

## At the origins of natural price: Smith's theory of value in reverse

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### Abstract

Reading Smith's theory of value in reverse, this article shows how the emergence of the natural price can be accounted for in the *Wealth of Nations*. Contrary to what is often stated, we argue that, for Smith, wages, profit and rent cannot be established prior to the exchanges. Their value is determined by the proportion established in exchanges, through common evaluation and agreement, taking into account different aspects associated with the employment of each factor. We show that the way in which the natural price of a good is determined in early and rude society is not substantially different from that in advanced society. However, advanced society may imply the splitting of the exchangers into the different figures of the worker, the owner of stock and the landlord. This division can lead to a bargaining power asymmetry between them, which is reduced only in the progressive state of this kind of society. In this state, the exchangers stand again on a more equal footing, as in the early and rude state.

**Key-words:** Adam Smith; Natural Price; Theory of Value; Exchange;

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### Introduction

In this article we show that Smith's theory of value can be read in reverse to how it is usually read, and that this inversion helps us to explain how, according to him, natural prices emerge in the first place.

Smith's theory of the natural price is commonly interpreted in one of the following ways. First, as a theory in which the natural price would be a long-run equilibrium price, determined by the normal costs of production, which would be taken as given by individuals prior to market exchanges (Schumpeter, 2006 [1954]; Hollander, 1973; Bowley, 1973; Dobb, 1973; Blaug, 1985; Brems, 1986).

This line of interpretation has been challenged for the circularity of its reasoning, as it requires that the long-run equilibrium price to be known *a priori* in order to calculate the initial cost of inputs (see Cartelier 1976, Benetti 1981, Garegnani 1983, and Aspromourgos 2009).<sup>2</sup> The alternative proposed is a component theory of prices, in which the natural price is determined by the sum of the natural rates of wages, profits and rent, which should be determined independently of the market process (supply and demand). However, those supporting this interpretation usually contend that Smith failed to explain the determination of the natural rates independently from the interaction between supply and demand (with the possible exception of the natural wage). So that, in the end, there would be no complete theory of prices in Smith, and the natural rates would be simply taken as given by customs.

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<sup>2</sup> See also O'Donnel (1990) and Hurtado (2003).

According to a third line of interpretation, relative prices would instead be determined by the proportion between the quantities of labor spent in production (Peach, 2009; 2020). In this sense, these quantities of labor are understood as the production costs of employing labor, i.e. the wage. This interpretation, however, assumes that wages are objectively given and does not explain how the natural wage arises in the first place.<sup>3</sup>

Reading Smith's theory of value in reverse, we instead intend to account for how the natural rates that compose the natural price (usually seen as given) emerge in the first place. We argue that, according to Smith, natural prices are originally established through the common estimation and agreement people make while exchanging. That is, that the natural rates whose sum determine the natural price are originally the result of an agreed evaluation regarding the exchange value of labor, capital and land employed in production. This evaluation takes into account the nature of the different employments of labor and capital, as well as the natural or improved fertility of the land. When measured in real terms, the natural price of something will thus consist in a proper quantity of labor that is due as a compensation for the labor, capital and land employed in production.

The point is that the quantity of labor that must be paid to properly compensate the employment of each factor is not given, nor can be calculated, before the exchanges, but rather can only be determined by common estimation and agreement in the market. This happens because, according to Smith, the quantity of labor employed in production, the risk and trouble of the merchant, and the compensation that is (at least partially) due to the landlord for the improvement of the land, all must be originally evaluated in the exchanges. That is, they are not objective quantities that can be calculated or are given *a priori*, but are subjected to common estimation, taking into account the nature of the employments.

This means that price, or the quantity of labor that must be paid for something, is not a proportion given by objective quantities of labor that could be originally calculated prior to exchange in terms of physical labor inputs<sup>4</sup>, by means of a given price of labor<sup>5</sup>, or in terms of units of an absolute disutility felt equally by all individuals.<sup>6</sup> So that the exchange value of commodities would be given by the proportion between known quantities of labor expended in production. As this paper shows, on the contrary, it is the proportion consensually established through bargaining in exchange that effectively provides an evaluation to the quantities of labor that must be paid to each production factor. In this sense, it is the common esteem that people have for different talents, as well as the recognition of the risk and trouble related to the employment of capital and improvement of the land, that gives value to the quantities of labor in the exchange (WN I.vi.3). Smith's theory of exchange value, therefore, can be read in reverse to how it is usually read.

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<sup>3</sup> For a critique, see Grieve (2019).

<sup>4</sup> Bowley (1973), for example, understands the quantity of labor employed in producing or acquiring something as the physical labor-input (at least in the "primitive" state). For Henry (2000), this concept means a kind of absolute value (different from the price), understood as the labor embodied in the commodities.

<sup>5</sup> This is the case of those who interpret Smith's "quantities of labor" in terms of a costs of production theory of prices, in which the quantities are prices that are given before the market exchanges. See Schumpeter (2006 [1954]), Hollander (1973), Dobb (1973), Blaug (1985) and Brems (1986). For a critique of these approaches, because of their circular reasoning (they require the long-run price to be known in order to calculate the initial cost of inputs) see Benetti (1981) and O'Donnell (1990). See also Hurtado (2003).

<sup>6</sup> See Bowley (1973, p. 113-4, 116) and Paganelli (2020, p. 34). For a critical view, see Aspromourgos (2009, p. 298-9, n. 55).

From this perspective, natural prices arise originally from the common estimation of the natural rates of wages, profits and rent. As it is argued in this article, this estimation is based on the nature of the different employments of labor and capital (while the compensation due to the improvement of land is seen as a kind of profit)<sup>7</sup>. According to Smith, wage and profit differentials depend on factors that are neither objective nor related to disutility<sup>8</sup>, but rather require evaluation, such as hardship, ingenuity, skill, risk and trouble, among many others.

This in turn means that the natural rates are not primarily and directly determined by the general economic circumstances of society, but only insofar as these circumstances affect the common estimations in the exchanges. It is primarily under certain general circumstances that a bargaining power asymmetry affects the estimation of the natural rates. In the declining or stationary state, workers stand in a disadvantageous position to negotiate with their employers, and must accept lower wages. In the progressive state, on the other hand, thanks to the increased demand for labor, masters cannot so easily combine to lower wages. Therefore negotiations between employers and workers take place on a more equal footing, allowing wages to rise to the levels to which they would naturally rise if they were not forcibly compressed. This means that a more impartial evaluation of the price of labor is possible, and, contrary to what is often stated, that in this case general circumstances exert no influence in the determination of natural rates.

In this case of “natural liberty”, as argued here, the common estimation of the natural rates occurs in a similar way to what happens in the primitive state, where no capital is employed, no land has been appropriated, and individuals are independent from one another. In both cases, individuals can negotiate on an equal footing, and therefore reach an agreement that reflects a more impartial judgement regarding the value of each other’s contribution. In both cases, the exchange is based on mutual persuasion. It is not based on one party dominating the other.<sup>9</sup> This means that, in the advanced state, a proper estimation of factor prices (and especially wages) may happen – preventing, for example, forced deductions of wages (that for Smith can happen, but above all in the declining or stationary states of society). This will be shown by considering the case of the gardener who “unites in his own person the three different characters, of landlord, farmer, and laborer” (WN I.vi.23), and pays himself not only wages, but also a certain profit and rent.

Thus, contrary to what is often stated, we will show that Smith applies his theory of the natural price to all states of society, including the “primitive” one.<sup>10</sup> And that a consideration of the latter is useful to understand how the estimation of natural rates occurs in “commercial society”.

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<sup>7</sup> See WN I.xi.a.2. Note on rent derived from natural fertility through monopoly (ownership of non-reproducible good) and as derived from improved fertility (thus, from invested capital and labor) [?] Only the former is forced deduction, while the latter comes from deserved recognition.

<sup>8</sup> As recognized even by those who try to read everything in terms of disutility (cf. Hollander, 1973, p. 128-132).

<sup>9</sup> On the importance of persuasion instead of domination in Smith’s exchange, see Young (1997). On the conflation of these two principles, which are opposed in Smith, see Winch (1978), Skinner (1992), Lewis (2000), Kalyvas and Katznelson (2001), Force (2003), Dupuy (2006), Diatkine (2010) and Luban (2012).

<sup>10</sup> On the view that Smith confined the labor theory to the “primitive” state, see the positions – however disagreeing on the meaning of “labor theory” – of Schumpeter (1954, p. 188, n. 20), Bowley (1973, p. 110–20), Dobb (1973, p. 45), Hollander (1973, p. 116–17), Winch (1978, p. 90), Skinner (1987, p. 364), Naldi (2003, p. 554) and Roncaglia (2005, p. 138)..

In the first section of the article, we show how Smith's theory of value can be read in reverse, starting from primitive society. We then show that the price that emerges naturally on this basis, i.e. the natural price, follows the same rules as the natural price in advanced society. In the second section we show that in such a society the natural price of labour and capital (and, to some extent, land) is linked to the common valuation of the nature of their employment, which takes place in the various negotiations in which wages and profits (and rents) are determined. In the third section we show that this may not happen because of certain general circumstances, but that in the "progressive" state of advanced society such circumstances are irrelevant. In the fourth section we show that the interpretation of Smith's theory of value proposed here is consistent with Pufendorf's idea of 'moral quantities'. In the fifth section we address Pownall's criticism of Smith regarding the problem of bargaining power, arguing that he has a different conception of exchange.

### 1- Natural price in the rude and advanced states of society

In the WN, Smith presents a theory of natural prices that he applies to any form of society. This is particularly seen in chapter six of the first book, where a similarity can be found between the hunters of the rude state of society and the stone gatherers, and also the gardeners, of the advanced state of society.

Smith begins the chapter by considering how "savages" would *naturally* exchange the produce of their different labors. In this state of society, in which there is no accumulation of stock, and no appropriation of land, "the proportion between the quantities of labour necessary for acquiring different objects seems to be the only circumstance which can afford any rule for exchanging them for one another" (WN I.vi.1). This means that, to exchange their goods, these individuals must somehow compare the respective quantities of labor spent in production and establish a proportion between them.

This in turn could mean that they must calculate these quantities beforehand in order to establish a proportion between them and thus obtain the value with which they can be exchanged. To this end, the problem arises of how to calculate such quantities of labor, since Smith says that it is not enough to know how much time has been spent, but one must also evaluate the difficulty they require in terms of hardship and ingenuity (WN I.v.4). In order to get as objective an assessment as possible, one could argue that these quantities are calculated in advance on the basis of their normal cost price.<sup>11</sup> However, to know the prices of the initial inputs, one must already know their long-run price.<sup>12</sup> Or, one could imagine that we all give up an equal "portion" of what Smith calls "ease", "liberty" and "happiness" (WN I.v.7) in the same unit of time, so that we can exchange equal quantities of labor. This assumption should be based on the premise of a universal human nature. If one labor requires more hardship than another, it will therefore have proportionately more value for all of us over the same unit of time as the other. Similarly, we could relate ingenuity back to quantities of ease, liberty and happiness by

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<sup>11</sup> See Schumpeter (2006 [1954]), Hollander (1973), Dobb (1973), Blaug (1985) and Brems (1986).

<sup>12</sup> See Benetti (1981) and O'Donnell (1990). See also Hurtado (2003).

considering that a skill can only be obtained after a certain amount of time of application, which then means giving up a certain quantity of ease, liberty and happiness.<sup>13</sup>

In chapter six, however, Smith says that to reasonably reward the acquisition of a skill one must reward "the time *and labor* which must be spent in acquiring them" (WN I.vi.3, emphasis added). Since the labor required in turn implies not only hardship but also ingenuity, the reasoning becomes circular. To assess the ingenuity of a type of labor on the basis of what was required to obtain it, one must calculate the ingenuity (as well as hardship) that was required along the time frame in which it was being learned.

However, as we intend to show, one needs not assume that it is necessary (and therefore possible) for Smith to reduce everything to such objective quantities. Neither is it necessary to assume that we all value in the same way the giving up of our ease, liberty and happiness. This is so because one must not calculate or measure the quantities of labor before the exchange in order to establish a proportion between them and obtain the price with which to exchange them. It is enough to agree on the proportion between them at the very moment of the exchange. In this sense, it is not the proportion of quantities of labor already valued that gives rise to a price (therefore obtained independently of the exchange), but it is the exchange that gives a price to those quantities by establishing their proportion. Labor and its products do not have an exchange value before exchange but only in it. If in one time and place some goods are usually exchanged for a certain value, while in another time and place for another value, this is because their exchange value is determined by the exchanges that usually take place in each situation. These values are modified by people's judgments, as well as by any general circumstances that affect the latter.

This means that such quantities of labor are not objective, like physical or mathematical quantities, as may be the quantities of time given up for equal ease, liberty and happiness. That is, they are not quantities that can be calculated independently of exchange. However, neither are they purely subjective and therefore impossible to equate. Rather, they are established by the equalization that takes place in exchange. They are the result of the mutual recognition of the hardship and ingenuity required by different kinds of labor that is revealed by the proportion with which the products of such labor are exchanged.

It is true that in chapter five of WN, Smith says that "it is not easy to find any accurate measure either of hardship or ingenuity" (WN I.v.4). However, immediately afterwards he says that there is a solution and that it is found in the adjustments that take place in the market, i.e., in exchanges: "In exchanging indeed the different productions of different sorts of labor for one another, some allowance is commonly made for both [hardship and ingenuity]. 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" (Ibid.).

It is in this sense that, while talking about the rude state of society, Smith states that when one labor is harder than another, although it is not easy to estimate it, in any case "some allowance will naturally be made for this superior hardship" (WN I.vi.2). That is, the "savages"

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<sup>13</sup> See Paganelli (2020, p. 34). This position is consistent also with that of Bowley (1973, p. 113-4, 116), based on an objective disutility as the physical labor-input.

somehow recognize the diversity of hardship employed in their respective employments and establish in the exchange the proportion they deem appropriate between the quantities of labor.

The same occurs and even more explicitly in the exchange of products or services of labor requiring different ingenuity: “if one species of labor requires an uncommon degree of dexterity and ingenuity, *the esteem* which men have *for such talents*, will naturally give a value to their produce, superior to what would be due to the time employed about it” (WN I.vi.3, emphasis added). What gives superior value to such work is the *esteem* people have for the other’s talent. If it is not possible for Smith to have an “accurate” measure for evaluating quantities of labor, this is because they are not objective quantities that can be calculated exactly<sup>14</sup>. They require the estimation that finds its adjustment in the agreements that take place in the exchanges.

This “theory” applies not only to the “earliest and rudest period” of society, but also to the advanced state. This can firstly be seen by considering that even in the latter there could be exchange of goods that only repay labor, just as there is in the early and rude state of society. In particular, Smith gives the example of “a few poor people” in some parts of Scoland of his day who “make a trade of gathering, along the sea-shore, those little variegated stones commonly known by the name of Scotch Pebbles” (WN I.vi.15). “The price which is paid to them by the stone-cutter” - Smith notes - “is altogether the wages of their labor; neither rent nor profit make any part of it” (Ibid). Like land in the early and rude state, the beach is in the public domain. Therefore, in both cases, the rent due is zero. Moreover, the stone gatherers do not need anyone to advance them wages, because they can trade the stones as soon as they have gathered them, just as the hunters in the early and rude state of society can do with their game.

From this perspective, the situation of these hunters is comparable to that of the stone gatherer, but also to that of the gardener in the advanced state of society, to whom Smith refers in the same chapter: “A gardener who cultivates his own garden with his own hands, unites in his own person the three different characters, of landlord, farmer, and laborer. His produce, therefore, should pay him the rent of the first, the profit of the second, and the wages of the third” (WN I.vi.23). This gardener is like the self-employed worker Smith just mentioned in this chapter, who pays himself the wages and profit due. Unlike the latter, with the sale of his property the gardener also pays himself the rent. The hunter of the early and rude state of society is, in some ways, like the independent worker or gardener of the advanced society. The difference with them is that by exchanging his goods the hunter pays himself only wages, because the profit and rent due are zero, as in the case of the stone picker on the beach.

This implies that price formation through its three components does not change between the early and rude state of society and the advanced society. The fact that there is accumulated capital and land ownership in the latter does not imply that the exchange value of goods depend on a different theory of prices than that in the early and rude state of society. Simply, in the latter, profit and rent are zero. When exchanging their game with each other, hunters take into account only the labor expended exactly as is the case between stone gatherers and stone cutters in the advanced society. Whereas in the advanced society not only wages, but also profit and rent must be estimated in the exchanges.

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<sup>14</sup> On the non-precision of this measure, which, however, still implies a sense of justice, albeit different from commutative justice (which instead requires precision like the rules of grammar), see Bee (forthcoming).

## 2- The nature of the employments

The common estimation of wages and profit is fundamentally based on a consideration of the nature of the different employments of labor and capital, whereas the part of rent that must be jointly evaluated is seen as a compensation similar to profit<sup>15</sup>. In the advanced society, where employments differ greatly from one another, this evaluation must take into account more criteria than those needed in the rude state of society. The two main criteria of hardship and ingenuity must therefore be expanded. As we shall see, wage and profit differentials depend on factors that are neither objective nor related to disutility, but rather require evaluation.

Smith lists several “circumstances” that influence the estimation of different employments of labor in an advanced society: their “agreeableness or disagreeableness”, “the easiness and cheapness, or the difficulty and expence of learning them”, “the constancy or inconstancy” with which they can be practiced, “the small or great trust which must be reposed in those who exercise them” and “the probability or improbability of success in them” (WN I. x.b.1 ).

In the case of the “agreeableness or disagreeableness” of the work, Smith includes the consideration of factors such as “the ease or difficulty, cleanliness or dirtiness, honorableness or dishonorableness of employment” (WN I.x.b.2). While some aspects such as cleanliness or dirtiness seem objective, they nevertheless need to be considered with respect to the happiness or unhappiness they may procure in practicing a given occupation. Such happiness can certainly be subjective (and in that sense can also be invariable for the subject experiencing it). But in order to be considered in the exchange value of such employment it must still find confirmation in the judgment of the person with whom it is exchanged. Otherwise, it has no exchange value. Its value, as with ease and difficulty, must be determined in the agreement that takes place through exchange. This is perhaps even more evident in the case of honorability or dishonorability of employment. This is a category that is certainly contextual to a particular place and time, but nonetheless a product of a common human judgment and agreement, and not something objective that can be evaluated without the confirmation that may take place in exchange.

According to Smith, “the difference between the wages of skilled labor and those of common labor” is founded on the differences of dexterity and skill of these labors (WN I.x.b.7). Again, dexterity and skill are related to talents that only acquire a price through the esteem of others in exchange. Such talents sometimes require long and tedious application. The boredom of a labor that is considered “tedious” (WN I.x.b.9) must be somehow acknowledged by both parties to be part of the proportionate equivalence that takes place in exchange. The same applies to “those anxious and desponding moments”, typical of inconstant employments, “which the thought of so precarious a situation must sometimes occasion” (WN I.x.12) and which must be recognized in the exchange, otherwise no one would be encouraged to do such labor.

While the difference between skilled and common labor may seem obvious, it is certainly difficult to compare different skilled labors on the basis of different dexterities and

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<sup>15</sup> “a reasonable profit or interest for the stock laid out by the landlord upon its improvement” (WN I.xi.a.2). Smith states, however, that this “can scarce ever be more than partly the case”, since the other part of rent is simply a monopoly price, and not the product of common evaluation (WN I.xi.a.5).

skills. The high rewards of some “ingenious arts”, for example, are based not only on the cost and tedium of learning them, but also on the “rarity and beauty of the talents”, as well as the discredit of employing them to make one’s livelihood (WN I.x.b.25). For their part, “liberal professions” demand high wages because they involve at the same time great difficulty in learning, great improbability of success, and great trust on the part of clients (WN I.x.b.9, 19, 22-4). Investing a great deal of time and labor in acquiring a profession in which one may not succeed is a risk that must be sanctioned in the exchange. In addition to the risk to the worker, these professions also entail a risk to those who rely on them. The trust placed in the worker may be greater in these professions than in other employments. The credibility and trustworthiness of such a professional, like that of a lawyer or physician, therefore, requires appropriate recognition. If this is not done, the professional may lose the proper motivation to continue striving for it.

All these circumstances require a proper appreciation, which certainly plays a role in encouraging people to carry on their work at their best. For a wage to be appropriate on the basis of the various circumstances just discussed, it is not enough to say that no one would accept less remuneration. To find people who pay what is considered appropriate, it is always necessary that the buyers do not think that such remuneration is inappropriate; this, otherwise, would mean - considering Smith's assumption that an equivalence between different quantities of labour is established in exchange - that the buyers would be willing to give part of their work for a part that they deem insufficient.

As Smith will later say about a profession he knows well, remuneration that does not adequately recognize a professor's merit does not “encourage” him to perform it in the way that profession requires (WN V.i.f.3). Only when such remuneration is appropriate does the professor “have some dependency upon the affection, gratitude, and favourable report of those who have attended upon his instructions; and these favourable sentiments he is likely to gain in no way so well as *by deserving them*, that is, by the abilities and diligence with which he discharges every part of his duty” (WN V.i.f.6; emphasis added).

Smith makes similar remarks about the estimation of the rate of profit. He states that “the lowest ordinary rate of profit must always be something more than what is sufficient to compensate for the occasional losses to which every employment of stock is exposed” (WN I.ix.18). In discussing the proportion between the rate of interest and the rate of profit, he suggests that ordinary profit must be a “sufficient compensation for the trouble of employing the stock” (WN I.ix.22). This agrees with the statement that “the agreeableness or disagreeableness of the business, and the risk or security with which it is attended” are the only circumstances taken into account in estimating the ordinary, or natural, rate of profit (see WN I.x.b.34; cf. WN I.x.b.4, 33). Discussing the profit tax, Smith reiterates this idea: “It is the compensation, and in most cases it is but a very moderate compensation, for the risk and trouble of employing the stock. The employer must have this compensation, otherwise he cannot, consistently with his own interest, continue the employment” (WN V.ii.f.2). It is clear that “risk and trouble”, as well as the “agreeableness or disagreeableness” of the business, are not objective criteria, nor does Smith reduce them to disutility. Therefore, they must be somehow estimated and agreed upon.

According to Smith, although the wages and profits are very different in the different employments of labor and stock, “yet a certain proportion seems commonly to take place



between both the pecuniary wages in all the different employments of labor, and the pecuniary profits in all the different employments of stock" (WN I.vii.36). It should be noted that this proportion is independent of the states of society, whether advancing, stationary, or declining, which means that it is independent of the way the general circumstances of society may affect the natural rates.

This is so because this proportion depends on two factors in particular: it "depends partly upon the nature of the different employments, and partly upon the different laws and policies of the society in which they are carried on" (Ibid.). Regarding the nature of the different employments, the differences between wages and profits are generally such that the advantages and disadvantages of different employments are counterbalanced by greater or lesser pecuniary gains (see WN I.x.b.39). However, some "inequalities" may be produced in cases where employments are not: 1. "well known and long established in the neighborhood"; 2. not "in their ordinary, or what may be called their natural state," i.e., the market price coincides with the natural price and thus there is no imbalance between actual supply and demand; and 3. not "the sole or principal employments of those who occupy them" (Ibid).

When, however, the employments are well known, when they are in their ordinary state, and when they are the principal employments of those who occupy them, it is only the differences in the nature of the different pecuniary wages and pecuniary profits that determine the proportion between the different employments. However, as Smith explains in the second part of this chapter, this is true when there is "the most perfect liberty. But the policy of Europe, by not leaving things at perfect liberty, occasions other inequalities of much greater importance" (WN I.x.c.1). But, if policies were such that they did not produce these inequalities, as Smith advocated, then the above proportion would be determined, again, only by the nature of the different employments.

### **3- Irrelevance of the general circumstances**

There is, of course, an important difference between the rude and advance states of society. In the latter, the labourer does not enjoy anymore "the whole produce of his own labour" (WN I.viii.5), but must share a part of it with the master and the landlord. This introduces the possibility of conflict and asymmetric bargaining power in the negotiations of factor prices, resulting in inappropriate judgments about the value of the different components of price. According to Smith, however, it is possible that a proper estimation of factor prices (and especially wages) will happen – and, therefore, prevent forced deductions of wages, for example.

It is clear from the gardener's example mentioned above that, for Smith, profit and rent are not always and everywhere forced deductions from wages. If they were always and in every case forced deductions, then the gardener in his example would have to regard his earnings exclusively as wages. Instead, for Smith, this would be a misjudgment. If the gardener judges himself properly, the exchange value of his goods also includes the profit and rent which he rightly owes himself, without the latter having to be "confounded with wages" (WN I.vi.23).

If the self-judging gardener does not forcibly subtract his profit and rent from his wages to himself, the same can happen for other types of workers. However, this does not always happen. While Smith's theory of exchange value does not change between the early and rude

state and the advanced state of society, what does change between these two forms of society is that in the latter there is a private and unequal accumulation of capital and appropriation of land.

The fact that in the advanced state of society capital and land may be in the hands of some and not others implies that "the three different characters, of landlord, farmer, and laborer" are commonly split and no longer united in the same person, as in the case of the gardener (WN I.vi.23). If in the early and rude state of society hunters are all independent laborers, in the advanced state of society only a minority are as independent as gardeners because of this historical split (cf. WN I.viii.10).

As Smith explains in chapter eight of the first book of WN, the split between the figure of the worker and that of the employer leads to unbalanced power relations in favor of the latter. Such unbalanced power relations can naturally lead toward a compression of the ordinary wage relative to what would naturally be established instead if workers and employers negotiated on an equal footing.<sup>16</sup> As Smith explains, these power relations are unbalanced in favor of employers because employers are easily (and even tacitly) able to combine, whereas the combination of workers is much more difficult, because they are often disorganized and their organization is severely punished by the laws (see WN I.viii.12). The latter are somehow obliged to yield easily to combinations of the former due to their lack of material independence: their "necessity" for employment is "immediate," while "in all such disputes the masters can hold out much longer" (Ibid).

However, for Smith this imbalance occurs primarily under certain general circumstances of society. As he writes at the beginning of chapter seven of Book One of WN, the rate at which wages and profits are naturally exchanged depends partly on the nature of the employments, but also partly on the general circumstances of society. The general circumstances of societies concern "their riches or poverty, their advancing, stationary, or declining condition" (WN I.vii.1). In its declining or stationary state, for example, employers are easily able to combine and workers are at best able to rebel in an often violent manner, thus suffering severe state repression (see WN I.viii.13). In the progressive state, on the other hand, the demand for labor increases sharply and employers cannot so easily combine because of the increased competition to find workers (see WN I.viii.17). In the absence of such employer-employee combinations, negotiations between employers and workers take place on a more equal footing, allowing wages to rise to the levels to which they would naturally rise if they were not forcibly compressed.<sup>17</sup> In the progressive state of the advanced society, negotiations can take place on a more equal footing – that is, such that no one imposes himself on the others by taking

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<sup>16</sup> At the same time, the split between the figure of landowners and that of employers or workers means that the former can claim a rent according to the fertility of the land, even where they have made no contribution to improving it (see WN I.vi.8).

<sup>17</sup> It is clear here that the natural price of wages is not given by the dynamics of supply and demand, just as the natural price of goods for Smith does not depend on such dynamics (which serve only to bring the market price back to the natural price in case of excess or deficiency of supply over actual demand). The progressive state may involve an excess of demand over supply and thus the need for continuous adjustment between them (see WN I.viii). But what Smith highlights with his reasoning is the rise in wages due to the difficulty employers find in such a state of society in combining with each other and thus forcibly compressing wages.

advantage of their non-independence – exactly as is the case in the early and rude state of society, in which the hunters are all independent.<sup>18</sup>

If in the progressive state the relations between employers and workers are less asymmetric, this implies that in this state the general circumstances of society - such as the accumulation of capital and the ownership of land in the hands of a few - do not alter the exchange value of labor that naturally arises when they exchange among equals. This means that the natural rate of wages (as well as profit and rent) for Smith is not essentially determined by general circumstances, but rather by the nature of the employments of labor and capital (as well as the natural or improved fertility of land for rent, see WN I.vii.1-2). That is, in situations where the general circumstances of society are irrelevant to the determination of natural rates – as in the early and rude state of society or in the progressive state of the advanced society – then it is the different nature of the employments that determines them.

#### 4- Pufendorf and the idea of price as a *moral quantity*

The idea that exchange value is established through mutual estimation and agreement in exchange recalls the idea of the “common price” as a “moral quantity” put forward by Samuel Pufendorf. In this natural jurist’s conception, the common price is not determined by the proportion between physical or mathematical quantities, but expresses an equivalence of moral quantities. These quantities are valued in the exchange, taking into account, among other things, elements similar to those that Smith considers the main ones in the estimation of the quantities of different labors, especially in advanced society.

Pufendorf’s system of natural law became the basis for the teaching of moral philosophy at Glasgow University since the time of Gershom Carmichael (Moore; Silverthorne, 1983). Carmichael published a Latin edition of Pufendorf’s abridged treatise, *De Officio Hominis et Civis juxta Legem Naturalem* (1st ed. 1718, 2nd ed. 1724), to which he added a series of critical notes and supplements on various aspects of that jurist’s doctrine. Through Carmichael’s notes, Pufendorf’s theory of prices was appropriated and modified by Hutcheson (see Taylor, 1965, pp. 26-8; Naldi, 1993; Pesciarelli, 1999). Following Carmichael, Hutcheson used the concept of “difficulty of acquiring” to synthesize all those aspects of the different labors that, according to Pufendorf, as we shall see, determine the common estimation of price in commerce (Hutcheson, 1755, p. 54, II.xii.1). This concept, in turn, was drawn upon by Smith as a basis for assessing the value different quantities of labor.<sup>19</sup>

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<sup>18</sup> Clearly, then, what is at issue here is not the ability to impose oneself in negotiation due to a certain persuasive capacity, but to prevent the very possibility of persuading each other, preventing this in particular from the other party (in this case, the workers’ party) and thus reserving the freedom of not having to persuade in turn. The issue of power relations in negotiation due to persuasiveness is discussed in the last section of this article.

<sup>19</sup> Many authors have analyzed the relationship between Smith’s and Pufendorf’s ideas on prices, also taking into account Carmichael’s and Hutcheson’s contributions. Differently from what is claimed here, some say Smith would have broken with these philosophers by abandoning the subjective elements present in their respective conceptions of price in the name of a theory of value based on labor and costs of production (Kauder, 1953; Robertson; Taylor, 1957; Taylor, 1965; Hutchison, 1988); while others emphasize continuities among the theories of Pufendorf, Carmichael, Hutcheson, and Smith, relativizing the “subjectivist” interpretations mentioned above and/or attempting to show that the labor and costs elements of the latter’s price theory were in some sense already present in the theories of the former (Bowley, 1973; Hollander, 1973; 1987; Pesciarelli, 1986; 1999; Naldi, 1993; Skinner, 1995; Young, 2008; Aspromourgos, 2009).

In the first chapter of the fifth book of *De Iure Naturae et Gentium* (1729 [1672]; ING, V.i), Pufendorf analyzes the determinants of the price of “things” and “actions” that enter into commerce. He notes that in order to exchange things of a different nature, it is necessary to establish a common measure by which such things and actions can be compared and equated through a quantitative relationship or proportion. Pufendorf clarifies that this quantitative relation does not refer to “physical” or “mathematical” properties of what is exchanged, but to a moral attribute that is imposed on them by the common agreement and estimation of individuals, that is, by the price commonly given to them in the market (ING, V.i.2).

The common or natural price is the value estimated through the common judgment and valuation of individuals in civil society when there is a system of natural freedom, while the “legal price” is imposed by a decree, or law, of a magistrate (ING, V.i.3, 8). Pufendorf’s natural price includes both the accidental and necessary aspects of price, which will later be analytically separated by Smith through the distinction between market price and natural price (see WN I.vii).

According to Pufendorf, the foundation of the common price is the “aptitude” of the thing to satisfy needs, whether physical or moral (ING, V.i.4).<sup>20</sup> However, he immediately states that this “aptitude” is only a presupposition of the price, its foundation “in itself”, and not its determining cause.<sup>21</sup> This is illustrated by the fact that the most useful things usually bear no price, whereas “many things that human life could very easily have done without” are priced very high (ING, V.i.5-6). This is a rather similar formulation to Smith’s distinction between “value in use” and “value in exchange”, to the extent that he states that the former is not the determining cause of the latter (WN I.iv.13). It also underscores the fact that value is determined “in exchange”.

Thus according to Pufendorf, the level of the common price is determined by an estimation process that takes into account, in addition to “aptitude,” the rarity (*raritas*) of the goods and the aspects associated with the nature of the work or technique in question. Rarity, however, relates mainly to two extreme cases of valuing things: on the one hand, luxury, and on the other, absolute scarcity.

Pufendorf then points out which qualities most commonly determine the estimation of the goods that enters into commerce: “the subtlety and elegance of the art they exhibit”, “the fame of the artisan”, “the excellence of their previous possessor”, “the abundance and rarity of the artisans or workmen”, “the difficulty, skill, usefulness, and necessity” of the works and actions, “the rarity of their agents”, “their pre-eminence or status”, “the freedom to interrupt the action”, and “the state of the art”. Several times Pufendorf concludes by adding “and the like”, as if to say that the list could go on and cannot be exhaustive (ING, V.i.6). All these qualities find their estimation in the common agreement that gives rise to the common price<sup>22</sup>.

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<sup>20</sup> This prompted many interpreters to see in Pufendorf the germ of the marginalist theory of subjective value. See, for example, Kauder (1953), Robertson and Taylor (1957), Taylor (1965) and Hutchison (1988).

<sup>21</sup> See Aspromourgos (2009, p. 307-8, n. 85) in his critique of Hutchison’s (1988) interpretation.

<sup>22</sup> Pufendorf’s theory of price was appropriated and modified by Hutcheson, who, in turn, was inspired by Carmichael’s notes to Pufendorf’s text (see Naldi, 1993; Pesciarelli, 1999). Following Carmichael, Hutcheson used the concept of “difficulty of acquiring” to synthesize all those aspects of the different labors that, according to Pufendorf, determine the common estimation of price in commerce (Hutcheson, 1755, p. 54, II.xii.1). This concept, in turn, was drawn upon by Smith as a basis for assessing the value different quantities of labor.

To this Pufendorf adds “the ordinary labor and expenses” of the merchant, which include the expense of importing goods, his time and dedication, the care expended in transferring and storing goods, as well as the expense with the wages of workmen (ING, V.i.10). Only later, after considering the necessary factors associated with estimating the ordinary price, does Pufendorf consider the circumstances that cause the common price to rise or fall *tout d'un coup*. Here abrupt and contingent, albeit frequent, fluctuations in supply and demand, derived from changes in the number of buyers, the quantity of money and the quantity of goods, come into play (ING, V.i.10; OHC, I.xiv.6).

Finally, Pufendorf argues that natural price estimation in the market admits of a certain latitude. As long as there is no deception in the product, small deviations from the real price are tacitly accepted by the market, given the difficulty of establishing exact equality in the buying and selling of goods (ING, V.i.9, V.iii.10).

## 5- Pownall's objections

As mentioned above, Smith argues that it is in exchanging different products of different kinds of labor that the different quantities of labor are evaluated, in the general terms of hardship and ingenuity. As he writes, “*In exchanging* indeed the different sorts of labor for one another, some allowance is commonly made for both” (WN I.v.4, emphasis added). He goes on to say that this is not done according to a precise measure and that the adjustment takes place through “higgling and bargaining” (Ibid.). That is, adjustment occurs through the agreements that may be reached from time to time in market exchanges. The actual quantities of the different labors exchanged are not objectively defined before the exchange, but only through exchange.

This however introduces the possibility that some exchangers might estimate their own quantities of labor differently from those of others, giving a preference to their own. In this way, they might seek to obtain in exchange a greater quantity of other people's labor than would naturally be recognized to them if both exchangers estimated each other's contributions impartially.

This, after all, is one of the several criticisms levelled at Smith by Thomas Pownall, one of his early reviewers.<sup>23</sup> Pownall states that in exchange “equal quantities of labor will receive very variable degrees of estimation and value” (CAS, 344). To demonstrate this, he proposes an idea of exchange in which each seeks to take advantage of the other either by overestimating one's work, or by underestimating the value of the other's good. This is an idea that Smith knows well because it was already presented by Mandeville in his *Fable of the Bees*<sup>24</sup>, an author who is explicitly criticized in TMS (as well as in WN, for his mercantilist positions).<sup>25</sup> It is about exchange based on self-love understood as a spirit of superiority.<sup>26</sup>

Pownall argues that “he who has not an impatience in his desire on one hand, or a soon-alarmed fear on the other of losing his market”, or who have “a certain firmness, perseverance,

<sup>23</sup> *A Letter from Governor Pownall to Adam Smith, LL.D.F.R.S., being an Examination of Several Points of Doctrine, laid down in his 'Inquiry in to the Nature and Causes of the Wealth of Nations'* (London, 1776). cf. Smith (1987, p. 337-376). On this, see Asproumouros (2009, p. 298-9, n. 55), who endorses Pownall's critiques.

<sup>24</sup> See Mandeville (1988 [1732], vol. II, Remark B).

<sup>25</sup> On Smith's view of Mandeville as a mercantilist, see Hurtado (2006).

<sup>26</sup> For a discussion of exchange in Mandeville, Rousseau and Smith see McHugh (2018), Bee (2021), and Sternick (2023).

and coldness in barter” and “a certain natural self-estimation, will take the lead in setting the price upon the meek and poor in spirit; upon the impatient and timid bargainer” (CAS, 344). Resuming and explaining the point in the WN where Smith states that it is possible for people to agree on a rather “rough” equivalence, Pownall argues that “by the higgling and bargaining of the market” exchange value can only be established arbitrarily and contingently (CAS, 345). As a result of this critique, however, Smith did not find it necessary to change his position in later editions of WN, although he was careful to clarify other points touched upon by Pownall.<sup>27</sup>

For Smith, it is possible that in the market people do not come to estimate the different quantities of labor through a “rough equality”, but this is mainly due to general conditions. As for Pufendorf, these conditions may relate to accidental moments of scarcity, for example “during the blockade of a town or in a famine” (WN I.vii.9), or a temporary over-importation of “perishable” (WN I.vii.10); when merchants succeed in obtaining monopolies from rulers, because of their “rapacity” (WN IV.iii.c.9) or when, especially in the depressive or stationary state of society, masters are easily able to combine among themselves to lower the price of labor than what would naturally be set if the workers were in a position to negotiate it with them on a more equal footing (WN I.viii.13). In other situations, however, that is, when the exchangers negotiate in common life on an equal and free basis, they can agree on equality, however rough. This can happen if they are not generally moved by rapacity, rather by what Smith says is perhaps the strongest of our desires, namely, the desire to deserve and obtain the esteem and credit of others (TMS VI.i.3).<sup>28</sup>

In this case, the exchange is not motivated by the desire to persuade the other at any cost, despite one's own merits, nor by the pleasure of feeling superior to the other<sup>29</sup>. Rather, it is motivated by the desire to gain the other's deserved recognition and credit for the work done. Such recognition is what, more than anything else, encourages one to continue doing it to the best of one's ability. From this perspective, exchange is an occasion when the parties can confirm each other's estimation of the value of their labor by obtaining an equivalent in return for what they have done. This type of exchange occurs when both parties impartially balance the mutual interests they have in seeing the approval they deserve recognized. Such impartial evaluation can be achieved when each party is able to make its own assessment as if consulting a third person, equidistant from both. In order to balance our interests with those of the other, Smith observes, “we must view them, neither from our own place nor yet from his, neither with our own eyes nor yet with his, but from the place and with the eyes of a third person, who has

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<sup>27</sup> For example, Smith modified the text on WN I.v.7 in response to Pownall's assertion that the same person will not estimate his or her labor very differently “in different habits, relations and circumstances of life” (CAS, 345). In a letter to Andreas Holt (October 1780), Smith says that: “In the second edition I flattered myself that I had obviated all the objections of Governor Pownall” (CAS, 250).

<sup>28</sup> On the pleasure of exchange based on this form of self-love, see Bee (2021). Because there is always the risk of self-deception (TMS III.4), individuals generally desire to gain the deserved approval of others as a way to confirm their own self-esteem (TMS III.2.3). On the possibility of self-deceit based on the internal division, and the division between the past and the present forms of the impartial spectator, see Fleischacker (2011). Self-deception, for Smith, occurs above all in the presence of “violent emotions,” when general rules come to our aid (see TMS III.4.3; see also Pack 1991, pp. 87–88). On self-deceit see also Darwall (1988) and Walraevens (2019).

<sup>29</sup> On the interpretation of Smith's conception of exchange as based on vanity and the desire of superiority, see Winch (1978), Skinner (1992), Lewis (2000), Kalyvas and Katznelson (2001), Force (2003), Dupuy (2006), Diatkine (2010) and Luban (2012).

no particular connexion with either, and who judges with impartiality between us” (TMS III.3.3).

Smith's implicit response to Pownall, in this sense, implies a distinct understanding of human motivation already developed against Mandeville in TMS. Individuals do not generally tend to overwhelm each other, but to find an agreement that satisfies their respective desire for deserved approval and credit. Although the agreement of feelings between the spectator and the agent is always imperfect, it is nevertheless “sufficient for the harmony of society” (TMS I.i.4.7). Similarly, in exchange it is possible to find an agreement that satisfies the desire for deserved appreciation, which recognizes the value of our labor. Although such agreement can only be rough, it is nevertheless “sufficient for carrying on the business of common life” (WN I.v.4).

## **Conclusion**

Smith's conception of “value in exchange” means that the origin of price, or “exchangeable value”, is in the exchange and not before it. The proportion in which two different quantities of labour are exchanged in primitive society should not necessarily be read as determined by the ratio of pre-calculated or given objective quantities. On the contrary, it is possible to read this proportion, agreed upon by common estimation in exchange, as what gives rise to the value of these quantities. This means that natural prices in primitive society are determined by a common valuation that takes into account various aspects related to the nature of each labour. Smith's discussion of wage and profit (and rent) differentials in advanced society reflects this idea, so that the price agreed upon for each type of employment expresses the common recognition of the merit that those who invest labour, capital or land deserve, given the circumstances and characteristics of such employment. Under conditions of equality and freedom, i.e. in the absence of asymmetries in bargaining power - as in the early and rude state of society or in the progressive state of advanced society - people are able and willing to value their own contributions and those of others as impartially as possible. The prices of labour, capital and rent, thus naturally determined by such free bargaining, give rise to the ordinary or natural rates of these factors. Reversing the logic of the theory of value in primitive society thus makes it possible to overcome the theoretical obstacles that have prevented natural price formation in that society from being read in a similar way to that in advanced society. Overcoming this obstacle also means taking into account the emergence of the natural price, i.e. the natural rates of labour, capital and rent.

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