



Fakultät für Wirtschaftswissenschaften
Faculty of Management and Economics



Institut für Soziologie
Department of Sociology

IfS Discussion Paper 01/2020

**Adam Smith on Division of Labour
and Competition:
Preliminary Notes on Important
Concepts**

Manuela Gantschacher

**Discussion
PAPERS**

Manuela Gantschacher

Adam Smith on Division of Labour and Competition: Preliminary Notes on Important Concepts

IfS Discussion Paper 01/2020

Institut für Soziologie, Alpen-Adria-Universität Klagenfurt
Department of Sociology, University of Klagenfurt

IfS Discussion Paper

ISSN 2306-7373 (Internet)

© 2020 by the author

Manuela Gantschacher is graduate student at the Department of Sociology, Faculty of Management and Economics, University of Klagenfurt, Austria.
[manuelag\(at\)edu.aau.at](mailto:manuelag(at)edu.aau.at)

Institut für Soziologie
Fakultät für Wirtschaftswissenschaften
Alpen-Adria-Universität Klagenfurt
Universitätsstr. 65-67 | 9020 Klagenfurt | Austria

Tel. +43 2700 3400
Fax +43 2700 993400

<http://www.aau.at/soziologie>
[sozio\(at\)aau.at](mailto:sozio(at)aau.at)

All papers published in this series can be accessed here:
<http://www.aau.at/soziologie>

Select *Publications/Discussion Papers* from the menu bar

Table of Contents

Abstract.....	4
1 Introduction.....	5
2 Adam Smith and <i>The Wealth of Nations</i>	5
3 About the Author.....	6
4 The Division of Labour and Resulting Effects	7
5 From Competition and Self-interest.....	9
6 The Invisible Hand Metaphor	10
7 Relevance and Conclusion	12
References	14

Abstract

Adam Smith's groundbreaking contributions to economics are probably known to every scientist or student of economics. Over the last decades, his great insights on the division of labour, his notions on competition and self-interest, as well as his famous metaphor of the invisible hand were still taught. Based on his work "*The Wealth of Nations*", this paper tries to give a glimpse into his discoveries. While Smith's work is said to be the basis of economics as we know it, still the question arises whether his notions are contemporary. The paper attempts to rediscover the key issues discussed by Smith and is answering the question of its contemporary relevance. Conclusions highlight his achievements as crucial for today's research on entrepreneurship and uncover limitations in his explanations.

Keywords: Adam Smith, Labour, Competition, Self-interest, Invisible Hand

1 Introduction

Adam Smith's work was the culmination of the early development of national economic thinking, and because of him, economics came to maturity (see Heimann 1949, p. 81). Among his predecessors and students, none of them could compete with him in terms of realism. His approach to economics reflected the concerns and approaches of philosophic inquiry (see Cantillon 2010, p. 5).

One of the most basic tasks of moral philosophy for Smith is explanation, to provide an understanding of forms of behaviour that are traditionally called moral (see Haakonssen 2006, p. 4). Smith saw moral philosophy as central to a new science of human nature. He analysed our moral practices in terms of the qualities of human agency, or character. Additionally, he found ways of accounting for our tendency to follow rules and our inclination to give moral weight to the consequences of actions (see Haakonssen 2006, p. 5).

Despite all these great insights which were generated through Adam Smith, it has to be questioned if his notions are still contemporary, and whether it makes sense to teach, read, or comply with them. Therefore, this seminar paper is dedicated to answering this question. The paper initially tries to rediscover the key content of Adam Smith's great opus *The Wealth of Nations*. First, the contents of the book will be described and also the relevant elements for writing this paper will be identified. Second, Adam Smith's life will be reflected, both in personal and in professional terms. It will be particularly emphasized how he came to writing his work *The Wealth of Nations*. Subsequently, chapter three deals with the division of labour and the specialization of individuals in their own branch. Moreover, in this context, competition and self-interest is discussed.

From there, chapter four moves on to the description of the invisible hand metaphor, and to an explanation of how it leads to unintended consequences.

At the end of this paper the content of *The Wealth of Nations* will be summarized and the initial question of the current relevance of Smith's theories will be answered. In addition, some ambiguities and limitations of Smith's notions will be discussed.

2 Adam Smith and *The Wealth of Nations*

Economists see the birth of their science in the publication "An Inquiry into the Nature and Causes of The Wealth of Nations" written by Adam Smith (see Loerwald et al. 2008, p. 13). Accordingly, economics and society are inseparably linked with each other in terms of discipline history. It can be noticed that the analysis of social phenomena and problems have been the core of economics since the beginning. Hence, this extremely important literary work was discussed in the context of the sociology class at the Alpen-Adria-University in Klagenfurt and builds the basis for this paper.

Before *The Wealth of Nations* was published, Smith had already written another significant work called *The Theory of Moral Sentiments*. In 1759 he began to address the question of how economy works and why people act economically. The content of this book is about why people, in addition to their natural instinct for self-preservation, also feel something like

charity. The Wealth of Nations was then published in 1776, seen as a violent attack on the economic system in the United Kingdom at that time. The book also represents the division of labour, the tendency of people to barter and trade, and describes a theory of an economic cycle at the end of which stands the prosperity of nations. Additionally, the concept of self-interest becomes important, which ensures a functioning economy. In this context the metaphor of the “invisible hand” appears, which is still one of the foundations of classical economics and will be discussed later.

The Wealth of Nations consists of 5 separated parts (books). The relevant parts for this paper are firstly “Chapter 1 - Of the Division of Labour” from “Book One”, secondly “Chapter II - Of Restraints upon the Importation from Foreign Countries of such Goods as can be produced at Home” from “Book Four”, which also contains the concept of the invisible hand, mentioned above and thirdly “Chapter II - Of the Principle which gives occasion to the Division of Labour” in “Book One”, which gives important information about competition. Smith made important foundational contributions to economics, but from perspectives that were quite different from those of other scientist (see Cantillon 2010, p. 5). Often, he is called “the father of political economy”, as his work is full of advice for people who hold political power. In both of his books, The Wealth of Nations and The Theory of Moral Sentiments, he argued that in order to create an effective and productive capitalist system, all individuals have to pursue their own interests and those of the society (see Newbert 2003, p. 251). But despite his assertions, modern economic theory has become focused on economic self-interest at the expense of other, higher order motives. Therefore, it can happen that the tendency to employ such an egocentric strategy often generates inequalities that serve to detract from the greater welfare of society. For this reason, the question of the relevance of Smith’s statements is justified and needs clarification.

3 About the Author

This section deals with the question of who Adam Smith was and how he came to write his revolutionary work on modern economics.

Adam Smith was born in 1723 in Kirkcaldy, which is located on the east coast of Scotland near Edinburgh (see Skousen 2007, p. 12). Unfortunately, he was born in the same year that his father died. From his birth on, Adam Smith was destined to be a student of trade and a customs agent, as seaports and commerce were integral parts of his life. At the age of fourteen, Smith started to attend the Glasgow University, then he won a scholarship to Oxford (see Skousen 2007, p. 13). He spent many years there studying Greek and Latin classics, as well as French and English literature, but also science and philosophy.



Figure 1: Adam Smith (see Skousen 2007, p. 3)

Although little is known about Smith, it can be said, that his focus of affection was always his mother, whom he cherished. Smith had many female acquaintances over the years, and from his biographers, it is related, that as a young man Smith fell in love with a beautiful lady, but unknown circumstances prevented their marriage, so he was never married. In terms of physical appearance, Smith was rather of average height and a little overweight (see Skousen 2007, p. 14). He stated about himself that he was a "beau" in nothing but in his books.

Between 1748 and 1751 Smith held numerous public lectures, which earned him a professorship in Glasgow. He took on this position as professor of moral philosophy, after his graduation and held it between 1751 and 1763. In 1759, his first major work *Theory of Moral Sentiments*, which was mentioned above, was published. At that time Smith was established as an influential Scottish thinker.

It was 1764 in Charles Townend, when a leading British Member of Parliament offered Smith a handsome fee as well as a lifetime pension to tutor his stepson (see Skousen 2007, p. 15). As part of his new position, they travelled to France, where Smith met many great French thinkers, among them Voltaire, Turgot and Quesnay. Thereafter Smith had lost interest in his tutoring duties, so he began researching and writing *The Wealth of Nations*. Writing this book took him ten years, but finally published by the premier English publisher, it immediately became a bestseller.

Several months before his death, he begged his closest friends to destroy nearly all of his unpublished papers, and so they did (see Skousen 2007, p. 17).

On July 17 in 1790 Adam Smith passed away in Edinburgh (see Skousen 2007, p. 18).

4 The Division of Labour and Resulting Effects

In addition to many other statements in Smith's great work *The Wealth of Nations*, one of the most significant findings was that the impact of the division of labour is a massive improvement in productive powers (see Smith 1977, p. 17). Smith's goal was to reveal the true source of wealth, as the accumulation of gold might have filled a lot of pockets of the rich, but he was interested in the question, what would be most beneficial or bring the most of wealth for the whole nation or the average citizen (see Skousen 2007, p. 9). With his work, and especially in this chapter one of the first book of *The Wealth of Nations*, it becomes clear that his assertions are not only a tract on free trade, but a world view of prosperity. Adam Smith argued that the keys to the "wealth of nations" were production and exchange. Hence the source of wealth does not lie in the acquisition of gold at the expense of other nations. Having the question in mind, where wealth is created, Smith first tried to define what wealth was. He stated that wealth is measured according to how well a person is lodged, clothed and fed, and not according to the amount of gold in their treasury. Having defined what he regards as the wealth for a nation, he asked, what could bring the greatest improvement in the productive powers of labour, and this led him to the

superior management technique of "division of labour".

In the general business of society, the effects of the division of labour, will be more easily understood by considering in what manner it operates in some particular manufactures (see Smith 1977, p. 17). The division of work in great manufactures is not nearly as obvious, and has been much less observed, as the division in very trifling manufactures. Therefore, Smith gives a very well-known example of a pin-factory to illustrate his findings. Apparently, the production of metal pins can be divided into about eighteen distinct operations, which can all be performed by distinct people or sometimes the same man can perform two or three of the operations (see Smith 1977, p. 18). The main message of this metal pin production example is, that if someone who is not specialized in the production of such a good or is unfamiliar with the machinery, despite his best efforts, will find it difficult to produce the required number of products per day. But if the same work is divided into a number of branches, the workmen are capable of producing a much greater number of products, in consequence of a proper division and combination of their different operations.

The effects of the division of labour will be similar in every form of manufacture, but it also depends on whether the work can be divided so heavily or reduced to such ease of use. Adam Smith's greatest finding was that this division of labour, as far as it can be done, results in a proportional increase in productive labour in every trade (see Smith 1977, p. 19).

This separation of different trades and employments is generally called furthest in those countries which enjoy the highest degree of industry and improvement.

This result of the division of labour - to establish an enormous increase in the amount of work, with a constant number of employees - has three causes (see Smith 1977, p. 21). Firstly, the improvement of the dexterity of the workman necessarily increases the quantity of the work he can perform. Secondly, the productive powers of labour increase due to the saving of the time which is commonly lost in passing from one species of work to another. And thirdly, Smith argues that everybody must be sensible of how much labour is facilitated and abridged by the application of proper machinery.

Although now this was just a quick overview of the first chapter it is noticeable that if Smith had stopped writing his long Wealth of Nations after the first chapter, the contribution to the economic prosperity of commercial society would still be secured forever (see Dougherty 2002, p. 38). This is because his opening pages already contain such an enormous insight into the infrastructure of capitalism, namely the division of labour. He also instructed his readers in something that is taken for granted today: the specialization of work. Thinking of all the improvements in machinery that happened over time, it can be derived that the inventions have by no means been made by the workmen who used the machinery, rather by the so called philosophers or men of speculation, whose trade it is to observe everything (see Smith 1977, p. 25). Like every other employment too, this kind of work is also subdivided into a great number of different branches. A subdivision of employment, may it be in philosophy or in any other business, improves dexterity and saves time. Thereby each individual becomes more expertized in his own branch and more work is done upon the

whole.

It can be determined that Smith's opinion of a market is not only its power as engine of wealth, but also it is a system of signals for setting prices and wages. Further, markets are regulating the supply and demand and inducing risk and invention (see Cantillon 2010, p. 54). But as the market raised the wages of the working class through accumulation of wealth, the number of workers with higher wages and better living conditions would increase as well and in the course of this, the competition among them.

5 From Competition and Self-interest

Now the division of labour has been explained, but in his first chapter, Smith mentions yet another important concept and describes it again by means of an example. Going back to the division of labour, it is stated that the nature of agriculture does not allow so many subdivisions of labour, nor allows such a complete separation of one business from another as it is the case with factories (see Smith 1977, p. 20). Therefore, Smith says that this impossibility of achieving a complete separation of all the different branches of work used in agriculture, is one reason why the improvement of productive labour in this art does not always keep up with the improvement of manufactories.

Although the most opulent nations generally excel their neighbours in agriculture as well as in manufactures, nevertheless it can be noticed that the work of a rich country is not always more productive than the one of a poor country. This is because the rich country yet enjoys a superior production but also has to shoulder more labour and expense. What this agricultural example tries to clarify is competition. If a poor and a rich country are compared in terms of competition, the poor country can compete to some extent with the richer one in cheapness and quality of its production, but it is crucial that it cannot fake such competition in its manufactures (see Smith 1977, p. 21).

In his work, Smith offers many more insights into the behaviour of individuals, which can also be applied to today's entrepreneurs. In the second chapter of *The Wealth of Nations*, among other things he deals with the difference of natural talents in different men. Smith states that the difference between the most dissimilar characters seems to arise not so much from nature as from habit, custom, and education (see Smith 1977, p. 32). When two different professions are compared, for example a philosopher and a street worker, it shows that they are by nature only half as different in genius and disposition (see Smith 1977, p. 33). He also tries to introduce an example from the animal world, which should show both the similarities and the differences of individuals. When comparing two breeds of dogs, for example a mastiff and a greyhound, they are quite similar by nature, like the human beings, but the strength of the mastiff is not supported by the swiftness of the greyhound. Hence each animal is still obliged to support and defend itself independently. It derives no sort of advantage from the talents of its fellow, so they are of scarce any use to one another and it can be concluded from that, that the biggest bone is taken by the strongest and fastest. On the contrary, among men, the most different geniuses and talents are of use to one another.

Now it may be asked what this animal-example has to do with human reality. The answer is, although a man can use the benefits from the talents of his fellows and can help them in return as well, he still will care about himself the most, like the dogs do. This statement can also be found in one of the most important sentences in this chapter: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest." (Smith 1977, p. 30) - and shows Smith's ideas about self-interest (see Smith 1977, p. 30).

In terms of competition, for a very long time people believed that the intensity of competition was depended above all on how many economic agents were participating in the market and that competition would function better, the greater the number of suppliers was (see Van Suntum 2005, p. 9). This imagination led to the development of the model of perfect competition, a model which was based on the assumption that products were being bought and sold on ideal markets by completely rational individuals.

Later, Schumpeter pointed out that every inventor of a new product was initially in a monopolistic position (see Van Suntum 2005, p. 10). In his opinion, this is the most important incentive for any entrepreneur to put new products and processes on the market in the first place. But what happens than is that over time increasing numbers of imitators will enter the market and the entrepreneur's initial lead over his competitors will fade away. This dynamic sequence of innovation and imitation constitutes the actual essence of competition, which was not described by Smith in this way, though his revolutionary work (see Van Suntum 2005, p. 11).

6 The Invisible Hand Metaphor

Although a person's self-interest plays a significant role, one would think that a truly wise person will overlook considerations of self-interest in order to embrace the interest of larger entities (see Force 2003, p. 69). At first sight it would seem that there is a contradiction between the idea that the pursuit of individual interest will have beneficial consequences for the whole. In Smith's perspective, however, these two ideas are far from being contradictory.

The invisible hand, which will be explained in this section, can only be found once in *The Wealth of Nations*, on page 593 in "Chapter II of Book 4". Basically, the expression "invisible hand" appears only three times in the entire corpus of Smith's work (see Force 2003, p. 70). The first occurrence has already been mentioned, the other two can be found in *The History of Astronomy* and in *The Theory of Moral Sentiments*.

"Chapter II of Book 4" states that the monopoly of a home market is secured if the importation of goods from foreign countries, as can be produced at home, is restrained (see Smith 1977, p. 589). Restraining these importations can either be made possible through high duties or by absolute prohibitions. Right at the beginning of this chapter, Smith states that no regulation of commerce can increase the quantity of industry in any society beyond what its capital can maintain. Moreover, every individual is continually exerting himself to

find out the most advantageous employment for whatever capital he can command. So again, it is his own advantage and not that of the society, which he has in mind. But the study of his own advantage necessarily leads him to prefer that employment which is most advantageous to society.

Smith makes two statements to explain the invisible hand metaphor. The first one says that every individual endeavours to employ his capital as near home as he can, and as much as he can in the support of domestic industry (see Smith 1977, p. 590). The second one states that every individual who employs his capital in the support of the domestic industry, necessarily strives so to direct that industry that its produce may be of the greatest possible value (see Smith 1977, p. 593). What Smith means with these statements is that every individual necessarily labours to render the annual revenue of the society as great as he can, but by preferring the support of domestic to that of foreign industry, he intends only his own security. As well as by directing that industry in such a manner as its production may be of the greatest value, he intends only his own profit.

In both cases, this person is led by the so called “invisible hand” to promote an end, which was no part of his intention. By pursuing his own interest, he frequently promotes that of the society more effectually than when he actually intends to promote it.

The “invisible hand” obviously implies a specific subset of possible unintended consequences, of which three elements may be identified. (see Aydinonat 2008, p. 12). The first element in the confusion in “unintended consequences” is the concept of “intention”. When talking about an individual’s intention, it could be implied that the individual has a purpose or a plan, but these two meanings should be distinguished. An intention necessarily indicates that one has a purpose, however it is not necessary that the person has a plan too. The second element is the concept of “consequence”. To be clear about what is implied by unintended consequences of intentional action, a distinction between “consequences” and “results” has to be made. The result of an intention should be considered as an action, on the other hand, the consequences of an action should be regarded as the things caused by that action, whether they were intended or unintended (see Aydinonat 2008, p. 13). The third element is the concept of “unintended consequence” itself, which implies relations between intentions and consequences.

To come back to Smith’s doctrine of the invisible hand, it can be said that it has become a popular metaphor for unfettered market capitalism (see Skousen 2007, p. 19). Besides the workings of the market economy, the phrase “invisible hand” has also come to symbolize the workings of natural science. The expression can be used in a positive way, like defenders of the market economics did. They characterized the market hand as one that improves the life of people and as “gentle”. Critics used a contrasting comparison for the phrase, expressing their animosity towards capitalism. This rather negative description contrasts the “invisible hand” with the “visible hand”, “the grabbing hand”, and the “iron fist” of government, a hand that destroys people’s hopes and dreams.

Overall, the “invisible hand” works in harmony, resulting in an increase in the output of goods which people desire (see Skousen 2007, p. 20). Consequently, still the “invisible hand”

is one of the best-known phrases in economics, but it is noticeable that its meaning is somehow ambiguous (see Holcombe 2006, p. 189). Adam Smith says that individuals are led by an “invisible hand”, yet it might also be viewed as holding the economy close to equilibrium. An economy generates progress because it is led by entrepreneurial forces, this forces though are determined by disruptive entrepreneurship. However, it is now more accurate to view an economy as characterized by continuing progress, which is led by the invisible hand of entrepreneurial activity, rather than viewing it as tending towards an equilibrium.

7 Relevance and Conclusion

With his book *The Wealth of Nations*, Smith provided many insights into the economy. Already after the first chapters, which was presented in this paper, it shows that his thoughts were pioneering. However, since his time, there have been vast economic changes and the question arises whether his notions of human nature are still of interest today.

Overall, it can be said that the modern reader of economy and society still benefits from Adam Smith’s understandings. Of particular interest was the division of labour that is taken for granted nowadays, as well the resulting degree of specialization, which is still relevant to today’s entrepreneurship. In *The Wealth of Nations*, Smith argued that in order to create a productive capitalist system, individuals must pursue interests of the self and the society (see Newbert 2003, p. 251). Modern economic theory though has become focused on the pursuit of economic self-interest at the expense of higher order motives. Regarding the division of labour, some things have remained unclear. It should have been explained better if the division of labour takes place on the level of concrete working levels, or on society, or in between businesses. Furthermore, Smith’s explanations are missing the inclusion of legal constructions or financial institutions, which would have surely complicated his findings.

Adam Smith attached a great value to natural liberty over all other systems of direction and he had serious reservations about capitalism. His remarks on how government intervention through trade and labour policies create inequalities still hold true for the modern capitalist system. This in turn serves to detract from the greater welfare of society. Fortunately, today’s entrepreneurs are not only seeking to satisfy selfish and ethical motivations, but they are also contributing to the overall welfare of society through job creation, wealth redistribution and a reduction of discrimination. The impact of the capitalist system which was envisioned by Adam Smith, is thus being realized through entrepreneurship.

It can be seen, that long before the field of entrepreneurship has emerged, Smith has already written about the self-interest of the individual, an entrepreneurial individual who creates added value for society through the pursuit of his own interests. However, two very important areas of current entrepreneurship research are missing: opportunity and innovation. Schumpeter, for example, argues that the process of creative destruction, which is characterized by the introduction of innovations into the marketplace by entrepreneurial

firms, is crucial to overall economic growth (see Newbert 2003, p. 257). For this reason, Smith's views should necessarily be supplemented by recent literature.

Finally, it remains to mention that Smith did not describe the "invisible hand" as a mechanism that holds the economy near an equilibrium. He described it as an "invisible hand" that leads the economy on a path of economic progress determined by the entrepreneurial actions of producers. Although the "invisible hand" is regarded as somewhat magic, despite it, capitalism does not universally result in a contribution to social welfare. For this reason, many social economists are critical towards a self-seeking and profit oriented entrepreneur and reject Smith's argument that self-interest will lead to social well-being.

There are many advantages and disadvantages in the notions of Adam Smith, but overall his work forms the basis of economics as we know it and is beyond that a crucial building block for entrepreneurship research.

References

- Aydinonat, N. Emrah (2008): *The Invisible Hand in Economics. How economists explain unintended social consequences*, London and New York: Routledge.
- Cantillon, Richard (2010): *An Essay on Economic Theory*. An English translation of Richard Cantillon's *Essai sur la Nature du Commerce en Général*, Auburn: Ludwig von Mises Institute.
- Dougherty, Peter J. (2002): *Who 's afraid of Adam Smith? How the market got its soul*, New Jersey: John Wiley & Sons, Inc..
- Force, Pierre (2003): *Self-interest before Adam Smith. A Genealogy of Economic Science*, New York: Cambridge University Press.
- Haakonssen, Knud (2006): *The Cambridge Companion to Adam Smith*, University of Sussex: Cambridge University Press.
- Heimann, Eduard (1949): *Geschichte der volkswirtschaftlichen Lehrmeinungen. Eine Einführung in die nationalökonomische Theorie*, Frankfurt am Main: Vittorio Klostermann.
- Holcombe, Randall G. (2006): Does the invisible hand hold or lead? Market adjustment in an entrepreneurial economy, Tallahassee: Springer, *The Review of Austrian Economics*, Vol. 19, pp. 189-201.
- Loerwald, Dirk / Wiesweg, Maik / Zoerner, Andreas (Hrsg.) (2008): *Ökonomik und Gesellschaft. Festschrift für Gerd-Jan Krol*, Wiesbaden: VS Verlag für Sozialwissenschaften, 1. Auflage.
- Newbert, Scott L. (2003): Realizing the Spirit and Impact of Adam Smith's Capitalism through Entrepreneurship, *Journal of Business Ethics*, Vol. 46, pp. 251-261.
- Skousen, Mark (2007): *The big three in economics. Adam Smith, Karl Marx, and John Maynard Keynes*, New York: M.E. Sharpe.
- Smith, Adam (1977): *An Inquiry into the Nature and Causes of The Wealth of Nations* (orig. 1776) (with Preface by George J. Stigler), Chicago: Chicago University Press.
- Van Suntum, Ulrich (2005): *The Invisible Hand. Economic Thought Yesterday and Today*, Heidelberg: Springer.