David Ricardo on Colonies

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Unlike Adam Smith, David Ricardo was not particularly interested in lengthy discussions of possible motives for establishing new colonies and he contented himself with devoting to colonial trade just the short Chapter 25 of his *Principles of Political Economy and Taxation*. Yet, within the latter it is possible to detect (at least) three main analytical arguments related to the colonial issue: *i*) colonies as a source of new fertile land and therefore as a viable solution to the problem of decreasing returns on domestic land; *ii*) colonies as possible outlet markets able to absorb domestic excess supply; and, finally, *iii*) the effects of trade restrictions between a colony and its mother country. In what follows we briefly discuss these three issues successively.

1. Colonies as a source of new fertile land

As is well-known, the rates of growth of capital and labour are determined within the Ricardian model: entrepreneurs increase their capital stock whenever the market rate of profits is above the minimum necessary to induce capital accumulation while workers expand their families whenever the market rate of wages is above its natural or subsistence rate (Pasinetti 1960). By the same token, also limits to growth are endogenous in Classical economics. Classical economists detect and discuss a number of different reasons why the rate of profits and the rate of capital accumulation may eventually decline and the stationary state set in. According to Mosselmans (1999), the Classical environment induces a perspective focusing on reproduction and internal scarcity, that is, scarcity provoked by ill-advised human actions. Within Ricardo's framework, scarsity is *apparently* provoked by the lack of fertile land, that is, by an objective, non-human factor; but the *real* culprits of Ricardian scarsity are restrictions to the free import of cheap foreign corn in England in the aftermath of Napoleonic wars.[1]

From this standpoint, the Classical authors' emphasis on the limits to growth deriving from the availability of fertile land makes the Classical analysis of growth in the newly settled regions particularly illuminating. In fact, as noted by Winch (1965):

> the classical writers were more interested in using the example of new countries to illustrate their analysis of the problems faced by mature economies than in presenting a detailed picture of the actual position of new countries. New countries possess

[1] Obviously, the free import of cheap foreign corn is not a solution to the problem of decreasing returns on domestic land viable at the world economy level. An alternative solution is given by the possibility that workers would change their consumption (and fertility) behaviour as their income increases: see Fiaschi and Signorino (2003a and b).

the ideal conditions for growth simply because they are free from the problems posed by diminishing returns in agriculture. (Winch 1965, p. 92)

In Ricardo's economics the pace of economic growth and the related dynamics of the distributive variables depend on supply side factors, namely the production conditions in the wage-goods sector of the economy. Assuming that the natural or subsistence wage bundle is made up of almost exclusively of agricultural products (corn), agriculture turns out to be the crucial sector of the economy and the ratio of (fertile) land to labour the crucial element shaping the growth perspectives of the economy under study. In Chapter 5, 'Of Wages', Ricardo claims that "the productive powers of labour are generally greatest when there is an abundance of fertile land" (*Works* I.v.19). In Chapter 6, 'On Profits', he writes:

in all countries, and all times, profits depend on the quantity of labour requisite to provide necessaries for the labourers, on that land or with that capital which yields no rent. The effects then of accumulation will be different in different countries, and will depend chiefly on the fertility of the land. (*Works* I.vi.37)

In the same vein, in an oft-quoted letter to Malthus Ricardo writes:

every accumulation is attended with increased difficulty in obtaining food, unless it is accompanied with improvements in agriculture; in which case it has no tendency to diminish profits. If there were no increased difficulty, profits would never fall, because there are no other limits to the profitable production of manufactures but the rise of wages. If with every accumulation of capital we could tack a piece of fertile land to our Island, profits would never fall. (*Works* VI, p. 162)

Thus, in Ricardo's view, the discovery of new fertile lands plays the same role of a technological innovation in agriculture: in both cases the fall of the rate of profits due to a rising cost of production of corn engendered by the accumulation of capital and the growth of labouring population is delayed.[2] Accordingly, the economic conditions for a sustained growth are likely to occur in newly settled regions where the ratio of (fertile) land to labour is usually very high:

On the first settling of a country, in which there is an abundance of rich and fertile land, a very small proportion of which is required to be cultivated for the support of the actual population, or indeed can be cultivated with the capital which the population can command, there will be no rent; for no one would pay for the use of land, when there was an abundant quantity not yet appropriated, and, therefore, at the disposal of whosoever might choose to cultivate it. (*Works* I.ii.3)

[2] Formally, $(1 + r) = f'(N)/x$ where r is the rate of profits, $f'(N)$ is the marginal product of labour in agriculture and x is the subsistence wage rate in terms of corn: see e.g. Pasinetti (1960, p. 85, fn 1, eq. 14a). Given the subsistence wage rate in terms of corn, the rate of profits is bound to fall as capital accumulates unless the marginal productivity of labour in agriculture turns out to be non-decreasing. Ricardo's model without decreasing returns in agriculture may sound either like Hamlet without the Danish prince or like an ancestor of a contemporary endogenous growth model with two factors which can be accumulated, capital and labour: see Kurz and Salvadori (2006) and D'Alessandro and Salvadori (2008).

In new settlements, where the arts and knowledge of countries far advanced in refinement are introduced, it is probable that capital has a tendency to increase faster than mankind: and if the deficiency of labourers were not supplied by more populous countries, this tendency would very much raise the price of labour. (*Works* I.v.21)

But initial optimism is soon replaced by long-run pessimism. For Ricardo, the Malthusian law of population and the objective limitation of fertile lands will eventually impede growth:

In proportion as these countries become populous, and land of a worse quality is taken into cultivation, the tendency to an increase of capital diminishes […]. Although, then, it is probable, that under the most favourable circumstances, the power of production is still greater than that of population, it will not long continue so; for the land being limited in quantity, and differing in quality, with every increased portion of capital employed on it, there will be a decreased rate of production, whilst the power of population continues always the same. (*ibidem*)

Thus, the process of growth in newly settled regions will inevitably be akin to that of mature economies. In short, the analysis of growth in newly settled regions does not shake Ricardo's belief that the pace of growth in every closed economy basically depends on supply side factors (such as the availability of fertile lands and the rate of growth of population), given the state of technological knowledge.

2. Colonies as outlet markets for domestic excess supply

The same supply side bias underlines Ricardo's rejection of the Smithian 'vent for surplus' doctrine.[3] According to Adam Smith, foreign trade in general and colonial trade in particular, by increasing the extent of the market, *i*) helps furthering the process of division and specialization of labour, thus enhancing domestic labour productivity, and *ii*) counteracts the fall of the rate of profits by opening new outlet markets for domestic excess supply (Winch 1963). While Ricardo was not oblivious to Smith's productivity argument (Sai-Wing Ho 1998), the 'vent for surplus' argument was entirely alien to his economic thought. In Chapter 21, 'Effects Of Accumulation On Profits And Interest', Ricardo got rid of the Smithian 'competition of capitals' explanation of the fall of the rate of profits by making recourse to Say's argument that "there is no amount of capital which may not be employed in a country because demand is only limited by production" (*Works* I.xxi.1). Accordingly, for Ricardo only supply side factors determine the rate of profits and the rate of capital accumulation in the long run:

there is no limit to demand − no limit to the employment of capital while it yields any profit, and…however abundant capital may become, there is no other adequate reason for a fall of profit but a rise of wages, and further it may be added, that the only adequate and permanent cause for the rise of wages is the increasing difficulty of providing food and necessaries for the increasing number of workmen. (*Works* I.xxi.12)

[3] Elmslie (1998) provides a concise discussion of recent literature on Smith's 'vent for surplus' doctrine.

As a consequence, foreign trade may affect the domestic rate of profits only to the extent that it makes cheaper those commodities generally consumed by workers living in the importing country (Maneschi, 1992):

It has been my endeavour to shew throughout this work, that the rate of profits can never be increased but by a fall in wages, and that there can be no permanent fall of wages but in consequence of a fall of the necessaries on which wages are expended. If, therefore, by the extension of foreign trade…the food and necessaries of the labourer can be brought to market at a reduced price, profits will rise. […] Foreign trade…has no tendency to raise the profits of stock, unless the commodities imported be of that description on which the wages of labour are expended. (*Works* I.vii.7 and 8)

Obviously, the same apply to the trade relationship between a colony and its mother country. As Ricardo made clear since his *Essay on the Influence of a low Price of Corn on the Profits of Stock* (1815), colonies can only offer an alternative allocation for domestic capital in search for a rate of profits higher than the low one that can be earned in the mother country because of the restriction to the import of cheap foreign corn (see also Kittrell 1965):

[the decline in profits is the] effect of a constantly accumulating capital, in a country which refused to import foreign and cheaper corn. But after profits have much fallen, accumulation will be checked, and capital will be exported to be employed in those countries where food is cheap and profits high. All European colonies have been established with the capital of the mother countries, and have thereby checked accumulation. (*Works* IV, p. 16)

In short, Ricardo's rejection of the Smithian 'vent for surplus doctrine' implies the rejection of the view that colonies may turn out to be a crucial element within a policy of demand-led domestic growth.

3. Trade restrictions between a colony and its mother country

Ricardo agreed with Smith on the negative effects of trade restrictions suffered by a colony to the benefit of its mother country. They both considered free trade as conducive to the best allocation of economic resources at the world economy level:

Adam Smith, in his observations on colonial trade, has shewn, most satisfactorily, the advantages of a free trade, and the injustice suffered by colonies, in being prevented by their mother countries, from selling their produce at the dearest market, and buying their manufactures and stores at the cheapest. He has shewn, that by permitting every country freely to exchange the produce of its industry when and where it pleases, the best distribution of the labour of the world will be effected, and the greatest abundance of the necessaries and enjoyments of human life will be secured. (*Works* I.xxv.1)

Yet, though the conclusions are the same, the economic models supporting them are different.[4] In Smith's economics the extent of the market is the crucial factor regulating the process of division and specialization of labour and thus affecting the growth of labour productivity and hence the growth of

[4] Readers should be warned that what follows is but an attempt to provide a rational reconstruction of the argument developed in Chapter 25 of the *Principles* consistent with Ricardo's overall economic analysis.

wealth. As a consequence, any restriction to free trade, by curtailing the extent of the world market, entails short-run welfare losses (prices of consumption goods are higher) and long-run efficiency losses (labour productivity stagnates). By contrast, in Ricardo's economics the high (and raising) price of commodities making up workers' natural consumption basket is the basic permanent obstacle to capital accumulation. A corollary of Ricardo's comparative cost analysis is that any restriction to free trade entails an inefficient international allocation of capital thus leading to a higher domestic price of wage goods in the long-run. Ricardo acknowledged that, in the short-run, a few domestic entrepreneurs may gain the monopoly profits generated by the trade restrictions in the exchange with colonies (see *Works* I.xxv.5 ff). Nonetheless, in the long run, such a monopoly does not entail any real advantage for the mother country economy since "the monopoly of the colony trade will change, and often prejudicially, the direction of capital; [...] there will be a worse distribution of the general capital and industry, and, therefore, less will be produced" (*Works* I.xxv.18). Thus, the argument used by Ricardo in Chapter 25, 'On Colonial Trade', to highlight the economic waste resulting from trade restrictions between colonies and the mother country appears to be fully integrated with his own general theory of economic growth: the local monopoly profits from trade restrictions turn out to be a purely monetary phenomenon, eventually eroded by the worsening of the production conditions in the wage goods sector of the mother country, and thus are definitely not to be considered as a growth-enhancing factor.

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