

Module 1

Lecture 3

Topic

1.3 Physiocracy

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For the next two lectures we would be talking about two pre-classical economic schools of thought: Mercantilism and Physiocracy. In spite of their methodological distances from classical economists, they crossed the path of classical thinkers mostly by providing viewpoints contrary to the classical ideals. Physiocracy was mostly in tune with the Classical economists with their emphasis on production rather than trade as a key component for generation of national wealth. Mercantilists on the other hand were more in favor of emphasizing trade and in favor of government protection which ran afoul of laissez fair principle of the classical. The school of physiocracy started its journey from France in the eighteenth century mostly as a reaction to the protectionist regime of Louis XIV and subsequently Louis XV's huge defeat in the hands of English who were mostly following open market principles. During these regimes land tax (taille) was the principle source of government revenue thereby imposing huge burden on the agriculturalists. Physiocracy provided a theoretical backing to the back to the nature movement.

Physiocracy was a French intellectual movement which lasted from 1750-1780. The most influential physiocrat was Francois Quesnay whose theoretical formulation was widely adopted by other physiocrats (PC). The PCs believed that economy is governed by some natural law which were not affected by human behavior and the key to designing good policies is to understand the underlying economic principles or unchanging natural laws governing the economy. His emphasis on the interconnected flows governing the economy like the flow of blood through the veins and arteries in the human body and the similarity between the laws of economics and the laws of nature probably derived from his training in physiology, which is the root of 'physiocracy'. PCs upheld agriculture as the only sector which can produce net product and therefore capable of driving the economy. This claim however was disproved by subsequent miraculous growth experiences of west Europe which was driven by industrial growth. Nevertheless, PC will be mostly remembered for their emphasis on inter-connectedness in an economy and their formulation of "Tableau Economique"

Let us now analyze a simplistic presentation of the "TableauEconomique". Suppose that there are three sectors in an economy: farmers, landowners and artisans. The physiocratic analysis begins at period t with a net product of Rs 4000 in the hand of the landowners. This comes from the operation of the period $t-1$. The physiocrats assumed that only land can produce more than the value of inputs (positive net product) and in the tableau it was assumed to be 100percent. Artisans, they assumed, only change the form of products when say they make hammer using wood and iron. But that transformation does not create any value in the society. Hence, Rs. 4000 spent on land creates a total value of Rs.8000 out of which Rs.4000 would be net product which landowners receive as rent. Then landowners spend Rs 2000 for buying food from farmers and Rs. 2000 for buying goods from artisans. Then the farmers spend that Rs. 2000 on agricultural activity and that again creates a total product of Rs 4000. Out of Rs.4000 worth of products Rs.2000 go to the landowners in exchange of their purchases and Rs.2000, which is the net product going to the landowners as rent. The artisans get Rs.2000 which they entirely spend on farmers for buying agricultural goods.

Hence, the only dynamic element in this model is what is spent on agriculture from the last period and creates net product. All other exchanges in this model are perfect quid pro quo which does not create any extra wealth. The model has the obvious problem of assuming away any possible contribution of any sector other than agriculture. This could not be defended empirically. Even though physiocrats could not formulate a coherent price theory they emphasized on the operation of free market for social welfare. They also concluded that given that agriculture is the only source of value added land tax would reduce national income. Physiocrats correctly perceived the inter connected nature of the economy and the fact that even someone freely choosing her occupation she ends up doing work for someone. Hence, the economy should be understood as a whole.

The physiocrats also believed that a natural order exists in the economic system which is self-regulating. Hence, they refuted the mercantilist call for governmental regulation. They, in tune with the classical argument, agreed that laissez faire policy is the best for the society.