Classical Political Economy

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Abstract
This essay provides a summary account of classical political economy and its
development from the late 17th to the early 19th centuries. It outlines basic
features of the classical approach to the theory of value and distribution, and
briefly reviews the ideas of major British classical political economists on: growth
and development; international trade; money and banking; economic policy,
taxation and public debt; and macroeconomic stability and crises. It then
discusses the spread of classical political economy to other countries, focusing
on the reception and development of classical economic thought in Continental
Europe, Russia and Japan against the background of different national traditions.
The essay closes with some remarks on the decline of classical political economy
in Britain in the mid-19th century and its revival in the 20th century.

The notion of a ‘classical political economy’ was first used by Karl Marx in A Contribution to
the Critique of Political Economy, where he related it to ‘the research carried on for over a
century and a half … beginning with William Petty in Britain and Pierre de Boisguilbert in
It was given a more precise meaning in vol. 1 of Capital, where he observed that ‘by classical
Political Economy, I understand that economy which … has investigated the real relations of
production in bourgeois society, in contradistinction to vulgar economy, which deals with
appearances only’ (Marx [1867] 1954: 85 n.). Marx referred to David Ricardo as ‘the last
great representative of classical economics’ (Marx [1867] 1954: 24), and from his discussion
in Theories of Surplus Value it is clear that he associated such well-known figures as John
Ramsay McCulloch and John Stuart Mill, often regarded as the British classical economists
par excellence, with the decline of classical political economy. In the secondary literature a
different characterization of ‘classical economics’ is sometimes used, and accordingly also a
different demarcation of the ‘classical’ period: the latter is associated with (roughly) 1776–
1848, placing at the centre of classical economics Adam Smith, David Ricardo and John
Stuart Mill. This definition appears to be based on an understanding of classical economics as
an ‘early and rude’ type of supply-and-demand analysis, with the demand side still in its
infancy. However, this ‘Marshallian’ interpretation of classical economic theory does not
stand up to close scrutiny, as Piero Sraffa’s ‘Introduction’ to David Ricardo’s Principles of
Political Economy and Taxation has conclusively shown (Sraffa 1951). Sraffa’s work on
Ricardo, and on the history of economic thought more generally, has indeed been of
overwhelming importance for the revival of interest in the classical approach to economic
theory in the 20th century.
Characteristic features of the classical approach

The analysis of the problems of value and distribution of the classical economists from William Petty to David Ricardo revolved around the concept of the annual social surplus. By the earlier authors this surplus was typically considered to be distributed to the propertied classes in the form of rents or profits, and used either for purposes of consumption or capital accumulation. Later authors, notably Smith and Ricardo, then discussed also the workers’ participation in the sharing out of the surplus. The surplus (or ‘neat produce’ or ‘produit net’) refers to those quantities of the different commodities that are left over after the necessary means of production have been used up and the means of subsistence in support of the workers have been deducted from the gross outputs produced during a year. In this conceptualization the necessary wage goods in support of the workers, the raw materials they work upon, and the tools and machines they work with are considered indispensable inputs in the production process. What became known as the ‘surplus interpretation’ of the classical economists is the mature classical economists’ approach to the problem of the determination of exchange values of the different commodities that can be expected to emerge from the gravitation or ‘market prices’ to their ‘natural’, ‘normal’ or ordinary levels.

In conditions of free competition – that is, in the absence of significant barriers to entry and exit in all industries – prices can be taken to oscillate around levels characterized by a uniform rate of profits on the value of the capital advanced at the beginning of the uniform production period, a uniform rate of rent for each of the different qualities of land, and a uniform wage rate for each type of labour. Piero Sraffa deserves the credit for having rediscovered and clarified the distinct analytical structure of the classical theory of production, distribution and value. The determination of the general rate of profits, the rents of lands and the corresponding system of relative prices for a given system of production in use constitutes the analytical centrepiece of classical political economy. It was designed to lay the foundation of all other economic analysis, including the investigation of capital accumulation and technical progress; of economic development and growth; of social transformation and structural change; of international trade; money, banking and finance; and of taxation and public debt.

The concern of the classical economists was the laws governing the emerging capitalist society, characterized by the stratification of society into three classes: (propertyless) workers, landowners, and the rising class of capitalists. Wage labour was the dominant form of the appropriation of other people’s capacity to work; there was an increasingly sophisticated division of labour within and between firms; economic activities were coordinated via a system of interdependent markets in which transactions were mediated through money; commodities and currencies were traded across national borders; and significant technical, organizational and institutional change was going on. In short, they were concerned with an economic system incessantly in motion. How to deal with such a complex system? The ingenious device of the classical economists to master the complexity of the modern economy consisted in the distinction between the ‘actual’ values and the ‘normal’ values of the relevant variables – the distributive rates and prices. The former were taken to reflect all kinds of influences, many of an accidental and temporary nature, about which no general propositions were possible, whereas the latter were conceived to express the persistent, non-accidental and non-temporary factors governing the economic system, which could be systematically studied.

The method of analysis adopted by the classical economists is known as the method of long-period positions of the economy (see Garegnani 1984). Any such position is the system of production towards which the economy is taken to gravitate as the result of the self-seeking actions of agents, thereby putting into sharp relief the fundamental forces at work. In
conditions of free competition the resulting long-period position is characterized by a uniform rate of profits (subject perhaps to inter-industry differentials reflecting different levels of risk), and uniform rates of remuneration for each particular kind of primary input. Competitive conditions were taken to engender cost-minimizing systems of production. Such a constellation is to be understood as reflecting the salient features of a capitalist economy in an ideal way. The prices are taken to fulfil the conditions of reproduction, because they allow producers just to cover production costs at the normal levels of the distributive variables, including profits at the ordinary rate. Accordingly, these prices have also been called ‘prices of production’.

It is a characteristic feature of the classical economists’ approach to the problem of value and distribution that the data contemplated all refer to magnitudes that can, in principle, be observed, measured and calculated. This ‘objectivist’ point of view was clearly spelt out by William Petty, who in his Political Arithmetick adopted the ‘“physician’s” outlook’, which implied expressing himself exclusively ‘in Terms of Number, Weight or Measure; to use only arguments of Sense, and to consider only such Causes, as have visible Foundations in Nature; leaving those that depend upon the mutable Minds, Opinions, Appetites, and Passions of particular Men, to the Consideration of others’ (Petty [1690] 1986, I: 244). The ‘objectivist’ or natural science point of view also informs François Quesnay’s Tableau économique and is present also in the writings of Adam Smith and David Ricardo: these authors generally refrained from having recourse to non-observable and non-measurable magnitudes in determining the general rate of profits and relative prices.

The many differences between individual authors notwithstanding, contributions to the theory of value and distribution in the classical tradition can be said to typically start out from the following set of data or independent variables:

1. the available set of technical alternatives from which cost-minimizing producers can choose;
2. the size and composition of the social product, reflecting the needs and wants of the members of the different classes of society, and the requirements of reproduction and capital accumulation;
3. the ruling real wage rate(s) or the wage share (or, alternatively, the rate of profits); and
4. the available quantities of the different qualities of land and the known stocks of depletable resources.

The treatment of wages (or, alternatively, the rate of profits) as an independent variable and of the other distributive variables as dependent residuals exhibits a fundamental asymmetry in the classical approach to the theory of value and distribution. The classical approach allows a consistent determination of those variables. It does so by separating the determination of income distribution and prices from that of quantities, taken as given in 2, above. The latter were treated as ‘intermediate data’, and considered as being determined in another part of the theory – that is, the analysis of capital accumulation, structural change and socioeconomic development (Garegnani 1984, 1987).

Some selected fields of inquiry in classical political economy

Growth, technological change, and development

Unlike the theory of value and distribution, where sufficiently general laws could be laid down by making use of the long-period method, the analysis of capital accumulation,
technological change and socioeconomic development was considered by the classical political economists to be wide open to influences stemming from non-economic factors, such as habits and customs, social and political institutions, and specific historical circumstances (see Garegnani 1984). Moreover, in the course of the development of the classical approach some earlier views, such as the Physiocratic idea that growth requires the concentration of capital accumulation in primary production, because only this sector is ‘productive’, were shown to be untenable. Accordingly, we find a great variety of classical theories of growth and development, from the Physiocrats’ idea of priority of the agricultural sector, to Adam Smith’s emphasis on increasing returns to scale which result from the increasing division of labour; or from David Ricardo’s ‘natural course’ scenario of a falling general rate of profits due to diminishing returns in agriculture, and a correspondingly falling rate of capital accumulation and population growth, to Karl Marx’s ‘rising organic composition of capital’ as a cause of the tendency of the rate of profits to fall. For summary accounts and expositions of some classical theories of growth and development, see Eltis (1984) and Kurz (2010).

**Foreign trade**

The classical economists strongly supported free international trade and the abolition of all duties, bounties and trade privileges. Gains from trade were explained by absolute and comparative advantages, and by dynamic increasing returns arising from enlarged markets which allow for further increases in the division of labour. In his exposition of the theory of comparative costs, Ricardo demonstrated that two countries can mutually benefit from trading with each other even if one of them can produce each of the commodities at lower real costs (see Faccarello 2015). Adam Smith also pointed out that foreign trade opens up the possibility to exchange jointly produced by-products for which there is insufficient domestic demand against foreign goods that are wanted (‘vent-for-surplus argument’). Ricardo endorsed free trade not only because it increases the amount and variety of commodities on which revenues may be expended, but also because with cheap corn imports the fall of the rate of profits could be retarded. Only Robert Torrens advanced theoretical arguments against unilateral tariff reduction, and thus could be said to have proposed a (moderately) protectionist trade policy. Through his theory of international values based on ‘reciprocal demands’, John Stuart Mill ([1844a] 1967, [1848] 1965) paved the way to a price theory on the basis of supply-and-demand relationships.

**Money and banking**

The classical economists, in particular Smith and Ricardo, are often depicted as having advocated the quantity theory of money, according to which an increase in the supply of money will raise only the general price level, but not affect relative prices, and thus have no real effects in the long run. However, the classical authors held different views on the design of the banking system (‘free banking’ versus ‘central banking’), and the view of Ricardo as a staunch advocate of the quantity theory has recently been challenged by Deleplace (2017). From David Hume the classical economists took over the idea of the ‘price-specie flow mechanism’, according to which an export surplus (deficit) will cause an inflow (outflow) of gold and an increase (decrease) in the domestic price level, and thus a deterioration (enhancement) of a country’s international competitiveness. Ricardo proposed a gold standard currency, in which bank notes are convertible into gold ingots (rather than gold coins). He also developed a plan for the establishment of a national bank, which was largely adopted in England with Peel’s Bank Act of 1844.
Economic policy, taxation and public debt

Although the classical political economists generally advocated the greatest possible individual freedom in economic activities (Adam Smith’s ‘system of natural liberty’), they saw many areas in which government intervention and/or the supply of public goods was necessary, for instance in banking, education, police and jurisprudence, defence, and large infrastructure projects. According to Smith, government expenditure should be financed by taxes that are proportionally equally distributed, which points to the equivalence principle as well as to the ability-to-pay principle. Ricardo focused on problems of tax incidence. Although he showed that with rational, non-myopic individuals it makes no difference whether government expenditure is financed through taxes or public debt (‘Ricardian equivalence’), Ricardo nevertheless agreed with Smith that taxes are preferable because with public debt less capital would be accumulated.

Macroeconomic stability and crises

Savings were not considered by the classical economists as a reduction of aggregate demand, but merely as a re-allocation of consumption expenditure, away from the employment of ‘unproductive’ servants towards that of ‘productive’ labourers. The savings-investment mechanism was not really discussed by Smith and Ricardo, because they tended to identify acts of saving and investment (characteristically, Smith used the term ‘parsimony’). Money was seen only as a medium of exchange, but not as a store of purchasing power, so that a general deficiency of aggregate demand (a ‘general glut’) could not possibly occur (Say’s Law of Markets). Thomas Robert Malthus argued against this optimistic view and suggested that a problem of insufficient demand could occur if the increased production from capital accumulation was not compensated by additional consumption from the landowning class. In France, a theory of crises was developed by Simonde de Sismondi.

The spread and development of classical political economy in Continental Europe, Russia and Japan

As we have seen, the origins of classical political economy in the 17th century can be traced back to William Petty in England and Pierre de Boisguilbert in France (Faccarello 1999). After the decline of the Physiocratic school and the publication of Smith’s Wealth of Nations, however, classical political economy was further developed predominantly in Great Britain (Gehrke 2016). At the beginning of the 19th century it then spread or emerged in several other places again. For a survey on the reception of Smith and Ricardo outside the UK, see Tribe (2002), and Faccarello and Izumo (2014).

The 19th-century French liberal school certainly belongs to the classical tradition, even if it cannot be assimilated easily with British, and in particular Ricardian, political economy. Its main representative was Jean-Baptiste Say, who in his Traité d’économie politique (1807) proposed a ‘neo-Smithian’ political economy, which emphasized subjective elements in the theory of value (Gehrke and Kurz 1995). Smithian ideas were also propagated by Germain Garnier and Pellegrino Rossi. Say and his followers can be credited with having elaborated a theory of entrepreneurship, in which uncertainty plays a central role (Béraud 2016). Say also proposed a monetary explanation of crises. Moreover, the dissemination of classical economic thought on the Continent owed much to Say’s writings, as well as to Heinrich Storch’s Cours d’économie politique (supported by Say), and to the French translation of Ricardo’s Principles of Political Economy and Taxation by F. Solano Constantâncio (also supported by Say and
amended with his ‘explanatory and critical notes’). Simonde de Sismondi can be credited with having demonstrated that Say’s Law was not logically necessary to classical economics, and with extending classical analysis to cases in which market failures due to entrepreneurial uncertainty and lasting disequilibria – that is, crises – can occur.

In Spain and Portugal there was only a late and rather fragmentary acceptance of the ideas of British classical political economy, and it was Smith rather than Ricardo who made a stronger impression on the Iberian Peninsula. Nevertheless, the aforementioned Portuguese author Constâncio contributed substantially to the diffusion of British classical political economy on the European Continent, both through his French translation of Ricardo’s *Principles of Political Economy and Taxation* (1819) and through his French translation of Malthus’s *Principles of Political Economy* (1820).

In the German-speaking countries the liberal doctrines of the classical authors, in particular Smith, were absorbed quickly up to the mid-19th century, but were amalgamated with cameralistic ideas and fused with the modifications introduced by Say. Authors who propagated Smithian ideas include Hufeland, von Jakob, Lotz and von Soden, who emphasized the role of the use value of a commodity (hence their designation as the so-called ‘German use value school’), and also von Schlözer and Storch, the main representatives of the ‘German-Russian school’ of political economy. Two authors who deserve special mention are Klaus Kröncke and Georg von Buquoy, both of whom used algebra and arithmetic to render their arguments precise. Buquoy in his *Theorie der Nationalwirthschaft* (1815) put forward a remarkable formalization of Smith’s theory of prices using the method of the reduction to dated quantities of labour (and land) services. Important contributions to the further elaboration of classical economics also came from F.B.W. Hermann and Johann Heinrich von Thünen, who in their theories of value and distribution combined Ricardian elements with marginalist concepts, thus paving the way to the eventual abandonment of classical economics. With the rise to dominance of the German historical school in the second half of the 19th century classical economics was quickly losing ground in the German-speaking countries. Karl Marx rediscovered classical political economy and saw that it offered a fundamentally different explanation of economic phenomena than the supply-and-demand analysis that had quickly gained acceptance after it had become available in ever more sophisticated forms. However, Marx’s more important writings, apart from vol. 1 of *Capital*, were published only posthumously. Notable contributions to classical political economy in the German-speaking countries relating to Marx’s contribution therefore only appeared shortly before the Great War. The two main authors, Ladislaus von Bortkiewicz and Georg von Charasoff, both had their origins in the Russian Empire. On the development of classical political economy in the German-speaking countries, see Kurz (1995).

In the 18th and early 19th centuries Russia was still dominated by feudal property relations, and the ideas of the classical political economists only began to diffuse there after the 1860s (Allisson 2015). The two most important early authors were the Swiss-Russian economist Nicolai Ziber, who introduced Ricardo’s and Marx’s economic theories in Russia, and Mikhail Tugan-Baranovsky, who used Marx’s reproduction schemes in order to disprove underconsumptionist ideas. Major analytical contributions were then made by Vladimir K. Dmitriev, who showed that labour values could be calculated from data on technology, thus proving them to be derivative rather than primary concepts. He formalized Ricardo’s theory of prices and distribution, and showed that relative prices and the general rate of profits can be determined simultaneously from solving a system of simultaneous equations. His work was a major source of inspiration for Von Bortkiewicz, who elaborated on the simultaneous equations approach and used it to disprove Marx’s ‘successivist’ approach to the determination of the general rate of profits and prices of production. Independently, the Georgian mathematician
Von Charasoff also arrived at a correct solution for the determination of prices and income distribution, and in the course of his investigation anticipated several concepts of modern classical economics.

In Italy the spread of classical political economy was hampered by the 18th-century Italian economic tradition, which was deeply rooted in a value theory based on utility and demand-and-supply relations. Eighteenth-century writers like Galiani and Beccaria had already come close to expounding the central elements of marginal utility theory, and when classical economics reached Italy in the early 19th century, it had no great impact, not least also because the authors who were more strongly influenced by Ricardian theory, like Francesco Fuoco and Pellegrino Rossi, attempted to reconcile it with the inherited utilitarian tradition. Important contributions to the classical approach were made in Italy only during the last decades of the 19th century, when Emilio Nazzani and Achille Loria scrutinized Ricardo’s and Marx’s theories of value and distribution.

In Japan the reception and dissemination of classical political economy only began in the first decades of the 20th century, when scholars like Tokuzo Fukuda, Shinzo Koizumi, Ichiro Nakayama and others undertook serious studies of the classical economists and Marx (Izumo and Sato 2014).

**Concluding remarks on the abandonment and revival of classical political economy**

The decline of classical political economy in Britain began after the first quarter of the 19th century, soon after Ricardo’s death, when the task of elaborating on his theory of value and distribution, and defending it against the criticisms of Malthus, Torrens and others, fell to his self-proclaimed disciples John Ramsey McCulloch, James Mill and John Stuart Mill. None of them was up to this task, and the ‘corrections’ and ‘amendments’ to Ricardo’s theory that they introduced amounted in effect to its abandonment, and its eventual replacement with a cost of production theory of value (Meek 1950). McCulloch believed he could render the labour theory of value compatible with the complications, already noted by Ricardo, that arise from different production periods, different ratios of fixed and circulating capital, and different durabilities of fixed capital, by means of the notion of ‘accumulated labour’, as including a ‘wage’ that remunerated the capitalist for the time during which the embodied labour remained stored up. However, McCulloch’s re-definition of the notion of ‘embodied labour’ transformed Ricardo’s labour theory of value into a ‘real cost’ theory consisting of wages paid plus profits accrued on advanced wages.

Samuel Bailey in his *Critical Dissertation* (1825) made some valid criticisms of the Ricardian theory of value, which prompted James Mill and McCulloch to incoherent reformulations and amendments. The importance that is sometimes attributed to Bailey’s *Critical Dissertation* as a landmark contribution to value theory owes much to the fact that Torrens had declared, in 1831, that this treatise had been decisive for the abandonment of Ricardo’s doctrines. However, this was as much an overstatement as the claims that have been made later for Bailey as a precursor of marginal utility theory and as an early exponent of the abstinence theory. Bailey’s remarks fell far short of anything that could be called an alternative theory, and indeed did not get beyond the vague suggestion that a theory of value must take into account ‘mental states’ and ‘estimations’. If Bailey contributed to the abandonment of the surplus approach and its gradual replacement by the marginalist approach, then this did not so much concern the demand side, but rather the supply side. More specifically, with his division of reproducible commodities into those that can be supplied at constant costs and those that are only producible at increasing costs Bailey introduced the idea of a relationship between cost and quantity produced. It was this idea
which eventually paved the way to Marshall’s attempted reconciliation of ‘cost of production’ and ‘marginal utility’ in the determination of prices.

Subjectivist elements were introduced into the theory of value by authors such as Nassau W. Senior and Mountiford Longfield. A combination of utility and cost of production elements in price determination was proposed also by Thomas De Quincey in The Logic of Political Economy (1844), where he made some decisive steps towards a theory of prices based on demand and supply, and a subjective theory of value. John Stuart Mill completed the abandonment of the surplus approach to the theory of value and distribution of the British classical political economists. His Essays on Some Unsettled Questions in Political Economy, written in 1829–30 but published only in 1844, contained an essay on the theory of foreign trade (Mill [1844a] 1967), in which he introduced the concept of ‘reciprocal demand’, and an essay on profit (Mill [1844b] 1967), in which he set out to correct Ricardo’s formulation of the wage-profit relationship. Mill’s reciprocal demand theory was later taken up by Marshall in the elaboration of his theory of value. In his Principles of Political Economy ([1848] 1965) Mill then merged Senior’s abstinence theory with the Ricardian theory of distribution.

For the revival of interest in the classical approach to economic theory in the 20th century Piero Sraffa’s work on Ricardo, and on the history of economic thought more generally, has been of overwhelming importance, together with his coherent reformulation of that approach in Production of Commodities by Means of Commodities (1960). Sraffa’s contributions have induced, and still continue to inspire, a host of contributions from historians of economic thought on the origins and further development of the classical approach (see, for instance, Aspromourgos 1996; Bharadwaj 1978; Dobb 1972; and the entries in Kurz and Salvadori 1998, 2015; and Faccarello and Kurz 2016), as well as analytical contributions by economic theorists in the tradition of classical political economy (Kurz and Salvadori 1995).

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