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Adam Smith's conceptual contributions to international economics: Based on the Wealth of Nations

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The 1776 dated "Wealth of Nations" work of Adam Smith has formed economic dimension of the Industrial Revolution and also transformed economics into the identity of a social science. As if the wealth of nations, namely the welfare increase became the top goal two and a half centuries ago, it is the top goal today and in the future as well. So understanding Smith's works well carries importance in fighting against poverty in the world. According to Smith, in the basis of the welfare increases (wealth of nations) are labor and cooperation. Tendency underlying cooperation is the tendency of swap. It is considered that understanding Smith's works well will provide solution for poor countries and therefore contribute to poor population in the world to decrease. For solving poverty and problems concerning welfare (destitution, hunger, etc.), Smith's works need more historic examination. In this study it was aimed to contribute to the given examination.

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Introduction

The work named "An Inquiry into the Nature and Causes of the Wealth of Nations" transformed economy into a science identity. Smith, in his book called with its short name as "Wealth of Nations", brought about new viewpoints in the way to be able to usher a new era by the term he lived. The given book was a work which prepared the end of Mercantilism being an economic and political doctrine valid until that term in the world and which started the term when "Classical Liberalism" was dominant, and it criticized mercantilism and also ushered for new concepts used in explaining economy to occur from that time up to now. The given work has a birth (starting) quality so to speak. Considering views of scientists arose also with the effects of the term they lived, A.Smith was affected by thinkers before himself as well. Physiocrats and Newton's "Natural Order" opinion became a source of inspiration and opinions of mercantilists provided him to bring about a critical alternative approach.

That the developments occurring in the time near to the date when the given work happened became effective can be said as the reason why opinions introduced by Adam Smith in his work "Wealth of Nations" became effective and caused wide after-effects. These are developments like the invention of vapor machine - 1769 and French Revolution - 1789. All three historic events mentioned here form three dimensions of industrial revolution. The given developments provided Mercantilism being an economic and political doctrine valid until that term to leave its place to classical liberalism.

Views of Adam Smith are used to explain today's economies after approximately two and a half centuries of time. Today the concepts we use in explaining developments in international economy are concepts acquired by Smith either as the first opinion or absolutely by him.

¹ This article was presented at the conference (at the "International Adam Smith Conference-International Conference of Political Economy: Adam Smith Today-Adam Smith's Significance for our Century," 1-4 October 2009, Kocaeli-Turkey). The paper is the modified and improved.

In the study, some of concepts A.Smith brought in International Economics are told in the axis of “Wealth of Nations”. For this, primarily developments being effective in Adam Smith's revealing this work and views influencing Smith will be told in brief and then in the following part, the concepts brought in international economics will be determined by taking basis from the work “Wealth of Nations” and how Smith states these in his work and what their meaning is today will be told shortly.

Developments (prior to classical liberalism) preparing the work “wealth of nations”

That economics science became appear happened in 1776 when Adam Smith's book “Wealth of Nations” was published. In the world prior to 1776, economic and political doctrine was “Mercantilism”. Reactions against mercantilism started in the mid 17th century and after this date, economic thought entered a transition term. That term between mid 17th century (after 1660) and 1776 is called transition term for this reason. The transition term is a term which started with Adam Smith and in which first theoretical and methodological steps of the theory called “Classical Theory” were taken. Therefore, in this term a set of thinkers started to concern economic subjects more as well as and more than businessmen. The leading characteristic specialty of the transition term is the interest in freedom of the individual. Societies started to think that the abolishment of limitations brought by the State would be useful both for the individual and economy. On the other hand, the reactions against the Middle Age's thought that people should be purified from material interests and keep human ego under pressure started to increase in this term. In contrary to this doctrine, a next doctrine Hedonism defending that material welfare should increase and which much enjoyment should be taken from life, started to gain followers. According to hedonism, prodigality was not an unethical behavior but a factor causing trade. Its followers were arguing out that high individual consumption would provide economic development. Opinions of hedonism followers transformed into the “Liberalism” doctrine identifying with the slogan “laissez faire, laissez passer” in the late 17th century and early 18th century and to determine the functioning principles of the economic system arranging itself became an essential aim as of this date (Savas, 1997, pp.165-66).

Another thought model occurring in the end of the transition term is physiocratic thought. Like Mercantilist thought, Physiocracy was affected significantly by economic specialties of the term it appeared. Revolutionary changes in agricultural production systems occurring in the early 18th century did prepare basis for physiocratic thought. The basic opinions of physiocratic system are stated in the works “Maximes Generales du Gouvernement Economique d'un Royaume Agricole (General Principles of Economic Government of an Agricultural Royalty)” published in 1760 and “Tableau Economique (Economic Table)” published in 1785 by Francois Quesnay being the founder of this school. Physiocracy, which means “Natural Order”, regards the intervention of the state to economic life as unnecessary and defends that people comply with laws of natural order will be enough. It is clear that these views are views quite far away from the intervening system of Mercantilism. In contrary to mercantilists who regarded valuable mines as the source of wealth and gave big importance to trade in ultimate goods export way, in physiocratic thought wealth is not composed of foreign trade but in the activity areas such as farming, fishing and mining, namely of goods produced with the help of nature (earth) (Olmezogullari, 2003, pp.48-49). Thought trends were affected by conditions where the society took place within. Physiocratic thought can be accepted as a transition term doctrine also including views forming an inspiration source for liberalism. Adam Smith was also affected by physiocrats and prepared the work “Wealth of Nations” in such a medium.

In the formation of economic systems, thought trends until that term in which rules are determined and in that term are very effective. In other words, there is a doctrine, a thought trend in the basis of every economic system (Olmezogullari, 2003, p.37). Since

Mercantilism is called a commercial capitalism as well, it can be considered as a thought trend in the development of capitalist economic system. Later, in the term called transition term, Physiocracy developed and this prepared a basis for "Classical Liberalism" being the school or trend founded by Adam Smith. Behind Mercantilism, when we looked at doctrines affecting it, inspirations of the term when there were concepts such as land ownership, cooperation, trade and money and opinions of Plato and Aristotle concerning these concepts doubtlessly became effective. Then, Smith's opinions about cooperation and specialization that mean "Economies of Scale" today are reflections of the given doctrines to today. Although the capitalist economic system thought was available before 1776, it was able to sit on a theoretical basis together with the economic school founded by Adam Smith.

The work "Wealth of Nations" became appear in a term when wars in Europe stopped and the world trade significantly increased. In the last quarter of the 18th century the leading sector in English economy was the agriculture sector (Savas, 1997, p.261). Physiocratic thought was a dominant thought in these years exhibiting last terms of Mercantilism. Adam Smith was also affected by physiocrats. The 18th century is a term when many changes were lived in the world. In this term, both the effects of Mercantilism, Physiocracy and immediately after that, Classical Liberalism or Classical Economic School were seen and also the "Industrial Revolution" spread starting from England. The impact accelerating the Industrial Revolution or in other words forming economic dimension of the revolution is Smith's "Wealth of Nations" work. The Industrial Revolution has three dimensions. These are: the dimension that in 1769 James Watt takes out the patent of the vapour machine (technological dimension of the Industrial Revolution); the dimension that in 1776 Adam Smith publishes the book called "Wealth of Nations" (economic dimension of industrial revolution); and the 1789 French Revolution (political dimension of the Industrial Revolution). These three dimensions prepared the end of Mercantilism. Especially the technological dimension of the Industrial Revolution facilitated rapid and easy production and after that, Mercantilist opinions started to be criticized. As known, Mercantilists prohibited the ultimate goods import (for it causes valuable mine output) and aimed to increase the input of valuable mines by increasing export. In contemporary phrasing, this situation necessarily means running the balance of payments surplus and this aim states the essential intend of mercantilists. In the point we came with the acceleration of the Industrial Revolution, to produce no longer became a problem and to find new markets became important. The important developments stated in the 18th century prepared the end of Mercantilism. And Adam Smith, in such a medium, got widespread interest thanks to his views in his work "Wealth of Nations". Smith explained the opposite views to Mercantilists' views defending that the world assets are stabile and that if a country takes more share from these assets, it leads to another country to take less share. Classical Liberalism (Classical Economic School) starting with the work "Wealth of Nations" is based on liberal doctrine and defends that free trade will provide assets to be used efficiently, optimal source distribution will realize in the world and so welfare levels will increase. The work "Wealth of Nations" also provided the distinction between positive economics and normative economics to occur.

While positive economics aims to analyze the present situation by being independent from value judgments, normative economics explains the thing necessary to be or not to be by making an analysis also including value judgments. Normative economics handles questions such as if economy authority's interventions are necessary, with which aims and which tools we can treat and what policies we will carry out (Sachs and Larrain, 1993, p.588). Adam Smith became the founder of normative economics as well: he described in his works the cases the government should or shouldn't intervene in economic life.

Adam Smith was much affected by Newton's views. Newton's views became effective in his approach to political economy, introducing concept of the general economic balance. Being affected by Newton, Smith wrote "History of Astronomy". Adam Smith is the philosopher of his age in the way that he can understand Newton's methodology and studies. John Maynard Keynes, who is deemed the founder of Modern macroeconomics,

revealed Newton's handwritings again and examined. Keynes, in this subject, interprets that "Newton is not the person of his term; he is a magician and the last person remaining from Sumerians and Babylonians" (Montes, 2006, pp.247-248). These inspirations are seen in his work "Wealth of Nations". Although sometimes Smith's views about economy are criticized today, this happens temporarily and Smith's views may be dominant again when the crises of capitalism pass.

Concepts brought in international economics after "Wealth of Nations"

Freedom (Liberalism) and Invisible Hand

Yearly income of every society is totally equal to changeable value of the total yearly production of its industry. Individuals generally want to invest in the domestic industry. Therefore individuals will spend effort to use their capital to support the national industry; and while they force a given industry to form high value product, inevitably they will contribute to increasing yearly income of the society. Actually here individuals don't work for the public benefit increases, even they don't know how much production they should make for increasing the country benefit. Their behavior here is driven by aim to guarantee himself by using his capital in domestic industry or not sending his capital to far regions and only consider his own income. The individual does work for the realization of a goal he never intent to reach through an invisible hand like in lots of other situations.

Moreover, such selfish behavior of individuals doesn't form any problem for the society. In contrary, therefore individuals hanker after their interests and elevate the society interests. Actually individuals do more behaviors while following their own interests than activities they do for following the society interests. Even if the aim had been only the society interest, such high social benefit couldn't have been got.

It is clear that an individual can evaluate the whole of the country industry which he can activate with his capital and which product will have the highest value better than any statesman or law maker. The statesman, who tries to direct people about how they must use capital, not only directs the interest of individuals to an unnecessary area but causes such a wide authority, which shouldn't pertain to any person or group, to be got by someone, and such an authority to be got by unqualified people even will be very hazardous for the country (Smith, 2002, pp.42-43). Statements of Smith are important for free trade and free enterprise to increase Gross National Product (GNP) and National Income (NI) in the country. Behavior that individuals keep capital near them (this behavior is instinctive) pushes them to use income in national economy. Therefore, not only that sector established by capital but also auxiliary sectors come into action. Intention of individuals to make their capital to be used in high value product manufacturing (in today's words, their want to produce high value added product) provides the most wanted products in the society to be produced. Because that product has high value means that needs of the society are in that direction. Therefore capital is used in profitable sectors within the country. Smith describes invisible hand mechanism as a functional mechanism for many areas. Here that capital tends to suitable area due to individual interests shows freedom (Liberalism) understanding of Smith. That the law maker shouldn't affect this tending states Smith's viewpoint to free market economy. Moreover, since this behavior individual's do by acting freely also causes the most positive state to occur in the society, he describes this state in the formation of economic activity as "invisible hand". This mechanism which Smith tells as "invisible hand mechanism" and describes as "like in many other situations" is stated as valid in the work "Wealth of Nations", in components on foreign trade, namely within import and export. In other words, "one of many other situations" is foreign trade. Smith's invisible hand mechanism opinion is an opinion developing under the effect of both physiocrats and Newton's "Natural Order" opinions.

Economy being open to the foreign, foreign trade and absolute advantages

That in any art or manufacture branches the internal market monopoly is given only to the monopoly of domestic producers' means directing private persons about how they should use their capital in a way, and in this state it becomes either useless or harmful arrangement. If goods of domestic industry can be bought cheaper than those of foreign industry goods, such an arrangement appears useless. If domestic industry goods can not be bought cheaply, the given arrangement is harmful. Even a family guardian's principle is that he mustn't try to make goods, the cost of which will be more than buying from outside, at home. A shoemaker doesn't attempt to sew his own clothes, he buys them from the tailor; a tailor doesn't attempt to make shoes for himself, he buys them from the shoemaker; a farmer doesn't attempt to make both two, he has these craftsmen make those. The vocational branches stated here find using their all working powers more advantageous than other vocational branches as suitable to their interests and thanks to some part of products they produce (in the same meaning, with the price of things they produce), they do buy all other needs. This situation being consistent for the family living is a wise attitude valid for a big country as well. If getting goods from a foreign country cheaper than those a domestic economy can accomplish is possible, it is more suitable to buy these goods in return for some part of goods in which domestic economy is advantageous. A country's natural advantage to another can be relatively huge especially in the production of certain goods and so all other countries think that struggling with the given country will be a futile effort (Smith, 2002, pp.43-45). According to Smith, the situation of an economy being closed to the foreign means giving the country markets to the monopoly of domestic producers, and in this case, freedom of domestic producers are restricted and a leading State intervention about in which direction they will use their capital is made. This limits free enterprise and leads to the negativity that goods produced by other countries more cheaply are produced in the country. However in external world some goods are produced more cheaply or less costly. If in economy there is a situation open to the foreign, enterprisers will realize production not in these goods but in goods which may be produced less costly than external world. Even in the shoemaker, tailor and farmer example Smith gave, it is stated that a family guardian making the living of his family makes the job in which he is advantageous and spends all his power in this work will bring in him a buying power to be able to purchase other goods and his welfare level will increase in this way. Smith says that this situation is valid in the situation of a country with other countries as well as in the person making the living of his family. The thing wanted to be told here is the situation that an economy open to the foreign increases welfare level of the country more than an economy closed to the foreign. This situation told in the "Wealth of Nations" takes its place as "Theory of Absolute Advantages" in the literature of international economy. In the international economy doctrine, microeconomics information are often referred to. In microeconomics, that we examine only one firm's behavior among lots of firms is often used, in international economics doctrine, in explaining behavior of one country among lots of countries in the world. The effect of foreign trade a country makes with external world on the country exchange income is mostly like the situation that one firm increases its revenue. Open economy widens markets of the country, increases its revenue (in the same time product) namely exchange income and can provide welfare advancement. In this point, it is necessary to emphasize that Smith has the identity of being the founder of normative economics in the direction of his views about necessities for welfare incomes of open economy and for economies. It is possible to separate economics science into the two according to his approach to economic events. While "Positive Economics" teaches an economic behavior far from suggestions about what things must happen, "Normative Economics or "Normative Analysis" is economic analysis' type reflecting value judgments and making evaluations about what things must happen (Husted and Melvin, 2004, pp.30).

Adam Smith, as he briefly wrote in the "Wealth of Nations", stated that foreign trade will cause welfare gain in this way by the sentence that "if a foreign country can supply a

commodity to us cheaper than one we produce, buying this commodity from that country is useful for the country". This opinion is based on a simple and intuitive logic. The country itself must produce the products it produces with less cost but he mustn't produce goods it produces with high cost compared to the other country and must buy goods its self produces by giving them to that country. With this way, both two countries together will get welfare gain (Ravenhill, 2005, p.21).

Goods entity of a country or a society is equal to the sum of goods of all members of that society or of all citizens of the country (Smith, 2004, p.295). Smith, with this statement, defines National Income of Gross National Product.¹ National income of the country may increase thanks to open economy. This result in the analyses of Smith forms a great criticism of Mercantilism. As stated before, mercantilists suggesting the world wealth was stabile were defending severely that foreign trade (especially import component of foreign trade) was causing the output of valuable mines, decreased the share of a country it took from the world wealth and increased the share of the other country. However Smith emphasizes that every country will turn out to be gainful from foreign trade.

While it is doubtless that the theory of Absolute Advantages is an important step in explaining the reason of international trade scientifically, this model cannot explain a significant part of trade between countries. For example, if a county is producing all products more cheaper than the other country, or namely a country is over industrialized and the other is very poor and underdeveloped, foreign trade facilities between these countries are not available according to this theory (Seyidoglu, 2009, p.26). The Theory of Absolute Advantages is available with its lacks. The theory, which ushered a new era in conditions of that term, cannot explain situations in which in any commodity production a country is superior to the other country and argues that these countries cannot do trade. This lack of the theory was eliminated with the "Theory of Comparative Advantages" of David Ricardo being another economist of the school of Classical Economics. Lacks of Ricardo's theory were tried to be removed by economics theorists after him and lots of theories towards explaining foreign trade came out. It must be known that in the origin of all theories towards explaining foreign trade is the "Theory of Absolute Advantages". The theory preparing the end of Mercantilism and the first of new foreign trade theories pertains to Adam Smith.

Cooperation, specialization and economy of scale

The development in the production power of the effort and a significant part of mastership, skill and judgment ability shown while spending effort are sourced from cooperation. To what extent cooperation can be applied to an activity area, more it causes the increase in the production power of the effort. It can be said that various works and professions differentiate to benefit from this advantage and become independent business lines. In the countries the development levels of which are increasing, this distinction becomes more apparent. In advanced societies a few people do the work made by one person in undeveloped societies. In developed countries cooperation is due to goods which should be produced in high amount. In the result of cooperation, the same number of people may provide great increase in work amount. The reason of this increase is sourced from three separate instances. First, the increase in each worker's skill (specialization); second, saving of time generally lost while passing from a work to another; third, availability of lots of machines facilitating and shortening work and providing one person to cover numerous people. The increase in the worker skill results from the reducing of every worker's work to only one simple operation and that this operation is his only effort in his life. Moreover, this situation causing specialization accelerates the production of new machines through applying to knowledge of that

¹ Two concepts as National Income (Net National Product with Factor Prices) and Gross National Product can be considered as the same expressions for an economy in which the State doesn't intervene in economic life.

worker and the putting of machines providing the effort efficiency to the production. In a society being administered well, wealth arriving to the lower layers of people realizes in all working fields in consequence of great production caused by cooperation (Smith, 2004, pp.17-23). The phenomenon activating mastership, skill and judgment (taking decision) ability that is defined by Smith as specialization is cooperation. It is understood from the statement of Smith, necessity of producing great amounts of goods has made cooperation obligatory in developed countries. So, it is necessary to state that cooperation realizes thanks to the production increase. Namely that production increase provides cooperation and specialization as well as cooperation provides the production increase and specialization is a result reached from Smith's statements.

The increase in the production affects positively costs and efficiency and that positive effect on costs and efficiency increases production again (so the situation described here continues and full employment is got in the country) define economies of scale. That costs are affected positively must mean to us that they increase slowly. The concept used today as "Economy of Scale" is a concrete statement of Smith's views that tell about benefits arising from cooperation and specialization and tell about an economy caused by the growth in the scale. It tells about the triple positive cycle which is between cost and efficiency and feeds each other (Ertek, 2006, p.138). Although Smith is an economist known with his theory of Absolute Advantages, he has referred to the "Economies of Scale" putted forward in the terms very after than him and handled this concept as a cause of foreign trade (Karluk, 2009, p.23). Countries want to magnify their markets thanks to foreign trade and to benefit from the production-cost-efficiency relations which are defined as economy of scale. So the idea of this concept also pertains to Adam Smith. It will be also useful to give place to other views of Smith concerning cooperation.

Cooperation is actually not a product of any conscious thought that predicts and aims wealth; it leads to and is a result of the tendency of goods exchange, swap and commuting a thing with another thing that are found in human nature. This tendency is seen in all people. There is not this kind of tendency in animals; they select the way of tricking another animal for taking help instead of commuting. Sometimes it is seen that human applies to the same games against his fellows. When he has not got any other way to have someone make the thing he wants, he tries to temper his fellow through various "ignominious actions". Human mostly needs the help of his fellows, and if he rely this help on generosity of them, his hand becomes empty. If he can address to selfishness of his fellows in the way that will provide benefit to himself, and can show that they accept the help wish of him is also useful for them, then the chance of his being successful will be higher.

The meaning of all these suggestions is in the way "give me the thing I want, and as a reward of this, get the thing you want in me" (Smith, 2004, pp.25-26). To Smith, cooperation has developed as a cause (reason) of the swap (exchange, commutation, shopping) behavior. Smith, again in the continuation of his words, with his sentence meaning "we get bread not due to the charity of the baker but because they seek for their own interests" (Smith, 2004, p.26), emphasizes that cooperation occurs due to individual interests and commutation and thanks to this, production varies. This behavior of individuals in capitalist, economic system, according to classical economic thought, increases social interests (welfare level). Namely, in a liberal economy, individuals work to maximize profit. Therefore they can buy other goods they need. This commutation tendency makes cooperation obligatory for maximizing profit by producing more. Smith, also as a person to have given lessons of moral philosophy¹, can present his explanations concerning the society behaviors that have sharpness as much as here. This identity of Smith also has affected his being the founder of normative economics, in other words, his views about what should be in economy.

¹ Information about both "Invisible Hand" and the nature of human behaviors can be got from the first book "Theory of Moral Sentiments" (Savas, 1997, p.266) Smith published in 1759. Smith has taken both moral philosophy and logics education and also given lessons in these subjects.

Labour theory of value, market price, perfect competition market, law of one price

Value concept has two different meanings. The value can be considered as the “use value” when stating usefulness/utility of a particular commodity, and as “market price” meaning the power of buying another commodity against the given commodity. Market value of objects having high use value is generally either so low or not available. In contrary, use values of objects having high market values are either so low or not available. For example, use value of water is high but its market value, namely exchange value is not available or is so low. However, market value of the diamond is so high and it can be commuted in very large amounts with other goods, but use value of it is very less. Value of an asset for his owner is equal to the effort amount which renders possible his owner's buying or management. Thus, the effort is the real criterion of value of all goods. The real price of everything is equal to the trouble of getting it.

Money is essentially a tool saving the person from the trouble of spending effort. The commodity given in return for money or goods is not a thing other than the commutation of the effort with the same amount of effort. Nevertheless, the real criterion of all goods' commutation value is effort, the assessment is generally not made in the type of the effort or determining the ratio between two effort amounts is difficult (Smith, 2004, pp.40-42). Smith's Labor Theory of Value explains that the real value of a commodity should be measured with the effort amount within that commodity or spent for that commodity. Thanks to the effort amount used for the production of goods, goods can be priced not monetarily but in real type. Even if Smith says that the determination of a calculation or ratio in the type of the effort amount is difficult, especially today thanks to the “opportunity cost”¹ concept, it can be possible not only to state the effort but also other used production factors within goods. It will be useful to say that Smith regards money as a tool facilitating commutation in economy, thus to him, even money denoting the value of goods is the concrete statement of a particular amount of effort.

Adam Smith argues out that money is only a trade function. For Smith, money has only the meaning of providing a calculation unit or exchange. Money in the form of paper is a credit tool and used as a payment tool in the struggle with expensiveness. Smith argues out that the tendency of putting much money into the market is high in capitalist societies and this will increase profitability of banks. He defends that high availability of money will reduce interests of it; in this situation banks will hold much money (because the increase in money supply is reduced by banks for one time) and try to increase their profitability in the future. In other words, money stock of banks will increase and they will start making profit planning. Here the thing wanted to be told us is not a possible hyperinflation effect caused by money (Paganelli, 2006, pp.273-278).

While the sum of prices spent for that commodity that is necessary to be paid until the advent of this commodity to the market, namely the total value of the annuity, effort (wage) and profit mean “Natural Price”, the actual price with which a commodity is mostly sold is called the “market price”. The profit stated here is the profit the seller expects while realizing this production. That a market price which will provide the profit the seller expects has realized gives him a normal profitability level; this price level, in a place where there is total liberalism or in a place where the seller can change his work in the frequency he wishes, is a price level in that it is possible for him to sell his goods for a certain time (Smith, 2004, pp.68-69). Smith here describes another hypothesis “Perfect Competition Market” often used in international economics doctrine (especially as standard assumptions used in international trade theory analyses and for using in the exchange market analyses) and micro economics. As known, the perfect competition market is a concept used to state the conditions where the competition is in equal conditions, there are lots of buyers-sellers (atomicity), input-outputs to the market are free

¹ The opportunity cost concept is a concept developed in 1930 by Gottfried Haberler very after than Smith, and in international economy literature it has been used in explaining foreign trade through new theories.

(mobility), there are homogenous goods in the market (homogeneity), there isn't a market trick or full information can be got (transparency). A corruption in one or a few of these concepts transforms the market into imperfect (or defective) competition market. In other words, it is a ruler used in measuring how defective competition market the market is (if monopoly, monopoly competition or oligopoly). That these conditions have been provided yields the market price to occur on its own.

The market price can be equal to natural price or bigger or less than it. The thing determining this is demand and supply. If the amount brought to the market is less than demand, then all of people being wishful to pay the whole value of the annuity, effort (wage) and profit cannot get the amount they want. So some, of them are willing to pay more money instead of not buying that commodity. Immediately a competition will start between these demanders and the market price will be more than natural price. If the amount brought to the market exceeds the demand, then the market price of that commodity will be below natural price. As a third situation, supply can be equal to demand, this means that natural price coincides with the market price. The thing being important is that natural price is a price which attracts all commodity prices. Even if the market price drops to the below of natural price or exceeds it, prices continuously tend to natural price no matter what the reasons making prices far away from this balance centre are. For example, when demand exceeds supply, the producer will bring goods to the market by using more factors; this provides elevated market price to approach to natural price, to drop again. In an opposite situation, namely when the market price drops to the below of natural price, the producer will decrease the factor use and supply, so the market price will rise and be equal to natural price. Moreover, the fluctuation in the market price also changes prices (profit and wages) of factors. Another important situation is that in a market where the competition is perfect (perfect competition market), in long term, excessive profitability disappears for new firms enter the industry (since the market price is above natural price) (Smith, 2004, pp.69-75). Smith, with his statements here, both defines prices of the production factors (annuity, wage, profit) and defines the situation in which "natural price= market price equality we often use as "market balance price" in free market economy today realizes and also defines the situation of the formation of "Law of One Price" in free market economy. The result reached here is the primitive state of the "Arbitrage" concept explaining the situation that in today's economy doctrine a commodity's price cannot be more than one and the price drifts into a single price. Namely, the first idea of the arbitrage concept pertains to A.Smith as well.

Law of one price and arbitrage

An economic asset's price being valid in all markets in the same time that can be a subject (tradable) of trade becomes the same as a natural result of a market structure based on high level competition in the way carrying conditions of perfect competition market or being in the same meaning. The occurrence of this phenomenon called Law of one price is related to the arbitrage mechanism. The person realizing arbitrage, namely arbitrageur, gets a riskless gain by benefiting from the price difference between two markets where transactions in the same time are free. This mechanism eliminates price deviations among markets. The Law of one price and the arbitrage mechanism based on this are valid both for domestic markets and also for international markets. In other words, when stated in the type of the same national money unit, the price of a certain economic asset must be equal in all world markets in the same time. Of course it is necessary to use the exchange rates (as stated, the same national money unit) to be able to make this comparison and transforming prices into each other. It is possible to make the more clear definition with the sentence that "Law of One Price or Arbitrage is the situation that the same economic asset' price stated with a national money according to the balance exchange rate is the same everywhere" (Seyidoglu, 2003, p.118). It is the situation that there cannot be any price difference in a commodity (any price differentiation cannot be made) in the two markets having the transaction liberty to each other or in the same market (these two

meanings are very near each other). This situation explains that exchanges between two markets becomes arbitrated (be drifted into one price) and is also used for all goods and services today. In other words, the arbitrage mechanism operates in the exchange markets, goods and service markets and factor markets behind these. If a difference has occurred in exchange markets, the difference will disappear thanks to the exchange arbitrage (Krugman and Obstfeld, 2000, p.336); if there is a difference in the price of the capital in markets in two countries, interest ratio will operate arbitrage and again the difference will disappear thanks to the "Law of One Price" (Mark, 2001, pp.164-165).

The price of effort varies between regions. Since this price difference mostly being insufficient to move effort from the region where the price is low to the region where the price is high, moving goods from cheap markets to expensive markets (even if distances are far) becomes inevitable. Thus, in the result of this carriage, the price differences vanish (Smith, 2004, p.89). Smith's statement also shows that in markets, having the transaction liberty near to each other, the prices of goods drift into one price. Although there are various types of arbitrage, to explain here every one of them will be groundless because it goes beyond the subject of the study. The thing necessary to be known is that Smith explained the arbitrage concept, even if it is not with the name of today, with the definition of Law of One Price as stated, in his work "Wealth of Nations".

Conclusion

Adam Smith is an economist and also a moral philosopher, who criticizes Mercantilism's views in the way that the world wealth is stabile and that certainly limit goods import, who prepares the end of Mercantilist opinions and transforms economics into the identity of science. He defends that the world wealth is not stabile and that free international trade increases welfare level of countries. With the acceleration in the Industrial Revolution, not producing but finding new markets has started to be a problem. And in this medium, the "Wealth of Nations" got widespread impact and Mercantilist opinions left their place to Classical Liberalism.

In Adam Smith's work "Wealth of Nations" one can trace adoration towards physiocrats and also Newton as well as the reaction against mercantilism. He was significantly affected by their "Natural Order" opinion and defended liberalism in economy. In views of Smith, freedom (liberalism) forms the action point. He examines the concept he described as the invisible hand mechanism as a result of freedom. The "Invisible Hand Mechanism" being a concept described by Smith is the price mechanism used often today in economy doctrine. Individuals behaving rationally and economically provide the production of the most useful goods for themselves and accordingly for the society to be produced thanks to their free actions. The price of a commodity means the value of that commodity in the eye of the society and more the price rises, more the production of that commodity widens. Hereby in an economy the question in which goods' production the sources will be used and how much will be produced from these goods finds its answer. Smith describes the "Invisible Hand Mechanism" as a mechanism valid for many situations. Smith's viewpoint to foreign trade becomes concrete with the "Theory of Absolute Advantages". According to the given theory, the country should make production in goods which it produces more cheaply compared to other countries and should buy other goods from the other country in return for those its self produces. Hereby foreign trade realized will increase welfare level of every country and all countries will provide gain from the world wealth. Smith's theory tells about the spread of economic activity over the world. A.Smith, who has told about the things necessary to be for the country economy with respect to welfare gains by based on value judgments, has the quality of being the founder of normative politic economics due to his these comments. A.Smith, in his given work, tells about benefits of cooperation and specialization in a wide form and by giving examples. He emphasizes that the tendency revealing cooperation is swap or commutation. Since individuals want to change more goods with goods, they want to make cooperation. This approach is also an interesting result of Smith's analyses.

Doubtlessly, this analysis must be a result of Smith's moral philosophy and logics accumulation in writing another work called "Theory of Moral Emotions" in 1759. The increase in the production makes cooperation obligatory. The "Economies of Scale" concept used today tells about the positivity process in the production-cost and efficiency which affect each other. That which brings this concept in international economics literature, not even if with this name stated, is the "cooperation-specialization-production-swap" relations in the work "Wealth of Nations".

There are concepts Smith brought in both international economics and micro economics doctrine such as "Labor Theory of Value", "Market Balance Price", "Perfect Competition Market and conditions of this market". It must be known that without using micro economics information, to explain foreign trade movements of international economics, the effect of open economy on welfare compared to closed economy, with what criteria components of foreign trade are determined (import and export) and the formation of foreign trade terms cannot be possible. The given concepts, from this viewpoint, are concepts brought in international economy by Smith.

Another concept he explained in his given work is "Law of One Price". This concept is not a thing other than "arbitrage" with its state used today. In the result of arbitrage, the price difference of a high-grade security between two markets disappears and the price becomes one price. In today's international economics literature, the arbitrage concept is a concept used the price equalization for all markets, namely in the factor markets, goods and service markets and exchange markets.

Smith, thanks to his views, provides the transfer of opinions of the term before him, namely of Mercantilism, Physiocracy and Newton to today. He brought many concepts, which we use in explaining today's economics, in the literature or formed the first idea of them about two centuries ago. It must be remembered that here only the work "Wealth of Nations" was the subject matter. His other works each is absolutely a value. Smith's cited opinions have the quality of ushering a new era for the term they have come out, they got widespread impact and became subject to new trends today as well.

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