MBHS Economics Club

Economic History Pt. 1 Notes

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In defensionem et propagationem nummarium Στην υπεράσπιση και τον πολλαπλασιασμό της οικονομικής επιστήμης

iBE

Disclaimer: The East Existed

What we're discussing today is purely Western economic history. Europe developed differently than China and India, and many of these economists' ideas had occurred earlier in the East. China was a large enough economy to be governed by the principles of modern economies, and India's *Arthashastra* basically outlined all of John Maynard Keynes's theories. That said, these ideas have had very little influence on modern economic thought, and are outside the scope of this lecture.

Early Economic Systems: In ye olde days, economics existed on a much smaller scale.

- This is reflected by the origins of the word economics in Greek: οἰκονόμος (pronounced '*oikonomos*'), which means *the ruler of the house*.
- Because of the smaller scope of economic activity, very few theories were proposed at the time.
- There were some other notable differences in ancient and modern systems in application rather than in theory. For example, ancient systems were much more reliant on slavery than modern systems; in, fact slaves comprised over 1/3 the population of Athens and Rome and 9/10 the population of Sparta.
  - This was based off the idea of the slave surplus: slaves were profitable if they produced more than they consumed. With this idea, slaves could be put to more work in times when everybody has jobs, and put to less work to create jobs when artisans needed them — so long as they provided a surplus. (When they stopped providing a surplus, they were put to death.)
  - As such, the economy was heavily controlled by those who had the most slaves: the landed gentry. Seeing that they had this economic influence, both through their slaves and other assets, they tended to heavily restrict commerce. Because of this, no sophisticated accounting systems were developed for a long time, making large scale economies nearly impossible.

Medieval Western Economics

- **Feudalism**
  - The main system under which medieval Europe operated.
  - A landowning lord gave his land out to vassals (usually members of the nobility who ranked lower than him) in return for their service, or rented it out to tenants who would produce crops for him and the Catholic Church.
  - **Guilds**
    - Associations of artisans and merchants who controlled the practice (read: had a total monopoly) of their craft in their country.
    - They were controlled by their country's elite and normally conducted affairs with the ruler's approval.

        - They set very high standards for their products.
    - Notable problems with feudalism:
        - No incentive for innovation — the guilds were extremely strict and rigid, thereby discouraging any form of innovation.
        - No possibility of social mobility — because of the highly rigid system, commoners could never hope to rise out of their class and become a nobleman or person with power.
        - Large-scale trade was nearly impossible

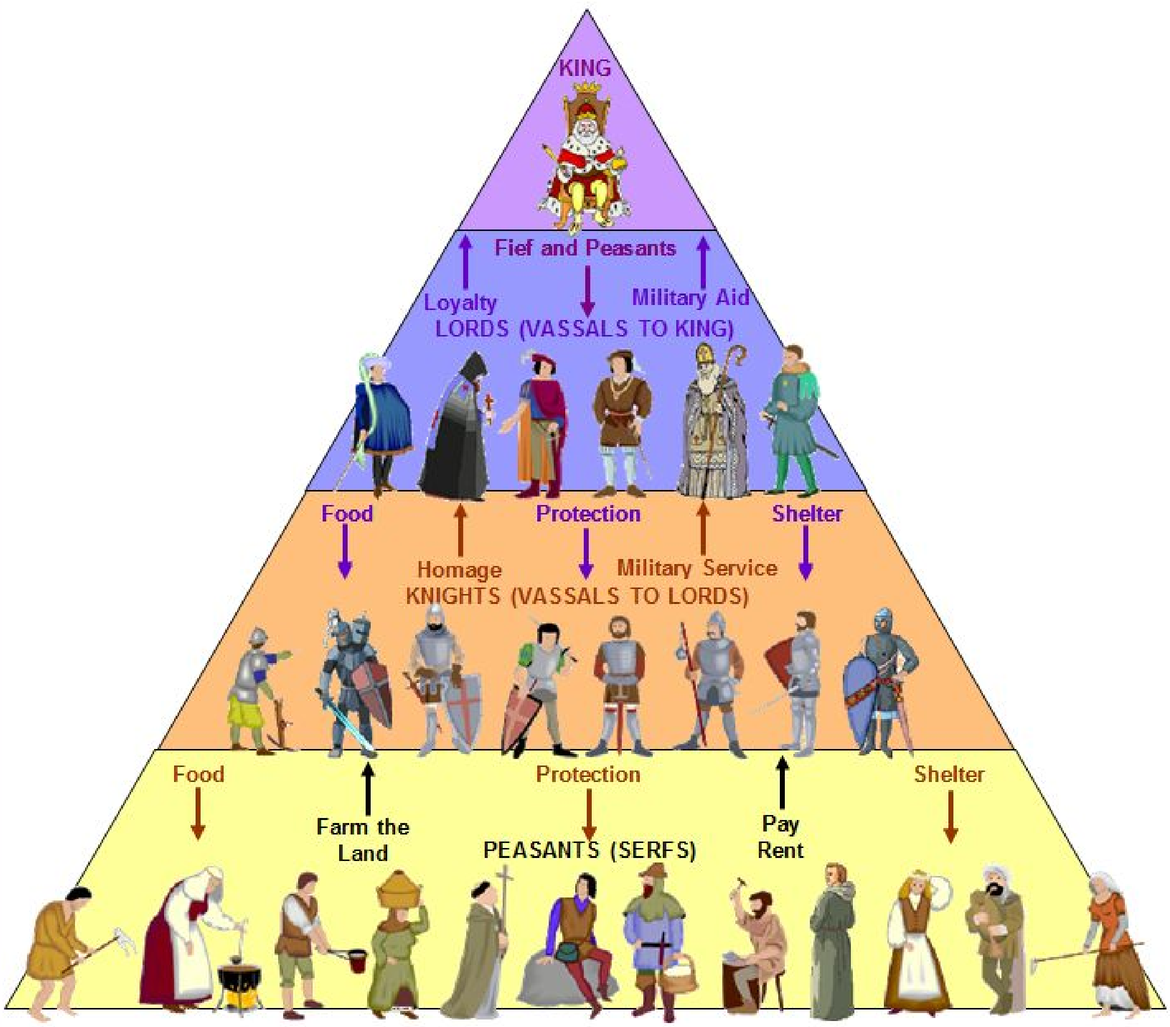

Fig 1.0: The highly rigid social hierarchy under feudalism.

    - The end of feudalism — THE BLACK DEATH
        - In the mid-14th century, the bubonic plague swept through Europe, killing off an estimated *1/3* of the population of the continent (basically, at least one person in every family died of plague). In fact,

        - the world population as a whole did not recover to pre-plague levels until the 17th century.
        - The deaths lead to a massive deficit in available labor. Therefore, many peasants who survived received permission from their lord to leave his territory to find work in other places. This led to the breakdown of the feudal system, since peasants weren't bound to and considered as their lord's property anymore.
- **Theological economic theories: St. Thomas Aquinas**
    - St. Thomas Aquinas (pronounced "Ah-kwai-nus") was a 13th century Catholic priest, philosopher, and theologian.
    - His contribution to economics, like that of most medieval economic thought, focused on morality in economic action.
    - *Just price*
        - He argued that a *just price*, which takes into account the amount of labor and commodities necessary to produce something, must be identified.
        - To sell things more than this just price would be considered immoral, even if supply increased.
    - Argued that "All gains in trade must be made due to the labor of the provider, not the need of the buyer."

Mercantilism

- A school of economic thought that was highly popular during the 16th and 18th centuries.
- The economic counterpart of the absolute monarchies that developed in the aftermath of feudalism, and it was therefore based around promoting the wellbeing of the crown and particular merchants, not that of the general economy.
- Core tenets:
    - Money, in the form of precious metals, is the only form of true economic value.
    - All states cannot benefit from international trade at the same time.
    - Therefore, measures should be taken to maintain a positive balance of trade by encouraging exports and discouraging imports.
    - This should be done through the use of tariffs, government-imposed restrictions and military force.
    - Large populations were an indirect form of wealth which made possible the development of bigger markets and armies.
- These ideas were particularly problematic for colonial nations, which tended to be exploited to get the natural wealth which mercantilists held so dear. You might

remember this from U.S. history, seeing that mercantilist policies drove the colonies to break away from Britain.

The Mercantilist Argument for Colonial Expansion

Fig 2.0: An allegory of mercantilism.
The American colonists felt exploited by their mother country, Great Britain, since all of the great stuff they were producing were going back to Britain — and it still wouldn't allow them representation in Parliament. Make sure to note Britain's face, though. That's a face only a mother country could love.

- The mercantilist theory was developed by numerous economists between 1500 and 1750, including Thomas Mun, James Steuart, and Philipp Wilhelm von Hornick. But the theory is perhaps best stated by one of it most famous advocates:
    - **Jean-Baptiste Colbert:** The epitome of mercantilist state control, Colbert was a renowned statesman, and the finance minister of France from 1665 to 1683. His policies and ideas included:
        - Establishing government-run corporations to control sectors of the economy and improve quality of goods
        - Raising tariffs dramatically to discourage any imports
        - Imposing strict requirements on the quality of goods and punishing those who transgressed severely
        - Completely prohibiting emigration of French artisans
        - Granting privileges to special companies to undergo trade with distant lands such as the Levant, Senegal, Guinea, and the Americas

Classical Economics

- **Adam Smith:** an 18th century Scottish economist who created classical economics (and capitalism) with his revolutionary book, *An Inquiry into the Nature and Causes of the Wealth of Nations*, which all sane people refer to as *The Wealth of Nations*.
  - The primary points of the book were that:
    - Supply and demand influence the economy.
    - Trade creates value to the benefit of all.
    - Specialization of labor is important in increasing production.
    - The detriment of barriers to entry (tariffs, over-regulation, and price controls).
    - The importance of investment in stimulating the economy
  - Above all, Smith argued that the free market would be regulated by a force dubbed the 'Invisible Hand', which would lead to the betterment of all mankind
  - We can't do this book justice on such limited space, so go read it.
  - Impacts:
    - *The Wealth of Nations* was published in 1776, when mercantilism saw a decrease in popular support.
    - After debate, Smith's ideas strongly influenced British policy, with several new taxes being passed and Smith's opinion being consulted for matters regarding free trade.
    - By 1820, his ideas began to be implemented in full force, promoting further free trade in Britain until WWI.
    - It also lead to the creation of a new set of ideas, carried on by his successors, including Ricardo and Malthus.

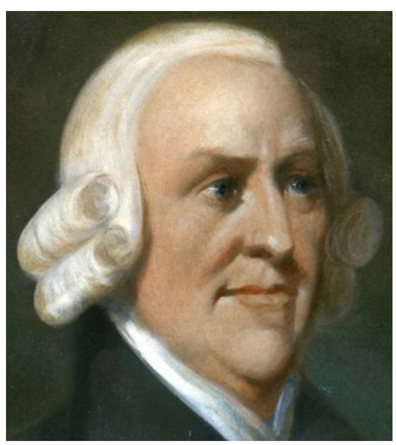

Fig 3.0: Adam Smith. The father of classical economics and capitalism.

- **Thomas Robert Malthus:** a professor of political economy at the East India Company College and key protectionist. You've probably heard of him from his paper *An Essay on the Principle of Population,* where he predicted that the world population would grow faster than the food supply, leading to global catastrophe. Sort of.
    - He argued that population multiplies geometrically and food arithmetically; therefore, the population will eventually outstrip the food supply (h/t comp team). He did however, also state that it was one of the goals of economists to prevent this and to find solutions to this, as society had in the past.
    - More notably, this was the first time people really took an analytical approach to economics and used *numbers*!
    - He also gave economics the name "the dismal science."

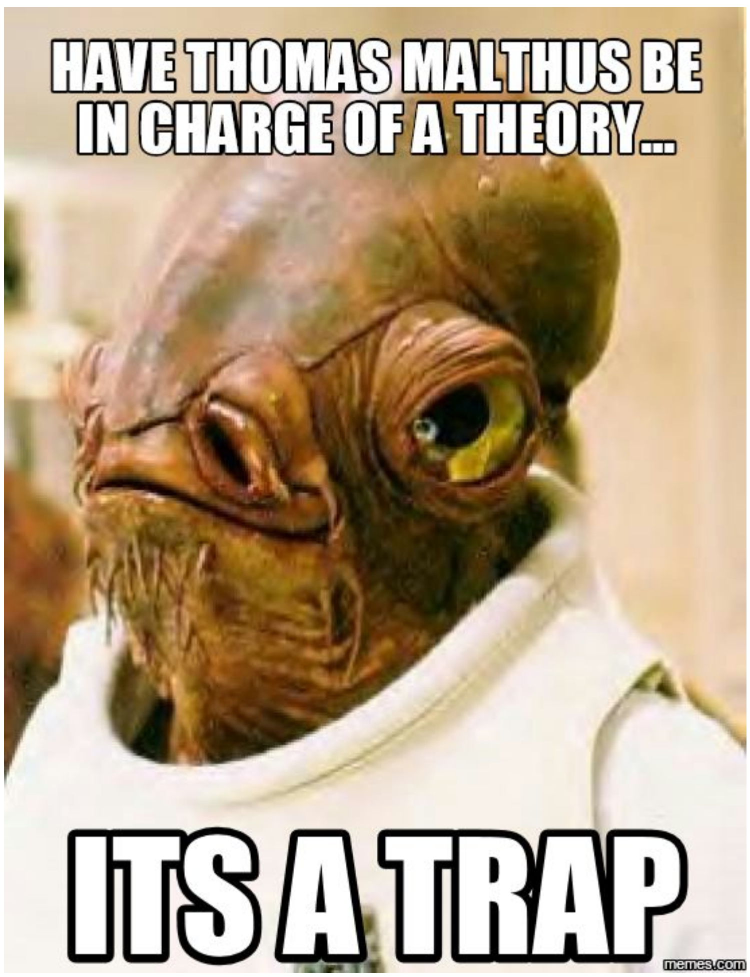

Fig 4.0: Thomas Robert Malthus. Old, white, and a formal leader in a church, but not a theologian.

- **David Ricardo:** a late 18th to early 19th century English political economist.
    - He was a good friend of Malthus's, despite dramatically different doctrine.
    - Personal achievements:
        - He made a fortune as a financial market broker and speculator.
        - He later served in the House of Commons.
        - He developed his systems on the ideas of
            - Classical rent
            - Malthus's population statistics
            - Wage-fund doctrine
            - Say's law
    - He is most famous for the theory of **comparative advantage**.
        - The theory states that a nation should concentrate its resources solely on industries where it is *most* internationally competitive while trading with other nations to obtain products not produced nationally as a result of industry specialization.
            - For example, let's say the U.S. is more internationally competitive in producing airplanes (because we have Boeing) than shoes, while the opposite is true of China. Therefore, the U.S. should focus on producing planes, while China should focus on producing shoes.
            - The U.S. will then trade planes for shoes, while China will trade shoes for planes.
            - Both nations' resources will therefore be put to the best and most efficient use.
        - This theory is still very applicable today and continues to be cited in defense of international trade.
    - He also championed free trade under central planning.
    - **Law of rent**
        - The economically reasonable rent for a plot of land is equivalent to the economic advantage obtained by using the site at optimal productivity, relative to the advantage obtained by using marginal (read: "best available rent-free") land for the same purpose and under the same conditions.
        - Basically, trash land becomes less trash from a tenant's perspective when the price of a good they seek to produce rises.

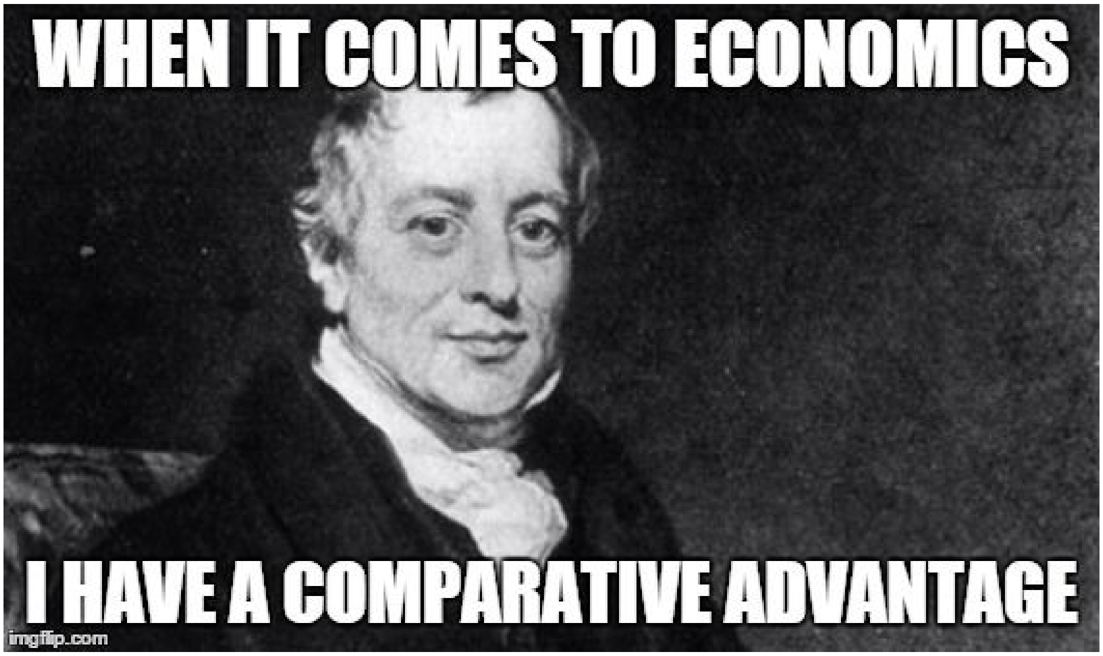

Fig 5.0: David Ricardo.

- **Corn Laws:**
  - In Malthus and Ricardo's time, Britain was engaged in the Napoleonic Wars (1803-1815).
    - Napoleon, then the Emperor of France, was pursuing a policy called the Continental System.
      - He tried to cripple Britain economically by forbidding the import of British goods into European countries allied with or dependant upon France (basically almost all of Europe).
      - He also tried to cut off all trade to Britain.
      - Fun fact: Once he realized that extensive trade was going through Spain and Russia, ***he invaded both countries*** — Spain in 1807, and Russia in 1812, *when he was still involved in Spain*. Everyone knows what happened in Russia: disaster and death.
    - Corn prices rose 18% in britain as a result.
  - After the war, many lords, who had benefitted from the price increase, wanted to keep it that way.
  - This led to the passing of the Corn Laws — restrictions and tariffs on importing agricultural products.
    - This led to a conflict between industrialists and landowners.
    - Ricardo opposed the laws, while Malthus supported them.

- **Malthus's theory regarding the Corn Laws:**
    - Asserted that economics was primarily agricultural.
    - Followed Smith's view that rent was the chief form of surplus.
    - Population increases led to increases in demand for food.
    - Food represented the demand for population.
        - Food create demand for itself.
        - Hence, food prices must be high because food is abundant.
    - Rent was a gift of nature to the owners of land that ultimately increased the wealth of society.
    - National reliance on foreign markets for food would be bad.
    - All this taken into account, protectionism is beneficial.
- **Ricardo's theory regarding the Corn Laws:**
    - Assumed, as was the norm, that poor people made themselves poor.
        - Wages were fixed by market pressures caused by the population pressures created by the working class itself.
    - Asserted that economics was primarily industrial and capital.
    - Rent was then a deduction of wealth from others, based on Say's law.
    - Hence food prices and profits moved inversely.
    - Profits were beneficial to society, hence protectionism was detrimental.
    - As history shows, Ricardo's theories were more correct as industrialization came to full steam, and made up the vast majority of Britain's economy, eventually reducing protectionism in Britain.
    - However, it should be noted that Ricardo's theories are based in Say's law, and this was another major point of contention between Ricardo and Malthus. One of the key applications of say's law is the claimed impossibilities of gluts.
- **Gluts**
    - Glut — excess supply of a good or service
    - General glut — a glut in all goods and services
    - Say's law stated that an increase in aggregate output caused a corresponding increase in aggregate demand.
        - This implies that general gluts are impossible.
        - Although Malthus may have lost when it came to protectionism, his ideas were vindicated with Keynes, who took inspiration from Malthus in his theories of economics when disproving Say's law.