

Chapter Four: The Classical School – Forerunners (pg 45-60)

Historic Background

Versailles and the Nobility

Two major trends were occurring in the world

The first was Newtonian Physics and the scientific revolution

The universe was an observed phenomena

And observation could lead to predictive theories

Innate knowledge derived from reason alone was insufficient

The universe ran on Natural laws

The laws were not arbitrary or capricious, they were universal

The laws of man

The laws of economics

The universe was static

It doesn't change over time, it cycles....

Note: the laws don't change, events might

Newtonian laws and the scientific revolution effected the classical school in several ways

Natural laws dictated the universe – no need for feudal laws and institutions

The laws of nature now were the “divine will”.

Returns on wealth (profits, interest, rent) were part of divine law

So they must also be good – they must do something good

They reward virtue – the productive use of resources

The industrial revolution

In 1776, the industrial revolution was just getting going

England wasn't the most advanced nation – but was quickly headed there

As the industrial revolution advanced

Monopolies began to break down as competitors arose

The need for regulation, and the ability to regulate, declined

English industries became very competitive, they didn't need protection

A new free, mobile, low-paid workforce began to emerge

Demographic shift – from farms to factories

Downward pressure on wages

Immigration, rising agricultural productivity (enclosure), falling death

rate

Local regulation to protect employers (wage ceilings)

Eventually, the call for regulation to protect workers (wage floors)

All of this made exporters and manufactures laissez faire

Major Tenants of the Classical School

Minimal Government interference: the best govt. was the least

The economy is self adjusting

So only provide for property rights, national defense, and public education

Self-interested Economic Behavior: self-interest is inherent to humans

Producers want profits
Consumers want benefits
Workers want wages

Harmony of Interests: no conflicts arise from self-interest
By pursuing one's own goals, one is also benefiting society
Importance of all Economic Activities and Resources
Agriculture was Important
 Modern day "extraction industries"
Commerce was important
 Redistributing goods adds value to them
Production was important
 Rearranging inputs adds values to them

Economic Laws

Economic theories or "laws"
 Assumed them to be universal across time and space
 Not situation, culture, or institution specific
Comparative advantage, diminishing returns, Say's law, quantity theory of money, etc.
Not all laws were correct, Labor theory of Value

Whom did the Classical School Benefit or Seek to Benefit

In the long run, it benefited almost everybody
 Businessmen became respectable
 Example: the United States
Making money was good....., it benefited the nation
Wage earners suffered at least in the early stages
 Charles Dickens
 Very disputable notion
The Rent Seekers (monopolists, regulators, guilds, etc.) suffered the most

But in the long run, a rising tide lifts all boats

How was the Classical School Valid, Useful, or Correct in Its time?

By focusing on production, classical economists
 shifted emphasis to the growing segment of the economy
By focusing on free markets, classical economist
 Shifted emphasis away from the notoriously corrupt govt. sector
Early industrialization required huge investments
 Classical economics encouraged this, and also encouraged
 Reinvestment, to maintain the system
 Since the public sector did not grow, profits could be reinvested
As production rose, so did output, and the need for urban labor
 More labor entered the cities, they had to buy food....
 This expanded the market in agricultural goods

Which in turn, began to rationalize and improve agriculture

Which Tenets of the Classical School became Lasting Contributions?

Far surpassed previous theories.

I Important Figures

Francois Quesnay (French, 1694-1774)