ADAM SMITH: NEOCLASSICAL OR MONEY-BARGAINING?

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Abstract: The article considers Adam Smith’s economic theories from the viewpoint of a concept of companies as the specialist bargaining agencies of a money-bargaining system, described in an article previous submitted to the World Economics Journal. It is suggested that Smith’s analysis, because of its focus on individuals and the division of labour, misses the importance of companies and technology. Smith misses the importance of organisation in the specialisation of the pin factory. In attributing the emergence of technology to specialisation, he also misses the primary importance of technology to the growth of companies and industry. It is further suggested that much of Smith’s analysis describes a money-bargaining system. His account of markets describes what are in effect the locational bargaining sets of money-bargaining and the bargaining sets formed under constraints arising from budgetary situation. He relates price formation to the costs of particular production units, as in the concept of companies. He describes combinations of both workers and ‘undertakers’, along with other constraints on the supply of goods, as means of achieving higher prices, corresponding to the development of bargaining position in the concept of companies. Smith’s own analysis is shown to be incompatible with his concept of the ‘invisible hand.’ Neoclassical theory has followed Smith’s analysis most importantly in neglecting the importance of companies and technology. It has drawn selectively on The Wealth of Nations to sustain the idea of ‘perfect markets’ as an alternative formulation of Smith’s concept of ‘natural prices’ and an ‘invisible hand.’ Smith’s account of value is contrasted with the account of value provided by social bargaining theory. The theories of both Smith and neoclassical economists are related to interests concerning the extent of government involvement in economic affairs.

Keywords: Adam Smith; invisible hand; bargaining; companies; technology; value.

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Introduction

Neoclassical economists regard Adam Smith’s enquiry into The Wealth of Nations as the direct origin of their theory. Haakonssen and Winch write (2006, p. 373),

To those neo-classical economists for whom general equilibrium of the Walras-Pareto type represents the highest achievement of modern economic theorising, Smith is remarkable for having posed the original problem: under what market conditions does the “invisible hand” generate the most efficient allocation of a society’s scarce resources on the basis of decisions made by individual economic agents, acting as the buyers and sellers of productive resources and final goods and services.

The same metaphor, the ‘invisible hand’, that has characterised Adam Smith’s understanding of an economy also characterises the workings of an economy understood in neoclassical terms. Furthermore, the invisible hand gives the stark individualism of neoclassical assumptions a redeeming social grace. Individuals responding to the prices of free markets will also, without necessarily knowing it, advance the interests of society.

It is, of course, widely acknowledged, even amongst neoclassical economists, that this recourse to Adam Smith involves a very selective reading of his work. The Wealth of Nations covers a great range of subject matter, and the coverage is only in places discernibly a part of neoclassical economics. Other academic disciplines have found plenty in Adam Smith, particularly when embracing also his earlier work, The Theory of Moral Sentiments, to sustain their own ideas. McLean (2006, pp. 120-49) gives an account of the various theoretical interests that can be seen as having foundations in the work of Adam Smith.

The present writer has proposed a theory to rival neoclassical economic theory as an account of the functioning of economies. The theory involves explanation of economic processes in terms of companies as the specialist agencies of a money-bargaining system. The theory is described in a previous article submitted to the World Economics Journal: ‘Companies and Markets: Economic Theories of the Firm and a Concept of Companies as Bargaining Agencies’ (Spread, submitted WEJ 2011). With this alternative viewpoint, questions arise as to whether Adam Smith was

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2 The theory of companies and money-bargaining is part of a broader development of social bargaining theory. The main published works are: A Theory of Support and Money Bargaining (Macmillan, 1984); Getting It Right: Economics and the Security of Support (Book Guild, 2004); Support-Bargaining: The Mechanics of Democracy Revealed (Book Guild, 2008); Situation as Determinant of Selection and
mistaken in paving the way to neoclassical theory; or whether neoclassical claims to origins in *The Wealth of Nations* are spurious. A question arises also as to whether there is anything in Smith’s work that presages the theory of money-bargaining. It could be that Smith rather pointed the way to a theory of money-bargaining, with the pointers ignored in the preference for neoclassical theory.

One reason why such preference might have arisen lies in the politics of theory making. Whatever the rights and wrongs of neoclassical theory, it has underpinned the development of capitalism in the west. Principles of free markets and free enterprise give scope for the advance of capitalism, so any theory that sustains such principles as conducive to public welfare will receive extensive support from those whose interests lie in the advance of capitalism. It is in their interests that such theories should be promulgated, and it is in their interests that a great work such as *The Wealth of Nations* should be recognised as supportive of the theory. The content of *The Wealth of Nations* may have been misinterpreted, or partially interpreted, to sustain a theory that attracted support for the interests of capitalists.

This paper looks at *The Wealth of Nations* from the viewpoint of money-bargaining. It suggests that Adam Smith himself viewed the economy of his time with a partial eye, conditioned by concern over the relationship of the individual to society and an associated concern over the role of government. It suggests that, because of these concerns, he did not give due weight to some important features of the emergent British economy, which became more prominent as time went on. It suggests also that his particular interest and the omissions that arose from it paved the way for the emergence of a neoclassical economics that sought unambiguously to sustain the interests in individualism and limited government that are apparent in Smith’s work.

More specifically, the paper argues that in his adoption of an individualistic approach to economic analysis Smith underrated the importance of technology and companies. These emerged over time as of central importance to the growth of economies and have central importance in the theory of money-bargaining. The individualist approach was maintained in neoclassical theory, giving rise to the same neglect of technology and companies.

There are, nevertheless, many elements in *The Wealth of Nations* that were necessarily ignored in the development of neoclassical theory – elements that clearly reflect the operations of a money-bargaining system. Once such a system is described, it can be seen that much of *The Wealth of Nations* is describing a system of the same kind. The nature of markets, price-setting and wage bargaining are all described in terms that are consistent with the theory of money-bargaining rather than neoclassical economics. It is easier to see money-bargaining in Smith’s work than neoclassical theory, once money-bargaining is understood. It would have been possible to derive from *The Wealth of Nations* something like the theory of money-bargaining if fractional but highly influential interests in the nineteenth and twentieth centuries had not preferred an apparently rational theory justifying the pursuit of individual self-interest.

In the following section a summary account is provided, for convenience, of the concept of companies as the specialist agents of money-bargaining systems. The

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paper then considers aspects of Adam Smith’s account of the workings of an economy and their relationship to neoclassical theory and the concept of companies.

**Companies in a Money-Bargaining System**

Companies are conceived as specialist money-bargaining agencies in money-bargaining systems. Because of their focus on money-bargaining, they are able to build the strongest bargaining positions. The bargaining position of all companies nevertheless depends fundamentally on capacity to meet the needs of consumers or other buyers.

The needs of consumers are determined by situation. In cold weather consumers want warm coats. Off on a beach holiday, consumers want sandals and sun-cream. A large family needs a large house. Various aspects of consumer situation define certain requirements, which translate into products and various features of products. The groups of products with the required features, or the suppliers of such products, form a bargaining set within which a consumer seeks the best fit to his situation. A consumer bargaining set will invariably incorporate a locational constraint. Products have to be available within reach of a consumer, which is normally the location in which he or she lives or works. It will also include an information constraint – consumers can only choose amongst products they know about. Consumers will also be constrained by their budgetary situation. Products will normally have to fall within a certain price range which the consumer judges to be within the capacity of his or her budget.

Consumers’ understanding of their situations is determined by social considerations as well as individual determinations – in fact, given the integration of individuals with their societies through support-bargaining, the two are scarcely distinguishable. People choose clothes, houses, cars, holidays and other items with concern for the understanding of others regarding the acceptability of the acquisition. People have concern for their social standing, as part of their understanding of situation.

Companies will endeavour to develop products with features that place them in consumer bargaining sets. The array of buyers whose situations are such that they will have an interest in acquisition of a company’s products is the ‘supplier bargaining set’, or ‘vendor bargaining set.’ Consumers with large families and large budgets in a certain area will constitute the vendor set for property developers operating in that area with expertise in the design and construction of luxury homes.

A company is viable if its revenues are greater than its costs, or ‘sales × price > production × unit cost.’ These four variables are interconnected. Sales depend on price, and price depends on unit cost of production. The unit cost of production depends on the level of production, and the level of production must be equal to sales. A company must format from the start so that it achieves a surplus of revenues over costs through an appropriate relationship between the four variables, or at least the initial format must be such that minor changes can enable the company to meet the viability criterion. A company will select a level of production, often influenced by available technology, with an associated unit cost. Price will be established by reference to the unit cost of production, but adjusted in accordance with the perceived bargaining position of the company. If the level of sales is on or close to the adopted level of production, the company will be viable. The viability condition constitutes a
minimum condition for the survival of a company. Beyond it, a company will seek to increase the surplus of revenues over costs.

In most formats location will be an important factor. Goods normally have to be delivered so that they are available within the locational constraints of buyers. At the same time, in a manufacturing operation, inputs will have to be transported to a factory. Transport costs add to unit costs and affect the viability condition. Location will be selected to minimise acquisition and distribution costs, subject to overall viability of format.

Companies achieve focus on a defined purpose through the use of hierarchies. A hierarchy permits a single leader to coordinate the actions of others through a chain of instruction. Military hierarchies constitute the archetypal hierarchy, where each level of the hierarchy is bound to obey the instructions of the level above. Company hierarchies operate on the same principle, but the ‘gradient’ of command is generally less steep. Instructions in a company are developed through support-bargaining within and alongside the hierarchical structure. At the head of the hierarchy of a large company, at board level, or amongst senior management, support-bargaining will be used to determine the focus of the company and the instructions to be carried out through the hierarchy. The capacity to focus the activities of many to a defined purpose gives companies their bargaining positions.

A company offering a product with features that fit it well to certain consumer situations, available in a location where there are large numbers of consumers in the relevant situation, where there are few or no other suppliers of products with features to rival it, and where the production level is well matched to the number of target consumers, has a strong bargaining position relative to the consumers in its vendor set. It will be able to sell at a price significantly above the unit cost of production, giving a substantial margin of revenues over costs. It can be seen that a company bargaining position is a mix of product fit to the situations of potential buyers, numbers to whom it is relevant, availability of alternatives and volume to be sold. In the broadest terms, needs and options, on both sides, determine relative bargaining positions. Monopoly constitutes an extreme of bargaining position, though virtually all monopolies are monopolies only within certain locational bargaining sets – local, regional or national. A consumer bargaining position is broadly the mirror of a company bargaining position – bargaining position is always relative. In the case of consumers, however, their situation related requirements depend on their definition of situation, and the definition is likely to depend on understanding of situation developed through social support-bargaining. Social pressures can determine the ‘must have’ products, and hence determine bargaining position. Fashion goods sell at a premium because social support-bargaining determines for many that they must appear in certain types of clothing.

The exercise of bargaining position depends on knowledge of the circumstances of supplier or customer. This is often limited, so bargaining position is not necessarily obtrusive in transactions. Transactions are commonly concluded at fixed prices without any assessments of bargaining position in the context of the specific transaction. Companies operating in a particular product group will nevertheless research the strengths and weaknesses of rivals in the product group in order to assess their own bargaining positions. Awareness of bargaining position can be acute when one or other actor is in a recognisably weak or strong position – as for example when
a burst pipe demands the attention of a plumber. Spread (2008, pp. 93-101, etc.) provides further consideration of bargaining position.

In *Survival of the Sociable* (Spread, Forthcoming, Chapter 9), it is suggested that money-bargaining has its origins in support-bargaining, and we understand bargaining position in money-bargaining because we instinctively understand its implications for our personal security in support-bargaining. Because of this origin, we all know what bargaining position is, even if precise definition is convoluted.

Money-bargaining is thus closely related to support-bargaining. It is a distinctive and important feature of support-bargaining that it includes ‘intellectual support-bargaining’, a process by which theories are formed in accordance with interests (Spread, 2008, pp. 275-320; 2011, pp. 350-54; see also Spread, Submission EJ). Groups assemble to support theories which advance their interests. The comments in the introduction associating both Smith’s theories and neoclassical theory with interests in individual advance reflect this process of intellectual support-bargaining.

**The Organisation of the Division of Labour**

The division of labour is the central explanatory feature in *The Wealth of Nations* for the wealth of nations. It is the major source of improvements in productivity. Smith opens Book I, Chapter I, *Of The Division of Labour*, with the statement: ‘The greatest improvement of the productive powers of labour, and the greater part of the skill, dexterity and judgement with which it is anywhere directed, or applied, seems to have been the results of the division of labour’ (2009, p. 5). The higher standards of living in ‘improved’ societies are attributed to specialisation of labour: ‘…what is the work of one man in a rude state being generally that of several in an improved one.’ The gains from specialisation are greatest in manufacturing, since ‘The nature of agriculture, indeed, does not admit of so many subdivisions of labour, nor of so complete a separation of one business from another, as manufactures’ (2009, p. 7).

The different requirements at different seasons in agriculture make it necessary that one man can perform several tasks. The division of labour in a pin factory provides Smith’s main example of the division of labour in manufacturing. Different workers draw out the wire, straighten it, cut, point, head, whiten, pack, etc. – 18 separate operations can be identified that may be performed by different workers.

Smith’s point is well made – the division of labour increases productivity. However, the point not made is that the opportunities for division of labour only arise as a consequence of organisation. There has to be an agency that recognises how getting people together to make pins, and assigning specialist tasks to them, can increase the volume of pins produced per person. There has to be an agency also to realise the idea. This, in the concept of companies as specialist money-bargaining agencies, described above, is what businessmen and their companies do. The pin factory is a company operation, but Smith’s account does not recognise the significance of the organisation that goes with incorporation. As Demsetz (1988, p. 156) remarks, ‘Smith has enshrined forever the idea that specialization is productive, but Smith’s focus is on the changes wrought in the individual worker. The problem of how the activities of cooperating specialists are organized so as to mesh better is largely ignored.’

Smith attributes the scope for division of labour to ‘a certain propensity in human nature…to truck, barter and exchange one thing for another’ (2009, p. 13). Because exchange is possible, people specialise, knowing that they can exchange what they
make for what other people make. People see advantage in exchange, and exert themselves to produce something that enables them to engage in exchange. Smith describes a number of activities in which people specialise: making bows and arrows, raising cattle, hunting for deer, making frames and covers for huts, being a smith, a tanner, or a dresser of hides and skins. All these are of an artisanal type that can be associated with individual engagement. They relate mainly to relatively ‘unimproved’ societies. The specialisms of the pin factory relate to the factory context, the corporate context, in an ‘improved’ society. The division of labour in the pin factory relates not to the propensity of those employed there to truck, barter and exchange, except in that they exchange their labour for the payments of the proprietor, but in the propensity of the proprietor of the factory to sell the products of the factory at a profit. Specialisation reduces unit costs, and hence is conducive to higher profit, though Smith does not explicitly identify the reduction in unit costs, being more concerned with increased aggregate production (2009, p. 6). If the division of labour is behind the prosperity of ‘improved’ societies, then the organisation that gives scope for the division of labour lies more fundamentally behind the prosperity of such societies. It is the human propensity to organise for purposes of truck, barter and exchange, rather than the mere propensity to exchange, that has produced the most notable improvements in human societies.

Smith’s account of the origin and use of money in BookI, Chapter IV focuses on the role of money as a substitute for individual barter. Exchange is very much ‘clogged and embarrassed’ if everyone who wants to exchange what they have made has to find someone who wants that product in just the right quantity, and can supply in just the right quantity just what the first producer wants. Coins provide an excellent intermediate store of value for this sort of exchange. Different denominations provide the means of subdividing value in accordance with the desired quantities of produce required. But the role of money in storing and subdividing value not only facilitates exchange between individuals, but permits the operation of concerted groups aimed at accumulating money and sharing it between them. It permits the operation of companies as specialist agencies concerned with exchange for the acquisition of money. Companies divide labour to make products at low unit cost, and sell them at low prices for money, using the money to reward the workers in the company. Without money, the pin factory could not function, and the division of labour that arises from the corporate organisation could not be realised. Money gives rise to specialist money-bargaining agencies, and it is these that are the essential elements in the ‘improvement’ of societies.

Neoclassical economic theory has taken up Adam Smith’s individualist account of the functioning of an economy and produced an abstract model of how an economy functions. Neoclassical economics has accepted Adam Smith’s account of the division of labour as fundamental to increases in productivity and hence to the prosperity of societies. The division of labour as the origin of material advances is very prominent in the opening pages of The Wealth of Nations, so no great selectivity is required to adopt it as the foundation of a new model. Like Smith, however, neoclassical economics has missed the importance of organisation, which is the importance of companies, and the significance of money as an end in itself, or at least as something worth pursuing with specific focus. It is widely acknowledged that neoclassical economics provides no coherent account of the role of companies or of corporate profit – companies remain in neoclassical theory a ‘black box’ of obscure content. Demsetz (1997, p. 426) notes, ‘Neoclassical theory’s objective is to
understand price-guided, not management guided, resource allocation. The firm does not play a central role in the theory. It is that well known "black-box" into which resources go and out of which goods come, with little attention paid to how this transformation is accomplished.' In this respect, neoclassical theory can securely claim to have its origins in *The Wealth of Nations*.

**Technology and the Division of Labour**

Adam Smith ties technology into his theme of the division of labour. He sees technology as deriving in the first place from the creation of machines to do the very simple tasks that arise from division of labour, with the innovations made by the same people who perform the tasks. Thus he recounts that a boy employed to open and close the valves on a fire engine is said to have designed a string attachment that caused the valve to move in time with the pistons, without any intervention by the boy. Hence technology is a consequence of the division of labour. This account implies that technology substitutes for labour in a very direct manner. It performs the mechanical motions of people.

The fire engine itself is a different order of technological sophistication. Smith recognises that not all technology arises from the simple substitution of machine for man, or boy. Smith notes that the makers of machines are responsible for some improvements. ‘Philosophers and men of speculation’ also create machines (Smith, 1986, p. 115). The philosophers and speculators are seen as specialists in much the same way as the workers in the pin factory. They gain in dexterity and save time by their specialist concern for philosophical matters.

This second association of technical innovation with the division of labour seems less satisfactory than the first. It is not so much that philosophers and speculators do not gain from being specialists. Societies universally depend on people working in specialist roles as chimney-sweepers, novelists, soldiers, etc. But the extensive institutional arrangements that lie behind the work of philosophers and speculators distinguish their work from the immediate shop floor division of labour in the pin factory. Improvements in education gave rise to advances in the natural sciences in the universities. Natural scientific findings gave rise to extensive technological innovation, as people came to see that the findings of natural science could be turned to commercial purposes. The organisation of society in such a way as to advance science and technology produced technologies that could be used in factories to make money. The machinery of the pin factory was technology of this kind. The provenance of such technology was so different to that which derived directly from the shop floor that it was misleading to classify them as having the same origin.

The pin-making machinery was essential to the existence or viability of the pin factory. Without the technology, there would have been no pin factory. The division of labour in the pin factory was not a division of the work formerly done by one man, but was organised around the technology. In terms of the concept of companies outlined above, the viable format of the pin company was made possible by the availability of the technology. The technology, rather than the division of labour, was the basis for the advance in productivity. The viability condition could be met because the technology permitted the production of a number of pins that could be sold at a price that covered the unit cost of production.
Companies ever since have been formatted on the basis of technology, with technology frequently determining which company formats are viable. Society has been increasingly organised over the years to educate and train people in technical development and provide facilities for the advance of science and technology in order to ensure the flow of technological innovation that is essential to the format of companies. In Smith’s time scientists and businessmen developed their contacts through arrangements such as the Lunar Society, recognising that there was money to be made by applying science to the format of companies (Langford 2001, p. 442-3). At present, scientists and businessmen collaborate in science parks, often in proximity to university science faculties, to apply technical innovations in company formats. Smith tries to explain technology as a consequence of his central explanatory theme, the division of labour, but in so doing he misses the central importance of technical innovation to the existence of the pin factory, to the division of labour within the pin factory, and to the advance of industry as a whole. As Lekachman (1964, p. 72) remarks of Smith’s account, ‘It was invention which flowed from division of labour, not division of labour that flowed from invention.’ Smith’s treatment of technology ensured that it could be sidelined as a factor in the advance of the wealth of nations.

With companies commonly dependent for viability on the choice of technology, successful choices become the mark of the successful businessman. The successful businessman sets the focus of his company in association with his choice of technology, and divides his labour according to the requirements of the technology and company purpose. Smith gives his ‘undertakers’ only the most limited role with regard to the organisation of their undertakings, entirely incidental to their role in controlling stock, and likely to be assigned to one of their staff: ‘In many great works, almost the whole labour of this kind is committed to some principal clerk. His wages properly express the value of this labour of inspection and direction’ (2009, p. 39). The undertaker is conceived in terms of a specialist and individual role in provision and control of stock, rather than functions that would mark them as the controllers of business organisations. While modern companies may be operated by owners or managers, the organisational function is regarded as critical and rewarded accordingly.

Neoclassical theory also accepts the central importance of the division of labour and the advance of individual productivity. It also sidelines technology and companies. The relationships of the neoclassical model implicitly assume certain standard levels of technology. In the concept of companies, by contrast, technology is a central factor in the competition between companies. Companies with the right technology – ‘right’ that is, in relation to establishing a viable corporate format – will survive, while companies that choose the ‘wrong’ technology will fail. Neoclassical theory derives its understanding of technology from Smith and consequently fails to take account of a major factor in the growth of economic prosperity around the world.

**Extent of the Market**

The title of Smith’s third chapter in Book I is ‘*That the division of labour is limited by the extent of the market.*’ A nailer, for example, can only work full time on nail-making if he can sell the nails he produces in that time. Smith (2009, pp. 16) notes that in the remote highlands of Scotland the scope for specialisation is very limited. All turn their hands to a variety of tasks, ‘A country carpenter…is not only a carpenter, but a joiner, a cabinet-maker, and even a carver in wood, as well as a
wheel-wright, a plough-wright, a cart and waggon maker.’ By contrast, in the towns, with a substantial population in a relatively small area, there is much more scope for specialisation.

Smith (2009, p. 16) understands markets in terms of level of population and the extent of its distribution. A great town constitutes a big market; an ordinary market town is a moderate market; a village is a small market. The rural areas offer scarcely any market at all. A porter serves the market which is available in a great town, but is unlikely to be able to gain subsistence in an ordinary town, because of the size of the market. It is assumed that there are ‘porter services’ which if sought in sufficient volume will sustain the specialist work of a porter. In the same way, neoclassical theory assumes the existence of markets, with prices determined by the supply and demand of pre-defined and homogeneous products. The producer then produces and sells up to the point where his marginal cost is equal to the market price. In Smith’s concept the scope for specialisation is limited by the size of the market. In the neoclassical view, a producer can sell at the market price everything he can produce to that price. But in the concept of companies outlined above, markets are conceived as bargaining sets. Consumers form bargaining sets comprising those goods and services relevant to their situations. Companies understand their ‘market’ as a vendor set comprising those agents whose situations indicate an interest in the products and services the company can provide. A consumer bargaining set will normally involve a locational interest – products must be available in a place that is accessible to the buyer. Accordingly, a company must ensure that its products or services meet this locational interest. A company is viable provided it achieves a sufficient level of sales in its vendor set. The scope for specialisation of a company rests not on the size of an abstract market but on the level of sales it can achieve in the bargaining set it targets through product design, costs, location and other aspects of company format.

Smith’s (2009, p. 16) idea of a ‘market’ incorporates an idea of locational bargaining sets. He understands markets in terms of distinct locations, rather than the universal markets of neoclassical theory: the large town; the moderate town; the village; the rural areas. In terms of money-bargaining, these are bargaining sets defined in spatial terms, corresponding to the locational situations of potential buyers. Smith (2009, p. 44) later makes a further refinement with his concept of ‘effectual demand.’ A poor man might like a coach and six, but without a budget that can bear the expenditure, his demand is not effectual. The poor man’s bargaining set is limited by his budget. He will not feature in the vendor sets of the suppliers of coaches and horses. Smith’s ideas on markets are readily understood in terms of bargaining sets. The viability of a portering service then depends on the success of the porter in meeting the requirements of his vendor set. It depends not on the whole requirement for portering services in a great town or an ordinary town, but on the level of sales that the porter can achieve. He may achieve a satisfactory level of sales with a small share of the required portering services of a great town, or a large share in an ordinary town. In either case, it is the level of sales that dictates the viability of his operation. An ingenious porter may invent new services that he can provide to his clientele, and increase his revenues. A tough porter may find means of ensuring that rival porters do not encroach on his share of the market, though his actions may incur the condemnation of rival porters and of the community. In some circumstances, a cartel, or ‘guild’, of porters may divide the provision of porter services between them and ensure that newcomers do not encroach. Arguments regarding the stability of the market, ensuring a high quality of portering services, and ensuring the security of
customers, may be used to stave off the condemnation of those obliged to pay higher prices for porterage. Smith’s account of markets is more an account of the bargaining sets of money-bargaining than the universal abstract ‘markets’ of neoclassical theory.

The major part of Smith’s Chapter III concerns the effects of water transport in extending access to markets. He notes that major rivers, such as the Nile and Ganges, have been the locations of early expansion of trade. He notes that the calm and tideless Mediterranean was the arena for the early advance of western society. Coastal areas in different parts of the world hosted early development of trade and commerce. Inland development, away from navigable rivers, came later. He notes that only such products whose value was substantial in relation to their weight could be traded if land-carriage was involved. London was trading with Calcutta because the cities were linked by sea. If they had been linked only by land, the cost of transport would have prohibited virtually all trade.

As noted in the earlier article (Spread, submitted WEJ 2011), neoclassical economics ignores spatial considerations. They are incompatible with the mathematical expression of the neoclassical model. Neoclassical economists have de-selected an important element of Smith’s theories in *The Wealth of Nations*. By contrast, distance and transport costs are fully incorporated in the idea of money-bargaining (Spread, 2008, pp. 145-60). As part of their format, companies adopt a certain location for their plant, headquarters, and other functions, taking account of the locations of their target markets, the locations of their major inputs and their requirements for staff. The viability condition takes into account the costs of delivering goods to the points of sale which customers find convenient. Transport infrastructure, whether in the form of sea, rivers or terrestrial infrastructure, extends spatial bargaining sets and facilitates the format of viable companies. Smith identified an important feature of economies that has been wholly ignored by neoclassical theory, but which is restored to its proper status in the theory of money-bargaining.

**Price Formation**

In Book I, Chapter VII, *Of the Natural and Market Price of Commodities*, Smith described the ‘natural price’ of a product as the price deriving from the ‘ordinary or average rate’ of wages, profit and rent used in its making (2009, pp. 43). This natural price may vary on account of short term shortages or excesses of supply or demand (2009, pp. 43-6). Labourers, controllers of stock and landowners respond, however, to these deviations from the natural price by increasing or decreasing the supply of their particular input, and hence returning the price to its natural level. This built-in adjustment mechanism is part of Smith’s ‘invisible hand.’

Smith, however, does not stop at deviations from natural price arising from short term shortages or excesses of supply or demand. He recognises that ‘...though the market price of every particular commodity is in this manner continually gravitating, if one may say so, towards the natural price, yet sometimes particular accidents, sometimes natural causes, and sometimes particular regulations of police may, in many commodities, keep up the market price, for a long time together, a good deal above the natural price’ (2009, p. 47). A rise in demand, for example, might produce profits above the normal rate, but if people do not know about the excess profit, it may be sustained for a long period. ‘Secrets’ may permit the maintenance of prices and profits above their natural rate. The market price of a product may also be sustained above the natural price by natural causes. For example, the special qualities of soil and
situation that are found in some French vineyards permit the maintenance of the price of wine above its natural price (2009, p. 47). ‘Regulations of police’ may also sustain prices above their natural rate for long periods. The grant of monopolies, the regulation of apprenticeships and laws affecting the mobility of labour may all cause divergence of market prices from natural prices.

In neoclassical theory Smith’s account of the invisible hand is supplanted by a marginal mechanism which provides a refined account of how automatic adjustments reallocate resources of land, labour and capital to produce renewed equilibrium. ‘Market prices’ are determined by the accommodation of aggregate supply to aggregate demand. Aggregate supply is the sum of the outputs of all firms, with each firm expanding production up to the point at which its marginal cost is equal to the market price. A rise in the market price will cause firms to increase their output and the price will fall, while a fall in the market price will bring about a fall in supply. Smith’s principle of automated equilibrium is maintained, though the mechanism is different. A concept of ‘perfect competition’ eliminates all the factors, including secrecy, that might move the market price away from the price determined by the marginal mechanism. Movement of prices away from the equilibrium is deemed ‘market failure.’

There are clear parallels between Smith’s account of pricing and the neoclassical account. Both have a basic idea of equilibrium at ‘natural’ or ‘perfect market’ prices, and these prices are displaced in trade by factors affecting supply or demand. In both cases there is a sense that, while some displacements are unavoidable, many others are due to improper, in the sense of immoral, machinations of traders, or improper, in the sense of immoral or misguided, interventions of governments. Nevertheless, Smith’s mechanism is closer to that of the formation of prices by companies described above than to neoclassical theory. Smith does not recognise companies in his exposition of price formation, but there is an implicit idea of some sort of producer unit that combines labour, stock and land into a product which is priced by reference to the costs of the inputs, with an adjustment for the ‘accidents’ that give short or long term bargaining advantage. In the concept of company format, the price is dictated by the unit cost of production, with an adjustment for the perceived bargaining position. In both Smith and the concept of companies pricing is done by the producer, taking into account the conditions in which the producer operates. Neoclassical theory takes pricing out of the hands of any individual supplier. Price is related instead to the marginal costs of all companies, through aggregate supply and demand. Neoclassical theory is obliged to treat economies of scale as supplementary to the model of perfect competition, recognising that they are substantially incompatible with the model. In the concept of companies, the fundamental implications of scale for unit costs, and hence for prices, are bound into corporate format through the viability condition. Smith does not deal specifically with economies of scale in the context of natural pricing, but the division of labour and its dependence on the size of the market constitutes an implicit idea of falling unit costs with increases in specialisation and the increases in scale that permit specialisation.

Both Smith and neoclassical theory assume that products are homogeneous and that the same products will have the same costs of production. In money bargaining, product innovation, commonly involving technological innovation, is a critical part of the competitive process. While competitive pressures will, as in Smith’s account, push prices towards the costs of production, incentives to seek bargaining position through constant product innovation and by other methods ensure that there are also
systemic pressures, not accidental, nor a consequence of ‘market failure’, that move prices above the costs of production.

It can be seen that Smith’s idea of an automatic adjustment to give equilibrium has been taken to an extreme in neoclassical theory, the mechanism being redesigned to give mathematical traction whilst still producing the required result. Much economic theory is concerned with modifications to the model that are necessary to accommodate selected relaxations of the conditions of the perfect market. Far more economical is the adoption of a theory of companies as specialist money-bargaining agencies in a money-bargaining system, ensuring that the starting point for further enquiry is a realistic representation of the functioning of an economy. It means that economists can observe what actually sets economies in motion, rather than finding themselves obliged to skew their observations and interpretations to the demands of a theory that bears little relation to the realities. The observation of economists has been skewed most particularly away from companies, and the interpretations offered for their presence have been unsatisfactory, as explained in the article ‘Companies and Markets’ (Spread, submitted WEJ 2011). What has been concealed or ignored in the ‘black box’ of companies is the key to the functioning of economies. While Smith misses the content of the ‘black box’, his account of pricing is closer to the concept of companies and more instructive than the marginal theory of neoclassical economics.

**Higgling and Bargaining versus the Invisible Hand**

In Book IV, Chapter II, *Of restraints upon importation from foreign countries of such goods as can be produced at home*, Adam Smith likens the working of an economy to the guidance of an ‘invisible hand’, in the following passage (2009, p. 325):

> As every individual, therefore, endeavours as much as he can, both to employ his capital in the support of domestic industry, and so to direct that industry that its produce maybe of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain; and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.

He also, however, in Book I, Chapter V, *Of the real and nominal price of commodities, or their price in labour, and their price in money*, describes wage settlements as a matter of ‘higgling and bargaining’, as in the following passage (2009, pp. 25-6):

> But though labour be the real measure of the exchangeable value of all commodities, it is not that by which their value is commonly estimated. It is often difficult to ascertain the proportion between two different quantities of labour. The time spent in two different sorts of work will not always alone determine this proportion. The different degrees of hardship endured, and of ingenuity exercised, must likewise be taken into account… But it is not easy to find any accurate measure either of hardship or ingenuity. In exchanging, indeed, the different productions
of different sorts of labour for one another, some allowance is commonly made for both. It is adjusted, however, not by any accurate measure, but by the higgling and bargaining of the market, according to that sort of rough equality which, though not exact, is sufficient for carrying on the business of common life.

In Book I, Chapter VIII, Of the Wages of Labour, he provides an account of wage setting with combinations formed by both workers and masters. Masters, he writes, are always in tacit combination not to raise wages, and may even combine to push them down (2009, pp. 51-2). Workmen may form a contrary defensive combination, but may also combine of their own accord to raise wages (2009, p. 52). Smith’s price formation process described above involves adjustments around the ‘natural price’ in accordance with the ‘accidents’ of the time. Smith comments, ‘People of the same trade seldom meet together…but the conversation ends in a conspiracy against the public or in some contrivance to raise prices’ (2009, p. 99).

In sharp contrast to the harmonious influence of the invisible hand, as in the quotation above, Smith argues earlier that the interests of those who live by profit are different to those of the rest of society, for profit, ‘...is always highest in the countries that are going fastest to ruin.’ In consequence, ‘The interest of this third order, therefore, has not the same connexion with the interest of the society as the other two’ (2009, p. 190). He maintains (2009, p. 67) that, ‘the increase of stock, which raises wages, tends to lower profit. When the stocks of many rich merchants are turned into the same trade, their mutual competition naturally tends to lower its profit; and when there is a like increase of stock in all the different trades carried on in the same society, the same competition must produce the same effect in them all.’ The influx of stock in times of expansion tends to lower profit. Of those who live by profit, Smith comments (2009, pp. 190-1, ‘As their thoughts, however, are commonly exercised rather about the interest of their own particular branch of business, than about that of the society, their judgement, even when given with the greatest candour…is much more to be depended upon with regard to the former of those two objects than with regard to the latter…The interest of the dealers, however, in any particular branch of trade or manufactures is always in some respects different from, and even opposite to, that of the public. To widen the market and to narrow the competition, is always the interest of the dealers.’ Smith recommends careful examination of the schemes of such men, ‘...not only with the most scrupulous, but with the most suspicious attention’ (2009, p. 191). Whether Smith’s analysis regarding the effects of economic expansion on profits is right or not, he plainly sees the interest of those who live by profit as opposed to the interests of everyone else. The invisible hand is not conducive to social harmony in economic relations. It is clear that economies function by higgling and bargaining, involving interests which are in some degree complementary – workers want work and dealers want profit, and the two go together; but which are also different – workers want high wages, while dealers want high profits. The bargaining process involves various manoeuvres by all involved to strengthen their bargaining positions and obtain good terms.

These assessments in terms of bargaining all appear in the micro-analytic chapters of Book I, whereas the comment on the invisible hand appears in the more discursive Book IV. In that context, individuals employ their capital in domestic trade in preference to foreign trade, and it is that preference, as much as the preference for putting capital where it has greatest effect, that constitutes the invisible hand that is beneficial to society. In terms of social bargaining theory, the subsequent prominence
of the phrase ‘invisible hand’ is a consequence of its attraction firstly to those with an interest in a mathematical formulation of economic theory, and secondly to those with an interest in promotion of a harmonised and sanitised view of business endeavour. It does not accord with Smith’s account of the functioning of an economy. As Rothschild and Sen (2006, p. 363) remark, ‘The principle of the invisible hand, in its twentieth century sense, was quite un-Smithian.’ Neoclassical economics, as remarked above, draws very selectively on The Wealth of Nations. It does not take up Smith’s substantive analysis of the process of economic exchange, for Smith described a money-bargaining system.

**Politics and Bargaining Position**

Smith (2009, p. 51) sees the ‘masters’ having generally the upper hand in achieving combinations for wage bargaining, mainly because, being few in number, it is easier for them to effect a combination, either tacitly or with explicit agreement. Furthermore, the law is in favour of the masters: ‘We have no acts of parliament against combining to lower the price of work; but many against combining to raise it.’ The political system ensures that masters have a stronger bargaining position than workers.

Smith (2009, p. 91) sees that the divergence of wages from their natural price is affected by other political interventions. He identifies three types of intervention: restricting competition in some employments to a smaller number than would otherwise be engaged; increasing it in other employments to more than would be natural; and by obstructing the free movement of labour and stock, both from employment to employment and from place to place. ‘Corporations’ (or guilds) and the apprenticeship system restrict access to certain types of employment (2009, pp. 93-5). According to Smith (2009, p. 94), ‘Long apprenticeships are altogether unnecessary.’ The regulations on labour affect the position of townspeople in their dealings with the country. Being in close proximity to each other, they find it easier to combine than country people, so that the town always has the advantage over the country. Smith’s (2009, pp.100-2) main example of the promotion of greater numbers into an employment than would naturally occur is the provision of pensions, scholarships, exhibitions and bursaries that qualify people for the professions, and in particular the church. Smith (2009, p. 104) sees the regulations on apprenticeships as the principle restriction on movement of labour between employments. Movement is restricted also by the poor laws (2009, p. 104-9).

Political interventions can also move prices away from their natural state through the creation of monopolies (2009, p. 48). Monopolists can keep produce off the market so as to push prices above their natural price and raise their emoluments, whether wages or profits. Smith sees monopoly as having the same effect as a secret in trade or manufactures.

These political interventions are seen in Book I as detrimental to the ‘natural’ order in which prices are established by reference to the normal cost of production. Neoclassical economists have selected this line of argument in The Wealth of Nations for special emphasis. It helps support the idea that the self-regulating ‘perfect competition’ of neo-classical theory needs no government intervention for the protection of social interests. Yet Smith recognises, at least by implication, that divergences from natural prices are so significant and so durable as to require some government intervention. He describes a money-bargaining system in which ‘natural
pricing’ – meaning prices determined by the ‘ordinary or average’ cost of production – does not naturally occur. Rather the manoeuvrings of the agents involved, motivated by their interest, naturally move prices of labour and all goods and services consistently away from his concept of the natural price. In later Books he is more specific with regard to requirements for intervention, as for example with regard to the regulation of joint-stock companies (2009, pp. 548-9).

The neoclassical idea of perfect competition, expressed largely in mathematical terms, and hence assuming some of the incontestability of a mathematical theorem, provides what is perhaps a more secure foundation than Smith’s idea of ‘natural prices’, with the implication that its rejection of government intervention is also better substantiated. Neoclassical theory sustains the fiction of the social efficacy of ‘market prices’, and the ill-effects of government intervention, when no markets in the neoclassical sense are operative. Like Smith, neoclassical theory provides modifications to the basic model that take into account elements of a bargaining process, but as adjustments, or modifications, to a mathematically refined system, that appear as of much lesser importance than the basic model, and are correspondingly less persuasive in countermanding the principle of laissez faire.

Neither Smith nor neoclassical economics deals satisfactorily with companies and technology, possibly because both companies and technology introduce such divergences from ‘natural pricing’ or ‘perfect competition’ as to make it plain that social control is necessary to maintain social interests. Demsetz (1988, p. 142) notes that perfect competition has little to say about firms, being derivative from eighteenth century theory that had similarly small understanding of firms:

What parades as perfect competition is a model that has much to say about the price system, but little to say about competition or the organization of firms. This probably is due to its intellectual origins in the eighteenth-century debate between mercantilists and free traders. The debate was not about competition per se, and it certainly was not about the organization of the firm. It was about the proper scope of government in the economic affairs of England and Europe.

Demsetz sees the theory formation of both Smith and neoclassical economics as deriving from concern not about competition but about the role of government. Smith is inclined to see government as detrimental to an ideal system of natural pricing, but describes a real system of money-bargaining, so that his judgements against government intervention are compromised and qualified. Neoclassical economists build a stronger core theory, and can more firmly condemn government intervention. But the adjustments to the basic model to bring it into something like plausible accord with reality inexorably make it plain that government regulation is required to produce a process that is socially tolerable.

These characteristics of both Smith’s account of an economy and the neoclassical account accord with the understanding in intellectual support-bargaining of theory formation as a means of assembling support for particular interests. This support is then available to sustain groups pursuing more specifically political interests in political support-bargaining. The common interest of both Smith and neoclassical theorists lies in the limitation of government regulation of business, and their theories display the advantages of such limitation.
Situation-related Value

The question of value is a central concern of economic theory, marking major phases in the development of economic theory, and major points of differences between economic theory groups. Neoclassical economics distinguished itself from classical theory by rejecting the labour theory of value, while Karl Marx insisted that labour was the source of all value.

Adam Smith approached the question of value by identifying what has come to be known as the ‘paradox of value’: that something so obviously valuable as water comes to have much less monetary value than something so obviously useless as diamonds. Smith (2009, p. 24) refers to the contrasting valuations of water and diamonds at the end of Book I, Chapter IV as a way of introducing his account of price formation in the following three chapters. He notes that the word value has two different meanings. It sometimes refers to the utility of an object and sometimes the power of purchasing other goods that possession of the object implies. The one is the ‘value in use’ and the other the ‘value in exchange.’ Water has a very high value in use, but scarcely any value in exchange. Diamonds, by contrast, have scarcely any value in use, but a high value in exchange. In Chapters V to VII he endeavours to explain the real measure of exchangeable value, the different parts of this real price, and the circumstances which generate divergences from the real price. Diamonds, Smith concludes (2009, p. 133), are valued for their beauty, and that value is enhanced by their scarcity and the expense of getting them. Their money value lies almost entirely in the labour and profit involved in getting them. It can be inferred that water can be had for very little labour, so its price is very low. Smith (2009, p. 24) apologises for the length of his exposition, before acknowledging that, ‘…after taking the utmost pains that I can to be perspicuous, some obscurity may still appear to remain upon a subject in its own nature extremely abstracted.’

The contrast in usefulness and exchange value between water and diamonds has subsequently formed one of the favoured illustrations of marginal valuation. The utility value of water bears little relationship to its price because the marginal utility of water is very low. People place little value on water beyond a certain limit. With diamonds, however, the marginal utility is held to be high, so high prices can be obtained for diamonds.  

It will be apparent from the above account of consumer selection that value in bargaining theory is conceived as relative to situation. People need and want what will improve their situation. Without water their situation will move very shortly from the uncomfortable to the critical, so water has very high value relative to situation. The services of a plumber have a high value in an emergency situation, when the consumer bargaining set has important time constraints. Diamonds are valuable because of their significance to a socially defined situation. In western culture – that is, in western social support-bargaining – diamonds are associated with love and marriage. A woman wearing diamonds is seen to be loved and honoured. Diamonds are consequently highly valued in western society.

The money value of water and diamonds is determined by bargaining positions in the money-bargaining system. In Smith’s time most people could get water by fetching or collecting. So its value in exchange would have been small. It is difficult to establish a money-bargaining position in a product that is so freely available. Today, companies

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3 For discussion of the same paradox in terms of jade and bread, see Spread, 2004, pp. 40-5.
find that people want not just ‘water’, but something that fits their situation more closely. They want water that can be drunk without risk to health; they want water on tap in their houses; they want reliable supply; they want an abundant supply at a price that fits their budget, so they can fill swimming pools and sprinkle their gardens. Companies can format to provide pure water in pipes to all the buildings in a locality at a price everyone can pay. The need for reservoirs and reticulation systems, facilities that are inconvenient to replicate in the space available, means that there is reason for the development of monopoly supply. In Britain the state intervenes to ensure that companies cannot establish the strong bargaining positions that arise from permanent monopoly, but can establish bargaining positions sufficiently strong as to permit viable businesses.

Similarly, people do not want just ‘diamonds.’ They want diamonds set in rings, earrings, necklaces, bracelets and other items of mainly female adornment. These requirements reflect the social significance of diamonds. Their social significance depends in part on a high monetary value. Being loved and honoured is being valued. If diamonds were cheap, they might not convey the right message. Consequently there is cultural value in a high price of diamonds. The De Beers mining company formatted its operations in the twentieth century in such a way as to maintain a high price of diamonds, involving stockpiling to control the flow of diamonds onto the bargaining sets for gem diamonds. They also reinforced the social significance of diamonds by their advertising. In the twenty-first century it has become more difficult to control supply and price, with supplies from various countries becoming available in substantial volume outside the control of the De Beers company. Suppliers have been involved in legal proceedings concerned with the manipulation of the price of diamonds. Strong demand, including strong Chinese demand, has, however, recently maintained good prices for diamonds.

Buyers normally have some interest in diamonds being of high value, but they must still fit within a consumer budget. The relevant budget is not necessarily that of the person who will enjoy the purchase, since a large proportion of sales of diamonds are bought as gifts. Men like to mark their commitment to an intended spouse with the gift of a diamond ring. While the value of the gift must reflect his valuation of his intended spouse, it must also fit in with his other budgetary commitments. The budgetary impact of the acquisition may be softened by the reflection that a substantial part of the money value of diamonds can be recovered in the future. This aspect of the purchase of diamonds depends on the ability of supplying companies to maintain high prices for diamonds.

Because the value of diamonds relates to a socially defined situation, it would in principle be possible to bring down the price of diamonds by convincing society that their value is illusory. If females could be convinced that diamonds were of no importance, then their price would drop. Smith (2009, p. 298) makes a contribution to this process, though his target is the vanity of men: ‘For a pair of diamond buckles, perhaps, or for something as frivolous and useless, they exchanged the maintenance, or, what is the same thing, the price of the maintenance of 1000 men for a year…’

Neither Smith nor neoclassical economic theory provides a satisfactory explanation of the valuations of water and diamonds. Neoclassical theory uses the water-diamond paradox to illustrate, as it claims, the advance of marginal theory over classical theory. But situation is the essential reference by which value is judged. In many respects, people’s situations are broadly similar. Everyone gets hungry and requires
clothes and shelter. They will value food, clothing and housing in similar ways. But in other respects, both material and conceptual, situations are always and necessarily dissimilar. People live in different locations. People have different experiences and different trains of thought that build up different ideas of their situations, and these generate different requirements, with different valuations. They have different budgets to allocate in accordance with these valuations. The valuations they derive by reference to their non-budgetary situations will be reflected in what they are prepared to pay from their budgets to accommodate those valuations. What they are prepared to pay will determine whether it is feasible for companies to format for the provision of the relevant products or services. Since most people derive revenues for their budgets from employment, what they are prepared to pay reflects the proportion of their work-time they are prepared to outlay on a particular product or service (Spread, 2008, 75-8).

Conclusion

The concept of companies prompts different interpretation of *The Wealth of Nations*, both with regard to its content and its omissions. It leads to queries regarding the association of neoclassical theory with *The Wealth of Nations*, suggesting that Smith’s description of the functioning of an economy is more a description of a money-bargaining process.

The major problem with Smith’s analysis is the failure to identify the importance of technology and companies. These emerged as the two most important factors in the growth of economies in the decades following publication of *The Wealth of Nations*. It has been suggested (Spread, 2008, p. 122) that the industrial revolution was set in motion basically by the assimilation of technology into business formats. Smith’s analysis emphasises from the outset the division of labour, without identifying the important of the organisational setting, and conceptually subordinates the development of technology to the division of labour.

Companies conceived as the specialist money-bargaining agencies of money-bargaining systems are the innovating, invigorating and organising elements in such systems. They focus the work of many to a purpose. Their formats very often depend on a particular technology. Smith assigns the ‘space’ of companies in an economy to the individuals that work for profit, though with very little of the function of companies. The individuals are presented in places as self-seeking to the point of greed, ready to exploit their mastery for their own ends and to the detriment of workers. Their sometimes excessive rewards contrast with the justice of a system of natural pricing providing a ‘normal’ profit. But given the concept of companies in money-bargaining, they are essential to the vigorous growth of an economy. The provision of goods and services suited to the circumstances of consumers, in locations convenient to them, depends on the skilful format of companies and their efficient operation.

Development of the neoclassical model in the late nineteenth century and subsequently was an academic exercise to establish social science on a similar footing to that of the natural sciences, in particular physics. Mathematics was the language of physics, so mathematics was adopted as the language of neoclassical economics. While in physics, the relationship between the mathematics and empirical observation was so close that they were inseparable, in economic theory-formation the mathematics was given great rein to diverge from empirical observation, partly
because it was thought that mathematics was preeminent in the definition of what was, and partly because the phenomena of economics were less well defined than the phenomena of physics, and consequently empirical observation could be imposed less readily as a check on the mathematical formulations. Neoclassical economists were building a mathematical model, not a realistic model. In that context, the omission of the phenomena of companies and technology was advantageous. Smith’s work seemed to sanction the omission. The division of labour, natural prices and the ‘invisible hand’ seemed to confirm the adequacy of the neoclassical conception. If they had been concerned with realism, they would surely have noticed the importance of companies and the significance of technology in the last two hundred years.

The neoclassical interpretation of The Wealth of Nations, and the dominance for over a century of neoclassical theory in the teaching of economics, has tended to obscure the fact that Smith describes a money-bargaining system. Those who make their living by profit, the ‘undertakers’ or ‘dealers’, manoeuvre to get the best returns they can. Workers similarly combine, if they are not prevented by law, to increase their wages. Smith’s account of pricing relates prices directly to the costs incurred by a producer unit, as in the concept of companies. Prices are determined in the producing unit. He describes markets with both locational and budgetary constraints, suggesting the bargaining sets of money-bargaining. He describes how transport facilities open up markets and facilitate business, corresponding to the role of transport in extending bargaining sets in a money-bargaining system. The division of labour, linked to the size of the market, though more accurately to the volume of sales, means that unit costs vary with the level of output and sales. One further step: put together in a company, Smith’s account of price formation, his account of markets and transport issues, and his account of the division of labour, shape something like the viability condition of the concept of companies described above.

Smith identifies frankly the injustices of the exchange process. He makes it plain that he disapproves of the advantages the ‘masters’ have in bargaining with labour. He also makes plain in the earlier books his disapproval of the interventions of government which create monopolies or permit particular ‘corporations’, or guilds, to limit the availability of the services they provide. In later books he makes it plain that to remedy various injustices it is necessary for the state to intervene. Smith generally approves ‘natural prices’ – the designation itself suggests approval – and opposes those influences that move prices from the ‘natural’, whether they are the result of artificial constraint on supply through private or public action or whether they are the result of natural limitations, though the latter are recognised as potentially irremediable. If an ‘invisible’ and just hand is active, then it is through ‘natural pricing’, though Smith’s analysis indicates plainly that natural behaviour in pursuit of private interest will not necessarily be conducive to social advantage.

Neoclassical theory appropriates Smith’s ethical overtones for its mathematical model. The model equates ‘natural prices’, with a new marginal interpretation, with an optimal allocation of resources and consequent social benefit. On that basis, Smith’s rejection of government intervention can also be appropriated. Theoretical economics takes the ‘perfect market’ as a core commitment of the theory group, the basis of its observation, understanding and prescription. It then seeks to reconcile the core to the displays of divergence from ‘natural prices’ described by Smith or to the diversity of competition described in money-bargaining. The incongruities apparent in reconciliation have troubled many economists for the last hundred years and more. If
a preconception is false it is inevitably difficult to interpret all that is observed without a sense of anomaly.

The motivation for this procedure was only partly the academic concern for a type of social theory that would have the security of natural science. By the late nineteenth century, with democratic reforms being instituted all over Europe, there appeared a real threat that the state would take over the running of great swathes of society, to the detriment of the interests of those who treasured their individual freedom of action. Smith’s concern over the encroachment of government into private affairs had grown more acute a hundred years later. Neoclassical economics provided a refined and ‘scientific’ justification for limiting the role of government in society. It provided a strong rationale for restraining possible incursions of government just when a threat of stronger incursions was apparent. Neoclassical theory flourished because it sustained not only the interests of its practitioners, but also the interests of broad business and political factions that were influential in the maintenance of the universities.

Smith’s condemnation of the behaviour of those who live by profit can be attributed in part to his lack of any concept of the role of companies as the specialist agents of money-bargaining systems. In the absence of such a concept the strong bargaining positions developed by companies are associated with ‘those who live by profit.’ Corporate bargaining strength is assigned to individuals. In some cases, for example the work of artificers and farming, the individual association no doubt reflected the reality. But when he is castigating ‘undertakers’ and ‘dealers’ Smith seems to have in mind larger business units. Without an understanding of the role and function of companies, including the complexities of management, the bargaining positions of the individual controllers of stock seem the consequences only of limitations on the supply of such people, or their collusion, rather than a consequence of their contributions. The monetary valuation of initiative and innovation, and capacities to direct, lead, inspire and organise, remain controversial today. The deficiencies of the analysis are the more apparent when associated with Smith’s extensive discussion, in Book V, Chapter I, Part III, Of the expense of publick works and public institutions (appearing first in the third edition of 1784, but quite probably in draft before the first edition (Anderson and Tollison, 1982, p. 1240)), of the problems associated with different legal forms of business organisation, including joint stock companies (2009, pp.545-62).

The concept of companies also illuminates the question of value, one of the most fundamental concerns of economics. Value relates to situation, understood in the broadest terms, including the obvious material elements of situation, but including also social situation as understood through a process of social support-bargaining. The realisation of requirements related to situation depend on allocations from a budget, itself part of the situation of any money-bargaining agency. How products and services are valued in a money-bargaining system depends first on how individuals value them in relation to their non-budgetary situation, and secondly on how they apportion their budgets, which is also the apportioning of the effort or action that goes into acquiring the revenues for their budgets. Neither The Wealth of Nations nor neoclassical economic theory provides a satisfactory account of value.

While it is suggested above that neoclassical theory is sustained principally by factional interest, its aesthetic and ethical elements may also give it wider appeal. The theory is neat in its rewards and penalties. Its components – ‘firms’, ‘consumers’, ‘markets’, ‘resources’ – all interact like a clockwork toy, governed by mathematical
relationships. It embodies a kind of mechanical justice. Resources are rewarded according to their productivity. It also maximises the output from a given input. It traces its descent from the venerable Smith. Neoclassical economists need not fret about the injustices of society. Rational economic man does not misbehave like rapacious capitalists. By contrast, money-bargaining involves secrets, injustice and ambiguity. Smith’s description of what is effectively a money-bargaining system (though it lacks crucial elements) is plainly an unfair system. Smith himself says so frequently and unequivocally. Money-bargaining lacks the allocative precision and justice of neoclassical theory. The name ‘money-bargaining’ suggests it lacks the refinement of a ‘neoclassical model.’ But then, it reflects how people behave, while neoclassical theory, without the factional role ascribed to it, is mere placebo. Money-bargaining is understood as deriving from support-bargaining, in which, though everyone is both individual and group member, the individual and the group are fundamentally and permanently engaged in bargaining for advantage (Spread, Forthcoming, Chapter 9). People retaining the concept of money-bargaining may be continuously disturbed by the recognition that much of it is ‘not fair’. It is not fair that workers lose their jobs. It is not fair that proprietors of businesses fail through no fault of their own. But while Smith condemns so much of what goes on in the system, he also sees its saving graces. He sees that the motivations of exchange bring prosperity. He sees that, to a great extent, people will get paid in accordance with the work they do. He sees that governments can enhance the fairness of exchange as well as diminish its effectiveness. The theory of money-bargaining, with its concept of companies, makes clear also that there is great advantage, and much virtue, in a money-bargaining system, even if there are also practices and outcomes that will be seen by many as unfair.
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