

Module 2

Classical Thought

(Lectures 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14 and 15)

Topics

2.1 Adam Smith I

2.1.1 Smith's analysis of market

2.1.2 The nature and causes of the wealth of nations

2.2 Adam Smith II

2.2.1 International Trade

2.2.2 Value theory

2.2.2.1 Relative prices

2.2.2.2 Smith on Value

2.3 Adam Smith III

2.3.1 Distribution Theory

2.3.2 Welfare

2.4 David Ricardo I

2.4.1 Ricardo's distribution theory: land rent

2.4.2 Is rent price determining or price determined?

2.5 David Ricardo II

2.5.1 Ricardo's distribution theory

2.5.2 Comparative Advantage

2.6 David Ricardo III

2.6.1 Ricardo's value theory

2.6.2 Ricardo's Monetary Theory

2.6.3 Technological Unemployment

2.7 Malthus

2.8 Mill's approach to economics

2.9 Mill on social policies: Laissez Faire or Socialism?

2.10 Mill's Value theory

2.11 Karl Marx I

2.11.1 Marx's Theory of History

2.11.2 Marx's Theory of Alienation

2.12 Karl Marx II

2.12.1 Socialism and Communism

2.13 Karl Marx III

2.13.1 Marx's Economic Theories

2.13.1.1 Marx's methodologies

2.13.1.2 Commodities and classes

2.13.2 Marx's Labor Theory of Value

2.13.3 Surplus and Exploitation

2.14 Karl Marx IV

2.14.1 Marx's Analysis of capitalism

2.14.2 The reserve army of the unemployed

2.14.3 Falling rate of profit

2.14.4 Business crises

2.14.5 The concentration of capital

2.14.6 Increasing misery of the proletariat

Module 2

Lecture 4

Topics

2.1 Adam Smith I

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2.1 Adam Smith I

2.1.1 Smith's analysis of market

- Adam Smith (1723-1790), was a typical early economics writer who did not see economics as a narrow technical theory but as a grand narrative of the society with a focus on the interrelatedness of its different parts. He was greatly influenced by his teacher Francis Hutcheson (1694-1746) and his contemporary David Hume (1711-1776).
- Attitude towards knowledge and learning during Smith's time differed sharply from those of today. The pursuit of knowledge was more interdisciplinary. Hence, people like Smith believed that it is possible to attain the rigor that is present in natural sciences.
- More like Physiocrats, Smith and other classical thinkers hoped that they can find natural laws governing the societies. But what distinguished him from many other social thinkers of the sixteenth century such as Bernard Mandeville (c. 1670-1733) was the idea that the pursuit of individual self-interest would lead to social welfare and therefore government intervention is not necessary for betterment of the masses. His argument against the protectionist argument of the mercantilist doctrines of protectionism was based on the same philosophy. His early degree in Moral philosophy from the University of Glasgow inspired him to go beyond the narrowly defined discipline of economics.

- Smith's major book is titled "An inquiry into the nature and causes of the wealth of nations (1776). Two other important books are "The theory of Moral Sentiments (1759) and "Lectures on justice, police, revenue and arms"
- Smith's main question: What constitutes wealth of nation?
- Smith's methodological contributions: Unlike Ricardo, who will come almost hundred years after Smith, he was not known for abstract modeling of economics. In the sense of abstract modeling that we find in present day economics, Smith's work was not rigorous. But he had the skill of mixing historical examples with an analytical framework.
- Smith's analysis of markets and policy conclusions:
- The major features of Smith's economics were:
 1. Contextual economic policy
 2. Natural order, Harmony and laissez faire
 3. The working of competitive markets
 4. Capital and capitalists
 5. The impact of Smith on Policy

1. Contextual economic policy:

- Theoretically, market without Govt. can produce both efficient and inefficient result depending on whether you are assuming presence of externalities or not.
- Smith put his argument in the context of the economic environment of the eighteenth century.
- Smith was not an abstract theorist but a policy formulator.

2. Natural order, Harmony and Laissez Faire

- There exists a natural order of society.
- The major assumption of Adam Smith was that competitive markets exist and within these markets factors move freely. Moreover, natural process at work in the economy can resolve conflicts more effectively than any arrangements devised by human beings.

3. The working of competitive markets

- Differentiated between two types of prices: Short term and natural price
- Movement of factors will ensure that natural price will prevail
- With competitive markets and an absence of government regulation, the resulting natural prices bring about an optimum allocation of resources in that consumers receive the goods they want at the lowest possible cost and maximum rates of growth are ensured.
- He strongly advocated against Mercantilist policy of government intervention in names of social good.
- But one needs to appreciate the qualifications attached by Smith with his argument for free market. Even Smith realized that this argument does not apply in case of sectors such as education.

4. Capital and the Capitalists

- Wealth of nation depends on capital accumulation because this is what determines the extent of the division of labor and the proportion of labor engaged in productive labor. This in turn determines overall economic development.
- Individual self-interest coupled with accumulation of capital leads to an optimum allocation of labor.
- Why is the capitalist class key to economic development? Because laborers get too little money to save and invest. Land owning class waste money on conspicuous consumption.
- An unequal distribution in favor of the capitalists is of great social importance.

5. The impact of Smith on Policy: The main policy implication Smith's theory is Laissez Faire – i.e. the policy of no government intervention in the working of market.

2.1.3 The nature and causes of the wealth of nations

- Annual labor of a nation rather than bullion and precious metal is the key.
- And end purpose of economic activities is consumption. This goes against the mercantilist who thought production is the ultimate goal of economic activities.

- What are the causes of the wealth of nations?
- Productivity of labor which depends on specialization and division of labor.
- Smith recognized that there are some costs of division of labor such as dehumanization of labor by the simple, repetitive, boring tasks they perform.
- According to Smith, wealth of nation depends on productivity of labor and ratio of productive and unproductive labor. Productivity of labor depends on the division of labor which in turn depends on the extent of market and capital accumulation. This is because the division of labor leads to mass production of commodities which is only possible in presence of a large enough market.
- The ratio of productive and unproductive labor depends on capital accumulation.
- Smith was not very clear by what he meant by unproductive and unproductive labor. According to Smith's view: labor employed for producing vendible commodities is productive service whereas labor used for producing service is unproductive. This distinction however, is ad hoc and reflects normative thinking.