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ADAM SMITH ON LABOR AND VALUE: CHALLENGING THE STANDARD INTERPRETATION

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ABSTRACT

This paper has two parts. In the first I critically analyze Smith's refutation of the labor theory of value in book I, chapter 6 of his "*Wealth of Nations*". My thesis is that Smith's refutation is unsound and that Ricardo and Marx rightly saw why. In the second part I discuss Blaug's critique of the Ricardo-Marx refutation of Smith. According to Blaug, Ricardo and Marx fail to understand Smith. I disagree with Blaug and hold, first, that he has not rightly understood the Ricardo-Marx refutation of Smith and, secondly, that this refutation is conclusive. Interestingly, the view that Smith's refutation of the labor theory of value is sound dominates current History of Economics which, surprisingly, does not pay much attention to the Ricardo-Marx refutation. Blaug's textbook is an exception and defends Smith from the Ricardo-Marx attack. In this paper, I want to rescue the Ricardo-Marx refutation of Smith from oblivion and explain why it is correct.

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Introduction

In his well known textbook "*Economic Theory in Retrospect*", Blaug discusses Smith's theory of value. One of his main conclusions is that Smith considered that the labor theory of value is valid only for an economy in which labor is the only productive factor. Though Smith seems to uphold the labor theory of value in book I, chapter 6, he ultimately restricts it to the "early and rude state" of society. According to Blaug, Smith rightly saw that, once capital enters the scene, labor alone cannot account for the exchange value of commodities. Thus, Smith's final position in book I chapter 6 is that the labor theory of value holds good only in economies in which labor is the only productive factor and no capital is employed. Smith rightly saw that the existence of the profit of capital implies that labor is not the only factor that determines value. The following quotation provides a precise statement of Blaug's understanding of Smith's refutation of the general validity of the labor theory of value:

> "The construction of Book I, chapter 6 shows clearly that it was meant to be a refutation of the labour-cost theory of value hinted at by some of Smith's predecessors: he shows that such a theory is valid only under the special and artificial conditions of an 'early and rude state of society'." (Blaug, 1998, 38)

According to this, Smith cannot be regarded as an early Marxian because he denied that labor could explain exchange value in a capitalist economy:

> "Smith did not try to formulate anything properly called a labour theory of value: Book I, chapter 5 presents a labour theory of subjective welfare; Book I, chapter 6 toys with a primitive theory of price determination in the special case in which labour is the only factor of production; and Book I, chapter 7 offers a cost-of-production theory of relative prices. It is perfectly true that the *Wealth of Nations* starts with the sentence: 'The annual labour of every nation is the fund which originally supplied it with…produce' but it is obvious that this is designed to emphasise the fact that wealth consists of real resources and not of money. Smith's phrase 'labour is the foundation and essence of wealth' was among the shibbolets of the time, a convenient weapon against mercantilist thinking."(Blaug, 1998, 51-2)

In short: Smith's project was not to explain value on the basis of labor. He toyed with the idea for a moment in Book I, chapter 6, perhaps as a conjecture, but gave it up as soon as he noticed the obvious fact that, in a capitalistic society, the value of commodities pays not only for the services of labor, but also for those of capital.

My contention in this paper is double. First, I hold that Smith's argument against the general validity of the labor theory of value, as it is formulated in book I, chapter 6, is unsound. Contrary to what today is the standard view, I hold that Smith failed to refute the determination of value by labor in capitalism. In my opinion, the validity of the labor theory of value in capitalism is unaffected by what Smith believes to say against it in book I, chapter 6.

I am going to argue that Smith's project in book I, chapter 6 is not to reject the labor theory of value, but exactly the contrary, namely, to explain exchange value in any economic system on the basis of labor. The problem is that Smith believes that he has found something that precludes the extension of his project to a capitalist economy, when, in my opinion, he has found nothing. My contention is that Smith failed to understand that his refutation of the determination of value by *labor* in capitalism is, actually, a refutation of the determination of value by *wages*. Indeed, since Smith, the *labor* theory of value is very often confused with the *wages* theory of value, though the two theories are fundamentally different.

Secondly, I argue that Blaug does not correctly understand the criticism that Ricardo and Marx directed against Smith's pseudo-refutation of the labor theory of value in capitalism. Ricardo and Marx do not accused Smith of not distinguishing embodied labor from commanded labor; their point is, rather, that, though Smith is right to draw this distinction in order to explain the origin of profit, he fails to apply it to the question of value. According to Ricardo and Marx, the fact that, in a capitalistic economy, the labor commanded by commodities and the labor embodied in them are not the same is irrelevant for the question as to whether labor determines value.

My impression after reading book I, chapter 6 is that Smith knows that he has refuted something, but he does not quite know what exactly is what he has refuted. This explains why, right after claiming that labor alone does not determine value under capitalism, we find Smith saying the contrary and writing that labor alone *does* determine value even in a capitalistic economy; look, for instance, at this passage, which comes right after the paragraph where Smith rejects the determination of value by labor in capitalism:

> "The real value of all the different component parts of price, it must be observed, is measured by the quantity of labour which they can, each of them, purchase or command. Labour measures the value not only of that part of price which resolves itself into labour, but of that which resolves itself into rent, and of that which resolves itself into profit." (Smith, 2003, 71)

Note: all three parts of price resolve themselves into labor, and only into labor. If Smith had ever had some confidence in his supposed refutation of the labor theory of value, he would have said not that the full price of commodities resolves itself into labor, but that it resolves itself into labor and profit or something of this sort. If labor measures the "real" value of profit, labor and rent, then it follows that labor measures the value of commodities, because the sum of labor, profit and rent is equal to the value of commodities. Other texts might be quoted. What I want to stress is that Smith ignores his own refutation of the labor theory of value; indeed, book I, chapter 6 unfolds as if he had not ever written the paragraph in which he rejects the labor theory of value!

The usual interpretation in textbook literature is that Smith's refutation of the labor theory of value in book I, chapter 6 is sound, that is, that Smith has conclusively shown that, in a capitalistic economy where the value of commodities must pay for the profit of capital in addition to the wages of labor, labor alone does not determine value. In what follows, I briefly summarize what I found in the textbooks that are available in my University's library.

In "*A History of Modern Economic Analysis*" Backhouse says that Smith did not uphold the labor theory of value. Backhouse agrees with Blaug that Smith proves that the labor theory of value has to be restricted to an economy in which there is no capital and the use of land is free (see Backhouse, 1985, 36-7). If, in addition to wages, the value of commodities must pay for profit and rent, capital and land play a role in the determination of value, and labor is not the only cause of value.

Hollander, in his erudite study "*Classical Economics*" dispatches Smith's labor theory of value in four paragraphs, which end as follows:

> "The labor theory of value, in either its pristine 'quantity' version or its more complex 'cost' version, Smith took to be a very special case. When allowance is made for interest on capital and rent on land, prices of commodities must cover not merely labor, but also rent and interest, and for this general case Smith devised the analysis of Book I, chapter 7." (Hollander, 1992, 72)

Ekelund and Hébert share likewise the standard view; they write in their textbook:

> "Many earlier writers had a labor-cost theory of value, and many later writers attributed the same theory to Smith. But his explanation is really something else. It is one thing to charge that the true *measure* of value, in real terms, is labor time, and another to avow that the *source* of value is the

necessary cost of production for each commodity. In short, Smith felt that labor theories of value were valid only for primitive societies where labor represents the main (if not the only) factor of production." (Ekelund and Hébert, 1990, 108)

In my opinion, Ekelund and Hébert are right to distinguish the problem about the measure of value from the problem about the source of value, but, as I am going to argue, this distinction plays no role in Smith's refutation of the labor theory of value in book I, chapter 6. They are also right to note that Smith felt that the labor theory of value is valid only for "primitive societies", but they suggest that Smith had a logical basis to substantiate this feeling.

Screpanti and Zamagni repeat correctly the core of Smith's argument against the labor theory of value, but they do not tell the reader whether or not it is conclusive. In my opinion, their silence and the context strongly suggest that their opinion is that it is, and, therefore, that Smith was right to hold that the presence of profit in the price of commodities rules out the determination of exchange value by labor alone (see Screpanti & Zamagni, 1997, 70).

Finally, there is the textbook by Ingrid Rima. As all the others, she takes up the question as to whether Smith upheld a labor theory of value, but, unlike all the others, it is more difficult to tell what her position is. On the one hand, she holds that Smith's theory of value is not a labor theory of value, which seems to imply that, somehow, she agrees with Smith's refutation of the labor theory of value (see, for instance, Rima, 1995, 107). On the other hand, however, she says that Smith does not restrict the labor theory of value to an early society without capital (see, for instance, Rima, 1995, 108). Summing up: Smith did not restrict the labor theory of value to a pre-capitalist society, but he did not extend it to a capitalist society either. The final conclusion is, at least, unclear.

In this paper, I aim at restating the Ricardo-Marx refutation of Smith's refutation of the labor theory of value because I think that it is correct. On its basis, I present an interpretation of Book I, chapter 6 of "*Wealth of Nations*" which is different from the standard one. I say "different" and not "new" because I am not putting forward any interpretation of Smith that can properly be labeled as "new". My thesis is that Ricardo and Marx correctly proved that Smith's refutation of the validity of the labor theory of value in capitalism is inconclusive because it is based on a confusion of "labor" and "wages". Book I, chapter 6 is so difficult to read not because Smith is toying with fundamental ideas, but because he uses "labor" and "wages" as equivalents after having said that, in capitalism, they have to be different.

According to Blaug, Ricardo and Marx did not understand Smith. They accused him of rejecting the labor theory of value on the basis of a confusion of the labor embodied in commodities with the labor commanded by commodities in the labor market. Ricardo and Marx held that this confusion led Smith to reject the labor theory of value. Blaug defends Smith from Ricardo and Marx: Smith did not confuse labor embodied and labor commanded, and was right in distinguishing them. It was not any confusion what led Smith to rejecting the labor theory of value, but a sound argument, namely, the realization of the fact that the existence of profit and rent shows that capital and land also contribute to value.

In my opinion, Blaug fails to understand the criticism that Ricardo and Marx directed against Smith's refutation of the labor theory of value. As I see it, Ricardo and Marx do not accuse Smith of having confused labor embodied and labor commanded. The accusation of Ricardo and Marx against Smith is that he is inconsistent with his own distinction between "labor" and "wages" of book I, chapter 6, paragraph 5 when he says that *labor* does not determine value when the price of commodities does not entirely consist in *wages*. After having distinguished "labor" from "value of labor" or wages, that is, labor embodied from labor commanded, Smith uses the two terms as equivalents and takes a correct refutation of the *wages* theory of value for a refutation of the *labor* theory of value. According to Ricardo and Marx, the problem of Smith is not that he fails to make a distinction between labor embodied and labor commanded, but that he fails to apply it to the analysis of the determination of value by labor.

The Ricardo-Marx refutation of Smith's refutation is very interesting in that it is very helpful to avoid the confusion of "wages" and "labor" that undermines so many discussions of value theory and of the labor theory of value. Blaug's interpretation loses sight of the very problem that perplexed Smith and led him to thinking mistakenly that he had found something against the labor theory of value, when in actual fact he had found nothing.

This paper is organized according to the following plan. In the first section I present Smith's refutation of the labor theory of value under capitalism in Book I, chapter 6 of his "*Wealth of Nations*". In section 2, I present Ricardo's and Marx' refutation of Smith's refutation. In the third section, I present Blaug's interpretation of the Ricardo-Marx refutation and discuss it critically. The fourth section is devoted to conclusions.

1. Smith's Rejection of the Labor Theory of Value in Book I, chapter 6 of the "*Wealth of Nations*"

In Book I, chapter 6, Smith writes:

> "In that early and rude state of society which precedes both the accumulation of stock and the appropriation of land, the proportion between the quantities of labour necessary for acquiring different objects seems to be the only circumstance which can afford any rule for exchanging them for one another. If among a nation of hunters, for example, it usually costs twice the labour to kill a beaver which it does to kill a deer, one beaver should naturally exchange for or be worth two deer. It is natural that what is usually the produce of two days' or two hours' labour, should be worth double of what is usually the produce of one day's or one hour's labour." (Smith, 2003, 67; Book I, chapter 6, paragraph 1)

There is only one class of people in the early and rude society, namely, workmen. The relative prices of the different productions of labor "seem" to be determined by the proportion between the quantities of labor embodied in these productions. Note that there is no attempt to prove that value must consist in labor. For all I know, only Marx undertakes the enterprise of establishing a necessary link between value and labor. Whether he fails or succeeds is not the point: the point is that he undertakes the enterprise, whereas Smith does not. Smith is content with saying that value and labor seem to be connected in a society in which everybody is a workman.

> "In this state of things, the whole produce of labour belongs to the labourer; and the quantity of labour commonly employed in acquiring or producing any commodity is the only circumstance which can regulate the quantity exchange for which it ought commonly to purchase, command, or exchange for." (Smith, 2003, 68; Book I, chapter 6, paragraph 4)

In Smith's early society there is a market for deer and a market for beavers, but there is not a market for labor: labor is not one of the commodities that it is sold and bought. Since the exchange relations between the products of labor are determined by the proportion between the amounts of labor embodied in them, it follows that each member of the economy receives from the rest of the economy the same amount of labor that he provides to it. Thus, the beaver hunter gives out two working days in the shape of a beaver and receives two working days in the shape of two deer; in other words: one beaver is the same exchange value as two deer because one beaver and two deer are the same amount of labor. Since property is given by labor, the laborer does not have to share its produce with anybody else: thus, each laborer gets from the economy the same as what he contributes to it.

> "As soon as stock has accumulated in the hands of particular persons, some of them will naturally employ it in setting to work industrious people, whom they will supply with materials and subsistence, in order to make a profit by the sale of their work, or by what their labour adds to the value of the materials. In exchanging the complete manufacture either for money, for labour, or for other goods, over and above what may be sufficient to pay the price of the materials, and the wages of the workmen, something must be given for the profits of the undertaker of the work who hazards his stock in this adventure. The value which the workmen add to the materials, therefore, resolves itself in this case into two parts, of which the one pays their wages, the other the profits of their employer upon the whole stock of materials and wages which he advanced." (Smith, 2003, 68; Book I, chapter 6, paragraph 5)

The feature that marks the essential difference between the pre-capitalist and the capitalist societies, as presented in this text, is that in the advanced society there are two classes of people: the class of the owners of the production means and the class of workmen. Production means consist of two types of goods: materials and subsistence. The class of workmen is not very well off: they do not even have subsistence goods and, of course, they do not own materials. They live on the sale of their labor. The class of owners purchases labor in exchange for subsistence goods. They supply the working class with subsistence in order to obtain a profit on the sale of what the labor of the working class produces.

What is the nature of profit? Consistent with his initial assumption that value consists somehow in labor Smith answers: if value in exchange consists in labor, then surplus value in exchange, that is, profit, must consist in surplus labor. Accordingly, there is profit to the extent that not all the labor added by the workmen to the value of the materials is necessary for replacing to the investor the value with which he purchased the labor of the workmen. In order to maintain a weaver during eight hours, for example, that is, in order to purchase the labor of a weaver for eight hours, the investor does not have to pay the weaver an amount of subsistence the labor time embodied in which is of eight hours. If such were the case, the labor added by the weaver could not leave any surplus over his wages.

This means that the production of the goods which constitute the wages of the weaver requires less than eight hours; say, five hours of labor. These five hours of labor are the value of the labor of the weaver, that is, his wages. The value added by the weaver to the materials supplied to him must be greater than the value of his labor. Smith's theory of profit rests crucially on the distinction between the labor added by the workmen and the labor embodied in the commodities that provide for the subsistence of the workmen and constitute their wages. This is but the distinction between a definite amount of labor and the value of this definite amount of labor. There is profit to the extent that the amount of labor added by the workmen is greater than the value of this amount of labor.

This implies that the amount of labor embodied in a commodity is not the same as the amount of labor that this commodity can command (purchase) in the labor market. Note that, in the advanced society, in contrast with the early society, there must be a market for labor: labor is bought and sold, and the price of labor is called wages. The labor market is not an essential part of the early society, whereas it is in the advanced society.

The existence of profit, as defined by Smith, requires that any commodity other than labor, when exchanged for labor, gets more labor than that embodied in itself. This weird "equilibrium condition" does not apply to markets other than the labor market; moreover, the reason why the investment in apples yields profit is to be found in the labor market. Smith's problem is not the labor theory of value as applied to the exchange of deer for beavers, neither in the early nor in the advanced society; his problem is the labor theory of value in the market for labor, because, if there is to be profit, there can be no exchange of equivalent values in the labor market. Every commodity exchanged for labor must systematically command more labor than the labor embodied in itself. The labor theory of value breaks down in the market for labor because of the existence of profit (which is the very end of production): wages cannot be equal to the amount of labor given by the workman to the undertaker.

As is well known, Marx made the labor theory of value applicable to the market for labor by saying that what is bought and sold in the labor market is not labor itself, but the "labor-power". This switch permits to restore the exchange of equivalents to the labor market, and thus provides a way out of the only exception to the theory of value that perplexed Smith. But the discussion of Marx' labor theory of value is not the subject of the present paper.

Smith's conception of profit can be viewed from another perspective. Why does the investor in the industry of hats make a profit? Not because he sells the hats for an amount of money the value of which is greater than that of the hat sold. The profit that Smith defines in paragraph 5 is the profit made in the exchange of equal values. In other words: the amount of labor embodied in the money given for the hat is equal to the amount of labor embodied in the hat. However, with his sale proceeds, the seller of the hat can buy more than just one hat. Where is the source of this inequality, of profit? Smith answers: that the seller of hats bought an amount of labor from the workman with a wages that contains an amount of labor smaller than the amount of labor supplied by the workman. Added labor is greater than the value of this added labor; the difference is profit.

Having so defined profit, Smith concludes, in direct opposition to paragraph 4, quoted above:

> "In this state of things, the whole produce of labour does not always belong to the labourer. He must in most cases share it with the owner of the stock which employs him. Neither is the quantity of labour commonly employed in acquiring or producing any commodity, the only circumstance which can regulate the quantity which it ought commonly to purchase, command, or exchange for. An additional quantity, it is evident, must be due for the profits of the stock which advanced the wages and furnished the materials of that labour." (Smith, 2003, 70; Book I, chapter 6, paragraph 7)

Here is Smith's refutation of the labor theory of value in capitalism. In order to analyze it, let me split this paragraph 7 into two separate parts which are mutually independent. The first part is:

> "In this state of things, the whole produce of labour does not always belong to the labourer. He must in most cases share it with the owner of the stock which employs him."

I agree with Smith: the problem does not lie here. Note, however, Smith's understatement when employing the adverbs "not always" and "in most cases". In fact, "not always" means "never" and "in most cases" means "in all the cases": this is what is consistent with a society in which the goal of production is the production of profit. The important thing to note is that the difference between the early and the advanced society does not have to do with the *determination* of value, but with the *distribution* of value.

What is new in the advanced society in relation to the early one is that the hunter must share in the output of his labor with the investor that furnished him the materials and purchased his labor with subsistence goods. The new society does not introduce any change in the art of hunting deer or beavers, nor in the exchange between them. The difference is that the hunters are now salaried workers.

The second part is:

> "Neither is the quantity of labour commonly employed in acquiring or producing any commodity, the only circumstance which can regulate the quantity which it ought commonly to purchase, command, or exchange for. An additional quantity, it is evident, must be due for the profits of the stock which advanced the wages and furnished the materials of that labour."

Why is it that the proportion between the amount of labor embodied in the deer and the beaver does not any longer determine the ratio of exchange between them? Because an "additional quantity" must be due for the profits of stock, answers Smith. This "additional quantity" breaks the determination of value by labor because, as the text stands, *it is added to value itself*. Note, however, that this idea contradicts Smith's own definition of profit in paragraph 5, where profit is not added to the value of commodities *because it already is a part of it*. In paragraph 5 profit was not value added to the value of commodities, but a part of it, a part of the value added by the workmen. If we add profits to value, we would be adding profits *twice*, but, obviously, this is not what Smith has to say against the labor theory of value. Smith's rejection of the labor theory of value in capitalism is not that you have two equal values and, suddenly, you add profit to one of them, thus breaking the equality.

The second part of paragraph 7, as it stands, contradicts the idea of paragraph 5 that *competitive profit is included in the value of commodities*. To make sense of paragraph 7 and reconcile it with paragraph 5, all we have to do is replace *quantity of labor* by *value of the quantity of labor* or, simply, *wages*, the text could be rewritten as follows:

> "*The wages* commonly *paid* in acquiring or producing any commodity *is not* the only circumstance which can regulate the quantity which it ought commonly to purchase, command, or exchange for. An additional quantity, it is evident, must be due for the profits of the stock which advanced the wages and furnished the materials of that labour." (in italics, my changes)

The labor commanded by the subsistence given to the laborer is greater than the labor embodied in this subsistence; therefore, the labor embodied in the commodity is the labor commanded by wages, but the amount of this is labor is greater than the amount of labor embodied in wages; the difference is profit. The novelty in the "advanced" society in relation to the "early" one is that the workmen must now share in their product with the "undertakers". Ricardo and Marx correctly point that this fact is totally irrelevant for the determination of value; it is a fact about the *distribution*, but not about the *determination* of value. The fact that part of the amount of value (labor) added by the workmen may not accrue to them, but to the owners of capital, has no effect on the magnitude of that amount of value (labor) added by the workmen. How the workmen and the undertakers distribute among themselves the value of commodities is of no consequence to the determination of this value.

In other words: the existence of profit does not imply that labor ceases to regulate the exchange between commodities. What it implies is that the exchange ratios between commodities need not coincide with the proportion between the shares of the laborer in the value of commodities, that is, with the proportion between the wages paid for the production of the different commodities.

It might be the case that relative prices coincided with relative wages, but, still, this is not the labor theory of value. The labor theory of value is the theory that *labor* determines value, not *wages*, that is, *labor* and not the *value of labor*. Even if relative prices happened to coincide with relative wage-costs, the labor theory of value would not receive any support.

Smith thinks that the second part of paragraph 7 establishes that, in the advanced society, the value of the deer in terms of beavers does not only depend on the relative amount of labor embodied in the two commodities. The reason is that the introduction of capital gives rise to profit and profit implies an addition to the value of commodities, so that the resulting relative value need not coincide with the relative value before the addition of profit. As I have tried to show, such a view is inconsistent with Smith's own theory of profit of paragraph 5. According to this theory, the existence of capital and profit does not involve any addition to the value of commodities because profit ism thought of as included within the value of commodities. Profit is a distributive share in the value of commodities, not any addition to it. We can give a second alternative version of paragraph 7:

> "Neither is the *value* of the quantity of labour commonly employed in acquiring or producing any commodity, the only circumstance which can regulate the quantity which it ought commonly to purchase, command, or exchange for. An additional quantity, it is evident, must be due for the profits of the stock which advanced the wages and furnished the materials of that labour."

If we replace "quantity of labor" by "value of the quantity of labor" the text makes sense. It says that once the product of labor is to be shared by the workmen and the capitalist, the proportion between the shares of the workmen need not be the same as the proportion between the total amounts of labor embodied in the commodities exchanged. What Smith has found out is that relative *wages* need not coincide with relative value; certainly they might, or even competition may force them to do so, but this is not what is at stake. The division of labor added between wages and profits is irrelevant to the validity of the thesis that relative value is determined by the proportion between the amounts of labor embodied in the commodities exchanged. This remains as baseless as it was in paragraph 1.

The question that Smith is discussing is whether *labor* determines value, not *wages*. A "wage theory of value" is a contradiction in terms because wages is one of the values that the theory of value has to explain. To explain *value* on the basis of *wages* amounts to explaining *value* on the basis of *value*. The project of Smith is not a *wages*, but a *labor* theory of value.

We see that the standard interpretation is wrong in saying that Smith rejected the labor theory of value because he thought that the existence of profit and rent implied that labor was not the only source of value. If Smith had been consistent with his own theory of profit as stated in book I, chapter 6 he would have said that the existence of profit and rent shows that *wages* are not the only part into which value is distributed in a capitalist society. In book I, chapter 6 profit is not any addition to value and capital is not any source of value; profit is surplus labor and, therefore, a part of the labor embodied in commodities.

Smith's explanation of rent provides a curious instance of Smith confusion of labor and wages. In the sixth edition, Smith accounts for the rent of land is exactly the same terms as for profit in paragraph 5:

> "As soon as the land of any country has all become private property, the landlords, like all other men, love to reap where they never sowed, and demand a rent even for its natural produce. The wood of the forest, the grass of the field, and all the natural fruits of the earth, which, when land was in common, cost the labourer only the trouble of gathering them, come, even to him, to have an additional price fixed upon them. He must then pay for the licence to gather them; and must give up to the landlord a portion of what his labour either collects or produces. This portion, or, what comes to the same thing, the price of this portion, constitutes the rent of land, and in the price of the greater part of commodities makes a third component part." (Smith, 2003, 70; Book I, chapter 6, paragraph 8)

The rent of land is defined in exactly the same terms as the profit of capital, that is, as the share of the landlord class in surplus labor. The only difference between profit and rent is the title that confers the right to share in the produce of labor: in the case of profit, the property of capital; in the case of rent, the property of land. According to Smith, the introduction of the property of land does not create any value in addition to labor, but only the right to a share in the value already determined by labor. In the first edition, this passage read:

> "As soon as the land of any country has all become private property, the landlords (…) demand a rent even for its natural produce. Men must then pay for the license to gather them; and in exchanging them either for money, for labour, or for other goods over and above what is due, both for the labour of gathering them, and for the profits of the stock which employs that labour, some allowance must be made for the price of the license, which constitutes the first rent of land. In the price therefore of the greater part of commodities the rent of land comes in this manner to constitute a third source of value. In this state of things, neither me quantity of labour commonly employed in acquiring or producing any commodity, nor the profits of the stock which advanced the wages and furnished the materials of that labour, are the only circumstances which can regulate the quantity of labour which it ought commonly to purchase, command or exchange for. A third circumstance must likewise be taken into consideration; the rent of me land; and the commodity must commonly purchase, command or exchange for, an additional quantity of labour, in order to enable me person who brings it to market to pay this rent." (Smith, 2003, 70-1n)

Smith deleted this passage in the sixth edition, and rightly so: if rent is the share of the landlord class in surplus labor, rent cannot be said to "constitute" any "source of value" in addition to labor, anymore than profits or even wages: rent, profit and even wages are distributive shares in labor added. The fact that some part of the value of commodities must accrue to the landlords in virtue of their right of property does not mean that land creates value and, thus, does not rule out in any way the determination of value by labor. What it rules out is the necessary coincidence of relative *value* with either relative *wages*, relative *profit* or relative *rent*. In my opinion, Smith should have followed the logic that led him to delete the passage just quoted and should have corrected paragraph 7 in accordance to it.

The following text provides yet another instance of Smith's self-inconsistent identification of labor and wages:

> "Labour measures the value not only of that part of price which resolves itself into labour, but of that which resolves itself into rent, and of that which resolves itself into profit." (Smith, 2003, 71; Book I, chapter 6, paragraph 9)

Rewritten in a way consistent with the distinction between labor and its value of paragraph 5, this text should read:

> "Labour measures the value not only of that part of price which resolves itself into *wages*, but of that which resolves itself into rent, and of that which resolves itself into profit." (Smith, 2003, 71, Book I, chapter 6, paragraph 9)

More instances of Smith's fundamental inconsistency can be provided, but I would not like to bother the reader, who, having grasped the idea, may find more on his or her own.

2. The Ricardo-Marx' Criticism of Smith's Rejection of the Labor Theory of Value

In "*Principles*", chapter 1, section 1, Ricardo writes:

> "It cannot then be correct, to say with Adam Smith, "that as labour may sometimes purchase a greater, and sometimes a smaller quantity of goods, it is their value which varies, not that of the labour which purchases them"; and therefore, "that labour alone never varying in its own value, is alone the ultimate and real standard by which the value of all commodities can at all times and places be estimated and compared";- but it is correct to say, as Adam Smith had previously said, "that the proportion between the quantities of labour necessary for acquiring different objects seems to be the only circumstance which can afford any rule for exchanging them for one another"; or in other words, that it is the comparative quantity of commodities which labour will produce, that determines their present or past relative value, and not the comparative quantities of commodities, which are given to the labourer in exchange for his labour." (Ricardo, 1962, 16-7).

Therefore, what determines the relative value of commodities is the relation between the amounts of *labor* embodied in them, and not the commodities given to the laborer in exchange for his labor, that is, the relation between the *wages* or the cost of the labor that produced the commodities. We saw in book I, chapter 6, paragraph 5 that, according to Smith, the value of the commodities that the laborer produces and the value of the commodities given to the laborer in exchange for his labor must be different under capitalism: the difference is, precisely, profit. Ricardo accepts this distinction of Smith and stresses that the *labor* theory of value is not any *wages* theory of value. Further on, in chapter 1, section 3 Ricardo makes the same point many times, though without quoting Smith explicitly:

> "No alteration in the wages of labour could produce any alteration in the relative value of these commodities; for suppose them to rise, no greater quantity of labour would be required in any of these occupations, but it would be paid for at a higher price, and the same reasons which should make the hunter and fisherman endeavour to raise the value of their game and fish, would cause the owner of the mine to raise the value of his gold. This inducement acting with the same force on all these three occupations, and the relative situation of those engaged in them being the same before and after the rise of wages, the relative value of game, fish, and gold, would continue unaltered. Wages might rise twenty per cent, and profits consequently fall in a greater or less proportion, without occasioning the least alteration in the relative value of these commodities." (Ricardo, 1962, 28-9)

As the value of commodities is determined by the relation among the quantities of labor contained in them, a changes in wages represents a change in the share of the laboring class in the value of commodities, but not any alteration of this value, as wages are a distributive share in a value already determined by labor. As the reader can tell, this is the idea on the basis of which I criticized Smith's rejection of the labor theory of value.

Marx accepts this idea of Ricardo and develops it in his "*Theories of Surplus Value*" in the chapter devoted to Smith:

> "I have already pointed out Adam Smith's inconsistence in his treatment of how exchange value is determined. In particular, I have shown how he sometimes confuses, and at other times substitutes, the determination of the value of *commodities* by the quantity of labor required for their production, with its determination by the quantity of living labor with which commodities can be bought. Here he makes the *exchange-value* of labor the measure for the value of commodities. In fact, he makes *wages* the measure; for wages are equal to the quantity of commodities bought with a definite quantity of living labor, or to the quantity of labor that can be bought by a definite quantity of commodities." (Marx, 1978, 70-1).

Without being aware of it, what Smith refuted in book I, chapter 6 is the thesis that the relative price of commodities is determined by their relative wage cost; Smith was thus refuting a "wage" theory of value. "Labor" and "wages" or "value of labor" are not equivalent concepts in capitalism, as Smith himself established in his theory of profit.

> "Smith concludes that labour-time is no longer the immanent measure which regulates the exchange-value of commodities, from the moment when the conditions of labour confront the wage-labourer in the form of landed property and capital. He should on the contrary, as Ricardo rightly points out, have drawn the opposite conclusion, that the expressions "quantity of labor" and "value of labor" are no longer identical, and that therefore the relative value of commodities, although determined by the labor-time contained in them, is not determined by the value of labour, since that was only correct so long as the latter expression remained identical with the former." (Marx, 1978, 73).

Accordingly, Marx is saying that Smith knew that "quantity of labor" and "value of labor" are different concepts: he knew it too well because this is his theory of profit. Smith came to the wrong conclusion about the validity of the labor theory of value not because he fails to distinguish labor as such from its value (wages), but because he lost sight of this distinction, which he himself had produced. The following text of Marx is very illuminating, as it establishes a relationship between Smith's fallacy in book I, chapter 6 and Smith's analysis of "natural price" in chapter 7:

> "In fact, at first it was the value of the commodity which he saw as regulating wages and profit and rent. Then however he sets to work the other way round (which was closer to what empirical observation showed and to everyday ideas), and now the natural price of commodities is supposed to be calculated and discovered by adding together the natural prices of wages, profit and rent. It is one of Ricardo's chief merits that he put an end to this confusion." (Marx, 1978, 96-7).

3. Blaug On the Ricardo-Marx Criticism of Smith

Blaug's is the only textbook I know that presents Smith's refutation of the labor theory of value in relation to its criticism by Ricardo and Marx. Although he acknowledges that Ricardo was the originator of the refutation of Smith's refutation, Blaug focuses his discussion on Marx' version of Ricardo:

> "It used to be said that Adam Smith tried to formulate a labour theory of value but got horribly confused between the 'labour commanded' by a product and the 'labour embodied' in its production. The origins of the legend are to be found in Ricardo's *Principles*, but the 'authorised version' is by Marx." (Blaug, 1998, 51).

Blaug defends Smith from the accusation of Ricardo-Marx of having confused labor embodied and labor commanded. In my opinion, however, he is defending Smith from an accusation that never was made. Ricardo and Marx do not reject Smith's refutation of the labor theory of value because Smith fails to distinguish labor embodied from labor commanded; indeed, Ricardo and Marx say that Smith establishes this distinction correctly and, in fact, it is the basis of his likewise correct theory of profit. Their point against Smith is, rather, that Smith forgets his own distinction when it comes to decide whether the presence of profit in price implies that labor alone does not determine value. In my opinion, Blaug has not fully understood the point that Ricardo and Marx are trying to make against Smith.

In relation to Marx, Blaug writes:

> "In a profit economy, the price of a commodity in terms of purchasing power over labour necessarily exceeds the labour required to produce it; hence, Marx implied that Smith failed to realise that price determination on the basis of labour commanded by commodities gives quite different results from price determination on the basis of the labour required to produce them." (Blaug, 1998, 51).

For all I see, Marx did not accuse Smith of failing to realize that "price determination on the basis of labour commanded by commodities" gives quite different results from "price determination on the basis of the labour required to produce them". His accusation was, rather, that Smith thinks (mistakenly) that the validity of the labor theory of value requires that there should not be any difference between "price determination on the basis of labour commanded by commodities" and "price determination on the basis of the labour required to produce them". As Smith sees it, the fatal problem of the labor theory of value is that the creation of profit seems to require a systematic break of the exchange of equivalents in the labor market.

In fact, the problem that leads Smith to reject the validity of the labor theory of value under capitalism is not any failure to establish a rule of correspondence between two systems of prices for the same commodities. Moreover; for Smith, it is not the case that labor commanded determines one set of prices and labor embodied another one. As Smith puts the question, what breaks the determination of value by labor is the very fact that the commodities other than labor, when exchanged for labor itself, command more labor than that embodied in them.

In the particular case in which the profit rate is uniform, the proportional excess of labor commanded over labor embodied would be uniform in all commodities, and, thus, relative value would coincide with relative wage cost. However, on the same basis, one could say just as well that exchange value is determined by *profit*, since, if the profit rate is uniform, relative value also coincides with relative profit. This coincidence does not establish any *profit* theory of value any more than a *wage*-theory of value. Judging by the texts, these obviously true arithmetical facts do not constitute any theory of value for Smith, who is looking *not* for an arithmetical rule to determine prices, but for the *nature* of exchange value. He believes (mistakenly, in my opinion) that the systematic break of the exchange of equivalents in the labor market excludes the determination of value by labor in capitalism.

The distinction between the labor embodied in and the labor commanded by commodities is the same as the distinction between "labor" and the "value of labor" (wages) looked at from a different standpoint. Profit is the surplus of the labor embodied in commodities over the value of this labor embodied (wages), or between the labor that a commodity purchases in the labor market over the labor embodied in this commodity.

For profit to exist, the commodities other than labor must purchase more labor than that embodied in them. Smith views this difference in the following way: there is profit to the extent that the law of exchange is violated in the labor market, to the extent that, in the labor market, the commodities other than labor command more labor than that embodied in them. Smith is perplexed by his belief that profit requires *the systematic suspension of the labor theory of value in the labor market*. A manifestation of this perplexity is his inconsistent implicit equalization of "labor" and "value of labor" after having held that, under capitalism, these two concepts cannot be equivalent.

The objection of Ricardo and Marx to Smith's refutation of the labor theory of value is that the fact that, under capitalism, commodities command more labor than that embodied in them means nothing to the question as to whether labor or something else than labor determines exchange value. The difference between labor and wages, or between labor embodied and commanded, has to do, for Ricardo and Marx, with the *distribution* of value, not with its *determination*.

Smith mistakenly sees himself as facing the following paradox: on the one hand, profit implies a systematic divergence between labor embodied and labor commanded, but, on the other hand, this systematic divergence implies a systematic suspension of the determination of value by labor in the labor market; therefore, exchange value cannot consist in labor only. He sees an opposition where, according to

Ricardo and Marx, there is none. To escape the dilemma he mistakenly thinks he is facing, Smith gives up one extreme and keeps the other: he retains his explanation of the origin of profit but rejects the labor theory of value. Smith's refutation can be alternatively stated as follows: since the value of commodities is greater than the value of the labor embodied in them, it follows that labor alone does not determine value.

After having attributed to Marx a view contrary to the one he actually held, Blaug writes:

> "The fallacy of such an argument [KMO: of Marx' criticism] is obvious. If two commodities exchange at ratios determined by the relative man-hours required to produce them, they will of course command the same labor, or apples, or nuts, or anything else." (Blaug, 1998, 51)

Blaug fails to note the peculiarity of the labor market that puzzles Smith and puts labor on the same footing as the rest of commodities. According to Blaug, if one beaver is exchanged for two deer so that the seller of the beaver gets the same value in the shape of deer, that is, the same amount of man-hours as that embodied in the beaver, then he will also get the same amount of man-hours if he exchanged his beaver not for deer, but for apples, nuts or, and here comes the mistake, *for labor*.

In putting labor on the same footing as the rest of commodities, Blaug misses the Smithian explanation of profit and, in fact, negates his distinction between labor commanded and labor embodied. What Smith said is that the exchange of beavers (or any other commodity other than labor) for labor is totally peculiar because it is where profit arises. The exchange of a beaver for labor is the only case in which the seller of the beaver does not get equals for equals; he must get more labor than the labor embodied in the beaver, because he purchases labor in order to make a profit. In all the other cases, that is, in the exchange of the beaver for apples, nuts or whatever, there arises no problem because these exchanges do not necessitate to break the law of exchange to make sense, but all the contrary. The source of all Smith's troubles is that the seller of the beaver is the purchaser of labor, and he purchases or commands labor in order to make a profit, which is but the excess of the labor that he gets or commands over the labor embodied in the beaver which he gives in exchange for the labor he commands.

Blaug does not distinguish the exchange of capital for labor as a special case within the general problem of the exchange of commodities. This is exactly the problem that tortures Smith, namely, that the exchange of capital for labor seems to be a special case when it should not: it is a special case because commodities, when exchanged for labor, command a greater amount of labor than that embodied in them.

Blaug goes on:

"However, what could it possibly mean to say that the exchange ratios of commodities are determined by the labour they command in exchange? This is like saying that the rate at which a thing exchanges for other things is governed by its purchasing power over other things, which is merely to repeat oneself in different words. The labour-commanded theory, whatever it is, cannot possibly be a theory of value, and to suggest that Adam Smith could have confused such different phenomena as the labour price of a product and its labour cost is simply absurd." (Blaug, 1998, 51).

Smith's rejection of the labor theory of value rests on the belief that the distinction between commanded and embodied labor implies that commodities do not exchange at ratios determined by the proportion between the amounts of labor embodied in them. Smith's problem is whether labor determines value, not whether value is determined by commanded or by embodied labor. His problem is that the systematic difference between commanded and embodied labor implied by profit seems to imply that labor does not determine value in capitalism.

It is to be noted, by the way, that a commanded labor theory has nothing to do with the statement "that the rate at which a thing exchanges for other things is governed by its purchasing power over other things", as Blaug writes. This statement is a plain tautology and Smith does not defend anything like it anywhere, at least in book I, chapter 6 (neither do Ricardo or Marx do so).

"to suggest that Adam Smith could have confused such different phenomena as the labour price of a product and its labour cost is simply absurd." (Blaug, 1998, 51).

Smith does not draw anywhere a distinction between "labor price" and "labor cost": this terminology is Blaug's. Since Blaug does not specify what the relationship between his terminology and Smith's, I am unsure about what he means. What is sure, however, is that if "the labor price of a product" is the labor embodied in it and "its labor cost" the wages paid for the labor embodied in the product, neither Ricardo nor Marx ever suggested that Smith had failed to note that they are different concepts under capitalism, but all the contrary.

4. Conclusions

From the preceding discussion, we can draw the following conclusions:

1) Smith rejected the universal validity of the labor theory of value on the ground that the existence of profit implies that capital creates value in addition to labor, and, therefore, that labor is not the only determinant of value. Such a view is inconsistent with Smith's own theory of profit of book I, chapter 6, paragraph 5.

Against Smith, Ricardo and Marx are right to point out that, on the basis of Smith's own theory of profit, the presence of profit does reveal any creation of value by capital, because this theory conceives profit as the part of the product of labor that does not accrue to the working class, but to the capitalist class. The same can be said about the existence of rent: it does not imply that land creates value, and, therefore, that not only labor determines value.

For a labor theory of value, the presence of profit and rent does not involve any refutation; precisely, they are the object that require explanation, and they are explained as shares in the product of labor in virtue of certain property rights. The presence of profit in the price of commodities does not imply that capital creates value, nor does the presence of rent imply that land creates value. But neither does the presence of *wages* imply that *labor* creates value. The distributive parts of price reveal nothing about the nature of exchange value, but about the structure of property rights over a value determined independently of these rights to appropriate it.

2) Smith rejected the validity of the labor theory of value under capitalism because he was not coherent with his theory of profit and thought, mistakenly, that the fact that the product of labor is to be shared between the workmen and the capitalist implies that labor does not determine the whole value of the commodity. Since wages do not exhaust the whole value of the commodity, something else than labor is causing value, thinks Smith in book I, chapter 6, paragraph 7. He draws the wrong conclusion from his own premises. Once the confusion of "wages" and "labor" is removed and the text rewritten so as to make sense, we can see that Smith, contrary to what he believed, had found nothing against the validity of the labor theory of value under capitalism, but, rather, against some "wages" theory of value.

3) Ricardo and Marx did not invent a false legend when they held that Smith had not been consistent with his distinction between "labor" and the "value of labor".

They did not hold that Smith had confused the two concepts: they held that though he had correctly distinguished them in his theory of profit, he failed to be coherent with himself when he rejected the labor theory of value under capitalism.

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