

HISTORY OF ECONOMIC THOUGHTS

Economics, study of how human beings allocate scarce resources to produce various commodities and how those commodities are distributed for consumption among the people in society.

The field of economics has undergone a remarkable expansion in the 20th cent. as the world economy has grown increasingly large and complex. Today, economists are employed in large numbers in private industry, government, and higher. Many subjects, such as political science and sociology, which were once regarded as part of the study of economics, have today become separate disciplines, although the study of any one generally implies a working knowledge of the others.

Ancient and Medieval Periods

The first attempts to analyze economic problems appear in the writings of the ancient Greeks. **Plato** recognized the economic basis of social life and in his *Republic* organized a model society on the basis of a careful division of labor. **Aristotle**, too, attributed great importance to economic security as the basis for social and political health and saw the owner of a middle-sized plot of land as the ideal citizen.

Roman writers such as **Cicero**, **Vergil**, and **Varro** gave significant advice about the economics of agriculture. The medieval period was marked by the disruption of the flourishing commerce of the ancient world, and its economic life was dominated by feudalism.

Mercantilism, the Physiocrats, and Adam Smith

In the transition to modern times (16th–18th cent.), European overseas expansion led to the growth of commerce and the economic policies of mercantilism.

Mercantilism - economic system of the major trading nations during the 16th, 17th, and 18th century, based on the premise that national wealth and power were best served by increasing exports and collecting precious metals in return. The period 1500 - 1800 was one of religious and commercial wars, and large revenues were needed to maintain armies and pay the growing costs of civil government. Mercantilist nations were impressed by the fact that the precious metals, especially gold, were in universal demand. Foreign trade was favored above domestic trade, and manufacturing or processing, which provided the goods for foreign trade, was favored at the expense of the extractive industries (e.g., agriculture). The state exercised much control over economic life, chiefly through corporations and trading companies.

As the classical economists were later to point out, however, even a successful mercantilist policy was not likely to be beneficial, because it produced an oversupply of money and, with it, serious inflation. Henry VIII, Elizabeth I, and Oliver Cromwell conformed their policies to mercantilism. In France its chief exponent was **Jean Baptiste Colbert**.

Physiocrats - school of French thinkers in the 18th century who evolved the first complete system of economics. The founder and leader of physiocracy was **Francois Quesnay**.

In the late 17th and the 18th cents., protest against the governmental regulation characteristic of mercantilism was voiced, especially by the physiocrats. That group

advocated laissez-faire, arguing that business should follow freely the “natural laws” of economics without government interference. They regarded agriculture as the sole productive economic activity and encouraged the improvement of cultivation.

In the 18th century the Scottish philosopher **David Hume** did important work in economics. His analysis of the natural advantages that some nations enjoy in the cultivation of certain products and his observations on the flow of commerce became the basis for the theory of international trade.



David Hume



Adam Smith

The most important work of the 18th century however, was **Adam Smith's** *Wealth of Nations* (1776), which is considered by many to be the first complete treatise on economics. Smith identified self-interest as the basic economic force .

. In 1776 appeared one of the most influential books of our time, **The Wealth of Nations**. Written by Adam Smith, it earned the author the title " The father of economics".

Smith objected to the principal economic beliefs of his day. He differed with the physiocrats who argued that land was the only source of wealth. He also disagreed with the mercantilists who measured the wealth of nation by its money supply, and who called for government regulation of economy in order to promotea "favorable balance of trade".

In Smith's view, a nation's wealth was dependent upon production, not agriculture alone. How much it produced, he believed, depended upon how well it combined labour and the other factors of production. The more efficient the combination, the greater output, and the greater the nation's wealth.

The heart of Smith's economic philosophy was his belief that the economy would work best if left to function on its ownwithout government regulation. To explain why all society benefits when the economy is free of regulation, he used the metaphor of the "**invisible hand**": The invisible hand was Smith's name for the economic forces that we today would call **supply and demand**, or **the marketplace**. He sharply disagreed with the mercantilists who, in their quest for favorable balance of trade, called for regulation of the economy.

Instead, he agreed with the physiocrats and their policy of "**laissez faire**", letting individuals and businesses to function without interference from government regulation or private monopolies. In that way, the "invisible hand" would be free to guide the economy and maximize production.

This book goes on to describe the principal elements of the economic system. In a famous section, Smith turned to the pin industry to demonstrate how the division of labour and the use of machinery increased output.

Similarly, other sections dealing with the factors of production, money and international trade are meaningful today as when they were first written.

Malthus, Ricardo, and Mill

One of the most influential writers of the 19th cent. was **Thomas Malthus**, whose predictions that population growth would always tend to outstrip advances in the means of subsistence earned for economics the title “the dismal science.” he contended that poverty and distress are unavoidable, since population increases by geometrical ratio and the means of subsistence by arithmetical ratio. As checks on population growth, Malthus first accepted only war, famine, and disease, but in his revised work he admitted also the preventive check of moral restraint.

An admirer of Adam Smith, John Baptiste Say’s **Treatise on Political Economy** (1803) helped to introduce **The Wealth of Nations** to his native France. In the course of explaining Smith’s theories and the role of markets in satisfying human wants, the author developed what came to be known as Say’s Law. According to this law, “**production creates its own demand**”. In other words, people produce and sell goods and services in order to buy the things they want. If buyers no longer want certain products, sellers will stop producing them, and shift into something that is in demand.

The onset of the Great Depression of the 1930’s, with its widespread unemployment and overproduction that dragged on for years, finally put Say’s law to rest.

The most important economist to follow Smith was **David Ricardo**. He was one of the most influential classical economists is often credited with systematising.

The Principles of Political Economy and Taxation (1817). In that book he presented most of his important theories, especially those concerned with the determination of wages and value. For the problem of wages he proposed the *iron law of wages* according to which wages tend to stabilize around the subsistence level. Any rise in wage rates above subsistence will cause the working population to increase to the point that heightened competition among the glut of laborers will merely cause their wages to fall back to the subsistence level. Ricardo was also concerned with the subject of international trade, and for that he developed the theory of *comparative advantage*, still widely accepted among economists.

John Stuart Mill was a follower of Ricardo and contributed to the study of international trade as well as to the study of the economics of industrial expansion. Among critics of free trade outside Britain were the German *Friedrich List* and the American *Henry C. Carey*.



David Ricardo

Classical economics is a school of economic thought whose major developers include William Pettz, Adam Smith, David Ricardo, Thomas Malthus and John Stuart Mill and Johann Heidrich von Thünen

Main ideas of classical economy are:

1. Wealth of the nations are assets which satisfy the human wants and needs. Therefore it is important to analyze production.
2. Liberalism and no government intervention
3. The market mechanism is self- control without government intervention, finding the equilibrium by itself

Capitalism, economic system based on private ownership of the means of production, in which personal profit can be acquired through investment of capital and employment of labor. Capitalism is grounded in the concept of free enterprise, which argues that government intervention in the economy should be restricted and that a free market, based on supply and demand, will ultimately maximize consumer welfare. These principles were most notably articulated in Adam Smith's treatise, *The Wealth of Nations* (1776), in which he opposed the prevailing theory of mercantilism.

The Socialists and Marx

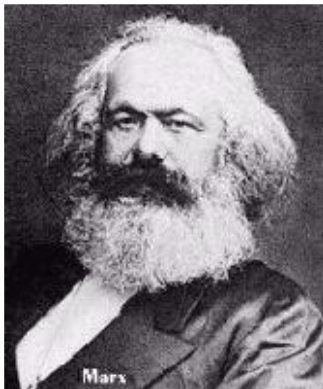
The early exponents of socialism, especially in France, attacked the idea of the necessity of private property and competition and were interested in revamping the economic and social order.

Socialism is general term for the political and economic theory that advocates a system of collective or government ownership and management of the means of production and distribution of goods.

Where capitalism stresses competition and profit, socialism calls for cooperation and social service. Among those were *C. H. Saint-Simon, Robert Owen, Charles Fourier, and Louis Blanc*. In Germany the historical school arose under *Wilhelm Roscher, Bruno Hildebrand, and Karl Knies*.

The greatest challenge to classical economics came from the followers of **Karl Marx**. Marx's critique of capitalism was moral and social, as well as economic; but in the exposition of the workings of the capitalist system he and his followers developed important insights into the structural weaknesses of the market economy, especially the recurrence of economic crises.

Marx developed a materialistic theory of history as science, ultimately predicting that the triumph of the working class was inevitable. With his collaborator **Friedrich Engels** Marx published the *Communist Manifesto* in 1848, predicting ultimate victory for the proletariat.



Karl Marx



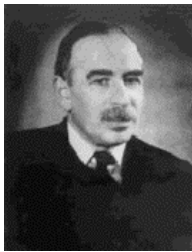
Friedrich Engels

Further Evolution of Classical Economics - neoclassicism

At the same time as Marx was writing, the principles of classical economics were being reformulated and refined—it was at this time that the term “economics” replaced the term “political economy,” which had been used through the mid-19th cent. The most important refinement was the doctrine of **marginal utility**, which asserts that the value of an item is determined by the need for it and by its relative **scarcity** or abundance at any given time.

The leading theorists in the development of the concept were *William Stanley Jevons* of Britain, *Leon Walras* of France, and *Carl Menger* of Austria. In the United States, *John Bates Clark* was notable in the development of marginal utility theory, forming his own hypothesis regarding the distribution of wealth. Classical economics reached its fullest expression at the end of the 19th cent. in the work of **Alfred Marshall** one of his students was John Maynard Keynes. He systematized the classical economic theories. He was concerned with theories of costs, value, and distribution and developed a concept of marginal utility. He wrote *Principles of Economics* (1890). Marshall used mathematics to perfect the application of classical techniques and introduced important modifications to the notions of competition, marginal utility, and rent.

John Maynard Keynes



British economist, who proposed that high unemployment, being a result of insufficient consumer spending, could be relieved by government-sponsored programs. He also advocated deficit spending by governments to stimulate economic activity. He rejected traditional theories of the free market and advocated vast government spending in times of recession, even at the risk of unbalancing the budget.

In his *General Theory of Employment, Interest, and Money* (1936), Keynes opened up a whole new range of investigation into business cycles. A principal result of Keynes's teaching has been reflected in governmental attempts to control the business cycle by putting money directly into the economy; the “**pump-priming**” technique, often accompanied by an unbalanced budget, is now a part of most capitalist economic systems.

Since World War II

In recent years, economic theory has been broadly separated into two major fields: macroeconomics, which studies entire economic systems; and microeconomics, which observes the workings of the market on an individual or group within an economic system. The use of complex mathematical techniques and statistical data in economic forecasting has resulted in a new branch of economics known as econometrics. British economist Arthur Pigou was influential in the development of welfare economics, an important branch of the discipline that suggested that an economic system was better if even one person's satisfaction was increased while no one else's was decreased.

In the 1980s supply-side economics (which sees economic growth as essential for improving the material health of society) was used as a policy tool by the Reagan administration. Another modern economic school that was influential in the Reagan years is monetarism.

Monetarists, such as Milton Friedman, believe that the money supply exerts a dominant influence on the economy.