

CLASSICAL SCHOOL OF ECONOMICS

(1776-1871)

AN OUTLINE

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INTRODUCTION

The Classical School of economics was developed about 1750 and lasted as the mainstream of economic thought until the late 1800's. Adam Smith's *Wealth of Nations*, published in 1776 can be used as the formal beginning of Classical Economics but it actually evolved over a period of time and was influenced by Mercantilist doctrines, Physiocracy, the enlightenment, classical liberalism and the early stages of the industrial revolution. Adam Smith [1723-1790] is recognized as the originator of Classical Economics. John Stuart Mill [1806-1873] is often regarded as the synthesizer of the school.

Classical economics as the predominant school of mainstream economics ends with the "Marginalist Revolution" and the rise of Neoclassical Economics in the late 1800's. In the 1870's William Stanley Jevons' and Carl Menger's concept of marginal utility and Léon Walras' general equilibrium theory provided the foundations. Henry Sidgwick, F.Y. Edgeworth, Vilfredo Pareto and Alfred Marshall provided the tools for Neoclassical economics. Neoclassical economics is an extension of Classical economics but, the focus of the questions changed as well as the tools of analysis. In spite of the dominance of Neoclassical thought, Classical Economics has persisted and influences modern economics, particularly the "New Classical Economics." The belief in the efficacy of a "free market" is central to both classical and neoclassical ideology.

While Adam Smith would be regarded as the originator and leader of the school, David Ricardo [1772-1823] should be credited with establishing the form and methods of the school. The debates between Thomas Malthus [1766-1834] and David Ricardo about policy issues such as the "Corn Laws" and the "Poor Laws" contributed to the focus and form of the school. Smith was concerned about the nature of economic growth. Malthus, Ricardo and other classical economists were concerned about the question of "distribution." One important debate among classical economists was whether there was or wasn't a "surplus" or "glut." Jean Baptiste Say [1767-1832] and Malthus were the two major protagonists in the question about the existence of a surplus and its effects on a market economy.

References

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Basic Outline

1. The formal beginning of the Classical School is with Adam Smith 's [1723 - 1790] publication *An Inquiry Into The Nature And Causes Of The Wealth Of Nations* [1776]. John Stuart Mill's [1806-1873] book, *Principles of Political Economy with Some of Their Applications to Social Philosophy*, published in 1848 may be regarded as a synthesis of Classical economics. The title of Mill's book is an indicator of the perception that economics is one component of a broader concern with social relations. With the publication of William

Stanley Jevons' [1835-1882] The Theory Of Political Economy, [1871], Carl Menger's [1840-1921] Grundsätze Der Volkswirtschaftslehre [1871], and Léon Walras' [1834-1910] Elements D' Economie Politique Pure in 1874, economics began the road to "professionalism" and narrowing of perspective.

2. Major contributors to the Classical School include

- a) Adam Smith [1723-1790, founder] Theory Of Moral Sentiments (1759), Wealth Of Nations (1776)
- b) David Ricardo [1772-1823], On The Principles Of Political Economy And Taxation (1817)
- c) Thomas Malthus [1766-1834], An Essay On The Principle Of Population (1789), Principles of Political Economy (1820), The Measure of Value (1823), Definitions in Political Economy (1827)
- d) James Mill [1773-1836], Elements Of Political Economy(1821)
- e) Jean-Baptiste Say [1767-1832], Traite D'economie Politque (1803, English 1821)
- f) Nassau William Senior [1790-1864], An Outline Of The Science Of Political Economy (1836)
- g) Karl Marx [1818-1883], The Communist Manefesto (1848), Grundriss Der Kritik Politshen Okonomie (1859) Das Kapital (1867)
- h) John Stuart Mill [1806-1873, son of James Mill], Principles Of Political Economy (1848)

3. Foundations of Classical School in the "Industrial Revolution"

- a) The industrial revolution arose out of the past, took centuries and included social, intellectual and agrarian revolutions as well as "industrial" changes
- b) "Scientific revolution," the rise of "natural law" and the separation of "knowledge" from theology
 - i) Protestantism [1571]
 - a) Martin Luther [1483-1546]
 - b) John Calvin [1509-1564]
 - ii) Nicholas Copernicus [1473-1543]
 - iii) Francis Bacon [1561-1626] - empiricism
 - iv) Galileo Galilei [1564-1642] - empiricism
 - v) Rene Descartes (1569-1650) - rationalism
 - vi) Johannes Kepler [1571-1630]
 - vii) William Harvey [1578-1657] - circulation of blood
 - viii) John Locke [1632-1704] - individualism, the role and secular justification of property
 - ix) Baruch Spinoza [1632-1677] - rationalism
 - x) Isaac Newton [1642-1727] - mechanical view of world, "matter in motion directed by knowable laws", mathematical concept of rates of change
 - a) PRINCIPIA (1687)
 - b) Master of the Mint (1699)
 - xi) G.W. Leibniz [1646-1716] - optimism
 - xii) David Hume [1711-1776] - positivism
 - a) all knowledge derived from and justified by sense experience

- b) objects of sense experience are atomistic events constantly conjoined in determinable ways
 - c) game theory and cooperation
 - xiii) Immanuel Kant [1724-1804] reason
 - xiv) Scientific societies [gave cohesion and direction to science]
 - a) Royal Society of London (1660)
 - b) Paris Academy of Sciences (1666)*
 - c) Berlin Academy (1700)*
 - d) St. Petersburg Academy (1724)*
 - (1) "salaried" scientists
 - e) American Philosophical Society (1769)
 - c) Role of technology and industrialization, examples include;
 - i) the building of canals and transportation system [In England between 1750-1820 3000 miles of navigable waterways built (often private for profit), in 1750 to 1770 nearly 12,000 miles of turnpikes were built]
 - ii) 1698 Thomas Savery obtained patent for steam pump for use in Cornish mines, 1712 he made an atmospheric pump, Newcomen's steam engine improved by James Watt in 1769
 - iii) 1709 Abraham Darby made coke from coal, (by 1750 it accounted of 5% of British steel)
 - iv) 1733 John Kay invented the "flying shuttle," James Hargreaves' "spinning jenny" was invented in 1764 and Richard Arkwright developed the "water frame." Samuel Crompton combined the jenny and water frame in 1774 and was adapted for steam power by 1790. Eli Whitney invented a mechanical gin in 1793, Edmund Cartwright patented the power loom in 1785. Use of raw cotton increased from 500 tons in 1700 to 2500 tons in 1770 and 25,000 tons in 1800.
 - v) Other industries included pottery [Josiah Wedgewood], chemical [Antoine Lavoisier (1743-1794), coal industry, railways [Richard Trevithick(1771-1833) locomotive in 1801]
 - d) Population Of Britain rose from about 6 million in 1700 to almost 20 million in 1850. There was increased urbanization and the growth of cities.
4. Adam Smith [1723-1790] "founder of Classical school"
 - a) *The Theory of Moral Sentiments* (1759)
 - i) Is a discussion of moral forces in society and how they guide individual behavior into patterns that are consistent with a workable society; ethics are the cement of society; moral values are based on human feelings.
 - ii) Moral Philosophy was a part of his lectures on Moral Philosophy [ethics]
 - a) Natural theology
 - b) Ethics
 - c) Jurisprudence
 - (1) Justice in the form of history of law
 - (2) Expediency [subject matter of WN]
 - iii) people can exist only in societies, need mutual assistance
 - a) may be offered out of love, gratitude, friendship

- b) corruption of morality - propensity to admire rich and powerful people, scorn poor and weak, should admire wisdom and virtue
 - c) people seek riches for purposes of vanity, not necessities
 - d) sympathy explains the origin and nature of moral judgment, of approval [propriety of action] and disapproval
 - e) sympathy creates a social bond, "everyone" seeks approval of others, we learn from experience, we learn rules of morality from observation and experience, generalize in moral rules (laws?). Smith aware of appeal of Utilitarianism.
 - f) Justice as a negative virtue of avoiding harm to others
 - g) Beneficence as positive virtue of doing good
 - h) "*Justice, on the contrary, is the main pillar that upholds the whole edifice (society). If it is removed, the great, the immense fabric of human society, that fabric which, to raise and support, seems, in this world, if I may say so, to have been the peculiar and darling care of nature, must in a moment crumble into atoms.*" TMS p 167.
- b) *An Inquiry in to the Nature and Causes of the Wealth of Nations (1776)*
- i) Comprehensive, systematic theory of an economy
 - a) Shows connections and relationships among variables
 - b) Didn't focus on single element
 - c) Model of workings of an economy shows
 - (1) Connections of elements in a continually maintained system
 - (2) How system can continually generate accumulation of wealth
 - d) Policy prescription of free trade
 - ii) Human nature
 - a) Much of Smith's work is permeated by a sociological approach
 - b) Humans are interested in those things that are nearest to us in time and space
 - c) Humans want to better their condition
 - d) Sympathy holds self interested behavior in check, if not jurisprudence
 - iii) Smith discusses both Microeconomics and Macroeconomics, he attempted to explain the interrelationships of all the elements in an economic system and justify the use [policy] of free markets. Free markets advocated to allow the operation of 'natural forces'
 - iv) National wealth is the "*exchangeable value of the annual produce of land and labour of a country*"
 - v) The division of labour starts the process of economic growth and capital accumulation keeps it going.
 - a) Three benefits of division of labour
 - (1) increase in skill and dexterity
 - (2) save time in moving from job to job
 - (3) invention of new machinery

- b) Division of labour is dependent on the “*extent of the market*” and capital accumulation. Division of labour determines the productivity of labour
- vi) Economic growth is also dependent on the proportion of productive to unproductive labour. Productive labour is that labour that produces tangible goods that have value in exchange. Unproductive labour is not useless, it just doesn’t produce tangible goods to be exchanged
- vii) “VALUE”
 - a) Value in use
 - b) Value in exchange, Smith focuses on value in exchange
 - c) Smith has 4 “prices”
 - (1) **“real” price** is the real value of a good determined by the *“toil and trouble of acquiring it.”* It *“consists of the necessities and conveniences of life which are given for it.”* In rudimentary society labour, in other societies a cost of production. Real prices always the “same.”
 - (2) **“nominal” price** is of different values depending on the value of gold and silver. It is the price in quantity of money
 - (3) **“market” price** is the *“actual price at which any commodity is commonly sold....It may either be above, or below, or exactly the same with its natural price.”*
 - (4) **“natural” price** is *“When the price of any commodity is neither more nor less than what is sufficient to pay the rent of land, the wages of the labour, and the profits of the stock employed in raising preparing, and bringing to market, according to their natural rates, the commodity is then sold for what may be called its natural price.”* [Long run equilibrium in a competitive market?]
 - d) Wages are (1) based on bargaining and contract [issue of combinations of masters and workmen] (2) wages fund argument and (3) the amount necessary to bring up a family and more workers
 - e) Profits are subject to variations. Wages and profits are inversely related
 - (a) For Smith , profits include interest
 - (b) Reduced capital stock increases profit, increased capital stock reduces profit
 - (c) profits equalize across industries
 - f) Rent is a residual
 - (a) may [or may not] be used for improvements
 - (b) Wages and profit are causes of price: rent is and effect
 - (c) beginnings of a differential theory of rent based on yield and location
 - g) Money is regarded primarily as a medium of exchange. It is the “wheel of circulation” Road metaphor. Paper money saves resources of extracting gold and silver
- viii) Role of government

- a) (1) provide for national defense, (2) provide for domestic justice and (3) those things that it is not "*in the interest for any individual to provide.*" [public works, roads, bridges, schools, ...]
 - b) Gov't to prevent workers from becoming as "*stupid and ignorant as is possible*" due to division of labour.
 - c) Government revenues
 - (1) Mercantile projects [usually not so good]
 - (2) Public lands
 - (3) Taxes
 - (a) "*..subjects of every state ought to contribute towards the support of government, as nearly as possible, in proportion to their respective abilities: that is, in proportion to the revenue which they respectively enjoy under the protection of the state.*"
 - (b) Should be (1) "certain and not arbitrary," (2) "levied at the time, or in the manner which it is most likely to be convenient for the contributor, and (3) "take as little as possible out of the pockets of the people."
 - c) Lectures on Jurisprudence. A manuscript on jurisprudence (and other documents) was burned at Smith's request about the time of his death. What we have is based on two sets of notes taken by students who attended lectures given by Smith in the 1762-63 and 1763-64 sessions at the University of Glasgow. These notes were published in 1886. Students' notes on Smith's lectures on ethics and economics are consistent with the *Theory of Moral Sentiments and Wealth of Nations*, so there is some evidence that the lectures Smith gave were consistent with his writings
 - d) Essays on Philosophical Subjects (1795)
 - e) Four stages of history
 - i) Hunters
 - ii) Shepherds
 - iii) Agriculture
 - iv) Commerce
 - f) Protection of Property is primary aim of government [there are other functions]
 - g) Civil Government is in reality instituted for defense of rich
5. Jeremy Bentham [1748-1832] Philosopher and popularizer of "Utilitarianism"
- a) Maximize Utility of Community
 - i) What is a community?
 - ii) Felicific Calculus
 - a) Factors to consider
 - b) Individual utilities are additive

David Ricardo [1772-1823]

1. Ricardo was the son of a Jewish immigrant stockbroker who moved from Spain to Netherlands to Britain. Entered business as a broker at age of 14, married a Quaker at the age of 21. His family disowned him. With the support of friends he entered market on

his own and within 10 years amassed a fortune [one estimate was 2,000,000 pounds]. His rule was that the market over reacted to most events. He anonymously gave wealth and maintained two almshouses. Studied math and science, encouraged his study of economics by reading of Smith's *Wealth of Nations* in 1799.

2. Retired in 1814 [age 42], studied, wrote, member of Parliament, founder of Political Economy Club in London
3. Friends included, Malthus, James Mill, J.B. Say
4. Representative Publications were divided between pamphlets and major works
 1. *On the Principles of Political Economy and Taxation*, 1817 [written in a single year]
 2. *The High Price of Bullion*, 1810
 3. *The Influence of a Low Price of Corn on the Profits of Stock*, 1815
 4. *In protection of Agriculture*, 1822
 5. *Plans for the Establishment of a National Bank*, 1824
5. Ricardo used abstract, deductive, theoretical reasoning, [an economists' economist] to create an analytic approach to economics. Premises lead to conclusions.
6. Three basic premises used by Ricardo
 1. Rent Theory
 2. Malthus' population theory
 3. Wages fund thesis
7. Policy Wonk in Parliament [elected in Pocket borough in Ireland]
 1. Independent, conscientious, respected often argued and voted against his own interests, sided with reformers in political matters
 1. Abolish flogging, for secret ballot, extend suffrage, free speech, reduce capital offenses, for civil liberties
 2. In monetary matters Ricardo espoused a narrow quantity theory of money, free trade
8. Value
 1. Follows Smith in value in use and value in exchange, focus on value in exchange
 2. Utility is not a measure of value, it is a necessary but not sufficient condition, assumes utility
 1. Two types of goods
 - (1) Those which derive value from scarcity, a rare painting
 - (2) Those which derive it from the quantity of labour required to obtain them
 - (3) relative values depend on the quantities of labour required
 - (4) profits and wages [rates] are equalized in all industries, equality of labour, capital is stored up labour. There may be differences in the *durability of capital* that allow value changes
 - (5) values, wealth _ riches or welfare
 - (1) "It is true that the man in possession of a scarce commodity is richer, if by means of it he can command more of the necessaries and enjoyments of human life: but as the general stock out of which each man's riches are drawn, is diminished in quantity, by all that any individual takes from it, other men's shares must necessarily be reduced in proportion as this favored individual is able to appropriate a greater quantity to himself."
 - (6) rent is the result not the cause of value
3. **Distribution** is fundamental question posed by Ricardo.
 1. Distribution is related to theory of value in Ricardo.
 2. What principles determine the shares of Labour, Capital and Land?
 3. Correlate the values of products with the incomes of producers.
 - (1) "Profits depend on high or low wages, wages on the price of necessaries, and the price of necessaries chiefly on the price of food."
 4. "It is the desire, which every capitalist has of diverting his funds from a less to a more profitable employment, that prevents the market price of commodities from continuing for any length of time either much above, or much below their natural price."

5. "The natural price of labour is that price which is necessary to enable the labourers, one with another, to subsist and to perpetuate their race, without either increase or diminution. The power of the labourer to support himself, and the family which may be necessary to keep up the number of labourers, does not depend on the quantity of money which he may receive for wages, but on the quantity of food, necessaries, and conveniences become essential to him from habit, which that money will purchase. The natural price of labour, therefore, depends on the price of food, necessaries, and conveniences required for the support of the labourer and his family. With a rise in the price of food and necessaries, the natural price of labour will rise; with the fall in their price, the natural price of labour will fall." [p 115]
6. "With a population pressing against the means of subsistence, the only remedies are either a reduction of people, or more rapid accumulation of capital." [p121]
7. "In the natural advance of society, the wages of labour will have a tendency to fall, as far as they are regulated by supply and demand; for the supply of labourers will continue to increase at the same rate, whilst the demand for them will increase at a slower rate."
8. " The natural tendency of profits is then to fall; for in the progress of society and wealth, the additional quantity of food required is obtained by the sacrifice of more and more labour. This tendency, this gravitation as it were of profits, is happily checked at repeated intervals by the improvements in machinery, connected with the production of necessaries, as well as by deliveries in the science of agriculture which enable us to relinquish a portion of labour before required, and therefore to lower the price of the prime necessary of the labourer." [139]
4. Differential Theory of Rents
 1. Land of different qualities [productivity]
 2. Labour is homogeneous
 3. As population increases, the price of corn rises bringing marginal land into production.
 4. Rent accrues to the best land, no rent on the marginal land.
9. Ricardo's Theory of distribution [p327 of Speigel]
10. In the long run, wages at subsistence, the rate of profits fall, rents rise. When the rate of profit is zero there is not inducement for further capital accumulation, welcome the arrival of the **stationary state**.
11. Comparative advantage and gains from trade

NUMBER OF LABOURERS REQUIRED TO PRODUCE		
	CLOTH	WINE
BEFORE TRADE		
ENGLAND - 1 UNIT	100	120
PORTUGAL - 1 UNIT	90	80
TOTAL	190	200
AFTER TRADE		
ENGLAND - 2 UNITS	200	-----
PORTUGAL - 2 UNITS	----	160
TOTAL	200	160

Thomas Malthus [1766 - 1834]

12. Son of lawyer

13. Studied at Cambridge, 9th Wrangler
14. Curate in Church of England
15. Married at 40
16. Close friend of David Ricardo and opponent in policy issues
17. First professor of economics, Haileybury College [owned by East India Company]
18. Interest in demography, undermining doctrine of human perfectibility, and economics, particularly distribution. His theories were popular [until 1830's] and had lasting influence on social and economic thought.
 1. Influence on Charles Darwin
 2. Influence on Ricardo
19. Opposed "poor laws," in favor of "corn laws"
20. Publications
 1. *Essay on the Principle of Population as it Affects the Future improvement of Society* [1789, published anonymously] was a reaction against William Godwin [1756-1836] and Marie Jean Antone Nicolas de Caitat, Marquis de Condorcet [1743-1794]
 1. Condorcet believed that through the application of reason and science it would be possible for the perfection of humankind
 2. Godwin believed in the perfectibility of humankind through the establishment of small societies anarchic, the dissolution of government and private property. Only in these small societies, could sympathy and virtue prevail.
 2. *Principles of Political Economy* [1820]
 3. *The Measure of Value* [1823]
 4. *Definitions in Political Economy* [1827]
21. Population
 1. Malthus' population theory became a integral part of classical economics
 2. It is a mixture of moral judgment and "positive economics"
 3. Inflammatory themes
 1. Reasons for economic inequality
 2. Role of self interest, laissez-faire rather than benevolence in human affairs
 3. The nature of the future and progress
 4. Relation between religion with a benevolent God and existence of widespread poverty
 4. Provided insight for Charles Darwin that led to theory of evolution and "survival of the fittest"
22. Three propositions
 1. Population cannot increase without food
 2. Population invariably increases if food is available, "passion between the sexes" is a given
 3. The "superior power of population cannot be checked without producing misery or vise."
23. Food production increases arithmetically, limited by land and diminishing returns
 1. Population increases geometrically
 1. Function of age at marriage
 2. Natural sexual instinct
 3. Never considered contraception or abortion
 2. Limits to population
 1. Preventative checks
 - (1) later marriages
 - (2) abstinence, moral restraint
 - (3) Abortion, contraception, "irregular connections" are preventative measures, but labeled as vice.
 2. Positive checks
 - (1) disease, pestilence
 - (2) famine
 - (3) wars
 3. Population and wages
 1. Increase wages above subsistence, increase population, wages fall

2. Decrease wages below subsistence, decrease population, wages rise
3. Wages at subsistence in long run, a variant of Ferdinand Lasalle's [1825 - 1864] "iron law of wages." The result is a stationary state at subsistence.
4. In subsequent revisions of the Essay on Population, Malthus concedes a normal feature of economic development is "industrialization" which raises the standard of living of even the poor.
5. Malthus' population theory is not testable, if a population is not starving there must be preventative checks.

24. Malthus' Economics

1. His 1814 publication [*Observations on the Effects of the Corn Laws*] was one of the first to suggest the use of calculus in economic analysis. However, he complained that Ricardo was "too abstract."
2. Malthus was an "agrarian." Felt that agriculture was morally superior to commerce [which was exploitive].
 1. As agrarian opposed importation of corn into Britain, argued for the "corn laws" [tariffs on imports of corn and bounties on production]
 2. Cheap corn would encourage excessive population growth. For the same reasons opposed the "poor laws."
3. Malthusian theory of "Gluts"
 1. Two ways to spend income,
 - (1) acquisition of goods for consumption
 - (2) accumulate capital [it follows that Savings = investment]
 - (3) Malthus disagrees with Says law. Land owners hire menial servants, capitalists hire productive ag or industrial workers. As a result total product rises, total income of workers is constant [shift from unproductive to productive employment], capitalists' demand for consumer goods is down, result is general glut.
 2. In 1818-19 there was a general depression in Britain, agricultural prices dropped, labour became militant [Manchester, Peterloo Massacre], concern of revolutionary danger.
 3. "The interests of no other class in the state is so nearly and necessarily connected with its wealth, prosperity and power as the interests of the landowner."
 4. Imbalance in the circulation of money and commodities. More goods than workers at subsistence could consume. Ultimate cause of gluts was excessive profits, increased capital, improved technology, and subsistence wages.
 - (1) if you increase wages, you increase population and wages fall to subsistence.
 - (2) if you increase income share to capitalist they save and invest, result is more goods.
 - (3) if you increase share to landowner they build bigger estates, hire more servants,
 - (4) Notice the problem of gluts is due to over production {or underconsumption?}