Ricardo: 'real' or supposed vices?

A Comment on Kakarot-Handtke's paper

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1. The paper's aim is to show that Ricardo's concentration on 'real' circumstances in order to determine value and distribution is at the bottom of the unsatisfactory state in which economic theory finds itself *at present*. The connection between Ricardo's, and more generally classical, economic theory on the one hand, and the (marginalist or 'neoclassical') theory that reached the dominant position towards the end of the XIX century on the other, is not however dealt with in the paper. Indeed, it sometimes appears that the author sees the history of economic thought as the gradual development of a *single* approach. As this is, I believe, a highly questionable position, it is not always easy for me to discuss the author's arguments without first settling this point. Furthermore, I am not quite sure whether the author's aim is to show that Ricardo's analysis is inconsistent (which would seem to me the most appropriate object for a purely deductive discussion conducted in terms of axioms as the one we find in the paper), or that it is not a good tool for the understanding of economic reality, as is repeated in several places by the author.[1] My general impression is that, *as far as I can see*, while the paper does not succeed in showing the former contention, it never even attempts at showing the latter. More in particular I find that: *i*) the argument presented in section 2 of the paper (discussed in more detail in § 2 below), which should give us a first instance of the defects of Ricardo's concentration on 'real' circumstances alone, should not be directed against Ricardo's theory of value and distribution but against Say's law (the fact that Ricardo adhered to Say's law does not imply that his theory of value and distribution depends on it); *ii*) the argument presented in section 3 of the paper (discussed in more detail in §§ 3-4 below) to the effect that real circumstances alone cannot determine

[1] Another (minor) source of possible misunderstanding is the author's concentration on the name of Ricardo, while his arguments appear to be directed to those general aspects of Ricardo's theory that form the structure of the classical approach as a whole. Apart from affording the author with the possibility of an elegant variation on Schumpeter's definition of the 'Ricardian Vice', the author's concentration on Ricardo seems to me to stem from a misunderstanding of the nature of Ricardo's early theory of profits in terms of a ratio between two quantities of corn. On this point, see below note 4.

profits is vitiated by an unduly restrictive use of the term 'real' which has no counterpart in Ricardo's writings: for in the paper the term covers only the social product and the technical conditions of production but not the real wage rate; *iii*) the argument presented in sections 4 and 5 of the paper (discussed in more detail in § 5 below) to the effect that rent and profits are not different shares of the social surplus is, if I have not misinterpreted the author's meaning on this point, based on a highly unrealistic condition which finds no counterpart in Ricardo's writings (the presence of a single firm owning all the available land, and hence the absence of competition among landowners); without this condition the argument appears to be wrong.

2. After some remarks on methodology on which one can easily concur, section 2 presents us with a first instance of the contrast between Ricardo's 'real' analysis and an 'integrate[d] real and monetary analysis' (p. 9). The gist of this 'integration' appears to be the following. Granted that the wage rate is lower than the average product of labour (this is *not* explicitly stated), in order for 'financial profit' (p. 7) to be positive we have to assume *in addition* at least one of the following (non-real) conditions: that the ratio of total expenditure to income is greater than one, or that 'distributed profit' is positive. The reason for this lies in the fact that the author has assumed that firms may choose not to distribute profits, while at the same time investment has been ruled out from what the author calls the 'consumption economy' (p. 6). Suppose for example that distributed profits are nil: it is clear then that if workers spend nothing more than their income (the 'expenditure ratio' being thus equal to unity), 'financial profits' will also be nil; while they will be positive if workers by borrowing spend more than their income.

What all this points at is therefore a possible *lack of effective demand*, or, to use Marx's expression, a problem in the 'realization of surplus value', though I wonder whether excluding investment from the picture altogether may in any sense help in clearing the main aspects of the problem. What I certainly find not clear is in what sense this is seen to contrast Ricardo's theory of value and distribution.

For, I would say, at a first level these problems are simply *ruled out* by Ricardo by referring to Say's law: so that Ricardo's analysis cannot be found *inconsistent* on this ground.[2] One would therefore expect the author's objections

[2] Under Say's law the author's conditions are *always* satisfied. We may distinguish two cases: *a*) if profits are entirely distributed, we will have:

$$P = 1;\ \rho_X = 1; \rho_E = 1;\ \rho_D = \frac{PX - wL}{wL} > 0\ ;$$

b) while if profits are not distributed, but are used for investment, we will have:

$$P = 1;\ \rho_X = 1; \rho_E = \frac{(wL + Y_D) + (PX - wL - Y_D)}{wL + Y_D} = \frac{PX}{Y} > 1;\ \rho_D = \frac{PX - wL - Y_{nD}}{wL} \geq 0$$

to be levelled against *this* law, and not against Ricardo's theory of value and distribution. It may be, however, that the author believes that Ricardo's theory of value and distribution actually *depends* on Say's law. Now, this is in my opinion an example of why the question whether the classical and the 'neoclassical' approaches are in several aspects *different* is not of merely historical interest. For indeed it is true that neoclassical theory depends on, and at the same time entails, Say's law. Here value and distribution on the one side, and the quantities of the commodities produced and of the factors of production employed on the other, are determined *simultaneously* in terms of the equilibrium between demand and supply curves. But the same is not true with respect to the classical approach. For here income shares different from wages and the prices of the commodities are determined once: *a*) the social product; *b*) the technical conditions of production; and *c*) the real wage rate are known; while these magnitudes are seen to be governed by conditions of a different nature from the ones determining prices and income shares different from wages and are hence studied *separately* from them (on the structure of the classical approach, and in particular on its distinction into 'distinct logical stages', see Garegnani, 1984). And the level of the social product may be determined either by Say's law *or* by the principle of effective demand. In other terms, by its separation into distinct logical stages, the classical theory is *open* to the determination of the level of output by means of the principle of effective demand. It is for this reason that a number of authors have consistently argued through the years in favour of the use of the classical theory of value and distribution *together* with Keynes' principle of effective demand (see, for example, Garegnani, 1978-79; Milgate, 1982). Of course, the author may find this approach completely unsatisfactory either on logical or on substantial grounds. But in the absence either of a critique of this literature or of a direct demonstration that the classical approach to value and distribution cannot be used together with the principle of effective demand, his argument cannot be considered conclusive.

It could be maintained that such a demonstration is after all presented in section 2 of the paper. I submit, however, that in order even to discuss the question, the author should first take a position on a second important—and, again, highly controversial—turn in the history of economic thought: for otherwise the nature itself of the variables he has in mind when presenting his axioms is not clear. I refer to the distinction between the method of 'normal', or long run, positions, adopted both by the classical economists and by the founders and the first systematisers of the neoclassical theory on the one hand, and, on the other, the method of 'temporary' or 'intertemporal' equilibrium on which the latter theory is based today. For the first method enables to distinguish between the normal rate of profit and the actual rate of

profit, and more generally between the theoretical and actual values of the variables under examination, and, what is more, of establishing a connection between the former and the latter; while it is not yet clear how the method in use today manages to deal with the problem. And of course the relevance of the author's arguments may be completely different whether he has in mind the traditional method, or the one now generally in use. For in the former case the problem he appears to have in mind would, I presume, manifest in a difference between the normal and the actual rate of profit, and would therefore present no insuperable difficulty[3]; whereas in the latter case that same problem, I believe, may quite possibly *have rather destructive consequences*, though in this case there would be obviously no reason to trace the problem back to Ricardo.

3. However, the problems arising from a possible lack of effective demand do not apparently stand at the bottom of the author's misgivings on Ricardo's analysis. For from now on we find that profits are always entirely distributed and that income is entirely spent; but this does not seem sufficient to the author to fill the gap between Ricardo's real analysis and his 'integrated real and monetary analysis'. It is indeed in section 3 that the author is concerned with his fundamental proposition: 'Using the term profit in a real model', writes the author, 'is *the* Ricardian Vice' (p. 11). A minor problem immediately presents itself in connection with this proposition. For the author's argument is now conducted with an eye to an economy in which lands of different fertility are cultivated, whereas the question of how Ricardo sees the distribution of that part of the social product which exceeds wages between capitalists and landowners is discussed only in section 4, where it is found invariably groundless. But as this last opinion is obviously open to doubt, the author will certainly grant us the liberty of reading *surplus* wherever he writes profit till we reach section 4. 'Using the term [surplus] in a real model is *the* Ricardian Vice' is therefore the proposition with which we shall be concerned at present.[4]

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[3] This is not to deny that the relation between normal and actual profit may present specific difficulties that the relation between normal and actual or market prices do not present.

[4] The choice of arguing against Ricardo's 'real' determination of profits in a context in which different types of land are cultivated may derive from the author's belief that Ricardo's early theory of profits (which, as is well known, appeared in print together with his theory of rent) is in some sense more 'viciously' real than the determination of the rate of profits we find in his *Principles*. The fact is, however, that, as Sraffa (1951) has shown, the characteristic feature of Ricardo's early theory is that the general rate of profit can be determined by looking at one sector alone because there capital and product consist of different quantities of the same commodity (corn). The point seems to be overlooked by the author, for, as we shall presently see, he uses numerical examples similar to

To prove the proposition the author starts from an economy consisting of three farms conducted on three pieces of land (*A*, *B*, *C*) of equal size but of decreasing fertility. The economy is first described in what the author terms its 'real' aspects. A number of 'monetary', or at any rate non-real, assumptions are then imposed on the economy (its 'real part', writes the author, 'not chang[ing] an iota', p. 12). These assumptions eventually lead to the emergence of a surplus, first at the farm level and then at the level of the whole economy. This should prove that 'it cannot be taken for granted that the [concept] of profit [surplus] [is] actually applicable to the real part of the economy' (p. 10). And surely it would, if only the distinction between real and non real aspects of the economy which is adopted by the author could be accepted and, what is more, could be shown to have any connection with the distinction between the circumstances that Ricardo saw as influencing, and those he saw as not influencing, the normal rate of profit, which is after all what the whole argument is supposed to be about.

The fact is, however, that what all the assumptions introduced by the author amount to is a *change in the real wage rate*, the lowering of which below a certain level is responsible for the emergence of a positive social surplus. To take *this* as contradicting Ricardo would be tantamount as claiming that he saw the rate of profit determined by the social product and the technical conditions of production and by nothing else. But surely it was Ricardo who repeatedly stressed that 'profits will be high or low in proportion as wages are low or high' (Ricardo 1951-1973, vol. I, p. 110; quoted in the paper at p. 8).

But let us briefly examine the author's numerical examples. The author has in mind three different situations, which I shall call (*a*) (*b*) and (*c*) and which are depicted in tables 1a, 1b and 2 of the paper. In each table the first three columns refer to the number of labour units employed, the (average) productivity of labour and the output for farms *A*, *B* and *C* respectively. These columns alone, writes the author, show 'the real sphere' of the economy (p. 9). The remaining columns refer to the (nominal) wage rate, the wage income and the overall consumption. As already said, the first three columns do not undergo changes when passing from situation (*a*) to situations (*b*) and (*c*). But why should we be surprised if the social surplus should do so? As we have seen, what the author terms the 'real sphere' of the economy includes only two of the circumstances that determine the social surplus: the social product and the technical conditions of production. (Notice that the real wage rate may be obtained in these tables from the nominal wage rate and from *the price of the product*, which appears in the first box to the top left. This means that if the price of the product remains fixed to unity the nominal

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those used by Ricardo in his *Essay on Profits* (1815) in order to discuss an economy in which a *single* commodity is produced.

wage rate is equal to the real wage rate. And as problems of aggregate demand have been excluded from the picture, it would seem that the only reason for the price of the product to vary would be given by a variation in the real wage rate. I shall return on this point below.)

In situation (*a*) apparently no surplus emerges. The reason for this is the following. The farms are conducted by independent producers. The whole product of each farm goes to the workers-owners. If a nominal account of this situation were taken, this would result in different wages being 'paid' in the different farms, each equal in value to the average product of labour in that particular farm. (Note however that workers in farm *C* subsist with a consumption of one unit of agricultural product for labour unit. This means that the subsistence level, taken as the strictly physical necessity for workers, cannot be above that level. Hence a net product of at least 60 – 30 = 30 units of agricultural product *does* exist. Only this does not manifest in any income share different from wages, because, in fact, in this economy there are neither wages nor profits, but only one undivided income.)

In situation (*b*), while workers remain the owners of the farms, they decide to impute the same wage rate in all the farms. As this otherwise inexplicable propensity to uniformity has also the peculiar property of fixing its attention on the economy wide average product of labour as a suitable level for wages (the value of 2 units of agricultural product per labour unit), no surplus emerges in the economy—though a kind of surplus does emerge in farm *A*, while a corresponding deficit emerges in farm *C*. The author points out that all this happens only 'in the minds of the calculating agents' (p. 11). Sure, though it would probably be more correct to say that it happens in our minds as observers: for it is not clear to me why independent producers should *think* as if they lived in a capitalist economy and hence reckon their incomes in terms of 'wages' and 'profits'. At any rate the 'mental' nature of the results obtained by the experiment has nothing to do with the fact that no surplus has yet emerged. For clearly had the workers agreed to impute a uniform wage rate of the value of only one unit of agricultural product, a 'mental' surplus of 30 units would have emerged, while a 'mental' deficit of 30 units would be the result of the workers agreeing on a uniform wage rate of the value of 3 units. And there are no grounds to decide which of these alternative levels of the 'mental wage rate' would be more naturally chosen.

Situation (*c*) finally introduces a distinction between the owners of the farms and the labourers, though I find the way the distinction is introduced rather awkward. 'Analytical clarity', the author asserts, 'demands that the multiple roles of the autarkic farmers are differentiated' (p 11). I really cannot see why 'analytical clarity' by itself should demand to distinguish between the 'role' of worker and that of owner of the means of production in order to

understand an economy in which no such distinction is present; unless, of course, one believes that the theory of value and distribution is independent of the fact that society is divided into different classes, prices being merely indicators of scarcity. To avoid discussion on this point, which would bring us back to the distinction between the classical and the neoclassical approaches, I shall once again take the liberty to refer what is said regarding situation (*c*) to an economy in which workers *are* different from the owners of the means of production, which is at any rate the economy Ricardo sought to explain. In addition to this I suppose for the time being that, contrary to what is supposed in the paper, the wage rate is fixed at a level equal to the value of 0,8 units of agricultural product per labour unit.[5] Using the author's table, we would then have the following situation, in which a surplus of 36 agricultural units emerges:

$P=1$	L	R	O	W	Y_W	C	Q	Y_D	Y
A	10	3	30	0,8	8	30	22	22	30
B	10	2	20	0,8	8	20	12	12	20
C	10	1	10	0,8	8	10	2	2	10
$\sum$			60		24	60	36	36	60

As can easily be seen, the surplus emerging in the economy is fully explained once the social product, the technical conditions of production and the real wage rate are known. And, given the first two circumstances, the amount of the surplus varies inversely with the real wage rate. The examples of the author therefore simply reproduce, and hence confirm, Ricardo's analysis.

Once again, of course the author may have in mind that important monetary forces are at work in the determination of the real wage or in the determination of the social product; or that it appears more promising to take the rate of profits, this in turn determined by monetary circumstances through the rate of interest, as the given distributive variable. It could be in other terms argued that the *structure* of the classical approach to value and distribution is sound, but that the forces seen to operate on the circumstances taken as given when determining value and distribution need to be supplemented by taking into account forces of a monetary nature that Smith or Ricardo did not consider relevant. Indeed, the flexibility of the structure of the classical approach explicitly permits this (Sraffa, 1960, p 33). But this is what we don't find in the paper; and it is in this sense that I think that the author does not

[5] The author assumes that in situation (*c*) the wage is fixed, as in situation (*b*), to 2 units of agricultural product. As we saw above, there is however nothing particularly obvious in this level of the wage rate.

even *attempt* at showing the relevance of monetary, or 'non-real' forces. For, I submit, even if we desired to conduct the argument on an axiomatic level, this would require not so much a deductive discussion from a given set of axioms, as a discussion concerning the nature and the relative advantages presented by *different sets* of axioms.

It is in this connection that I think it may be useful if I stress what I have already alluded at when expressing my perplexity about the purely 'analytical' nature of the treatment of wages. In the old classical economists the view of wages as tending to a historical subsistence level finds its basis in the different bargaining power of the labourers on the one side and of the owners of the means of production on the other. Or, to put it differently, the fact that the real wage is taken as given in the determination of value and distribution is the reflection, at a logical level, of their *substantial* view of the economy. Once the logical structure of their approach is found consistent, it is then only from a new substantial view of the working of the economy that relevant changes to the theory can arise. And this will never be achieved by pure deductive reasoning (though, of course, this will be necessary in order to check that the new view finds expression in a set of mutually consistent relations).

4. It is true that at a certain point (p.14) the author affirms that 'the real wage is not fixed, as Ricardo maintained, by some physical or social minimum'—incidentally an instance of the belief on the part of the author that Ricardo was not simply 'miss[ing] reality' (p. 1), but that he was actually inconsistent. What we find in support of this contention is however the following argument.[6] Remember that when the workers-owners of the farms had decided (in situation *b*) to impute a uniform rate of wages, they had settled their minds on a wage of the value of 2 units of agricultural product per labour unit. This, as will be remembered, caused the emergence of a 'mental' loss in farm *C*. Now suppose that also when workers *are* different from the owners of the firms the same uniform wage rate of a value of 2 units of agricultural product were initially fixed. 'Since firm *C* makes a loss', the author comments, 'the situation is not stable in the longer run'.[7] The way out of this difficulty is, according to the author, simply the following: 'To establish struc-

[6] Reference to Hollander (1973) in support of this contention is not convincing. For Hollander objections against Sraffa's reconstruction of Ricardo's early theory of profits is based on the fact that the wage rate *is* fixed by some physical or social standard; only that as Hollander's maintains that also in his *Essay on Profits* wages consisted for Ricardo of corn *and of other commodities as well*, he concludes that it was not possible for him to determine the general rate of profit in the agricultural sector alone.

[7] No distinction between fixed and variable costs having been introduced, it is difficult to understand why we should wait the 'longer run' for this to happen.

tural stability it is necessary that the profit is at least zero in the marginal firm. This can be achieved by raising the price from $P = 1$ to $P = 2$' (pp. 11-12). But what does this increase in the price of the product mean; or, to put it in a different way, what should occasion the rise in that price? As I mentioned above, problems connected with the possible lack or *excess* of effective demand having been excluded by hypothesis, the increase in the price of the product has the *only* role of lowering the real wage rate. It would seem then more natural to start with a given real wage rate.

But what if we take the author's objection disregarding the possibility of movements in the price of the product, *i.e.* taking the figures in the fifth column of his tables to refer directly to real wages? This appears to be a more interesting case. The author's objection could then be framed in the following terms: what is to happen if the real wage rate is equal to two units of agricultural product when the average productivity of labour on lands of type *C* is only one unit of agricultural product? From a strictly logical point of view, the problem here seems to lie in the fact that, before the subsistence level is known, it cannot be taken for granted that all three types of land will be used. This in turn appears to point to one of those possible *interactions* between the circumstances taken as given in the classical theory of value and distribution which the flexibility of this approach explicitly permits. And that the proper place to deal with the question is outside what is sometimes called the 'core' of the classical approach (Garegnani, 1984) may be seen from the fact that whether this interaction will give place to a reduction of the subsistence level, or to an emigration of part of the working population or indeed to death by starvation cannot be stated independently of the historical circumstances in which the case may happen.

5. Sections 4 and 5 deal with a more specific question (it is the question that gives the title to the paper: but we are warned in the abstract to take it as a 'specific result' of the contrast between 'real' and 'non-real' analysis). According to the author Ricardo would have been totally wrong in distinguishing profits from rent as two different parts of the social surplus. I must confess that I find the author's argument on this point quite difficult to follow and I may consequently be responsible for some serious misrepresentation of it.

The argument begins by stating that, if we comprise in the 'business sector' a firm *D* which owns all the land, the payment of rent 'does not alter the profit of the business sector as a whole' (p. 15) and hence has to be viewed as a redistribution of the given profit. But as with the term 'profit' the author means the social surplus, this is clearly what Ricardo has always said.[8]

[8] But is this what the author himself should maintain if he consistently followed what *he* has said in section 2? I may be wrong, but his reduction of aggregate demand to con-

The crucial point is that Ricardo saw the determination of rent and the determination of profits as governed by different conditions, while in the author's opinion *rent is just another form of profit* (taking this time the term in its usual meaning). It is in order to prove this proposition that the author introduced firm *D*. In this way, the author suggests, we are capable 'to pierce through the historical surface' (p. 18-19). The idea seems to be that while '[c]apitalist and landlord are colourful figures' they are devoid of 'analytical value', the determination of rent being just one instance of 'profit ratio equalization' (p. 18). But of course if there is to be profit equalization, there has to be a profit rate for firm *D*. And it is in this connection that the author introduces *wage costs* for firm *D* (p. 14). We are not told, however, what the workers whose employment originates these costs are supposed to produce. Nor is it clear how profit equalization should occur. For profit equalization entails the possibility to move capital from a sector where a low rate of profit is earned to one in which a higher rate of profit obtains. But clearly it is not possible to move workers from the 'production' of land *B* to the 'production' of land *A*; while on the other hand if this were possible, obviously only land of type *A* would be 'produced'.[9]

As far as I can see, all the difference between the case the author has in mind and Ricardo's theory of rent is the following. *If* all the land is owned by one single gigantic firm, the distribution of the social surplus between the owners of this single firm on the one hand, and the owners of all the other firms on the other, is to a large extent indeterminate. However, if in addition to this we assume that this firm has some kind of wage costs, so that it is possible to define a profit rate for it, it is always *possible* to find a distribution of the social surplus in which the rate of profit of this firm is equal to the general rate; though it appears to me that this would have very little economic significance: the monopolistic power of the single landowning firm being so great, I can see no force that would systematically bring to this result (also note that in the absence of competition between landowners there will be no piece of land on which no rent is paid). But of course, if no costs for the landowning firm are present, the exercise cannot even be conceived (see

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sumption expenses alone has a Malthusian flavour to it. As it will be remembered (see § 2 above), the financial profit was there made to depend on, among other things, the quantity of distributed profits, non distributed profits being essentially a leak form the income circuit. But of course rents cannot be detained by the firms: so that it would seem that the mere fact that part of the 'profit', *i.e.* the social surplus, has to be paid to landowners, has the power to increase profits (again in the author's meaning of surplus).

[9] In this connection I find the following statement by the author difficult to understand: 'There is no scarcity of land', he writes, 'only productivity differentials'. But clearly there is scarcity of land of type *A*. For otherwise why would land of type *B* and *C* be cultivated?

equation 21 in the paper, which cannot be written when no labour inputs are required in the landowning firm).

The existence of rent as a distinct part of the social surplus is however only blurred by the hypothesis of a single landowning farm. This can be seen by introducing three different firms D_A, D_B, D_C which own all the land of type A, B and C respectively. Even if wage costs can be supposed for these firms, the system that should impose that the rate of profit of these landowning firms be the same and equal to the general rate of profits would clearly be overdetermined.

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