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\*Broad and Shallow Knowledge for Intellectual Conversations\*

Vol 1. [Reality] Part 2. [Economics] Chapter 5.

> \*\*[Early Capitalism]\*\* - Market is freedom

Early Capitalism is, like the name suggests, the earliest economic system that appeared in modern era. Most iconic person who established this theory is Adam Smith – father of economics – in 18C. It is the idea that markets tend to work best when the government leaves them alone. Prices will adjust by themselves through competition in freedom.

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(1) Early Capitalism

(Market)

Adam Smith 🧍‍♂️ /

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Here’s an example. A, B and C are running a coffee shop. Price for a cup of coffee is arbitrarily set to 5 bucks. $1 for buying coffee beans, $1 rent, $1 maintenance, and $2 is profit, but $1 goes out for paying part timers, so and net income is $1. Let’s say you’re C. What would you do to maximize your net income? Maximizing is your goal, so would you raise its price for a cup?

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┌ coffee beans $1

│ rent $1

☕ ┤ maintenance $1

$5 │ wage expense $1

└ net income $1

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If you raise the price to $6, then your profit would double to $2. If you really thought so, then you must not run a business. For you, your family, and relatives, close your store. If you’re a reasonable person, you must also consider downsizing your profit to maximize it. From a dollar to 80 cents. Why? That way you can gain price competitiveness over A and B. Reasonable people will look for the lowest price and buy your coffee. Then what about giving up your profit? You may be able to run the most popular shop, but you’re selling them to gain a profit so there’s no reason to even sell it. You will give up your net income as much as you can handle, and lower the coffee bean prices, rent, maintenance fees, and wage expense, while retaining quality to a reasonable amount. So while the price started at $5, A, B, and C will compete with each other so it will be decided somewhere lower than $5.

Adam Smith called this free market’s ability to freely adjust prices \*Invisible Hand\*. It is both beneficial to both consumers and producers. Producers will of course earn profits from selling, and consumers will get quality coffee for a cheap price from their competition. There isn’t really a reason for government to intervene the free market that can not only adjust the prices on their own but also beneficial to the whole society. Trusting free market is the characteristic of Early Capitalism.

How does it sound? Does it look okay? It looks like there might be some problems. Usually when there’s a problem that looks complex and want to see the meaning of it, we can check who are benefiting and suffering from it. Let’s apply this method. Who benefits from Early Capitalism and who suffers from it? Let’s rephrase the question. Who prefer Early Capitalism? Of course people who has capabilities and work hard. People who work diligently to make coffee early in the morning, research market to find the cheapest coffee beans, and keep the shop clean will have high probability to obtain wealth. Capitalism promises wealth to people who works hard with their abilities. But not only them, people who already owns wealth also really prefers Early Capitalism. In other words, people who already has capital strength will further collect massive wealth through Capitalism. In fact, it’s not easy to be successful even if you work hard if you have no wealth. Let’s get back to our example.

You’re C who sells coffee at reasonable price decided by competition. You lowered it as much as you can. But somehow A drastically lowered their price. It’s dumbfounding considering there shouldn’t be any place to lower it even more. Turns out it’s something you can’t do. A doesn’t have to pay the rent because he owns the building. A’s coffee price has its rent price subtracted that you must pay. Now what are you going to do? It’ll be easy once you also buy the building, but that doesn’t seem easy. You can’t persuade consumers that A’s price is unfair nor complain about it. This is a free market where competition is unlimited and government doesn’t intervene.

As C, you can do two things. Switch to a different industry, or overly lowering the price just so you can keep the job. Getting a different job is meaningless. There are loads of people with capitals who can lower the price lower than him. Only option is to lower the coffee price even more. But there’s a limit. At most you can give up your profit even more, or part timers’. It’s long time ago since you gave up your net income. What’s left is wage expense. But now that you think about it, since this is a free market where government doesn’t intervene, there is no such thing as minimum wage. What a relief. Now C massively lowered their wage enough to compete with A. Part timers protested, but you had no choice. C felt bad, but firmly told them, “Leave if you don’t like. There are many people who want to work even at this wage.” Since this is a free market where all kinds of competition are allowed, workers also had to compete for jobs and were always in danger of their payment going down.

Then by lowering their pay, is the problem all solved? Can C compete with A by supplying coffee for such lower price? Not really. Nothing really got solved. A can also lower their wage expenses. Between A and C is an unsurmountable giant wall called capital strength.  
  
 Another problem of Early Capitalism is that their work environment gets poorer. So all sacrifices of pricing goes to part timers. But the problem is it doesn’t end there. Workers are also consumers. If their pay get extremely lowered, so will their purchasing power. Less purchasing means less demands for coffee and will lead to oversupply issue. To solve the issue A, B, C will all lower their wage expense even lower for price competitiveness, then consumer’s purchasing power will get even poorer. Hold on, we’ve seen this cycle before. This is the Great Depression.

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<Failure of Early Capitalism market> ☕

price competition → reduce wages

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oversupply ← decrease in consumer spending

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This very natural and sensible looking Early Capitalism brought an inevitable “market failure” situation called great depression, through decrease in consumer spending and oversupply issue by overheated competition. So now we must get ready for this economic crisis. Remember what the solutions were? We looked at three countries: US, Russia, and Germany. Us solved it with government intervention called New Deal. Russia abolished it and became a Communist country called Soviet Union. Germany kept Capitalism, readied for war, and started WW2. Now let’s take a look at the US choice, modification of Capitalism.  
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