

LECTURE 5: CLASSICAL POLITICAL ECONOMY

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Introduction

- From the period 0-1700 there was limited improvement in living standards.
 - This often described as the Malthusian era.
- It was only from the late 18th century that economic growth (capitalist development) began to take off.
 - Revolutions in production, distribution and exchange
- Classical political economists were interested in explaining this divergence.
 - What interested them was the development of commerce

Adam Smith (the labour theory of value)

- The essential starting point for growth and productivity improvements is the ***division of labour***.
 - *The manufacture of a pin or a watch.*
- Dividing up the production process into different stages.
 - *Skill specialization (dexterity, tacit knowledge, judgment)*
- Skill specialization leads to a diversified economy
 - *Mutually dependent laborers co-operating freely in a process of exchange.*

Adam Smith (2)

- The division of labour is wealth improving when the market is bigger:
 - *Large markets increase the incentive to specialize and trade*
- Large markets are made possible by
 - *Trust*
 - *Good government*
 - *Free trade*
- Individual “self-love” gives rise to trade and barter
 - The wealth of a nation comes from commercial expansion (which is dependent on labour specialization).

Adam Smith (division of society)

- The labour theory of value divides society into three classes of persons:
 - Landowners, wage-earners and capitalists
- Those who live by rent, wages and profit.
- The hero in Smith's tale of wealth accumulation (told in 4 historical stages) is the capitalist entrepreneur.
- Prudence (the desire to save) rather than greed is considered the core virtue.
 - Think Max Weber and the Protestant Ethic.

Adam Smith (on government)

- Governments should get out of the way of commerce
 - But what he is referring to is **feudalism** and mercantilism
- The role of government is to:
 - Administer justice
 - Provide security
 - Defend property
 - Build infrastructure
 - Provide public education
 - and other services

David Ricardo

- The principal problem of political economy:
 - sharing national income between rent, profit and wages
- This division is the outcome of the workings of commercial system:
 - Landowners, workers and capitalists
- Ricardo is deeply concerned about the rise and fall of *real wages* (purchasing power) as a % of national income.
 - He is concerned too much of national income is going to rent

Ricardo (on comparative advantage)

- Most famous for his theory on *comparative advantage*:
 - A nation should specialize in those industries where it has comparative advantage (exporting steel)
 - It should import those goods that it no longer specializes in at home (importing wine).
 - Open international trade for exchange (liberalize)
- What does the US specialize in? China? Ireland?

Ricardo (on rising rents)

- In the *Principles* Ricardo is concerned with:
 - the long term evolution of *land prices* and *land rent*
- His **scarcity principle** states:
 - Once population and output grows, land will become more scarce. Land prices will then increase. This implies higher rents for landowners. Landowners claim a growing share of national income.
- His scarcity principle is important for understanding why certain prices might rise to very high levels.
 - Think about this in relation to housing in Dublin today.

Discussion

- Adam Smith once wrote:

“in times of necessity the people will break through all laws. In a famine they will break open the granaries and force the owners to sell at what they think is a reasonable price”

Discuss. When do prices become destabilizing?

What is a reasonable ‘price’ for housing? Third level education?

Conclusion

- Classical economics coincided with a growing interest in the political theory of *economic liberalism*
 - *This is why it is called political economy*
- It is usually associated with “the hidden hand” of the market and a defence of free trade.
- But what really united these scholars was the **labour theory of value** (which Marx borrowed in total)