A Short History of Economic Thought

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Outline

- Very brief overview of a few dominant authors (starting around 1700 and ending in our times)
- Due to time restrictions: selection is to some extent arbitrary
- Emphasis on authors with a major influence on the development of economics
Relevance: Reasons for concentrating on the history of thought

- General historic interest (assumed!)
- Developing a sense for connections between political/technical history and the emergence of new economic ideas
- Many recently discussed topics in economics have ancestors in previous decades and centuries; many ‘brand-new’ approaches actually possess long beards (however often forgotten).
Contents

- The Classics – Petty, Mandeville, Quesnay, Smith, Ricardo, Say, Malthus, Marx
- The Neoclassics – Marshall, Walras, Menger, Gossen
- The Keynesian Revolution
- The Neoclassical Synthesis and the New Classical School
- Strategic Behavior and Game Theory
- Evolutionary Economics
Preliminaries: A (Very Brief) Recall of a Few Historic Events

1492  
Columbus’ discovery of America

1533-1603  
Elizabeth I queen of England; foundations of the Empire

1618-1648  
30 years’ war; 1648 Peace of Westphalia; independence of Holland from Spain

1640  
Revolution in England; Cromwell’s Commonwealth (Republic in England, incl. Ireland & Scotland)

1638-1715  
Louis XIV of France; zenith of mercantilism

1660-1690  
Newton/Leibniz: first heyday of modern science and math

1750-1790  
Enlightenment era in philosophy; Rousseau and Hume as prominent examples

1776  
US Independence

1789  
French Revolution
# Preliminaries: (cont.)

<table>
<thead>
<tr>
<th>Year</th>
<th>Events</th>
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<tr>
<td>1792-1815</td>
<td>Napoleonic Wars; Vienna congress in 1815; restoration of political order</td>
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<td>1770s</td>
<td>James Watt (1736-1819); first really functioning steam engine</td>
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<td>1820s</td>
<td>George Stephenson (1781-1848): winner of a locomotion competition; first test track in Darlington/Stockton (1821/25); first regular line in 1829</td>
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<td>1876</td>
<td>First automobile: Daimler/Benz; many subsequent followers</td>
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<td>1880</td>
<td>Electricity (Edison – Tesla – Westinghouse)</td>
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<td>1914-1918</td>
<td>Great War among major European states (and the US in 1917)</td>
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<td>1917</td>
<td>Russian Revolution; establishment of the Soviet Union</td>
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<td>1929–1932/33</td>
<td>Great Recession (in most European countries and the US</td>
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<td>1939-1945</td>
<td>World War II</td>
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Literature
(This is only a very brief collection from a huge body of literature)


The Most Influential Classical Writers:

- François Quesnay (1694 - 1774)
- Adam Smith (1723 - 1790)
- David Ricardo (1772 - 1823)
- Jean-Baptiste Say (1767 - 1832)
- Robert Malthus (1766 - 1834)
- Karl Marx (1818 - 1883)
The Eve of the Classical Era – The Mercantile Era

- Roughly between 1550 and 1800 in most major European countries (France, England, Spain, Portugal, Austria, Russia). Exception: Netherlands (after independence from Spain – 1648)

- Basic principle: wealth (in an international context) is a zero-sum game: "one country wins – the other looses”

- "Bullionist” position: national wealth can be measured by the quantity of gold hoarded in the treasury

- Consequence: attempts to increase this stock by
  - Pirates’ attacks on Spanish ships
  - achieving trade surpluses (exports > imports with the help of import duties and quantity restrictions)

- Usually not recognized: gold stock ↑ ⇒ p ↑ ⇒ exports ↓
The Classics

William Petty (1623 - 1687)
Born May/1623 in Hampshire/England

Educated by Jesuits in Caen/France. Medicine studies in Holland.

Personal assistant to John Hobbes at his exile in Paris/France

Medicine exam in Oxford; invented several technical instruments and machines/engines (e.g., the double-writing machine and a catamaran sailing boat

In 1652, member of Oliver Cromwells ”New Model Army” in Ireland as a physician.

Career as a statistician in Ireland (so-called ”Down Report”) with an extensive recording of the Irish counties. (P. as one of the earliest economic statisticians – econometricians). Petty made a fortune as one of the wealthiest land owners afterwards.
Academic merits:

- "Land" is not the only productive factor (in contrast to Quesnay, see below)
- The division of labor (see below) can improve everybody’s welfare
- Free trade (including imports of raw materials) can improve a country’s situation
- Interest rates are just "prices" for the provision of capital and should be positive
- The state should be active in order to
  - finance its personnel
  - finance military expenses
  - remove unemployment
  - organize the infrastructure (schools, bridges, canals, etc.)
François Quesnay (1694 - 1774)
François Quesnay (1694-1774)

- Originally: Animal surgeon (for horses at the court of Louis XV, sponsored by Mdm Pompadour)
- Most prominent member of the so-called *Physiocratic School* (others include Jacques Turgot (1727-1781))
- Basic idea: *circular flow* of goods (or money)
- 3 “poles” (something like ‘classes’, ‘sectors’ or ‘production factors’):
  - Landlords: owners of farmland, lent to farmers for a fixed rent
  - Farmers: production of agricultural goods by means of the use of farm lands, agricultural work, and handcrafted goods (bought from merchands)
  - Merchands and artisans: production of handcrafted goods; sold to farmers and landlords.
The agricultural sector is the only **productive** sector

Consequence: Taxing of the landlords as the most ‘unproductive’ sector

Graphical illustration: Tableau Économique (often called: ‘zig-zag’ scheme due to the graphical arrangement by Quesnay himself, not shown here)

F: Farmers
L: Landlords
M: Merchants/Artisans

(numbers indicate monetary flows)
Quesnay’s Circular Flow
(U = ‘units’)

- Farmers produce a crop of 5 U
- Farmers pay a rent of 2 U to landlords and receive 1 U from landlords and 2 U from merchands for the selling of the crop.
- Merchands receive 1 U from landlords and 1 U from farmers for the delivery of agricultural instruments and daily life goods
- Farmers use 2 U of the crop for recreational purposes and the seed enabling them to repeat the process in the next period
Bernard de Mandeville (1670 - 1733)
Bernard de Mandeville

- Born in Rotterdam on Nov/15/1670 into a family of naval officers
- Medical studies in Leyden. Move to England to study the language, but stayed there for the rest of his life
- Publication of his satiric pamphlet "Fable of the Bees: or, Private Vices, Publick Benefits" in 1714
- Basic content (and message): bees (resp. human beings) act selfishly according to their own advantage. Consequence: everybody benefits (in the form of totally collected honey, for example)
- The bad boys (and girls) with bad habits (vices) imply public benefits.
It’s not the virtue but the vice which implies a public advantage

Mandeville’s pamphlet was often considered a charter for "laissez-faire" politics, i.e. no state intervention and restriction of private activities

Mandeville therefore appears as a theoretical founder of liberal ideas. Motivation for Mandeville himself (probably): Satiric reaction on popular romantic ideas expressed by the Earl of Shaftsbury (1671-1713)

However: M. was often criticized already during his lifetime.
The Classics

Adam Smith (1723 - 1790)
Originally: chair in logic and later chair in moral philosophy at the University of Glasgow (1751)

Friend of David Hume (1711-1776), representative of the British variant of J.J. Rousseau’s enlightenment ideas

Main works: *Theory of Moral Sentiments* (1759) and *The Wealth of Nations* (1776)

Gives up his professorship in 1764 and becomes teacher and companion of the Duke of Buccleuch in France. Later: Commissioneer of Customs in Scotland
Three basic, interrelated fields of interest:

- Division of labor
  Famous example: pin production
  Assume a worker who produces a number of pins in 18 production steps every day. 18 workers would produce 18 times as much of the original single worker by means of the same technique.
  Alternative: occupy 18 workers, each of whom concentrates on a single production step. Smith’s claim: the result is more than 18 times the amount of a single worker.
Invisible hand (mentioned only once in the *Wealth of Nations*)

Coordination of individual actions is not due to eternal forces but happens as a result of individual actions according to their own interests.

“It is not from the benevolence of the butcher, the brewer or the baker, that we expect our dinner, but from their regard to their own self interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.”

Important: Social benefits as so-called “unintended consequences” of the individual behavior

However (in contrast to a popular misconception): **No** unlimited ‘laissez-faire’! The state is responsible for suppressing all tendencies which restrict individual activities. In particular: monopoly controls!
Free international trade

- Basically the same argument as for the division of labor
- Countries should concentrate on the production of goods which can be produced cheaper than in other countries (absolute cost advantages)

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<tr>
<th>Product</th>
<th>Portugal</th>
<th>England</th>
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<tr>
<td>per unit of wine</td>
<td>100</td>
<td>120</td>
</tr>
<tr>
<td>per unit of clothes</td>
<td>120</td>
<td>100</td>
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Consequence: England produces clothes and Portugal produces wine; savings: 20 labor units in each country in case of exclusive production

- Welfare increases due to international trade
- Political consequence: basically no tariffs, no non-tariff barriers