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Breaking Out of the Smithian Box: The Division of Labor and Entrepreneurship

HAI-TRIEU V. NGUYEN
Independent researcher

Abstract: This paper revisits the critique of Murray Rothbard and Frank Fetter leveled against Adam Smith's economic theory. We offer a "historical reconstruction" of Rothbard and Fetter's critique as seen from their point of view, as understanding their arguments requires situating them within their broader economic analytical framework. We focus on the case of the division of labor and the role of entrepreneurship, with the conclusion being that in light of the Austrian tradition, it is justified that Smith's understanding of labor and entrepreneurship remained unsatisfying for Rothbard and Fetter, whose criticisms can be seen as complementary to each other's.

Keywords: Adam Smith, Murray Rothbard, Frank Fetter, Division of Labor, Production Theory, Entrepreneurship

I. INTRODUCTION

The development of economic theory since the time of Adam Smith occupies a central place in the history of economic thought. The simple Whig story, such as those of Samuelson (1978, 1987) and Stigler (1976), goes that Smith (1982a) developed a theory of market cooperation through the invisible hand postulate, and even though his value theory was fundamentally flawed, his mistakes were corrected by the marginalist revolution. Smithian ideas were then fully absorbed into the neoclassical mainstream. The end. Except, of course, the actual story is not that simple: Smithian ideas have been continually celebrated as well as chal-

AUTHOR'S NOTE: The title is, indeed, a paraphrase of McCaffrey et al. (2023) *Breaking Out of the Kirznerian Box*, which is in turn a paraphrase of Rothbard (1987) *Breaking Out of the Walrasian Box*. The idea and first draft of this paper stemmed from discussions with Charles Steele. Later developments of the paper benefited significantly from the support of Matthew McCaffrey, who gave the author early access to unpublished works of Frank Fetter. Critical and constructive feedback from two anonymous referees is acknowledged. The usual caveat applies. The author also acknowledges the use of ChatGPT (GPT-5) and Claude (Sonnet 5) to refine the writing of the paper.

lenged throughout the history of economic thought. The vast literature in Smithian scholarship indicates that Adam Smith's ideas are regularly reevaluated and reinterpreted.

The existence of changing views on Adam Smith among economists, however, underscores a lack of clarity and coherence in his works that lends itself to multiple interpretations, both positive and negative (West 1964; Montes 2003). On the one hand, proponents of Smith have attempted to unpack the nuances of his ideas and demonstrate how Smithian political economy is part of a broader social theory (Fitzgibbons 1995; Evensky 2005). On the other hand, criticisms of Smith have expanded into multiple dimensions, ranging from pure theory to political implications and philosophical underpinnings. Among many critics, there exists a line of challenge that runs from Edwin Cannan to Joseph Schumpeter and Murray Rothbard, and, as has only recently come to light, Frank Fetter. This line of critique focuses on Adam Smith *the economist*, with the central objections directed at the body of economic theory presented in *The Wealth of Nations*, without emphasizing his social thought or philosophy.

Cannan (1926, 2010), for instance, raised concerns about the inconsistency and ambiguity in Smith's treatment of labor and his value theory. Cannan's central thesis is that, by employing multiple approaches, Smith ended up proposing several competing explanations for value and price formation without sufficiently resolving their tensions. In a similar vein, Schumpeter (2006) argued that *The Wealth of Nations* contained no analytical idea or principle that was new at its time, and Smith's achievement lay primarily in assembling the ideas of his predecessors rather than in advancing a coherent theory of his own. Under the influence of both Cannan and Schumpeter, Rothbard (1995) extended the critique on several fronts: the division of labor, the distinction between productive and unproductive labor, theories of value, distribution, and money, and finally, Smith's theory of taxation. Despite Smith being regarded as the forerunner of modern economic ideas, Rothbard's Smith: "originated nothing that was true, and that whatever he originated was wrong" (Rothbard 1995, 435). Finally, the recent discovery of Frank Fetter's unpublished works reveals that Fetter, too, held a dim view of Smith's pure economic theory. As Fetter (2026, 51) put it: "*The Wealth of*

Nations was not a well-organized systematic treatment of the major economic problems."[1]

As seen, a major theme running through the critiques of Cannan to Fetter is their charge against Smith's lack of analytical clarity. For these economists, economic explanation must be grounded in a consistent theoretical framework–most importantly, a theory of value and price. However, while both Cannan (1926, 2010) and Schumpeter (2006) pointed out Smith's inconsistencies, they were equivocal about what a consistent and satisfactory theory should be. This is not the case with Rothbard and Fetter, however. This paper argues that the theoretical foundation of Rothbard and Fetter's critique lies in their Austrian dynamic theory of costs and production, which emphasizes the active role of the entrepreneur. With this in mind, we focus on the case of the division of labor, showing how Smith's understanding of labor and entrepreneurship remained unsatisfying to Rothbard and Fetter, whose criticisms can be seen as complementary to each other's.

We would like to first clarify what the paper does and does not aim to do. We offer a "historical reconstruction" of Rothbard and Fetter's critique as seen *from their point of view*, as understanding their arguments requires situating them within their broader economic analytical framework.[2] We do *not* propose a comprehensive critique of Smithian political economy, nor do we argue that the Rothbard-Fetter strand of production theory is superior. However, this paper does suggest that any full assessment of Smith on the division of labor would necessitate engagement with the Rothbard-Fetter theory of production. This cannot be accomplished solely through reinterpretations of Smith–whether economic, political, or philosophical–and the reverse also holds true.

We begin with the second section as a summary of Smith's view on the division of labor. The third section then aims to clear the notion that Rothbard and Fetter's critique was motivated by ideological prejudices. The fourth and fifth sections present the key elements of Rothbard and Fetter's arguments against Adam Smith's understanding of labor and

[1] Fetter (2026) is an incomplete draft of a comprehensive survey of economic thought since Adam Smith, which Fetter began working on in the early 1940s and continued revising until his death in 1949. Fetter initially planned to work on a book about economic terminology and its development, but eventually abandoned that project in favor of a systematic treatment of the history of economic thought.

[2] The term "historical reconstruction" here is used in its broad meaning. As pointed out by Blaug (1999, 213), it means "attempts to recover the ideas of past thinkers in terms that they, and their contemporaries, would have recognized as a more or less faithful description of what they had set out to do; it tries to see the past as the past saw itself."

costs. The sixth section fleshes out the Smithian entrepreneur and contrasts it with the Rothbard-Fetter framework of production theory as the core foundation for their criticism of Smith. The seventh section offers a response to the potential critique that Rothbard and Fetter might have followed a kind of Whiggish history of thought.

II. THE SMITHIAN DIVISION OF LABOR

Adam Smith began *The Wealth of Nations* with a detailed discussion of the division of labor. He famously illustrated this concept using a pin factory with 10 workers, comparing its production capacity before and after the implementation of labor division. Without the division of labor, the factory's maximum production capacity was only 20 pins; with it, production increased to 48,000 pins, meaning the factory's productivity grew by at least 2,400 times. For Smith, the division of labor was the sine qua non for enhancing national productivity and, consequently, the wealth of nations. Thus, he began his book with the affirmative statement: "The greatest improvement in the productive powers of labour, and the greater part of the skill, dexterity, and judgment with which it is any where directed, or applied, seem to have been the effects of the division of labour" (Smith 1982a, 13).

Smith was aware of the difference between the division of labor in the production of one good and in the production of different goods. His choice of the pin factory was deliberate. As he explained, in the great manufactures serving the demand of a large number of the people, the division of labor is carried much further than in trifling ones. But its full extent is difficult to observe, since it is not feasible for a single workhouse to contain all the laborers. The pin factory was chosen precisely because the whole process could be "placed at once under the view of the spectator" (14).

Smith traced the root of the division of labor to the human "propensity to truck, barter, and exchange" (25), a concept he developed in greater detail in his *Lectures on Jurisprudence* (Smith 1982b). In this account, the division of labor arises from the propensity to exchange, which itself stems from human speech and the desire for sympathetic persuasion (Montes 2019). As Smith (1982b, 352) observed:

> If we should enquire into the principle in the human mind on which this disposition of trucking is founded, it is clearly the natural inclination every one has to persuade. The offering of a shilling … is in

> reality offering an argument to persuade one to do so and so as it is for his interest. Men always endeavour to persuade others to be of their opinion even when the matter is of no consequence to them ... This being the constant employment or trade of every man, in the same manner as the artizans invent simple methods of doing their work, so will each one here endeavour to do this work in the simplest manner. That is bartering, by which they adress themselves to the self interest of the person and seldom fail immediately to gain their end.

This propensity to exchange, however, does not derive from natural differences among individuals. Rather than viewing natural disparities as the cause of the division of labor, Smith regarded them as its effect. As he noted through the comparison between a philosopher and a street porter (Smith 1982a, 28):

> The difference of natural talents in different men is, in reality, much less than we are aware of; and the very different genius which appears to distinguish men of different professions, when grown up to maturity, is not upon many occasions so much the cause, as the effect of the division of labour. The difference between the most dissimilar characters, between a philosopher and a common street porter, for example, seems to arise not so much from nature, as from habit, custom, and education.

The extent to which Smith generalized this belief in human homogeneity remains open to interpretation. While he clearly downplayed the significance of natural talent, he also emphasized that individuals engage in persuasion "for his interest." This suggests that although heterogeneity in talents may be inconsequential, differences in preferences or tastes might still matter.[3] Even assuming complete homogeneity, the division of labor still functions to differentiate abilities, as individuals increasingly engage in market exchange. In Smith's words (37):

> When the division of labour has been once thoroughly established, it is but a very small part of a man's wants which the produce of his

[3] This, therefore, depends on one's reading of Smith. It is possible to interpret that Smith extended homogeneity of labor to include homogeneity of preferences as well (Buchanan 1978).

> own labour can supply. He supplies the far greater part of them by exchanging that surplus part of the produce of his own labour, which is over and above his own consumption, for such parts of the produce of other men's labour as he has occasion for. Every man thus lives by exchanging, or becomes in some measure a merchant, and the society itself grows to be what is properly a commercial society.

Smith famously asserted that "the division of labor is limited by the extent of the market" (ch. 3), meaning that the intensification of specialization is constrained by the size and power of the market. From the foregoing, it follows that the intensification of the division of labor can, in turn, expand the market itself. Crucially, Smith's conception of the market extends beyond producers; in a commercial society, anyone can participate through exchange. What defines the merchant, in Smith's vision, is not necessarily the capacity to produce but the possession of goods available for exchange. This is articulated by Smith (48):

> The power which that possession immediately and directly conveys to him, is the power of purchasing; a certain command over all the labour, or over all the produce of labour which is then in the market. His fortune is greater or less, precisely in proportion to the extent of this power; or to the quantity either of other men's labour, or, what is the same thing, of the produce of other men's labour, which it enables him to purchase or command. The exchangeable value of every thing must always be precisely equal to the extent of this power which it conveys to its owner.

To sum up, although Adam Smith's economic man may not possess any exceptional talents or innate abilities, he is driven by a desire to persuade, motivated by self-interest or preference. This impulse generates a propensity for exchange, which ultimately gives rise to the division of labor. Once established, the division of labor enables the differentiation of abilities through ongoing participation in market exchange. Because market exchange underlies this process, the division of labor is ultimately constrained by the relative size of the market. Smith's vision of a commercial society founded on universal exchange and persuasive self-interest, however, was later challenged by Murray Rothbard and Frank Fetter. Before presenting their critiques, it is necessary to first ad-

dress the concern that their arguments were ideologically motivated, an issue discussed in the next section.

III. ROTHBARD AND FETTER DEIDEOLOGIZED

It is necessary to state at the outset that Rothbard and Fetter's critique of Smith was first and foremost a theoretical critique. However, as we shall see later, due to their critical nature and, at times, overtly dismissive tone, Rothbard and Fetter's treatments of Smith could potentially invite questions on whether ideology plays any role in their argument. Indeed, this is the general reception for Rothbard (1995). For instance, Ahiakpor (1999, 381) contends that Rothbard's hostility toward Smith stemmed not from academic disagreement but from ideological opposition, suggesting that "Rothbard's libertarian aversion to government regulation of or participation in an economy leads him to treat [Smith and his theories] with disdain". Elsewhere, Matthews and Ortmann (2002, 380) interpret Rothbard's critique as a "strategic decision" aimed at overturning the Weberian thesis: "From this perspective, Smith, the moderate Calvinist, is suspicious of the individual and Cantillon, the Roman Catholic, is a *bona fide* champion of unfettered markets". It is admittedly true that Rothbard's analysis of many economists, including Smith, often intertwined theoretical critique with political implications. As Pack (1998, 74) also pointed out, "in terms of rhetoric, Rothbard has rough stuff to say about most everyone with whom he disagrees." There might indeed be a political dimension to Rothbard's critique, nevertheless, to focus exclusively on this aspect is to overlook the substantial theoretical component of his argument, which warrants careful consideration.

This paper thus adopts a different approach by refraining from further inquiry into whether Rothbard's critique was wholly or partly driven by political bias. This distinction is crucial, for as will be demonstrated, Frank Fetter raised many of the same criticisms of Adam Smith well before Rothbard, despite the likelihood that Rothbard was unaware of Fetter's manuscript. Furthermore, while Rothbard's libertarian radicalism is well-known, it cannot be said that Fetter interpreted Smith through a libertarian lens. Although Fetter was relatively restrained in his political opinions, there is evidence that his political stance was a mixture of both free-market ideas and progressive policies (McCaffrey 2016). As shown throughout his career, Fetter's economic thought was a synthesis of American institutionalism and Austrian economics (McCaf-

frey 2019). Yet he selected what he regarded as the most theoretically sound elements from each school, without regard for their political implications.

This, then, supports the central argument of the paper: that the ultimate source of both Rothbard's and Fetter's criticisms of Smith lies in the realm of pure economic theory. Accordingly, this paper narrows its scope to examine the theoretical foundations of their critiques, particularly with respect to the division of labor and the role of entrepreneurship.[4] It is argued that the fundamental source of their critique of the Smithian division of labor lies in their distinctive theory of cost, production, and entrepreneurship. While Fetter's line of critique eventually diverged from Rothbard's in some respects, their arguments can ultimately be seen as complementary.

IV. ROTHBARD ON SMITH

Rothbard noted that "for Smith [the] division [of labor] had crucial and decisive importance" (Rothbard 1995, 441). However, he also argued that Smith's focus on the pin factory diminished the perceived importance of the division of labor across industries. It remains unclear why Rothbard emphasized the significance of the external division of labor. If he was referring to the *scope* of the division, then his critique appears unwarranted. As Trescott (1998, 62) and Matthews and Ortmann (2002, 384–385) observed, Smith demonstrated elsewhere in *The Wealth of Nations* a clear awareness of the broader scope of the division of labor, even if he did not devote as much attention to it as he did to the pin factory. Smith's (1982a, 22) example of the woollen-coat production illustrates this well:

> The woollen coat, for example, which covers the day labourer, as coarse and rough as it may appear, is the produce of the joint labour of a great multitude of workmen. The shepherd, the sorter of the wool, the wool-comber or carder, the dyer, the scribbler, the spinner, the weaver, the fuller, the dresser, with many others, must all join their different arts in order to complete even this homely production.

[4] Notably, although Rothbard was by no means friendly toward Smith and repeatedly complained about his interventionism, the section on the division of labor (Rothbard 1995, 441–444) contains no discussion of free-market policy whatsoever.

There is, however, a second possibility: in referring to the division of labor across industries, Rothbard may have been alluding to its role *at each stage of the structure of production*. For intermediate goods, the output of one market effectively becomes the input for another. Thus, engaging in the division of labor presupposes the *ex ante* existence of a market for specialized output. This is analogous to the limit imposed by "the extent of the market." The key difference, however, is that while Smith emphasized exchange, the Austrian perspective centers on production. This distinction is not trivial, for the division of labor "requires a market (or at least the expectation of a market) ... for the capital goods in process and the capital goods to aid production" (Bylund 2016, 32–33). In this framework, the division of labor is inseparable from the division of capital, which, for Rothbard as an Austrian, must be necessarily heterogeneous. The mere possession of goods for exchange, as in Smith's system, is not sufficient.[5] What matters instead is how one *combines* heterogeneous factors of production, which in turn requires the exercise of judgment under uncertainty. Therefore, either Smith failed to fully articulate his ideas, or he "avoids the crux of the problem by assuming both that there is a firm in which labour workers are employed, and through which productive tasks are 'subdivided' and coordinated, and that 'new machines come to be invented' to support this directed division of labour" (33).

If this interpretation is correct, then Rothbard significantly undersold his own criticism, since this line of reasoning is deeply connected to the issue of heterogeneity, which is another central element in his critique of Smith. It is necessary here to restate Smith (1982a, 25):

> This division of labour, from which so many advantages are derived, is not originally the effect of any human wisdom, which foresees and intends that general opulence to which it gives occasion. It is the necessary, though very slow and gradual consequence of a certain propensity in human nature which has in view no such extensive utility; the propensity to truck, barter, and exchange one thing for another.

[5] Hueckel (1998) proposed that the Smithian merchant might be interpreted as employing commodities as capital. However, if this were the case, it would introduce inconsistencies into Smith's theory of value. See Peach (2009, fn. 21) for discussion.

As shown in the second section, Smith did not consider natural differences among individuals to be a prerequisite for the division of labor. Rather, he suggested the opposite: it is through the division of labor that such differences emerge. In the Smithian economy (McNulty 1975, 376–377):

> There is no comparative advantage, in terms of natural talents for the work, possessed by the workmen who are engaged in the various processes of this particular activity. The increased production, which the division of labor makes possible, is the result of the organization of work within the enterprise and essentially unrelated to the talents of the individual workmen.

Rothbard (1995, 442) characterized Smith's position as "the egalitarian ... position, still dominant today in neoclassical economics, that all laborers are equal." Put differently, labor heterogeneity is an outcome, not a prerequisite, of the division of labor. This view stands in sharp contrast to Rothbard's, who maintained that the division of labor would be impossible without pre-existing heterogeneity.[6] Yet there may be more to this disagreement than Rothbard himself realized. As noted earlier, while Smith rejected talent heterogeneity as a cause of the division of labor, he may still have accepted heterogeneity of tastes or preferences as relevant. This further illustrates the fundamental divergence between Smith and Rothbard: while Smith focused on consumers and exchange, Rothbard placed his emphasis on producers. From an Austrian perspective, even if heterogeneity of tastes is assumed, it remains insufficient to explain the division of labor. This is because the Austrian resolution of the division of labor and capital rests on the figure of the entrepreneur. All laborers operate within firms, and firms arise through entrepreneurial judgment under uncertainty to combine heterogeneous capital (Foss and Klein 2012). Stated differently: the core tension between Smith and Rothbard lies not simply in heterogeneity of talents versus heterogeneity of tastes, but in heterogeneity of judgment versus heterogeneity of tastes.[7] Smith's treatment of the entrepreneur, by contrast, was more ambiguous, a topic we will return to in section 6. For now, it suffices to observe that in Smith's system, the exercise of judg-

[6] Heterogeneity as a precondition for the division of labor is also upheld by Mises (1951, 292).
[7] Although special talents may be attributes of the Austrian entrepreneur, they are not the *functional* characteristic of the role.

ment is not the defining function of the entrepreneur (Hébert and Link 2009). A direct implication of this critique is that, from Rothbard's perspective, the division of labor is not a spontaneous occurrence, but the result of deliberate actions by purposeful entrepreneurs in the market. As Rothbard (2000, 300) observed:

> In contrast to this emphasis on specialization and exchange as a result of conscious human decision, Smith shifted the focus from mutual benefit to an alleged irrational and innate "propensity to truck, barter, and exchange," as if human beings were lemmings determined by forces external to their own chosen purposes.

This emphasis on pre-existing heterogeneity could invite an objection along the lines of Peart and Levy (2005). In their account, Smith's analytical egalitarianism was a methodological safeguard: once economists admit innate differences among agents, they are inevitably led to rank them, and such hierarchies opened the door to discrimination, as seen in postclassical economics. Rothbard's rejection of the "egalitarian position" might appear to commit this error. However, a hierarchy in this sense can only be defined from the standpoint of an external observer, but judgment is individual, tacit, and informal, and thus cannot be accessed externally. Heterogeneity of judgment therefore differentiates agents without ranking them.[8]

In summary, Rothbard's critique of Adam Smith's theory of the division of labor comprises two key points: first, the division of labor must be analyzed within the structure of production, where entrepreneurs exercise judgment under uncertainty in their investment decisions; and second, human heterogeneity, especially among entrepreneurs, is a cause, not a consequence, of the division of labor. Central to this critique is the entrepreneur's active role as the driving force of production and the market. Frank Fetter, whose engagement with Smith's view of the division of labor we will examine in the next section, shared many of Rothbard's concerns. Perhaps unsurprisingly, Fetter's assessment of Smith was similarly critical.

[8] Talents, unlike judgment, are externally observable and can be ranked. The Peart–Levy objection would thus apply if talents were the basis of the division of labor. But as argued above, the heterogeneity lies in judgment, not talents, and the objection does not apply.

V. FETTER ON SMITH

Despite the fact that the bulk of Rothbard's criticism arose from the domain of pure theory, it is true that his theoretical arguments were often interwoven with political interpretations. The same cannot be said of Fetter, however. In fact, Fetter devoted an entire chapter–entitled *Adam Smith's Changing Economic World*–to celebrating the success of *The Wealth of Nations* in promoting free-market policies, particularly in stimulating the free-trade movement and the Industrial Revolution (Fetter 2026, 51–56). That said, despite his general sympathy toward the practical influence of *The Wealth of Nations*, Fetter expressed dissatisfaction with the theoretical substance of Smith's economics. As he remarked (51): "This success cannot be explained by the merits of the author's basic theory, which was left in such confusion. *The Wealth of Nations* was not a well-organized systematic treatment of the major economic problems."

Fetter clearly recognized labor as a foundational element in Smith's economic system. Consequently, the majority of his critique centered on Smith's treatment of labor and labor-costs. In a manner similar to Rothbard, Fetter began by questioning Smith's conception of the division of labor: "Smith's conception of the nature of division of labor was a narrow one; it was the division, among several workmen, of the successful manual processes necessary in the making of a single commodity. The result emphasized is simply the increased skill of the individual workman" (26). Following this, Fetter raised concerns regarding Smith's treatment of labor homogeneity:

> But instead of attributing the motive for division of labor to the desire to produce more and better goods, he attributed it to a conjectural "propensity to truck, barter, and exchange," never discovered by anthropology or psychology. Increased production is thus conceived of as an accidental and unexpected result of division of labor, and the desire for more, or better, or different goods not being any part of the motive, or cause of it ... Even more remarkable is the lack of any recognition that men differ in talent, fitness, and liking to perform different tasks.

As we demonstrated previously, it is the heterogeneity of judgment that characterizes the division of labor within Rothbard's framework. Given that Fetter's conception of the entrepreneur closely parallels

Rothbard's, in which the entrepreneur's defining function is exercising judgment under uncertainty, we believe that the same critique applies equally to Fetter. Fetter argued that Smith's assumption of labor homogeneity undermined the contribution of specialized qualities in the business enterprise, which are crucial to the division of labor. As he noted: "As opposed to both of these it was Smith's announced intention to show that the best plan is for governments to deal 'equally and impartially with every sort of industry,' and this because of his belief that labor, not either the merchant's activity or the productive powers of land, is the real source of wealth" (25). In the Fetterian account, the merchant holds a central role due to his entrepreneurial qualities, which enhance both the division of labor and the efficiency of production. Like Rothbard, Fetter saw the division of labor as a fundamentally rational and intentional process, driven by the merchant qua capitalist-entrepreneur.

However, while both Fetter and Rothbard emphasized the essential role of heterogeneity, their criticisms diverged at a crucial point. For Rothbard, labor heterogeneity was a necessary precondition for the division of labor, and he considered Smith's denial of this point to be an error of causal reasoning. Fetter, by contrast, extended this critique further by arguing that Smith's assumption of labor homogeneity formed the very foundation of his labor-cost theory of price (27). According to Fetter, labor homogeneity enabled Smith to use labor as a measure of value, a kind of accounting unit (31–33). Since any unit of accounting must consist of homogeneous units, Smith's theory of value could not be formulated without presupposing labor homogeneity. This implies that Smith may have adopted a belief in the natural equality of labor primarily to construct and legitimize a particular theory of value.[9] The precise nature of Smith's theory of value, however, remains unsettled in the literature on the history of economic thought. There continues to be debate over whether Smith conceived labor as the measure of value or

[9] Even in rejecting the labor-cost reading of Smith as a Ricardian artifact, Hurtado and Paganelli (2023) agree that Smith made labor the unit of account, or a form of "money" more reliable than gold and silver. In their reading, Smith's concern is not the source of value but its measurement. Induced by Smith's analytical egalitarianism, labor alone is constant across time and place, since equal quantities of labor always cost the laborer the same. For a detailed discussion of Smith's analytical egalitarianism, see Peart and Levy (2005).

its ultimate source–effectively, whether he held a labor-cost theory of value.[10]

Nevertheless, regardless of whether Smith endorsed a labor or labor-cost theory of value, the core of Fetter's critique lies in the implication that, once labor serves as the measure of value, prices become exogenous and observable to the firm. That is, if labor costs are revealed through their rates in the market, then commodity prices effectively enter the production process as given. As we will see in the next section, this is where, on their account, the deeper problems for Smith's production theory arise.[11]

As Smith (1982a, 72) wrote:

> When the price of any commodity is neither more nor less than what is sufficient to pay the rent of the land, the wages of the labour, and the profits of the stock employed in raising, preparing, and bringing it to market, according to their natural rates, the commodity is then sold for what may be called its natural price. The commodity is then sold precisely for what it is worth, or for what it really costs the person who brings it to market.

Fetter was deeply skeptical: "The more essential question is: How are these natural rates caused, or determined? No real answer was given by Smith in this connection; he merely promised to give the answer later" (Fetter 2026, 41). For Fetter, "the natural rates (prices) of agents are presented [by Smith] as the primary, causal factors in the explanation of commodity prices". On the contrary, Fetter believed that a sound explanation of prices must incorporate the interdependence between factor markets and commodity markets, which constituted the essence of general equilibrium analysis in his view and which he found conspicuously absent from Smith's framework.

In summary, while Rothbard argued that the division of labor is a rational process made possible only through labor heterogeneity, Fetter extended this critique further: not only does labor homogeneity obscure the special role of the entrepreneur in production, but it also results in a

[10] The labor-cost interpretation is challenged by O'Donnell (1990) and Hueckel (2000). A reconsideration of this thesis is offered by Peach (2009). For a critique of Peach's account, see Grieve (2019). Hurtado and Paganelli (2023) also deny altogether that Smith held a labor theory of value.

[11] It is possible that Fetter understated the Smithian distinction between natural and market prices. However, if the crux of his critique is the exogeneity of prices, then this problem applies equally to either case.

deficient explanation of price formation. These two lines of criticism are ultimately complementary, as both stem from the Austrian theory of production.

VI. THE AUSTRIAN VERSUS THE SMITHIAN ENTREPRENEURS

We have argued throughout this paper that Rothbard and Fetter's criticisms of Smithian economics were fundamentally motivated by their conception of the entrepreneur. A comparison between Smith's understanding of the entrepreneur and that of Rothbard and Fetter is therefore warranted. However, assessing the figure of the entrepreneur in Smith's work is far from straightforward. Smith offered multiple characterizations of the entrepreneur, and depending on one's interpretive stance, these portrayals may appear either consistent (Pesciarelli 1989) or outright contradictory (Hébert and Link 2009).

Drawing from Hébert and Link (2009), we briefly outline the Smithian entrepreneur. Broadly, Smith proposed three types of entrepreneurs. The first is the adventurer, who faces uncertainty and earns profit under risk. Yet Smith viewed investment under such conditions as irrational. The second type is the projector, often criticized by Smith for squandering capital on speculative ventures, thereby contributing to economic decline. The third and most celebrated type is the undertaker, whom Smith (1982a, 65–66) describes as follows:

> As soon as stock has accumulated in the hands of particular persons, some of them will naturally employ it in setting to work industrious people, whom they will supply with materials and subsistence, in order to make a profit by the sale of their work, or by what their labour adds to the value of the materials. In exchanging the complete manufacture either for money, for labour, or for other goods, over and above what may be sufficient to pay the price of the materials, and the wages of the workmen, something must be given for the profits of the undertaker of the work who hazards his stock in this adventure.

From this description, some scholars have attempted to reconstruct a coherent Smithian definition of the entrepreneur. Pesciarelli (1989), for instance, argues that the Smithian entrepreneur accumulates capital, organizes the factors of production, and implements production plans under risk and uncertainty, among other functions. Setting aside the

question of whether Smith's various definitions cohere, one point is clear: Smith was not a proponent of investment under uncertainty. In fact, he tended to associate entrepreneurial judgment under uncertainty with irrationality. Moreover, while Smith attributes capital accumulation to the merchant, it is ambiguous whether this figure is understood as a true capitalist or merely as a "manager-producer." This ambiguity in Smith's treatment of the entrepreneur is precisely what prompts the critiques by Rothbard and Fetter.

For Rothbard and Fetter, the division of labor must be understood in conjunction with the division of capital, both coordinated through entrepreneurial judgment. Crucially, they maintain that human heterogeneity, particularly heterogeneity in judgment, is a cause, not an effect, of the division of labor. Trescott (1998), by contrast, finds Smith's assumption of labor homogeneity innovative, as it allows analysis of economic outcomes without relying on assumptions of heterogeneity. Others advance an even stronger claim: that the division of labor remains possible under labor homogeneity (Block et al. 2007). This possibility arises from learning effects that generate economies of scale, a phenomenon exemplified in Smith's pin factory. To meaningfully compare the arguments of Smith and Rothbard, one must contextualize them within the framework of production theory. As noted earlier, for Smith, possession of a commodity is sufficient for a merchant to act as a producer. Rothbard and Fetter, however, require that the entrepreneur not only own but also invest in heterogeneous factors of production, thereby exercising judgment under uncertainty. According to Fetter, Smith's theory of market price implies that factor prices are exogenous to firms. This leads to two distinct interpretations of economies of scale: for Smith, economies of scale arise from enhancements in labor productivity; for Rothbard and Fetter, they are inseparable from entrepreneurial activity.[12]

[12] A complete treatment of Rothbard-Fetter's production and entrepreneurship theory can be found in Rothbard (2009), McCaffrey (2016), and Salerno (2008).

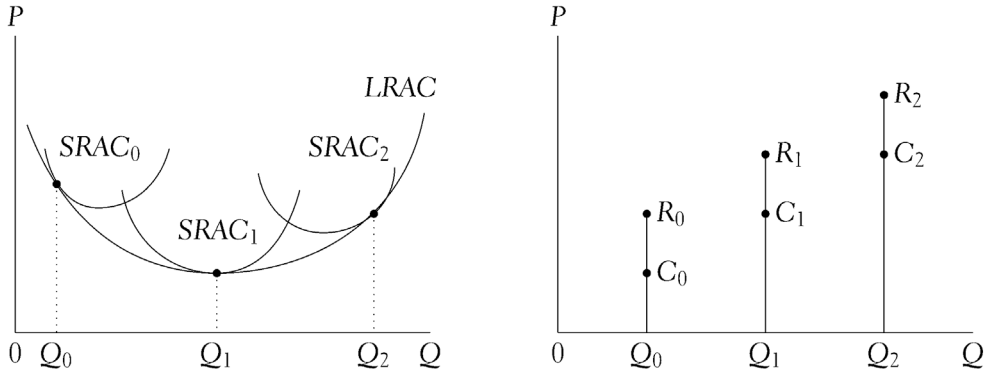

Figure 1: Neoclassical cost curves (left, produced by the author) and Austrian cost curves (right, reproduced from Herbener (2018, 151)).

This theoretical contrast is illustrated in simplified form in Figure 1. We acknowledge that these diagrams are somewhat reductionist and cannot fully capture the complexity of either Smith's or Rothbard-Fetter's ideas. Indeed, several scholars have cautioned against interpreting Smith through the lens of neoclassical language (Aspromourgos 2008). Nevertheless, by focusing narrowly on productivity-enhancing effects and the exogeneity of prices in Smith's system, we believe the comparison captures a crucial theoretical divergence. Economies of scale, under given input prices, can be described as follows: given homogeneous labor and capital, along with their associated given prices, changes in production techniques corresponding to variations in the use of labor or capital lead to different short-run average costs (*SRAC*) curves. As long as these *SRAC* curves decline, the long-run average cost (*LRAC*) function, by the Envelope Theorem, also decreases, thus yielding economies of scale. Smith's example of the pin factory demonstrates that homogeneous factors can indeed generate lower production costs (Smith 1982a, 17).

However, the above mechanism relies on the assumption of given factor prices, a premise that Rothbard and Fetter find problematic. For them, this reverses the true causality in price formation: it is not that input prices determine output prices, but rather that output prices determine input prices. As Newman (2018, 62) explicates: "The correct method of deriving a demand curve for a factor of production is through marginal productivity analysis that does not assume the price of the factor is already given. Moreover, this procedure does not start from the perspective of a firm but rather from the general demand for the factor and its interrelations." In contrast to Smith's framework, Austrian production theory admits no such given prices. In this theory, pro-

duction unfolds over time, with a production run (that is, quantity) chosen in advance by the entrepreneur. As Herbener (2018, 151–152) puts it:

> The revenue and cost anticipated for each production-run quantity, and corresponding period of production, are shown as the vertical distances *R* and *C*, respectively. The entrepreneur will select the economizing combination of inputs for each level of output production. The marginal costs of production (C_0, C_1, or C_2) vary with each production run (Q_0, Q_1, and Q_2) and include the market prices of all inputs used in production, both those purchased and those owned by the entrepreneur.

In short, without a defined time period and a production-run chosen in advance by the entrepreneur, production cannot take place. Furthermore, "...The prices of the assets owned and used by the entrepreneur will vary as conditions change regardless of what happens to prices for inputs [labor and capital] purchased by the entrepreneur" (150). From the Austrian standpoint, this points to a further limitation of the economies-of-scale argument: the model is constrained by its timeless nature and the implicit absence of the entrepreneur. As previously discussed, Fetter emphasized the distinctive role of the merchant *qua* entrepreneur within the division of labor. This is because it is the entrepreneur who selects the production technique in order to realize the gains from trade that stem from lower costs of production. While the Smithian entrepreneur possesses commodities and executes production plans, it remains unclear whether he actually owns the factors of production and undertakes investment. One might argue that he does, but such ownership would necessarily entail judgment under uncertainty. Smith, however, did not advocate for investment under such conditions. We find these two aspects of Smith's position, namely execution without uncertainty-bearing, difficult to reconcile.[13] The distinction between an entrepreneur who invests and a "manager" who merely executes production plans is effectively articulated by McCaffrey (2016, 507–508):

[13] If such a reconciliation were possible, it would place Smith closer to Rothbard and Fetter, thereby undermining their critique. However, this reconciliation remains, as yet, to be seen.

> More importantly, the special role of entrepreneurs as owners means they are the ultimate or residual decision-maker for an enterprise ... Making ... decisions requires the entrepreneur's careful judgment in selecting the managers, who in turn decide how the firm will allocate resources to specific uses. The minor factors that Fetter mentions are production inputs chosen to optimize output, while 'business as a whole' refers to the broader choice of market. This latter choice is made by entrepreneurs but must be taken as given by managers.

As the entrepreneur assumes the role of investor in the production process, another key difference emerges between Rothbard and Fetter, on one hand, and Smith, on the other. In the former view, the capitalist-entrepreneur can allocate resources across *multiple* lines of production. In contrast, Smith's conception of investment appears limited to a single firm. Although Smith acknowledged that economies of scale and specialization are constrained by the extent of the market, his emphasis remained on exchange across industries. Rothbard and Fetter, by contrast, shifted focus to the structure of production itself, something they regarded as inseparable from the ownership of heterogeneous factors of production.[14]

The ambiguity surrounding the role of the entrepreneur in *The Wealth of Nations* was also recognized by Matthews and Ortmann (2002, 382), who observed that "what bothers Rothbard is not the absence of capital accumulation per se, but rather the passive role of the entrepreneur [in Smith's discussion]." This critique echoes Schumpeter (2006), who also expressed dissatisfaction with Smith's portrayal of the entrepreneur. Despite Smith's various definitions and attributions of function, Schumpeter did not consider Smith's entrepreneur to be an active innovator. Matthews and Ortmann (2002, 383), however, argued that Smith demonstrated at least a rudimentary awareness of the Schumpeterian entrepreneur, identifying him as the "innovative worker." In Smith's account, "the innovator becomes an entrepreneur because, as a worker in a firm, he is unable to capture the rewards of his innovation." As Smith (1982a, 20) wrote:

[14] One might argue that Rothbard and Fetter's production theory would not be able to explain why people having different talents from the start would be sufficient to explain differentiation in goods. We would argue that since Rothbard and Fetter defined the functional property of entrepreneurship as judgment, which is in turn a purely subjective phenomenon depending on the entrepreneur's mind, the production plan and properties of goods produced are thus also subjectively imagined by the entrepreneur. Hence, heterogeneity of judgment explains differentiation in goods.

> A great part of the machines made use of in those manufactures in which labour is most subdivided, were originally the inventions of common work- men, who, being each of them employed in some very simple operation, naturally turned their thoughts toward finding out easier and readier methods of performing it.

Smith's own elaboration of this point deserves attention. His most vivid example of the innovative workman is the boy who, employed to open and shut the valve of a fire engine, tied a string from the valve handle to another moving part so that the valve worked without him (20–21). The boy appears to be an entrepreneur: he perceives an opportunity and innovates upon the production process, and Smith himself ranks the improvement among the greatest made to the machine. Yet the boy possesses no capital and bears no uncertainty. He owns neither the engine nor the string; he advances nothing today in anticipation of uncertain returns tomorrow, and the device costs him nothing to try and innovate. The innovative worker thus poses little challenge to the present analysis, as the core of Rothbard and Fetter's critique lies in their conception of the capitalist-entrepreneur as a property owner, an individual whose asset ownership enables investment. This stands in contrast to the Schumpeterian entrepreneur, for whom ownership is not a necessary condition of entrepreneurial function (Rothbard 1987; Foss and Klein 2012).

VII. HISTORICAL RECONSTRUCTION AND WHIG HISTORY

We have examined the arguments of Rothbard and Fetter through the lens of their Austrian theory of costs, production, and entrepreneurship. A natural concern arises from this approach: by adopting the Austrian framework as the benchmark for theoretical soundness, Rothbard and Fetter may inadvertently engage in a form of Whiggish history of economic thought. Specifically, while Adam Smith's contributions to economic theory were not without flaws, his work represented one of the most nuanced and sophisticated theoretical frameworks of his time. Thus, employing a more advanced post-marginalist theory, one that emerged nearly a century after the publication of *The Wealth of Nations*, as a standard risks imposing an anachronistic and arguably unfair evaluative framework, thereby undermining their critique.

However, we contend that this concern does not fully apply to either Rothbard or Fetter. Both were motivated by a substantive theoretical agenda, and each was explicitly critical of the Whig narrative. Fetter's manuscript grew out of his long dissatisfaction with the state of economic theory in his own time. Convinced that the subjectivist revolution had been compromised by the survival of Ricardian elements, he turned to the classical period to trace why those concepts arose and persisted. His purpose was to identify where sound theory on value and price had been derailed, not to narrate an ascent toward the present (Fetter 2026, xv–xxii). Rothbard's motivation was similar, as he conceived his volumes as a counter-history to the Smith-centered canon, reconstructing a tradition from the Scholastics through Cantillon and Turgot in which subjectivism formed the analytical core (Rothbard 1995, vii–xiii). For both of them, the history of economics was a record of struggle between progress and regress rather than cumulative advance. This view placed them far closer to historical reconstruction than to the Whig historiography they criticized in others.

To begin, Rothbard explicitly rejected Whiggish interpretations as methodologically unsound, and on these grounds he challenged Hollander's (1973) neoclassical reading of Adam Smith (Rothbard 1995, 529–532). Nonetheless, it is conceivable that Rothbard may have committed a similar error of his own, interpreting Smith through an Austrian lens.[15] Even so, this critique appears limited. The issue is not that he imposed marginalist theory as an ideal, but rather that he regarded earlier thinkers, particularly Cantillon and Turgo, as offering more coherent and insightful contributions than those found in Smith's system. Indeed, Rothbard viewed the proto-marginalist insights of Cantillon and Turgot as foundational to sound economic reasoning, which, in his estimation, was subsequently disrupted by Smith's influence. As Rothbard (1995, 436) wrote: "[Smith's] economics was a grave deterioration from his predecessors: from Cantillon, from Turgot, from his teacher Hutcheson, from the Spanish scholastics."

Second, even if we assume, for the sake of argument, that Rothbard held Austrian theory as the maximal ideal, this critique does not carry over to Fetter. Interestingly, despite being influenced by both American

[15] This raises a further question on whether it is legitimate to compare pure theory across different eras in the history of economic thought. Without pursuing that debate here, we believe that if one adopts the view of the history of thought as a laboratory for evaluating and discovering theory, the answer is yes. On the reception of Smith in various contexts, see for example Liu (2022).

institutionalism and the Austrian school, Fetter was notably skeptical of the Austrian approach to economics. As he remarked (Fetter 1931 quoted in McCaffrey 2019, 481): "As a matter of fact I am fundamentally interested always in the historical approach and never have had real sympathy with the a priori deductive treatment of economics when it is completely severed from observation and historical studies." He went further, expressing skepticism toward intellectual labeling, emphasizing instead the content of ideas: "I have never been consciously an adherent of any 'school' or sect of economic theory and have earnestly striven to prevent either pride of personal opinion or a mistaken sense of loyalty to the ideas of any writer or school from dimming my eyes to newly discovered truth" (Fetter unpublished, quoted in McCaffrey 2019, 481).

Besides, with regard to pre-Smithian economists, Fetter's engagement with them was limited. The only explicit instance is his brief commentary *Turgot on Rent* (Fetter 2026, 383–391). Even then, in this work and in *Adam Smith on Rent* (393–401), Fetter expressed strong admiration for Turgot's theory of rent and favorably compared it to Smith's treatment of the same topic. He observed that "the great work of Adam Smith presents a less systematic outline of economic theory than does the little essay by Turgot" (393). Fetter further noted Smith's relative lack of conceptual clarity and consistency, particularly in contrast to Turgot's theoretical precision:

> In his treatment of rent perhaps as well as anywhere can be seen Smith's liking for, and ability in, the historical and descriptive style of treatment, in contrast with the abstracter theoretical method. There is a great deal said about rent, many facts bearing on rent are brought forward, *but nowhere is there an earnest attempt to set forth a clear concept of rent, nor to develop a consistent theory of it.*

A further instance, though less explicit, appears in Fetter (1912, 790). There Fetter proposed a typology of price theories in which Cesare Beccaria, Pietro Verri, and Étienne Bonnot de Condillac figure as pre-Smithian economists. Notably, he classified all three as parts of the "subjective-value non-monetary" camp of price theory, which he regarded as sounder than the "objective" one to which Smith belonged.

In short, the assertion that Smith's theory represented the most sophisticated economic framework of his time poses a limited challenge to Rothbard and Fetter. Both were acutely aware of alternative, and in their

view, more rigorous theoretical developments that preceded *The Wealth of Nations*. Their critiques, therefore, are better understood not as retrospective impositions of anachronistic standards, but as grounded evaluations rooted in a broader historical understanding of economic thought. We do admit, however, that there remains a possibility that Rothbard, and potentially Fetter,[16] tended to overstate the maturity of political economy before Adam Smith.[17] This, however, requires a comprehensive survey of economic thought over an extended period of history. Such an ambitious and more involved project unfortunately falls outside the scope of the current paper.

VIII. CONCLUSION

This article reexamines the differing perspectives of Frank Fetter and Murray Rothbard on the division of labor and entrepreneurship, as contrasted with Adam Smith. It focused solely on the theoretical aspects of their criticisms, deliberately avoiding any discussion of Smith's ideas from philosophical or political aspects. The analysis demonstrated that, despite Rothbard never having access to Fetter's manuscript, their criticisms shared significant similarities and could be regarded as complementary. The conclusion is, then, that when viewed through the lens of Rothbard and Fetter's distinct analytical framework, which is centered on their theories of costs, production, and entrepreneurship, Smith's understanding of the division of labor is inevitably open to criticism. Although the article is by no means a refutation of Smithian political economy, it adopts a "historical reconstruction" approach by addressing Rothbard and Fetter's criticisms of Smith from their own theoretical perspectives.

This article leaves open three areas for future research. First, by presenting the Rothbard-Fetter theory of production as an alternative, we argue that the dominant trend of responding to critiques through reinterpretations of Smith has certain limitations. This effectively implies that any full assessment of Smith's views on the division of labor would necessitate engagement with alternative theories. Such an assessment

[16] As noted above, at the time of writing this paper, we are aware of only two occasions, one explicit and the other implicit, on which Fetter discussed pre-Smithian economic thought. The case for Fetter overstating the maturity of pre-Smithian economics is therefore necessarily less definitive than that for Rothbard.

[17] For example, the theory of entrepreneurship in Turgot was arguably premature, and possibly even inferior when putting against one from Cantillon. See Hébert and Link (2009, 15–17).

cannot rely solely on reinterpreting Smith, whether economically, politically, or philosophically, just as the reverse holds true for any appraisal of Rothbard and Fetter.

Second, as our focus is limited to Rothbard and Fetter, we leave open the question of how Cannan and Schumpeter would have thought about the argument posed by the former two. We nonetheless wish to highlight a continuity: it is well documented that Rothbard's production theory was heavily influenced by the works of Fetter, and in developing their production theories, both Rothbard and Fetter were, in turn, influenced by Cannan (Fetter 1977; Rothbard 2009). Thus, if Rothbard and Fetter's criticism of Adam Smith was rooted in their theory of costs and production, the same line of reasoning could possibly be extended to Cannan as well. Furthermore, in the case of Schumpeter, it is evident that the entrepreneur serves as the central engine of his theory of development (Schumpeter 2021). A thorough treatment of Cannan and Schumpeter, however, would require a much deeper investigation, which would be an interesting question for future studies.

Finally, as mentioned in the introduction, even though economists from Cannan to Rothbard held certain disagreements both methodologically and politically, they all converged when examining the economic theory of Adam Smith. If ideological biases do not explain this interpretive tradition regarding Smith, what then is the ultimate factor? We believe the explanation lies in Smith's lack of a consistent and coherent theory, but there may be more to this story.

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Hai-Trieu v. Nguyen is an independent scholar based in Saigon, Vietnam. He holds an M.A. in Economics from University of California, Santa Barbara, and a B.S. in Mathematics & Economics from Hillsdale College. His broad interests include History of Economic Thought, Philosophy and Methodology of Economics, and Philosophy of Mathematics
Contact e-mail: <nguyenviethaitrieu@gmail.com>