question is: given that hunters do not have any

[3] Thus, for instance, David Hume (1963: 454): 'When we consider how nearly equal all men are in their bodily force, and even in their mental powers and faculties, till cultivated by education, we must necessarily allow, that nothing but their consent could at first associate them together, and subject them to any authority.' For a brief review of the views on this issue of some earlier thinkers, see Prendergast (1995).

[4] Ricardo (1951, chapter I); Marx (1976, chapter 1, section 2).

innate comparative advantage in any activity, why do they specialise in particular fields instead of satisfying their needs by undertaking both types of hunting?

Smith does not answer this question in the present context (discussion of the theory of value, I. vi). This is because he has already dealt with it in the chapter 'Of the Division of Labour' (I. i.). In this chapter, using a pin factory he had visited as an example, he shows how dividing a particular process of production into its various components and assigning a particular task to a single worker improves labour productivity. He contrasts this way of doing things with a situation in which only one person attempts to perform all the distinct sequential operations by himself. In the first case, where the process has been divided up into eighteen distinct sub-processes and where the operation at each sub-process is performed by distinct hands the output per person is some thing like 5,000 pins a day. 'But if they had all wrought separately and independently, and without any of them having been educated to this particular business, they could not each of them made twenty, perhaps not one pin a day….' (I. i:15)

The reasoning behind this way of thinking has been neatly summarised by Arrow. Commenting on the first two reasons given by Smith for increase in labour productivity as a result of division of labour (repetition of a given task improves the worker's dexterity and skill, and the saving of time that results when the worker concentrates on one task instead of moving from one sub-process to another), he writes (1979:154-55):

> When specialising, the individual is learning only what is necessary to accomplish a task and can, so to speak, *spread the overhead of learning over a much longer run*. A professional, such as a physician, is rather an extreme exemplification of this. A physician essentially serves you with knowledge about diseases… It would be possible for a person who was willing to spend five years or more at the task to acquire this knowledge. But obviously no individual can justify five years of learning devoted solely to the prospect of self-medication. It is socially worthwhile for some individuals to specialise in health care when that education can be used to handle many thousands of cases (emphasis added).

Herein lies the rationale for the specialisation found in the tribe of beaver and deer hunters. Assuming that beaver and deer hunters have similar innate abilities with respect to hunting, it is socially desirable for one to concentrate his efforts on learning one hunting skill and for the other to invest time and effort in the acquisition of the other skill. Both will be more productive as a result, as compared with a situation where they chose to undertake both types of hunting. But specialisation is profitable only if 'the overheads of learning can be spread over a longer run. That is, only if there are economies of scale in production. If that were not the case (and people had similar innate abilities) there would be no reason for specialisation. We would have to turn to the comparative advantage principle to explain the observed division of labour in society.

This point of view is so fundamental to the Smithian system (in which the division of labour is the principal, if not the only, factor in the increase in the wealth of nations) that we must pursue this it further. And for this we first turn to Smith's discussion of division of labour within the enterprise

We may ask, why the technique (with its eighteen sub-processes) that is used to produce nearly 5,000 pins a day cannot be used to produce, with the *same degree of efficiency*, at, say, the scale of 1,000 pins a day? The answer is, because Smith's illustration assumes that production is characterised by economies of scale. When production is organised on a large scale (in response to increase in the size of the market) it is possible to find a technique of production that is more efficient than the one that is more appropriate for a smaller scale. And the larger investment associated with it can only be profitable when production is organised on a large scale. (In the absence of economies of large-scale production the same technique would be replicated both at small and larger scales of production and there would be no advantage in increasing the division of labour, and Smith's entire argument would fail.) The importance of the size of the market, which in Smith's theory of development occupies a central place, lies in the fact that it permits more detailed division of labour and realisation of economies of large-scale production.

Although division of labour at the level of the shop floor is an essential element of the mechanism of growth, the process of development cannot be understood exclusively in terms of this factor. To get a more complete picture we have to turn to social division of labour or industrial specialisation. As in so many other cases, Smith explains an important idea by using a simple illustration (i. iii: 31). In 'so desert a country as the Highlands of Scotland' population is scattered in small, isolated hamlets. Here 'every farmer must be his own butcher, baker and brewer for his own family'. Markets are too small to support specialised businesses of butchers, bakers and brewers. But let us now imagine that with general development (say, as a result of improvements in communications) taking place around the region there is enlargement of markets for meat, bread and beer. In Smith's story this region will now begin to experience social division of labour. There will emerge specialist producers of meat, bread and beer. The reason for the emergence of specialisation has to do with larger markets and the possibilities they create for the adoption of techniques with greater division of labour and higher productivity – techniques that call for larger investment and that are profitable only when employed at large scales of production. That is the reason why the production of bread in one large bakery, say, for hundred families, is cheaper as compared with production at the level of the household. The same, of course, applies to other products. Eventually, with continuing economic expansion, households will give up domestic production of these items, and purchase them, through the market, from specialist producers. Farmer households will now be able to specialise in farming.

To see more clearly the phenomenon envisaged here, let us extend Smith's illustration a little further. Suppose that at an early stage of the development of this economy there are multi-product workshops producing wooden products such as cartwheels, agricultural implements, cabinets, and so on. Markets are yet too small to support specialist producers of these items. But as the market for, say, cartwheels increases there comes a point where the making of cartwheels *splits off* from general woodworking and comes to be undertaken by a specialist producer.

The reasoning behind this process of industrial differentiation has already been suggested. The specialist producer makes cartwheels at a larger scale than does the general woodworking shop (though, of course, the overall size of the latter may be larger than the former.) Because cartwheel production is on a larger scale the specialised producer can use more detailed division of labour *and* the specialist equipment that goes with this level of specialisation as compared with the multi-product enterprise that must use general-purpose tools.[5] The specialist producer is more efficient because total costs associated with the increased division of labour and the specialist equipment can be spread over a larger volume of output. Eventually, with the expansion of markets and through the actions of profit-motivated businesses cartwheel production becomes a distinct trade (and with further expansion of the market it will become further differentiated). The same argument applies to the making of agricultural implements, cabinets and other trades.

The discussion of these issues leads directly into Smith's theory of economic development. (See, for instance, Young 1928.)[6] But it is not necessary, in the present context, to go further into that. I think we have achieved the objective set for this section: to identify the rationale for division of labour following upon Smith's rejection of the comparative advantage principle. It lies in the phenomenon of economies of large- scale production. To summarise: increased specialisation results in greater efficiency, but requires higher initial investment; a larger market is necessary if this scale-related efficiency is to be exploited. Smith's statement about innate similarities between people's abilities is not a mere rhetorical flourish of an Enlightenment man. The idea that industrial specialisation does not derive from any inherent differences among people and that the skill composition of society evolves with the process of development is an essential aspect of Smith's thinking on the subject.

4. *The natural balance of industry and the law of gravitation*

After having laid the groundwork for his theory of economic progress in the first three chapters of *The Wealth of Nations*, Smith turns to the theory of value. This raises an interesting question. Why, one may ask, someone whose principal concern is with the increase in the wealth of nations *over time* should not only be interested in the theory

[5] See Marx (1976, chapter 14) on the development of specialisation of tools as an aspect of the division of labour.

[6] In order to emphasise the role of social division of labour (and, what he calls, 'more roundabout methods of production') in the process of development, Young (1928: 531), quite wrongly, in our view, underplays the importance of economies of large- scale production. As argued in the present discussion, the latter phenomenon is central to Smith's view of social division of labour, and not merely 'an incident in the general process by which increasing returns are secured …'

of value, but should give it an important place in his system of thought?[7] Let us first try to answer this question.

Social division of labour, according to Smith, pre-supposes exchange or the existence of some kind of a market. It therefore becomes important to understand how the market functions and the role it plays in the economy. In an earlier chapter (I. i: 22-23) Smith had indicated the context of his present discussion. There he asked his readers to consider the nature of social division of labour in the kind of economy that was the subject of his analysis. He asked them to imagine the making of a simple product as the coat of an ordinary labourer. Smith's illustration shows that through direct and indirect industrial linkages, practically all the branches of the economy contribute to the manufacture of this item. More generally, Smith is visualising an economy in which every branch of production depends, directly or indirectly, on others for its inputs and therefore its operations. All industries are bound together in a network of quantitative relationships. There is a 'natural connection of all trades'.

Now, we know that economic development is associated with increase in the social division of labour. In a dynamic economy trades differentiate, they multiply in numbers, new industries emerge, old ones decline or disappear, capital accumulates and is distributed unequally across different industries. In other words, there is constant change in the structure of industry or constant disturbance of the 'natural connection of trades'. But progress requires that there must be forces or a mechanism that restores the 'natural connection of all trades'. If that were not the case there would be overproduction of some commodities and underproduction of others. Such imbalances, if they remained uncorrected, would result in the system breaking down. In Smith's way of thinking it is the purpose of the theory of value to suggest the presence of tendencies that help correct the imbalances that inevitably arise in the course of economic progress.

Thus, the theory of value or, what comes to the same thing, the theory of natural balance (stationary analysis), and the theory of development (dynamic analysis) do not, in Smith's system, stand in opposition to each other. Study of the progress of division of labour leads Smith naturally toward a realisation of the need to discover a balancing or correcting mechanism that would tend constantly to restore the balance of the changing economy. It is thus perfectly understandable that after having considered the nature and progress of division of labour that Smith should turn to the theory of value which in his system of thought deals with the nature of such a mechanism.

Let us now see what this mechanism is and how it works.

We begin with the definition of natural price, the central concept in the system of natural balance Smith suggests in Book I, chapter vii. Natural price is that at which

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[7]. Kaldor (1972: 1240-41) in his powerful critique of neoclassical theory, argues that 'economic theory went astray' when the 'theory of value took over the centre stage'. And this happened when Adam Smith, after having presented a brilliant account of the process of division of labour, was sidetracked into value (equilibrium) theory. I hope the present discussion will be seen as an effective rebuttal of Kaldor's contention. (Kaldor recognises the central importance of increasing returns in Smith's theory of development, but believes that Smith's theory of value is based on the assumption of constant returns to scale.)

capital obtains the ‘natural’ rate of profit, labour receives the ‘natural’ rate of wages, and the same type of land the ‘natural’ rent. This definition and the approach to the theory of value it implies raises a number issues that have been the subject of much criticism.[8] These issues do not concern us here since the problem discussed here relates to the nature of equilibrium and the adjustment process Smith has in mind. And in these respects Smith’s approach here, though open to certain objections, is no different from that in the so-called one-factor model of deer and beaver hunters. In both cases the problem is the same, namely, the maintenance of the balance of the system. In both cases, costs are conceptualised in objective terms and the balance of the system requires that there is a tendency toward equalisation of payments to those engaged in production. This will become clearer as we proceed.

The natural price is distinguished from the market price. The market price is one at which the commodity is *actually* sold, given the ‘effectual’ demand of those who are prepared to pay the natural price. We note that the natural price is defined in a way that we know it before the commodity is brought to the market. It therefore rules out any notion of subjective factors entering its determination. By contrast, the market price (as we will see presently) is determined by the current demand for the product without reference to costs. While in the first case it is the costs that are the governing factor, in the latter it is entirely the subjective factor.

When producers actually receive natural prices, that is, when natural prices coincide with market prices, (when the profit rate everywhere is at its natural level) they are satisfied with their production plans. They are selling at the ‘right’ prices – prices at which their long-term costs are recovered and they obtain the natural or ‘ordinary’ rate of profit.[9] In this situation business decisions are mutually consistent and the quantitative relations between industries are being ‘reproduced’, that is, business operations at the current level can be repeated during the next year. This is Smith’s ‘natural balance of industry’ (economy), a situation in which the ’natural connection of all trades’ is being maintained. As there is no incentive for producers to shift their resources from one branch of production to another, Smith refers to this situation (where the natural rate of profit prevails in all branches of production) as one of ‘repose and continuance’. Having thus established the condition for the natural balance to prevail, he goes further and claims that the actual economy is ‘constantly tending’ toward this state. ‘The natural price, therefore, is, at it were, the central price to which prices of all commodities are continually gravitating (I. vii: 75).

Let us now consider the law of gravitation Smith has in mind.

To direct our attention to the essence of Smith’s argument (I. vii) we consider the case of only two commodities, say, ‘A’ and ‘B’, and ignore the influence that changes in the output of these commodities may have on other parts of the economy. We start from a position where the system is in its natural balance, and imagine that it is disturbed by, say, a shift of demand from commodity ‘B’ to commodity ‘A’. In the Smithian ‘short run’ the quantity of commodity ‘A’ placed on the market is given – a situation that arises from the fact that resources employed in the industry with all their

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[8] See, for instance, Sraffa (195: section IV) for Ricardo’s objections to Smith’s ‘adding up’ theory of value.

[9] To focus on the essentials of Smith’s argument we will ignore rent which in any case receives less than satisfactory treatment in his discussion (I. xi).

technical characteristics and physical form are fixed in their present uses, and resources employed in the production of commodity ‘B’ (for which demand has fallen) cannot be transferred so as to increase the production of ‘A’. Thus, with the quantity of product ‘A’ placed on the market being fixed and with an increase in the demand for it, buyers are unable to obtain this commodity in the quantities they want at its natural price. Competitive bidding on the part of buyers raises the market price above the natural price to the point where the market is cleared at the market price. Profits of producers of ‘A’ rise above the normal rate (as those of the producers of ‘B’ sink below it). Note that the link with costs of production is broken, the new market price, as indicated, is determined entirely by the eagerness of buyers. We may also say that the commodity ‘A’ (and resources employed in its production) has become relatively more scarce. This scarcity arises from the fact that while these resources are fixed in their concrete, physical form (and in the short run resources from the production of ‘B’ cannot be transferred to the production of ‘A’) demand for their services has increased. The new market price reflects this scarcity.

The same analysis applies to the market for commodity ‘B’. Briefly, here competition of sellers pushes the market price below the natural price, the lower market price reflecting the fact the commodity (and the resources used in its production) has become less scarce. And this because resources used here are fixed in their concrete form and the demand for their services has declined. The producers of commodity ‘B’ are obtaining less than normal profits, possibly suffering losses.

This situation may be one of ‘equilibrium of supply and demand’ (the markets are cleared), but for Smith it is neither one of ‘repose’ nor of ‘continuance’. The situation is inherently unstable. And this instability arises from the fact that profits rates in the two industries are unequal. Businesses producing the commodity ‘B’ will want to shift some of their resources into the production of commodity ‘A’ where the profits are supernormal. The natural balance can only be restored when the profits in both the industries are equal. So the question arises: what are the conditions that will equalise the profit rate in the two industries and thus restore the balance of the system?

First, and this is obvious, there must be competition in the sense that there are no institutional barriers to the movement of resources between the two industries. That is, in our illustration, producers of commodity ‘B’ should be able to move some of their resources into the industry producing commodity ‘A’. But mobility of resources - in the simple sense, that particular resources with given characteristics can move from one application to another – is not a sufficient condition to restore Smith’s natural balance. Whether or not the natural balance of the system will be established depends further on the assumption we make about the nature of the resources that will move from one industry to the other. If, for instance, we conceptualise resources, as they move from one industry to the other, such that they retain their concrete, physical form the natural balance of the system will not be restored. It would still essentially be the Smithian ‘short run’, though in a modified form. Prices would still reflect relative scarcities of resources and profit rates will not be equalised. For the Smithian balance to be restored the resources must be assumed to be able to change their physical form so that when they move from the production of ‘B’ to the production of ‘A’ they replicate the characteristics of the resources in the latter. That is, they must lose the characteristic – their concreteness - that makes them more or less scarce. Only then will the market price coincide with the natural price. Thus, to revert to the illustration of the deer and beaver hunters: beaver hunters when they move into deer hunting must become deer hunters (just like the existing deer hunters) and their simple tools can be re-fashioned for deer hunting (just like those of deer hunters), and vice versa. Only then will there be tendency for the equalisation of earnings and the restoration of the Smithian natural balance. The law of gravitation requires competition in this precise sense: labour and resources in general (except those like Ricardo's 'land of peculiar quality' and 'rare statutes') are conceptualised as potentially homogeneous or abstract (Ricardo 1951: 12).

To conclude: It has been suggested that Smith's approach the theory of value is dictated by his broader objective, to inquire into the nature and causes of the wealth of nations over time. In an economy undergoing change accumulating capital is distributed in different branches of production in different proportions, old industries die or decline and are replaced new branches of production, existing resources, e.g. labour skills and equipment are replaced by new ones. This means that a growing economy is characterised by persistent imbalances. Smith's theory of value suggests a mechanism that ensures that such imbalances are corrected. It has been argued in this section that the concept of abstract labour in its general form that includes all producible resources, as a tendency, has a central place in the balancing mechanism devised by Smith.

5. *The 'general interest' of society*

We see how the market works and how the pursuit of profit motive results, as a tendency, in the economy maintaining its balance. But Smith goes further and claims that individuals, while pursuing their gain, also promote the 'general interest' of society.[10] Our aim in the present section is to consider this claim. We will see that our preceding discussion suggests a reading of Smith's observation regarding the general interest that is different from the usual story. It will be argued that Smith's famous remark about the 'invisible hand' must be read in the context of his balancing mechanism, the operation of which depends on the existence of competitive markets and abstract labour.

It is widely believed that Smith's statement concerning the correspondence between the pursuit of self-interest and the general interest of society has provided a source of inspiration for the fundamental propositions of modern (neoclassical) economic theory.[11] It may therefore to be useful, for the purpose of our exposition, to consider

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[10] It is noteworthy that this statement is made in Book IV in the context of Smith's argument that public restraints and regulation may divert capital into channels into which it will not flow naturally and that this would result in distorting the natural balance of industry. It reads: 'As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestick industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the publick interest, nor knows how much he is promoting it. By preferring the support of domestick to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases led by an invisible hand to promote an end which was no part of his intention.' (IV. ii: 456; see also p. 453)

[11] Kaldor (fn.7 above) sees a continuous line of theoretical development from Smith through Ricardo, Walras, Marshall 'right up to Debreu and the most sophisticated of present-day Americans.' And, in the same vein, Samuelson (1992: 5) writes: 'Given their respective dates we might better compliment Walras for his Smith-like approach to general equilibrium.'

Smith's viewpoint with reference to the core standpoint of this theory. In this theory the focus is on the 'final' consumer. It is the individuals or households who own society's resources. They have certain psychological preferences in relation to the goods they wish to consume. Businesses borrow or buy from households these resources and transform them into consumer goods – goods that households want. The outcome of the market process in which firms borrow or purchase resources from households and then sell them the consumer goods they desire is considered as socially optimal. In this situation, every individual in society, given his wealth and tastes, is maximising his utility; and one person's wellbeing can only be increased at the cost of some one else's. This is the ideal of social efficiency that the market achieves, the best possible allocation of resources. Given the initial distribution of resources among households, this outcome is conflict free and (some would go further and say) morally just. When political commentators talk of people's 'freedom of choice' and the 'consumer's sovereignty', this is the argument from which they are drawing their inspiration.

Now the point to which we wish to direct attention is that this approach lies completely outside Smith's way of thinking about how the capitalist economy works (and, indeed, how it should work). Smith is no proponent of the 'sovereignty of the consumer'. The concept of consumer preferences as it appears in the modern theory, and, in general, a subjectivist approach to understanding the market economy, has no place in his schema. Smith disdains all luxury consumption. In fact, he disapproves of all 'unproductive' consumption – consumption that does not contribute to the generation of investible surplus. He calls the 'prodigal' (the person who chooses to spend his inheritance on 'unproductive' consumption) a 'public enemy' (II. iii: 340). By exercising their 'freedom of choice' the prodigal and other 'profligates' (generally, members of the landed nobility) who are given to a life of luxury detract from capital accumulation.[12] From the Smithian perspective, they are engaged in an anti-social activity. To Smith, it is only an expanding economy, fuelled by capital accumulation, that represents a socially desirable state of affairs – a point that will be taken up presently. It is therefore not surprising that Smith's statement regarding the individual pursuit of self-interest promoting the 'general interest' of society appears not during his discussion of the theory of value (I. vii)) where the modern economist expects it to be,[13] but in the dynamic analysis of Book IV.

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[12] It is worth pointing out that when considering productive/unproductive consumption, Smith draws a sharp distinction between expenditure on durable and non-durable goods. (II. iii. 346-47). The former is lesser of the two evils. While the food consumed at the dinner table of the 'profligate' nobleman perishes in the moment of its consumption, the dinning table has the potential of being used for productive purposes – it could one day be used as a desk for the bookkeepers of a pin factory. Rostow's following comment, in our view, represents the conventional view (1992:40) : 'Smith, in passages such as these, which apparently reject the ultimate legitimacy of consumer's sovereignty, is writing as a moralist at least as much as a market analyst.' In the interpretation suggested here, Smith's distinction tells us that he saw consumption only from the perspective of capital accumulation.

[13] For instance, Maurice Allais attributes the placing of this remark to faulty exposition. He writes: '…Smith's exposition is not without its faults, some of them major… The most important questions are in general dealt with incidentally and in connection with altogether subordinate questions. The best and perhaps most striking example of this is Smith's famous aphorism about the 'invisible hand', which is lost in a very lateral comment of chapter 2 of Book IV.' M. Allais (1992:.32) It is noteworthy that Smith's statement about the pursuit of private self-interest leading to the promotion of the general interest of society appears not once but twice, and on both occasions in Book IV, chapter 2.

What are then Smith's reasons for the claim that the pursuit of self-interest in a system of natural liberty (competitive market) promotes the general interest of society? In the interpretation suggested here, first, Smith argues that the pursuit of individual interest in a framework of competition promotes economic growth, and second, he equates, in a rather pragmatic way, economic growth with the general interest of society, the latter being equated with general prosperity ('universal opulence'). We take these points up in turn.

It is a fundamental postulate of Smith's that human beings 'naturally' seek to improve their material condition. He therefore expects that people will use their own resources more wisely than if they were entrusted with other people's capital. This is one of Smith's arguments against entrusting investment decisions to public servants. He applies the same reasoning to servants of large private corporations in which ownership and management are separated. (Some of Smith's strongest castigations are directed at the servants of the East India Company. See, for instance, IV. vii: 638-40.) In the same vein, Smith argues that individuals in their 'local situation' are better informed about what the market requires, and therefore, generally, the private individual producer is likely to make better informed investment decisions from his private viewpoint than would public servants. The latter are inevitably remote from particular 'local situations' and cannot be in possession of all the needed information that is diffused throughout the economy (IV. ii: 456).

But human beings are made of crooked material. They love to reap where they have not sown, and, when possible, they will subvert the system to promote their self-interest. Thus, there must be a social mechanism, a system of incentives, rewards and penalties that would ensure that only initiative, hard work and efficiency are rewarded and that slackness and inefficiency are penalised. The competitive market provides such a mechanism. Thus, individual initiative under conditions of competition, protected by institutions that guarantee security of person and property, is likely to produce better results with respect to efficiency and growth of the national product than state regulation and publicly owned enterprises.[14]

The competitive market also ensures that resources that are invested from motives of private profitability are invested productively from the social perspective. The important supposition here is that, generally (though not necessarily in every case), profit rate higher than the normal rate indicates a higher, and profit rate lower than the normal rate a lower social priority for investment in that particular branch of production. Thus, when profit-motivated businesses respond to market signals by undertaking new investments in the former and withdrawing capital from the latter they are performing a socially useful purpose.

The idea underlying this standpoint has already been indicated. At any given stage of development, we have 'the natural balance of industry'- a situation that shows that society's capital stock is distributed in the economy in a way that it reproduces itself. But economic development and technical improvements constantly disturb this balance. There is, therefore, constant need to redistribute the existing and newly

[14] Note this is not a *theoretical* case against state intervention in economic activity. Governments are not all the same, some are more 'profligate' than others, just as servants of some are more accountable and socially conscious than others. And of course there are many socially desirable activities that only the state can perform. On the important place of institutions in Smith's thought, see Rosenberg (1960).

accumulating capital between different sectors. It needs to be withdrawn from some and placed in others.

Now Smith's argument is that it is only under competitive market conditions that the actions of profit-motivated individuals help restore the economic balance. For instance, Smith's strong attack on monopolistic privileges and state intervention is based on the view that they 'derange' the distribution of capital in the economy. The existence of monopoly means that too little capital goes into those industries that are protected from competition and too much into those that are unsheltered; and government servants, even with the best of intentions, will misallocate resources for lack of information. And that such distortions are inimical to economic progress (IV. ii: 453). The conclusion is that the social rationale of the competitive market lies first, in the fact that it provides a framework of incentives and penalties thus promoting efficiency and second, that it provides signals for the correct distribution of capital in different branches of production; and that both these considerations help ensure continuing increase in the wealth of the nation.

We turn now to our second point. We have seen that the pursuit of self-interest leads to increasing national wealth. But on what grounds can we equate increase in national wealth with the 'general interest' of society? Indeed, what do we mean by the 'general interest' of society?

In Smith's way of thinking the 'general interest' of society is understood entirely in terms of 'universal opulence' or the general prosperity of the population. And the index of general prosperity is the wage rate, per capita income of 'by far the greater part of population'. For instance: 'The liberal reward of labour, therefore, as it is the necessary effect, so it is the natural symptom of increasing national wealth.' (I. viii:.91) And (I. viii. 95):

> 'Servants, labourers, and workmen of different kinds, make up the far greater part of every great political society. But what improves the circumstances of the greater part can never be regarded as an inconveniency to the whole. No society can surely be flourishing and happy, of which the greater part of the members are poor and miserable.

Further, it is not great national wealth, but its sustained increase over time that generates general prosperity and rising incomes of the working people. The justification for the system of natural liberty is thus to be found in the *increasing* national wealth. To quote Smith again (IV. viii: .99):

> It deserves to be remarked, perhaps, that it is in the progressive state, while the society is advancing to the further acquisition, rather than when it has acquired the full complement of riches, that the condition of the labouring poor, of the great body of the people, seems to be the happiest and the most comfortable. It is hard in the stationary, and miserable in the declining state. The progressive state is in reality the cheerful and hearty state to all the different orders of society. The stationary is dull; the declining, melancholy.'

Here Smith's reasoning seems to be as follows: If capital accumulation and development slow down (even at a high level of development) demand for labour will begin to slacken. But the supply of labour (an anticipation of the Malthusian 'law' of population) will continue to increase as long as the wage rate is above the subsistence level[15]. Eventually, with continuing slow-down in the rate of accumulation, the supply of labour will catch up with the demand for labour at the subsistence wage. When this situation materialises, we have the stationary state when 'things are at a stand' and when the 'labouring poor' receive no more than their 'scanty maintenance' (I. viii: 91). But when capital is accumulating and national wealth is increasing, demand for labour keeps ahead of supply. In these conditions, competition among employers for labour breaks down their combinations to keep wages down and the bargaining position of labour is strengthened. Thus, a buoyant market for labour ensures that wages – per capita income of the bulk of the population – keeps rising. Private initiative and competitive markets are to be preferred to state regulation and monopolistic privilege even in a stagnating economy, but if that was all that the principle of perfect liberty produced, that would give no cause for celebration.

It will have been noted that the question of the long run behaviour of wages leads us toward Smith's theory of income of distribution – a theory which has been subjected to much criticism.[16] But the argument of this section does not depend on the adequacy of Smith's theory of income distribution. The point that we have tried to make is that in Smith's scheme of thought the proposition regarding the pursuit of private self-interest resulting in the promotion of the general interest of society is entirely free of any subjective considerations (which dominate the approach of the modern theory); and this proposition makes sense only in the context of his principal concern - the increase over time of the wealth of the nation which he equates with the general interest of society. This is of course the same concern that necessitated the assumption of abstract labour.

6. *Conclusion*

We have argued that the assumption of abstract labour by Smith is dictated by his choice of the kind of economy he is studying – a capitalist economy characterised by a fairly advanced degree of social division of labour – and the nature of the problem he is investigating – causes of increase in the wealth of nations. It was natural for him to conceptualise labour (and resources in general) as potentially homogeneous, rather than as one with fixed technical characteristics. And this because he saw the

[15] The subsistence wage in Smith is made up of two components. First, labour is an input as, for instance, farm animals are. In any viable economy, it has to be fed to reproduce itself. It is thus a requirement of the model that there is a limit below which the wage cannot fall without making the economic system unviable. The other component is socially determined. Labour is unlike farm animals: it is part of society, and by far the greater part of it. The subsistence wage must be such that it is 'consistent with common humanity' (I. viii: 86). The size of this component is a product of economic, political and social development. It thus changes over time: with economic growth it rises over time, but it can also fall if economic conditions deteriorate. It is not possible to go into any detail on this aspect of Smith's thinking, but two points may be noted. The notion that a crucial economic variable is influenced by political, cultural and social factors is quite fundamental to his standpoint on the determination of the natural rate of wages. But, at the same time, Smith's argument can also been seen as pointing in the opposite direction – toward the determination of wages by the forces of supply and demand. On this see Dobb (1973, 1975).

[16] For instance, Dobb (1973). For a discussion of Dobb's critique of Smith, see Bharadwaj (1978).

development process in terms of advancing social division of labour, creation of new industries, and skills and other resources to suit the requirements of the time. The alternative assumption of concrete labour would have left no room for the principle of objective historical change, a principle on which Smith's mind was focused. This interpretation of Smith's thinking has suggested a new reading of the famous statement about the role of the invisible hand that is free from any subjective considerations.

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