

History of Economic Thought I

3 : II . The Birth of a New Science (2)

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Key Points for Today's Lecture

- The Formation of “First Core of Economics” by “First Economists”
- ① Richard Cantillon
- ② Physiocracy
- ③ Hume and Smith
 - Criticizing “international competitiveness,”
state control = criticizing mercantilism

Background

- 18th century : Western European States clashed
- Seven Years' War, 1756-1763) : The first Global War : Britain emerged as global Empire
- Britain : Oligarchy: Parliamentary system by the privileged
- Scotland : 1705, Union with England, 1746, Battle and Culloden
- Scottish Universities:
 - Innovative and pioneering, learning from the Continental Universities
 - Practical: the University of Glasgow provided workshop to James Watt
- 1776
 - The War of Independence in the US, the Crisis of the First British Empire
 - James Watt improved the steam engine

Post-Bubble Economics:

Richard Cantillon, 1680?-1734?

- *Essays on the Nature of Trade in General* (1755)
- Discovering
 - the “real” economy
 - general economic interdependence
 - City and Rural area
 - Manufacturing and agriculture
 - Market
 - The role of entrepreneur: Bearing uncertainty
- Legacy, carried and forgotten
 - Quesnay, Tableau Economique
 - Entrepreneur

The Role of Money Redefined

- Limited role of money
 - Short-run non-neutrality
 - Long-run neutrality : cannot achieve long-run growth or development by manipulating money
- Cyclical view of history of rise and fall of states
- price specie flow mechanism :
 - $X \uparrow \Rightarrow \text{Trade surplus} \Rightarrow \text{Outflow of specie} \Rightarrow \text{Domestic price level} \uparrow \Rightarrow \text{Price of export goods} \uparrow \Rightarrow X \downarrow, M \uparrow \Rightarrow \text{Trade surplus} \downarrow$
- But an “able minister” can restart the cycle
- Cyclical view, not continuous and sustained economic growth

Physiocratie

Rule by Nature

- François Quesnay, 1694-1774
- The first “school” in the history of economics
 - “économistes”
 - Founder
 - Canons
 - Disciples:
 - Marquis de Mirabeau,
Pierre Samuel du Pont
de Nemours



Tableau économique

- Original Table (1759), Formula (1767)
- Economic Circulation among three classes
 - Productive Class: farmers
 - Sterile Class: manufactures, merchants
 - Proprietors of the Land, the Sovereign, the Tithe owners
- “advances”: capital
 - Original advances = fixed capital
 - Annual advances = circulating capital

TABLEAU ÉCONOMIQUE.

Objets à considérer, 1^{re} Trois sortes de dépenses; 2^e leur source; 3^e leurs avances; 4^e leur distribution; 5^e leurs effets; 6^e leur reproduction; 7^e leurs rapports entr'eux; 8^e leurs rapports avec la population; 9^e avec l'Agriculture; 10^e avec l'Industrie; 11^e avec le Commerce; 12^e avec la masse des richesses d'une Nation.

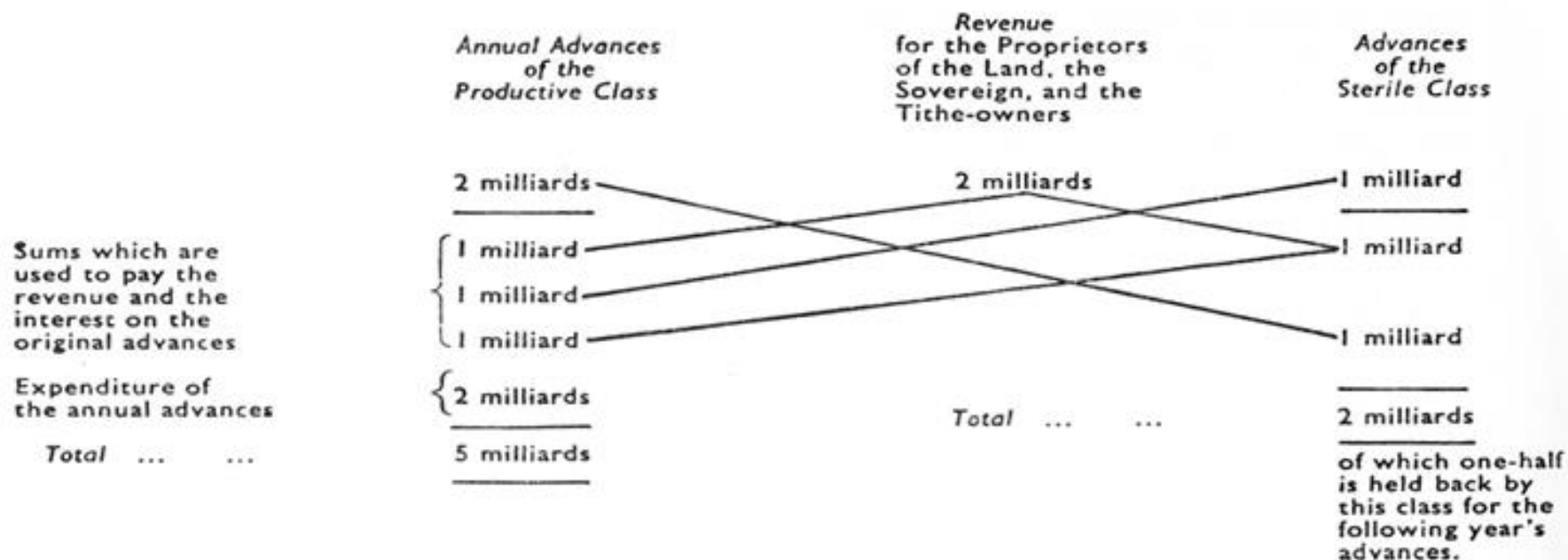
DEPENSES PRODUCTIVES relatives à l'Agriculture, &c.	DEPENSES DU REVENU l'impôt prélevé, se partageant aux Dépenses productives & aux Dépenses stériles.	DEPENSES STÉRILES relatives à l'Industrie, &c.
Avances annuelles pour produire un revenu de 600 ^{fr} dont 600 ^{fr} 600 ^{fr} produisent net.....	Revenu annuel de 600 ^{fr}	Avances annuelles pour les dépenses des dépenses stériles, comp. 300 ^{fr}
Production annuelle brute.....		Production annuelle brute.....
300 ^{fr} reproduisent net.....	300 ^{fr}	300 ^{fr}
150 ^{fr} reproduisent net.....	150 ^{fr}	150 ^{fr}
75 ^{fr} reproduisent net.....	75 ^{fr}	75 ^{fr}
37.10 ^{fr} reproduisent net.....	37.10 ^{fr}	37.10 ^{fr}
18.15 ^{fr} reproduisent net.....	18.15 ^{fr}	18.15 ^{fr}
9 ^{fr} reproduisent net.....	9 ^{fr}	9 ^{fr}
4.13 ^{fr} reproduisent net.....	4.13 ^{fr}	4.13 ^{fr}
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0.1.5 ^{fr} reproduisent net.....	0.1.5 ^{fr}	0.1.5 ^{fr}
&c.		
REPRODUIT TOTAL.....	600 ^{fr} de revenu; de plus, les frais annuels de 600 ^{fr} et les intérêts des avances primitives du Laboureur, de 300 ^{fr} que la terre restitue. Ainsi la reproduction est de 1500 ^{fr} comprise le revenu de 600 ^{fr} qui est la base du calcul, abstraction faite de l'impôt prélevé, et des avances qui exigent sa reproduction annuelle, &c. Voyez l'Explication à la page suivante.	

Diagram I.

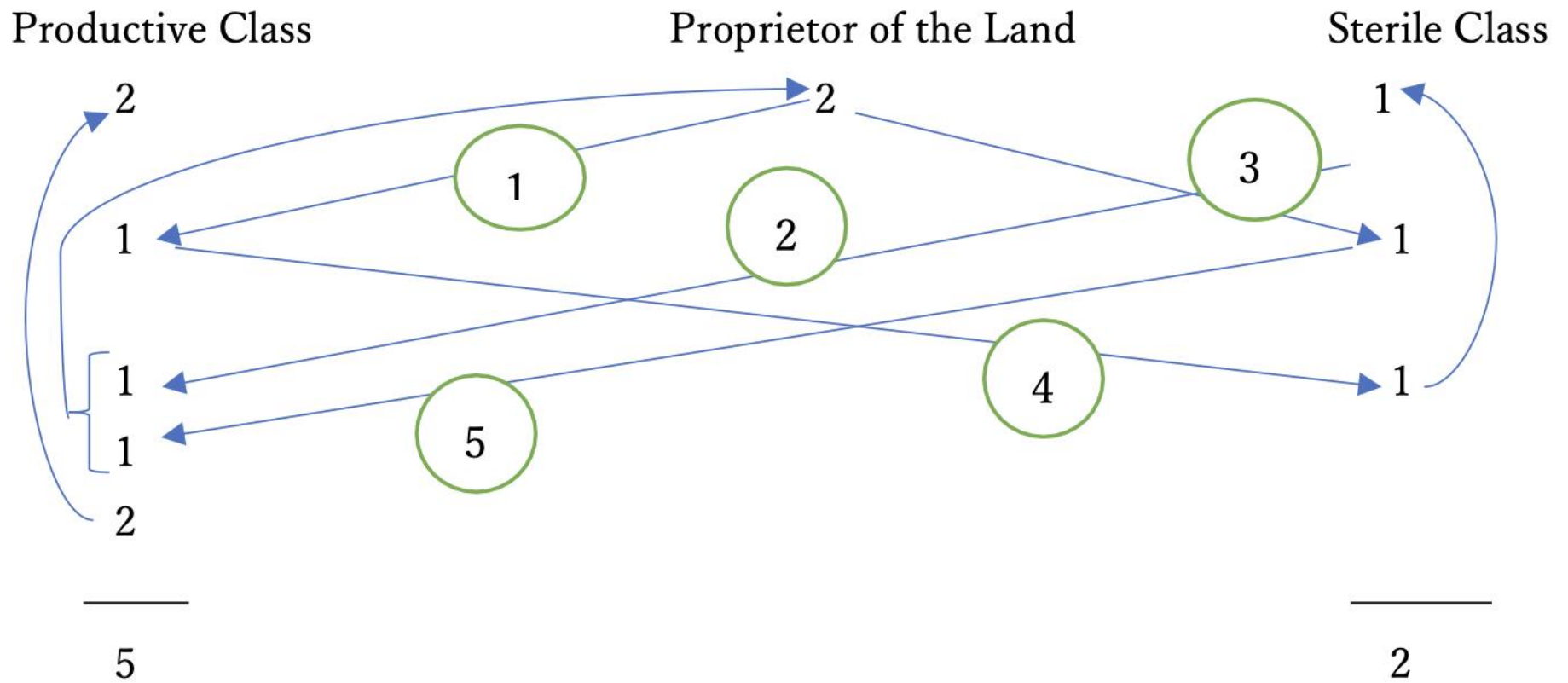
(from R.L. Meek's
The Economics of Physiocracy)

FORMULA OF THE *TABLEAU ECONOMIQUE*

Total Reproduction: Five milliards



Formula



Circular Flow of the Economy

- Initial stage : Productive class (P) 2 billion as product, Proprietors (L) Money 2, Sterile Class (S) Money 1
- P: Original advances 10, depreciates in 10 yrs = advance 1
- P produces agricultural products : 5
- ①L: Use 1 to purchase agricultural product
- ②S: Use 1 to purchase agricultural product, produces manufacturing products 2
- ③L: Use 1 to manufacturing products
- ④P: Purchase manufacturing products 1
- ⑤S: Purchase agricultural product 1
- S has Money 1, P has agricultural products 2 → L as Rent
- Back to the initial stage

Physiocracy

- Characteristics
 - ① Only agriculture produces “net products” = “revenue” (profit)
 - ② With laissez-faire, “good price” prevails and agriculture revives naturally
 - ③ Mercantilist artificial controls should be abolished
- Criticisms
 - Only agriculture produces “net product” = “revenue”?
Only agriculture is productive?
 - 1) Adam Smith : depends on the definition of revenue
 - 2) depends on numerical example

The Birth of Economic Growth/Development

- The product of the modern age
- Brewer 1995
 - Continuous increase in total product of a nation
 - Emerged in late 18th century
 - Probably Hume, Anne Robert Jacques Turgot (1727 – 1781), but definitely Smith
- Economists lagged the reality in recognizing it.

Economic Growth Came to England

Gross domestic product (GDP) in England

This data is expressed in British pounds, adjusted for inflation.



Data source: Broadberry, Campbell, Klein, Overton, & Van Leeuwen (2015)

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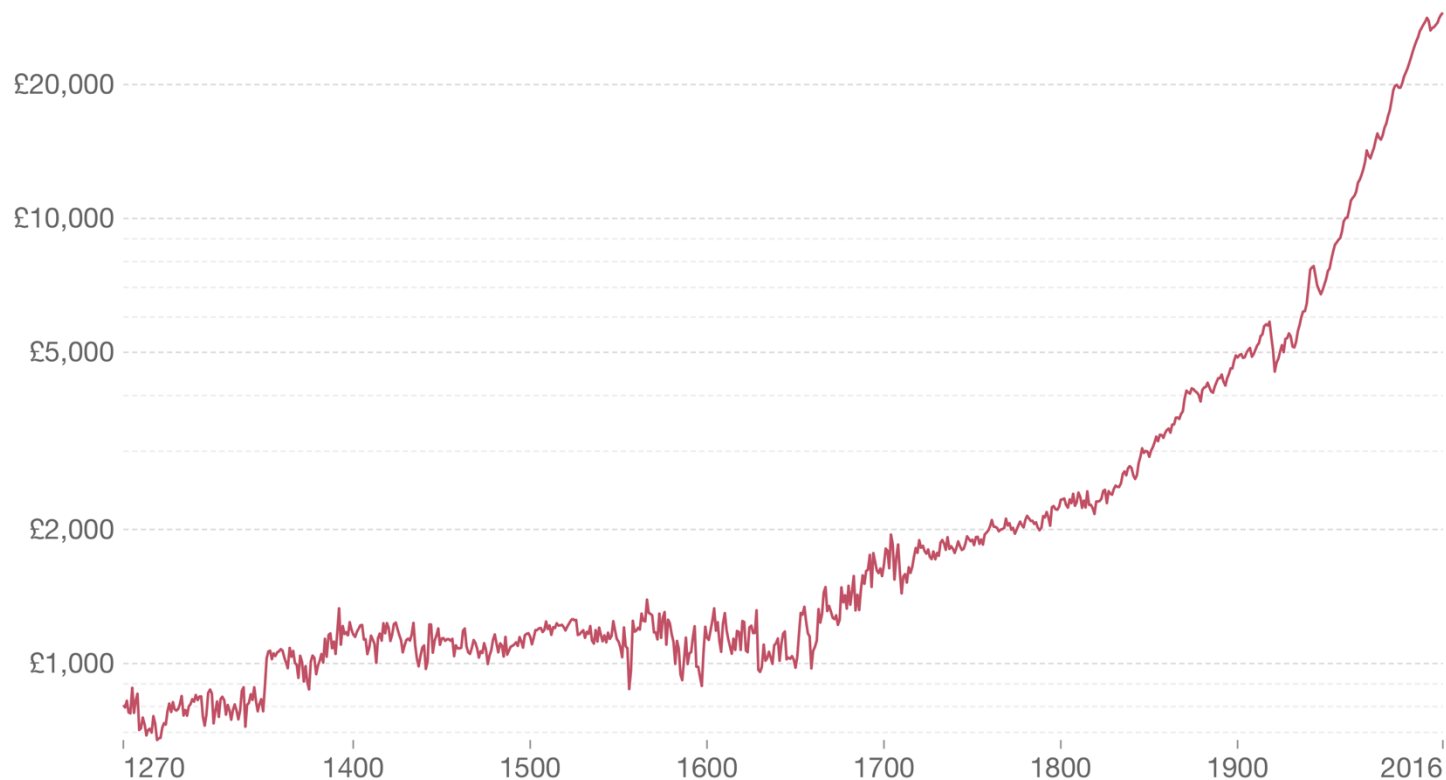
Note: This data is expressed in constant 2013 British pounds. Data refers to England until 1700 and the UK from then onwards.

Economic Growth Came to England

GDP per capita in England

This data is expressed in British pounds, adjusted for inflation.

Our World
in Data



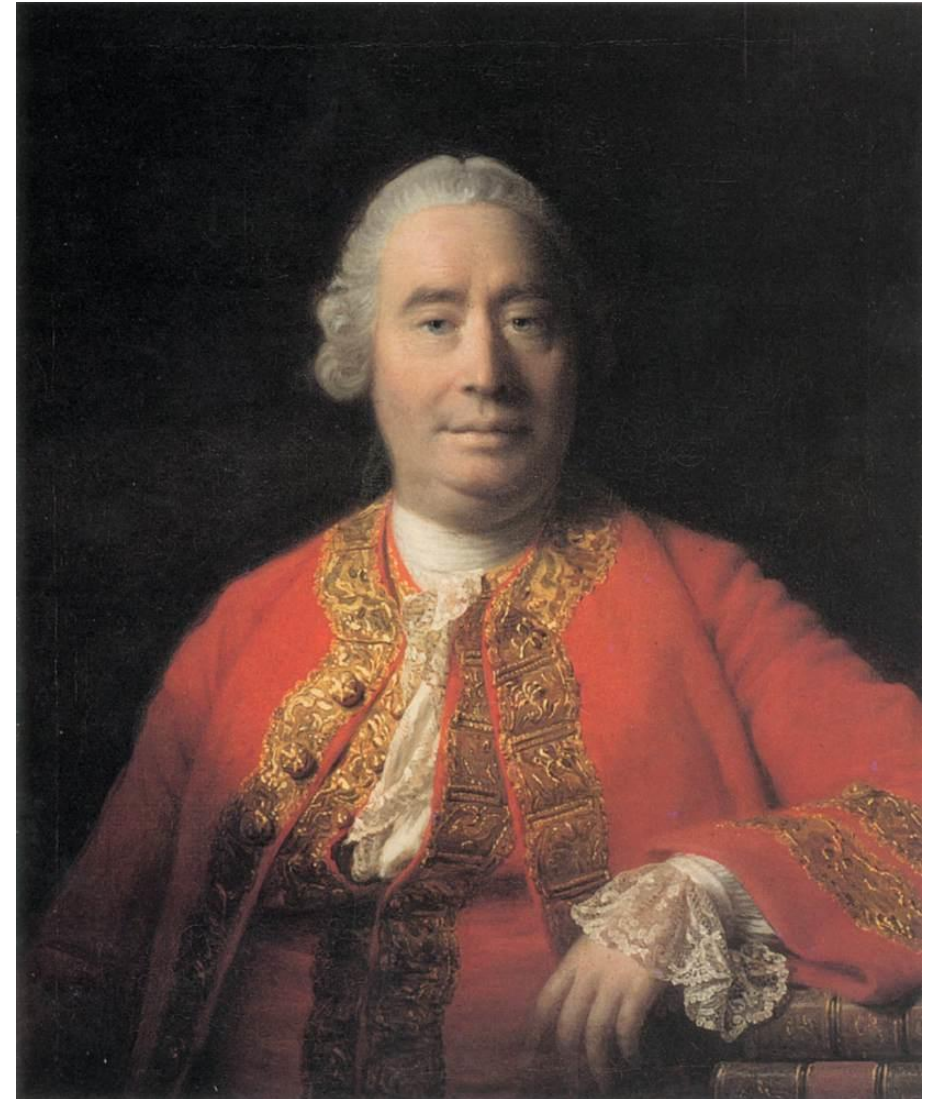
Source: Broadberry, Campbell, Klein, Overton, and van Leeuwen (2015) via Bank of England (2020)

Note: This data is expressed in constant 2013 British pounds. Data refers to England until 1700 and the UK from then onwards.

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David Hume (1711-1776)

- Scottish
- Philosopher
- Never had an academic post
- *Essays on Human Nature* (1739-40)
- *Essays, Moral, Political, and Literary* (1741)
- Good friend of Smith



Hume's Achievement (1)

“A Science of Man”

- Philosopher of 17th and 18th century: “What Human Should Be” “What Human Is and/or Does”
- A wide variety of complex human motivations: avarice, animosity, hatred, fondness, attachment, love, excessive pride, megalomaniac, looking down on others, putting down yourself, disappointed, lose confidence (Holmes 1995, Chapter 2)
- “So little are men govern'd by reason in their sentiments and opinions” (Hume 1740/2000, 240)
- Humans as social and society-making animal: “man, as being the creature of the universe, who has the most ardent desire of society, and is fitted for it by he most advantages” (Hume 1740/2000, 234)
- “A perfect solitude is, perhaps, the greatest punishment we can suffer. Every pleasure languishes when enjoy'd a-part from company, and every pain becomes more cruel and intolerable. Whatever other passions we may be actuated by; pride, ambition, avarice, curiosity, revenge or lust; the soul or animating principle of them all is sympathy; nor wou'd they have any force, were we to abstract entirely from the thoughts and sentiments of others.” (Hume 1740/2000, 234-5)。

Hume's Achievement (2)

Theory of Economic Development

- Chain of “industry, knowledge, and humanity”
- Imported Technology and Increased consumption
- Import of Foreign goods (luxury) → excites industry, technology transfer by emulation and imitation
 - Hume's answer to industrious revolution, consumption revolution and debates on luxury
- Desirability of Trade : Against “international competitiveness”
 - “Of Jealousy of Trade” (1758)
- A civilized society
 - The development of a commercial society → Refinement of human nature
 - How far Hume came from the Medieval Norms

“industry, knowledge, and humanity, are linked together by an indissoluble chain”

- In times when industry and the arts flourish, men are kept in perpetual occupation, and enjoy, as their reward, the occupation itself, as well as those pleasures which are the fruit of their labour. The mind acquires new vigour; enlarges its powers and faculties; and by an assiduity in honest industry, both satisfies its natural appetites, and prevents the growth of unnatural ones, which commonly spring up, when nourished by ease and idleness. Banish those arts from society, you deprive men both of action and of pleasure; and leaving nothing but indolence in their place, you even destroy the relish of indolence, which never is agreeable, but when it succeeds to labour, and recruits the spirits, exhausted by too much application and fatigue.
- Another advantage of industry and of refinements in the mechanical arts, is, that they commonly produce some refinements in the liberal; nor can one be carried to perfection, without being accompanied, in some degree, with the other. The same age, which produces great philosophers and politicians, renowned generals and poets, usually abounds with skilful weavers, and ship-carpenters. We cannot reasonably expect, that a piece of woollen cloth will be wrought to perfection in a nation, which is ignorant of astronomy, or where ethics are neglected.
- The more these refined arts advance, the more sociable men become: nor is it possible, that, when enriched with science, and possessed of a fund of conversation, they should be contented to remain in solitude, or live with their fellow-citizens in that distant manner, which is peculiar to ignorant and barbarous nations. They flock into cities; love to receive and communicate knowledge; to show their wit or their breeding; their taste in conversation or living, in clothes or furniture. Curiosity allures the wise; vanity the foolish; and pleasure both. Particular clubs and societies are every where formed: Both sexes meet in an easy and sociable manner; and the tempers of men, as well as their behaviour, refine apace. So that, beside the improvements which they receive from knowledge and the liberal arts, it is impossible but they must feel an encrease of humanity, from the very habit of conversing together, and contributing to each other's pleasure and entertainment. Thus *industry, knowledge, and humanity*, are linked together by an indissoluble chain, and are found, from experience as well as reason, to be peculiar to the more polished, and, what are commonly denominated, the more luxurious ages.

Hume's Achievement (3)

Monetary Theory

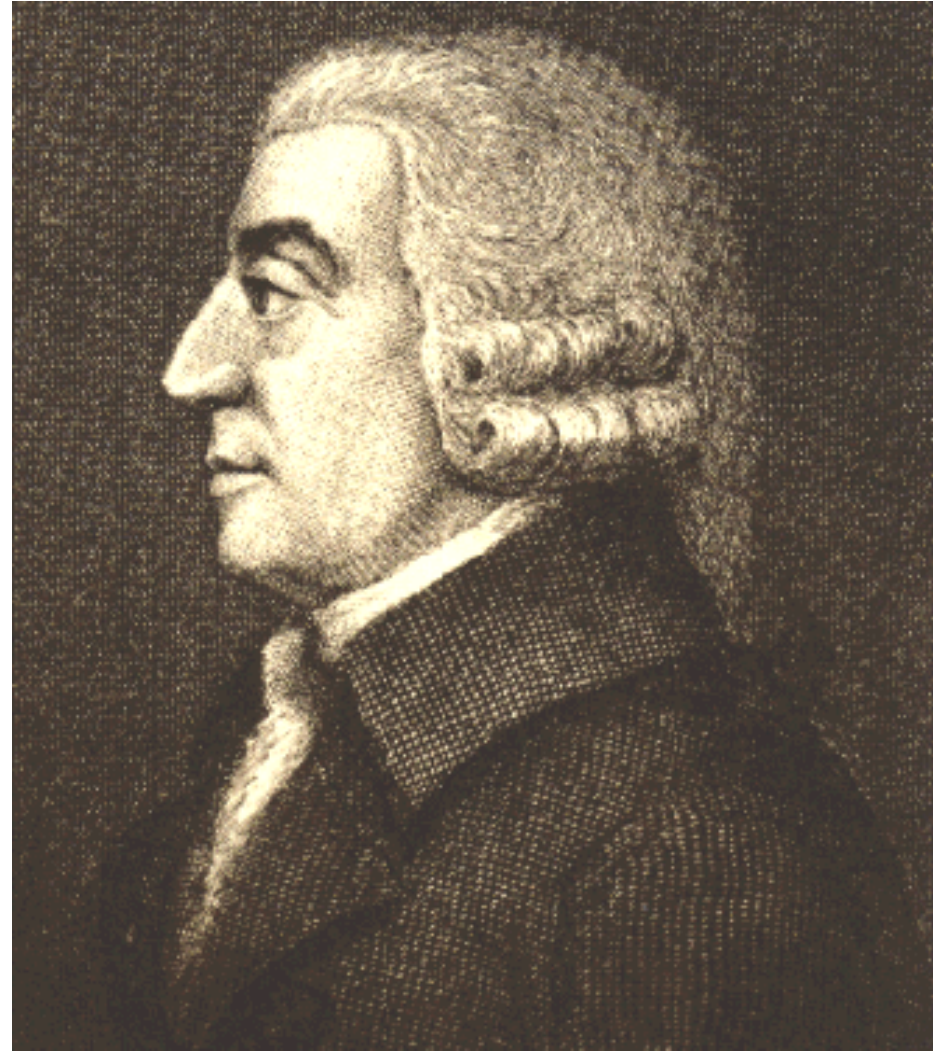
- The QTM: “Of the Balance of Trade” (1752) : “suppose, that all the money of Great Britain were multiplied fivefold in a night, must not the contrary effect follow? Must not all labour and commodities rise to such an exorbitant height”
 - ① Short-run Non-neutrality
 - ② Long-run Proportionality
- The Price Specie Mechanism, rebuttal of “Mercantilism”
 - Following Cantillon
 - Trade surplus \Rightarrow Inflow of money \Rightarrow Price level $\uparrow \Rightarrow$ Prices of export goods \uparrow 、prices of import goods $\downarrow \Rightarrow$ No trade surplus

Long-run non-neutrality of money?

- “the greater quantity of money, like the Roman characters, is rather inconvenient, and requires greater trouble both to keep and transport it. But notwithstanding this conclusion, which must be allowed just, it is certain, that, since the discovery of the mines in America, industry has [i]ncreased in all the nations of Europe, except in the possessors of those mines; and this may justly be ascribed, amongst other reasons, to the [i]ncrease of gold and silver. Accordingly we find, that, in every kingdom, into which money begins to flow in greater abundance than formerly, every thing takes a new face: labour and industry gain life; the merchant becomes more enterprising, the manufacturer more diligent and skilful, and even the farmer follows his plough with greater alacrity and attention.” (Hume 1987, pp. 285-86)
- "It is only in [an] interval or intermediate situation, between the acquisition of money and rise of prices, that the [i]ncreasing quantity of gold and silver is favourable to industry."
- "it is of no manner of consequence, with regard to the domestic happiness of a state, whether money be in a greater or less quantity."
- “The good policy of the magistrate consists only in keeping it, if possible, still [i]ncreasing; because, by that means, he keeps alive a spirit of industry in the nation, and [i]ncreases the stock of labour, in which consists all real power and riches. A nation, whose money decreases, is actually, at that time, weaker and more miserable than another nation, which possesses no more money, but is on the [i]ncreasing hand. This will be easily accounted for, if we consider, that the alterations in the quantity of money, either on one side or the other, are not immediately attended with proportionable alterations in the price of commodities. (Hume 1987, p. 288)”

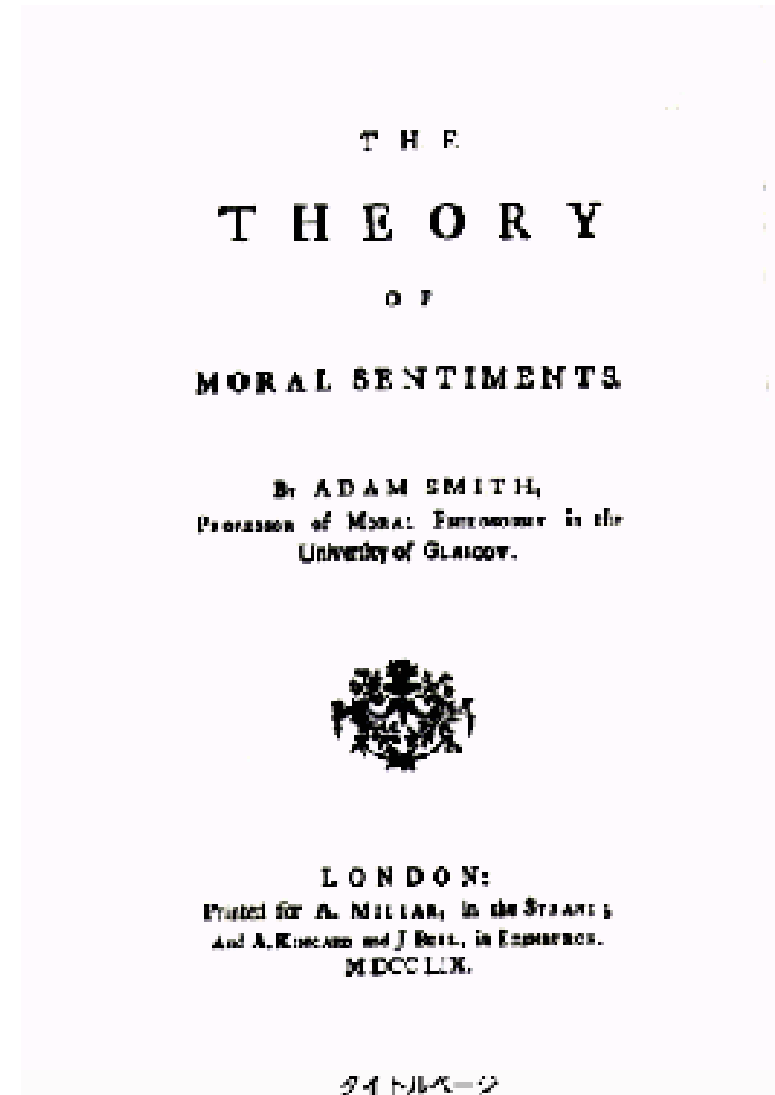
Adam Smith (1723-1790): Two Strands Merged

- Scottish
- University of Glasgow and University of Oxford
- Professor of Logic, Rhetoric and Moral Philosophy
- Resigning professorship, became a private tutor for an aristocrat's son (Grand Tour), visited France
 - Met Voltaire and Quesnay
- Wrote only two books



The Theory of Moral Sentiments (1759)

- moral philosophy : how a society can exist
 - Theology, Jurisprudence, and economics
- From “sympathy” which everyone has to “impartial spectator”
- Justice as the common rule for a society
 - Justice = the minimum rule to form and sustain a society

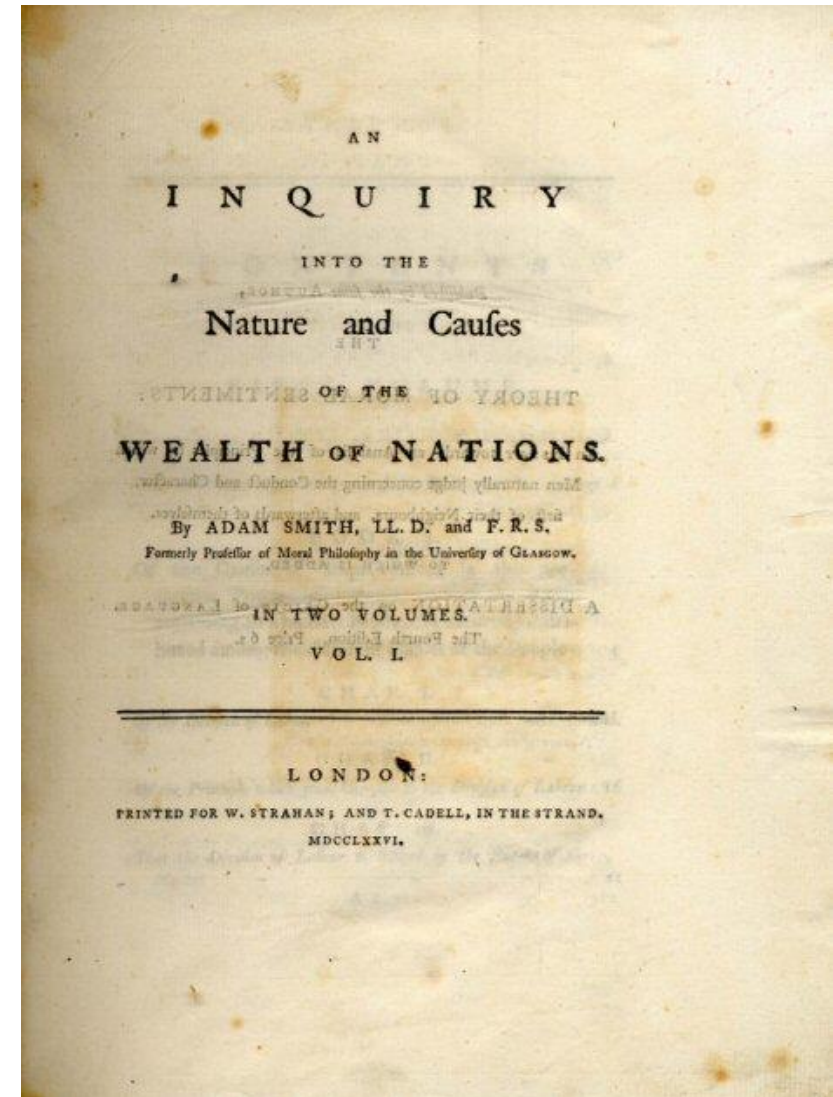


Sympathy, Impartial Spectator, and Justice

- “How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it.” (Smith 1759/1976,9)
 - “Man naturally desires, not only to be loved, but to be lovely; or to be that thing which is the natural and proper object of love. He naturally dreads, not only to be hated, but to be hateful; or to be that thing which is the natural and proper object of hatred.” (Part III, Chapter 2)。
- From Sympathy to Justice as the foundation of the society: psychological grounds of rules
 - Seen by others and by seeing others → forming “impartial spectator” → judging whether others’ feelings and actions appropriate, in turn judging own feelings and actions → Foundation of general rules of justice and obligations
- Limitations and weaknesses
 - Ability of sympathize vary (close to own or not)
 - One cannot follow the impartial spectator, succumb to others’ opinion or self-deceive
- Later appreciation
 - Smith as a Behavioral Economist (Ashraf et al. 2005)
 - Smith starts from human being as “biased” one
 - Smith as a Brain Scientist: Sympathy and Impartial Spectator akin to “mirror neuron”

The Wealth of Nations (1776)

- Why some countries are rich, while others are poor?
- “wealth”: the amount of goods during a certain period (flow)
 \equiv national income * no service
- Books I and II : Theory
- Book III : History
- Book IV : Critique of contemporary economic policy and doctrines
- Book V : The role of government



Smith's Egalitarian View of Human Nature

- ① Humans as exchanging animal, only humans exchange
- ② Equality of natural talents \Rightarrow difference in talents as mainly the result of the division of labour (“vanity of philosopher”)
 - Humans as Learner
- ③ Complex motivations: Smith the 18th century man comes closest to 21st century behavioral economics
 - “the desire of bettering our condition, a desire which, though generally calm and dispassionate, comes with us from the womb, and never leaves us till we go into the grave”
 - But, self-deception, overconfidence, pride, vanity, monopoly, domination, jealousy, greed

Implications

- Positive
 - No difference in nations, or races
 - On principle, any nation can develop
 - But why some succeed, while other fail?
- Normative : Should treat equals as equals
 - ① Criticizes preference for a special interest of the society \Rightarrow criticizes “preferences and restraints”, monopoly, protectionism, and regulations
 - ② Social choice rule? Focus on “the great body of the people” = labouring poor \Rightarrow justification for economic development (Levy 1995)

Smith's Egalitarianism

- The difference of natural talents in different men is, in reality, much less than we are aware of; and the very different genius which appears to distinguish men of different professions, when grown up to maturity, is not upon many occasions so much the cause, as the effect of the division of labour. The difference between the most dissimilar characters, between a philosopher and a common street porter, for example, seems to arise not so much from nature, as from habit, custom, and education. When they came into the world, and for the first six or eight years of their existence, they were, perhaps, very much alike, and neither their parents nor playfellows could perceive any remarkable difference. About that age, or soon after, they come to be employed in very different occupations. The difference of talents comes then to be taken notice of, and widens by degrees, till at last the vanity of the philosopher is willing to acknowledge scarce any resemblance.(Bk. I, Chap.2)

Why Economic Development is Desirable

- Increases the standard of living of the labouring Poor = “the great body of the people”
- 1) Infant mortality rate decreases, life expectancy increases
- 2) Caring for income distribution
- 3) Refinement of humanity: the commercial nations are honest
- 4) Feeling Happier in a growing economy

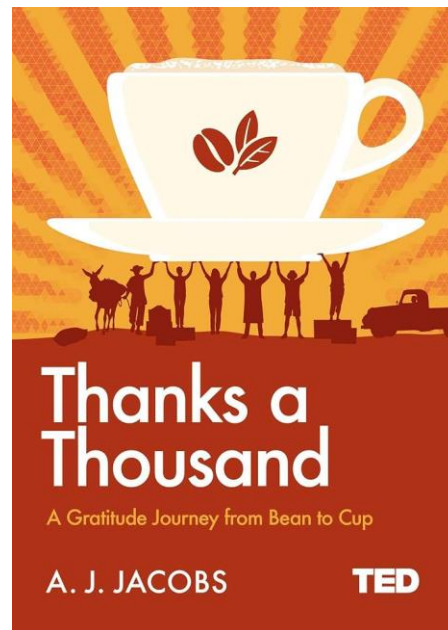
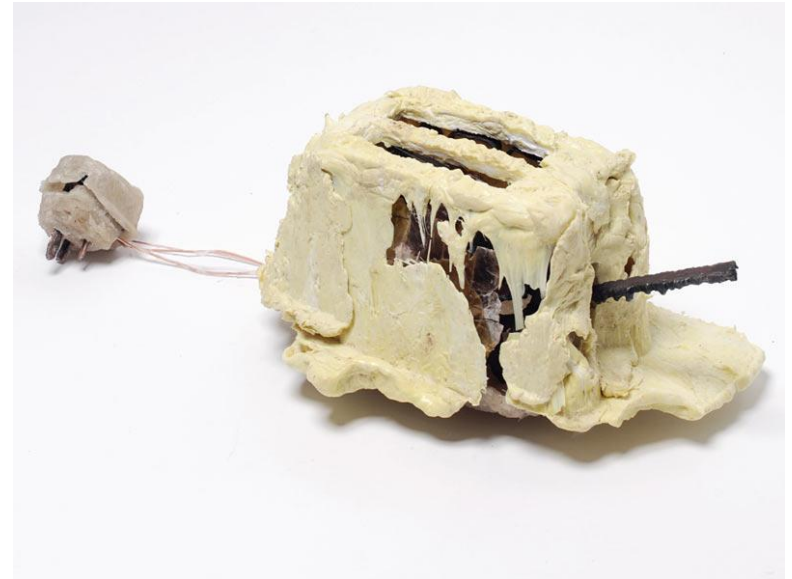
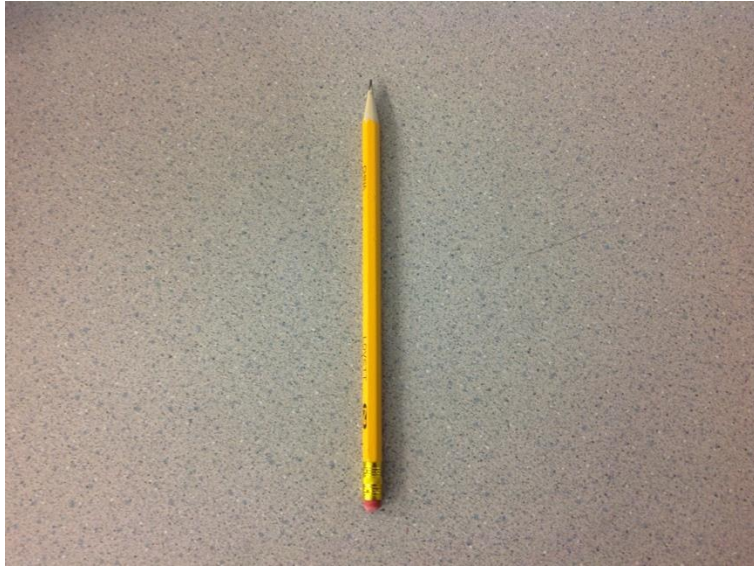
- High earnings of labour are an advantage to the society. Is this improvement in the circumstances of the lower ranks of the people to be regarded as an advantage or as an inconveniency to the society?
- The answer seems at first sight abundantly plain. Servants, labourers and workmen of different kinds, make up the far greater part of every great political society. But what improves the circumstances of the greater part can never be regarded as an inconveniency to the whole. No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable. It is but equity, besides, that they who feed, cloath and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves tolerably well fed, cloathed and lodged.

- The liberal reward of labour, therefore, as it is the effect of increasing. High wages increase population. wealth, so it is the cause of increasing population. To complain of it, is to lament over the necessary effect and cause of the greatest public prosperity.
- It deserves to be remarked, perhaps, that it is in the progressive. The progressive state is the best for the labouring poor state, while the society is advancing to the further acquisition, rather than when it has acquired its full complement of riches, that the condition of the labouring poor, of the great body of the people, seems to be the happiest and the most comfortable. It is hard in the stationary, and miserable in the declining state. The progressive state is in reality the cheerful and the hearty state to all the different orders of the society. The stationary is dull; the declining melancholy.

Mechanism of Economic Development

- Engines
 - ① Division of Labor
 - ② Capital accumulation
- ① “Increasing returns” by the division of labor
 - Dexterity improving, time saving, facilitating invention
- ② Capital accumulation through saving
 - Productive vs. unproductive laborer
- Market exchange realizes the virtuous cycle of two engines to the fullest extent
- Cumulative causative mechanism: “the division of labor is limited by the extent of the market”
- Proper institutions and government necessary : proper law, esp. establishment of property rights, and liberty within institutional framework. “System of Natural Liberty”

The Power of the Division of Labor

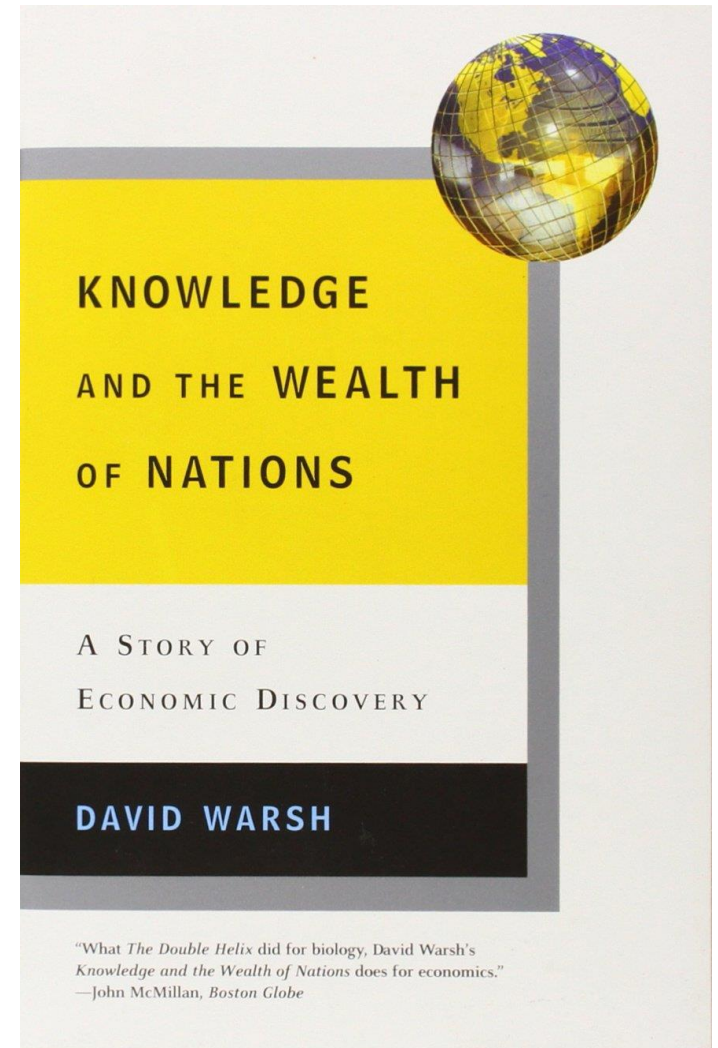


The Power of the Division of Labor

- Observe the accommodation of the most common artificer or day-labourer even the day-labourer's coat being the produce of a vast number of workmen in a civilized and thriving country, and you will perceive that the number of people of whose industry a part, though but a small part, has been employed in procuring him this accommodation, exceeds all computation. The woollen coat, for example, which covers the day-labourer, as coarse and rough as it may appear, is the produce of the joint labour of a great multitude of workmen. The shepherd, the sorter of the wool, the wool-comber or carder, the dyer, the scribbler, the spinner, the weaver, the fuller, the dresser, with many others, must all join their different arts in order to complete even this homely production. How many merchants and carriers, besides, must have been employed in transporting the materials from some of those workmen to others who often live in a very distant part of the country! how much commerce and navigation in particular, how many ship-builders, sailors, sail-makers, rope-makers, must have been employed in order to bring together the different drugs made use of by the dyer, which often come from the remotest corners of the world! What a variety of labour too is necessary in order to produce the tools of the meanest of those workmen! To say nothing of such complicated machines as the ship of the sailor, the mill of the fuller, or even the loom of the weaver, let us consider only what a variety of labour is requisite in order to form that very simple machine, the shears with which the shepherd clips the wool. The miner, the builder of the furnace for smelting the ore, the feller of the timber, the burner of the charcoal to be made use of in the smelting-house, the brick-maker, the brick-layer, the workmen who attend the furnace, the mill-wright, the forger, the smith, must all of them join their different arts in order to produce them. Were we to examine, in the same manner, all the different parts of his dress and household furniture, the coarse linen shirt which he wears next his skin, the shoes which cover his feet, the bed which he lies on, and all the different parts which compose it, the kitchen-grate at which he prepares his victuals, the coals which he makes use of for that purpose, dug from the bowels of the earth, and brought to him perhaps by a long sea and a long land carriage, all the other utensils of his kitchen, all the furniture of his table, the knives and forks, the earthen or pewter plates upon which he serves up and divides his victuals, the different hands employed in preparing his bread and his beer, the glass window which lets in the heat and the light, and keeps out the wind and the rain, with all the knowledge and art requisite for preparing that beautiful and happy invention, without which these northern parts of the world could scarce have afforded a very comfortable habitation, together with the tools of all the different workmen employed in producing those different conveniences; if we examine, I say, all these things, and consider what a variety of labour is employed about each of them, we shall be sensible that without the assistance and co-operation of many thousands, the very meanest person in a civilized country could not be provided, even according to, what we very falsely imagine, the easy and simple manner in which he is commonly accommodated.

From the growth theory perspective

- Origins of Endogenous Growth Theory
 - The Engine of growth is knowledge: how knowledge is created in the economy?
 - Technology transfer (Hume), Division of Labour (Smith)
 - Beyond the Neo-classical growth model
- Smith preceded, but he had no analytical tools that we have
 - History is not straightforward thus interesting



System of Natural Liberty

- Market Economy
 - Convergence of Market Price to Natural Price
 - Natural price has desirable characteristics
 - Social mechanism leads to “unintended consequences”
- Protect one industry = Restrain another industry
 - “invisible hand”
- Actual history = violation of system of natural liberty
- The prime example = “system of commerce”
 - Similarities with Physiocracy:
 - Differences with it:

Common Misunderstanding about Smith ①

- Harmonic world view?
- Smith used the “invisible hand” only three times in his works, only once in WN
 - Capital is invested to the most profitable sector
 - Only in the “system of natural liberty”
- But he did not think the system of natural liberty did not materialize
 - “To expect, indeed, that the freedom of trade should ever be entirely restored in Great Britain, is as absurd as to expect that an Oceana or Utopia should ever be established in it.” (Bk.IV, Chap.II)

“an invisible hand”

- “the annual revenue of every society is always precisely equal to the exchangeable value of the whole annual produce of its industry, or rather is precisely the same thing with that exchangeable value. As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, **led by an invisible hand** to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it.”

Misperception②

Was Smith an apologist for the capitalists?

- Mercantilism was conceived by privileged merchants and manufacturers
- “To widen the market and to narrow the competition, is always the interest of the dealers. To widen the market may frequently be agreeable enough to the interest of the public; but to narrow the competition must always be against it, and can serve only to enable the dealers, by raising their profits above what they naturally would be, to levy, for their own benefit, an absurd tax upon the rest of their fellow-citizens. The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it.”

Saving Capitalism from the Capitalists (Rajan and Zingales 2003)

- Securing property rights
- Establishing the market mechanism
 - Competition
 - Freedom of entry and exit
- Minimizing political interference
 - Restricting corruption
 - Minimal regulation
 - Breaking vested interests

SAVING CAPITALISM *FROM THE CAPITALISTS*

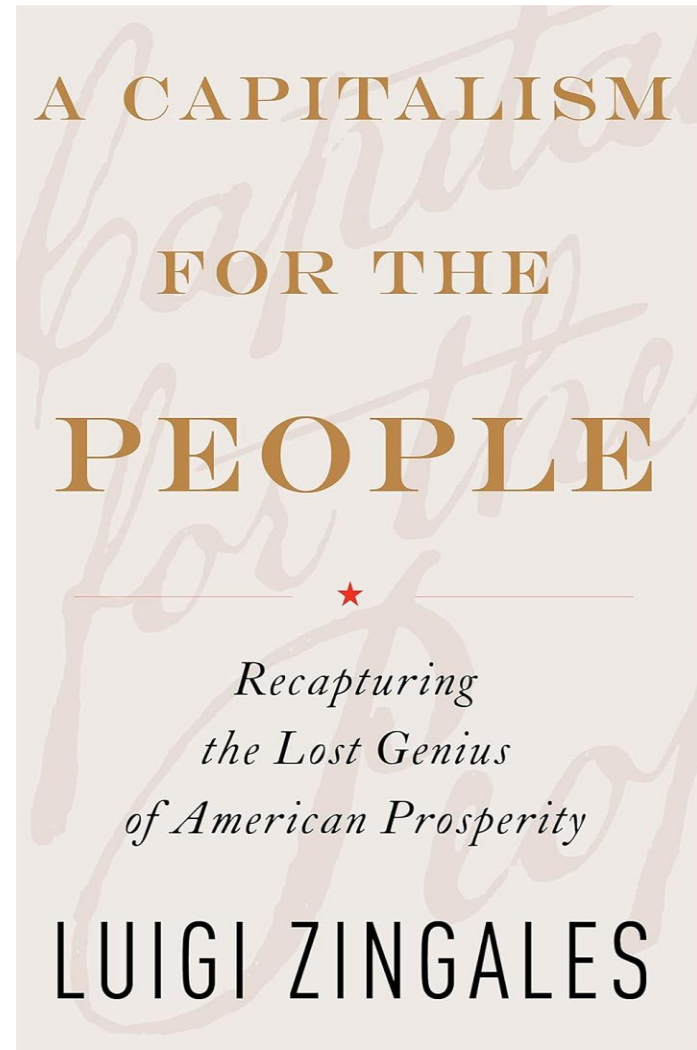


UNLEASHING THE POWER
OF FINANCIAL MARKETS
TO CREATE WEALTH AND
SPREAD OPPORTUNITY

RAGHURAM G. RAJAN & LUIGI ZINGALES

A Capitalism for the People (Zingales 2012)

- Warning for the transformation of American Capitalism after GFC: crony capitalism
- Pro-market or pro-business?
- Which side Economics is?



The Role of Government

- Appropriate regulation is necessary: “those exertions of the natural liberty of a few individuals, which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments”
 - Externalities
- “The system of natural liberty leaves the sovereign only three duties”
 - (1) the defence of the country: “defence, however, is of much more importance than opulence”
 - (2) the administration of justice
 - (3) the maintenance of certain public work
 - Public infrastructure and elementary education
 - Was Smith a small government person?

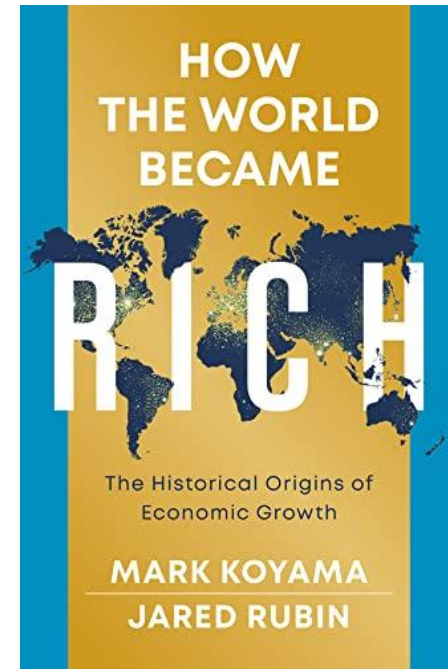
Would the system of natural liberty naturally materialize?

- No, why?
 - 1) the most fundamental problem: violation of property rights
 - Slavery
 - 2) Persistence of inefficient property rights
 - Primogeniture, entails
 - 3) Government Regulation, Protection, Monopoly:
- Smith's answer: Politics. Collision of interested people
- System of natural liberty and economic development not automatically achieved
- Progress is possible, but not guaranteed

Now : Explanations for Economic Growth

Cf. Koyama and Rubin (2021)

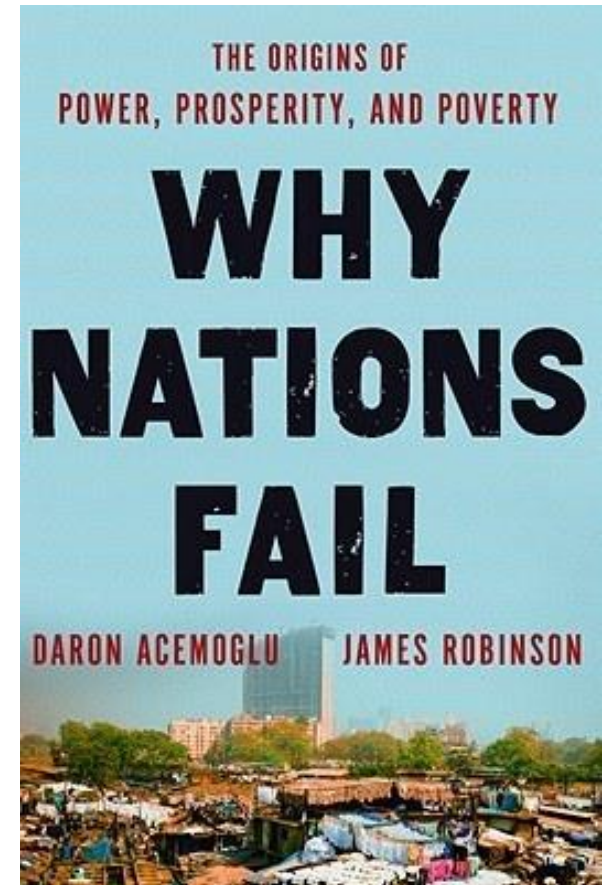
- 1. Geography: environments, climate, resources, location
 - Diamond 1997
- 2. Institutions: rule of law, property rights, political institutions
 - North 1991, North, Weingast and Wallis 2009, Acemoglu and Robinson 2012, 2019
- 3. Culture: attitudes, ethics, religion
 - Weber 1904-5
- 4. Fewer Babies
 - Clark 2007, Galor 2011, 2022
- 5. Colonialism and Exploitation
 - Marx 1867, Global History



Why Nations Fail

(Acemoglu and Robinson 2012)

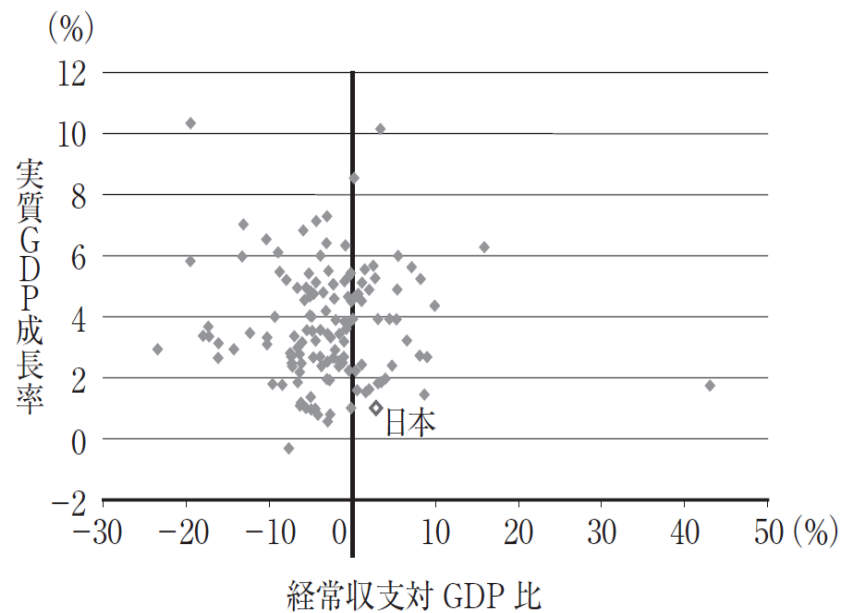
- Economic growth depends on institutions
 - Two Koreas, Two Germanies
- Are political elites inclusive or extractive?
 - All elites are self-interested
 - But inclusive ones are favorable toward economic development than extractive ones
- Depends on historical contingencies



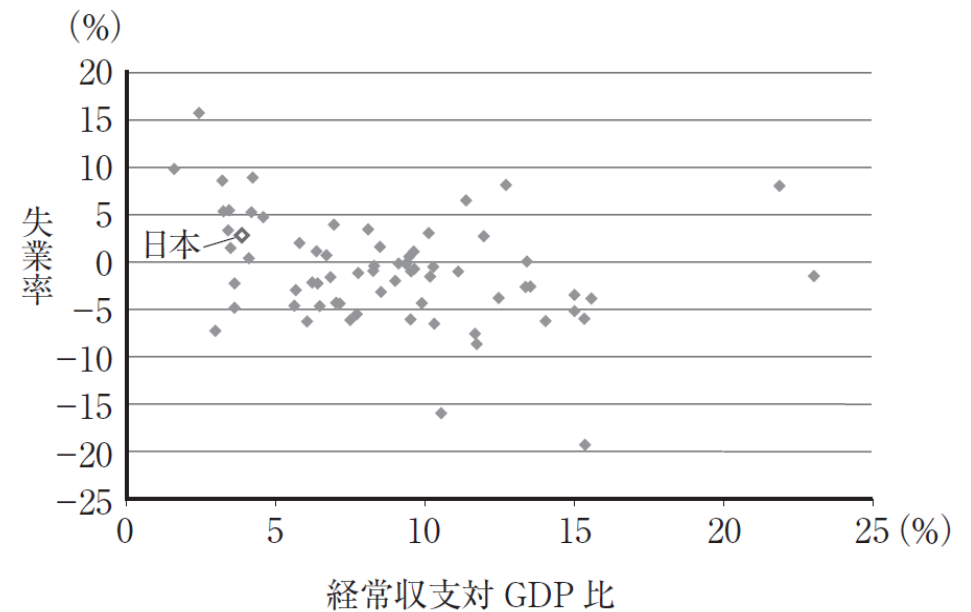
Was Mercantilists Right?

No statistical relationship between real variables and current account

経常収支対 GDP 比と実質成長率の関係 (1990～2009 年)



経常収支対 GDP 比と失業率の関係 (1990～2009 年)



Think Further

- Whatever happened to Cantillon's concept of the entrepreneur?
- What is the legacy of Physiocracy?
- Why did Hume say somewhat contradictory things about the non-neutrality of money in the long-run?
- Why is Smith called the father of economics, despite there are others who excel in economic analysis?
- "Adam Smith is a behavioral economist." Evaluate this sentence.
- If Smith were alive today, what would he say about today's PRC?

Next Week

- Read:
 - Malthus, *An Essay on the Principles of Population*, Preface, Chapters 1-2, 10
 - Ricardo, *Principles of Political Economy and Taxation*, Chapters 1-6
- Watch YouTube:
 - https://www.google.co.jp/search?q=avengers+infinity+Thanos&client=safari&sca_esv=569794731&channel=mac_bm&tbm=vid&ei=5fEYZY6NEtSO2roP96i2wAI&start=10&sa=N&ved=2ahUKEwjOk6SI_tOBAXVUh1YBHXeUDSgQ8tMDegQIDRAE&biw=1512&bih=865&dpr=2#fpstate=ive&vld=cid:32111f96,vid:Ap-QHaF-WtQ,st:0
- After reading Malthus think about whether Thanos is right or wrong.

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