Labour and Capital

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In its most fundamental, constructive parts devoted to descriptive theory, the *Wealth of Nations* is first and foremost an account of the causes of economic growth and development, notably, in Books I and II. The remaining Books III to V provide, respectively, a critical account of the actual economic development of Europe, contrasted with the ‘natural’ course of development; a critique of mercantilism (‘the mercantile system’), with also a chapter in Book IV on Physiocracy; and a lengthy account of public finance and the economic role of the State. The ‘wealth’ referred to in the title of the book denotes, not a stock of assets of some kind, as in typical modern usage, but rather, the flow of annual national product. Smith’s theory of economic development gives primary place, at least as the proximate determinants of development, to labour and capital. Labour productivity growth and capital accumulation are the immediate causes of development, and one may almost say, in that order of importance, except that the contributions of these two factors are not separable and additive (Aspromourgos, 2009: 192). It is a striking fact that the quite detailed, summary ‘Introduction and Plan of the Work’ which prefaces Smith’s book, a little over a thousand words in length, does not once refer to markets or prices. Economic growth and development – in particular, rising output per capita and consumption per capita – are the object, with respect to which, markets, prices and exchange are only the means. What follows examines successively the key dimensions of Smith’s treatment of labour and capital, and the relations between the two, both in WN and other writings: division of labour, the concept of capital, capital accumulation and economic development, productive versus unproductive labour, the theory of real wages and of profit rates, and economic policy in relation to labour and capital. There are some concluding reflections on Smith’s legacy in relation to these matters.

DIVISION OF LABOUR

Aside from the ‘invisible hand’, Smith’s doctrine concerning division of labour and ‘extent of the market’, presented in the opening chapters of WN, is perhaps that for which he is best known (WN, I.i–iii/13–36). It is also to be found fully worked out in writings from the 1760s. There are two elements to the argument. Labour productivity or output per worker increases with increasing labour specialization or ‘division of labour’, due to improved labour dexterity, time-saving and innovations in machinery. Secondly, increasing labour specialization in the production of a commodity is enabled by an expanding market or demand for the commodity. While extent of the market
enables division of labour, Smith understands it to arise out of a uniquely human natural ‘propensity to truck, barter, and exchange’, which in turn derives from ‘the faculties of reason and speech’, themselves derivative from ‘the desire of persuading’; but this latter subject, he implies, belongs to another science. Smith also argues that at least much of the different abilities of different individuals and groups within the socio-economic division of labour are the effect of division of labour, rather than being the result of natural differences among human beings.¹

In striking contrast to the opening chapters of WN, where division of labour appears as an entirely beneficial element in the dynamics of economic development, hundreds of pages later a very different picture is painted. There we are told that labour specialization degrades the intellect and sensibilities of the labourer. In ‘the progress of the division of labour’ the employment of the great bulk of the population ‘comes to be confined to a few very simple operations’. As a result, they become ‘as stupid and ignorant as it is possible for a human creature to become’; incapable of ‘rational conversation’ or of conceiving ‘any generous, noble, or tender sentiment’; the worker’s ‘dexterity’ is ‘at the expense of his intellectual, social, and martial virtues’ (WN, V.i.f.50/781–2). It would be overly cynical to suppose that these broader human ill consequences of division of labour have been relegated to consideration so late in the book in order to minimize their significance. The problem is stated in vigorous terms; and it arises in Book V on public finance because Smith regards public education as at least a partial solution to the problem. On the contrary, its presence in WN, at all, is evidence of Smith’s not being an ideologue for liberal capitalism: he is not prepared to suppress this undesirable consequence of economic development. There has been much discussion of this issue in the secondary literature, with some even seeing in it a precursor of Karl Marx’s concept of labour alienation, or at least as telling against the notion of liberal capitalism as an unqualified good for Smith. There is truth in the latter point, though his proposed educational remedy indicates that the problem is not perceived by Smith as so deeply intractable.²

In another line of interpretation on the division of labour issue, it has been suggested that in fact Smith imputed too much importance to labour specialization in economic development, at the expense of missing the significance of ‘mechanization’ (Campbell and Skinner, 1976: 43, 48–9; Rashid 1998: 21–3, 27). Perhaps there is some truth in this; and it is certainly true that new divisions of labour are rather more salient in Smith’s commentaries on technical progress than new machinery. But it is also the case that in WN the two phenomena are rather frequently coupled together. Nor should this surprise: in processes of technical change, changing forms of labour specialization and new organizations of work almost inevitably entail new forms of non-labour means of production, and similarly, new machines entail new forms of labour. They are two sides of the same coin. Furthermore, innovations in machinery are explicitly one of the three causal mechanisms by way of which Smith rationalizes how division of labour increases labour productivity. This points to a certain analytical connection between the labour degradation issue and the role of new machines in relation to new divisions of labour. In the dynamics of technical change as Smith understands them higher productivity comes from simplification of processes, both labour activity and machines. Here is the
connection with labour degradation: increasing labour specialization raises labour productivity precisely by simplifying labour activity; and it is this simplification of labour activity, making it more machine-like, which is at the root of labour degradation. Hence Smith comments that ‘improved dexterity of a workman may be considered in the same light as a machine or instrument of trade which facilitates and abridges labour’ (WN, II.i.17/282).

There is one further dimension of division of labour worth noting, for its own sake, but also because it casts some light on how we should understand Smith’s body of writings as a whole. As well, it says something ironic about the man himself. The doctrine of greater labour productivity from increased specialization is applied by Smith, not only to commodity production in the usual sense, but also to science:

Philosophy or speculation, in the progress of society, naturally becomes, like every other employment, the sole occupation of a particular class of citizens. Like every other trade it is subdivided into many different branches, and we have mechanical, chymical, astronomical, physical, metaphysical, moral, political, commercial, and critical philosophers. In philosophy as in every other business this subdivision of employment improves dexterity and saves time. Each individual is more expert at his particular branch. More work is done upon the whole and the quantity of science is considerably increased by it. (ED, 20/570; also ED, 30/574, WN, I.i.9/21–2, LJA, vi.43/347, LJB, 218/492)

A good deal of the interest in the whole corpus of Smith’s writings in recent decades, particularly since the publication of the Glasgow Edition of his works and correspondence, has concerned the connections between the various parts of his œuvre, particularly TMS and WN. These connections are certainly important for more fully understanding his thought. But they should not imply a rejection of the fact that, for Smith, political economy has integrity as a distinct and separable (though not thereby autonomous) science. His endorsing division of labour among the sciences points to that. Secondly, Smith had projected for himself, partly publicly, partly privately, a much larger and grander intellectual programme than, in the end, he was able to complete, as time ran out for him (TMS, 2/3, VII.iv.37/342, CORR, 168, 286–7, 310–11). This ‘failure’ may be read as a consequence of Smith’s violating his own principle concerning intellectual productiveness and the division of labour among the sciences. He refused to acquiesce in intellectual specialization himself.

THE CONCEPT OF CAPITAL

The division of labour analysis in the opening chapters of WN, Book I abstracts from one decisive aspect of the associated dynamics, which is only clarified in Book II, on ‘the Nature, Accumulation, and Employment of Stock’. Division of labour presupposes accumulation of ‘capital’ or at least ‘stock’, and advances in division of labour presuppose increasing accumulation. The two terms are not for Smith synonyms. A stock of commodities or other produced means of production only becomes capital when it is employed in production to generate for its owner, revenue, value added or
profit, a conception further clarified by his notion of productive labour. Capital is then divided into ‘fixed’ versus ‘circulating’ capital. The former is defined as capital that generates revenue ‘without changing masters, or circulating’: machinery, ‘instruments of trade’, capital embodied in land improvement, industrial and commercial buildings, ‘labouring cattle’ and similarly employed livestock, seed-corn, and ‘the acquired and useful abilities of all the inhabitants or members of the society’. Circulating capital essentially embraces all those capital goods that are used up in production processes, embodied in the resulting commodities intended for sale: material inputs (intermediate goods in modern language), wages (but strictly speaking, only of ‘productive’ labour), inventories, and also, strangely, the aggregate quantity of money used in the circulation of commodities. That seed-corn appears as fixed capital in this conceptualization exposes some inadequacy in Smith’s definitions here. In latter-day terms, the pertinent distinction between fixed and circulating capital is that the former is not entirely used up in the (say, annual) production cycle, but remains still a usable input for future cycles. The distinction thereby is ultimately relative to the length of the production period specified for analysis.4

Smith’s proposition concerning stock or capital as a prerequisite for division of labour rests upon three, perhaps four, grounds. Labour specialization means that labourers do not produce their own subsistence in the course of their work; they must therefore secure prior acquisition of the means to sustain themselves during labour, via exchange of some kind. Secondly, to the extent that the labouring classes are understood to live at or in the neighbourhood of mere ‘subsistence’ (an issue taken up further below), to ‘live from hand to mouth’ as the saying goes, they lack the means to accumulate a prior stock of consumption goods (e.g., WN, I.viii.7/83). Hence wages become, not merely a prior accumulated ‘stock’, but part of the capital that must be advanced by employers, and so, become outlays upon which profits must be earned, in line with the profit rates earned on any other capital advances. Hence labour, or at least wages, and capital are not mutually exclusive categories in Smith’s political economy. Wages, at least of ‘productive’ labour, are an element of capital – and recall also that labour skills are explicitly treated as a component of society’s fixed capital. Thirdly, in a predominantly agricultural social economy, as Britain was in 1776, subsistence, itself predominantly agricultural in content, must be provided to agricultural labourers (as well as others) from accumulated stocks, across the cycle of seasons and of good and bad years – even during periods in which there is no, or abnormally low, current output (Kurz, 2006: 7). Finally, the process of increasing labour specialization is understood by Smith to be generally accompanied by rising nonwage capital per worker:

The quantity of materials which the same number of people can work up, increases in a great proportion as labour comes to be more and more subdivided; and as the operations of each workman are gradually reduced to a greater degree of simplicity, a variety of new machines come to be invented for facilitating and abridging those operations. As the division of labour advances, therefore, in order to give constant employment to an equal number of workmen, an equal stock of provisions, and a greater stock of materials and tools than what would have been necessary in a ruder state of things, must be accumulated beforehand. (WN, II.3/277)
The treatment of wages as part of capital raises the question of the relation between the demarcation of the three fundamental economic functions in Smith’s treatment of production – labour, capital and land provision – and the class character of the social economy he theorizes. It is tempting to read into WN a simple and straightforward correspondence between the two, in the sense that workers only own and supply labour, so that wages are their sole source of income; ‘masters’ (‘capitalists’ is a term of the nineteenth century) only advance capital, so that profits are their only income; and landowners only earn rents from land. In fact, while an oversimplification, this is a reasonable first approximation of Smith’s world as he sees it, and such an interpretation does not, in the main, lead to grave error. However Smith has a somewhat more nuanced view than that. Those who advance capital in production may also themselves be providing necessary labour input to the same enterprise, so that their consumption is to some extent an element of capital as self-investment (WN, I.viii.9/83, I.viii.20/86, II.v.8–9/362, II.v.16/365). The ‘inferior’ classes who predominantly live by wages include some who derive also profits from ‘small capitals’ (‘small shopkeepers, tradesmen, and retailers’), those profits making a ‘very considerable’ part of the national product; and ‘a considerable part’ of ‘those who are somewhat below the middling rank’, even ‘a small part’ of ‘the lowest rank’, own some land that earns rent (WN, V.ii.k.43/887; cf. WN, II.iii.7/333). But Smith also elsewhere observes that instances of the self-employed worker who provides his or her own capital ‘are not very frequent’, amounting to less than five percent of the European workforce (WN, I.viii.10/83); ‘the greater part of the labouring poor in all countries’ derive income from their ‘labour only’ (WN, II.i.1/279).

**CAPITAL ACCUMULATION AND ECONOMIC DEVELOPMENT**

Economic growth, as expansion of the ‘annual produce’ or national product, presupposes expansion of the capital stock. At minimum, this is due to output growth being understood as generally accompanied by expansion of aggregate employment and hence rising wage capital, but also because Smith expects growth to be commonly accompanied as well by rising nonwage capital per worker. However, it is ‘division of labour’ that delivers the crucial benefit of rising output per worker. The division of labour dynamics that Smith highlights in the opening chapters of WN are not about one-off improvements in production methods and labour productivity. They are an ongoing process of more or less continuous technical progress (Aspromourgos, 2010: 1172; Kurz, 2010: 1187–93). It is this conception of division of labour, via the consequent ongoing labour productivity growth, that makes it the fundamental, proximate cause of growth in Smith’s theory, at least, in commercial society, when enabled by capital accumulation. At the same time, it is recognized that some natural resource scarcities likely will become more binding in the course of economic growth; but Smith is ultimately a moderate technology optimist. As indicated above, the division of labour dynamics are accompanied by innovations in machinery as well as in the forms of labour specialization, though what Smith means by ‘machines’ is commonly more rudimentary than our latter-day sense of the term. Those dynamics also involve innovation in consumer goods.
All this innovation and qualitative change points as well to a role for entrepreneurship, though Smith has been much accused, somewhat unfairly, of underestimating its significance (Pesciarelli, 1989; Fontaine, 1993; Aspromourgos, 2012). Enabled by capital accumulation, technical progress embodied in new forms of labour organization and of (nonwage) capital goods is the proximate cause of growth and economic development. But division of labour and capital accumulation in turn are derived from three, but really ultimately two, deeper causes: fundamental characteristics of human nature that, for the purposes of Smith’s political economy, are largely treated as data or psychological parameters, though they are susceptible of further investigation and explanation by other sciences, and indeed, are further examined in other parts of Smith’s corpus. The derivation of division of labour from a natural propensity to exchange, in turn arising out of speech and the desire to persuade, was noted above. Second, there is of course ‘self-interest’ or ‘self-love’ (Smith uses both terms). But as a characterization of human motivation, ‘self-interest’ as such is a rather empty formalism; the substantive question is, what is the self interested in? It is ‘the desire of bettering our condition’ which gives substantive content to self-interest, at least in the economic dimension of human life. Moreover, Smith seems to think that self-regard as such largely will flow into this benign, indeed socially beneficial, channel, at least in well-ordered commercial society (WN, II.i.31/343), though he is by no means oblivious to antisocial channels (e.g., LJA, iii.130/192). The pursuit of material self-betterment is at work in division of labour as well; whatever the significance of the propensity to exchange, Smith makes evident that expectation of material improvement motivates specialization (WN, I.i.4/15). It is the most fundamental force in economic behaviour, giving rise to competition, which drives the tendency of market prices to gravitate towards natural prices in Smith’s treatment of distribution and value. It is also the stimulus to innovation, which is induced as well by competition itself, at least in commercial societies with high rates of growth and capital accumulation; and it is the motivation to saving or capital accumulation, hence also understood to be non-myopic, and governed by prudence and self-command.

This vision of economic growth and development in liberal commercial society captures the purpose of political economy as a policy science, and at the same time, the legitimate economic purpose of government, as Smith understands them. If the natural propensities to accumulate and exchange can be relied upon, in a well-ordered social economy, to generate competition, high rates of accumulation, and innovation, then the result will be ‘universal opulence’, understood as high and rising consumption per capita, widely distributed across the members of such societies. Smith expects liberal capitalism to deliver high and rising real wages across the board, and greatly favours this outcome. This is an important instance of the core idea expressed in his famous (or infamous) ‘invisible hand’ metaphor, in the sense that widely distributed rising consumption per capita is a socially beneficial but unintended consequence of these dynamics. And it is a vital consequence for Smith’s values and for his economic theory. For even if commercial society might produce greater or increasing inequality, as Smith acknowledges – greater than in other forms of social economy or in pre-commercial society – this ‘trickle-down’ effect might ensure that the worst remunerated members
of commercial society are materially better off than the best off members of societies without division of labour. If this theoretical characterization of how commercial society or liberal capitalism will evolve is sound, it perhaps provides a kind of legitimation of the system. Smith’s line of argument here presupposes that sophisticated division of labour and its benefits are inseparable from liberal capitalism. Smith’s treatment of economic growth, at the level of purely descriptive theory, is exposed to one fundamental difficulty in particular. Labour productivity growth and the rate of capital accumulation together determine the growth of production capacity. But there is nothing in the theory to guarantee that the resulting capacity growth will meet with a sufficient growth of aggregate demand to validate it (Aspromourgos, 2009: 173–8, 192–6). On the one hand, he sidesteps the issue, by treating a decision to save as one and the same thing as a decision to invest, so that supply of savings and demand for capital goods are identified; on the other, he asserts that saving and investment being undertaken by different persons, in any case, results in the same outcome (WN, II.iii.14–19/337–8). But for a decentralized economy, resolving the balancing of aggregate demand and aggregate supply – or equivalently, the balancing of planned aggregate investment and planned aggregate saving (Aspromourgos, 2009: 330–31, n. 83) – requires a theory of the coordination of the investment and saving decisions of a multitude of different individuals. On the other hand, in contrast to the supply-side, saving-is-investment-spending doctrine, in other parts of Smith’s theory, demand-side determination of activity levels seems to be suggested (notably, ‘extent of the market’ as the autonomous element in the division of labour dynamics).

In truth, there is not to be found anywhere in Smith’s texts a theory of the growth of aggregate ‘effectual demand’ (WN, I.vii.8/73), parallel with his theory of the growth of production capacity. To that extent, one may construe Smith’s growth theory as an account merely of potential growth: a growth of capacity that would only be realized if, somehow or other, validated by a corresponding growth of aggregate demand. This coordination issue has only really been faced squarely and addressed in the twentieth century, particularly in the context of controversies around John Maynard Keynes’s critique of the post-classical marginalist or ‘neoclassical’ supply-side theory, the rising new orthodoxy in the course of that century. Eltis (1975; reproduced revised in Eltis, 1984: 68–105) remains the best formal model of Smith’s growth theory, incorporating growth of labour productivity and real wages, as well as the possibility of a stationary end-state to the growth dynamics. However, the problem of aggregate demand sufficiency is very lightly passed over by him (Eltis, 1975: 432; cf. Waterman, 2001: 28–9, 39–40).

**PRODUCTIVE VERSUS UNPRODUCTIVE LABOUR**

Of all the major elements of Smith’s political economy, the concept of productive versus unproductive labour is perhaps the most alien to latter-day marginalist economics. This is, in fact, a reason why it should be paid particular attention: it is in the aspects of Smith’s system most alien to latter-day frameworks of economic analysis that one is likely see particularly clearly the difference between his approach and latter-day modes
of thought. Nevertheless, it is true that there is some inconsistency between Smith’s various formulations of the dichotomy. On the one hand, it is a distinction between labour that produces physical commodities and labour that produces services that ‘perish in the very instant of their performance’, while at the same time, it is conceived of in terms of labour that produces value added versus labour that does not, as if these two distinctions are equivalent (WN, II.iii.1/330). Elsewhere, the dichotomy is expressed in terms of labour that maintains and augments society’s capital stock versus labour devoted to other purposes, notably, luxury (or above-necessary, or ‘surplus’) consumption (WN, II.iii.13–17/337). It is the latter distinction which best captures Smith’s intention with respect to the dichotomy. It amounts to characterizing productive labour as that part of the workforce which contributes to accumulation of capital and hence, economic growth. This is not equivalent to the distinction between physical commodity production and services, since Smith himself allows that there are services which are productive or capital-producing (WN, II.v.1–10/360–63), not least, education, to the extent that it contributes to the acquisition of labour skills which are explicitly treated as part of society’s capital stock (Aspromourgos, 2009: 164–73).

It is a striking fact that capital theory is almost entirely absent from Smith’s lectures on jurisprudence, though ‘stock’ plays some role (Aspromourgos, 2009: 164). This, contrasted with the centrality of capital theory to WN, and combined with the fact of Smith’s time spent in Paris between the lectures and the writing of WN (Ross, 1995: 195–219), points to a crucial intellectual debt to François Quesnay and Anne Robert Jacques Turgot. Capital is absolutely fundamental to the theory of WN, books I and II, both the treatment of functional income distribution and commodity prices, and of output and productivity growth. In both dimensions, the allocation and accumulation of capital are central to the dynamics of competition. The concepts of fixed versus circulating capital, and the dichotomy between productive and unproductive economic activities, also derive from Quesnay and the French Physiocratic school, though Smith develops them further. At one point, he was intending to dedicate WN to Quesnay (Stewart, 1811: 304). But Smith overcomes the Physiocratic error, that agriculture is productive and manufacture, as such, unproductive (WN, IV.ix/663–88), only to replace it with a further error, that agriculture and manufacture are productive but the services sector of the economy, as such, unproductive.

Hence productive labour is labour employed with capital goods – the wages or consumption of those labourers, together with the other produced means of production that they utilize – to produce further and more capital goods, echoing Quesnay’s circular conception of production, in which wealth produces wealth. The ratio of productive to unproductive labour then is an expression or correlate of the propensity to save or accumulate, at the aggregate, societal level – an expression of the proportion of a society’s revenue allocated to capital accumulation, as against ‘unproductive’ consumption. Subject to some analytical qualification, the former ratio, as much as the latter proportion, can be treated as one of the two fundamental determinants of growth, along with labour productivity (Aspromourgos, 2009: 21, 40, 175–8, 182). Thereby, Smith can articulate the core of his growth theory in a formula employing the productive labour concept:
The annual produce of the land and labour of any nation can be increased in its value by no other means, but by increasing either the number of its productive labourers, or the productive powers of those labourers who had before been employed. The number of its productive labourers, it is evident, can never be much increased, but in consequence of an increase of capital, or of the funds destined for maintaining them. The productive powers of the same number of labourers cannot be increased, but in consequence either of some addition and improvement to those machines and instruments which facilitate and abridge labour; or of a more proper division and distribution of employment. (WN, II.iii.32/343; cf. WN, 6/11, IV.ix.36/677)

If there is a particular tangible image of unproductive labour which features in Smith’s commentaries, a supposed archetypal example of the species, it is ‘menial servants’. But his most detailed listing of who are the unproductive in society includes a great variety of activities which do not produce capital goods, with government employment prominent (WN, II.iii.2/330–31); and he elsewhere comments that ‘the revenue of the sovereign ... seldom maintains any but unproductive labourers’ (emphasis added). Note that this leaves open the possibility of government activities including productive employment in Smith’s strict sense of the term. And indeed, to the extent that government expenditures or outlays could finance education, a policy Smith endorses (WN, V.i.f/758–88), and education enables acquisition of labour skills that are part of a society’s capital, as Smith also allows, then that public spending must be allowed, on Smith’s own terms, to be productive. It is also important to recognize that a category of activity being unproductive does not necessarily entail Smith denying that it is useful, desirable, or even necessary, in some larger or wider sense. Officers in public employment in legal administration and the military are unproductive ‘how useful, or how necessary soever’ their services (WN, II.iii.2/331; emphasis added). Maximizing accumulation and growth requires minimizing unproductive labour. But some activities, while not contributing directly to production of capital, are indispensable to the functioning of the social economy, most obviously, those elements of the apparatus of State requisite for guaranteeing property rights and contracts, which include external defence. Smith, the historian and theorist of property rights in the lectures on jurisprudence, of course understood that: ‘Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in possession of their property, in which the faith of contracts is not supported by law’ (WN, V.iii.7/910).  

Furthermore, even beyond such necessary socio-political or legal infrastructure, Smith is not vehemently opposed to all above-subsistence consumption (which can strictly be regarded as unproductive on his terms). While a necessities-versus-luxuries dichotomy constitutes satisfactory mutually exclusive and collectively exhaustive consumption categories for the purposes of much of his economic analysis, they do not suffice for all of it. There is also a category he refers to as ‘conveniences’ (e.g., WN, I.v.1/47, I.xi.c.7/181, II.ii.45/299). Smith is disparaging of the luxuries of the rich (TMS, I.ii.1.2/15–21), though not opposed to all luxury (WN, II.iii.38–42/346–9, V.i.g.15/796–
But as indicated above, he favours and expects rising consumption for the bulk of the population in commercial society. Growth is good but so is increase in the conveniences of life, as distinct from the conspicuous consumption of the rich. This favouring of above-necessary or above-subsistence consumption is a moral viewpoint. Smith never, for example, in the manner of Bernard Mandeville, argues for luxury on economic grounds, as a means to higher levels of labour employment. Smith’s saving-is-investment-spending doctrine (also discussed above), means that capital accumulation faces no potential insufficiency of aggregate demand that might undermine accumulation. Hence, no recourse to expenditure on luxuries is required in order to meet an employment objective (Aspromourgos, 2009: 176, 186–91).

Part of the reason, one may suggest, for some inconsistency in Smith’s conceptualization of the productive/unproductive distinction is that when he writes of unproductive labour, he is commonly thinking of menial servants. (For that category of labourer, the inconsistency disappears.) This points to one further dimension of the phenomenon worth noting here: a certain moral aspect to the distinction between unproductive labour – or at least the menial servants element of it – and productive labour. In a lengthy historical commentary, Smith argues that the rise of commercial society has reduced the numbers of such ‘menial servants’, ‘retainers and dependents’, replacing ‘servile dependency’ with ‘liberty and security’, and ‘more or less independent’ labourers (WN, III.iv.4–17/412–22). In the lectures on jurisprudence he observes that ‘establishment of commerce and manufactures … brings about … independencey, … the best police for preventing crimes’; the dependent labourers here referred to as much led to criminality are typified by ‘menial servants’ and ‘retainers’ (LJB, 204–05/486–7; similarly, LJA, vi.3–7/332–3). And further in WN he reiterates that in ‘opulent and civilized’ societies there is very much less direct subordination of people to the rich (WN, V.i.b.7/712). This line of argument does not precisely entail the moral superiority of productive labour, since retainers could become, for example, producers of luxury consumption goods. But it points in that direction. One may wonder whether this can be reconciled with the labour degradation Smith associates with division of labour (discussed above); probably it can, via the role he proposes for education.

WAGES AND PROFITS

In seeking to explain the income returns to labour and capital Smith attempts to analogize from the pricing of commodities. His approach to theorizing the latter is framed in terms of market prices, under conditions of free competition, gravitating around and towards ‘natural prices’, with the latter determined by the quantities of labour, capital and land required in the production of commodities, together with ‘natural rates’ of wages, profits and rents that must be paid for those production inputs, once competition has taken full effect. The core notion of competition here is free mobility of capital and labour, in pursuit of the highest possible remunerations. So, in turn, wages and profits (and rents) are theorized in terms of natural rates of return toward which market rates are drawn by competition. What then determines the natural levels of these remunerations?
With regard to wages, Smith’s fundamental theoretical position is that the general level of wages is determined by the balance of bargaining power around the labour contract, a balance that he perceives as usually favouring employers:

What are the common wages of labour depends everywhere upon the contract usually made between those two parties, whose interests are by no means the same. The workmen desire to get as much, the masters to give as little as possible. ... It is not, however, difficult to foresee which of the two parties must, upon all ordinary occasions, have the advantage in the dispute, and force the other into a compliance with their terms. ... In all such disputes the masters can hold out much longer. ... In the long-run the workman may be as necessary to his master as his master is to him; but the necessity is not so immediate. (WN, I.viii.11–12/83–4)

Then, at a somewhat more concrete level of analysis he conceives of this balance of power as being shaped by the proportion between the rate of capital accumulation together with the growth of ‘revenue’ or incomes, as a proxy for the growth of labour demand, and the rate of population growth, as a proxy for the growth of labour supply. (The growth of incomes is relevant to labour demand growth, along with accumulation, because income growth can influence the demand for unproductive labour.) In a tight – that is, supply-constrained – labour market the balance may shift in favour of labour.

The point to notice here is that the balance of supply and demand is utilized to explain both the gravitation of market wages towards natural wages, and the level of natural wages themselves (Aspromourgos, 2009: 85, 97–101). In the limit, on one side, natural wages may be reduced to the level of more or less strict subsistence, but understood as determined by custom and social convention (WN, I.viii.14–15/85–6). However, particularly in competitive commercial society with high accumulation, the natural rate can settle at levels above subsistence. To this approach to the general level of wages Smith adds a theory of differential wages for the varieties of kinds of labour, by reference to five factors (putting aside the influence of policy): the relative ‘disagreeableness’ of occupations, the costs of acquiring skills or ‘human capital’ (our term), the irregularity or otherwise of employments, ‘the small or great trust’ involved in employments, and differential risk (WN, I.x.b/116–35). These wage relativities are understood to be independent of the balance of accumulation and population growth, that enters into the determination of the general level of natural wages (WN, I.vii.36/80, I.x.c.63/158–9).

It is, in fact, essential to the overall coherence of Smith’s political economy that the general level of natural wages can rise above customary subsistence. It was indicated above that his conception of ‘universal opulence’ entails that commercial society will bring about high and rising real wages. But what then precisely determines the course of natural wages? There is no simple determinate theory to explain that, and one may regard this as, in an important sense, a virtue of Smith’s approach, rather than a defect. All of the potential factors that may influence the balance of bargaining power around the labour contract (evidently, a much richer set of factors in the centuries subsequent to Smith’s era), and hence all the contingencies that might arise to shape any such factors, are relevant. This indeterminacy from the point of view of theory points to the
role of history in these outcomes. (The minimum subsistence wage, being customary, is also a creature of history.) In the end, Smith’s approach to the theory of wages is not so different from Marx’s, except that a century after Smith, the set of factors shaping bargaining power had indeed become richer and more complex.

To be sure, Smith enunciates also a proposition, derived from Cantillon (1755: 23–85), that rather mechanically treats labour as if it were akin to livestock: ‘the demand for men, like that for any other commodity, necessarily regulates the production of men; quickens it when it goes on too slowly, and stops it when it advances too fast’ (WN, I.viii.40/98). This evidently refers to a very long-run mechanism; but even this proposition cannot be understood as entirely determining the level of real wages. The general level and content of real wages can vary independently of the balance of labour demand and supply, to the extent that bargaining power can change independently of that balance. For example, ‘combinations’ of ‘workmen’ or ‘masters’ can independently influence bargaining power and hence wages, even though the workers face asymmetric legal impediments in Smith’s world, as he points out (WN, I.viii.11–13/83–5).

Furthermore, Smith’s notion of universal opulence is partly based on the diffusion of new modes of consumption via emulation (TMS, I.iii.2.1/50, WN, I.i.10/22, I.viii.35/96). This must be understood as ratcheting up over time the content of at least customary subsistence, which constrains bargaining power on one side, by raising the floor below which wages cannot fall (for any length of time). But it can also plausibly be supposed as raising the demands or aspirations of the labourers for wage levels above customary subsistence. Indeed, customary labour subsistence can only rise or improve if real wages above subsistence persist for quite some time, thereby making the new level or character of consumption habitual; and to be consistent with Smith’s market/natural wage framework, this requires that natural wages can persistently exceed subsistence (Aspromourgos, 2010: 1179–80).

All this is lost in the overly mechanical reconstructions of Smith’s wages theory, by Paul Samuelson and others who, with some variations, have followed his lead. These approaches are united in interpreting Smith’s wages theory in terms of a unique equilibrium real wage (whether or not at subsistence in some sense) fully determined by the equalization of rates of growth of labour supply and labour demand, by way of recourse to some combination or other of the following functional relations: labour supply growth a positive function of real wages, real wages a positive function of labour demand growth (or the rate of capital accumulation), and labour demand growth (or accumulation) a negative function of real wages (or a positive function of profit rates). It is not evident that Smith proposes full employment as the normal situation in commercial or other societies, except perhaps as a very long-run tendency; and even if this is so, real wages in his conception are subject to influence by a wider set of forces that enter into the balance of bargaining power around the labour contract. In fact, closer attention to Smith’s text in relation to how wages are influenced by the balance of labour demand and supply reveal that it is persistent excess labour demands and supplies that are at work in shaping the wage outcome. Even if the production-of-men doctrine can reasonably be regarded as a kind of full-employment mechanism, it involves reverse causation to that of the latter-day marginalist full-employment
mechanism, since labour supply adjusts to labour demand in Smith’s story. Though in its departures from Samuelson’s model, Waterman’s (2009) formalization certainly displays a historical sensitivity to Smith’s thought superior to that of Samuelson, it proceeds in the same kind of full-employment equilibrium growth framework. Nevertheless, in a sense Waterman’s (2009: 54–5) negative conclusion accords with our point, that Smith’s theory of real wages is not reducible to a simple labour demand-and-supply growth mechanism: ‘accumulation can no longer explain the natural wage’ once one admits evident key factors in Smith’s account of growth dynamics.12

With regard to explaining the general level of profit rates, Smith offers ‘competition of capitals’: the increase of capital, in the aggregate just as in particular industries, is supposed to place downward pressure on the general level of natural or ‘ordinary’ rates of profit, just as it does on rates in particular industries (WN, I.ix.1–7/105–07, I.ix.12–14/110–11, II.iv.8–12/352–6, IV.vii.c.19/596; on ordinary profits, e.g., WN, I.ix.14–22/111–14). Also due to competition, the ‘usual market rate of interest’ serves as an indicator of the general level of profit rates, which are not so easily observable as interest rates (WN, I.x.4/105). Parallel with the account of wage relativities, he provides a theory of competitive profit rate differentials for alternative capital investments, by reference to differential risk and ‘the agreeableness or disagreeableness’ of alternative employments of capital, with the former the more important factor (WN, I.x.b.33–52/127–35). The competition-of-capitals idea is of course entirely plausible for the process of actual profit rates tending towards the relevant natural rates, but is much less convincing in relation to the determination of the natural rates themselves. Indeed, this attempt at a theory of the general level of profit rates is rendered redundant, a generation or two after Smith, by David Ricardo (1817). He demonstrates that the level of real wages and the general rate of profit are functionally bound together in an inverse relationship, that relationship being determined by the set of production methods in use for producing the commodities of the system. (Ricardo’s demonstration is not entirely satisfactory; but his principle still stands in more general and compelling theoretical frameworks; see Kurz and Salvadori, 1995: 54–5.) In other words, once real wages are determined – let us say, by bargaining power and the factors Smith supposes as determining wage relativities for heterogeneous labour – the general level of profit rates is fully determined by technology. Given Smith’s theory of wages, he has no need of a further and additional theory to explain the general rate of profit.

Whatever the merits or defects of Smith’s theory of profits, it is a striking fact that at one point he quite vigorously argues that high profit rates, rather than being necessary or desirable for a thriving commercial society, actually discourage accumulation (WN, IV.vii.c.61–2/612–13; also I.ix.11/109–10). This points also to the wider and very large question of the significance and possible role of economic inequality in his scheme of things. Suffice it to say here that Smith’s scenario of rising real wages in commercial society is certainly compatible with greater inequality in commercial society than in pre-commercial society, and further, it is also consistent with greater inequality over time within commercial society, notably, due to real wages rising less rapidly than labour productivity (Aspromourgos, 2010: 1179). As the productivity of labour increases due to
division of labour, labour ‘produces ... a much greater quantity of work than in proportion to the superiority of its reward’ (ED, 12/567).

ECONOMIC POLICY

One could almost say that all Smith’s thought on policy, and not just ‘economic’ policy for that matter, is relevant to labour or capital or both. Here just some particularly pertinent aspects of Smith’s economic policy views may be noted. He is of course, first and foremost, an economic liberal: his fundamental policy is commercial society or liberal capitalism itself, with the rule of law, secure property rights and free competition. But although Smith is commonly perceived as a more or less thoroughgoing economic liberal who allows only the most limited role for government in economic activity, careful attention to all his commentary on policy reveals a much more moderate economic liberal, who allows considerable exceptions to the rule of no government involvement in, or regulation of, economic activity. This is not the place to give a full account of these policy views (Viner, 1927; Skinner, 1996: 183–208; Aspromourgos, 2009: 223–47). A modern economist might be tempted to suppose that these exceptions to no government intervention must be due Smith’s allowing for ‘externalities’. But while this can explain some of them, it does not account for all of them.

One striking instance of an exception to non-intervention, directly related to labour and involving nothing resembling externalities, is Smith’s endorsement of prohibitions against employers paying wages in kind: ‘the law which obliges the masters in several different trades to pay their workmen in money and not in goods, is quite just and equitable’ (WN, I.x.c.61/158). Why not leave employers and employees to contract for payment in kind, if they freely choose to do so? Smith provides no specific justification for this regulation, merely appealing to a general principle (quoted below, at the very end of this essay). But that omission is surely because the justification is obvious: it is an intervention of law limiting the terms of private contracts, in order to constrain the imbalance of bargaining power around the labour contract (cf. WN, I.vii.11–13/83–5, partly quoted earlier). Further instances of policy exceptions to non-intervention, particularly pertinent to labour and capital, include regulation of interest rates, though in a certain proximity to market-determined rates (WN, II.iv.14–16/356–8); ‘vice taxes’ (our term) aimed at regulating the consumption of ‘the inferior ranks’ (WN, V.i.k.7/872); and perhaps most surprisingly, endorsement of some modest progressive taxation measures (WN, V.i.d.5/725, V.i.e.6/842). With regard to these latter three instances, suffice it to note here that although Smith merely favours a legal maximum interest rate to be set in the neighbourhood of normal market rates, this regulation nevertheless is intended, in part, to protect ‘from themselves’, so to speak, some persons entering into debt contracts – to protect them from succumbing to ‘the extortion of usury’. Like the prohibition against wage payments in kind, it is a clear departure from the kind of strict economic liberalism which would endorse such ‘voluntary’ contracts.
Even with regard to protectionist policies he opposes in principle, Smith is inclined to favour *gradual* dismantling, because of the losses that will result to both workers and capital (WN, IV.ii.40–45/468–72, IV.vii.c.43–5/604–07). As indicated earlier, the role proposed for government in education – compulsory education, it may be noted – makes that activity at least partly ‘productive’ in Smith’s strict sense, insofar as labour skills are an element of society’s ‘capital’, as he understands it (WN, V.i.f.48–57/781–6; Skinner, 1996: 191–5). And Viner (1928: 150) points out Smith’s sanctioning of a government role in health services, which might imply that this also is ‘productive’ government activity, to the extent that it involves maintenance of the labour component of the capital stock (cf. Aspromourgos, 2009: 226). Smith also allows that government, at least in principle, is capable of successfully running commercial enterprises, postal services being the best example (WN, V.ii.a.4–5/817–18). Given that he explicitly makes wholesale and retail distribution services productive activities (WN, II.v.2–10/360–63), it would be difficult for Smith to deny that an element of postal communications is then also productive in his strict sense.

Smith’s treatment of tax policy with respect to wages and profits is noteworthy also, particularly for confirming his bargaining-power approach to the theory of wages. With regard to wages, Smith’s position that incidence of taxes on ‘luxuries’, even ‘those of the poor’, will fall on their money wages (thereby reducing real wages), rather than being passed on to others via compensating higher money wages, and perhaps higher commodity prices, confirms that real wages are understood to tend above customary subsistence. If that were not the case, all taxes on wages or on the commodities consumed by workers would have to be shifted onto others via compensating money-wage increases. With regard to profits, Smith decomposes profit rates into what may be called ‘the pure rate of return’ (our term; equivalent to the level of the relevant rate of interest) and a premium paid for the ‘risk and trouble’ of production. The latter is conceived of as a kind of necessary production cost, reflecting an essential contribution to production, so that taxes imposed upon it will be shifted via compensating higher prices. But the pure profits, like land-rents, are a taxable surplus income, in principle, though Smith raises two pragmatic objections to taxing them in practice. However convincing those objections may appear, they do not alter the fact that pure profits are understood to reflect part of a social dividend or surplus available for distribution in a variety of ways, thereby implying a spectrum of feasible functional income distributions. No particular level of the pure rate of profit is ‘necessary’ to the reproduction of the activity levels of the economic system. (Recall also Smith’s view, noted in the previous section, that high profit rates, so far from being necessary for accumulation, discourage it.) And that which is appropriable by taxation is also privately appropriable, via shifts in the balance of bargaining power that governs real wage determination. This concept of the social surplus, reflected in rent and profit incomes (as well as a part of wages) is the ultimate foundation for the bargaining-power approach to real wages, providing the degree of freedom, the space, for bargaining power to play a role. It also points back to the influence of Quesnay and Turgot, but unlike in those writers, it is unambiguously extended by Smith to account for pure profits as well as land-rents.13
This approach to income distribution is in sharp contrast to the latter-day marginalist approach. The classical concept of surplus refers to that part of the gross product of the economic system which is available for free disposal, after replacement of the necessary inputs used up in the production of that gross output, including among those inputs the customary subsistence consumption of the labour employed – or more particularly, in Smith’s case, the consumption of the productive labour employed. For Smith, the surplus is realized in the income forms of land-rents, pure profits and a part of wages, depending on the balance of bargaining power. In modern marginalist theory, the net product of the economic system in the national accounting sense is not conceived of as available for free disposal, because under competitive conditions, there are ‘necessary’ rates of return to all factors of production, including both labour and capital (at least at the margin), such as to bring forth the requisite quantities of factors to ensure the equilibrium of the economic system. Competition fully determines functional income distribution, with no scope for wider social forces to play any role. Between these two conceptions, the classical approach is to be preferred.

Those who view the classical theory (both in Smith and in others) unsympathetically, from the standpoint of the later and still dominant marginalist approach, can too easily and uncomprehendingly dismiss it, failing to understand the classical approach, because not taking it seriously enough. Boss (1990: 3–4, 9–11, 42–62) is the best example. Suffice it to comment here that Smith’s distinction between productive and unproductive labour is equivalent to a distinction between production of capital goods and all other economic activities. Putting aside the economically necessary infrastructure of government, it is thereby equivalent to the modern distinction between investment and final consumption, except that for Smith capital or investment includes the consumption of productive labour. Smith’s conceptualization is therefore no more vulnerable to Boss’s attempted critique than is that modern distinction. The commodity content of the social surplus is then given by net capital accumulation plus unproductive consumption. It may be added, however, that Smith’s concepts of ‘gross revenue’ and ‘net revenue’ somewhat complicate interpretation, since his definition of the latter does not coincide with surplus income (Aspromourgos, 2009: 150–52, 163, 196–8). It may be added, with regard to the third of Smith’s three fundamental categories of functional distribution, that his attempt at a theory of land-rents is very problematic (Ricardo, 1817: Chapter 24; Hollander, 1973: 163–79; Brewer, 1995; Kurz and Salvadori, 2009: 72–4). Both Hollander and Brewer, in somewhat different ways, are rather too inclined to interpret Smith on rents in marginalist terms. Hollander (1973) is also, more generally, the best example of interpretations of Smith’s political economy which attempt to assimilate it to the marginalist framework.

LEGACY

In the centuries subsequent to Smith’s watershed contribution to the formation of political economy, labour productivity and capital accumulation (including human capital accumulation) have become the accepted foundations of all growth theory. The key contentious issue is whether growth can be understood as a supply-driven process
(the conventional marginalist view) or a demand-led process (the Keynesian view), an issue upon which Smith is somewhat ambivalent. The dynamics of division of labour, technical progress and extent of the market were transformed by Young (1928) into a theory of cumulative causation, and then taken over by Kaldor (e.g., 1972) and placed within a Keynesian framework in which demand growth drives activity levels and productivity growth (see also Richardson, 1975; Lowe, 1975: 420–22). Smith’s optimism with respect to technical progress – human ingenuity overcoming natural resource scarcity – has been largely vindicated by the course of economic development since his time. But such optimism is being tested in the early twenty-first century by serious threats to environmental sustainability, global warming being the most salient example. His stationary state may yet be our future (see note 6 above) – unless technical progress can reconcile rising consumption per capita with sustainable depletion of renewable and nonrenewable natural resources.

In virtually all modern economic theory, the treatment of wages as part of capital, a procedure which continued in economic theory well after Smith (e.g., in Marx), has given way to treating them as a share of value added, paid post factum – a consequence of wages being commonly well above subsistence in modern, developed, mixed capitalist economies. Also, as indicated above, after Smith, the demarcation between circulating and fixed capital has been better drawn, by reference to whether or not a produced input to production is entirely used up in the production process. But neither of these developments fundamentally compromises the integrity of the classical approach to price theory, which Smith shares, and which remains a robust theoretical framework for analyzing capitalist economies (Sraffa, 1960; Kurz and Salvadori, 1995). The distinction between productive and unproductive activities was, and remains, as conceptually coherent as the distinction between capital goods and other goods and services; that is to say, completely coherent. It may be noted in this context that the proposition that most wage rates in developed economies today are above customary subsistence presupposes that ‘subsistence’ remains an empirically meaningful concept.

It is clear also that public sectors now much more include productive activities in Smith’s strict sense than they did in his time. This possibility of productive government economic activities was allowed by Smith, if somewhat inconsistently, though this of course does not mean that he would approve of all contemporary government involvement in such activities.

With regard to income distribution, one might be tempted to conclude that Smith’s prediction of generalized rising real wages under liberal capitalism, like his expectation of technical progress, has been vindicated by the course of events. (Of course, it is precisely technical progress that enables rising real wages without any necessary downward pressure on profit rates.) But the capitalism we have actually had in the nineteenth and twentieth centuries, even putting aside the relatively illiberal variants, is not exactly the capitalism favoured in the Wealth of Nations. In the actual capitalism, there has been a substantial role of labour unionism, and not unrelated, the development of a large body of labour law and associated regulation, both of which have served to shift the balance of bargaining power around the labour contract. It seems clear that Smith would not endorse the former (but nor employer ‘unions’), and
one may wonder what the course of real wages would have been in its absence. What chance ‘universal opulence’ then? As indicated in the previous section, there is at least somewhat more reason to think he might endorse the developments in labour law and regulation, in some measure. The Adam Smith who writes of ‘the production of men’ being like that of ‘any other commodity’ (WN, I.viii.40/98, quoted more fully earlier) is the same Adam Smith who also wrote, and in the same book: ‘Whenever the legislature attempts to regulate the differences between masters and their workmen, its counsellors are always the masters. When the regulation, therefore, is in favour of the workmen, it is always just and equitable’ (WN, I.x.c.61/157–8).

REFERENCES
Boss, H. (1990), Theories of Surplus and Transfer: Parasites and Producers in Economic Thought (Boston, MA: Unwin Hyman).
Hollander, S. (1973), The Economics of Adam Smith (Toronto: University of Toronto Press).


NOTES

* The author is indebted to P.D. Groenewegen, S.J. Pack and D. Winch for comment, without thereby implicating them in the final product.


3. Along with frequent references to machines in the major division-of-labour texts cited in the opening sentence of this section, and in note 1 with respect to the 1760s writings, division of labour is coupled with introduction of new machines at WN, I.viii.57/104, I.xi.1–6/260–61, II.3–4/277, II.iii.32/343, IV.ix.35/676, IV.x.41/680–81. On simplification of labour and machines, see, for example, WN, I.8/20, I.x.c.24/144, II.3/277, EPS, IV.19/66–7, LRB, 41–2/223–4 (from ‘Considerations Concerning the First Formation of Languages...’, 1761).


5. On the other hand, the supposition that in WN, wages, at least for much of the workforce, settle at ‘subsistence’ in the sense of necessary consumption, albeit understood as shaped by custom and social norms, does lead to serious interpretive error, certainly with regard to commercial society.


9. Menial servants: e.g., WN, II.iii.1/330, IV.ix.31/675, V.ii.k.43/887; government maintains unproductive labour: WN, V.ii.h.14/862, and II.iii.30/342, V.ii.k.64/898, V.iii.47/924–5; guaranteeing property rights: LJA, i.1–8/5–7, i.32–5/16, iv.7–25/202–09, LJB, 1–11/397–401, 20–27/404–07, WN, V.i.b.12/715. Skinner (1996: 165) somewhat overstates the case in suggesting that for Smith all government services are unproductive ‘by definition’. The argument of this paragraph is more fully developed in Aspromourgos (2009: 167–70, 186–7).

10. On Smith’s views concerning luxury, see Winch (1978: 132–5; 1996: 59–80). Perrotta (2004: 225–34) is also a valuable commentary on seventeenth- and eighteenth-century pro- and anti-luxury views. Even in the absence of the saving-is-spending doctrine, whether luxury consumption is the only or best solution to an underemployment problem is of course contestable.

11. Labour market tightness, bargaining power, and above-subsistence wages: WN, I.viii.16–57/86–104, I.ix.14/111, I.x.c.26/145, II.iv.8/353; and also on above-subsistence wages, the citations given in note 8 above. The balance of supply and demand here is not equivalent to the labour supply and demand functions of latter-day marginalist theory (Aspromourgos, 2009: 93–4, 100–01, 261–2).


13. Taxation of wages: WN, V.ii.i./864–7, V.ii.k.1–16/869–76; taxation of profits: WN, V.ii.f.1–7/847–9, V.ii.g.13/857–8; the ‘net product’ or ‘disposable revenue’ of Quesnay (Meek, 1962: 103–04, 112; Kuczynski and Meek, 1972: pp. 4 and 6, respectively, of the 2nd and 3rd editions of his ‘tableau économique’, reproduced there) and Turgot (1769–70 [1977]: 90–95). For a more thorough account of the issues in this paragraph, and additional pertinent citations of Smith’s texts, see Aspromourgos (2009: 196–202; also 152–60, 190–91, 263–4). Note also that with real wages above customary subsistence, it is possible for shifts in bargaining power to favour profits rather than real wages. O’Donnell’s (1990: 27–52) interpretation of Smith’s concept of surplus suffers from a too rigid identification of wages with subsistence, and insufficient appreciation of the significance of the distinction between pure profits and risk premia (also pp. 91, 101, 104–06, 110, 212).