



The Return of Thomas Mun

by Martin Hutchinson. July 27, 2009

China's recent announcement that it would use its \$2 trillion of foreign reserves to boost its companies overseas acquisitions tells us that its economic beliefs are neither those of Adam Smith, nor of Karl Marx, but of the 17th Century mercantilist Thomas Mun. It is becoming clear that in economics, unlike in "hard" sciences, old belief systems never die.

Mun (1571-1641) wrote a classic magnum opus "England's Treasure by Foreign Trade." Published only after his death in 1664, it was nevertheless very influential. Mun had been a Director of the East India Company, and, unlike earlier theorists, believed that foreign trade was beneficial. However he didn't hold with any high-faluting nonsense like comparative advantage, or maximization of global economic welfare. For Mun the purpose of foreign trade was to export more than you imported and, consequently, amass a huge store of foreign "Treasure," which you could then use to found colonies that would take control of natural resources.

To further this objective, countries should: cut back domestic consumption as far as possible; increase the use of land and other domestic resources to reduce imports; encourage the export of goods made with foreign raw materials; and export goods with price-inelastic demand because profits would be greater.

Mun's theory made sense in the 17th Century economic jungle — and today it obviously makes sense to China. The renminbi, China's currency, is undervalued, so exports consistently exceed imports. Domestic consumption is kept low and savings high, both of which suppress imports. In industries such as automobiles where consumer demand is inevitable, foreign manufacturers are forced into domestic joint ventures, so that domestic manufacturers can be developed to replace imports. Domestic agriculture and resource extraction efforts are intensive. China has set up free trade zones, in which foreign parts are assembled into goods that are then exported. Finally, the country has amassed a gigantic store of \$2 trillion of "Treasure," which is now to be used to assist in foreign acquisitions. Those acquisitions are not to be on Wall Street, as prime minister Wen Jiabao helpfully explained, but in natural resources, where China can assure itself of exclusive raw materials supplies for decades to come.

It's not often you see an economist's ideas put into effect with such precision. "Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist" said Maynard Keynes, but he probably didn't expect the economist to be almost 370 years defunct, nor the slavery quite so deferential. William Gladstone's Britain never followed Adam Smith's theories with such

precision. Neither was Clement Attlee's Britain so scrupulously faithful to the teachings of Keynes himself. Certainly Josef Stalin's Russia played fast and loose with the teachings of Karl Marx, as did Mao Zedong's China.

It indeed has to be doubtful whether any member of China's current State Council has read Mun with any care. Wen himself is a geologist by training. One vice premier, Li Keqiang, has an economics PhD, but he got it at Beijing university in the early 1980s, so probably did not have Mun high on his reading list. Two other vice premiers, Hui Liangyu and Zhang Dejiang, have economics first degrees, but Hui got his at Jilin Party Provincial School while Zhang aced the economics syllabus at Pyongyang's Kim Il Sung University. Neither institution is known as a haven of Mun studies.

Still, to us practical men, the interesting question is not where the Chinese leadership got its exquisite understanding of Mun's theories, but whether they are likely to work.

For Adam Smith, writing a century later, Mun's nostrums were clearly inadequate. "If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage," he wrote. China does not believe this. China preferred to force GM into a joint venture in China that even now, twelve years after the joint venture's foundation and with Buick sales volume in China higher than in the US, makes China's citizens pay \$32,200 for a base model 2010 Buick LaCrosse—16% more than its US price of \$27,835.

Thus in Smith's time the ideas of Thomas Mun had come to seem hopelessly primitive. With the supply of natural resources essentially infinite, countries maximized their wealth by exploiting their comparative advantages, whether through cheap natural resources, as in British coal, through high quality agriculture, as in French wines, or through high-level mechanical ingenuity, as in German manufactures. Whether a country ran a balance of payments surplus or deficit was of little short-term consequence, and unless a country ran out of money altogether, "Treasure" was of no consequence at all. It was Smith's economics that brought the world the Industrial Revolution and the enormous advances in global prosperity that marked the nineteenth and twentieth centuries.

There is, however, some evidence that Smith's economics are ceasing to work so well, and that we may be re-entering the world of Thomas Mun.

The key problem is natural resources. In Smith's time, with a global population of only 1 billion and little industrialization, the global supply of resources was almost infinite. Today, however, when we have allowed global population to bloat to 6.8 billion, there are signs that the global resources supply may be becoming disturbingly finite. Under Smith's economics, that isn't a problem; if one resource becomes scarce its price rises, and the world switches to an alternative. If, however, we are now dependent on a few critical resources for which alternatives are not readily available, price signals alone may not prevent us from depleting those resources altogether, causing catastrophic disruption to our economic life.

China clearly believes this is about to happen. That's why it is attempting to appropriate control of oilfields, mines and so forth in emerging markets, providing itself with secure sources of supply that will allow its economy to continue to flourish in a world of scarcity. Mun would surely have approved. In the dog-eat-dog world of 17th Century mercantilism, a \$2 trillion hoard of "Treasure" would find ready use in such activities, whether through formal colonies, or, as in China's case, merely through exploitation agreements backed, if necessary, by the People's Liberation Army.

In reality, China is probably a few decades premature. Oil, the world's most critical natural resource, is still in ample supply if the price is high enough to bring offshore drilling, oil shale and tar sands into operation. Other natural resources may certainly find their prices driven up by the rapid industrialization of China and India, but there is no sign of their rising prices being due to any absolute global scarcity—not yet.

Nevertheless, over the coming decades we are in danger of reverting to a Thomas Mun world, in which prosperity depends on hoarding sources of natural resources and "Treasure." That will be a world significantly poorer than our own, in which the price mechanism no longer carries much weight and innovation is stifled by the dead hand of the government bureaucracies that dominate economic life through their direction of nations' economic policies. While initially a Mun world might survive fairly comfortably, the long-term economic prognostication for it must be truly grim.

There are two possible escapes from this future. One is the 1950s dream of space exploration, in which technology advances to the level where we can garner resources from other worlds, and if necessary dispose of surplus population in galactic colonization. However, 40 years after Apollo 11, our advance to that future seems much less certain than it did. Indeed, we are in reality no closer to it than were Jules Verne's fantasy astronauts of 1865, who shot to the moon from the barrel of a gigantic Florida-based cannon.

The other possibility is to return to the world of Adam Smith, in which global population was around 1 billion, so that resources and environmental problems posed little constraint. In such a world, natural resources would be abundant for centuries to come, so China's economics would be wholly foolish, and the free market would reign supreme. Government policy would no longer be relevant, and private sector companies would build new technologies and possibilities in a world of globalised free trade. Environmental constraints such as global warming would also pose little threat, since the carbon emitted into the atmosphere by the global economy would be a fraction of its current level.

Returning to a global population of 1 billion would be difficult, but it may be more practicable than a gigantic interstellar exploration program. If so, it may form the only viable exit from the inexorable approach of the world of Thomas Mun.

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