**The Ancient Economic Thought**

* **The** **Greeks**
	+ Civilizations linked to the west began as early as 8000 BC
	+ Between 1200 and 200 BC – classical Greek civilization developed and flourished
	+ Lived in city-states and sustained a level of economic development
	+ Success resources, weather and location, attitudes toward knowledge and philosophy
* **Plato (468-399 BC)**
	+ In *“The Republic”*, mentions specialization as the reason for and justification of society.
	+ Specialization results in increased production because the individual becomes more knowledgeable about their craft
	+ Two-effects:
		- It increases output and improves the welfare of the individual in society by producing more goods and services
		- It is a component of justice
* **Xenophone (430-355 BC)**
	+ viewed division of labor and the allocation of resources within the ***Latifunda*** as a way to self-sufficiency
	+ ***Occonomicus*** – with efficient management of this large estate, it will eventually lead to self-sufficiency
* **Aristotle (384-322 BC)**
	+ **2 Concerns:**
		- Oikonomiks – production and consumption of goods; an analysis of how decisions were made regarding the management of resources
		- Chrematistiks – encompassed the activities of money-making as well as some aspects of production; studied human activities involved with wealth-getting which could be natural or unnatural
* **The Rise of Mercantilism**
	+ Theory that holds the prosperity of a nation depends upon its supply of capital, and that the global volume of trade is “unchangeable.”
	+ The ruling government should advance these goals by playing a protectionist role in the economy, by encouraging exports and discouraging imports, especially through the use of tariffs.
	+ Economic policy based on these ideas is called the *“mercantile system”*.
* **Mercantilism**
	+ - Established during the early modern period (starting 16th to the 18th century)
		- Roughly corresponded to the emergence of the nation-state
		- Led to first instances of significant government intervention and control over market economics
		- Much of the modern capitalist system was established during this time
		- The rise of nation-states and expanded trade, economic thought was restructured
		- It provided justification for and explanation of the activities of the rising merchant class
		- The accumulation of bullion was the objective of trade and was to be accomplished by a favorable balance of trade or the exercise of national power
	+ Problems (particularly in Spain):
		- Quantity theory of money
		- Inflation
* **Quantity Theory of Money**
	+ An economic theory which proposes a positive relationship between changes in the money supply and the long-term price of goods. It states that increasing the amount of money in the economy will eventually lead to an equal percentage rise in the prices of products and services. The calculation behind the quantity theory of money is based upon Fisher Equation:

	Calculated as:
	 M x V = P x T

	Where:
	M represents the money supply.
	V represents the velocity of money.
	P represents the average price level.
	T represents the volume of transactions in the economy.
* **The Physiocrats**
	+ Group of economists who believed that the wealth of the nation derived solely from the value of land agriculture or land development
	+ Theories originated in France and most popular during the 2nd half of the 18th century
	+ First well-developed theory of economics
* **The Physiocrats**
	+ Prominent figures
		- Anne-Robert-Jacques Turgot (1727-1781)
		- Francois Quesnay (1694-1774)
	+ Began with the publication of Adam Smith’s *The Wealth of of Nations* in 1776
	+ *Significant contribution:* emphasis on productive work as the source of national wealth
	+ Chief weakness: only considered agricultural labor to be valuable
	+ Viewed the production of goods and services as consumption of the agricultural surplus
* ***Turgot***
	+ Believed that self-interest was the motivating reason for each segment of the economy to play its role.
	+ Individual determines goods he wanted and work which would provided it. A person works for the benefit of others; he’ll work harder for himself. But each person’s needs is supplied by many other people.
	+ The system works best when there is a complementary relationship between one person’s needs and another person’s desires, and trade restrictions place an unnatural barrier to achieving one’s goals.
* ***The Laissez-faire Theory***
	+ French phrase meaning “let-do”
	+ First used by 18th century physiocrats as an injunction against government interference with trade
	+ Doctrine that maintians that private initiative and production are best allowed to roam free, opposing economic interventionism and taxation by the state beyond what is perceived to be necessary to maintain individual liberty, peace, security and property rights
	+ Originally introduced in the English-language word in 1774 by George Whatley in the book Principles of Trade (co-authored by Benjamin Franklin)
	+ The state has no responsibility to engage in intervention to maintain a desired wealth distribution or to create a welfare state to protect people from poverty, instead relying on charity and the market system
	+ Government should not be in the business of granting privileges.
		- Should not create legal monopolies or use force to damage de facto monopolies
	+ Support the notion of free trade on the grounds that the state should not use protectionist measures such as tariffs and subsidies in order to curtail trade through national frontiers

**The Industrial Revolution and Classical Economics**

* **Adam Smith (1723-1790) and the Classical School**
	+ - Founder of the Classical School
		- Constructed explanation on how social behavior is regulated
		- View of the world:
			* Each person sought their own self-interest but was constrained by morality, markets, and government
		- Developed an analysis of the
			* moral system - “The Theory of Moral Sentiment” in 1759
			* Economics – “The Wealth of Nations” in 1776
* Adam Smith’s The Wealth of Nations
	+ Rejects the Physiocratic school’s emphasis on the importance of land
	+ Division of labor would effect a great increase in production
	+ Excessive division of labor would lead man to his most ignorant state possible
* Division of Labor
	+ Ten people working separately could produce 20 pins each or 200 in a day
	+ In a modern pin factory with the division of labor (“One man draws out the wire, another straights it, a third cuts it…”) and machines (“to the invention of which the same division of labor has probably given occasion”) the same 10 people can produce forty-eight thousand pins a day
* Why does division of labor increase production?
	+ Savings of time (reduction of set-up costs)
	+ Dexterity and education; learning by doing
	+ Invention of machines
		- “inventions of common workmen”
		- “the ingenuity of the makers of the machines”
* In the progress of society, philosophy or speculation becomes, like every other employment, the principal or sole trade and occupation of a particular class of citizens. Like every other employment too, it is subdivided into a great number of different branches… Each individual becomes more expert in his own peculiar branch, more work is done upon the whole, and the quantity of science is considerably increased by it. Smith I.1.9
* **What makes division of labor possible?**
	+ “…it is the power of exchanging that gives occasion to the division of labor…”

 Smith WON I.3.1

* **How to Increase Trade and Division of Labor**
	+ *Larger Markets: “The division of labor is limited by the extent of the market.”*
		- * Larger markets increase the incentive to specialize. “When the market is very small, no person can have any encouragement to dedicate himself entirely to one employment.” Smith WON I.3.1
			* Larger markets increase the incentive to invest in machines (new technologies)
		- What makes for larger markets
			* Trust and good government
			* Free trade
			* Geography: cities and sea-coasts
			* Natural Liberty
	+ *Capital Accumulation*
* **David Ricardo (Theory of Comparative Advantage)**
	+ Notable work: “Principles of Political Economy and Taxation”
	+ Introduce the theory of comparative advantage
	+ Even if a country could produce everything more efficiently than another country, it would reap gains from specializing in what it was best at producing and trading with other nations (Case & Fair, 1999)
	+ Believed that wages should be left to free competition, so there should be no restrictions on importation of agricultural products from abroad
* **Comparative Advantage**
	+ Benefits are both distributional and related to improved real income
	+ Distributional effects: foreign trade could not directly affect profits because profits respond only in changes to the level of wages
	+ Effects on income are always beneficial because foreign trade does not affect value
* **Heckscher-Ohlin Theorem**
	+ A country has comparative advantage in the production of a product if the country is relatively well-endowed with inputs that are used intensely in producing the product.
* **Thomas Robert Malthus and the Principle of Population**
	+ Developed his view in reaction to the optimistic opinions of his father and his associates (notably Jean Jacques Rousseau)
	+ “An Essay on the Principle of Population” (1798), predicted that poupulation would outrun food supply, leading to the decrease in food per person.
* **Principle of Population**
	+ Depended on the idea that population, if unchecked, increases at a geometric rate (i.e. 2,4,8, 16 etc.) where as the food-supply grows at an arithmetic rate (i.e. 1,2,3,4 etc.)
	+ Check excessive population-growth:
		- Natural causes (accidents, old age)
		- Misery (war, pestilence, plague, famine)
		- Moral restraint\* and vice (infanticide, murder, contraception and homosexuality)
	+ Misrepresentation of Malthus’ theory
		- “…this constantly subsisting cause of periodical misery has existed ever since we have had any histories of mankind, does exist at present, and will forever continue to exist, less some decided change takes place in the physical constitution of our nature”
* **Marginalist School**
	+ Emphasized that prices also depend upon the level of demand, which intrun depends upon the aount of consumer satisfaction provided by individual goods and services.
	+ Provided modern macroeconomics with the basic analytical tools of:
		- Demand and supply
		- Consumer utility
		- Mathematical framework for using these tools
	+ Free market economy: factors of production receive returns equal to their contributions to production
		- this principle was used to justify the existing distribution of income
* **Marxist Economics**
	+ From the German economics Karl Marx
	+ The Capital (Germany 1867)
	+ Focus on the labor theory of value (exploitation of the workers by the capitalists)
	+ Capitalism was doomed and would soon be followed by business depressions, revolutionary upheavals and socialism
	+ Socialism is a stage of society in Marxist theory transitional between capitalism and communism and distinguished by unequal distribution of goods and pay according to work done
* **Socialism**
	+ any of various economic and political theories advocating collective or governmental ownership and administration of the means of production and distribution of goods