

Key points of adam smith david ricardo economics essay



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The classical writers of the eighteenth and nineteenth century when offering definitions of their science expressed themselves about the nature of the economic in two distinct ways. They could define the subject known as political economy. Or having defined the political economy as the science of wealth, they could proceed to set forth the nature of that wealth with which it was maintained that economics is concerned. (Israel M. Kirzner, *The Economic Point of View*, p 13). The earliest classical economist adopted the description of the economic side of affairs in terms of wealth, but developments narrowed down the concept of wealth to the idea of material wealth of mankind. The attitude toward the utility of economic inquiries in elevation of wealth became an object of scientific study. Investigations that aims finding the means of enriching people and the sovereign; discovering laws of governing and to make the nation wealthy. From the beginning alternative suggestions were made by the economists themselves about what should and what should not be included under the heading of wealth.

Adam Smith in "An Inquiry into the Nature and Causes of the Wealth of Nations", 1776, explains that the free market, while appearing chaotic and unrestrained, is actually guided to produce the right amount and variety of goods by a so-called "invisible hand". He argued that self-interested competition in the free market would tend to benefit society as a whole by keeping prices low, while still building in an incentive for a wide variety of goods and services. An often-quoted passage from *The Wealth of Nations* is:

"It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own self-interest. We address ourselves, not to their humanity but to their self-love, and never talk

to them of our own necessities but of their advantages.”(Adam Smith, p. 18). Smith believed that economic development was best fostered in an environment of free competition.

Smith saw no role for government in economic life but believed that the government should enforce contracts and grant patents and copyrights to encourage inventions and new ideas. He also thought that the government should provide public works, such as roads and bridges that, he assumed, would not be worthwhile for individuals to provide. Interestingly, though, he wanted the users of such public works to pay in proportion to their use.

Value theory was important in classical theory. Smith wrote that the real price of one thing is the labor and difficulty of acquiring it as influenced by its scarcity. Smith also believed that the main cause of prosperity was increasing division of labor. It would affect a great increase in productivity, one example he used was the making of pins. One worker could probably make only twenty pins per day. However, if ten people divided up the eighteen steps required making a pin, they could make a combined amount of 48, 000 pins in one day (Adam Smith, ch. 1). Smith claimed that an individual would invest a resource-for example, land or labor-so as to earn the highest possible return on it. Consequently, all uses of the resource must yield an equal rate of return (adjusted for the relative riskiness of each enterprise), otherwise reallocation would result. Smith used this insight on equality of returns to explain why wage rates differed. Wage rates would be higher, he argued, for trades that were more difficult to learn, because people would not be willing to learn them if they were not compensated by a higher wage. Similarly, wage rates would also be higher for those who

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engaged in dirty or unsafe occupations, such as coal mining and butchering. In short, differences in work were compensated by differences in pay.

David Ricardo another classical economist wrote his famous work “ Principles of Political Economy and Taxation”, (1817). Ricardo continued to work on value theory (ch. 1). He explains the labor theory of value that the relative price of two goods is determined by the ratio of the quantities of labor required in their production. He demonstrates that prices do not correspond to this value; he retained the theory, however as an approximation. His labor theory of value, however, required several assumptions: 1- both sectors have the same wage rate and the same profit rate; 2- the capital employed in production is made up of wages only; 3- the period of production has the same length for both goods. Ricardo himself realized that the second and third assumptions were quite unrealistic and hence admitted two exceptions to his labor theory of value: 1- production periods may differ; 2- the two production processes may employ instruments and equipment as capital and not just wages, and in very different proportions.

In his book, Ricardo’s concept of rent is laid out. Due to variation in scarcity of land, some land pays a higher monopoly value due to its scarcity than other land. Ricardo labels Rent as the portion of individual benefit, that accrues to scarce, resources such as land or gold or houses that is over and above any socially beneficial exchange (ch. 2). If all land were equally situated, however scarce, one could determine that all market exchange of the produce thereof was free and equal and that the exact value of the trade was conveyed simultaneously to both parties and to society. Ricardo

extrapolates the problem of monopolistic rent to other situations/resources that are fundamentally scarce: land or gold.

Like Adam Smith, Ricardo was also an opponent in the field of a nation's trade protectionism policy. In this book Ricardo introduces the theory of comparative advantage (ch. 28). According to this theory, even if a country could produce everything more efficiently than another country, it would reap gains from specializing in what it was best at producing and trading with other nations. The benefits of comparative advantage are both distributional and related to improved real income. Ricardo believed that wages should be left to free completion. .

Another idea developed by Ricardo is Ricardian

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http://en.wikipedia.org/wiki/Ricardian_equivalence#Introduction, is an economic theory that suggests consumers internalise the government's budget constraints and thus the timing of any tax change does not affect their change in spending. Consequently, Ricardian equivalence suggests that it does not matter whether a government finances its spending with debt or a tax increase, the effect on total level of demand in an economy being the same.

Ricardo believed that in the long run, prices reflect the cost of production.

The price of an object is determined by the sum of the costs of the resources that went into making it, and referred to this long run price as a Natural

price. The natural price of labor was the cost of its production that cost of

maintaining the laborer. If wages correspond to the natural price of labor,

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then wages would be at subsistence level. In his Theory of Profit, Ricardo stated that as real wages increase, real profits decrease because the revenue from the sale of manufactured goods is split between profits and wages. He assumed in his "Essay on Profits" (1815) that

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<http://socserv.mcmaster.ca/~econ/ugcm/3ll3/ricardo/profits.txt>", 1815 that profits depend on high or low wages, wages on the price of necessaries, and the price of necessaries chiefly on the price of food.

We will treat the economic definitions of another classical writer John Stuart Mill in his writing "Essays on Some Unsettled Questions on Political Economy", 1844 as below.

-If a country produces both commodities with greater facilities or both with greater difficulty in exactly the same degree, then there will be no motive for exchange. On the other side if they have advantage in producing some commodities, then through commerce the nations can benefit both if each one will specialize in producing those commodities. So a country, by devoting all inputs in the production of goods which their advantage is greatest and give for exchange to the foreign country, would obtain a greater return from labor and capital. But in what proportion the two countries would share the advantage of trade? The problem is concerning about of proportion of goods in exchange, thus exchangeable value or price, regulated by the demand and supply to respective importing and exporting countries. The costs of carriage, tariffs, and taxes are deductive to gain advantage. So two countries would have equal shares of benefit of trade if

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cost of transportation and other barriers would not exist, otherwise the gross gain is divided in unequal ratio. So a country through the legislative policy can affect the benefits from foreign commerce. As conclusion we may say that a country gains most from the foreign commerce as much as are the foreign needs for its products (Essay I: On the Laws of Interchange Commercial Between Nations and Gain of Commerce Among of Commercial World).

- A great and rapid consumption leading to an extensive demand, fast circulation and big spending of money was conceived to be the great conditions of prosperity. But consumption is of two kinds: reproductive and unproductive and the first augments to the national wealth while the second weaken it. What is consumed for unproductive is gone for present enjoyment, but what is consumed for reproductive consumption leaves commodities of equal value, commonly with addition of a profit (Essay II: Of the Influence of Consumption on Production).

-The phrases productive labor and productive consumption has been used by writers of political economy considering all the labor which serves for useful purposes and consumption which is not waste- in a limited sense productive of wealth. When it is uncertain to which of the two classes (productive and unproductive) an object belongs then should be distinguished characteristics and usage of it. All workmen that work in producing or giving value to things and functionaries positions who have invested to their skills are included in productive labor. The settled classification definitions were used for determining their consequences in economy. A country is enriched in proportion to the amount of the productive labor and consumption and <https://assignbuster.com/key-points-of-adam-smith-david-ricardo-economics-essay/>

impoverished in proportion of unproductive labor and capital (Essay III: On the Words Productive and Unproductive).

-Profit is the surplus which remains to the capitalists after replacing his capital in a gain purpose process. The rate of profit depends on the ratio between the price and proportion of labor, materials, tools and the produce of them; upon the proportionate share of the produce of industry. David RicardoArtComComputers2010-08-11T16: 32: 00

On the Principles of Political Economy and Taxation, 1817 said that profits depend upon wages: it increases when wages fall and decreases when wages rise. When he says rise of wages it is meant an increase in the cost of production of wages or an increase in the number of hours. So as we can see it is strictly true, that the rate of profits varies inversely with the cost of wages. Rate of profit can increase if: there is an increase of population beyond the capital; improvements in labor efficiency and new entrance successive technologies. The producer, who borrows capital to employ in his business, will pay for the use of it (the interest). There are variations in the market-rate of interest from day to day establishing the actual rate from the movement of demand and supply. The rate of interest has the increase tendency if there is a big demand, low supply, low security individual loan or industry and specific situations. The difference between the profit which can be made by the use of capital and the interest which will be paid for it is characterized as wages of superintendence (for the risk and labor for carrying business). Interest and wages of superintendence are in the same inverse relation as wages and profits are (Essay IV: On the Words Profit and Interest).

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-Adam SmithArtComComputers2010-08-11T17: 39: 00

Inquiry into the Nature and Causes of the Wealth of Nations. gives a definition that Political Economy is a science which teaches or gives the means and laws of making a nation rich. It has included individual decisions connected with the ideas and feelings in man- forming part of a union or aggregations. John S. MillArtComComputers2010-08-11T17: 53: 00

Essays on Some Unsettled questions of Political Economy. gives another more complete definition of Political Economy: -The science which treats of the production and distribution of wealth so far as they depend upon the laws of human nature, or -The science relating to the moral or psychological laws of the production and distribution of wealth. Under the influence of this desire it shows operations of: accumulating wealth, employing that wealth, producing other wealth under the influence of competition, governed by laws, sanctioning by mutual agreements, establishing laws etc. The science proceeds to investigate the laws which govern several operations on acquisition of wealth (Essay V: On the Definition of the Political Economy and on the Method of Investigation Proper to it).