Chapter VI

ON PROFITS

The subject of profits was one of those important subjects that came under discussion between Ricardo and Malthus from almost the beginning of their famous correspondence. In February 1814 Ricardo had written some "papers on the profits of capital"¹ which he had shown to Malthus, Trower and James Mill and which have not survived. However, a perusal of Ricardo's letters written during 1813 and 1814 clearly indicates that although Ricardo, at that stage, was not very clear about the proposition which he later laid down in his 'Essays on Profits' and elaborated subsequently in his Principles of Political Economy and Taxation, yet he did believe that the rate of profits was essentially related to the 'facilities in the production of food'² and the 'cheapness of provisions.'³ As regards the position of Malthus, some of his important letters written during the same period are missing,⁴ but those that are available

1. Cf. Works and Correspondence of Ricardo, Vol.IV p.3. These papers indeed embodied Ricardo's view about the relation between the accumulation of capital and the rate of profits which he had arrived at in the course of his discussion with Malthus on the subject in the previous year. Cf. Works and Correspondence of Ricardo, Vol.VI pp.92-95.


clearly reveal that Malthus held that the rate of profits depended upon what he called the 'arena for the employment of capital' or the 'state of capital compared with the demand for it.'

According to Ricardo's theory the price of corn is regulated by the quantity of labour necessary to produce it with that portion of capital which pays no rent. The manufacturers of goods also do not pay any rent. Hence the whole value of the produce of what may be called the marginal producer is divided into two portions; the profits of stock and the wages of labour. It is obvious that the larger is the one portion of the total the smaller will be the other. Since with the progress of a society in wealth and population, cultivation is extended to inferior plots of land, the price of corn constantly rises. The increased price of corn leads to higher money wages in all lines of industry resulting into a fall in the rate of profits. In the case of manufactures, for example, the increase in the price of corn does not lead to an increase in their price but the consequent increase in the money wages lowers the profits. Ricardo describes this position as follows:

"Supposing corn and manufactured goods always to sell at the same price,

5. Cf. Ibid., p.104.
profits would be high or low in proportion as wages were low or high. But suppose corn to rise in price because more labour is necessary to produce it; that cause will not raise the price of manufactured goods in the production of which no additional quantity of labour is required. If, then, wages continued the same, the profits of manufacturers would remain the same; but if, as is absolutely certain, wages should rise with the rise of corn, then their profits would necessarily fall. If a manufacturer always sold his goods for the same money, for 1000£, for example, his profits would depend on the price of the labour necessary to manufacture those goods. His profits would be less when wages amounted to 600£ than when he paid only 600£. In proportion then as wages rose, would profits fall. 7

The farmer also cannot escape the fall of profits. 8 The increase in the price of corn will be counterbalanced either by rent or by additional wages. Since he will also have to pay an increase of wages to each labourer he employs, his

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rate of profits will also fall. Nor will the case of farmers using better land be different. They too would have to pay higher wages and they would also have to pay higher rent. Hence:

"In every case, agricultural, as well as manufacturing profits are lowered by a rise in the price of raw produce, it it be accompanied by a rise of wages." 10

The question arises what will be the effect on profits if the rise in the price of corn is not followed by a rise in wages. Ricardo answers that in that case profits will not fall. He is, however, convinced that a rise in the price of corn will necessarily lead to a rise in money wages. 11

Ricardo has also pointed out that a fall in the general level of profits is not incommutable with a rise of profits in a particular branch of industry. The high profits


To prove that a rise of wages will not raise the price of the product Ricardo has put forward two arguments. His first argument is that for the payment of higher prices more money would be required, and if by money we mean gold, an increased supply would be unobtainable in the circumstances (Cf. Ibid., p.104.). The second argument is that even if the prices of all commodities could be raised consequently upon a rise in wages, the capitalists would gain nothing and the effect on profits would be the same. (Cf. Ibid., pp.126-127.).

10. Ibid., p.115.

in one employment will attract capital from other employ-
ments till the profits conform to the general level. Accor-
ding to Ricardo the temporary variations of profits due to
comparative state of demand and supply of a particular
commodity does not invalidate his theory that:

"Profits depend on high or low wages,
wages on the price of necessaries,
and the price of necessaries chiefly
on the price of food." 12

Ricardo believes that since in the natural advance
of society, on account of the operation of the law of dimin-
ishing returns in agriculture, the price of corn must rise,
the fall of profits is inevitable. He says:

"The natural tendency of profits then
is to fall; for, in the progress of
society and wealth, the additional
quantity of food required is obtained
by the sacrifice of more and more
labour." 13

Now since it is the rise in the price of corn and
the consequential high money wages that lead to a fall in
profits, it follows that any thing that checks the rise in

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12. Ibid., p.119.
13. Ibid., p.120.
in the price of corn will at the same time check the tendency of profits to fall. Hence all improvements and inventions in agriculture that check the rise in the price of corn counteract the tendency of profits to fall. Ricardo writes:

"This tendency, this gravitation as it were of profits, is happily checked at repeated intervals by the improvement in machinery, connected with the production of necessaries, as well as by discoveries in the science of agriculture which enable us to relinquish a portion of labour before required, and therefore to lower the price of the prime necessary of the labourer."^{14}

It also follows that if corn and other commodities consumed by the labourers are obtained at a cheaper rate by foreign trade, money wages will fall and therefore profits will rise. Ricardo says:

"If, therefore, by the extension of foreign trade, or by improvements in machinery, the food and necessaries of the labourers can be brought to market at a reduced price, profits will rise. If, instead of growing

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^{14}. Ibid., p.120.
our own corn, or manufacturing the clothing and other necessaries of the labourer, we discover a new market from which we can supply ourselves with these commodities at a cheaper price, wages will fall and profits rise."

Since according to Ricardo the price of food is regulated by the quantity of labour necessary to produce it on the last land taken into cultivation, the proposition that profits depend on wages and wages depend on the price of food has been put in different words:

"That 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." 16

Malthus is not satisfied with Ricardo's theory of profits. He indeed agrees with Ricardo that profits are related to the productiveness of no-rent land but he considers this productiveness as only setting the upper limit for profits. As early as November 23, 1814 he wrote to Ricardo:

15. Ibid., p.132.
16. Ibid., p.126.
"...though the state of the land whether it is fresh and fertile, or comparatively at its utmost stretch of exertion, be the main cause of high profits, and of the final fall and almost ultimate extinction of profits, yet as the state of the land is by no means the sole cause which determines profits, but as they are powerfully influenced by the varying demands for produce occasioned by the prosperous or adverse state of commerce and manufactures, and the constant tendency to a fall in the wages of labour, it neither accords with theory or experience to call the state of the land the regulator of general profits."\textsuperscript{17}

In his Principles of Political Economy Malthus says:

"If the last land taken into cultivation can only be made to yield a certain excess of value above the value of the labour necessary to produce it, it is obvious that, upon the principles of competition, profits, generally, cannot

\textsuperscript{17} Works and Correspondence of Ricardo, Vol. VI p. 152.
possibly be higher than this excess will allow. In the ascending scale, this is a barrier which cannot be passed. But limitation is essentially different from regulation."¹⁸

It is obvious that Malthus considers Ricardo's explanation as only a limiting case of profits and not as a regulating principle. Malthus also believes that the cause pointed out by Ricardo for the falling tendency of profits, though powerful in its final operation, operates very slowly 'in the actual state of the world' and hence it is wrong on the part of Ricardo to estimate rate of profits for ten, twenty or fifty years in terms of diminishing returns to land alone. He says:

".....the natural and necessary tendency of profits to fall in the progress of society, owing to the increasing difficulty of procuring food, is a proposition which few will be disposed to controvert; but to attempt to estimate the rate of profits in any country by a reference to this cause alone, for ten, twenty or even fifty years together, that is for periods of sufficient length to produce the most important effect on national prosperity,

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¹⁸. Malthus, op.cit., p.300.
would inevitably lead to the greatest practical errors.\textsuperscript{19}

Malthus believes that below the highest limit set by the productiveness of no-rent land the variations in profits take place because of the operation of another cause which is more important for a period of ten to fifty years; this cause is 'the proportion which capital bears to labour' or, in other words, the relative plenty or scarcity of capital. According to Malthus it is the proportion of capital to labour that must be considered the regulating cause of the profits. In a letter to Ricardo, he writes:

"The real question is, what is the main cause which determines the rate of profits under all the varying degrees of productiveness? and I have no hesitation in answering distinctly that it is the proportion which capital bears to labour; or the plenty or scarcity of capital compared with the plenty or scarcity of labour; and what I mean by the demand for capital is a scarcity of capital compared with labour."\textsuperscript{20}

In his Principles of Political Economy Malthus asserts:

\textsuperscript{19} Ibid., p.308.
\textsuperscript{20} Works and Correspondence of Ricardo, Vol.VII p.80.
"When capital is really abundant compared with labour, nothing can prevent low profits, and the greatest facility of production is incapable of producing high profits, unless capital is scarce compared with labour."

According to Malthus in the agricultural sector the main cause of the necessary diminution of profits is, of course, the operation of the law of diminishing returns. But in case of manufactures and commerce, where the law of diminishing returns does not operate, it is the fall in the prices of commodities consequent upon too rapid an accumulation of capital and the excessive supply of output that leads to fall of profits.

Ricardo is not convinced by Malthus's argument. He believes that the only permanent cause of difficulty in the profitable use of increasing capital is due to greater difficulty in the production of corn and that even if it be said that the rate of profit is determined by the relative scarcity or abundance of capital, ultimately it is related to the facility or the difficulty of the production of food. In a letter to Malthus, he writes:

"I agree with you that when capital is scanty compared with the means of employing it, from whatever cause arising,

profits will be high. Whether temporarily or permanently most of course depend upon whether the cause be temporary or permanent. It is however very important to ascertain what the causes are which make capital scantily compared with the means of employing it, and how far when ascertained they may be considered temporary or permanent.

It is in this enquiry that I am led to believe that the state of the cultivation of the land is almost the only great permanent cause. There are other circumstances which are attended with temporary effects of more or less duration, and frequently operate partially on particular trades. The state of production from the land compared with the means necessary to make it produce operates on all, and is alone lasting in its effects."\textsuperscript{22}

Malthus, however, does not believe that the arena for the employment of capital is necessarily related to the state of production on the land. He is sure that the only way in

\textsuperscript{22} Works and Correspondence of Ricardo, Vol.VI p.133.
which the regulation of profits can be explained is through the operation of the principle of supply and demand. In a letter to Ricardo he writes:

"By the by the more I think on the subject the more I feel convinced that the rate of the profits of stock depends mainly on the demand and supply of stock compared with the demand and supply of labour, and very little (directly) on facility or difficulty of production."²³

Malthus does not dispute the influence of the price of necessaries on the profits of stock. But he insists that the results produced by this cause can be easily covered by invoking the principle of competition put forward by Adam Smith. His main complaint is that Ricardo does not attach sufficient importance to this principle. Malthus argues:

"It is merely a truism to say that if the value of commodities be divided between labour and profits, the greater is the share taken by one, the less will be left for the other; or in other words, that profits fall as labour rises, or rise as labour falls. We can know little of the laws which determine profits,

unless, in addition to the causes which increase the price of necessaries, we explain the causes which award a larger or a smaller share of these necessaries, to each labourer. And here it is obvious that we must have recourse to the great principles of demand and supply, or to that very principles of competition brought forward by Adam Smith, which Mr. Ricardo expressly rejects, or at least considers as of so temporary a nature as not to require attention in a general theory of profits."

Ricardo, however, is convinced that accumulation of capital in itself cannot lower the rate of profits. It is the high price of corn and the consequential rise in the money wages along with the process of accumulation of capital that lowers the rate of profits. In a letter to J.B. Say, he writes:

"It certainly was a great mistake of Adam Smith to suppose that profits depended on the degree of accumulation of capital, without reference to the question of popu-

...ation, and the means of providing for
that population."25

Similarly in his Notes on Malthus while commenting
upon a passage in Malthus's Principles of Political Economy
Ricardo remarks:

"It is here inferred that a fall of
profits is a necessary consequence of
an accumulation of capital. No mistake
can be greater."26

Ricardo admits only one possibility when profits can
fall due to greater accumulation of capital. If the funds for
the maintenance of labour increase at so fast a rate that
there is a want of hands then, of course, on account of the
relative scarcity of labour to capital the wages will be high
and profits low. He says:

"There is only one case, and that will
be temporary, in which the accumulation
of capital with a low price of food may
be attended with a fall of profits; and
that is, when the funds for the mainten-
ance of labour increase much more rapid-
ly than population;—wages will then be
high and profits low."27

Ricardo believes that this will be only a short-run situation. Encouraged by high wages labourers will increase their numbers and the increased supply will reduce the wage rate. It is only the increased cost of food that makes the rise of wages and fall of profits permanent.