

Module 2

Lecture 9

Topics

2.6 David Ricardo III

2.6.1 Ricardo's value theory

2.6.2 Ricardo's Monetary Theory

2.6.3 Technological Unemployment

2.6 David Ricardo III

2.6.1 Ricardo's value theory

- Ricardo's value theory was developed in response to the Corn Law controversy.
- Malthus argued that raising tariff is beneficial for England which Ricardo opposed. Ricardo maintained that high tariff → low rate of profit → low capital accumulation → low economic growth.
- Ricardo found that Smith's theory was unsatisfactory to counter Malthus and other protectionist arguments. Both Ricardo and the protectionists agreed that:
 1. Higher tariff would result in high money wages.
 2. Increased tariff would push down the margin as less fertile land were utilized and intensive margin would also increase.
 3. As a result cost of production would increase, money wage must increase.
- But some protectionist argue using Smith's cost of production theory of value that higher money wage would not necessarily decrease profit as increase in wage leads to increase in value.
- Some protectionists also argue that removing tariff → decrease in price → depression.

- The underlining question of Smithian and Marxian value theory was how prices are determined.
- Ricardo was not concerned about how prices are determined from value. He rather concerned about how value theory can determine changes in relative price.
- For Ricardo wage paid to labor was a measure of the necessary labor time. He could avoid circularity embedded in Smith's analysis as he was concerned with change in relative price.
- Smith and Ricardo both would agree that wage rates paid to different workers reflect their skills and hardship.
- According to them, value depends upon the quality of labor necessary for production not on the wages paid to labor. Ricardo's solution is to measure by clock hour.
- Ricardo tried to solve the problem of different skill level by saying that relative wage is measure of relative productivity.
- Does it involve the same circularity as Smith?
- Ricardo maintained that if relative skill requirement remains the same changes in the prices of final products will not be a result of the wages paid to labor. Ricardo's Assumption: Skill premium remains the same

$$\frac{P_A}{P_B} = \frac{AC_A}{AC_B} = \frac{w_A \cdot L_A}{w_B \cdot L_B} \times \frac{q_B}{q_A} \quad (1)$$

- Note that $q_i = MP_i^L$ where $i = A, B$. If skill requirement remains the same then wage ratio remains constant. In that case $\frac{P_A}{P_B} = f\left(\frac{L_A}{L_B}\right)$

2.6.2 Ricardo's Monetary Theory

- Ricardo is more famous for his distribution theory, theory of rent and trade theory. However, Ricardo made some important contribution in monetary policy debate during the Bullion Debates of 1800.
- The issue was the cause of Napoleonic wartime inflation.
- The Bullionists argued that inflation was caused by wartime expansion of money while the anti-Bullionists maintained that inflation was caused by real (i.e. non-monetary) factors such as harvest failures.
- The latter group favored Real Bills Doctrine: this doctrine says that if the monetary expansion is geared to deal with short term commercial operations (e.g. financing of inventories), money printing cannot create inflation.
- Ricardo joined the Bullionist side who were the monetarists of the nineteenth century. According to them inflation is a purely monetary phenomenon. Money is just a veil over the real economy; it cannot affect the working of real variables.
- On the other side of the debate was Henry Thornton (1760-1815) who traced how money can affect the real world through the interest rates and lending practices of the banks. However, he never got his due recognition as his opponent Ricardo was an overwhelming public figure.