



The topicality of David Ricardo's thought (on the bicentenary of the publication 'On the Principles of Political Economy, and Taxation')

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Abstract

Motivation: On April 19, 2017 200 years had elapsed since the publication of his book, *On the Principles of Political Economy, and Taxation*. Using the method of abstraction, deduction, and modelling, the British stockbroker and economist — despite his lack of formal economic education — produced many original concepts that have earned him a lasting place in the history of economics.

Aim: The objective of this study is to analyze the views of D. Ricardo, one of the most eminent representatives of the classical school, while the research problem is an attempt to assess their relevance.

Results: It follows from a critical analysis of his views that the creators of the marginal revolution overthrew his theories of value and the theory of wages. The institutional, legal and social changes that have taken place in the capitalist economy in the past two centuries have made his theory of price-specie-flow and the theory of economic development obsolete. However, his theories of money, foreign trade and rent of land, and his methods of investigation have withstood the test of time. Controversial remains the law of market ('Say's law') advocated by the classicists, and rejected by the followers of Keynesianism.

Keywords: *history of economic thought; classical school; economic methodology; theory of value; theory of money; division theory; foreign trade theory; law of market*

JEL: B1; B12; B40; E24; E30; E40; F10

1. Introduction

The history of economic thought records works whose fate could be the subject of fascinating treatises. Some works, despite their originality and importance for the development of economic thought, have remained unknown for several centuries. Examples include: *Tractatus de origine, natura, jure et mutationibus monetarum* by Nicole Oresme, written around 1355, and published after his death in 1484 (Oresme, 1864, p. XCI et seq.; Bochenek, 2004, p. 131), monetary treatises by Nicolaus Copernicus: *NC Meditata*, written in 1517, *Modus cudendi monetam*, prepared in the years 1519–1522, and *Monete cudende ratio*, developed in 1526, and issued for the first time — respectively in 1855, 1592, and 1816 (Kopernik, 1923, p. 23 et seq.; Bochenek, 2010, pp. 69–71), and finally the contributions of Józef Maria Hoene-Wroński on the history and theories of economics and finance, written in 1803, and issued only in 1879, titled *Sept manuscrits inédits, écrits de 1803 à 1806* (Hoene-Wroński, 1879, pp. 141–168) and in 1884 as *Caméralistique. Économie politique et finances* (Hoene-Wroński, 1884, pp. 1–322), *Création absolue de l'humanité* completed in 1818 and published in 1923 (Hoene-Wroński, 1923, pp. 92–103, 129–132), as well as the work of 1848, forgotten for more than 100 years, entitled *Adresse aux nations civilisées sur leur sinistre désordre révolutionnaire; comme suite de la Réforme du savoir humain* (Hoene-Wroński, 1848, p. 12 et seq.; Bochenek, 2008, pp. 32–35). In turn, the book by Hermann Heinrich Gossen entitled *Entwicklung der Gesetze des menschlichen Verkehrs und der daraus fließenden Regeln für menschliches Handeln*, issued in 1854 (Gossen, 1854, p. 8 et seq.), did not find a buyer and was withdrawn from sale, and almost the whole edition was destroyed. Through Julius Kautz (*Theorie und Geschichte der National-ökonomie*, vol. 2, 1858–1860) and Robert Adamson, the book by H.H. Gossen was discovered in 1878 by William Stanley Jevons and saved from oblivion (Bochenek, 2016, p. 43).

Many of the works became bestsellers soon after they were published. This group of treatises included, among others, Adam Smith's book titled *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), John Maynard Keynes's *The General Theory of Employment, Interest and Money* (1936), and Friedrich August von Hayek's *The Road to Serfdom* (1944) and *The Constitution of Liberty* (1960).

The book by the prominent representative of the classical school, David Ricardo, titled *On the Principles of Political Economy, and Taxation*, is also included in outstanding works and books. The previously mentioned bicentenary is a good opportunity to take a closer look at the life of this British broker and economist and to recall the most important concepts contained in his epochal work. The purpose of this paper is to analyze the views of D. Ricardo while the research problem is an attempt to assess the validity of his concept. A critical analysis of his views has allowed us to formulate a thesis that, despite the 200 years since the publication of his book and the three scientific revolutions in economics (Marxian, Marginal and Keynesian), his method of inquiry, as well as his important theories, remain valid.



2. Biography of David Ricardo¹

David Ricardo was born in London on April 18, 1772, to a family of Jewish stockbrokers Abraham Ricardo and Abigail Delvalle. At first he studied at home and later was educated in the Netherlands. From the age of fourteen he ran a brokerage business with his father. After converting to Christianity and marrying a quaker (Priscilla Ann Wilkinson), he parted from his family and started his own brokerage business. Thanks to his intuition, talent, and ability to engage in risky stock transactions, he quickly made a fortune. At the age of twenty-five he was one of the wealthiest Britons. He then became interested in mathematics, chemistry, mineralogy, and geology. While at a resort in 1799, he came across *An Inquiry into the Nature and Causes of the Wealth of Nations*, and started to expand his economic knowledge. In 1807 he co-founded the Geological Society, and two years later he started his writing activity. In his first works, that is: *The High Price of Bullion, A Proof of the Depreciation of Bank Notes* (1810), *Reply to Mr Bosanquet's Practical Observations on the Report of the Bullion Committee* (1811), *An Essay on the Influence of a Low Price of Corn on the Profits of Stock; shewing the Inexpediency of Restrictions on Importation: with Remarks on Mr Malthus' two last Publications: 'An Inquiry into the Nature and Progress of Rent'; and 'The Grounds of an Opinion on the Policy of restricting the Importation of Foreign Corn'* (1815) and *Proposals for an Economical and Secure Currency; with Observations on the Profits of the Bank of England, as they regard the Public and the Proprietors of Bank Stock* (1816), he raised the issue of inflation, monetary policy, excessive state debt and high grain prices. In 1814, he acquired the estate of Gatcomb Park in Gloucestershire. Three years later — on April 19, 1817 — his most important economic work, *On the Principles of Political Economy, and Taxation*, was published. As a freeholder, he became a member of the House of Commons. In 1821, together with Thomas Tooke, he founded the 'Political Economy Club' which was one of the first economic societies in the world. He lived in great friendship with James Mille and Thomas Robert Malthus. With the latter he corresponded for many years, exchanged views, and conducted scientific discussions, and even advised on how to make a profit on the stock market. In his last two works: *On Protection of Agriculture* (1822) and *Plan for the Establishment of a National Bank* (posthum, 1824), he criticized the cereal laws, and further developed a plan for the gradual recovery of the gold money and the basis for the reorganization of the Bank of England in 1844. He died on 11 September, 1823 at Gatcomb Park near Gloucester.

The considerations of this British stockbroker and economist included most of the issues of contemporary economics. Through his original concepts he contributed to the development of the classical school and was recognized as one of its most prominent representatives.

¹ Based on: Hartwell (1971, pp. 9–45) and Semkow (1988, pp. 24–33).

3. D. Ricardo's research method

Thanks to economic modelling and the use of the abstraction method, and by contributing to the formalization of economics, D. Ricardo was recognized as the greatest authority in the methodology of the English classical school. In his book *On the Principles of Political Economy, and Taxation* he created a complete deductive theoretical system of economics, formulated and presented in an abstract manner. His preferred method of reasoning was the abstract-deductive method which he developed most fully in the classical school. He was the master of abstraction and deduction. His economic analysis included the connections between economic phenomena of quantitative nature. He naturalized and absolutized the existing production relations. The economic laws discovered by him, which govern economic life, are — in his opinion — also of a general and an absolute character. The analyzed economic categories reflected real economic phenomena occurring in the contemporary reality. He argued that the relations in production between owners of land, owners of capital, and workers are decisive for the distribution of social income. Promoting a new way of thinking is also D. Ricardo's claim to fame. It was about embracing a wide range of significant problems by means of a simple analytical model that included only a few strategic variables. He masterfully created pure ahistorical theories, extracted from the existing reality. Through his way of pursuing scholarship, D. Ricardo set the direction for the development of economics (towards its theoretization) in the next century (Boniecki, 1984, pp. 82–87; Blaug, 1995, p. 98 et seq.).

This extremely successful economist also created many original theories, including theory of value, land tenure theory, labour wage theory, theory of money, and foreign trade theory.

4. Theory of value

To the author of *On the Principles of Political Economy, and Taxation* — theory of value was — as it was to Adam Smith — the main pillar on which he based his theoretical system. With it he united production with distribution. It was a criticism and development of the Smithsonian theory. D. Ricardo adopted value in use and value in exchange from A. Smith. Value in use is a prerequisite for value in exchange, but cannot be the basis for it. The usable goods can be assigned value in exchange owing to their scarcity or to the amount of work that has been spent on their production.

The value of a commodity is determined by the quantity of work necessary for its production. If changes in work quantities cause changes in value, then value in exchange must also change. It follows that the value in exchange of commodities is directly proportional to the amount of labour required to produce them, and inversely proportional to the productivity of the work. This regularity has been called Ricardo's law. In A. Smith's reflections on value, D. Ricardo saw inconsistency and contradiction. The British stockbroker-economist

rightly considered the view of A. Smith that the value of commodities is divided into income. On the other hand, he rejected A. Smith's claim that the value of commodities consisted of income. Value is divided into wages, profit and rent of land, but does not consist of them (Ricardo, 1951, p. 11 et seq.).

Including Smith's distinction between fixed capital and working capital, D. Ricardo explained the importance of capital in the process of creating value. Directly involved in value creation is the work needed for the production of a good and the value of the capital transferred to the good produced in the production process. Consequently, D. Ricardo distinguished between labour used immediately and prior labour. The value of a commodity is determined by the work performed directly in the production of the commodity concerned and the work performed earlier, which is currently included in the means of production. Capital is the sum of the work contained in the means of production and the means of consumption necessary for the livelihood of workers. The value of a product is not determined by the individual workload, but by the required time. The value of commodities is determined by the necessary work, performed in the worst conditions of production.

The author of *On the Principles of Political Economy, and Taxation* pointed out the difference between value and value in exchange. Value in exchange is an independent category, separate from value. This distinction led D. Ricardo to the identification of value with price. Within this latter category he identified the 'natural price' and the 'market price'. The natural value is identical with value in exchange, while market prices hover around value in exchange (Ricardo, 1951, p. 22 et seq.). In his opinion, 'It is the cost of production that must ultimately regulate the price of commodities, and not, as has often been said, the proportion between supply and demand. The market value of a commodity, until it is supplied in greater or less abundance, according to the demand may have increased or diminished; but this effect will only be of temporary duration' (Ricardo, 1951, p. 382).

5. Theories of money and theories of price-specie-flow

Like Jean Bodin, Bernard Davanzati Thomas Mun, William Petty, John Locke, Richard Cantillon, Cesare Beccaria, and David Hume, in his theory of money, Ricardo advocated the quantitative theory. Money itself is a commodity that only serves as a means of circulation. Standing firmly on the ground of the theory of value based on work, D. Ricardo maintained that also in the case of money, its value is determined by the amount of work needed to produce it. Assuming that the mass of goods and their value do not change, the amount of money needed for money's circulation depends on their value. He concluded that the amount of money in circulation determines its value. Any change in the amount of money triggers changes in commodity prices. This means that if other conditions do not change, the price level is proportional to the amount of money, and price changes are proportional to the change in the amount of money and the rate



of circulation, with the rate of circulation not changing, being rather constant. Thus, there is a close link between the amount of money and the price level in a given country. In other words, the value of money depends on its quantity.

Based on his own quantitative theory of money, D. Ricardo formulated the theory of international price-specie-flow. The existence of free international trade makes the balance of payments of various countries automatically equilibrate. If there is an excess of price-specie above the quantity needed for circulation, then the price of goods increases. The excess of price-specie occurs when a country obtains a surplus of exports over imports. Influx of price-specie from abroad causes an increase in prices of domestic commodities which become less competitive. National exports decline. As foreign goods are relatively cheaper, imports grow. As a result of a surplus of imports over exports, price-specie flows out of a country until balance is restored. These adjustment processes are the result of an automatically acting mechanism in the context of free international trade. Any interference by the state causes only disturbances in the operation of this mechanism (Ricardo, 1951, p. 47 et seq.).

6. Criticism of the corn laws

D. Ricardo touched on this issue in his book *On the Principles of Political Economy, and Taxation* and in his article *On Protection to Agriculture*. The British economist pointed out that during the industrial revolution in England, the demand for agricultural commodities increased sharply, mainly for corn (as a result of the increasing number of workers in industry) and wool (from the dynamically developing textile industry). While wool production was quickly adapted to demand, the corn market experienced an imbalance that caused a significant increase in its price. This phenomenon was accompanied by a fivefold rise in rent of land. Corn deficits on the market were to be supplemented by imports, a situation which was opposed by landlords. In their interest, Parliament — dominated by the Tories — passed corn laws that introduced customs barriers to cheap corn from abroad. The effect of the protectionist policies was high corn prices, which led to a rise in labour wages, which made English industrial products less competitive on the world market. D. Ricardo criticized the corn laws and fought for their abolition. He considered that the interests of the landlords, or landowners, were contrary to the interests of the rest of society. In his work entitled *On Protection to Agriculture* D. Ricardo argued that the effect of the abolition of customs duties would be a fall in the price of corn, because the cultivation of inferior land would be unprofitable, and management of better plots would reduce the costs of production and cause a fall in prices. To justify his views he used the theory of the rent of land and the theory of the distribution of labour on an international scale (Ricardo, 1951, pp. 301–337, Landreth & Colander, 1998, pp. 169–170).

7. Theory of foreign trade

David Ricardo advocated laissez-faire economic relations with foreign countries, not for ideological but for theoretical-and-practical reasons. The argument for a free international trade policy was not only the concept of the automatic price-specie-flow and automatic balancing of payments, but also the theory of foreign trade. This theory is called the theory of comparative costs. The author of *On the Principles of Political Economy, and Taxation* was of the opinion that there was a division of labour in the international arena. Individual countries should specialize in the production of certain goods, that is produce those goods for the production of which they have favourable conditions. Thanks to favourable conditions they can produce at relatively lower costs, compared to other countries. As a result of the international division of labour and free foreign trade, individual countries can gain more goods than if they produced them in their own country. D. Ricardo showed that the benefits of international specialization can be achieved when a country produces all goods more expensively than other countries. Relative cost differences between different countries are a basis for the benefits of specialization and exchange. International specialization in export production and for domestic needs should concern those goods which can be produced relatively most cheaply.

As an example, he gave the effects of international exchange between England and Portugal (picture 1.). England produced relatively cheap cloth, while Portugal — relatively cheap wine, although in the production of cloth Portugal also used less work. England, therefore, specialized in the manufacture of cloth and exported this product, while Portugal specialized in wine. Through specialization and exchange, these countries — which can be graphically represented — increased their consumption capacities and increased the aggregate ('global') production capacity (Ricardo, 1951, pp. 128–149) (picture 2.).

On the basis of the theory of comparative costs, D. Ricardo provided strong — valid to date — arguments for the supporters of free international trade. Reducing protectionism increases the well-being of all trading participants on a global scale.

8. Theory of distribution

To formulate the theory of distribution of social income, that is, the theory of distribution, closely linked to the theory of production, D. Ricardo used the theory of value. Thus the theory of value, as the foundation and binder of the whole system of economics, served to explain the mechanism of shaping and determining the level of wages, capitalist profit, and rent of land. The analysis of the above economic categories referred to the quantitative side of the determinants of their height and their mutual relationship (Ricardo, 1951, pp. 5–6).

According to D. Ricardo, the level of wages is dependent on the value of the means necessary to keep a worker's family. He assumed that the number



of workers and the level of real wages were constant. Referring to A.R.J. Turgot's law of the diminishing productivity of land and the Malthusian law of population adopted by the classical economists, D. Ricardo showed that workers can earn only a living minimum. In short periods, wages may temporarily shift to a higher level than their 'natural price'. In the long run, however, wages are determined by natural law, which acts automatically to reduce the wages to the minimum of subsistence. In a market economy, workers have no way of improving their position. Workers are destined to live in poverty. This is not a fault of the capitalist system, but of the workers themselves, who are obliged to regulate their natural growth in order to influence the level of wages. The position of workers is the result of natural law and, therefore, Ricardo fought against the statutory system of aiding the poor, which did not improve the living conditions of the working class and, on the contrary, it worsened them, as it increased the quantity of the class, resulting in a reduction in wages. The situation on the labour market is thus a consequence of the demand for labour and labour supply (Ricardo, 1951, p. 29 et seq.). The British economist-stockbroker noted that with the overall increase in payrolls, entrepreneurs replace human labour with machines. F.A. von Hayek called this claim 'Ricardo's effect' (Blaug, 1994, p. 547).

To D. Ricardo the existence of entrepreneurial profit was natural and obvious for the capitalist mode of production. Profit is thus a natural category. D. Ricardo focused his attention on the amount of profit and on the mutual interaction of profit and wages. The author of *On the Principles of Political Economy, and Taxation* thought that there was a contradiction between profit and wages. An increase in the rate of profit results in a lowering of the wages and vice versa — an increase in wages leads to a reduction in the profit rate. This means that there is class antagonism between the class of capitalists and the class of workers (Ricardo, 1951, pp. 110–127).

9. Theory of rent of land

D. Ricardo's theory of rent of land, along with the theory of comparative cost, is one of his greatest and lasting achievements. Previously, the question of rent of land, in the form of a differential rent, was the subject of James Anderson's reflections (1739–1808), in the work of 1777, *An Inquiry into the Nature of the Corn Laws*, and Sir Edward West (1782–1828), in a book from 1815, *Essay on the Application of Capital to Land*. Ricardo was, however, the first economist to analyze rent of land based on the theory of value. In contrast, J. Anderson and E. West used the theory of cost of production for their theory of rent of land and found that rent of land was a difference in production costs (Marks, 1965, p. 31 et seq., Marks, 1957, p. 259).

According to D. Ricardo, rent of land is a part of the value of a product of land, not an additive or a mark-up to its value. As part of the value of an agricultural product, rent belongs to the landlord who makes the use of land



available. Rent appears owing to the fact that the amount of land is limited and it is qualitatively uneven, and because of population growth and the need to cultivate less fertile and less favourably situated land. In his opinion, the worst plots of land do not bring rent to the owner of land, so there is no absolute rent, but only a differential rent.

According to the Ricardian theory of rent of land, the various parcels of land are differentiated in terms of fertility, and therefore capital expenditures incurred bring uneven effects. On the other hand, the value of agricultural products is determined by the conditions existing on the worst plots. Differential rent of land is received by the owner of a plot which is more fertile or more advantageous in relation to markets. Such an income is not obtained by the owner of the worst plot of land (Ricardo, 1951, pp. 67–83, 327–337, 398–429).

10. Theory of social development

The author of *On the Principles of Political Economy, and Taxation* was of the opinion that in every society there are quantitative shifts in the distribution of social income. This issue was highlighted in the theory of the development of society, which explained the quantitative movement of wages, profits, and rent, accompanying the development of the capitalist mode of production.

As the economy grows, the profit rate will inevitably decrease because rent of land rises steadily, while real wages are on a constant level. These tendencies are caused by the increase in rent of land as a consequence of progressive population growth and a simultaneous effect of the law of decreasing land productivity. As a result of the increase in the number of people, worse and worse plots of land are increasingly being cultivated. In turn, the existent plots of land are subject to intensified cultivation, but owing to the law of decreasing land productivity, the yield of these plots is constantly decreasing. The effect of these two basic factors is that rent of land is rising and will take over an increasing share of social income. Nominal wages will rise, but real wages will remain unchanged.

Landlords who gain more and more income in the form of a rising rent are the only beneficiaries of economic development, while capitalists lose because the profits, or their incomes, are decreasing. Natural factors, such as population growth and the law of decreasing productivity are also among the causes of a falling profit rate. Therefore, the British stockbroker-economist gave an absolute and natural character to the law of falling profit rate. D. Ricardo thus came to the pessimistic conclusion that capital accumulation would disappear and society would inevitably approach the limits of production growth (Ricardo, 1951, pp. 273–299).

II. Defence of the law of markets

The view of the impossibility of overproduction and of the existence of a balance of global demand and global supply, was formulated independently by James Mill, in his work of 1804, *Lord Lauderdale on public health*, and of 1808 — in *Commerce Defended*, and *Mill's commerce defended*, as well as Jean Baptiste Say in the second edition of *Traité d'économie politique, ou simple exposition de la manière dont se forment, se distribuent et consomment les richesses* of 1814. The claim, then called law of market, was taken over and developed several years later by D. Ricardo. In his book, he explicitly pointed out that demand is the only limit to the volume of production. Individuals produce only with the intention of consuming or selling and always sell commodities in order to buy other commodities for consumption or future production. The manufacturer becomes either the consumer of his own products or the purchaser and consumer of the products of other manufacturers. Knowing the demand for their products, manufacturers maximize their own benefits, which manifest themselves in obtaining the desired goods (Ricardo, 1951, p. 290). The British stockbroker-economist wrote: 'Productions are always bought by productions, or by services; Money is only the medium by which the exchange is effected' (Ricardo, 1951, pp. 291–292). So it is not possible to overproduce all commodities, but only individual goods. Satisfaction of needs depends on available resources, and these come only from production (Ricardo, 1951, p. 292).

Probably D. Ricardo did not understand the importance of the law of market. He believed that this law was applicable at all times and in all conditions, and therefore the economy tends to engage fully the factors of production and balance. He also did not present a mechanism for the sale of ever-increasing production. He argued, however, that the mechanism of maintaining balance in the economy is the more efficient, the greater the range of freedom available to competition. But D. Ricardo's dogmatic and defective defence of the law of market was a logical defence. Ricardo's victory in a dispute with T.R. Malthus meant the victory of correct reasoning. Unfortunately, there was no further discussion on this law, nor on the problems of the business cycle (Blaug, 1994, pp. 189–190).

12. Conclusion

Although Ricardo did not have a formal economic education, his book *On the Principles of Political Economy, and Taxation*, published in 1817, was soon recognized as an outstanding work and even brought him international fame. Some of the concepts presented in it have become obsolete, while others have been timeless. D. Ricardo was the master of abstraction and deduction, and of economic modelling in the classical school. Economic modelling is recognized by modern economic theorists as one of the most highly valued skills. His original works include: theory of value, theory of money, theory of land tenure,



theory of wages, and theory of foreign trade and economic development. D. Ricardo argued that the value of a product is determined by the amount of work needed to produce it. He distinguished labour used immediately and prior labour, as well as natural price and market price. His theory of value was rejected by the precursors and authors of the marginal revolution. In time, postulates (Vilfredo F.D. Pareto, Gustav K. Cassel, and Władysław M. Zawadzki) appeared to remove the notion of value from economic considerations. The theory of wages indicated that workers could earn only a living minimum and were destined to live in poverty. This theory was replaced by the neoclassical theory, based on the concept of marginal productivity. The departure from the standard of gold in the twentieth century made obsolete his his theory of price-specie-flow in international trade, in which he demonstrated that under free international trade price-specie flows freely and leads to the equilibrating of the balance of payments in various countries. New legal and institutional solutions, such as trade unions, the democratization of political life, social insurance, etc., changes in the social structure, the increase in the well-being of societies, and finally the impetus for innovation have made the theory of economic development obsolete. Other concepts have withstood the test of time. And so in his quantitative version of the theory of money, D. Ricardo maintained that the amount of money in circulation determines its value. In the 20th century, Alfred Marshall and Milton Friedman developed it and it still has many zealous followers. The theory of comparative costs justified the conduct of a free international trade policy. D. Ricardo was of the view that individual countries should specialize in the production of the goods which they can produce relatively most cheaply. At the same time, he criticized protectionism, which in most cases is a burden on domestic consumers and protects inefficient producers. His theory of rent of land is a differential theory. It points out that extraordinary profits are received both by landlords who are more productive and have a better location in relation to markets Just like James Mill and Jean Baptiste Say, D. Ricardo also advocated the law of the market, that is the balance between global demand and global supply, which testifies to the inability to overproduce. This view is also supported by contemporary supporters of the classical trend. The above means that his method of inquiry and ideas remain a permanent and valid element of the store of economic knowledge.

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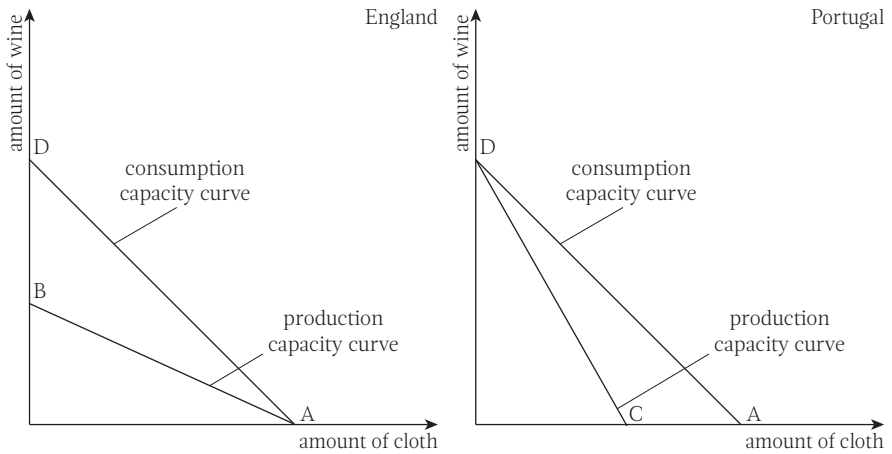
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Appendix

Picture 1.

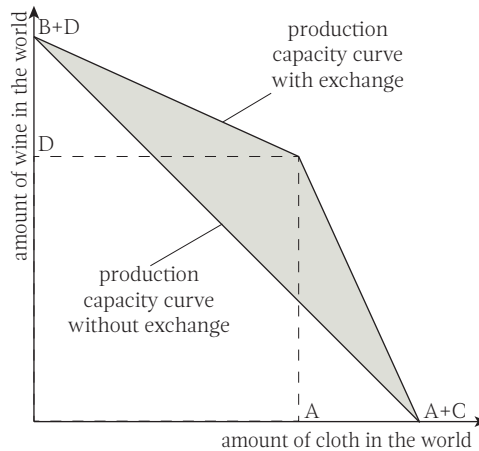
Production and consumption capacity in England and Portugal



Source: Own preparation.

Picture 2.

Expanding the world's manufacturing capacity through specialization and exchange



Source: Own preparation.