

David Ricardo (1772-1823)

Background: Ricardo was only 4 years old when Wealth of Nations was published. He wrote an enormous amount, much of it correspondence with his friend Malthus (Sraffa's edited version of their correspondence comes to 12 volumes). Ricardo's main works are:

- *Essay on the Influence of the Corn Laws* (1815)
- *Principles of Political Economy* (1817—1st ed)

Main contributions, though:

- theory of differential land rent (which we'll ignore)
- international trade theory;
- distribution of national income (factor shares) and growth;

I. International Trade Theory

This is what Ricardo is best remembered for: the principle of comparative advantage. What is interesting too is the use he makes of simple economic models (and *ceteris paribus* assumptions) to illustrate his arguments.

Figure 1: Comparative advantage

	man-hours required per unit		
	Cloth	Wine	Pw/Pc
England	100	120	1.20
Portugal	90	80	0.88

In the example above, there are 2 countries, two products, one factor of production and fixed technology. Exchange rate assumed 1:1.

Although Portugal has an absolute advantage in both lines, it pays Portugal (P) to enter into trade. Why?

- if P did not trade it would expend (90 + 80 = 170) days to produce one unit of wine and one of cloth;
- if it expends 160 man-days to produce 2 units of wine and can exchange wine against English cloth at 1:1, it will be better off. In fact it will be better off for any price ratio between 1.20 and 0.88;
- Exactly the same logic holds for England. Taken together, P and E together expend 390 labour units before trade and 360 labour units after trade.

J-S Mill later extends this analysis to include 'offer curves' which gives an equilibrium price for trade. The basic argument eventually formalised by Heckscher & Ohlin, though with two factors and variable technology. Emmanuel's objection (unequal Exchange): why does UK capital not go to Portugal?---fundamentally upsets neo-classical trade theory as does empirical observation that 50% of trade is intra-industry. Still, there is but one example of the elegant analytical style used by Ricardo.

II. Growth and Distribution

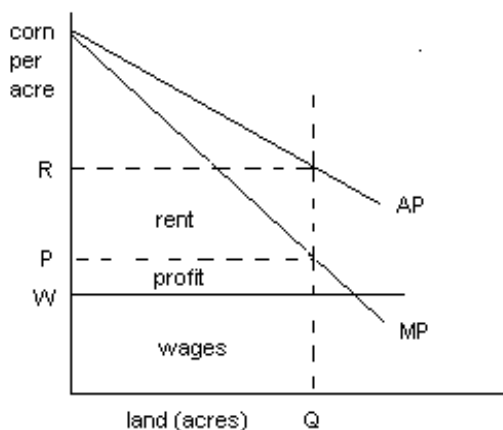
Like Smith, Ricardo was interested in the question of 'wealth'---a country's long term growth. However, he saw that this was determined by the rate of return on capital (rate of profit), and that the rate of profit was related to the (functional) distribution of National Income between wages, profit and rent.

To do this he assumes the following schema:

- the whole economy is like a giant landlord's estate, the management of which can be given over to a tenant farmer (capitalist) who hires labour;
- there is only one output (corn) which serves as the I-good and C-good;
- there are diminishing returns (infertile land);
- wage rate is institutionally determined at subsistence level in terms of corn.

Figure 2: Ricardo's Income Distribution

Theory



Although Ricardo does not use diagrams (a marginalist invention), his system can be represented diagrammatically for simplicity (below in straight line terms).

What does diagram mean?

- as we move out along MP line, marginal product of land (yield on each new ha.) is falling. Say it started at 100 tonnes/Ha; at point P it is (say) 50, while AP (average yield) would be 75.

- National Income: $OQ \text{ land} \times OR \text{ average yield} = \text{total corn output}$; say that average yield is 75 and land under cultivation at $Q = 400 \text{ ha}$. Total output (income) is 30,000 tonnes.
- Wage bill: 'institutionally determined' subsistence wage (just enough to support the worker & family; Malthus (Iron Law of Wages) argues this can never rise much because of demographics.
- Profit/acre: farmers will vie with each other to produce more corn until rt. of profit per acre is only marginally acceptable;

- ❑ Rent: residually determined; once wage bill and profit rt known, rent is a residual— differential rent for cultivating different quality land also determined. (NB: rt of profit here determines rt of profit in all other sectors.)
- ❑ Landlords: parasitic because they cut into re-investible profit; Corn Laws force more poor-quality land into production thus lowering profit rate both for agro & industry; their repeal would raise the rate of profit---and (implicitly) turn the domestic terms of trade in industry's favour.
- ❑ Tech change: if surplus were saved & re-invested, AP and MC would shift upwards raising profit rate until one 'ran out' of labour ---but Ricardo assumes low tech change.

Policy Conclusions for Ricardo

Corn Laws (1813-1846) had the effect of forcing marginal lands into cultivation which raised rent and lowered the rt of profit for capitalists. The repeal of the Corn Laws would hurt landlords, benefit capitalists and foment industrialisation, thus postponing the 'stationary state'.

Broad objection

Falling profit rt: Malthus suggests that, quite apart from diminishing returns, the problem might be one of 'realisation'; ie, will the whole of Nat Y be 'bought back' by capitalists and workers? Ricardo invokes Say's Law to avoid the problem.

***Say's Law:** Jean Baptiste Say (18th Century) argued 'supply creates its own demand'*

Conclusion:

Ricardo is the first of the truly modern economists to use the logic of the abstract 'model' with simplifying assumptions. Sets up the question: ---> how is distribution of Nat Y determined; what implications does it have for growth? Does maldistribution lead to capitalist crisis (Malthusian under-consumption)?

Some Questions for Discussion in Part 2 of Session

1. Does 'following comparative advantage' mean that Britain has to lower its production costs to be competitive? Explain.
2. Does Ricardo see a conflict of interests between industrialists and the land-owning aristocracy? Discuss.
3. What is 'Say's law' and how did Ricardo and Malthus differ in its interpretation? What is the relevance of this debate to modern times?

Figure 3: Comparative advantage

	(man-hours required per unit)		
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