

HISTORY OF ECONOMIC THOUGHT I (Eco 307)

Lecture Notes

Introduction and Definitions

History of economic thought deals with different thinkers and theories in the subject that became political economy and later economics, from the ancient world to the present day. It encompasses many different schools of economic thought.

History of economics thought deals with the origin and development of economic ideas and their interrelations. It is a historical account of economic doctrines.

According to H.L. Bhatia history of economic thought includes the doctrines and generalizations of various thinkers which deal with the economic phenomena of our life. It went through a lot of evolution with specific contributions from various thinkers that had great impact upon the future of economic thought.

Prof. Schumpeter defines Economic thought as the sum total of all the opinions and desires concerning economic subjects especially with public policies of different times and places. He stated further that the history of economic thought traces the historical change of attitudes. It also speaks about economic problems and various approaches to those problems.

Prof. Haney defines history of economic thought as a critical account of the development of economic ideas, searching into their origin, interrelations and manifestations.

Prof. Bell says the history of economics thought is the study of the heritage left by the writers on economic subject.

History of economic thought is different from Economic History and History of economics.

While History of Economic thought deals with the development of economic ideas; Economic History is the study of the economic development of a nation or country. On the other hand, History of economics deals with the science of economics.

Even though Economic History and History of Economic Thought constitute separate branches of study they are closely related. Economic ideas are directly or indirectly motivated by economic conditions and environment of a country. Ideas and environment are very important hence the close relationship between History of economic thought and Economic History.

The History and development of economic ideas can be studied under three (3) periods, namely;

1. Ancient
2. Medieval
3. Modern

Ancient Greek writers such as the **philosopher Aristotle** examined ideas about the art of wealth acquisition, and questioned whether property is best left in private or public hands.

In medieval times, with its root *medi* – meaning “Middle”, and *ev* – meaning “Age” that is the period in the history of Europe, the middle Age period from the 5th to the 15th (500 to 1500) century. It started with the fall of the great Western Roman Empire and merged into the Renaissance and the Age of discovery. That is after the “rebirth” of culture that we call Renaissance. Scholastics such as Thomas Aquinas argued that it was a moral obligation of businesses to sell goods at a just price.

The history of economic thought can further be broadly divided into two parts;

1. The Origin and the development of economic ideas before the development of economics as science.
2. The second part deals with economic ideas after the development of economics as a Science.

The history of economic thought can be studied and analyzed by adopting different approaches;

1. Deductive or Classical approach
2. Inductive approach
3. Chronological approach
4. Conceptual approach
5. Philosophical approach
6. Neo-Classical approach
7. Welfare approach
8. Keynesian approach
9. Institutional approach

There are a variety of modern **definitions of economics**. Some of the differences may reflect evolving views of the subject itself or different views among economists.

The earlier term for 'economics' was political economy. It was adapted from the French Mercantilist usage of *économie politique*, which extended *economy* from the ancient Greek term for household management to the national realm as public administration of the affairs of state.

The philosopher Adam Smith (1776): defines the subject as "an inquiry into the nature and causes of the wealth of nations," in particular as:

A branch of the science of a statesman or legislator [with the twofold objective of providing] a plentiful revenue or subsistence for the people and to supply the state or commonwealth with a revenue for the public services

J.B.Say (1803): distinguishing the subject from its public-policy uses, defines it as the science of production, distribution, and consumption of wealth.

John Stuart Mill (1844): defines the subject in a social context as:

The science which traces the laws of phenomena of society as it arise from the combined operations of mankind for the production of wealth, so far as those phenomena are not modified by the pursuit of any other subject.

Alfred Marshall in (1890): provides a still widely cited and accepted definition in his textbook *Principles of Economics* (1890) that extends analysis beyond wealth and from the societal to the microeconomic level:

Economics is a study of man in the ordinary business of life. It enquires how he gets his income and how he uses it. Thus, it is on the one side, the study of wealth and on the other and more important side, a part of the study of man.

Lionel Robbins (1932): developed implications of what has been termed "perhaps the most commonly accepted current definition of the subject "Economics is a science which studies human behaviour as a relationship between ends and scarce means which have alternative uses".

Robbins describes the definition as not *classificatory* in "picking out certain *kinds* of behaviour" but rather *analytical* in "focusing attention on a particular *aspect* of behaviour, the form imposed by the influence of scarcity."

Some subsequent comments criticized the definition as overly broad in failing to limit its subject matter to analysis of markets. From the 1960s, however, such comments abated as the economic theory of maximizing behavior and rational-choice modeling expanded the domain of the subject to areas previously treated in other fields.

There are other criticisms as well, such as in scarcity not accounting for the macroeconomics of high unemployment.

ECONOMICS AS A SOCIAL SCIENCE:

The scientific study of the society of human behavior and of social interactions. Economics is one of several social sciences. Others are sociology, political science, Psychology, Geography and anthropology. Economics is considered a social science because it seeks to explain how society deals with the scarcity problem.

Economics is one of several disciplines that apply the scientific method to the study of human behavior in social science. The social part of this phrase means the study of society, human behavior, and social interactions. The science part means the use of the scientific method to describe and explain the world. Economics stands apart from other social sciences because it is the scientific study of human behavior related to the problem of scarcity.

SCIENTIFIC METHOD:

A structured way of investigating and explaining the operation of the world by testing and verifying hypothesized relations. The scientific method is a process of discovery, a method of explaining the way the world operates. Positive economics is the application of the scientific method to economic analysis.

The **scientific method** is a body of techniques for investigating phenomena, acquiring new knowledge, or correcting and integrating previous knowledge. To be termed scientific, a method of inquiry is commonly based on empirical or measurable evidence subject to specific principles of reasoning

The Oxford Dictionaries Online define the scientific method as "a method or procedure that has characterized natural science since the 17th century, consisting in systematic observation, measurement, and experiment, and the formulation, testing, and modification of hypotheses". Experiments need to be designed to test hypotheses. The most important part of the scientific method is **the experiment**.

The scientific method is a continuous process, which usually begins with observations about the natural world. Human beings are naturally inquisitive, so they often come up with questions about things they see or hear and often develop ideas (hypotheses) about why things are the way they are. The best hypotheses lead to predictions that can be tested in various ways, including making further observations about nature.

In general, the strongest tests of hypotheses come from carefully controlled and replicated experiments that gather empirical data. Depending on how well the tests match the predictions, the original hypothesis may require refinement, alteration, expansion or even rejection. If a particular hypothesis becomes very well supported a general theory may be developed.

The scientific method is the process used to study, explain, and analyze economic phenomena. It helps make sense of the seemingly chaotic events of economic life. The price of gasoline rises. Why? A local factory lays off a hundred employees. Why? The President proposes a tax cut to stimulate the economy. Why?

Answering these questions, and thousands of others, is what the scientific method is all about.

Explaining Things:

The scientific method seeks to explain the mechanisms of the world and how things work. Science seeks to identify the basic laws of nature that govern the world. More to the point, economic science, or positive economics, seeks to explain how the economic world works, to identify the economic laws of nature.

It is one thing to attribute the daily movement of the sun across the sky to the efforts of a Greek god. It is quite another to explain this movement using gravity and planetary orbits.

The great thing about the ability to explain is the resulting ability to predict. Knowing that the sun's movement is guided by the law of gravity which makes it possible to predict its position tomorrow, next week, or next year. This information helps when doing things like flying to the moon.

Components of the Scientific Method

A little more insight into the scientific method with an overview of several key components ; Model, Theory, Principles, World view, Hypothesis, and Verification.

- **Model** is a theoretical construct representing economic processes by a set of variables and a set of logical and/or quantitative relationships between them. The economic model is a simplified framework designed to illustrate complex processes, often but not always using mathematical techniques. Frequently, economic models posit structural parameters. Structural parameters are underlying parameters in a model or class of models.

A model may have various parameters and those parameters may change to create various properties. Methodological uses of models include investigation, theorizing, and fitting theories to the world.

- **Theory:** The starting point, but also the end result of doing science is the theory. A theory is a scientifically accepted, interrelated body of general principles used to explain and understand some aspect of the world. A theory creates a framework for investigating and explaining the world. It helps make sense out of what might appear to be random events. A theory offers an explanation for these events. It explains WHY things happen.
- **Principles:** Principles are generally accepted, verified, fundamental laws of nature. As a house is constructed from concrete, lumber, and nails, a theory is constructed from principles. To be a fundamental law of nature, a principle must capture a cause-and-effect relation about the workings of the world. One example might be something like, "people seek the greatest benefit at the lowest cost." The scientific method is essentially the process of building theories by identifying and verifying these fundamental laws of nature.
- **World View:** A world view contains fundamental and unverifiable axioms, beliefs, and values about how the world works. Religious beliefs, political philosophies, and cultural conditioning are just a few of the components that go into a person's world view. These components are largely "accepted on faith" and cannot be tested or verified directly.

Without a doubt, the best example of a world view component is the belief in God - a supreme, omniscient, omnipotent being. Another example is the presumption that human beings are basically good (as opposed to basically evil). These beliefs cannot be directly verified and must be accepted on faith.

- **Hypotheses:** Principles are the end result of a long, scrutinizing process that starts with hypotheses. A hypothesis is a reasonable proposition about the workings of the world that is inspired or implied by a theory and which may or may not be true. Hypotheses are generated from informed ignorance. Informed, because they are implied by a theory that has been previously subjected to a great deal of scrutiny, but ignorance, because no one yet knows if the hypothesis is right.
- **Verification:** This gives rise to the fifth and last part of the scientific method, verification. It seeks know if a hypothesis is right or wrong. Comparison is made with data, empirical observations drawn

from the real world. The scientific method is ultimately concerned with explaining the workings of the real world.

Perhaps a Greek god carries the sun across the sky. Perhaps the sun's apparent trek across the sky is caused by the rotation of the earth. Both are hypothesized relations for the perceived motion of the sun. Which is correct? The only way to know is through verification and testing to compare the hypotheses with what actually happens in the real world.

Verifying hypotheses with real world data is the crucial step in transforming a hypothetical relation into a fundamental law of nature that is a principle. A hypothesis must pass the real-world-data test to become a principle. And this is the scientific method.

Other components of the scientific method:

The scientific method also includes other components required even when all the iterations of the steps above have been completed.

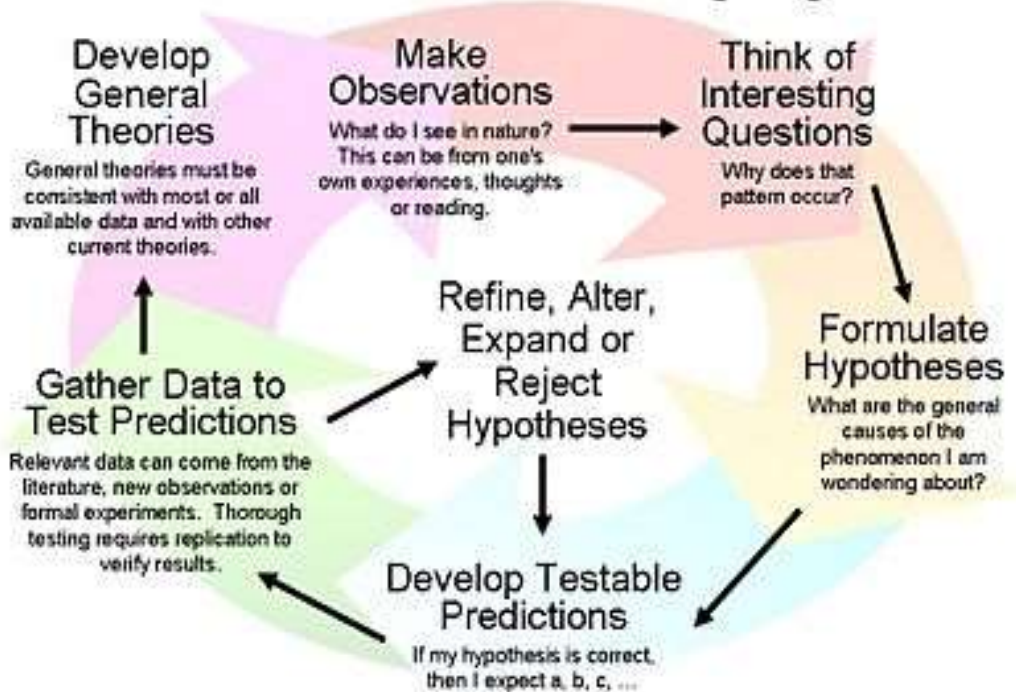
Replication: If an experiment cannot be repeated to produce the same results, this implies that the original results might have been in error. As a result, it is common for a single experiment to be performed multiple times, especially when there are uncontrolled variables or other indications of experimental error. For significant or surprising results, other scientists may also attempt to replicate the results for themselves, especially if those results would be important to their own work.

External review: The process of peer review involves evaluation of the experiment by experts, who typically give their opinions anonymously. Some journals request that the experimenter provide lists of possible peer reviewers, especially if the field is highly specialized. Peer review does not certify correctness of the results only that, in the opinion of the reviewer, the experiments themselves were sound (based on the description supplied by the experimenter).

If the work passes peer review, which occasionally may require new experiments requested by the reviewers, it will be published in a peer-reviewed scientific journal. The specific journal that publishes the results indicates the perceived quality of the work.

- **Data recording and sharing:** Scientists typically are careful in recording their data, a requirement promoted by **Ludwik Fleck** (1896–1961) and others. Though not typically required, they might be requested to supply this data to other scientists who wish to replicate their original results (or parts of their original results), extending to the sharing of any experimental samples that may be difficult to obtain.

The Scientific Method as an Ongoing Process



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The steps of the scientific method are to:

- Ask a Question.(Problem)
- Do Background Research. (Observation)
- Construct a Hypothesis. (Formulate Hypotheses)
- Test Your Hypotheses. (By Doing an Experiment)
- Analyze your Data .(Analyze Your Results)
- Communicate Your Results. (Conclusion)

Thus systematic thought process is usually broken down into induction and deduction both of which are used in the scientific method. They are:

Inductive and Deductive Method of Reasoning:

In logic, we often refer to the two broad methods of reasoning as the **Deductive or Classical** and **Inductive** approaches.

- 1. Deductive or Classical Reasoning Approach:** It works from the more general to the more specific. The classical believe in the universal application of economic laws. They adopted the deductive approach. Sometimes this is informally called a "top-down" approach. We might begin with thinking up a **theory** about our topic of interest. We then narrow that down into more specific

hypotheses that we can test. We narrow down even further when we collect **observations** to address the hypotheses. This ultimately leads us to be able to test the hypotheses with specific data - **a confirmation** (or not) of our original theories.

Example;

All birds have wings..... 1st premise (major or general rule)

Eagles are birds..... 2nd premise (Specific or minor rule)

Therefore eagles have wings 3rd premise (conclusion)

- 2. Inductive Reasoning Approach:** The Historical school emphasized on the inductive method. These economists believe that the laws of economics are not universal in nature. Inductive reasoning works the other way, moving from specific observations to broader generalizations and theories.

Informally, we sometimes call this a "bottom up" approach (please note that it's "bottom up" and *not* "bottoms up" which is the kind of thing the bar tender says to customers when he's trying to close for the night!). In inductive reasoning, we begin with specific observations and measures, begin to detect patterns and regularities, formulate some tentative hypotheses that we can explore, and finally end up developing some general conclusions or theories.

These two methods of reasoning have a very different "feel" to them when you're conducting research. **Inductive reasoning**, by its very nature, is more open-ended and exploratory, especially at the beginning.

Deductive reasoning is more narrow in nature and is concerned with testing or confirming of hypotheses. Even though a particular study may look like it's purely deductive (e.g., an experiment designed to test the hypothesized effects of some treatment on some outcome), most social research involves both inductive and deductive reasoning processes at some time in the project.

In fact, it doesn't take a rocket scientist to see that we could assemble the two graphs into a single circular one that continually cycles from theories down to observations and back up again to theories. Even in the most constrained experiment, the researchers may observe patterns in the data that lead them to develop new theories.

- 3. Chronological approach:** The Chronological approach discusses economic ideas in order of time. The economic ideas of different economists can be presented year wise and can be studied. In this approach we can find continuity in the economic ideas of different economists.
- 4. Conceptual approach:** This approach speaks about the evaluation of different economic concepts (ideas) and the interdependence of these concepts. Conceptual approach can also be called ideological approach.

5. **Philosophical approach:** This was first adopted by Greek philosopher, Plato. In the past economics was considered as a handmade of ethics. Naturally philosophical approach was adopted by the very early writers/thinkers to discuss economic ideas.
6. **Neo-Classical approach:** This approach aims at improving the classical ideas by modifying them. The Neo-classical approach was first adopted by Marshall. The Neo-classical approach believed that "Inductive and Deductive reasoning are necessary for the science of economics just as the right and left feet are necessary for walking".
7. **Welfare approach:** This approach mainly aims at providing the basis for adopting policies which are likely to maximize social welfare.
8. **Institutional approach:** The institutionalists questioned the validity of the classical ideas and gave more importance to psychological factors.
9. **Keynesian approach:** This is a major development in modern economics and is associated with the name J.M. Keynes. His approach is new and different from the classical school. It takes into consideration the operation of business cycles that affect the entire economic policies. Keynesian approach deals with the problem of the aggregate economy as a whole.

SIGNIFICANCE/IMPORTANCE OF HISTORY OF ECONOMIC THOUGHT

The Study of History of economic thought is important for the following reasons:

1. The study of history of economic thought clearly shows that there is a certain unity in economic thought and this unity connects us with ancient times.
2. The study helps us to avoid committing the same mistakes of the earlier economic thinkers.
3. The significance of history of economic thought is that it is an important tool of Knowledge.
4. The study will help students realize that economics is different from economists.
5. It helps students to know that economic ideas are conditioned by time, place and circumstances.
6. The study enables us to know the economic thinker responsible for the formulation of certain important economic principles and concepts.
7. The study of History of economic thought will help us to understand the origin of economics as a discipline.
8. The study will help students to know that economic ideas have been instrumental to the shaping of economic and political policies of different countries of the world.
9. A study of the History of economic thought will help to provide a broad basis for comparison of different economic ideas. It will enable a person to have a well-balanced and reasonable judgment.

HISTORICAL VIEW OF ECONOMIC THEORIES

Ancient Economic Thought

The study of the Ancient of Economic Thought may not appear to be fascinating to modern student but there can be little doubt that for a clear understanding of economic theories and institutions in a proper sequence,