THE CLASSICAL ECONOMICS

INTRODUCTION

There are circumstances which make up the present condition of human knowledge, more unlike what have been expected, or more significance of the backward state in which speculation on the most important subjects still lingers than the little progress which has been made in the decision of the controversy respecting the criterion from right and wrong. Since the dawn of history, the question concerning how societies can operates and what can shape it, has occupied the most gifted intellect. One of such gifted intellectual body of reasoning is the classical doctrine.

The Classical school, which is regarded as the first school of economic thought, is associated with the 18th Century Scottish economist Adam Smith, and those British economists that followed, such as Robert Malthus and David Ricardo. It began in 1776 when Adams Smith published his *Wealth of Nations* and ended in 1871 when W. Stanley Jevons, Carl Menger, and Leon Walras independently published works expounding neoclassical theories.

In The *Wealth of Nations*Smith presented a comprehensive analysis of economic phenomena based on the notions of free markets and actions guided by individual self-interest in a laissez faireenvironment. This work by Smith was motivated in large part as a critique of the then existing mercantilist system. The classical framework developed by Adam Smith was enhanced, refined, and improved over the ensuring 150 years by a number of scholars. The basic principles were refined and applied to an assortment of topics and issues, including resource markets, international trade, economic development, and industrial activity--to name just a few. Much of this work remains relevant to the modern study of microeconomics.

Smith's *Wealth of Nations* can be used as the formal beginning of Classical Economics but it actually it evolved over a period of time. 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. 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.

It was the primary school of thought in economics until the 1930's and the time of the Great Depression. The shortcomings of the Classical school became extremely evident when its practitioners were unable to explain the extraordinary decline in economic activity and increase in unemployment during the 1930s. The Classicists were mostly criticized for being unable to see the importance of the short-run changes that were taking place. Their models which held many variables fixed and focused on the supply side of the economy could not give a viable answer for what was happening. This brought about a great deal of criticism from many analysts and cast the entire economics discipline in a bad light, much like what happened after the Great Recession of 2007-09. Nonetheless, Classical economics is the jumping off point for understanding all modern macroeconomic theories, since in one way or another they change or relax the assumptions first discussed in the Classical school of thought to derive a more realistic model.

Classical economics ruled economic thought for about 100 years. It focused on macroeconomic issues and economic growth. Because the growth was taking place in an open economy, with a currency that (except during 1797–1819) was convertible into gold, the classical writers were necessarily concerned with the balance of payments, the money supply, and the price level. Monetary theory occupied a central place, and their achievements in this area were substantial and – with their trade theory – are still with us today. Those ideas developed amid an international economy free from major wars. However, the French wars of 1793– 1815 had a powerful influence on classical economics, leading to major problems with public finance, and to a significant national debt. Because convertibility of the note issue into gold was suspended, it was necessary to develop a theory of the operation of an inconvertible paper currency.

BIOGRAPHICAL DETAIL

Adam Smith (1723-1790), the brilliant founder of the classical school, was born in the Seaport, a manufacturing town of Kirkcaldy, Scotland. His birthday is undocumented. His father, a comptroller of customs in the town, died before his son was born. Margaret Douglas Smith provided a home for her son until her death in 1784 in her ninetieth year.

Young Smith attended Glasgow College at 14 years of age. He later studied moral and political science and languages at Balliol College, Oxford. He then returned to his mother's home to continue independent study for two years. After that, Smith moved to Edinburgh where he gave lectures on rhetoric and literature. He was elected professor of logic at Glasgow College in 1751, and in the following year he was given the chair of moral philosophy, which he held for nearly twelve years. In 1759 he published the theory of moral sentiments, and "An Inquiry into the Nature and Causes of the Wealth of Nations", which he had begun in France 10 years early. Its fame was immediate, and it established Smith's reputation forever.

IMPORTANT INFLUENCES

There were several influences on Smith's thinking. First and foremost was the general intellectual climate of his time. This was the period known as the enlightenment. This intellectual movement was built upon two pillars: people's reasoning ability and the concept of the natural order. The scientific revolution associated with Newton established that order and harmony characterize the physical universe. Through systematic reasoning, people could discover not only this physical loss but also those that govern the society. Enlightenment thinkers therefore were optimist; they generally believed that human thought and energy could produce virtually unlimited progress.

Secondly, Smith was influenced by the physiocrats, particularly Quesnay and Turgot. He praised the physiocratic system despite its imperfections, as perhaps the nearest approximation to the truth that has yet been published on the subject of political economy. The physiocrats' attack on mercantilism and their proposals to remove trade barrier won his admiration. From these thinkers he drew the theme of "wealth of nations" as the desirability of minimal government interference in the economy, and the concept of the circular process of production and distribution.

Finally, Francis Hutcheson, Smith's instructor at Glasgow College, was a third significant influence on Smith. Hutcheson felt that people themselves could discover what is ethically good - the will of God- by discovering the actions that serve the good humankind.

THE THEORY OF MORAL RESENTIMENTS

The theory of moral sentiments was published seventeen years before wealth of nations. Moral sentiments discussed the moral forces that restrain selfishness and bind people together in a workable society. Moral Sentiments opens with a chapter titled "Of Sympathy". Sympathy, said Smith, overcomes even selfishness. Sympathy or fellow-feeling interests us in the fortune of others and makes their happiness necessary to us.

WEALTH OF NATIONS

Smith's, "an inquiry into nature and causes of wealth of nations", appeared in 1776, the year of American Revolution. This was the book that established him as one of the premier economic thinkers in the history of economic thought. The insights contained in wealth of nations therefore require careful scrutiny.

1. Division of labour:

Division of labour can be defined as the separation of a work process into a number of tasks, with each task being performed by a separate person or group of persons. It is most often applied to systems of mass production. Adam Smith saw this splitting of tasks as a key to economic progress by providing a cheaper and more efficient means of producing goods. . The greatest improvement in the productive powers of labour, and the greater part of the skill, dexterity, and judgment with which it is anywhere directed or applied, seem to have been the effects of division of labour.Division of labour increases the quantity of output produced for three reasons. First, each worker develops increased dexterity in performing one single task repeatedly. Second, time is saved if the worker need not go from one kind of work to another. Third, machinery can be invented to increase productivity once task have been simplified and made routine through the division of labour.

The mercantilists were concerned mainly with how the exchange of goods, once produced, could add to the nation's well-being. The physiocrats, on the other hand, focused on agricultural output. By beginning his book with a discussion of how the same number of workers could produce substantially more output by dividing their labour, Smith immediately made it clear that ***"wealth of nations"*** was a break from the prominent economic notions then in existence.

2. The harmony of interests and limited government:

Smith pointed out that participants in the economy tend to pursue their own personal interests. The person of business pursues profit: "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 interest." The consumer looks to find the lowest price for a good, given its quality. The worker tries to find the highest pay, given the non-wage aspect of the job. There is an invisible hand that channels self-interestedbehaviour in such a way that the social good emerges.

The key to understanding Smith's invisible hand is the concept of competition. The action of each producer or merchant who is attempting to make profit is restrained by the other producers or merchants who are likewise attempting to make money. Competition drives down the prices of goods and in so doing reduces the profit received by each seller. In situations in which there is initially only a single seller, extraordinary profit attracts new competitors who increase supply and erase (wipe out) the excessive profit. In the same way, employers compete with one another for the best workers. Workers also compete with each other for the best jobs, and consumers compete with one another for the right to consume products. Stated in contemporary economic terms, the result is that resources get allocated to their highest valued uses and economic efficiency prevails. Furthermore, because business persons save and invest and again out of their self-interest, restrained by competition, thus tends to produce Smith's social good – maximum output and economic growth.

The harmony of interests implies that intrusion by government into the economy is unneeded and undesirable. According to Smith, governments are wasteful, corrupt, inefficient, and the grantors of monopoly privileges to the detriment of society as a whole.

Smith extended his belief in the harmony of interests and laissez-faire to international trade. In a direct attack on mercantilism, Smith argued that government should not interfere in international trade. Nations, like individuals and private families, should specialize in producing goods for which they have an advantage and trade for goods for which other nations have an advantage.

It is tempting to label Smith as an advocate of laissez- faire; we have seen his dislike for government involvement in the economy. But unlike some of the more extreme advocates of that view, Smith did see significant even dough limited role for the state. Specifically, he saw three major functions of government:

- To protect society from foreign attack,
- To establish the administration of justice and
- To erect and maintain public work and institutions that private entrepreneurs cannot undertake profitably.

Throughout his book, Smith favours a variety of state interventions that fit into the preceding three categories or that enlarge the scope of acceptable government action. He thought they should enforce the performance of contracts, control over the issue of paper money by bankers necessary even though it might be considered a violation of natural liberty. Legal control over exchange rate is acceptable; but the rate should be somewhat (though not much) above the lowest market rate to promote sound projects rather than frivolous, wasteful, and speculative ones, which high interest rate might permit. Laws ensuring the security of agricultural tenant are good because they promote improvements and investments in the land. Smith approved of patents and copyrights of limited duration. He even favoured two kinds of protectionist tariffs: Firstly, those that protect a domestic industry essential to the national defence and secondly, those that equalize the tax burden on a particular domestic industry by imposing a tariff on imports of that good. Otherwise, free trade is in order. But if free trade is to be introduced after a long period of protectionism, stated Smith, it should be done gradually to avoid suddenly throwing many people out of work and entrepreneurs into bankruptcy.

Among the public works that a government should support are those that promote commerce and education, including canals, roads, harbours, post offices, coinage, schools, and churches. Free public education for the common people is essential as a way to, among other things, counteract the stultifying effects of the division of labour:

To finance these government activities Smith recommended taxation. His four maxims for good taxes are as follows: first, taxes should be proportional to the revenue enjoyed under the protection of the state. This was a drastic departure from the regressive taxes prevalent at the time. Second, taxes should be predictable and uniform as to the time of payment, the manner of payment, and the amount to be paid. Third, taxes should be levied at the time and in the manner most convenient to the contributor. Finally, taxes should be collected at minimum cost to the government.

THE THEORY OF INVISIBLE HAND

In economics, the invisible hand of the market is a metaphor conceived by Adam Smith to describe the self-regulating behaviour of the market place. According to him individuals can make profit, and maximize it without the need for government intervention. He captured an important claim that individuals' efforts to maximize their own gains in a free market may benefit society, even if the ambitious have no benevolent intentions.

The theory for the Invisible Hand states that if each consumer is allowed to choose freely what to buy and each producer is allowed to choose freely what to sell and how to produce it, the market will settle on a product distribution and prices that are beneficial to all the individual members of a community, and hence to the community as a whole

Laissez-faire philosophies, such as minimizing the role of government intervention and taxation in the free markets, and the idea that an invisible hand guides supply and demand are among the key ideas, responsible for promoting free market. These ideas reflect the concept that each person, by looking out for him or herself, unconsciously helps to create the best outcome for all. "It is not from the benevolence of the butcher, the brewer, or the baker, that we can expect our dinner, but from their regard to their own interest," Smith wrote.

By selling products that people want to buy, the butcher, the brewer and the baker hope to make money. If they are effective in meeting the needs of their customers, they will enjoy the financial rewards. While they are engaging in their enterprises for the purpose of earning money, they are also providing products that people want. Such a system, Smith argued, creates wealth not just for the butcher, the brewer and the baker, but for the nation as a whole when that nation is populated with citizens working productively to better themselves and address their financial needs. Similarly, Smith noted that a man would invest his wealth in the enterprise most likely to help him earn the highest return for a given risk level.

Smith also applied the concept of the invisible hand in his books, “the moral resentment” and “the causes and nature of wealth of nations”. Today, the invisible-hand theory is often presented in terms of a natural phenomenon that guides free markets and capitalism in the direction of efficiency, through supply and demand and competition for scarce resources, rather than as something that results in the well-being of individuals.

The ideas that became associated with Smith not only became the foundation of the classical school of economics, but also gained him a place in history as the father of economics. His work served as the basis for other lines of inquiry into the economics field, including ideas that built on his work and those that differed. Smith died on July 19, 1790, but the ideas he promoted live on.

DAVID RICARDO

BRIEF HISTORY

David Ricardo ***(18 April 1772 – 11 September 1823)*** was a British political economist. He was one of the most influential of the classical economists, along with Thomas Malthus, Adam Smith, and John Stuart Mill. He began his professional life as a broker and financial market speculator. He amassed a considerable personal fortune, largely from financial market speculation and, having retired, bought a seat to enter Parliament. He held his parliamentary seat for the last four years of his life. Ricardo became interested in economics after reading ***Adam Smith's The Wealth of Nations in 1799***. He wrote his first economics article at age 37. Ricardo was a close friend of James Mill. Other notable friends included Jeremy Bentham and Thomas Malthus, with whom Ricardo had a considerable debate (in correspondence) over such things as the role of landowners in a society.

CONTRIBUTIONSOFRICARDO

EARLYWORKS:

Ricardo first gained notice among economists over the "**bullioncontroversy**." In 1809 he wrote that England's inflation was the result of the Bank of England's propensity to issue excess banknotes. In short, Ricardo was an early believer in the quantity theory of money, or what is known today as **monetarism**.

In his Essay on the Influence of a Low Price of Corn on the Profits of Stock (1815), Ricardo articulated what came to be known as **thelawofdiminishingmarginalreturns**. One of the most famous laws of economics, it holds that as more and more resources are combined in production with a fixed resource—for example, as more labour and machinery are used on a fixed amount of land—the additions to output will diminish.

Ricardo also opposed the protectionist Corn Laws, which restricted imports of wheat. Like Adam Smith, Ricardo was an opponent of protectionism for national economies, especially for agriculture. He believed that the British "Corn Laws"—tariffs on agricultural products—ensured that less-productive domestic land would be harvested and rents would be driven up (Case & Fair 1999, pp. 812, 813). Thus, profits would be directed toward landlords and away from the emerging industrial capitalists. Since Ricardo believed landlords tended to squander their wealth on luxuries, rather than invest, he believed that the Corn Laws were leading to the stagnation of the British economy. Modern empirical analysis of the Corn Laws yield mixed results. Parliament repealed the Corn Laws in 1846.

Between **1500** and **1750** most economists advocated **Mercantilism** which promoted the idea of international trade for the purpose of a nation gaining riches by running a trade surplus. Ricardo challenged the idea that the purpose of trade was to accumulate gold or silver. With "**comparativeadvantage**" he argued in favour of **specialization** and **freetrade** among countries. He argued there is mutual benefit from international trade even if one party is more competitive in every possible area than its trading counterpart and that a nation should concentrate on sectors where it had a comparative advantage while engaging in international trade in order to acquire those products in which it does not have a comparative advantage.

Ricardo's theory of comparative advantage attempted to prove, using a simple numerical example, that international trade is always beneficial. Paul Samuelson called the numbers used in Ricardo's numerical example dealing with trade between England and Portugal the "four magic numbers".

MAJORCONTRIBUTIONSTOECONOMICS:

Ricardo's most famous work is his **PrinciplesofPoliticalEconomyandTaxation(1817).** Ricardo opens the first chapter with a statement of the labour theory of value and the second the chapter on the theory of rent, which are the major works and contributions of Ricardo to the discipline of economics.

THETHEORYOFVALUE:

The labour theory as an explanation for value contrasts with the subjective theory of value, which says that value of a good is not determined by how much labour was put into it but by its usefulness in satisfying a want and its scarcity. Ricardo's labour theory of value is not a normative theory, as are some later forms of the labour theory, such as claims that it is immoral for an individual to be paid less for his labour than the total revenue that comes from the sales of all the goods he produces.

It is arguable to what extent these classical theorists held the labour theory of value as it is commonly defined. For instance, David Ricardo theorized that prices are determined by the amount of labour but found exceptions for which the labour theory could not account. In a letter, he wrote: "I am not satisfied with the explanation I have given of the principles which regulate value." Adam Smith theorized that the labour theory of value holds true only in the "early and rude state of society" but not in a modern economy where owners of capital are compensated by profit. As a result, "Smith ends up making little use of a labour theory of value.

- **THERENTTHEORY:**

The law of rent was formulated by David Ricardo around 1809, and presented in its most developed form in his magnum opus, ***ontheprinciplesofpoliticaleconomyandtaxation***. This is the origin of the term **Ricardianrent**. Ricardo’s formulation of the law was the first clear exposition of the source and magnitude of rent, and is among the most important and firmly established principles of economics. John Stuart Mill called it the **PonsAsinorum** of economics.

The law of rent states that the rent of a land site is equal to the economic advantage obtained by using the land in its most productive use, relative to the advantage obtained by using marginal (i.e. the best rent free) land for the same purpose, given the same inputs of labour and capital. Ricardian rent should not be confused with contract rent, which is the actual payments tenants make for use of the properties of others. Rather the law of rent refers to the economic returns that the land should accrue for its use in production. Being a political economists Ricardo was not just referring to land in terms of soil. He was primarily interested in the economic rent (The portion of income paid to a factor of production in excess of its opportunity cost) and location value associated with private appropriation of any factor of production. The law of rent applies equally well to urban land and rural land, as it is a fundamental principle of economics.

Ricardo noticed that the bargaining power of labourers can never dip below the produce attainable on the best available rent-free land is known as the margin of production. Since landlords have a monopoly over a given location, the only limiting factor for rent is the margin of production

This law has a number of important implications, perhaps the most important being its implication for wages. The law of Rent implies that wages bear no systematic relationship to the productivity of labour, and are instead determined solely by the productive capacity of marginal land, as all production in excess of that amount will be appropriated by landowners in rent.

The law of rent makes it clear that the landowner has no role in setting land rents. He simply appropriates the additional production his more advantageous site makes possible, compared to marginal sites. The law also verifies the claim by Adam Smith that the landowner cannot pass on the burden of any cost such as land value taxes to his tenants, as long as such taxes truly do not bear down upon improvements and affect the relative productivity of his land compared to marginal land. For this to be true the tax must be levied on the rental value of land and not the rental income after it is taken by the landlord, otherwise landlords will be less inclined to rent.

JEAN-BAPTISTE SAY

THE MAN

Jean-Baptiste Say (1762- 1832) was a Frenchman who popularized Adams Smith's ideas on the European continent. In France, Say was considered by himself as the interpreter and the moderniser of Smith's thought. His major work, A Treatise on Political Economy, was published in 1803. Say's career was temporarily blocked because Napoleon was displeased with his extreme laissez-faire views. Sometime after Napoleon's defeat at Waterloo, Say became a professor of political economy, after having spent numerous years in business.

CONTRIBUTIONS TO ECONOMICS

A. SAY'S LAW

Say's chief claim to fame rest on his theory that general overproduction is impossible and this is known as the Say's law. The law states that the production of goods creates its own demand.

In 1803, John-Baptiste Say explained his theory.

"It is worthwhile to remark that a product is no sooner created than it, from that instant, affords a market for other products to the full extent of its own value." **(J. B. Say, 1803: pp.138–9)**

This view suggests that the key to economic growth is not increasing demand, but increasing production. Say's views were expanded on by classical economists, such as James Mill and David Ricardo. John Maynard Keynes summarized Say's law in his 1936, *General Theory of Money*, "From the time of Say and Ricardo the classical economists have taught that **supply creates its own demand..**."

The earliest statement of this idea can found in the writings of Smith's instructor, Frances Hutcheson. Smith himself implied such a law and specifically stated, "A particular merchant, with abundance of goods in his warehouse, may sometimes be ruined by not being able to sell them in time, [but] a nation is not liable to the same accident." The idea was put most succinctly by James Mill in 1808: "If a nation's power of purchasing is exactly measured by its annual produce . . . the more you increase the annual produce , the more by that very act you extend the national market, the power of purchasing and the actual purchases of the nation." But Say also expressed this idea, and Keynes later attributed it to him. As a result it became Say's law. Let us listen to Say:

Should a tradesman say, "I do not want other products for my woollen, I want money," . . . he may be told. You say you only want money; I say, you want other commodities, and not money. For what, in point of fact, do you want money? Is it not for purchase of raw materials or stock for your trade, or of victuals for your support? Wherefore, it is products that you want, and not money. "

In Say’s language, “products are paid for with products” (1803: p. 153) or “a glut can take place only when there are too many means of production applied to one kind of product and not enough to another.”(1803: p. 178-9). Explaining his point at length, he wrote that; “it is worthwhile to remark that a product is no sooner than it, from that instant, affords a market for other products to full extent of its own value. When the producer has put the finishing hand to his product, he is most anxious to sell it immediately, lest its value diminish in his hands. Nor is he less anxious to dispose of the money he may get for it; for the value of money is also perishable. But the only way of getting rid of money is in the purchase of some product or other. Thus the mere circumstance of creation of one product immediately opens a vent for other products. (J.B Say, 1803: pp. 138-9)

He further wrote , that is not the abundance of money but the abundance of other products in general that facilitates sales: money performs but a monetary function in this double exchange; and when the transaction is finally closed, it will always be found that, one kind of commodity has been exchanged for another. Say’s law is the principle that supply creates its own demand or supply constitutes demand. Or, in the words of Say “… a product is no sooner created, than it, from that instant, affords a market for other products to full extent of its value.”

According to Say’s law, supply creates its own demand. When an economy produces a certain level of real GDP, it also generates the income needed to purchase that level of real GDP. In other words, the economy is always capable of demanding all of the output that its workers and firms choose to produce. Hence, the economy is always capable of achieving the natural level of real GDP

Explaining Say’s Law

Why does supply create its own demand?

If a businessman produces a good, then he will be keen to sell it. This production creates wages for workers and income for the businessman. Therefore, the production has increased wealth and leads to demand for other goods. Say argued it was irrational to hoard money because ***“he is most anxious to sell it immediately, lest its value should diminish in his hands*”** i.e. inflation may reduce the value of cash. This theory assumes that markets clear and that, businessmen produce goods that are demanded by the market.

The revenues of the productive agents enter the cost of production but do not determine it; the value of output independently determined in the market goes entirely to the owners of the productive services. The above consideration led to the formulation of Say's law and to the view that the sum of all distributed revenues is equal to that of the value of total output.

The production of a good implies the creation of a demand of equal value, through the revenues of the owner of the three elements of production: The sum of the revenues of all the individuals which make up a nation makes up the revenue of that nation. It is equivalent to the gross value of all her products. (Ibid., p. 359; see also p. 327)

Goods are of course exchanged for money and not directly for other goods. It is also true that individuals are anxious to get rid of money in order to obtain commodities; money is just the way in which value is expressed and the medium of exchange. Some sectors may experience difficulties in selling their products, but there can be no generalised crisis due to lack of purchasing power in the overall economy. The most convincing description by Say of the impossibility of a general lack of purchasing power is found in the famous chapter (XV of Book I) entitled, Of Markets. This reiterates money's intermediary role in exchanges of products and that in fact, 'the purchase of a product cannot take place that with the value of another product' (ibid., p. 140).

<u>Implications of Say's Law</u>

- The economy should always be close to full employment. There shouldn't be demand deficient unemployment.
- According to classical economists, any unemployment must be due to wages being artificially kept above the equilibrium level or structural factors, such as, lack of skills in specific industries.
- To increase output, we should concentrate on increasing production rather than demand.

B. VALUE THEORY, COSTS OF MONOPOLY, AND ENTREPRENEURSHIP

Say opposed the labour theory of value of the classical school, replacing it with supply and demand, which in turn are regulated by cost of production and utility. Thus in some respect his analysis is more advanced than that of Ricardo. Say's discussion of demand and supply, however, did not include development of schedules showing price-quantity relationship as did that of Marshall. Instead the terms supply and demand are used loosely and imprecisely.

Say contributed to the modern theory of costs of monopoly by pointing out such monopolists not only create what today we today we call today we call efficiency losses (or deadweight losses) but also use scarce resources in their competition to obtain and protect their monopoly positions.

Say also contributed to economic thought by emphasizing entrepreneurship as a fourth factor of production along with the more traditional ones of land, labour and capital. He coined the term entrepreneurship to describe an economic agent independent from the landlord, worker or even capitalist (since the entrepreneur may secure financing from others).

Say wrote his TREATISE to counter the Mercantilist doctrine that money is the source of wealth. According to Say, goods buy goods, and money mediates the transaction: “it is not the abundance of money but the abundance of other products in general that facilitates sales”.

CONCLUSION

Although challenged by Malthus, Sisimondi, and Marx, Say’s law continued to dominate economic thinking until Keynes highlighted its weakness in 1936. But although Smith, James Mill, and Say were wrong in assuming that the economy always tends towards full employment, there is a certain long-run validity to this doctrine. Underdeveloped economies are characterized by low output and corresponding low income payments to people. As an economy grows, it simultaneously generates an increased supply of goods and increased payments to the factors of production, which in turn generates an increased in demand for goods. Similarly, in international trade as a country produces more, it can export more, and it can therefore afford to import more. In both domestic and foreign trade, “supply creates its own demand” in the long run. This principle does not hold true, however, in the short run in market based economies. Even though payments to factors of production would be enough to buy all the goods produced, there is no guarantee that the recipients of these income payments will spend them on the existing output.

THOMAS ROBERT MALTHUS

INTRODUCTION

Rev. Thomas Robert Malthus is arguably the most misunderstood economist of all time. The adjective ‘Malthusian’ is used today to describe a pessimistic prediction of a lock step demise of a humanity doomed to starvation via overpopulation. Malthus was born on 13th February 1766 at Great Britain and died on the 23rd of December 1834.

Malthus was interested in everything about population. He accumulated figures on births, deaths, age of marriage, child bearing and economic factors contributing to longevity. His main contribution was to highlight the relationship between food supply and population. Humans do not overpopulate till the point of starvation, he contended, only because people change their behaviour in the face of economic incentives.

THE MALTHUSIAN POPULATION THEORIES

Two centuries ago, Thomas Malthus was convinced humans were growing much faster than were their sources of food, he calculated. More specifically, he came out with the idea that human population was rising geometrically (thus by multiples- 2, 4, 8, 16, 32…..).While the food available to them was growing arithmetically (thus by addition- 2, 4, 6, 8……). As Malthus himself said in his 1798 Essay on the principle of population, man needs food in order to survive, and man is multiplying at a rapid rate. He concluded: ***"I say that the power of population is indefinitely greater than the power in the earth to produce subsistence for man. Population, when unchecked, increases in a geometrical ratio. Subsistence only increases in an arithmetical ratio. A slight acquaintance with the numbers will show the immensity of the first power in comparison with the first".***

In his eyes, the human race was heading for inevitable crunch. Unless it voluntarily cut its birth rate which he taught was inconceivable, the human race will would suffer one of three unpalatable checks imposed by nature to keep it at certain sustainable limit; famine, disease or war. People will be unable to eat, succumb to some plaques or another, or fight each other for increasingly scarce resources.

Malthus argued that it's not surprising that people thus choose to check population growth. People can increase food production, Malthus thought, only by slow, difficult methods such as reclaiming unused land; but they can check population growth more effectively by marrying late, using contraceptives, emigrating, or in more extreme circumstances, resorting to reduced health care, tolerating vicious social diseases or impoverished living conditions, warfare, or even infanticide. Malthus was fascinated not with the inevitability of human demise, but with why humans do not die off in the face of overwhelming odds.

A worm-view into his observations will reveal an irrefutable and simple illustrative side by side comparison of an arithmetic and geometric series,-food increases more slowly than population, he is usually taken out of context. The observation is indeed so stark that it is still easy to lose sight of his actual conclusion ***that because humans have not all starved, economic choices must be at work***, and it's the job of an economist to study these. His work on population is still used today by various experts who advocate the necessity of controlling the size of the world population. This idea has been adopted by many environmental movements to illustrate the sustainability of the human race.

JEREMY BENTHAM

Bentham (15th February 1748 – 6th June 1832) was born in Houndsditch, London, into a wealthy Tory family. He attended Westminster School and, in 1760, at age 12 was sent by his father to The Queen's College, Oxford where he completed his Bachelor's degree in 1763 and his Master's degree in 1766. His father and grandfather were lawyers in the city of London, and his father intended for him to follow and surpass them as a practicing lawyer. Jeremy Bentham was a British philosopher, jurist, and social reformer. He is regarded as the founder of modern utilitarianism. Bentham became a leading theorist in Anglo-American philosophy of law, and a political radical whose ideas influenced the development of welfarism. He has also become known in recent years as an early advocate of animal right. Bentham(1748-1832) argued in favor of individual and economic freedom, including freedom of expression, animal rights, the end of slavery, the abolition of the death penalty, the abolition of physical punishment (including that of children), the right to divorce, free trade, and no restrictions on interest rates, equal rights for women, and the decriminalizing of homosexual acts. Among his many proposals for legal and social reform was a design for a prison building he called the panopticon.

Animal Rights

Bentham argued that the ability to suffer, not the ability to reason, should be the benchmark, or what he called the" insuperable line." If reasons alone were the criterion by which we judge who ought to have right, human infants and adults with certain forms of disability might fall short. Bentham made it clear that he accepted that animals could be killed for food, or in defense of human life, provided that the animal was not made to suffer unnecessarily.

Gender and Sexuality

Bentham said that it was the placing of women in a legally inferior position that made him choose the career of a reformist. He spoke of complete equality between sexes. Bentham does not believe homosexual acts to be unnatural, describing them merely as "irregularities of the venerable appetite."

Recall that while using the water/diamond paradox comparison as an example, Adam Smith rejected the notion that utility or use-value could be systematically linked to exchange value. However, Bentham proponents of utility theory of value held that it was not the total utility of a commodity that determined its exchange value, but rather its "marginal" utility or the additional utility derived from a small, marginal increase in the commodity. Bentham (1748-1832) refuted Smith's water/diamond illustration by pointing out that it was not a question of abundance so much as it was a question of circumstance. At times water can be highly valuable and worth a lot in exchange, especially when a man is very thirsty. Hence, the value was concluded to be highly circumstantial, and the value's comparative analysis was most accurately conducted by using the principle of marginal utility.

In 1780, Jeremy Bentham published a book titled “An Introduction to the Principles of Morals and Legislation”. He was most noted for his idea of the principle of utilitarianism based on the idea of man seeking for his own greatest happiness. Viewing human beings as being fundamentally individualistic and essentially lazy, He introduced the idea for the "natural" governance of mankind under two sovereign masters: pleasure and pain and asserted that all human motivation can be reduced to the single principle of a desire to maximize one's utility.

In specific, He said: "all human activity springs from the desire to maximize pleasure." Since any kind of work, for example, could give pain, all work was undertaken with calculation of the potential returns of both pleasure and pain. Hence, the key for human welfare and happiness was the calculation of individual pleasure.

The central theme of Bentham’s thought is called “Utilitarianism,” or the principle of the greatest happiness.

Utilitarian is basically the theory that the right course of action is the one that maximises happiness and reduces suffering. His idea of utilitarianism was based on the concept of psychological hedonism, the idea that pleasure and pain were the motivation for all human action and the view that every individual exhibit a natural and rational self-interest. Bentham argued that the right act or policy was that which could cause “the greatest happiness for the greatest number”. That is to say most people pursue things that provide pleasure and avoid things that produce pain. According to him, if an individual pursue only personal pleasure, will this action promote the general happiness of the society? He thought not necessarily, however he had his own methods of compelling individuals to promote the general happiness. He argues that the concept of the individual pursuing his or her own happiness cannot be necessarily declared “right” because often these individual pursuits can lead to greater pain and less pleasure for a society as a whole. The rule of law establishes sanctions to punish individuals who in their own pursuit of pleasure harm others excessively. He also suggested a procedure for estimating the moral status of any action, which he called the Hedonistic or Felicific calculus. In his exposition of the felicific calculus, He proposed a classification of 12 pains and 14 pleasures, by which we might test the "happiness factor "of any action.

Nature has placed mankind under the governance of two sovereign masters, pain and pleasure. It is for them alone to point out what we ought to do, as well as to determine what we shall do. On the other hand the standard of right and wrong, the chain of causes and effects, are fastened to their throne. They govern us in all we do, in all we say, in all we think.

Bentham's An Introduction to the Principles of Morals and Legislation focuses on the principle of utility and how this view of morality ties into legislative practices. His principle of utility regards "good" as that which produces the greatest amount of pleasure and the minimum amount of pain and evil as that which produces the most pain without pleasure. He laid down a set of criteria for measuring the extent of pain or pleasure that a certain decision creates. The criteria are divided into categories of intensity, duration, certainty, proximity, productiveness, purity and extent. Using this measurement, he reviews the concept of punishment and when it should be used as far as whether a punishment will create more pleasure or more pain for a society.

CRITICISMS

Bentham's philosophy and economics have been widely criticized on both philosophical and economic grounds. Assessments of pleasure and pain are subjective; they vary from person to person. His theory of the greatest happiness for the greatest number of people required making interpersonal comparisons. To make such comparisons would necessitate the precise measurement of utility in a cardinal form. That is, utility must be measured in units that can be added, subtracted, multiplied, and divided, just as cardinal numbers 1 through 10. According to some philosophers the goal of a "good" is more than seeking out pleasure. As John Stuart Mill said "It is better to be a human being dissatisfied than a pig satisfied; better to be Socrates dissatisfied than a fool satisfied." George Bernard Shaw said "Happiness is not the object of life: life has no object: it is an end in itself: and courage consists in the readiness to sacrifice happiness for an intense quality of life."

Finally, many people deny the idea that every society and every government should promote the greatest happiness for the greatest number of people. Plato taught in his Academy that pleasure is subordinate in value to knowledge and that it should be a by- product of successful achievement. Thomas Hobbes (1588-1679) held that humans have a fundamentally depraved nature that drives them towards war, strife, and the self-appropriation of all that they can lay their hands on; therefore a strong and absolute government is necessary to keep them in check. John Locke did not believe that every good is a moral good, and found in people a social bent and sense of obligation that would bind them together where no restraint of law existed.

JAMES MILL (1773-1836)

James Mill was born on 6 April 1773 at Northwater Bridge in the county of Forfarshire in the parish of Logie Pert in Scotland. His father, James Milne, was a shoemaker and small farmer of modest means who was quiet, mild-mannered, and devout. His mother, Isabel Fenton Milne, was a more forceful figure. Determined that her first-born son should get ahead in the world, she changed the family name from the Scottish "Milne" to the more English-sounding "Mill," and kept young James away from other children, demanding that he spend most of his waking hours immersed in study. He was prominent as a representative of philosophical radicalism, a school of thought also known as Utilitarianism, which emphasized the need for a scientific basis for philosophy as well as a humanist approach to politics and economics. His eldest son was the celebrated Utilitarian thinker John Stuart Mill. He distinguished himself as a Greek scholar at the University of Edinburgh. He was a Scottish philosopher, historian, and economist.

In October 1798, he was ordained as a minister of the Church of Scotland, but met with little success. He soon turned to teaching, however, and embarked on historical and philosophical studies. In 1802 he went to London to devote himself to a career in journalism. In 1804 he wrote a pamphlet on the corn trade, arguing against a bounty on the exportation of grain, and in 1806 he began his History of British India. Mill became acquainted with Jeremy Bentham, who founded Utilitarianism, in 1808. As Bentham's chief companion and ally for many years, he adopted Bentham's principles in their entirety and did more to propagate them and to oppose the beginnings of Romanticism than anyone else.His Elements of Political Economy (1821), an especially precise and lucid work, summarizes the views of the philosophical radicals, based primarily on the work of the economist David Ricardo. He was a regular contributor (1806–18) to the *Anti-Jacobin Review*, the *British Review,* the *Eclectic Review,* and the *Edinburgh Review*.

In 1811 he helped edit the periodical *Philanthropist* with the English writer William Allen, contributing his opinions on education, freedom of the press, and prison discipline. He also participated in the discussions that led to the founding of London University in 1825. In 1814 Mill undertook to write various articles on politics, law, and education for the six-volume Supplement to the 4th, 5th, and 6th editions of the *Encyclopaedia Britannica.* As reprints they enjoyed a wide circulation in his time. One of the articles, "government," had considerable influence on public opinion in the 1820s

In 1819, two years after Mill's *History of British India* appeared, he was appointed an official in India House, despite his drastic criticisms in the *History* of British rule in India. He rose gradually through the ranks until he was appointed head of the examiner's office in 1830. Mill was also influential in English politics.

THE CORN LAWS

The background to Mill's pamphlet, like the Corn Laws themselves, is rather complex. One sign of the structural changes in the British economy associated with the industrial revolution was that towards the end of the eighteenth century Britain became a net importer of corn in contrast to her net exporter position at the beginning of the century. Although domestic agriculture had expanded by means of enclosure, cultivation of waste land, and improvement of farming methods, the expansion was not sufficient to keep pace with the growth of population and of the manufacturing sector. Together with this secular change, and to some extent confused with it, were periodic crises brought on by poor harvests and exacerbated by the hindrance to foreign supplies during the Napoleonic Wars.

The CornLaws were trade laws designed to protect cereal producers in the United Kingdom of Great Britain and Ireland against competition from less expensive foreign imports between 1815 and 1846. To ensure that British landowners reaped all the financial profits from farming, the corn laws imposed steep import duties, making it too expensive for anyone to import grain from other countries, even when the people of Great Britain and Ireland needed the food (as in times of famine).

"Corn" included any grain that requires grinding, especially wheat. The laws were introduced by the Importation Act 1815 and repealed by the Importation Act

The political issue was a dispute between landowners (a long-established class, who were heavily represented in Parliament) and the new class of manufacturers and industrialists (who were not). The former desired to maximize their profits from agriculture by keeping the price at which they could sell their grain high. The latter wished to maximize their profits from manufacture by reducing the wages they paid to their factory workers—the difficulty being that men could not work in the factories if a factory wage was not enough to feed them and their families; hence, in practice, high grain prices kept factory wages high also.

The Corn Laws enhanced the profits and political power associated with land ownership. Their abolition was a significant increase of free trade.

Corn Laws were regulations in England governing the export and import of grain, all kinds of which were called corn. The best known of the Corn Laws were those from the 12th to the middle of the 19th century. The laws were originally government attempts to make sure there would be enough grain to feed the people. When grain production eventually increased to the point where it was possible to sell some to other countries, the government allowed but strictly regulated such sales except in time of shortage. Eventually the Corn Laws were used to protect farmers from losing sales because of cheaper grain shipped in from other countries. This was done by charging very high import duties.

THE ESSAY ON GOVERNMENT

Mill's modern reputation as a political theorist rests on a single essay. The *Essay on Government*, Government, Mill maintains, is merely a means to an end, viz. the happiness of the whole community and the individuals composing it. We should begin by assuming that every human being is motivated by a desire to experience pleasure and to avoid pain. Pleasures and pains come from two sources, our fellow human beings and nature. Government is concerned directly with the first and indirectly with the second: "Its business is to increase to the utmost the pleasures, and diminish to the utmost the pains, which men derive from one another. Nature and human nature combine to make government necessary. It is man's nature not only to desire happiness but to satisfy that desire by investing as little effort as possible. Labour being the means of obtaining happiness, and our own labour being painful to us, we will, if permitted, live off the labour of others. To the degree that others enjoy the fruits of my labour, my primary incentive for working—namely my own happiness—is diminished if not destroyed.

Therefore, Mill continues, the primary problem in designing workable political institutions is to maximize the happiness of the community by minimizing the extent to which some of its members may encroach upon, and enjoy, the fruits of other people's labor. This cannot happen, Mill maintains, in a monarchy (wherein a single ruler exploits his subjects) or in an aristocracy (wherein a ruling elite exploits the common people). Nor can communal happiness be maximized in a direct democracy, since the time and effort required for ruling would be subtracted from that available for engaging in productive labour (Mill 1992, 7–9). The only system that serves as a means to the end of individual and communal happiness is representative democracy, wherein citizens elect representatives to deliberate and legislate on their behalf and in their interest. The problem immediately arises, however, as to how representatives can be made to rule on the people's behalf rather than their own. Mill's answer is that frequent elections and short terms in office make it unlikely that elected representatives will legislate only for their own benefit. After all, representatives are drawn from the ranks of the people to which they can, after their term in office ends, expect to return. Given what we might nowadays call the incentive structure of representative government, representatives have every reason to promote the people's interests instead of their own. Indeed, in a properly structured system, there will be an “identity of interests” between representatives and the electorate (Mill 1992, 22).

KARL HEINRICH MARX

INTRODUCTION:

The worker becomes all the poorer the more wealth he produces, the more his production increases in power and range. The worker becomes an ever cheaper commodity the more commodities he creates. These are the words of theGerman philosopher, economist, sociologist, historian, journalist, and revolutionary socialist, Karl Heinrich Marx in his economic and philosophy manuscript, 1844. Karl Marx is without a doubt the most influential socialist thinker to emerge in the 19th century. Born into a wealthy middle-class family in Trier in the Prussian Rhineland on 5th May 1818, Marx studied at the University of Bonn and the University of Berlin, where he became interested in the philosophical ideas of the Young Hegelians. After his studies, he wrote for a radical newspaper in Cologne, and began to work out his theory of dialectical materialism. He moved to Paris in 1843, where he began writing for other radical newspapers and met Fredrick Engels, who became his lifelong friend and collaborator.

Marx occupied himself primarily with describing capitalism. As a prophet of doom for capitalism and chief saint in communist hierarchy, he called capitalism the "dictatorship of the bourgeoisie," believing it to be run by the wealthy classes for their own benefit; and he predicted that, like previous socioeconomic systems, capitalism produced internal tensions which would lead to its self-destruction and replacement by a new system: socialism.

In his book titled Capital, Marx elaborated his version of the labour theory value and his conception of surplus value and exploitation which would ultimately lead to a falling rate of profit in the collapse of industrial capitalism.

CONTRIBUTION OF KARL MARX

Theory of Surplus Value

Surplus value is a concept written about by Karl Marx. Although Marx did not himself invent the term, he developed the concept. It refers roughly to the new value created by workers that is in excess of their own labour-cost and which is therefore available to be appropriated by the capitalist. A worker who is sufficiently productive can produce an output value greater than what it costs to hire him. Although his wage seems to be based on hours worked, in an economic sense this wage does not reflect the full value of what the worker produces. Effectively it is not labour which the worker sells, but his capacity to work.

Imagine a worker who is hired for an hour and paid $10. Once in the capitalist's employ, the capitalist can have him operate a boot-making machine using which the worker produces $10 worth of work every fifteen minutes. Every hour, the capitalist receives $40 worth of work and only pays the worker $10, capturing the remaining $30 as gross revenue. Once the capitalist has deducted fixed and variable operating costs of (say) $20 (leather, depreciation of the machine, etc.), he is left with $10. Thus, for an outlay of capital of $30, the capitalist obtains a surplus value of $10; his capital has not only been replaced by the operation, but also has increased by $10.

The worker cannot capture this benefit directly because he has no claim to the means of production (e.g. the boot-making machine) or to its products, and his capacity to bargain over wages is restricted by laws and the supply/demand for wage labour. Hence the rise of trade unions which aim to create a more favorable bargaining position through collective action by workers.

MARXIST RATIO

On the theory of growth, the gross output of an economy is composed of 3 elements.

Variable capital: this is defined as advances to labour i.e. total wage payment.

Constant capital: this is composed of the plants and raw material used up in production.

Surplus Value: value added to in production. To Marx, the amount of profit is equal to the absolute amount of surplus which arises because the worker does not receive the entire value of his MP in wages.

Marx described the following 3 ratios with regards to the component of total output.

1. The rate of surplus value or rate of exploitation: this is calculated by dividing the surplus value (s) by the variable capital (v) i.e. $\frac{s}{v}$.
2. The rate of profit: this is calculated by dividing the surplus value (s) by the addition of variable capital (v) and constant capital (c) i.e. $\frac{s}{c+v}$
3. The organic composition of capital: this is calculated by dividing the constant capital (c) by variable capital (v). $\frac{c}{v}$. He added that with time the organic composition of capital will rise.

GENERAL PHILOSOPHY OF THE CLASSICAL ECONOMISTS

The fundamental principle of the classical theoryis that the economy is self-regulating. Classical economists maintain that the economy is always capable of achieving the natural level of output, which is the level of output that is obtained when the economy's resources are ***fully employed***. While circumstances arise from time to time that cause the economy to fall below or to exceed the natural level of output, self-adjustment mechanismsexist within the market system that work to bring the economy back to the natural level of output.

The Classical school believes that markets work best when they are left alone, and that there is nothing but the smallest role for government. The approach is firmly one of laissez-faire and a strong belief in the efficiency of free markets to generate economic development. Markets should be left to work because the price mechanism acts as a powerful 'invisible hand' to allocate resources to where they are best employed.

Classical economists claimed that free markets regulate themselves, when free of any intervention. Adam Smith referred to a metaphorical "invisible hand," which will move markets towards their natural equilibrium, without requiring any outside intervention.

The classical economists produced their "magnificent dynamics" during a period in which capitalism was emerging from feudalism and in which the industrial revolution was leading to vast changes in society. These changes raised the question of how a society could be organized around a system in which every individual sought his or her own (monetary) gain. Classical political economy is popularly associated with the idea that free markets can regulate themselves.

The classical doctrine—that the economy is always at or near the natural level of real GDP—is based on two firmly held beliefs: Say's Law and the belief that prices, wages, and interest rates are flexible. According to Say’s law, supply creates its own demand. When an economy produces a certain level of real GDP, it also generates the income needed to purchase that level of real GDP. In other words, the economy is always capable of demanding all of the output that its workers and firms choose to produce. Hence, the economy is always capable of achieving the natural level of real GDP. The flexibility of the interest rate as well as other prices is the self-adjusting mechanism of the classical theory that ensures that real GDP is always at its natural level. The flexibility of the interest rate keeps the money market, or the market forloadable funds, in equilibrium all the time and thus prevents real GDP from falling below its natural level. Similarly, flexibility of the wage rate keeps the labour market or the market forworkers, in equilibrium all the time. If the supply of workers exceeds firms' demand for workers, then wages paid to workers will fall so as to ensure that the work force is fully employed. Classical economists believe that any unemployment that occurs in the labour market or in other resource markets should be considered voluntary unemployment**.** Voluntarily unemployed workers are unemployed because they refuse to accept lower wages. If they would only accept lower wages, firms would be eager to employ them.

Classical economics indicates that full employment is achieved and maintained without the need for government intervention and that government intervention is more likely to cause than to correct macroeconomic problems.

In terms of explaining *value*, the focus of classical thinking was that it was determined mainly by scarcity and costs of production.

In terms of the macro-economy, the Classical economists assumed that the economy would always return to full-employment level of real output through an automatically self-adjustment mechanism.

MAJOR TENETS OF THE CLASSICAL SCHOOL

The major tenets of this classical school can be summarized as follows:

- Minimal government involvement. The first principle of the classical school was that the best government governs the least. The forces of free, competitive market would guide production, exchange and distribution. The economy was held to be self-adjusting and tending toward full employment without government intervention. Government activity should be confined to enforcing property rights, providing for national defense, and providing public education

- Self-interested economic behavior. The classical economists assumed that self-interested behavior is basic to human nature. Producers and merchants provide goods and services out of the desire to make profit; workers offered their labor services to obtain wages, and consumers purchased products as a way to satisfy their wants.
- Harmony of interests. With the important exception of Ricardo, the classicists emphasized the natural harmony of interest in a market economy. By pursuing their own individual interests, people serve the best interests of society.
- Importance of all economic resources- land, labor, capital and entrepreneurial ability- as well as all economic activities- agriculture, commerce, production and international exchange- contributes to a nation's wealth. The mercantilists had said that the wealth was derived from commerce; the physiocrats had the viewed land and agriculture as the source of all wealth.
- Economic laws. The classical school made tremendous contributions to economics by focusing analysis upon explicit economic theories or "laws". Examples include the law of comparative advantage, the law of diminishing returns, the Malthusian theory of population, the law of markets (Say's law), the Ricardian theory of rent, the quantity theory of money, and the labour theory of value. The classicists believed that the laws of economics are universal and immutable.