Adam Smith, the Patterns of Foreign Trade and the Division of Labour: A Country as a Jack-of-All-Trades Rather Than a Specialist

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Abstract:

Adam Smith is commonly referred to as one of the first who thought of foreign trade in terms of an international division of labour, whereby each country specialises in the production of certain goods. It is argued that he made a strong case for foreign trade on this basis. In this article, I will, in contrast, show that Smith does not understand foreign trade as an international division of labour. Economic progress rather than international trade determines domestic production structures. Apart from domestic development, international trade patterns are affected by transport costs and geographical factors, as well as producer and consumer preferences. In Smith's theory, countries will not specialise, but rather produce similar goods. The division of labour plays a role in Smith's theory of foreign trade, but in a mechanical, not territorial, sense.

1 INTRODUCTION

In economics, international trade is portrayed as an international division of labour, whereby each country specialises in the production of certain commodities. This line of thought is traced back to Adam Smith, whose theory of foreign trade is largely disparaged by modern economists. From the point of view of neoclassical trade theory, Smith's so-called theory of absolute advantage is seen as inferior to the theory of comparative advantage. At the same time, however, he is praised for having made a strong and convincing case for free trade and against mercantilist trade policies in his economic magnum opus *An Inquiry into the Nature and Causes of the Wealth of Nations (WN)* on the basis of an international division of labour. This is one reason why he is depicted as an early forerunner of modern trade theory. It is argued that, even though international trade theory has evolved considerably since Smith, the basic understanding of trade has remained the same, namely as a geographical division of labour on a global scale.[1]

However, a careful reader of Smith's *Wealth of Nations* will not come to this conclusion. In this article, I will show that Smith does not conceive of foreign trade in terms of an international division of labour in which every country specialises in the production of a few commodities. Rather, this idea is absent in the *Wealth of Nations* and is not the basis for Smith's theory. The focus of this article is on the positive part of Smith's theory of foreign trade. Modern trade theory is divided into a normative and a positive part. The normative part is concerned with the gains (and losses) from international trade, while the positive part deals with how trade patterns will develop. Smith does not separate his theory into these parts. Both are to a certain degree entangled in his theory. Yet, the emphasis in this article is not on the normative part of Smith's theory, but on how trade patterns develop. This positive part of Smith's theory has been neglected in the literature. Scholars have generally focussed on the benefits of trade.

In order to understand trade patterns and their development in the *Wealth of Nations*, it is necessary to examine the role of foreign trade in Smith's theory of economic progress. A textual analysis will be presented in the next section.[2] It is shown that the production structure of a country is determined by its level of capital accumulation. In addition to the domestic development of a country, transport costs, geographical factors and the preferences of capital owners are significant in Smith's theory. After these considerations, the role of the division of labour in Smith's trade theory will be discussed, which also differs from its general interpretation. The article ends with a conclusion.

2 FOREIGN TRADE IN THE *WEALTH OF NATIONS*

Foreign trade is integral to Smith's theory of economic development and cannot be considered without it. The basis of his theory of economic development is capital accumulation, on which all economic developments are dependent. Capital accumulation itself is restrained by other factors like technological development, population growth and economic wealth in a circular causation. However, capital accumulation is most crucial, as Smith discusses in Books II and III of the *Wealth of Nations*. Without capital accumulation, economic development would not be possible in the first place (*WN* II.3). Any further economic progress depends on an increase in capital (*WN* II.iii.32).

Smith expounds his theory of development especially in the second half of Book II and at the beginning of Book III, after having described the reasons for wealth and its distribution in Book I. He first discusses how capital is employed most beneficially for a country. Smith argues that "the quantity of [productive] labour,[3] which equal capitals are capable of putting into motion, varies extremely according to the diversity of their employment; as does likewise the value which that employment adds to the annual produce of the land and labour of the country" (*WN* II.v.1), i.e. to its wealth. Capital employed in agriculture puts most productive labour into motion because "[i]n agriculture too nature labours along with man; and though her labour costs no expence, its produce has its value, as well as that of the most expensive workmen" (*WN* II.v.12). Capital invested in manufacture puts less productive labour into motion, and capital invested in trade still less (*WN* II.v.19). Smith divides trade into "[t]he home trade, the foreign trade of consumption, and the carrying trade" (*WN* II.v.24), whereby home trade puts into motion more productive labour than foreign trade, followed lastly by carrying trade (*WN* II.v.24-31). Foreign trade is ranked below home trade because it replaces only one domestic capital (and one foreign capital), compared with two distinct domestic capitals replaced by home trade, and because its rate of return is lower and thus capital cannot be reinvested as quickly (*WN* II.v.26-27). This means that capital employed in agriculture adds the greatest value to national wealth, while manufacturing and trade contribute less to the wealth of a society.

In addition, capital invested in agriculture is also the most secure for a country, because it "must always reside within that society" (*WN* II.v.13). Capital used in manufacturing and trade, in contrast, "is all a very precarious and uncertain possession" (*WN* III.iv.24). Its owners can withdraw their capital and invest it abroad. Smith adds that a merchant "is not necessarily the citizen of any particular country" and his capital does not "belong to any particular country," at least "till it has been spread as it were over the face of that country, either in buildings, or in the lasting improvement of lands" (*WN* III.iv.24, see also II.v.14-5, V.ii.f.6). In addition, Smith rates agricultural workers highly, praising their superior level of knowledge, judgement and discretion compared to industrial workers (*WN* I.x.c.23-4).[4]

But this order of investment, first in agriculture, than in manufacturing and lastly in trade, is not only the most beneficial to a country but is to some degree necessary, because a certain amount of stock needs to be accumulated before manufacturing and trade can be established (*WN* II.v.4). The country has to produce enough food in order to be able to afford manufacturing (*WN* III.i.2, see also I.x.c.19). Smith, consequently, notes that "[m]anufactures require a much more extensive market than the most important parts of the rude produce of the land. [...] Agriculture, therefore, can support itself under the discouragement of a confined market, much better than manufactures" (*WN* IV.ix.45). As to foreign trade, it requires capital, which the merchant invests in order for trade to be carried out.[5]

More significant, this order of investment is *natural* for Smith, because it reflects the investment choices of capital owners who do not consider the good of the whole society in their decisions. In contrast, "the sole motive" of a capital owner is the "consideration of his own private profit" (*WN* II.v.37). If profits are "equal or nearly equal," capital owners "will chuse to employ their capitals rather in the improvement and cultivation of land, than either in manufactures or in foreign trade" (*WN* III.i.3). The reason for this is the greater security a capital owner will gain. In agriculture, he "has it more under his view and command, and his fortune is much less liable to accidents than that of the trader, who is obliged frequently to commit it, not only to the winds and the waves, but to the more uncertain elements of human folly and injustice" (*WN* III.i.3).[6] Manufacturing itself is preferred to foreign trade "for the same reason [...] As the capital of the landlord or farmer is more secure than that of the manufacturer, so the capital of the manufacturer, being at all times more within his view and command, is more secure than that of the foreign merchant" (*WN* III.i.7, see also IV.ii.6). The result is that "every individual endeavours to employ his capital as near home as he can, and consequently as much as he can in the support of domestick industry; provided always that he can thereby obtain the ordinary, or not a great deal less than the ordinary profits of stock" (*WN* IV.ii.5).

It is in this context that Smith uses his famous metaphor of the invisible hand:

> "As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestick industry, and so to direct that industry that its produce may be 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 publick interest, nor knows how much he is promoting it. By preferring the support of domestick 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." (*WN* IV.ii.9)

However, the accumulation of capital leads inevitably to a decrease in the rate of profit (see especially *WN* I.ix and II.iv). Smith is clear about the causation: "The increase of stock, which raises wages, tends to lower profit" (*WN* I.ix.2). There are two reasons for the falling rate of profit. First, "the increase of stock, by increasing the competition, necessarily reduces the profit" (*WN* I.x.c.26, see also I.ix.2 and II.iv.8). More competition decreases the chance of monopolies, which keep the rate of profit above the 'natural rate.' Second, the capital-output ratio increases because an enhanced division of labour leads to the mechanisation of the production process. This means that "the proportion between that part of the annual produce, which [...] is destined for replacing capital, and that which is destined for constituting a revenue, either as rent, or as profit" (*WN* II.iii.8) increases. An ever larger share of the output of (productive) labour, which is the source of profit in Smith's theory, is needed to replace the invested capital and the share that pays for profit decreases. Thus, with the increase of capital in relation to output, the rate of profit falls.[7]

With the rate of profit falling, the employment of capital first in manufacturing and later in foreign trade will become worthwhile and justify the higher risks. The corollary is that the actual employment of capital coincides with the most beneficial employment from a societal point of view. This happens even though a capital owner is only interested in "his own advantage [...] and not that of the society" (*WN* IV.ii.4). This self-interest "naturally, or rather necessarily leads him to prefer that employment which is most advantageous to the society" (*WN* IV.ii.4, see also IV.vii.c.88).

Thus, how capital ought to be invested in order to be most beneficial is, according to Smith, also the way capital will be invested, at least in a system of natural liberty.[8] The reason lies in the profit motive combined with the desire for security by the capital owners. In this way, Smith arrives at the *natural progress of opulence*, which is "promoted by the natural inclinations of man" (*WN* III.i.3). It is here that Smith discusses the role of foreign trade in economic development and how trade might develop: "According to the natural course of things, therefore, the greater part of the capital of every growing society is, first, directed to agriculture, afterwards to manufactures, and last of all to foreign commerce" (*WN* III.i.8). Political interference cannot lead to a more beneficial outcome; it is, rather, likely to lead to a worse result. On this basis, Smith criticises both mercantilism ("the system of commerce") and physiocracy ("the agricultural system") in Book IV of the *Wealth of Nations*. These systems encourage foreign trade and agriculture, respectively, beyond their *natural* share.[9]

The natural progress of opulence is the offspring of Smith's theory of economic development. Foreign trade plays a minor role, introduced only near the end of this order; solely carrying trade is less beneficial. The *Wealth of Nations* is predominantly about domestic production. For Smith, agriculture and manufacturing are far more important for the economic development of a country. Even inland trade is much more beneficial than foreign trade. Consequently, he notes that the "great commerce of every civilized society, is that carried on between the inhabitants of the town and those of the country" (*WN* III.i.1, see also IV.ix.48).

Foreign trade is the result of a certain level of economic development, not its cause.[10] A country in which land lies fallow is better off investing its capital into agriculture rather than manufacturing or foreign trade, and under 'natural' circumstances its capital owner would do so. This was the case, e.g., in North America. where "no manufactures for distant sale have ever yet been established in any of their towns" (*WN* III.i.5). Only "where there is either no uncultivated land, or none that can be had upon easy terms," will a capital owner "prepare work for more distant sale" (*WN* III.i.6). Foreign trade is subordinated to capital accumulation. Smith argues consistently that "[t]he general industry of the country [is] always in proportion to the capital which employs it" (*WN* IV.ii.12). If its capital accumulation has reached a certain level, foreign trade will be introduced automatically: "This continual increase both of the rude and manufactured produce of those landed nations would in due time create a greater capital than could, with the ordinary rate of profit, be employed either in agriculture or in manufactures. The surplus of this capital would naturally turn itself to foreign trade" (*WN* IV.ix.23). Foreign trade depends on the accumulation of capital and increases along with it. The more opulent a country, the greater its volume of foreign trade: "the foreign trade of every country naturally increases in proportion to its wealth" (*WN* IV.vii.c.22).

3 FOREIGN TRADE PATTERNS

On the basis of these considerations, international trade patterns and their development in Smith's theory should be expounded. According to Smith, current market prices determine these patterns: "If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage" (*WN* IV.ii.12). The actual magnitude of the advantage is irrelevant (*WN* IV.ii.15). Less-developed countries that only have an agricultural sector are not excluded from foreign trade per se. They will be able to export some agricultural commodities. However, they will not employ their own capital in foreign trade. The necessary capital will come from abroad, i.e. from a foreign merchant (*WN* II.v.16, 21), with which some of the domestic produce can be exported. The country is better off investing its capital in agriculture and manufacturing rather than in foreign trade (*WN* II.v.18-20). This can be illustrated by Smith's discussion of the North American colonies, which are for Smith the “example of a ‘progressive’ society *par excellence*” (Winch 1996: 150): “It has been the principal cause of the rapid progress of our American colonies towards wealth and greatness, that almost their whole capitals have hitherto been employed in agriculture” (*WN* II.v.21). They would be worse off if they started producing manufactured goods themselves instead of importing them. However, this is only the case for actual, ongoing trade and Smith is much more concerned with economic development. In the long run, less-developed countries will accumulate capital and introduce manufacturing. They will not specialise in agriculture.

In order to see how trade patterns will develop, three additional aspects besides domestic capital accumulation have to be considered, namely transport cost, geographical and climatic factors, as well as the preferences of capital owners and consumers. They all affect foreign trade in Smith’s theory. Transport costs play a very important role for Smith and have a great impact on foreign trade. Smith argues that agricultural goods and “rude produce” are difficult to transport over long distances. The same is true to a lesser degree of coarse manufactured commodities. This is due to their bulkiness, which makes the transport of these goods expensive. Their ratio of value to volume or weight is very low.[11] In contrast, refined and improved manufactures are better suited, because they “contain a great value in a small bulk” (WN IV.i.29). Smith exemplifies this with a “piece of fine cloth [...] which weighs only eighty pounds, contains in it, the price, not only of eighty pounds weight of wool, but sometimes of several thousand weight of corn, the maintenance of the different working people, and of their immediate employers. The corn, which could with difficulty have been carried abroad in its own shape, is in this manner virtually exported in that of the complete manufacture, and may easily be sent to the remotest corners of the world” (WN III.iii.20).[12] As a result, finer manufactured goods are better adapted for foreign trade: “Manufactures, as in a small bulk they frequently contain a great value, and can upon that account be transported at less expence from one country to another than most parts of rude produce, are, in almost all countries, the principal support of foreign trade" (WN IV.ix.41, see also IV.i.29).

From these considerations, Smith draws the conclusion that free trade in agriculture barely affects the domestic market, if at all, while free trade in manufactures means competition for domestic producers (*WN* IV.ii.16). He argues that "[i]f the importation of foreign cattle, for example, was made ever so free, so few could be imported, that the grazing trade of Great Britain could be little affected by it" (*WN* IV.ii.17). A country as close as Ireland could not import a great amount of cattle.[13] The same is true for the most basic staples: "Even the free importation of foreign corn could very little affect the interest of the farmers of Great Britain" (*WN* IV.ii.20). To conclude, transport costs play a huge role regarding what is tradeable internationally and what is not.

Climatic and geographical factors – "the nature of [...] soil, climate, and situation" (*WN* I.ix.15) – also have to be considered. Some countries are better suited to the production of certain agricultural products as a result of these factors: "The natural advantages which one country has over another in producing particular commodities are *sometimes* so great, that it is acknowledged by all the world to be in vain to struggle with them" (*WN* IV.ii.15, italics added). Smith illustrates this kind of unbridgeable advantage with his famous example of wine production in Scotland: "By means of glasses, hotbeds, and hotwalls, very good grapes can be raised in Scotland, and very good wine too can be made of them at about thirty times the expence for which at least equally good can be brought from foreign countries" (*WN* IV.ii.15). As Smith indicates by the word *sometimes*, this is not the rule. Such unbridgeable advantages exist solely in the production of certain agricultural commodities and raw materials, because "[s]ome natural productions require such a singularity of soil and situation" (*WN* I.vii.24).

The preferences of merchants and consumers have an effect as well. As discussed above, Smith assumes that capital owners prefer to invest their capital as close to home as possible for the security and quicker returns of such an investment. This leads merchants whose imported products are successful and who have established a domestic demand to attempt an "imitation of some foreign manufactures" (*WN* III.iii.19). They will invest their capital to produce those commodities domestically: "But when this taste became so general as to occasion a considerable demand, the merchants, in order to save the expence of carriage, naturally endeavoured to establish some manufactures of the same kind in their own country" (*WN* III.iii.16). One last point worth noticing here is that some consumers "might sometimes prefer foreign wares, merely because they were foreign, to cheaper and better goods of the same kind that were made at home" (*WN* IV.ii.41). However, "this folly could, from the nature of things, extend to so few" that it would therefore have little overall impact on the economy and Smith does not dwell on it.

This leads one to the conclusion that Smith had no international division of labour in mind. There is no specialisation among different sectors of production in his theory, as is claimed unanimously by modern interpretations of Smith's trade theory. If a country produces predominantly agricultural goods, this is the result of its state of development, i.e. its level of capital accumulation. It is not the consequence of specialisation resulting from international trade. Each country will accumulate capital and ultimately produce agricultural commodities, as well as rude and finer manufactured commodities. Additionally, due to their bulkiness, agricultural commodities and rude manufactures will not be traded in great quantities. Rather, they are produced and consumed mostly domestically. Smith refers to empirical evidence and states that the "average quantity" of corn imported by Great Britain "amounts only [...] to twenty-three thousand seven hundred and twenty-eight quarters of all sorts of grain, and does not exceed the five hundredth and seventy-one part of the annual consumption" (*WN* IV.ii.20, see also IV.v.b.28). Similar, the corn exported by Great Britain "does not [...] exceed the one-and-thirtieth part of the annual produce" (*WN* IV.v.b.29).[14] Thus, Smith assumes that each nation is more or less self-sufficient in agricultural commodities and also in most coarse manufactures:

> "In every large country, both the cloathing and houshold furniture of the far greater part of the people, are the produce of their own industry. This is even more universally the case in those poor countries which are commonly said to have no manufactures, than in those rich ones that are said to abound in them. In the latter, you will generally find, both in the cloaths and houshold furniture of the lowest rank of people, a much greater proportion of foreign productions than in the former." (*WN* III.iii.17)

Foreign trade is predominantly a trade of more sophisticated manufactured commodities. Additionally, Smith does not assume an international specialisation in different manufacturing sectors. Since producers are likely to imitate foreign commodities and produce them domestically, the production structures of countries are likely to become more similar rather than different. Countries will predominantly trade similar manufactured commodities and merchants will try to exploit price differences. Smith does not discuss this in detail, above all because most countries during his lifetime had no or only small manufacturing sectors. But, he explicitly states that foreign trade increases competition for domestic manufacturers. Specialisation is, however, an antithesis to competition. Referring to international specialisation, Arrow notes that "Smith never realized that there is something of a contradiction between this proposition and his basic economic theory of competition" (1979: 156). If all nations specialised in the production of certain goods, international competition would decrease. In case of a full specialisation, whereby each commodity is only produced in one country, there would be no international competition anymore. Yet, Arrow's supposed contradiction in Smith's theory disappears once it is realised that Smith does not assume an international specialisation.

This relation of economic progress and foreign trade is also illustrated by Smith's statements on the prospects of free trade between England and Ireland. Smith was asked in private about his opinion and he expounds this in two letters to Henry Dundas and Frederick Howard (Lord Carlisle). Smith argues that, due to the level of the Irish economy, Ireland will only be able to compete in agricultural goods. British manufactures will not face any competition in the near future. However, Smith predicts that Ireland will develop and establish its own, competitive manufacturing sector eventually: “I cannot believe that the manufactures of G.B. can, for a century to come, suffer much from the rivalship of those of Ireland, even tho' the Irish should be indulged in a free trade. Ireland has neither the Skill, nor the Stock which could enable her to rival England; and tho' both may be acquired in time, to acquire them compleatly will require the operation of little less than a century” (Smith 1977a [1779]: 240).[15] He argues that the Irish manufacturers will eventually compete with British manufacturers, meaning that there will not be a specialisation among both countries.

Based on these considerations, Smith assumes that the volume of trade between rich countries is greater than between poor countries, as well as between rich and poor countries. There are two reasons for this: first, the volume of foreign trade increases with capital accumulation and thus with economic development and, second, transport costs are lower for more sophisticated manufactures which are only produced by rich countries. Thus, the largest share of international trade will consist of fine manufactures traded between rich countries. More commodities will be traded between countries with large markets than between countries with smaller markets. Moreover, the volume of trade between neighbouring countries will be greater than that between countries far apart from one another, because of transport costs but also because the rate of returns is higher in the first case (e.g., *WN* IV.vii.c.35). Smith illustrates this by comparing the potential trade volume between England and France with trade between England and its North American colonies. France was both richer and closer to England: “France, therefore, could afford a market at least eight times more extensive, and, on account of the superior frequency of the returns, four and twenty times more advantageous, than that which our North American colonies ever afforded" (*WN* IV.iii.c.12). Between neighbouring regions belonging to different countries, the rate of returns is as high as between regions of the same country: "In the trade between the southern coast of England and the northern and north-western coasts of France, the returns might be expected, in the same manner as in the inland trade, four, five, or six times in the year" (*WN* IV.iii.c.12).[16]

Transport costs are not only determined by physical distance but also by the type of transport route. Countries that have access to the sea or to important rivers have advantages over countries that lack such access, because "by means of water-carriage a more extensive market is opened to every sort of industry than what land-carriage alone can afford it" (*WN* I.iii.3). The extent of trade between countries that have access to international waters is greater than that between landlocked countries.[17]

In short, trade volumes are "in proportion to the wealth, population and proximity of the respective countries" (*WN* IV.iii.c.12). The extent of trade between two countries is positively correlated to their level of capital accumulation, their market sizes and their geographical nearness. In this respect, international trade patterns are similar to domestic trade patterns: "Were all nations to follow the liberal system of free exportation and free importation, the different states into which a great continent was divided would so far resemble the different provinces of a great empire" (*WN* IV.v.b.39). Domestically, all regions have agriculture and are mostly self-sufficient. It is progress in agriculture that yields manufacture in towns in the first place. Manufactures depend on the surrounding countryside for food production. Therefore, Smith describes manufactures as "the offspring of agriculture" (*WN* III.iii.20). Different regions of a country mainly trade manufactured commodities for the same reason as do countries, namely high transport costs and a lower rate of return. As different regions inside a country produce both agricultural and manufactured commodities, so will countries in a world market. No country would specialise solely in agricultural goods and no country would specialise solely in manufacturing.[18]

It should be stressed again that the illustration of trade patterns in Smith's theory given here supposes a system of natural liberty, in which policies are absent that either discourage or encourage foreign trade significantly. Such political interferences would, of course, alter trade patterns to a certain degree. For example, Smith deplores the fact that trade between England and France is suppressed, while the trade between England and North America is actively supported by English policies (*WN* IV.iii.c.12-13). This leads to less trade between England and France and more between England and North America. Such policies cause a deviation of international trade patterns from their natural state, according to Smith. They are harmful for a country, because they lead to a less productive employment of capital. This leads to a lower accumulation of capital and thus to slower economic development. This reasoning is the basis for Smith's support of free trade.

4 FOREIGN TRADE AND DIVISION OF LABOUR

In the literature, Smith is associated with the division of labour, which many see as the major force in the *Wealth of Nations*. This is at least partly due to its prominent position in the text. Smith discusses the division of labour at length in the first chapters of the *Wealth of Nations*. Schumpeter, for example, notes that "nobody, either before or after A. Smith, ever thought of putting such a burden upon division of labor. With A. Smith it is practically the only factor in economic progress" (1954: 187). Wakefield, in his edition of the *Wealth of Nations* comments that Chapter I of Book I "is, beyond all comparison, the most popular chapter in the *Wealth of Nations*: no part of the work has been so often reprinted in English, or translated into so many foreign languages; no part of it is so commonly read by children, or so well remembered by them" (1843: 21). This, however, leads to an overestimation of the division of labour in

Smith's theory, underestimating the role of capital accumulation, which is the major force in Smith's theory of economic development.

In international economics, Smith is connected to an international division of labour, a concept which is used by modern theories of international trade. However, after having examined Smith's writings in detail, it must be concluded that such an international division of labour is absent in his thinking. Smith does not conclude that nations specialise in the production of only a few goods.

At the same time, Smith himself uses the division of labour and technological progress in the context of foreign trade. In order to understand this connection, a closer look at his concept of the division of labour is necessary. He argues that the increase in "the productive powers of labour," which results from an enhanced division of labour, "is owing to three different circumstances; first, to the increase of dexterity in every particular workman; secondly, to the saving of the time which is commonly lost in passing from one species of work to another; and lastly, to the invention of a great number of machines which facilitate and abridge labour, and enable one man to do the work of many" (*WN* I.i.5). In Smith's theory, the division of labour is "limited by the extent of the market." Foreign trade increases the market and thus enhances division of labour: "By opening a more extensive market for whatever part of the produce of their labour may exceed the home consumption, it encourages them to improve its productive powers" (*WN* IV.i.31). However, this is not to be understood in terms of a territorial division of labour. Producers have a bigger market for their commodities. They can increase their production, enhance the division of labour inside their respective production process and exploit the "three different circumstances." This leads to an improvement of their productive powers.

Thus, Smith's understanding of the division of labour is solely in terms of a *mechanical division*, not a *territorial division*, to use two terms introduced by Robert Torrens. Torrens defines these two subcategories of the division of labour as follows: "By the mechanical division, each acquires, in his calling, an expertness and skill which he could not otherwise acquire; by the territorial division, cultivation is made to co-operate with the process of nature, and the productions of the earth are multiplied" (1808: 44; see also Torrens 1821: 248-50). Torrens argues that both forms are increased by foreign trade. Later economists predominantly argue that the mechanical division of labour is already extended as far as possible by domestic trade, and that foreign trade only increases the territorial division (e.g., Cairnes 1874: 356-61; Haberler 1950 [1930]: 130; Harrod 1933: 11-2). It is claimed that the mechanical division of labour can be increased as a result of foreign trade merely in small countries, in which the "population is very sparse" (Cairnes 1874: 359). This is only an exceptional case: "In the main, however, it would seem that this cause does not go for very much in international commerce" (Cairnes 1874: 361; see also Haberler 1950 [1930]: 130-1).

After Smith, foreign trade was described almost entirely in terms of an territorial division of labour (see, e.g., McCulloch 1825: 119; Senior 1863: 76). As Williams notes, classical economists in the 19th century from David Ricardo onward used "a theory of benefits from territorial division of labour." National specialisation became "thus the characteristic feature and the root idea of international trade" (Williams 1929: 203) and remained thus to the present.[19] Modern economics depicts international trade as an international division of labour in the sense of a territorial division of labour on a global scale. Additionally, modern scholars ascribe this international division of labour to Smith. This results from a misunderstanding of the division of labour in the *Wealth of Nations*. Smith's concept of the division of labour differs from the one used in modern trade theory. In Smith's theory, there is no international specialisation and thus no international division of labour resulting from foreign trade. Only the mechanical division is enhanced by foreign trade. A territorial division of labour does not play a crucial role in foreign trade for Smith.

This misrepresentation of trade patterns in Smith's theory is reinforced by a selected reading of the *Wealth of Nations* by many modern scholars. They mostly refer only to Book IV[20] and the first chapters of Book I, often out of context. At the same time, Books II and III, in which Smith develops his theory of economic progress, have been commonly disregarded. Yet, they are essential to understanding the role of foreign trade and its development in Smith's theory.[21] The neglect of these two books has a long tradition, as Tribe (2006) shows. The role of capital accumulation as the driving force behind economic development and foreign trade in Smith's theory has often been overlooked. This neglect has led to a misunderstanding of Smith's trade theory, ascribing to him the concept of an international division of labour.

5 CONCLUSION

The discussion of foreign trade and especially of trade patterns in the *Wealth of Nations* shows that Smith's own approach differs widely from modern interpretations, which present Smith's foreign trade theory as an international, territorial division of labour in which nations specialise in the production of certain goods. In this paper, I demonstrate that Smith does not envision this kind of international specialisation.

In Smith's theory, foreign trade is a result of economic development, not its cause. It is inseparable from economic development and thus from capital accumulation. Smith's natural progress of opulence assumes that a country will first establish agriculture. When its level of development allows it, i.e. when it has accumulated enough capital, its capital owners will employ their capital beyond agriculture. Manufacturing is thereby gradually introduced. Only once a manufacturing sector is established will capital be employed in foreign trade. As Blecker points out, "each country develops autonomously along a natural path that is largely if not entirely independent of its external trade relations" (1997: 531-2). The domestic accumulation of capital leads to the establishment of all sectors of production and eventually to foreign trade: "Each of those different branches of trade, however, is not only advantageous, but necessary and unavoidable, when the course of things, without any constraint or violence, naturally introduces it" (*WN* II.v.32).

According to Smith's theory, foreign trade will mainly take place between opulent developed countries trading fine manufactured goods, for two reasons. First, these countries have the necessary capital for foreign trade, and second, due to transport costs, sophisticated manufactured commodities are the main objects of international trade. In contrast to modern interpretations of Smith's trade theory, Smith contends that trade volumes will not be largest among the most diverse countries. Rather, trade volumes are largest between similar, highly developed countries. According to Smith, agricultural commodities and coarse manufactured goods are less suitable for foreign trade because of their bulkiness, which leads to high transport costs. Poor countries and agricultural commodities are not precluded from foreign trade, but their respective volume of trade Smith believes to be much lower. There are some agricultural commodities that can be produced in only some nations due to natural advantages. Other countries have to acquire these goods through foreign trade. However, such commodities are an exception.

Smith does not assume that some countries specialise in agricultural commodities, while other specialise in manufacturing. Even an international specialisation into different kinds of manufacturing is not anticipated by Smith. Popular products from abroad will be imitated and produced domestically because capital owners prefer to invest at home rather than in insecure foreign trade, which additionally has a slower rate of return. Nations will trade similar goods and foreign producers will compete with domestic ones. Thereby, international trade will lead to higher competition; however, there will be no worldwide territorial division of labour.

Overall, foreign trade plays a minor role in economic development compared to domestic production, in Smith's theory. Smith does not assume that trade is as crucial for a country's wealth as many mercantilists thought at the time. Only for a rich country does foreign trade play an important role in increasing its opulence even further. He does not agree with his close friend David Hume that a wealthy, highly developed country “may lose most of its foreign trade” (1987 [1777]: 264). On the contrary, Smith contends that the trade volume will increase with the level of wealth. Smith would also not agree with those who argue, as William Spence (1807) does, “that our riches, prosperity, and power [...] would not be affected, even though our commerce were annihilated,” as the subheading of Spence’s work *Britain Independent of Commerce* states.

For Smith, foreign trade does not only grow to its full potential in fine manufacture; there is, as is so often the case in Smith’s thinking, a circular causation. Reaching the highest level of sophistication in manufacturing requires foreign trade and international demand. Otherwise, the productive powers of labour could not be brought to their full potential. Manufacturers “generally require the support of foreign trade. Without an extensive foreign market, they could not well flourish [...] The perfection of manufacturing industry, it must be remembered, depends altogether upon the division of labour; and the degree to which the division of labour can be introduced into any manufacture, is necessarily regulated, it has already been shown, by the extent of the market” (*WN* IV.ix.41); that is, the mechanical division of labour. Smith does not expect a world characterised by increasing international specialisation, as is often believed about his theory. In contrast, Smith’s original idea was that nations may become more and more similar over time. This corollary of his theory is generally overlooked.

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Notes

[1] Textbooks usually depict the historiography of international trade theory as a Whig history starting from Smith and ending with modern trade models (Schumacher 2012). Thereby, they attribute an international territorial division of labour to Smith. Recent interpretations that connect Smith to the New Trade Theory have tried to increase Smith's reputation as a trade theorist, because they stress the dynamic elements of his trade theory. The New Trade theory is described as representing "a return to the bases for trade as outlined by Smith".(e.g., Elmslie and James 1993: 72); see also Darity and Davis (2005), Kibritçioglu (2002) and Maneschi (1998: 222-3). This line of thought also attributes an international territorial division of labour to Smith, based on increasing returns, not on inherent differences between countries as does the neoclassical interpretation.

[2] As such, this article can be seen as complementary to Tribe (2006), who concentrates on the gains from trade and thus on the normative part.

[3] Smith divides labour into productive and unproductive labour (see *WN* II.iii). The former "produces a value" (*WN* II.iii.1) and thus increases wealth. In fact, "the whole annual produce, if we except the spontaneous productions of the earth, being the effect of productive labour" (*WN* II.iii.3). Unproductive labour, in contrast, does not produce value. While capital always sets into motion productive labour, unproductive labour is paid for by revenues (*WN* II.iii.5-6).

[4] Smith argues that "[h]ow much the lower ranks of people in the country are really superior to those of the town, is well known to every man whom either business or curiosity has led to converse much with both" (*WN* I.x.c.24). However, agricultural wages tend to be lower than industrial wages. The reason is that workers can more easily join forces in towns, enforcing higher pay (*WN* I.x.c.22-3).

[5] In contrast to subsequent theories of international trade which assume international immobility of capital, Smith argues that such mobility is necessary to carry out international trade. Nicholson lists this as one of "the lost ideas of Adam Smith" (1909: xii).

[6] Additionally, Smith assumes a somewhat romantic superiority of rural life. Investment in agriculture is preferred by capital owners upon equal profits also because of "the pleasures of a country life" (*WN* III.i.3).

[7] On the falling rate of profits in Smith's theory, see also Tsoulfidis and Paitaridis (2012) Tucker (1960: 49-73) and Verdera (1992).

[8] Smith is aware that this *natural order* was not the norm in Europe's actual development. Rather, this order "has, in all the modern states of Europe, been, in many respects, entirely inverted." Government policies "necessarily forced them into this unnatural and retrograde order" (*WN* III.i.9). In contrast, Smith's theoretical system, which forms the basis of the present article, relies on an ideal case, i.e. a system of natural liberty. Additionally, this order of capital employment and development cannot be completely reversed and is at least to some degree necessary: "this natural order of things must have taken place in some degree in every such society" (*WN* III.i.9).

[9] Smith emphasises that a country should not promote foreign trade above its natural level: "But the great object of the political œconomy of every country, is to encrease the riches and power of that country. It ought, therefore, to give no preference nor superior encouragement to the foreign trade of consumption above the home-trade, nor to the carrying trade above either of the other two. It ought neither to force nor to allure into either of those two channels, a greater share of the capital of the country than what would naturally flow into them of its own accord" (*WN* II.v.31, see also IV.ii.3). At the same time and for the same reason, Smith argues against all measures restricting and thus discouraging foreign trade. Such policies would in the same way divert capital away from more beneficial employments.

[10] In this sense, Smith describes the carrying trade as “the natural effect and symptom of great national wealth: but it does not seem to be the natural cause of it” (*WN* II.v.35).

[11] Smith discusses the durability of agricultural commodities as well. For example, he argues that “of all the productions of land, milk is perhaps the most perishable” (*WN* I.xi.l.11). This perishability is an additional reason why agricultural goods are hard to transport, but Smith never discusses this in connection with foreign trade.

[12] Smith also compares clothes to certain rude products: “The materials of lodging cannot always be transported to so great a distance as those of cloathing, and do not so readily become an object of foreign commerce” (*WN* I.xi.c.5). Materials of lodging are barren timber and stones.

[13] Smith adds that even meat in the form of salt provisions would not present competition for domestic meat producers because “when compared with fresh meat, they are a commodity both of worse quality, and as they cost more labour and expence, of higher price” (*WN* IV.ii.19).

[14] Smith is cautious about the validity of these numbers and adds that “I have no great faith in political arithmetick, and I mean not to warrant the exactness of either of these computations. I mention them only in order to show of how much less consequence, in the opinion of the most judicious and experienced persons, the foreign trade of corn is than the home trade” (*WN* IV.v.b.30).

[15] In the second letter, Smith speaks of centuries: “In the present state of Ireland, centuries must pass away before the greater part of its manufactures could vie with those of England” (1977b [1779]: 243). In accordance with his theory, Smith is supportive of the Irish demand for free trade.

[16] Smith adds that even the trade "[b]etween the parts of France and Great Britain most remote from one another […] would be, at least three times more advantageous, than the boasted trade with our North American colonies" (*WN* IV.iii.c.12),

[17] Therefore, the interior of Africa is unlikely to reach the same level of development as other countries and to develop major foreign trade: "There are in Africa none of those great inlets, such as the Baltic and Adriatic seas in Europe, the Mediterranean and Euxine seas in both Europe and Asia, and the gulphs of Arabia, Persia, India, Bengal, and Siam, in Asia, to carry maritime commerce into the interior parts of that great continent: and the great rivers of Africa are at too great a distance from one another to give occasion to any considerable inland navigation" (*WN* I.iii.8).

[18] Services are not considered by Smith, because they played no role in international trade in the 18th century. Additionally, most services are *unproductive labour* according to Smith's categorisation and are thus not part of his theory of economic progress. They would, according to his definition of unproductive labour, not add to capital accumulation and thus not to wealth.

[19] David Ricardo, to whom the discovery of the theory of comparative advantage is attributed, stresses the importance of the territorial division. He argues that more commodities can be produced "by the better distribution of labour, by each country producing those commodities for which by its situation, its climate, and its other natural or artificial advantages, it is adapted" (2004 [1817]: 132).

[20] Most often, they refer to *WN* IV.i.31 and IV.ii.11-12, 15.

[21] Nicholson labelled Chapter V in Book II "the forgotten chapter of the *Wealth of Nations*" (1909: xii). As far as interpretations of Smith's theory of foreign trade are concerned, this is still true today, even though this is one of the crucial chapters for understanding Smith's economic theory.

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