

Physiocrats and the classical model of economy economics essay



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The society has various institutions embodied in it, the government, church, ECONOMY, and family. Government takes care of governance, the church takes care of religion the economy takes care of subsistence, this consist of consumption production and distribution and lastly the family deals with reproduction. The society drives the economy and not the other way round. Anything that happens to the society will change the economy. The society is made of groups of people that are linked together. The economy works with the society to satisfy wants and needs. Society gets its character from the economy. No society would exist for any length without the possession of an economy of some sort. It determines both the means and mode of production. The economy is that thing that will combine the methods and goals to satisfy needs and wants. The economy as an institution consists of producers and consumers who interact with one another to get satisfaction as pa consumers and profits as pa producers.

Classical Model of Economy:

The classical school was the starting point for other economic schools of thought. This school is made of some scholars, Adam smith, David Ricardo, Thomas Malthus, Jeremy Bentham and others. Adam smith also known as the father of economics was born in the year 1723 and he died in the year 1790. Smith`s central idea or message is labor as the basis of value. Smith talked about wealth accumulation from the stand point of the production function combining capital, labor and technology to produce surplus. He was interested in surplus because for him nations get wealthy through generation of surplus. He also talked about economy as a result of change in society or social behavior and interprets society as a modern state. Other things he

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talked about were national output, aggregate supply of capital and labor. In explaining the classical model introducing this equation is vital. (from Smith to Marx)

$f(k, l) = Y = C + I + G + NX$ where a is technology, k is capital, l is labor, c is consumption, I is investment, G is government and NX is net export (import and export). For the classicals there is no government intervention. The classical model talks only about instruments of production. Smith's treatment of two variables in the classical model government and net export are what defines classical model by Smith. Classical model goes against Government intervention. Classical model by Smith is government is not supposed to interfere in the market. Government might behave in ways that would hold back progress and improvement. "Government meant restrictions and that restrictions necessarily frustrated the natural division of labor, the operation of the invisible hand, and the progress of improvement". There should be surplus and surplus is directly tied to exports. Surplus does not go into consumption but production. Surplus is derived from net export where export has to be greater than import and should be greater than zero because if it's zero then it means there's no surplus. Smith introduced value in use and exchange; He found only exchange economically interesting. I think he chose the latter because the classicals were more interested and focused on production and not consumption. Money is the measure of value and it is used as a medium of exchange between producers and consumers in the market. He saw value as independent of the market. He agreed that market prices could fluctuate but value would remain constant. Smith stated that labor was the measure of value and the value for a commodity is the

labor required for its production. He argued, that natural price that is value of commodities, was from three elements wages, rents and profits. These forces of competition were expected to push the market price toward the natural price Equilibrium.

Smith`s major explanation for economic growth was the division of labor. His interpretation of division of labor was not just limited to job specialization but also to the division of the labor force between those employed in useful labor and those not so employed. Division of labor determined productivity of labor. Productivity of labor is the type of labor that produces tangible goods and has exchange value and also unproductive labor that produces intangible goods. According to smith whatever increases output is what is valuable in the economy. Labor is the basis for value in an economy. Embodied labor is the labor that is used to make machines that will in turn increase productivity.

David Ricardo was born in the year 1772 and died in the year 1823, he made contributions to the history of economics as well. He was interested in problems and believed that the main problem in political economy was determining the laws regulating distribution and their relations to the happenings in the society. Ricardo does not talk about money but corn and he used it to show how profit is being created. He introduced the concept of comparative advantage into the model and he was also against government intervention in the market. He assigned a special role to agriculture and he rejected the Physiocratic view that agriculture was the economy`s only productive sector. He made arguments in support of free trade for agricultural products. He explained in his value theory that value may differ
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depending on the amount of labor units required to obtain goods and that the relative values of goods depended on the quantities of labor required to produce them. Profits he said will rise if by improvements in machinery, food and necessities of labor are introduced to the market at reduced rate or prices. Ricardo read Malthus and suggested that investment was missing in his writing of the explanation that agriculture is re-invested back to land in order to produce more output.

Thomas Malthus was born in the year 1766 and died in the year 1834, he wrote on the principles of population. He was also a supporter of the free market and an opponent of government restrictions. For him population has a tendency to increase food supply. He examined the relationship between population income and surplus accumulation. He made arguments that increases in wages within an economy will increase birth rate and decrease death rate. This is so because having high income will give people the ability to cater for their children which in turn will push them to want to have more and also income will allow them or give them the ability to fight killer diseases thus, decrease the rate of deaths. His theory of society states that when population is unchecked it increases in a geometric ratio while subsistence increases in an arithmetic ratio. Malthus made two propositions, " First, that food is necessary to the existence of man. Secondly, that the passion between the sexes is necessary, and will remain nearly in its present state...."

Malthus also developed the law of diminishing returns. Others favored free trade Malthus defended the agricultural protection provided by the corn laws, while others opposed unproductive expenditures particularly
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government spending he in certain instances made positive cases for them. Agricultural protection was justified on the grounds that high food prices would encourage productivity-raising investment in agriculture.

Physiocrats model of economy

Physiocrats are a group of French enlightened thinkers that believed that creation of economic growth in the mercantilist system is agricultural surplus and not manufacturing. This economy included thinkers like Francois Quesnay and Mercier De La Riviere among others. Quesnay `s Tableau Economique was the basis of their (physiocrats) thinking. They suggested government to implement policies to help maximize agricultural surplus just agriculture not in other economic sectors. Was against government intervention because the farmers in France at that time were not able to sell at higher prices and buy inputs at cheaper because of monopoly power and tariffs internally affecting agricultural commerce. They developed the single tax system where all tax imposed in the economy on land rents will only add to the surplus and will avoid distortions in the system. They believed that the set of policies they were setting down will bring about natural order and the government role was only in implementing laws to make people obey in return for attaining surplus. The physiocrats made a distinction between the natural and positive order. The natural order was God made convention and could not be changed by man which is also known as the laws of nature and the positive order was man-made and so it could be changed. There existed three classes in the economy, the productive, the sterile and the proprietor class. The productive class included agricultural farmers and laborers, the sterile class included industrial laborers and merchants and the proprietor

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class includes those that have net profit as rents. Maximized surplus is produced when each sector and class in the economy has equal income flow and not in a case where one sector or class benefits at the expense of the other.

Marxian Elaboration of Classical Model

Karl Marx was born in the year 1803 and died in the year 1883; he tries to show the transition from feudalism to capitalism from the point of view of labor and value, that is the ownership of labor. He saw capitalist as those who privately owned production. Marx talked about both the society and the economy. Marx does not deal with government intervention and he includes social conditions of production. He explained how the society functions over time with an economy as an institution. During the feudal system of economy, the laborer was the owner of the means of production but as time went on the laborer changed.

With Adam Smith's contribution of division of labor, specialization and the coming of the industrial revolution. The laborer lost the means of production and when you lose your means of production you become a commodity with exchange value. This happened because their means of production was taken away from them which transformed them from being producer laborers to wage laborers. Laborer began collecting wage and the aristocracy owned the means of production and became the bourgeoisie collecting rent.

Mode of subsistence was then divided into three parts consumption, production and distribution. Before the feudal system there was primitive accumulation of capital. For him, Capitalist production produced surplus
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value and surplus value brought about the Accumulation of Capital. The secret of primitive accumulation by Marx was about the mode of production in that primitive accumulation of capital and the accumulation of capital are both modes of production. Marx explains the difference between primitive accumulation of capital and accumulation of capital that primitive accumulation deals with the gathering together of commodities and accumulation of capital deals with labor and capital in the production process.

He says money changes into capital and surplus value is made through capital. His main concern was explaining how capitalist economy works; he tries to modify expectation labor losing ownership of itself. He looks at the entire society and how it affects economic behavior. He introduced the concept of exchange, without exchange, products of labor cannot acquire any value. He said the produce from different individuals make up the aggregate for the whole society and that individuals do not have any form of social interaction with other individuals until exchange takes place. This meant that the relationship between individuals in a society is directly between their products and indirectly between themselves. Marx differentiated the owners of the means of production from the laborers and criticized Malthus's theory of population.

Marginalist Elaboration of Classical model of economy

Marginalist consist of Alfred Marshall, Jevons, Walras, Menger among others they were concerned with individual and not social production. It is important to note that the marginalist where not just concerned with only the

production but also the consumption side of the equation or model.

Production takes place for the benefit of just individuals and not the society.

The relationship between producer and consumer is based on their needs, wants and desire subject to their income. Scarcity is the basis of value; this is so because when a commodity is scarce, its value is higher than a commodity that is not scarce it in turn affects the behavior of the consumer. Both consumers and producers seek to maximize utility as pa consumer and profits or reward as pa producer.

Neo-classicals believe that an economic system is not just for the production of commodities but the production of satisfaction. Marginal cost was used to determine market supply and Marshall used the concept of demand and supply to explain price. Where the demand and supply curves met, equilibrium happened, above the equilibrium sellers would offer more than buyers would take and this will result in surplus and below equilibrium it will result in shortage. The Neo-classical production theory addressed itself to two principal issues. The first concerned the manner in which any producer set about combining the productive factors. The second dealt with the adjustments a producer might be expected to make when market conditions altered.

Gossen distinguished the marginal utility curve from the demand curve.

Gossen proposed three Laws, the first is as more and more is consumed utility will diminish at a point, the second law is that a person maximizes his utility when he distributes his income among various goods so that he

obtains the same amount of satisfaction from the last unit of each good and

lastly a good has value only when the demand for that good exceeds supply.
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Jevons argued that labor supply was governed by disutility of labor: the greater the amount of work, the greater the marginal disutility of labor. He continued arguing on Gossen's Second Law, that the marginal utility of consuming a good must be equal to the marginal disutility of producing it. He summarizes the story in a famous "catena" "Cost of production determines supply; Supply determines final degree of utility; Final degree of utility determines value". The first seeks to explain output determination process, which is how higher or lower wages shift around the marginal utility of income/disutility of labor curves so that output level changes, the second is once we have supplies of goods determined, we know what marginal utility of those goods will be and lastly it sums up the pure exchange process. All this didn't make so much sense until Alfred helped Jevons correct it.

Walras believed that the value of a good depends both on the utility and its rarity. He made the connection between utility and rarity by saying that "rarete" (marginal utility) is personal or subjective using two agents exchanging two goods as an example. Rarete becomes an individual phenomenon when there are many agents. He derived demand curve from utility function through household budgets. If demand for a good exists there must then be a medium used for or as exchange and the aggregate value of what is offered must be equal to the aggregate value of what is demanded. Equilibrium is achieved where market demand equals to market supply equilibrium remains constant through price adjustments. Finally, Walras included production, capital and money into his general equilibrium model.

Menger introduced the concept of diminishing marginal utility and used the term as Smith used it in terms of objective use value.

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Keynesian Elaboration of classical Model:

Keynes brought or introduced G that is government intervention into the classical model. His issues were that of the depression, introducing interest rate among others, in order to solve problems interest rate had to be reduced and government had to step in to make sure or ensure it happened. Keynes concerns were for short run issues unlike the classical economists that were concerned with long run issues. He was also concerned about unemployment and inflation but was concerned more about unemployment because inflation was not a problem at that time due to the fact that economic activities were low. Keynes developed a general theory of employment, interest and money in response to the classical economic model because he felt it was not explanatory enough. Keynes mentioned that there has to be government intervention; the classical operated *laissez faire* because the economy was thought to regulate itself. To stabilize problems of misallocations of the market, we need government to step in to take care of spill-over effects, under allocation etc. Keynes felt without the government the market system will be unstable and incapable of assuring full utilization of productive resources.

Keynes attack on Say's law was centered on the analysis of money. Money had no intrinsic value. Neoclassical writer looked first at money when it was spent whereas, Keynes looked at money in the hand and not when it was spent. He argued that there is apart from spending another reason to hold cash. Keynes talked about income, savings, investment, rate of interest and money just like the classical system but had differing views on the variable money. His view of money made way for a different and new perspective of <https://assignbuster.com/physiocrats-and-the-classical-model-of-economy-economics-essay/>

interest rate. " He described the problem in the following manner: "The habit of overlooking the relation of the rate of interest to hoarding may be part of the explanation why interest has been usually regarded as the reward of not-spending, whereas in fact it is the reward of not-hoarding".

Keynes answered how the level of interest rate was determined; he said it was determined by the supply of and demand for money not by the supply of and demand for loanable funds. The supply of money is regulated by government and central bank and the demand of money is established by the preference of community. The Keynesian argument held that the rate of interest was primarily a monetary phenomenon. This position further implied that the rate of interest could no longer be invoked as the delicate mechanism for equilibrating intended saving and intended investment. These relationships played no part in the determination of the rate of interest itself. Saving and investment might respond to changes in the rate of interest but they were not its primary determinants.

For Keynes, people sought first an acceptable level of consumption and undertook to save only when their income was more than sufficient to cover consumption requirements. Saving was thus a residual, varying in amount with changes in the level of income. The decision to save and invest according to Keynes was solely a person's decision and it could be for different reasons. He argued that the volume of private investment would be governed largely by two considerations the cost of borrowing and the anticipated rate of return. Keynes used the multiplier concept to explain the manner in which the level of income was determined and emphasize the importance of investment expenditure to recovery from depression.

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Keynesian point of view, the process of balance of payments adjustment could more usefully be traced through changes in aggregate income associated with surpluses or deficits in the international accounts than through gold movements and the ancillary monetary and price changes to which the neo-classical economists had directed attention. The supply for money is tied to savings, as savings increase, interest rate goes down which makes money available for investors and in turn increases output and when income increases, consumption increases leading to an increase in the rate of production of output.

Application of Classical model

A society with problems can only find suitable solutions that have a lot to do with the problem that is put in place. What I mean here is that, if for example a person demands for indomie and it is not available in the market. Instead of finding a way to make it available there by solving the problem, you decide as an economist to teach the consumer how to prepare spaghetti. In other words, providing a different solution to the problem at hand, The model was not meant for a system like Nigeria based on the fact that the model was put in place to solve problems that were taking place in Europe. The model will therefore have some cracks in matching Nigerian economy.

In Nigeria there is a problem of money demand and supply, interest rate, inflation and income that affects our output. The central bank that controls supply of money through selling or buying of government bonds as the case maybe in periods of election a lot of money is pumped into circulation. This money is not even properly circulated because few people hold the money

and will not save them in banks but keep them at home or in most cases banks outside the country. This increases poverty and increases the gap between the rich and the poor. This affects consumption which in turn will affect output.

Interest rate is tied to money supply, the money that is being circulated by central bank is supposed to help Nigerian s get more and therefore increase consumption. This is not the case because when money is pumped into the economy few people get it and this automatically decreases consumption which will also automatically affect output.

Based on this model:

$f(K, L) = Y = C + I + G + NX$ where

a is technology, k is Capital, l is labor, y is GDP, c is household consumption, I is Investment, g is Government expenditure and nx is Net exports. Looking at it from a Nigerian economy point of view, a lot of problems can be seen. Increasing output is the main concern of the economy. Nigeria does not have adequate technology that if used properly could increase output, specialization leads to increase in output, to get labor to produce more and as a result increase output we need it to be specialized and labor in Nigeria is not specialized, we import more than we export, do we even export. For example oil and some raw materials, in the case of oil, Nigeria is blessed with oil and this commodity can make us very rich thereby increasing our GDP but it's unfortunate that we produce it and then send it out of the country for when it has been refined we still pay them to get it back. Why should this be happening when we can as well as produce it refine it. This <https://assignbuster.com/physiocrats-and-the-classical-model-of-economy-economics-essay/>

increases their GDP and reduces ours because we are in no way accumulating capital.

All these variables that are directly or otherwise linked together are supposed to help an economy grow, in this case we are referring to the Nigerian economy.

The model could work for Nigeria if it was Nigerian based. Unlike Europe that was the basis for the classical model, Nigeria has different cultures and societies and every society has its own culture and mode of subsistence that may in most cases be entirely different from the other. Since an economic model is supposed to be developed to take care of the economy as a whole in the case of Nigeria this is going to be a big problem. For a model cannot be developed for every society based on their differing cultures and modes of subsistence.

Government intervention in the market economy of Nigeria is essential even though with them present there isn't much impact but the laissez faire doctrine will not work in Nigeria because a self-regulating market for an economy like ours will make matters worse and the living conditions of Nigerians will be terrible.

These things can be corrected and possibly the classical model can be used. If Nigerian lawmakers and economic correctors, if I can call them that, put their heads together and find out what it is that every society has in common and use that to develop our own unique model. Or develop a model that will not be at the expense of others. They could even just come up with a model that will not affect anyone and make it happen. No problem is too big we just

have to be ready to make aments and be determined to improve our standard of living in order to increase our GDP for our own good.