

Letters of Ricardo to Malthus (1810-1823)

David Ricardo

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More than 12 years of correspondence between the two economists between 1810 and 1823 is undoubtedly relevant in understanding the development of political economy. Despite the fast break of the industrial revolution, it is important to understand that farming still represented quite an enormous part of the economy at that time, while other industries (metal, textile, mining) just started to develop successfully. Fast growth of the population and a low standard of living for the workers were some of the reasons for the theoretical exploration in economics. Thomas Malthus (1766-1834), David Ricardo (1772-1823) together with Adam Smith (1723-1790) and John Stuart Mill (1806-1773) all played a crucial part in strengthening the political economy as a scientific discipline. It is clearly seen from their writings that both Malthus and Ricardo had, unlike Smith, a very pessimistic outlook on the future of capitalism. Core concepts of their theory were wages, rents and profits. Smith's Distribution Theory focuses on explaining which social classes get different types of income. He stated that wages belong to workers, rents to the landlords and the profits to the capitalists.

In 1810 Ricardo published a pamphlet titled "The High Price of Bullion, a Proof of the Depreciation of Bank Notes" in which he wrote about monetary questions that led to the first meeting between Malthus and Ricardo which took place in 1811. Ricardo defended the so-called "gold standard" which is nowadays among economists generally known as a disastrous economic experiment.

More interesting were the debates between Ricardo and Malthus about the corn law, which limited import of foreign corn and on the other hand stimulated export with subsidies. The

main objective of the law was to maintain high corn prices. Ricardo said that the international market could be a solution that would limit possible upcoming economic problems which may appear because of The law of diminishing returns. In the 22nd letter he wrote: »I have no doubt that, if the free importation of corn is allowed into this country, inasmuch as it will direct foreign capital to foreign land, it will tend to lower foreign profits, and if all the earth were cultivated with equal skill up to the same standard, the rate of profits would be everywhere the same, though the superior industry and ingenuity of particular countries might secure to them a greater abundance of other commodities...« When Ricardo was developing theoretical definitions about wages, rents and profits he sometimes leaned on definitions of Malthus. Malthus's hypothesis on the impact of rising population played a very important role in Ricardo's work. The biggest problem that he saw was the trend in downsizing the profit rate. Due to the population growth, the food demand increases, which means that farmers must use less fertile land and because of that, both production costs and the food price increase. Because of the market principals the food on the market has the same price even if it is produced on the land of best quality where costs did not change. In the short term this increases profits, but the competition amongst capitalists causes the enlargement of the rent.

In conclusion the improvement of the standard of living contributes to an increased population, a bigger population causes bigger needs for food and less land that is of good quality is being used. Therefore, the costs go up and so does the price. Competition raises the price of food produced on a higher quality land and all the additional income is collected by the landlords, because the competition amongst capitalists pushes the rents up. The rent represents the differences between the production cost on the land that is less fertile and the production cost on the highly fertile land. The problem that then appears is that higher food prices demand higher wages which lower the profit rate. The main thesis of the 29th letter to Malthus is that the progression of wealth tends to lower profits and increase rent.

In October 1814 Ricardo wrote (20th letter in the book): »Accumulation of capital has a tendency to lower profits. Why? Because every accumulation is attended with increased difficulty in obtaining food, unless it is accompanied with improvements in agriculture.« Ricardo understood that the increase in productivity increases profits, but he didn't believe that the increase in productivity will be fast enough. He announced a pessimistic scenario where he stated that the more the prices will grow - because of the growing costs – the higher will rents and wages be, and in turn profits will decrease.

Ricardo saw the only reason for increasing rents in the law of diminishing returns, while Malthus on the other hand believed there could be other reasons for the rent to grow. He stated that in the future, profits will fall to zero rate which will stop the capital from accumulating and cause the end of economic growth. Ricardo saw the solution in international trade which allows import of cheap raw materials and export of cheap products and capital. The solution disables the rapid growth of the rent and at the same time ensures normal profit rate. Import restrictions benefit only landlords through the rise of rent, but it hurts other people and economic development. Free trade in corn increases the amount of profits more than a policy of restriction increases the amount of rents (67th letter). Even Smith claimed in his book that profit rate does not depend on the wealth, but on the rate of the growth of wealth.

Ricardo even took a step further when he claimed that the growth of wealth automatically leads to a decreasing rate of profits. This is clear if we understand that production depends on three production factors: land, capital and work. Land is a fixed production factor and the law of diminishing returns says that every additional quantity of capital and work on the same land brings less output growth. Because of this the new quantities of capital and work move on the less fertile land, which again increases costs and decreases profit everywhere (because of the increases in rent). Growth of nominal prices would be the sign of prosperity and not the cause of it. In letters he wrote that prices of corn will not be followed by the growth of corn products, but by the lowering profit rate. In the letters is clearly shown that Ricardo and Malthus did not estimate the power of technological growth, which is normal if we understand that fast technological progress only appeared after Ricardo's time. As the economist Robert J. Gordon wrote, the fast productivity growth started just before the end of 19th century (Gordon, 2016).

Interesting are also Malthus' and Ricardo's views on the aggregate demand displayed in the 73rd and 74th letters: »I quite agree with you in thinking that Say's letters to you are not very well done. He does not even defend his own doctrine with peculiar ability, and on some other of the intricate questions, on which he touches, he appears to me to be very unsatisfactory.« Despite Ricardo's critic, he comes from Say's law which says that each offer generates its own demand. On the other hand, Malthus was the first economist who started to develop the so-called theoretical problem of effective demand. His arguments were early and got validated only in the first half of 20th century with John Maynard Keynes. Malthus position was that a potential aggregate demand and an effective aggregate demand exists. He agreed that Say's law

applies for workers whose income is so small that everything they earn is being used for survival, but there is a different story with capitalists who have a bigger income.

Malthus believed that capitalists sometimes delay consumption because of the general conditions in the economy, profits rate expectations, the degree of uncertainty etc. He went against a thesis, still dominant today, which states that savings are always equal to investments. He called the situation in which saving is bigger than productive consumption the crisis of realization. Malthus even took a step further because he believed that a higher rate of capital accumulation will automatically increase the problem of insufficient consumption. That's the main reason for the profits rate falling and the solution for this situation are so-called unproductive consumers (those who don't participate in the production process). We cannot ignore that he defended high rents, because the rent is intended fully and entirely for the consumption. Through Malthus's views, high rents help remedy imbalances between demand and supply, but too high capital accumulation deepens imbalances. This view goes absolutely against Ricardo's view on rent, because he claimed rent can never help in the creation of wealth, what does apply for profit. This thinking was very important, because more than a hundred years later John Maynard Keynes developed the exact theories about aggregate demand.

When we take hands on some of the work from 200 years ago, it is important to understand social circumstances of that time. Only then we can truly comprehend Ricardo's writings. We need to understand that they did not have an enormous amount of statistical data which is nowadays used by economists. Their views were based on probably statistically unrepresentative observations. Malthus got his pessimistic views from the writings of the agronomist Arthur Young, where he recognized a threat for England. Some people saw the fear of revolution in Malthus's work which took place in France before the essay was published. Ricardo had the same fears; his biggest fear was relative rarity in which the land would because of growth of the other goods become relatively rare. He predicted enormous growth of rent and he saw a solution in international market and rent taxes. Even today some of Ricardo's views are an important part of the classical economy. Rule of the decreasing returns and margin rates play a crucial part in today's economy, although practices showed that his theories were based too much on farming economy. Rents did stay up for some time, but progress did push agriculture on the side and eventually the rent prices went down. The principle of relative rarity is still important nowadays especially on the land with the richest areas (Silicon Valley).

Technical progress which took place after Ricardo's death was not expected nor from Ricardo nor from Malthus. These readings reveal the evolution of our economy. They also reveal the way economists were thinking about a capitalistic economy when there was no statistical data on which they could rely on. It is left to the reader alone to figure out which theses are correct and where the mistakes were made. If reader will read the letters which Ricardo wrote until his death, he or she will find out that their relationship was respectful, which we cannot be said for today's economists with opposing views.

The writings ended in 1823 with David Ricardo's death. Malthus did attend the funeral and said: "I never loved anybody out of my own family so much. Our interchange of opinions was so unreserved, and the object after which we were both enquiring was so entirely the truth and nothing else, that I cannot but think we sooner or later must have agreed."

And with that came the end of an intellectual correspondence between two friends. Today, 200 years later, the letters help us understand the very first insights of the political economy.

Literature

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