



Settlement

Capitalism, Markets, and Innovation

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Overview

Trade was important to the colonies

Today's question: what did the colonies produce and export and why?

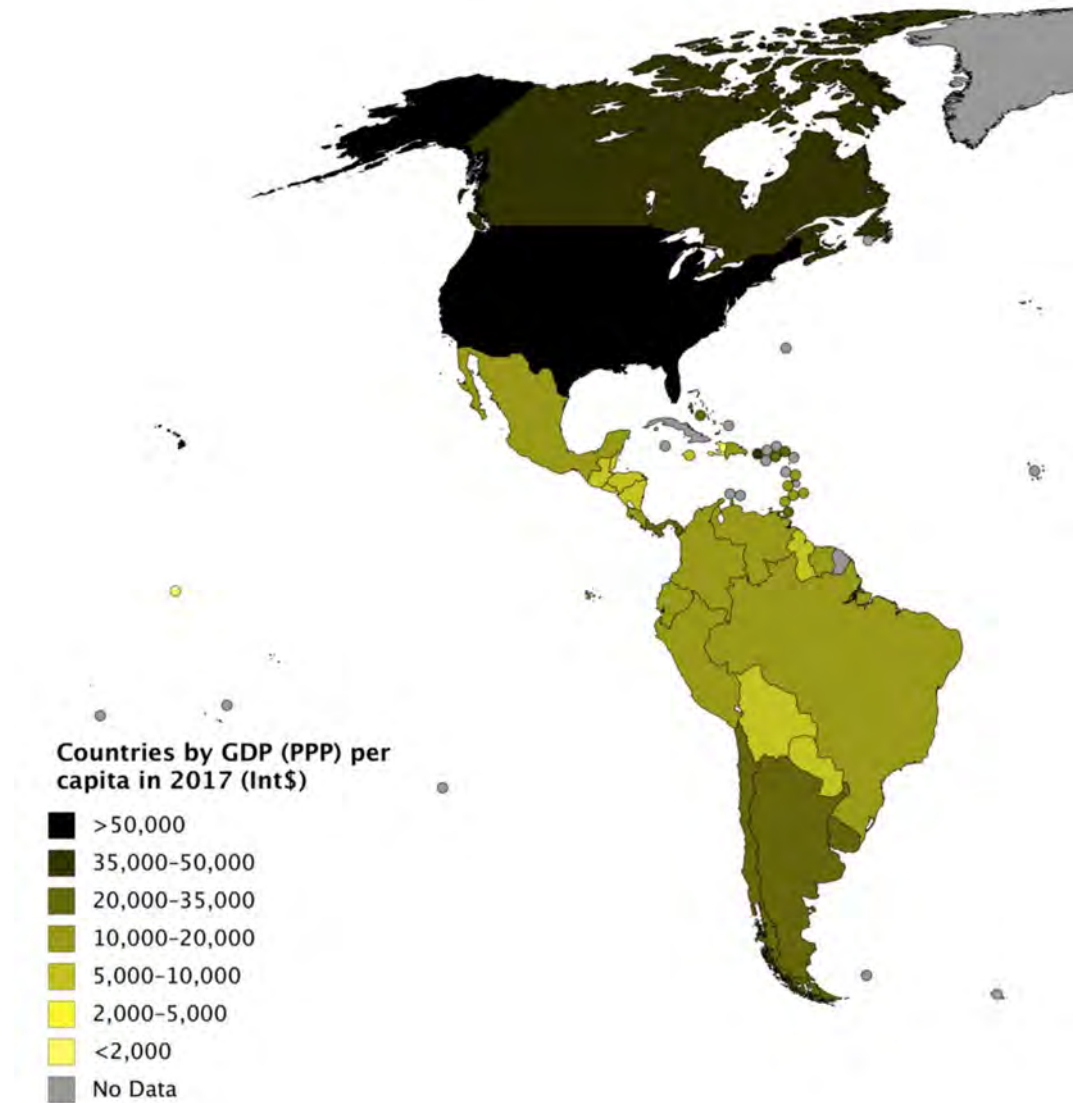


Overview

The New World today

Why are there large differences in prosperity today?

What can be done about them?



The American venture

The joint stock company

Joint stock companies proliferated in the 1600s to fund large-scale ventures like colonization and maritime trade. Key attributes:

- Separate legal existence. Can enter contracts, acquire assets, assume liabilities.
- Limited liability: shareholders cannot lose more than their initial investment.
 - ✓ Enables the pooling of funds from a large number of investors.
- Indefinite duration: continue to exist despite changes in shareholders or management.
 - ✓ Allows the company to access long-term financing.

The American venture

Joint stock companies established the first colonies

- The Merchant Adventurers was a joint stock company that financed the voyage of the Mayflower.
- The Virginia Company (1606) established Jamestown, the first permanent English settlement in North America.
- The Massachusetts Bay Company (1629) established Boston, Charlestown, and Salem.
- The South Sea Company (1711) was established to conduct trade with South America.
 - ✓ The South Sea Bubble (1720) was a major financial crisis in Britain.

None of these companies made money for their investors.

The American venture

The settlement of the New World helped develop capital markets and popularized the use of the corporate legal entity.

The Hudson Bay Company was founded in 1670.
This is a map of its territory in the early 1800s



Factor endowments and trade

Economic models

- An economic model is a simplified representation of reality used to illustrate fundamental forces or relationships.
- Models are based on assumptions and lead to conclusions.
- Models could be equations, graphs, diagrams, or simply verbal descriptions.
- The primary purpose of a model to highlight the most critical variables and interactions, **not** to account for every detail.
 - ✓ We can learn valuable insights by simplifying complex phenomena; however, it's crucial to remind ourselves of the important historical details that these models may overlook.

Factor endowments and trade

The basic idea

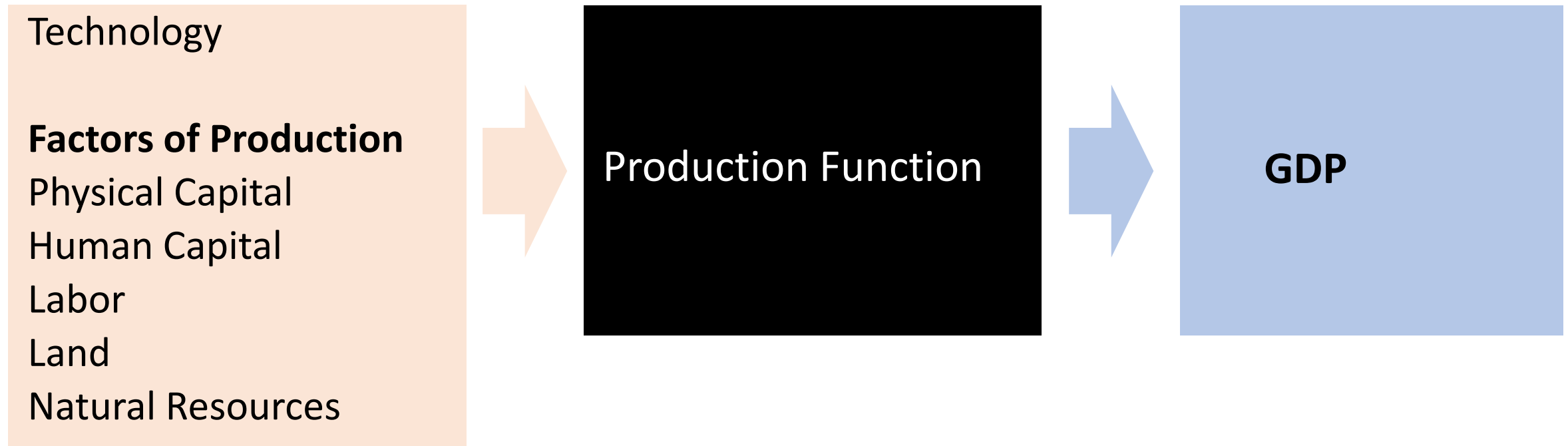
The **production function** shows how GDP is produced with **technology** and inputs called **factors of production**.

- Technology represents society's knowledge of how to produce GDP.

Real GDP growth is driven by (1) increases in factors of production or (2) improvements in technology.

Factor endowments and trade

The aggregate production function



Factor endowments and trade

Factors of production

- GDP is produced with inputs called **factors of production** (land, labor, natural resources, capital).
- A country's **factor endowments** are the **factor inputs** it has available.

Factor endowments and trade

Factor endowments, production, and exports

The factor proportions theory predicts what a country will export:

- The **land-abundant** country will produce and export **land-intensive** goods.
- The **labor-abundant** country will produce and export **labor-intensive** goods.

Factor endowments and trade

Factor endowments and factor abundance

A country's factor endowments are the **factor inputs** it has available.

Factor abundance is determined in relative terms. Country A is abundant in land if:

$$\text{Land}_A / \text{Labor}_A > \text{Land}_B / \text{Labor}_B$$

- Country A is land abundant **and** labor scarce.
- Country B is labor abundant **and** land scarce.

Factor endowments and trade

A simple example

	Farmland	Labor
Georgia	200	10
England	1,000	1,000

Which region is abundant in farmland (used to grow wheat)?

Which region is abundant in labor (used to make clothes)?

Factor endowments and trade

A simple example

	Farmland	Labor
Georgia	200	10
England	1,000	1,000

Which region is scarce in farmland (used to grow wheat)?

Which region is scarce in labor (used to make clothes)?

Factor endowments and trade

Factor endowments, production, and imports

The factor proportions theory predicts what a country will do:

- The **labor-scarce** country will import **labor-intensive** goods.

Factor endowments and trade

Factor endowments and factor abundance

You can “go backwards”—identify the abundant factor by looking at production and exports.

Compared to the US, what is:

- Qatar’s abundant factor?
- China’s abundant factor?
- Canada’s abundant factor?

Factor endowments and trade

Another simple example

	Farmland	Labor
Georgia	200	10
England	1,000	1,000

What pattern of migration would you expect?

Factor endowments and productivity

All else equal, a country with more factor inputs per worker will produce more output per worker.

- In other words, its workers will be more productive.

Factor endowments and trade

Last simple example

	Farmland	Labor
Virginia	200	10
New York	1,000	1,000
Georgia	1,000	50

Suppose the Democratic party supports agriculture. Which states are most likely to vote for the Democrats?

Factor endowments and trade

Summary

The factor proportions theory says that factor endowments affect:

1. What a country (or colony) will produce and export.
 - Also what a country will import.
2. Migration (movements in labor).
3. Political interests.

Class exercise

Trade with Britain was important to the colonies

Reasons: economics and the Navigation Acts, a series of laws passed in the mid-1600s.

Main provisions:

- All colonial trade was to be carried in English vessels.
- All trade of the colonies had to be conducted through Britain.
- Certain enumerated commodities could only be exported to Britain.

Class exercise

Factor endowments and trade

Compared to Britain, what were the colonies' abundant factors of production?

What did the colonies export and what did they import?

