

ECON 400: History of Economic Thought

Lecture Slides 2

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Pre-Classical Economists

- Early Scholastics: Aristotle, St. Thomas Aquinas, School of Salamanca.
- Bullionism and Mercantilists: Mun, Petty, Locke.
- Physiocrats: Cantillon, Quesnay, Turgot.
- Misfits: Mandeville.

Bullionism and Mercantilism

- A system of beliefs and ideas that dominated the Europe in the 17th and 18th century.
- More of a political ideology that represents the beliefs of elite thinkers who are generally wealthy merchants rather than a theoretical system.
- Concerns with the economic policy prescriptions for rulers where the key objective is to build wealthy and powerful state.
- Country, nation, the state is generally assumed to be the same – what is good for the ruler is good for the subjects.
- What was good for the ruler was essentially storing as many as bullions of gold and silver, hence the *bullionism*.

Bullionism and Mercantilism

- Foreign trade was seen as a zero-sum game which led to the idea of a “competitive” state. The crucial element of mercantilist thinking was that the production of all goods, if possible, must take place within country borders.
- Tariffs should be exercised on imported goods. At the most, only raw materials for production should be imported and value-added versions should be exported at a gain.
- To support payment for the imported raw materials, payment systems should store enough precious metals. Aim is to create a state with a surplus in the balance of trade.
- Puts merchants and export-oriented producers into the center of the economy. A narrow-minded approach if concerned with income equality but effective to promote country's military and economic power.

Bullionism and Mercantilism

Thomas Mun (1571–1641)

- A wealthy English merchant and the director of East India Company
- **Key aspect:** Unlike his contemporaries, he focused on net exports and measuring net gains from the trade.
- His work, *England's Treasure by Forraign Trade* emphasizes the importance of maximizing net inflow of wealth.
 - *The ordinary means therefore to encrease our wealth and treasure is by Forraign Trade, wherein wee must ever observe this rule; to sell more to strangers yearly than wee consume of theirs in value.*

Bullionism and Mercantilism

Thomas Mun (1571–1641)

To generate a favorable balance of payments, for the purposes of business profit, royal revenue, and economic prosperity, the means included:

- tariff protection against imports
- selective subsidies of production and exports
- acquisition of colonies which provided
 - raw materials
 - a workforce of settlers and native peoples at low cost
 - a market for the mother country's finished goods
- maintaining a monopoly of colonial trade and shipping and the development of naval power
- minimizing the cost of maintaining the domestic population such as low agricultural prices, low wages, and fisheries for cheap food.

Bullionism and Mercantilism

William Petty (1623–1687)

- An English Mercantilist, medical doctor, land surveyor and a major landowner.
- His works include *A Treatise of Taxes and Contributions* on public finance and theory of rent
- Also wrote *Political Arithmetik* on national accounts and government revenues, a forerunner of “political economy”.
- **Key aspect:** One of the first to inquire nature of economic rents.

Bullionism and Mercantilism

William Petty (1623–1687)

- Under the influence of Baconian thinking, he adopted a more empirical approach which helped him create a scientific sphere, “political arithmetic” .
 - *The Method I take to do this, is not yet very usual; for instead of using only comparative and superlative Words, and **intellectual Arguments**, I have taken the course (as a Specimen of the Political Arithmetick I have long aimed at) to express my self in **Terms of Number, Weight, or Measure**; to use only Arguments of Sense, and to consider only such Causes, as have visible Foundations in Nature; leaving those that depend upon the mutable Minds, Opinions, Appetites, and Passions of particular Men, to the Consideration of others.*

Bullionism and Mercantilism

William Petty (1623–1687)

- Tasked with surveying Irish lands, Petty became a large landowner himself and he thought and wrote on taxation on lands.
- Need to value lands for tax purposes and his obsession with “measuring things” pushed him to inquire *mysterious nature of land rents*.
 - *I say, that when this man hath subducted his seed out of the proceed of his Harvest, and also, what himself hath both eaten and given to others in exchange for Cloths, and other Natural necessities; that the **remainder of Corn is the natural and true Rent of the Land** for that year.*

Bullionism and Mercantilism

William Petty (1623–1687)

- To measure crop prices and land rents, went further to assert a “theory of value” claiming there is an equivalence across good values based on labor time and effort spent in their production:
 - *how much English money this Corn or rent is worth? I answer, so much as the money another single man can save, within the same time, over and above his expense, if he employed himself wholly to produce and make it... So if the labor time to produce a silver shilling is equal to the labor time to produce a bushel of corn, then the value of a bushel is a shilling, and the value of a shilling is a bushel... One is the natural price of the other.*
- But then he also adds that labor value is not the end of it and market prices are determined by various factors:
 - *This I say to be the foundation of **equallizing and balancing of values**; yet in the superstructures and practices hereupon, I confess there is much variety, and intricacy.*

Bullionism and Mercantilism

John Locke (1632-1704)

- An English philosopher and political theorist.
- Developed an interest in economic issues after travelling to Americas and being appointed as the secretary to the Council of Trade and Plantations.
- **Key aspect:** Developed a labor theory of property and one of the first to articulate “the quantity theory of money”.

Bullionism and Mercantilism

John Locke (1632-1704)

- His theory of property rights builds upon the value of labor:
 - His logic as follows: Everyone owns their own labor and so the right to property is derived from the labor of those who worked for it.
 - *Though the Water running in the Fountain be every ones, yet who can doubt, but that in the Pitcher is his only who drew it out?*
- He was a Mercantilist thinking that the country's interest should lie in commerce:
 - *In a country not furnished with mines, there are but two ways of growing rich, either conquest or commerce... Commerce, therefore, is the only way left to us, either for riches, or subsistence...*

Bullionism and Mercantilism

John Locke (1632-1704)

- Differed from other Mercantilists with his thinking that a nation must store great wealth, which consists of amenities and conveniences enjoyed by its people.
 - This is different from the view that the state must expand its gold and silver stocks at the expense of its inhabitants.
- Emphasized the importance of having a certain amount of money in circulation within the nation (Quantity Theory of Money).
 - Argued against lowering interest rates as it would lead to a collapse of “natural scarcity” of money and then a collapse in production or prices.

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- Misfits: Mandeville.

Physiocrats

- A group of thinkers based in France and centered around François Quesnay who provided the reference text, *Tableau Économique*.
- They argued that land (in terms of sector, agriculture) is the only thing that creates a surplus (net product).
- They supported increase in agricultural prices (dissolution of town guilds) and free flow of agricultural laborers (lifting forced labor laws).
- Unlike Mercantilists, they saw government as an interventionist and proposed a single tax on land for less “disruption”.
- As opposed to Mercantilist restrictions, ideas on freeing prices and labor, simplifying tax code can be characterized as a *laissez-faire* approach.

Physiocrats

Richard Cantillon (1680?–1734)

- An Irishman with a banking career in France.
- Considered to be the “first economist” by Jevons.
- **Key aspect:** His “land theory of value” in *Essay on the Nature of Commerce in General* was the first general equilibrium theory
- His system influenced Physiocrats but also Classical Economists.

Physiocrats

Richard Cantillon (1680?–1734)

- Distinguishes between “intrinsic value” and “market value”:
 - *But it often happens that many things which have actually this intrinsic value are not sold in the market according to that value: that will depend on the humours and fancies of men and on their consumption... There is never a variation in intrinsic values, but the impossibility of proportioning the production of merchandise and produce in a state to their consumption causes a daily variation, and a perpetual ebb and flow in market prices.*
- Assumed for production, only land and labor were needed and labor itself was created and sustained by land:
 - *The land is the source or matter from whence all wealth is produced.*
 - *The intrinsic value of any thing may be measured by the quantity of land used in its production and the quantity of labor which enter into it, in other words, by the quantity of land of which the produce is allotted to those who have worked on it; and as all the land belongs to the prince and the landowners, all things which have this intrinsic value have it only at their expense.*

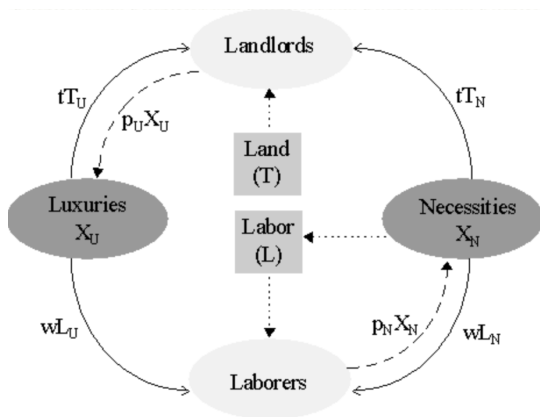
Physiocrats

Richard Cantillon (1680?–1734)

- Only two goods: luxuries (U) and necessities (N)
- Only two inputs: land (T) and labor (L)
- Laborers get wages (w) and buy necessities and landowners get land rents (t) and buy luxuries
- Claim: There will be an equilibrium where relative price of goods is determined by land, its creation (labor) and input ratios in production of goods.

Physiocrats

Richard Cantillon (1680?–1734)



Cantillon's system

Physiocrats

Richard Cantillon (1680?–1734)

- In the long run, there must be a balance between expenditures and incomes for both luxuries and necessities:

$$p_N X_N = wL_N + tT_N$$

$$p_U X_U = wL_U + tT_U$$

- In the long run, there must be a balance between expenditures and incomes for both laborers and landowners:

$$p_N X_N = wL_N + wL_U$$

$$p_U X_U = tT_N + tT_U$$

- Cantillon argued that this system can be solved for “equilibrium” amounts of goods produced given a fixed amount of necessities to sustain labor ($c = X_N/L$), land-output and labor-output ratios for the production of each good (a_{TU} , a_{TN} , a_{LU} , a_{LN}) and total land (T).

Physiocrats

François Quesnay (1694-1774)

- A French physician who was born to a farmer.
- Acclaimed as the leader of Physiocrats, forerunners of political economists.
- His work, *Tableau Économique* was the first multisectoral input-output system.
- **Key aspect:** Influenced the Physiocrats who coined the maxim, *laissez faire et laissez passer*, and Adam Smith's ideas on markets.

Physiocrats

François Quesnay (1694-1774)

- His system includes three classes: (i) Landlords, (ii) producers (farmers and farm laborers), and (iii) sterile class (merchants and artisans)
- He represents the flow of goods and cash across sectors (classes) in zig-zags.
- Starts the system with initial injections (grains, cash or manufactured goods) and ends it with farmers paying the land rent to the landlord.
- Claims that only agriculture produces surplus and other sectors are *sterile* in the sense that inputs and outputs are the same.
- Policy highlight was that the wealth of an economy was not measured with stocks of gold or silver but with total net product.

Physiocrats

François Quesnay (1694-1774)

Productive expenditure
Relative to agriculture, etc.

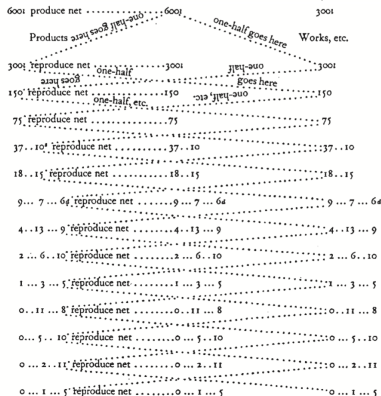
Expenditure of the revenue
After deduction of taxes, is
divided between productive
expenditure and sterile
expenditure

Sterile expenditure
Relative to industry, etc.

Annual advances required to
produce a revenue of 600/ are 600/

Annual revenue

Annual advances for the works
of sterile expenditure are



Physiocrats

Anne Robert Jacques Turgot (1727-1781)

- A French civil servant who briefly served as the minister of finance before the French Revolution.
- His liberal take on economic issues deeply influenced the concepts discussed in *the Wealth of Nations* of Adam Smith who stayed in close contact while he was in France.
- **Key aspect:** First to recognize the concept of diminishing returns to capital, which puts him ahead of his time.

Physiocrats

Anne Robert Jacques Turgot (1727-1781)

- Jumping-off point is **capital per land** from the Quesnay's Tableau, where cash initially injected to land for production is assumed to be fixed.
- Turgot realized that changing capital per land can make a difference in production:
 - Ploughing an unploughed land for the first time would increase the yields by a lot.
 - Up to a point, ploughing will increase the yield in proportion to labor input but then the increase will be less and less until there is no increase.
 - This is not the marginal product but still refers to decreasing returns.
- Also recognized that optimal capital used does not maximize the production but the surplus (difference between value of production and interest on capital).

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Misfits

Bernard Mandeville (1670-1733)

- A Dutch physician who moved to Britain and became a literary figure.
- Famous for his poem, “The Fable of The Bees: Or Private Vices and Publick Benefits” that tells a story of bees that used to work for themselves (for vice) but later on find the “truth” and retrieved into a tree hollow.
- His basic argument is that only if people follow their self-interest, there can be benefits for the public to enjoy.
- Taken seriously but also criticized by others including Adam Smith who borrowed Mandeville’s ideas when developing the *invisible hand* concept but Smith still believed in “virtuous” self-interest that led to unspoken cooperation.