THE CLASSICAL SCHOOL

THE TURBULENT BIRTH OF ECONOMICS IN TWENTY EXTRAORDINARY LIVES

CALLUM WILLIAMS

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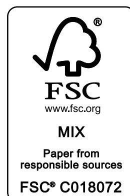

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INTRODUCTION: 20 EXTRAORDINARY LIVES

What the founders of economics argued, why they argued it, and what they got wrong

If you read a quality newspaper, watch historical documentaries or attend public lectures you will often hear passing references to the founders of economics. Appealing to the authority of one of these people remains a useful rhetorical device. What better way to support an argument than to claim that Adam Smith, John Stuart Mill or David Ricardo took the same position?

The *Financial Times* tells us that "the core ideas behind Adam Smith's vision of capitalism are being ignored", and that we need to relearn what Smith wrote "if we are going to replace the opaque and exclusive system modern finance has created". An essay in the *Wall Street Journal* invokes John Stuart Mill in the debate on free speech on campus. The implication of the article is that Mill would have supported an environment in which students are exposed to opinions that they do not like. After all, Mill wrote: "He who knows only his own side of the case, knows little of that." Liam Fox, Britain's international-trade secretary in 2016–19, organised an event where he "celebrated 200 years of Ricardo's comparative-advantage theory". That was intellectual ballast for his view that Britain would be better off outside the European Union, where it can strike its own free-trade deals.

Of course Smith had no idea about the derivatives, futures and

options that make up modern finance. Ricardo's theory of comparative advantage described a very different international economy from the one that we have today. But none of that matters a jot. If someone can make it seem as though their argument, no matter how arcane, was or would have been supported by one of these thinkers, it carries that bit more weight.

Which makes it essential to get a better sense of what these economists really meant. What did Adam Smith mean by the term "invisible hand"? Did Karl Marx predict the end of capitalism? Was John Stuart Mill a utilitarian? Did Thomas Malthus believe that famines were desirable?

This book will talk about what the founders of economics actually thought. That involves debunking some popular myths. I will also explain the significance of their ideas in simple language. The book has no equations and hopefully no jargon. After reading this book, you will know a few interesting things about the very famous (Smith, Malthus, Mill) and the much less famous (Harriet Martineau, Bernard Mandeville, Dadabhai Naoroji).

But the book offers more than that. Often people treat Adam Smith's theories as things that just dropped from the sky. On closer inspection, however, it is clear that the political economists were influenced by prevailing economic, social and political conditions. You cannot understand the work of the famous "physiocrat" school of economics of 18th-century France without a basic understanding of the state of French agriculture at the time. David Hume and Adam Smith were best friends – and possibly lovers – yet Smith practically ignored Hume's writing: why? Ricardo's theories mean nothing, meanwhile, without knowing a bit about the Corn Laws. And your understanding of what Thomas Malthus argued will be far better once you know a bit about William Godwin and Mary Wollstonecraft's sex life. Placing the political economists in their proper context has recently become a whole lot easier, as more and more high-quality historical data on the economy are published.[1] My aim is to offer an inevitably partial assessment of what these thinkers wrote, the impact it had, and the worthiness of their contributions. This book is far from the final word on any of these people, but a useful way of understanding what they were all about.

Why these 20 thinkers? There is a certain amount of arbitrariness in choosing such a select list. Many significant names – Boisguillebert, Walras, Lenin, to name a few – do not feature. I have limited the time period under consideration to roughly three centuries. The oldest thinker in the book is Jean-Baptiste Colbert, an economic adviser to Louis XIV, who was born in 1619. The last of our thinkers to die was Alfred Marshall, in 1924. (The chapters, which deal with one person each, are ordered by year of the person's death.)

Don't be afraid to ask

Throughout the book I will try to answer basic questions about our 20 people that historians rarely bother to ask. The first one is this: why did economics come into being during the period 1600–1900? Before that period people did think about economic questions, of course. But not in the way that economics is understood today. Hannah Sewall argued in 1901 that "[t]he Greeks, in common with most ancient peoples, had no conception of rational laws governing the phenomena of the distribution of wealth."[2] They were more interested in questions of duty and nobility, questions of right and wrong, "rather than to know the ultimate relations of all actions". Very broadly speaking, people thought this up until around 1600. Sewall explains that "economic activities were subordinate to political and aesthetic interests, and the study of economic problems therefore was subordinate to the solution of the more important problems of ethics and jurisprudence."

On the question of economic value, medieval thinkers were more interested with what value "should be" rather than what value "is" (the latter question preoccupied the early economists such as Adam Smith and David Ricardo). Thomas Aquinas wrote about the concept of a "just price" – which gets at the ethical issues behind a question such as "is it legitimate for a shop to raise the price of umbrellas when it is raining?"

Why did people view economics differently back then? One reason is that markets were not a big part of everyday life for most people.[3] Feudalism, after all, relied more strongly on loyalty and coercion than it did on price signals. Hannah Sewall argues that "a large portion of the people, especially in the lower ranks of life, even so late

as the middle of the 15th century, still depended upon the direct personal services of their neighbours for the satisfaction of most of their everyday wants". There were few opportunities for the investment of capital for profit. And, speaking very broadly, medieval societies were more concerned about the welfare of the sovereign and the church than they were about the welfare of the average person. It followed that people did not much think about how to allocate scarce resources fairly and efficiently.

Also, from the earliest recorded history, up until around the 17th century, all places across the world were roughly as rich as each other. The most authoritative historical GDP data is from Angus Maddison. These show that in the year 1000 the country with the highest per-person GDP (Iran and Iraq, tied first) was only about 50% richer than the world's poorest country for which there are data (Denmark, Finland, Norway, Sweden and Britain, all joint last).

From around 1600, however, economics as a coherent discipline began to emerge. As feudalism withered, markets became stronger. That called for an explanation as to how they worked. And the world entered a period known to historians as "the great divergence".[4] By 1900 Western Europe and America had become far, far richer than anywhere else. In that year the world's richest country, Britain, was over *eight* times as rich as the poorest, China. People were driven to explain what was going on. "[T]he wealth and poverty of nations", wrote Thomas Malthus to David Ricardo in 1817, was "the grand object of all enquiries in Political Economy".

Most of the intellectual action took place in Britain and the Netherlands, which vied to be the world's richest country in the 17th and 18th centuries. There were also many French economic thinkers. France at the time was a comparatively wealthy place, but was doing far worse than Britain. France's smartest people applied themselves to try to understand what was going wrong. You may have noticed, however, that the book contains no contributions from Americans. That may seem surprising: today America dominates both the global economy and academic economics. However, Joseph Schumpeter says that "[a]s regards the United States, there is nothing to record in the way of systematic endeavor before the nineteenth century. This is as we should expect from environmental conditions that

were unlikely to produce either a demand for or supply of general treatises." Even in the 19th century America did not produce many economists, and those that it did, such as Henry George, tended to borrow ideas from the European classical economists. No Americans featured in the "family tree of economics" which was introduced in the 1958 edition of Paul Samuelson's famous textbook, *Economics*. It was not until the 20th century that American economists began to dominate the discipline as a whole.[5]

You, and you…

Why does the title of this book refer to a "classical school"? To be sure, the people profiled here had very different ideas about how the world worked. Nonetheless, in some important ways they make up a coherent body of thought. Members of the classical school, which lasted from roughly 1600 to 1900, asked themselves common questions. How do markets work? What is value? Why are some countries becoming fabulously rich, while others seem destined to remain poor for ever?

To explain these historically unprecedented trends, they also tended to point to similar phenomena. The benefits or otherwise of international trade were one important theme. Others were preoccupied with the question of how much of a role the government should have in the economy. At the same time, many worried about the spiritual and intellectual degradation that might accompany capitalism and economic growth.[6]

But members of the classical school were a coherent body also in a methodological sense. They rarely employed complex mathematics to express their theories. Even less commonly did they test their theories against empirical data in a rigorous way. They were philosophers more than they were hard scientists. The book ends with Alfred Marshall largely because in his work you start to see a break with the classical way of doing things: Marshall loved his equations, and he fumbled his way towards testing his theories with empirical data. After Marshall came John Maynard Keynes, Paul Samuelson, Milton Friedman – and the emergence of modern economics.

Some histories of economic thought read more like hagiographies than critical examinations. But I will show that most of the

people in this book made big intellectual mistakes. Historians generally caution against using the benefit of hindsight to judge the people of the past. What may seem irrational or obvious to us may have been perfectly reasonable or insightful at the time. Nonetheless, in researching and writing this book I have been frequently baffled at the shortsightedness and daftness of some of the ideas that the 20 classical economists in this book put forward.

I'll also make an effort to talk about people who achieved enormous things but have been forgotten. Harriet Martineau wielded great influence when she was writing. Her books sometimes sold better than Charles Dickens's, a remarkable achievement in itself, but even more so when you consider that she was writing about economics. Rosa Luxemburg, meanwhile, was in her time the most controversial of controversial thinkers, doing what few Marxists had dared to do: pointing out what Marx had got wrong. Dadabhai Naoroji, as well as being a fascinating character in his own right – he was Britain's first Asian MP – was also the first person to think systematically about the economic impact of colonialism.

Throughout the book, too, I will try to draw the links between the thinkers together. (For me, that has been the toughest but most interesting bit.) The people in this book were a fairly close-knit bunch. Malthus and Ricardo were best friends. Shortly before Marx's death, Marx met Dadabhai Naoroji, probably at a dinner party, and the two swapped ideas. Marx would surely have incorporated them into the later volumes of *Capital* if he had lived long enough. Ricardo had been looking forward to meeting Jean-Baptiste Say, but was ultimately left underwhelmed. Harriet Martineau seemed to know pretty much everybody.

Even if they did not know each other personally, the 20 were constantly criticising and critiquing each other. Adam Smith published the *Wealth of Nations* in 1776 in opposition to the "mercantile system" of Jean-Baptiste Colbert, France's finance minister from 1661 to 1683. John Stuart Mill at first slavishly adhered to Ricardo, but would later come to reject much of what he had written. Alfred Marshall, the final economist profiled in this book, constantly referred to Sir William Petty, one of the first. Marx and Engels, meanwhile, were not intellectual outsiders who proposed an entirely new body

of economic theory. They very consciously worked *within* the tradition of Smith, Ricardo and Mill but purported to expose the flaws contained therein.

So it is best to see the book as a coherent whole. Having said all that, it is definitely possible to dip in and out of it, chapter by chapter. At the very least, after finishing it you will be better equipped to deal with the onslaught of references in popular culture to the founders of economics. Having something interesting to say about these people is more useful than ever – and so is being able to see through dubious appeals to their authority. I hope, too, that you will have a new sense of how economics came into the world: the sequence of ideas, developments and events that led us to where we are today, when the founders of an academic discipline are for better or worse treated as sages. This book seeks to put them in their proper perspective, as the time-bound and fallible originators of ideas that still speak to us today.

— 1 —

JEAN-BAPTISTE COLBERT (1619–1683)

The whipping boy

Mercantilism is never, ever a good word in the world of economics. The word has connotations of ideas that are pre-modern, irrational and innumerate. Economists who deride President Donald Trump's trade policy, which is almost all of them, dismiss it as "mercantilist". And in the 18th and 19th centuries most political economists explicitly defined themselves in opposition to mercantilism. Adam Smith coined the term "mercantile system", which in his *Wealth of Nations* (1776) was target practice.[1] From Smith onwards you could be respectable only if you were "against" the mercantile system. Yet few people have ever bothered really to understand what the mercantilists were all about – or even who they were. A more complex picture emerges. To be sure, many of the mercantilists had daft ideas. But not all of them were stupid.

Josiah Child (c.1630/31–99) and Thomas Mun (1571–1641) were England's most famous mercantilists. But the best-known of all is Jean-Baptiste Colbert, the finance minister of France in 1661–83, when Louis XIV (the "Sun King") was in power (1643–1715). A look at Colbert's life gives the reader the strongest overall impression of how mercantilist ideas worked in practice.

Colbert is today perhaps most remembered for his quip concerning taxation, beloved by journalists: "The art of taxation consists

in plucking the goose so as to obtain the largest possible amount of feathers with the smallest possible amount of hissing." But that was about as far as Colbert's economic theorising went. He never wrote a book (though according to a 1991 edition of the journal *Libraries & Culture* his library contained 23,000 of them) nor delivered any lectures. Sir John Clapham, perhaps the most esteemed economic historian of his age, remarked that Colbert had "no single original idea". Why, then, is he so important? Because he put mercantilist ideas into practice, and thus to understand him is to understand that system of thought. Donald Coleman reckons that "Colbert was perhaps the only true 'mercantilist' who ever lived."

Jean-Baptiste Colbert was born in Reims, now the centre of France's champagne industry, in 1619. Unlike most of the people in this book he did not have a distinguished academic career. Nor was he rich. But he did have fairly good connections in the French bureaucracy. Before he was 20, Colbert had secured a job in military affairs. From 1645 to 1651 he was an assistant to someone responsible for military matters. Soon after, he went to work for Louis.

Colbert did not have a reputation for being a particularly nice man. The Abbé de Choisy, a cross-dresser who published a memoir in 1737, remarked that Colbert had a "naturally scowling face". But he would suck up like the best of them in order to curry favour with superiors, buying jewels for Louis's mistresses, for instance.[2] Clapham rather childishly refers to Colbert as a "big stupid man". Rumours and intrigue abounded. According to the Abbé's memoirs, Colbert "let himself be touched by the charms of Françoise de Godet", who had "an advantageous size", and he also "took care of Marguerite Vanel, wife of Jean Coiffier". Colbert features in the BBC drama *Versailles*, which depicts the sordid affairs of Louis XIV's court in often graphic detail.

The popular image of Louis XIV's reign (1643–1715) is one of utter inefficiency and decadence. France was corrupt and backward. The incompetence of Louis's administration set the ball rolling for the French Revolution several decades later. And Colbert was right at the centre of it. Data from the Angus Maddison database suggest that during the 17th century French GDP per capita grew at an average annual rate of just 0.08%, while that of the Netherlands grew by

0.43%.[3] But Pierre le Pesant, sieur de Boisguillebert (1646–1714), calculated that in 1665–95, which corresponds more closely to the period when Colbert was actually in charge of stuff, French national income declined by an astonishing 50%.[4] The French economy noticeably accelerated in the 18th century, after Colbert had departed. Politicians who sympathise with mercantilist logic might take a look at what happened under Colbert's direction.

Make France great again

Colbert's policies were the best expression of mercantilist economic doctrine. One core notion is "bullionism". This amounts to an obsession with the balance of trade, and more specifically, with the notion that it must be in surplus (meaning that exports exceed imports). Bullionists prioritised the accumulation of gold and silver – "specie", in the jargon – above all else. Exports would result in goods leaving the country, with specie entering the country. Imports would result in the opposite. So if exports exceeded imports a country would see a net inflow of bullion.

It is easy to see why bullionism was such an attractive notion. You can measure and hoard specie. It also looks nice. In many people's minds, bullion *is* wealth. By contrast, the consumption of goods and services involves money disappearing. If you use money to buy an apple, and then eat it, you are left with no money and no apple.

Accumulating as much bullion as possible called for a Trumpist trade policy – duties on imports (to reduce their number) and subsidies or "bounties" on exports (to increase their number). As specie flowed in from abroad, the receiving country would necessarily get richer, or so the argument went. The mercantilists subscribed to a "zero-sum" notion of the international economy: for every country becoming richer, there *must* be one becoming poorer. After all, there is only so much gold and silver to go around.[5]

Mercantilist theory is so intuitive that it continues to hold sway today. Not only Trump but a large number of Brexit supporters see a trade deficit (where imports exceed exports) as inherently a bad thing. A trade deficit seems to represent money "leaking" from the country. An export surplus, by contrast, is seen as inherently good.

Few contemporary economists agree with this view of the world.

The end purpose of economic activity is consumption. If exporting amounts to working hard to produce something that foreigners then get to enjoy, then imports are the opposite – by that logic, it's a good thing if imports exceed exports.[6] Meanwhile, bullion (or money) is merely a claim on the things we care about, rather than the thing itself. Imports can also improve productivity. A country can in theory run trade deficits indefinitely, with no ill effects. Trade deficits are usually associated with strong, not weak, economic growth.

Nonetheless, in the 17th century the view was widely held that having a trade surplus was a good thing. Joseph Schumpeter says that it is "strikingly illustrative of the ways of the human mind that [John] Locke of all men should have committed himself to this [mercantilist] argument". Michel de Montaigne was another supporter, noting that "no man profits but by the loss of others". Daniel Defoe reckoned that wealth increased as the value of products that could be exported similarly increased. As he put it, "nothing that is consumed at home is an advantage to the national wealth". And Samuel Pepys remarked that "the trade of the world is too little for us two, therefore one must down". John Maynard Keynes argued that "both economic theorists and practical men did not doubt that there is a peculiar advantage to a country in a favourable balance of trade, and grave danger in an unfavourable balance, particularly if it results in an efflux of the precious metals". It is hard to say why mercantilist ideas took hold around this time.[7] It may have been because the 1600s were a period of rapid growth in overseas trade, as naval technology improved. People started to view trade as more central to daily life than they had previously done.

Colbert liked the theory that a trade surplus equalled national prosperity. Schumpeter goes further, claiming that Colbert was "addicted" to it. "The universal rule of finances", Colbert said to the King, "should be always to watch, and use every care, and all the authority of Your Majesty, to attract money into the kingdom."[8] Contrary to modern economists, who basically argue that it is possible for all countries to get richer at once, Colbert implied that France could only get rich at the expense of other places. "Commerce amounts to a perpetual combat, in peace and in war, between the nations of Europe," he told Louis in 1669.[9]

Historians have noted that under the watchful eye of Colbert

there was a clear change in French government policy from what had come before. Martin Wolfe, for instance, finds little evidence of high import tariffs in Renaissance France. By the 17th century that had decisively changed. "The famous mercantilist principle of the balance of trade and its connection with the nation's stock of money", Wolfe argues, "is nowhere to be found in Renaissance France – at least not as we see it in Colbert's time."

As Donald Coleman, a historian, shows, in the mid-1660s Colbert started a trade war with France's closest partners, England and the Netherlands, "in the interest of revenue, the balance of trade, and shipping, or in order to encourage and protect industry". Tariffs imposed in 1667 were "protective to the point of aggression". The English and Dutch responded with higher tariffs on French wines and brandies. Within a few years of Colbert taking the helm of economic power English exporters were moaning that exporting to France was impossible. Colbert also wanted the French navy to muscle in on trade in the Indian Ocean. According to Glenn Ames, a historian, Colbert's motivation for doing so rested on a theory that "held that any French gains would necessarily have to come at the expense of the Dutch, the dominant power in that trade".

Did Colbert succeed in his objective to bless France with an enormous trade surplus, which would allow it to accumulate vast quantities of gold? It is hard to be sure since trade data for the 17th century are poor. Margaret Priestley, however, points to evidence that by 1674 France exported *to* England £965,128 more than it imported *from* England (that's around £200 million in today's prices). In other words, in that year France was attracting £965,128-worth of bullion from England, which could then be squirrelled away in the nation's coffers. Success? Not necessarily. France had long had a trade surplus with England. The data suggest that by the end of Colbert's tenure, France's trade surplus was probably barely bigger than it had been before he came to power. So, even in his own terms, Colbert was not much of a success.

Yet Colbert was not only obsessed with France's external trade. He also wanted to improve the domestic French economy. And this speaks to one of the central concerns of mercantilists, which today is underappreciated.

The other face of mercantilism

In a paper of 1952 William Grampp, a historian of economic thought, argued that the "objective of mercantilist doctrine was different from what it is usually thought to be".[10] The group's goal, he suggests, was not simply to accumulate bullion for its own sake, as in the popular understanding, but something different: full employment.

Grampp does not really explain why a group of thinkers emerged who all addressed themselves to improving employment rates. It might have something to do with how the economy was changing from the 17th and 18th centuries. Look at the British economy, for instance. Agriculture was becoming a relatively less important economic activity. More and more people were living in cities, for a wage. Unemployment, in a word, may simply have been getting more visible. And people wanted to do something about it.

Enough speculation. What is clear is that the mercantilists' view of the employment question was quite different from the hardline political economists who were to follow them. In its purest form, classical economics says that society naturally tends towards a pleasant equilibrium in which everyone can earn a decent wage. Eli Heckscher, writing in the 1930s, characterises the classical political economists, reasonably fairly, as believing that the "desired results" were "expected to follow from the untrammelled forces of economic life" (see, for instance, Chapter 10 on Jean-Baptiste Say). The mercantilists did not believe this. They thought that "the desired results were to be effected 'by the dextrous management of a skilled politician'".[11] In other words, you *need* state intervention to reach full employment. In this regard the mercantilists appear to have pre-empted John Maynard Keynes, who argued in favour of extra government spending during times of poor economic growth and high unemployment. Indeed, in his *General Theory* (1936), Keynes referred approvingly to mercantilist doctrine.

What could be done, in the mercantilist view, to create lots of jobs? Just like Simonde de Sismondi (Chapter 12) and Alfred Marshall (Chapter 20), mercantilists worried about the propensity of the rich to hoard their wealth rather than spend it. Low spending by the rich would, in turn, deny employment opportunities to the less well off.

Many of them, therefore, encouraged the rich to spend, spend, spend. In 1598 Barthélemy de Laffemas, a French thinker who is seen as an intellectual precursor to Colbert, criticised those who opposed the purchase of expensive silks. He suggested that people who went out and bought luxury goods created job opportunities for the poor, whereas the miser who saved his money caused them to die in abject poverty.[12] Bernard Mandeville (Chapter 3) made similar arguments. Mandeville suggested that spending on luxuries – indeed, even on things like prostitution – had considerable economic benefits since it created employment. Lots of employment, too, since the production of luxuries tended to involve hiring more people than the production of run-of-the-mill commodities. These arguments presage what Thomas Malthus would argue a century or so later (see Chapter 11).

Crucially, too, the mercantilists reckoned that *trade surpluses* would also help to increase spending. The gold and silver flowing into the country could be used to spend on activities that would give employment to the poor.[13] A healthy export sector, meanwhile, would lead to more jobs. Edward Misselden noted in 1622 that "when trade flourishes, the King's revenue is augmented, lands and rents improved, navigation is increased, the poor employed. But if trade decay, all these decline with it."[14]

From theory to practice

Back, then, to Colbert. He was also a paid-up member of the full-employment club. And that called for direct forms of state intervention. Clare Crowston shows how in 1665, to reduce female unemployment, Colbert created a royal company with a nine-year monopoly over a new "French" style of lace that was to replace imported Venetian lace. A "series of edicts from 1666 to 1669 repeated prohibitions on selling imported lace", Crowston notes. Colbert in effect believed that the more precise the regulations, the more unique a product France could produce. That in turn would allow France to corner the market, and hence more people could end up in work. In 1666 Colbert issued a rule which in effect stipulated that fabrics made in Dijon had to contain exactly 1,408 threads. Regulations such as these were in the modern jargon a "non-tariff barrier", making it more difficult for foreign fabric-makers to get access to the French market. The desire

to boost jobs was also behind his imperialistic instincts. According to C. W. Cole, writing in 1939, Colbert believed that as a result of French expansion into the West Indies "employment would be given to 6,000 more Frenchmen". However wrongheaded Colbert's means to improve employment, his objective was pretty clear.

A confused legacy

What, then, to make of mercantilist doctrine? The belief that "more gold equals more wealth" is seductive but false. The policies that flowed from that belief – restrict imports and boost exports, no matter how much government intervention is required – almost certainly did a lot of economic damage to the country that implemented them most enthusiastically.

On the other hand, the mercantilists' focus on how to provide employment to as many people as possible is far from misguided. As we will see most clearly in the chapter on Jean-Baptiste Say, many economists in this book basically believed that high unemployment over a long period of time was impossible – no government intervention was required to reduce it. Indeed, not until Keynes did the economic mainstream take seriously the notion that unemployment did not necessarily blow itself out, and that the government might have to step in if it endured year after year. In many ways Colbert and his mercantilist crew were daft. But in others they were prescient.