

The background of the slide is a collage of economic symbols. On the left, a US quarter coin is partially visible, showing the Presidential Seal and the words 'LIBERTY' and 'IN GOD WE TRUST'. In the center, a US dollar bill is visible, with the word 'LIBERTY' and the number '1' partially shown. On the right, a portrait of Adam Smith, a key figure in classical economics, is depicted. The overall color scheme is warm, with shades of gold, brown, and red.

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Early and Classical Economics

Learning Goals

Once you have completed this chapter, you should be able to:

- Understand the major ideas and economic theories of Adam Smith, Thomas Robert Malthus, David Ricardo, and Karl Marx
- Understand how economic thinking has helped change the world
- Recognize cause and consequence relationships
- Begin thinking like an economist by testing hypotheses



Key Terms

- Oikos
- Physiocrat
- laissez-faire
- Mercantilism
- Protectionist
- Tariff
- Industrial Revolution
- self-interest
- invisible hand
- division of labour
- law of accumulation
- law of population
- geometrical progression
- arithmetical progression
- positive check
- preventive check
- Corn Laws
- absolute advantage
- comparative advantage
- Bourgeoisie
- Proletariat
- labour value
- surplus value
- hypothesis



Adam Smith (1723-1790)

- Known as the “father of modern economics” as well as the “founder of capitalism.”
- Outlined the characteristics and benefits of a complete economic system in a two-volume work called *An Inquiry into the Nature and Causes of the Wealth of Nations*, published in 1776. This work, known more commonly as simply *The Wealth of Nations*, is recognized as the foundation of modern economic theory.
- **Self-interest:** Adam Smith believed that human beings are motivated primarily by the desire each of us has to better our condition in life. This means that the profit motive provides the major stimulus for economic growth and prosperity.
- **Invisible Hand:** Adam Smith’s notion that the unintended result of individual producers’ desire for profit is to supply society with the goods and services it needs, at prices consumers are willing to pay, as a result of competition.



Adam Smith (1723-1790)

- ***Division of Labour:*** The specialization of labour in a complex production process, leading to greater efficiency.
- ***Law of Accumulation:*** Adam Smith's theory that business people who invest a percentage of their profits in new capital equipment increase the economy's stock of capital goods, thus ensuring economic growth and future prosperity.
- ***Law of Population:*** Adam Smith's theory that the accumulation of capital by businesspeople requires more workers to operate the equipment, leading to higher wages, which in turn lead to better living conditions, lower mortality rates, and an increase in population.



Thomas Robert Malthus (1776-1834)

- Recognized historically as the first professional economist, Malthus challenged Adam Smith's view of ever-increasing prosperity.
- Malthus predicted poverty and famine for the masses in a book he published in 1798 called *An Essay on the Principle of Population, as It Affects the Future Improvement of Society*.
- **Population Production:** Malthus based his ideas on what he thought to be two self-evident premises. First, that food is necessary to sustain human life. And second, human sexual instinct is constant. With these two premises, Malthus argued that the population, if left unchecked, would double every 25 years, resulting in what statisticians call a **geometric progression**.
- **Food Production:** Malthus argued that food production, on the other hand, can only grow in **arithmetical progression**



Thomas Robert Malthus (1776-1834)

FIGURE 5.1

The Malthusian dilemma

A balanced economic system (in which 1 unit of food is available for 1 unit of population) naturally transforms— if left unchecked—into an economically unbalanced situation. After 10 generations (or 225 years), 512 units of population must subsist on only 10 units of food. Unless population growth is controlled, famine awaits the entire human race!

Generation	1	2	3	4	5	6	7	8	9	10
Year	1	25	50	75	100	125	150	175	200	225
Population	1	2	4	8	16	32	64	128	256	512
Food	1	2	3	4	5	6	7	8	9	10

Note: Each 25-year period refers to one generation. Each generation, the population doubles. Every 25 years, food production increases by an amount equal to the original quantity produced during the first year.

To keep this table simple, constant units of population and food production are used instead of actual figures. One unit of population might represent 1 million people, and 1 unit of food might represent enough wheat to sustain 1 unit of population from one harvest to the next.

Thomas Robert Malthus (1776-1834)

- **Positive Checks:** Malthus's theory that war, famine, and disease would check population increases to some extent, but not enough to prevent the geometrical progression of the world's population to unsustainable levels.
- **Preventive Checks:** Malthus's theory that restraints such as late marriage and sexual abstinence would help reduce the birth rate to some extent, but not enough to prevent the geometrical progression of the world's population to unsustainable levels.



David Ricardo (1772-1823)

- Ricardo lived during a period of great social conflict and political unrest in Britain. The British population grew rapidly, putting strain on food supplies.
- Where Adam Smith saw society as a family making progress, Ricardo saw clear divisions between conflicting groups. He identified three main groups in British society:
 - The working class, who lived on modest wages
 - The industrialist class, who made healthy profits by operating the factories they owned
 - The aristocratic landlord class, who received substantial rent from the land titles they held
- Ricardo argued that one group could prosper only at the expense of the others.
- **Corn Laws:** Early nineteenth-century taxes on grains imported into Britain that drove up the market price of domestic grain to the benefit of aristocratic landlords.



David Ricardo (1772-1823)

- ***Iron Law of Wages:*** Ricardo argued that, because of the working class's unchecked rate of reproduction, labour's natural wages would always remain at the subsistence level. Low wages became the figurative leg irons that shackle the working class to their slums.
- ***Theory of the Comparative Advantage of Trade:*** Ricardo was the first person to recognize and explain two key concepts related to trade:
 - ***Absolute Advantage:*** the capacity of one economy to produce a good or service with fewer resources than another.
 - ***Comparative Advantage:*** The capacity of one economy to produce a good or service with comparatively fewer resources than another (i.e. at a lower opportunity cost).



Karl Marx (1818-1883)

- According to Karl Marx, all of human history is governed by economic laws and a series of struggles between people of different social classes.
- Marx believed that people's need to eat, drink and have shelter (the "*material means of existence*") comes before other pursuits such as politics, science, art, and religion.
- Two main classes in society:
 - Bourgeoisie (industrial capitalists)
 - Proletariat (the working class)



Karl Marx (1818-1883)

- Marx, with the help of his friend Frederick Engels, published the *Communist Manifesto* in 1848, inciting all exploited workers (proletariats) to rise up against their oppressors (bourgeoisie)
- *Capital (or Das Kapital*, in the original German text), was Marx's most comprehensive work, published in three volumes. In his complex analysis, Marx predicted that capitalism would ultimately destroy itself.
- According to Marx, the international communist revolution would begin in the most industrialized countries of Western Europe, where capitalism was strongest and where workers were exploited most severely), and then would spread throughout the world. The overthrow of capitalism would lead to international socialism based on common ownership of land and capital. Socialism, once fully evolved, would be transformed into its ideal state of communism: a worker-governed society based on the founding principle "from each according to ability, and to each according to need."



Karl Marx (1818-1883)

- ***The Labour Theory of Value:***

- For Marx, the value of any item is calculated by totaling the value of all labour used in its production. Marx refers to this as ***Labour Value***. It includes the direct labour supplied by the workers in the manufacturing process, as well as the amount of indirect labour embodied in the machinery and buildings used in the manufacturing process.
- In a capitalist system, workers receive only a portion of what their labour is worth. The difference, which Marx called ***Surplus Value***, is stolen from the worker in the form of profit for the capitalist.

