

A Study of History of Economic Thought and it's Relevance

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Abstract:

There are many possible approaches to organizing economic activities of individuals living in social systems. Whatever method is chosen, it is necessary to coordinate or integrate the behavior of individual members of the society. The history of economic thought is a study of the more important attempts to analyze, describe and explain the relationships in actual or idealized economic systems. Knowledge of alternative explanations of economic processes provides a basis for evaluating the performance of industrial economies. It also provides a basis for critically evaluating economic theories and models that purport to describe modern industrial economies.

Keywords: Economics, Economic thought, Ideology, Neoclassical, Society.

Introduction

Economics is the study of how a society organizes the economic functions or processes. There are many definitions of economics. Jacob Viner is credited with defining it as, "Economics is what economists do." This is correct but not a very useful definition. More recently, in a popular principle of economics text, economics was defined (as it is typically defined by most principles of economics texts) as: Economics is concerned with the efficient utilization or management of limited productive resources for the purpose of attaining the maximum satisfaction of human material wants. [McConnell, p 1] The contrast of the definitions used by Marshall and McConnell suggest a difference in emphasis. Marshall focuses on economics as a social science and the role of the individual in a social system; it is "a part of the study of man" [humanity] in a social context. McConnell's definition is more narrowly focused on the allocative mechanism with respect to production, distribution and consumption of "material" wants; it seems to imply a study of "things" with relation to humans or individuals.

Human behavior is complex. Human interaction or social behavior is even more complex. Because of this complexity, it is necessary to abstract from reality. These abstractions are presented as models, analogies or metaphors. These models may be presented as narrative stories, mathematical systems [or equations], graphs or other representations of relationships among the relevant elements in the social and economic systems. There are three fundamental reasons that economic behavior may be studied. First, as an academic discipline there is a desire to understand, describe and explain the world in which we live. Second, as a practical matter there is the desire to predict and control economic processes and their outcomes. Third, the method selected to describe, explain and predict economic processes shapes the perceptions and values that individuals in societies hold about those processes. Therefore, the values held by the members of society can be influenced by the theories, models or "stories" we believe and use. What we learn, teach and accept is the nature of our culture. Story telling is a mechanism for transmitting values and civilization. Economists are storytellers; their theories and models are stories that contribute to the character of society.

The process of integrating individual behavior has three important elements, all of which require the collection, interpretation and communication of information;

- The identification of objectives of the individual(s) and society,
- Identification all possible alternatives that are feasible given the finite resources, social institutions and the current state of technical knowledge (technology),
- Criteria to evaluate each possible alternative with respect to the objectives.

It is necessary to know the objectives or goals in order to make a rational choice. In a world with finite resources and technological constraints, individuals must choose among competing alternatives. They must know their preferences and objectives in order to make appropriate choices. In a social group the problem is more difficult, not everyone has the same preferences. Therefore, the preferences among individuals must be prioritized or assigned weighted values. The task is to establish criteria to identify the appropriate relative weights of values, or priorities, of the alternative uses of available resources among individuals as well as among different goods that could be produced. Is it more important for individual A to have a new car or individuals B, C, D and E each have a new refrigerator? Is it more important that individual A should have cigarettes or individual B have milk? The weighting of values should consider relative scarcity of inputs and technology as well as social and individual objectives. Each society must devise processes to make choices about allocation of resources and the distribution of goods and services. There is a continuum of approaches to the problem of allocation. At one end of the continuum, is the individualistic free market approach; individuals know their own preferences and then rely on a system of markets to signal information about the appropriate weights of individual preferences and establish incentives to coordinate their voluntary choices. At the other extreme of the continuum, the allocation process may be centralized and decisions are made through the authority of an individual or group; individual choices are not allowed. A third possibility is an economy where decisions are based on tradition; behavioral patterns that have seemed appropriate in the past become embedded in the system. While markets, command and tradition may be present in most societies, one approach is usually emphasized and determines the character of the economy. In modern, Western, industrial societies, the process is called "the economy." Beginning in the mid 1700's with the Physiocrats and later Adam Smith, there has been an ideological bias and emphasis toward the use of markets as the primary allocative mechanism. Traditional solutions to some economic problems are present. There may be some economic activities and processes that are controlled by law, regulation or other forms of command. However, the dominant approach to the coordination of economic behavior and the allocation problem is the market. The economy is one of many components, or sub-systems that work together to make up a social system. Using the reductionist approach of Western science, the social system can be thought of as many sub-systems including politics, religion, ethics, law, kinship, symbols, values, customs, mores and a variety of other processes and institutions. Other sub-systems might be identified such as the health care system, transportation system, educational system, legal system, industrial system, communications system, telephone system, etc. Each of these systems can be divided further. The health care system can be viewed as composed of an insurance system, medical education system, hospital system, and so forth. The transportation system is composed of a road system, trucking system, airline system, railroad system, system of navigable rivers, etc.

All of these systems are interrelated and each influences the nature and operation of the others. As one component, the economy is related to each of the other components in society and influences and is influenced by each of the other components. The nature of political beliefs and the political system influences social perspectives and attitudes about the operation of the economy. At the same time, the structure and performance of the economy is an important influence on the political system. This is true of law, religion, ethics, and other components of the social system. Individual attitudes about the direction and strength of these influences or relationships are an important factor that explains the existence of different approaches and schools of thought in economics. The economic system has two related functions in all societies. One function is to contribute to the wellbeing of the individual and to promote the operation of society; to balance individual autonomy with the commonweal. The other function is to allocate or ration scarce resources among competing uses and among the members of society. The attainment of these functions is interdependent. The allocation process is more obvious and mechanical. Balancing individual wants with the social welfare is more difficult to observe and depends on an appropriate allocation process. The identification of two separate functions is to emphasize that the allocation process is not the end; rather it is a means to an end.

The most important task for any economy (or for that matter any social system) is to contribute to a balance between the autonomy of the individual with the commonweal or social wellbeing. The question about how to best insure the freedom and wellbeing of the individual within a just, stable and peaceful society is an issue that has been a common thread that has run through most of the important contributions to the history of economic thought. There are two extreme perspectives to this issue. The first is that there is a natural harmony of interests among the individuals in society or there are natural processes that result in a harmony of interests. The second view is that there is a conflict of

interests among various individuals, groups or classes. A common element in both Classical and Neoclassical economics is that voluntary exchanges among individuals in a free market will resolve all or most conflicts. At the other extreme, Marxist economics is based on a belief that there are inherent conflicts among classes in the capitalist system, which results in its inevitable failure.

The absolutist tends to believe that there are some objective, absolute “facts or truths” about the perceptions and patterns of economic behavior that cross cultural, temporal and social boundaries. These beliefs and patterns of behavior are perceived as universal. They are believed to apply in every society at all times in similar ways. From this point of view the study of the history of economic thought becomes a process of reading the works of economists that have contributed in the past and sifting out the grains of truth. Each generation of economists is seen as correcting errors made by their antecedents and adding new insights. Adam Smith corrects errors in the theories of the Mercantilists and Physiocrats and earlier works, synthesizes them and adds new insights to further economic knowledge. Alfred Marshall corrects mistakes in Smith and other Classical economists, includes new developments, tools of analysis and insights about microeconomics and improves the ability of economic theory to describe economic phenomena. The relativist approach to the history of economic thought holds that what is “true,” or useful, in one time or place may or may not be useful in some other time or place. Economic theory is a product of its environment. What was “true” for Adam Smith in a “nation of shopkeepers” in the mid 18th century may or may not be useful or true in the early 21st century or for Alfred Marshall in the late 19th century. The relativist tends to believe that economic theory is shaped by technology, social and economic institutions. Both the absolutist and relativist positions have attractive features. Perhaps a position somewhere between the extreme relativist and absolutist positions is more reasonable. There may be universal patterns of economic beliefs and behavior that span all societies. However, cultural features, technology and other factors influence our perceptions, values and behavior. Mark Blaug writes; “No assumptions about economic behavior are absolutely true and no theoretical conclusions are valid for all times and places, but would anyone seriously deny that in the matter of techniques and analytical construct there has been progress in economics [Blaug, 1985, p 3].

The history of economic thought is a critical investigation of the criteria that have been used to decide which economic ideas are relevant and to identify which direction “progress” might lay. The structure of society, technology and the economy are interrelated: each influences the nature and structure of the other. The appropriate forms of technology, society and the economy and their interrelationships have long been the subjects for debate. Different perspectives about these relationships and the relative importance of each element in the social system are the grist for the mill of history. The direction of causation is one source of debate. Does technology primarily determine economic or social systems? Or, do the economic and social forces determine the nature of technology? Different perspectives regarding the interrelationships of technology, economy and society also influence the methods used to analyze and describe the relationships. In turn, the description of the relationship may alter the course of technology, economic and social systems. The technology of the industrial revolution and conditions of the workers was an influence on Karl Marx. At the same time, Marx’s analysis and assessment of capitalistic societies was an influence on the course of history. The economies of China and the former Soviet Union were influenced by various interpretations of Marxist economics. The very existence of these systems has influenced not only those countries, but also the rest of the world community.

Economic theory is constructed by economists who are members of society. Their perspectives of relationships and events are products of the society to which they belong. Some economists construct theories that represent the views of smaller, sometimes disenfranchised social groups. Generally, only those theories consistent with the prevailing and/or dominant social values will displace earlier theories. However, theories that represent the disenfranchised may influence the mainstream economics that represents the society at large. Economic theory is both a determinant and reflection of the society of which it is a part. The methods, theories and perspectives are like lens. As we view economic behavior and processes through these lenses, our perceptions are shaped. To critically evaluate the economic processes in society we need to understand the nature of the lens that influence, focus or distort our interpretation of the “facts.”

Three fundamental components of human perception and action to be included in a study of history of economic thought are ideology, theory and policy choices. The outcomes of the policies is a forth item which should be included since it interacts with the first three. While outcomes of economic choices and policies are the subject of applied micro and macro economics, they are also important in a study of the history of economic thought because they are interrelated to the other components. It is possible to just study the chronology of economic theories or of policies and their outcomes. However, one of the reasons to study the history of economic thought is to understand how we have come to believe what we believe and why we interpret some economic ideas as knowledge. The interaction of ideology, theory, policy and their outcomes contributes to the explanation of our beliefs.

Ideology

Joan Robinson comments that ideology is much like the proverbial elephant, it is difficult to define but we know one when we see it. [Robinson, p 2] Ideology is a complex concept that arises from many sources and takes many forms. It influences our perceptions of the world about us and alters our behavior patterns. The word “ideology” can be used in a variety of contexts. There are political and epistemological issues associated with ideology. [Eagleton, pp. 8-12] Ideology consists of values, attitudes, beliefs, and perspectives that are held in common by a social group. It is often difficult to specify the exact nature of ideology although we can identify specific ideas that are contained in the ideology. Joan Robinson says; “What then are the criteria of an ideological proposition, as opposed to a scientific one? First, that if an ideological proposition is treated in a logical manner, it either dissolves into a completely meaningless noise or turns out to be a circular argument.

This ideology influences what we choose to observe as important and the interpretations we make of those observations. It also alters the criteria we use to evaluate phenomena and judge the morality of choices and behavior. Ideology is a fundamental aspect of a culture. The dominant ideology shapes the rules that establish what is acceptable and unacceptable behavior patterns. It is also a guide and the criteria that are used to evaluate “right and wrong.” It is the foundation of our system of morality and ethical behavior. From a political perspective, ideology may establish the distribution of power within a society. The dominant ideology is typically associated with a system of implicit and explicit rules and rewards for those whose behavior and views are consistent with those of the prevalent ideology. Smaller groups within a society may have an ideology that is inconsistent to the dominant ideology. Ideology is also present in the individual. Each individual accepts, consciously or unconsciously, a set of values and principles that shape their perceptions and guide their choices. Adherence to ideologies that are inconsistent with the principles and values expressed in the dominant ideology may lead to disenfranchisement of an individual or group. From an epistemological perspective, ideology is a strong influence on perceptions of important phenomena. It identifies which phenomena are relevant to our values and it shapes the interpretation of those phenomena. A superficial view of history suggests that the ideology shifts over time. The foundation of the Greeks’ ideology (Athenian) included beliefs which valued discourse, rhetoric, democracy, nature (including a view of the nature of humans), interaction of humans with nature (or gods) and the appropriate roles for classes and gender. The Romans’ ideology stressed many of the aspects of the Greeks but less emphasis was placed on democracy and more on domination and war. The Scholastics placed value on the importance of the human mind, and its ability interprets and reconciles the scripture with Aristotelian philosophy. The renaissance and the rise of science are related to a shift in of ideology (from an epistemological perspective) to observation, measurement and categorization of phenomena in order to identify atomistic, mechanical relationships among all natural and social phenomena. In recent years, a pecuniary facet has been added. In addition to empirical observation and quantification of physical phenomena, the market system has strengthened the importance of the measurement of monetary or pecuniary values.

These monetary, pecuniary or market values are proxies for human values as demonstrated through the ability to pay in a competitive, market context. The sources of ideology are varied. Storytelling and theory are two important ways in which ideology is created, transmitted and embedded in a culture. In most societies, fables and stories are used to express and reinforce ideology. Aesop’s fables, fairy tales and nursery rhymes often have ideological content. A classic example is the story of “The Little Red Hen” which stresses the importance of hard work and cooperation. Theories too rationalize and justify particular choices and behavior patterns. In the words of Joan Robinson,

“It was the task of the economist to overcome these sentiments and justify the ways of Mammon to man. No one likes to have a bad conscience. Pure cynicism is rather rare. Even the Thugs robbed and murdered for the honour of their goddess. It is the business of economists, not to tell us what to do, but to show why what we are doing anyway is in accord with proper principles.” [Robinson, p 21]

A theory of markets that is based on individual pursuit of self-interest justifies behavior that is based on self-interest. A person living in a society explained by theories that stress individual self-interest feel justified in pursuing their self-interest. If the ideology and resulting theories ignore forces (ethics, duty, morality, sympathy etc.) the individuals feel justified in behavior that ignores or is devoid of those same forces. Problems may arise, not so much for what the ideology includes, but for what it leaves out. John Locke [1632-1704], Adam Smith [1723-1790], Jeremy Bentham [1748-1832] and the other philosophers who helped to frame our individualistic, mechanical market ideology, included sympathy, empathy, morality, ethics, law and social values as well as self-interested individual motives. In a more simplistic interpretation of their work, self-interest is often seen as the isolated motive that guide and justifies human behavior. A study of the history of economic thought should create an awareness of the richness and complexity of our ideological heritage.

Individuals living in societies must make decisions about their interaction with nature and other humans. One of the most important functions in any society is the coordination and integration of individuals' behavior in a manner consistent with the operation of a society. Policy may be implicit or explicit. At the social level, policy is an agreed upon course of action encouraged by a set of rules that constrain or encourage particular actions within a social setting. In a sense, policy is an important part of the “rules of the game.” Individuals make choices within the social policies. Traditions, customs, mores and culture form implicit rules or policy. Social institutions define and enforce these implicit rules. Noncompliance with these implicit rules will (or may) result in social sanctions. Laws, orders and both private and public regulations constitute much of explicit policy. Generally, explicit rules can be thought of as the rules or policies that are consciously created and explicitly stated by social groups, corporations, organizations and governmental units. Mark Blaug describes the relation of policy and theory: “It may be granted that, even in its purest form, economic theory has implications for policy and in that sense makes political propaganda of one kind or another. This element of propaganda is inherent in the subject and, even when a thinker studiously maintains a sense of Olympian detachment; philosophical and political preferences enter at the very beginning of the analysis in the formation of, as Schumpeter would have it, his 'vision': the preanalytical act of selecting certain features of reality for examination. [Blaug, 1985, p 5] Policies are the result of what a society or individual thinks they know about their natural, social and built environment. The notion of rational behavior suggests that policies must be consistent with theory. Rationality may be thought of as using knowledge to choose among alternatives to best achieve desired objectives. To make choices counter to what we think we know would be irrational.

The relationships among ideology, theory, policy and outcomes are multidirectional and multifaceted. Each influences and is influenced by the others. In an ideal world, the relationships might be viewed as a flow diagram. Ideology is the foundation that provides the axioms and nature of the theories that are used to explain the ways that the world works. At an individual level, the ideology is influenced by a variety of forces; peer groups, family, religion, social position, education, training, ethnicity, gender and a multitude of other factors contribute to an individual's ideology. At the social level, the ideology consists of the values, principles, attitudes, beliefs and perspectives that are held in common by a group. At this level, ideology is integrally related to religion, education, the legal system, philosophy, and all the other components of society. Ideology is transmitted and reinforced by stories and the theories that are accepted by the group. The theories and ideology must be consistent. The theories, based on ideology, are expressions and explanations about the nature of things and their relationships. Theory provides the framework to interpret observed facts about the real world. This “knowledge” about things and relationships among things provides a basis for making choices and establishing policy. Each policy and choice has outcomes. These outcomes are evaluated against the expectations that theory suggested. If the outcomes are not consistent with theory and policy then it may be necessary to reevaluate the theory and the accompanying policies. Outcomes may also be evaluated by comparing outcomes with the values, attitudes and beliefs expressed by the prevailing ideology. If outcomes are inconsistent with the expectations of theory or the values expressed within the ideology, it may be necessary to modify the theories and/or

the ideology. The theories may change with greater ease and speed. Ideology is slow to change. The changes in ideology may be in response to changes in theories. The classic example of theory changing faster than ideology is the story of the “Copernican Revolution.” The Copernican Revolution began as a change in the theories that explained the observed orbits of planets. The theory evolved over time through the work of Nicholas Copernicus [1473-1543], Tycho Brahe [1546-1601], Galileo Galilei [1564-1642] and Johann Kepler [1571-1630]. The Copernican theories were published in 1543. The heliocentric theory of the system of planets and their relation to the sun were in conflict with ideology that was primarily an expression of the Church. The observations and predictions of the Copernican model were more consistent with the new theories than the Ptolemaic system. The theory changed quite rapidly; in 1543 Copernicus’ system was published, in 1609 Kepler published New Astronomy, and in December of 1610 Galileo verified that Venus orbits the sun, thus showing that the Copernican system was a more accurate theory (explanation) than the Ptolemaic system. By 1611, the Jesuits at Collegio Romano had verified Galileo’s astronomical observations and honoured him. The ideology related to the theories of planetary movement changed more slowly. It is also in 1611 that the Inquisition decided to investigate Galileo. In 1613 Galileo responded by writing a letter on the relationship of his findings to the scripture, and by 1615 Galileo went to Rome to defend himself. In 1633 he was questioned by the Inquisition, detained, and threatened with torture and imprisonment. Ultimately he was placed under house arrest and died in 1642, almost 100 years after Copernicus’ publication. The basic ideology had resisted change in the face of empirical evidence. Overtime however, the ideology was modified to produce a consistency with the theory and observed outcomes. The evolution of economic thought is also a story of ideology, theory, policies and outcomes. Neoclassical microeconomic theory of the late 19th and early 20th centuries focused on explanations of self equilibrating market economies that always returned to full employment equilibrium. The policies it fostered were free market polices. Yet the outcomes of the “great depression” [1929-1941] were inconsistent with the theories and the ideological values that were held. The result in this case was a shift in the theories; Keynesian economic theory replaced, at least for a time, the neoclassical models.

In A Modern Guide to Economic Thought, Mair and Miller present a summary statement about several important schools of thought. The summaries are divided into topics such as world view, values, goals, methodology, criteria (to evaluate theories) “hard core,” concepts, agenda and themes. [Mair, pp. 68-69] One of important differences between different schools is their view of “human nature.” There are two important ways of classifying human nature that influence perspectives of different economic schools of thought. First, is whether humans are viewed as basically “good” or “evil.” If humans are basically good there is little need for social institutions to constrain behavior. William Godwin [1756-1836] is an example of an anarchist who believed that humans were basically good and social institutions encouraged them to be “bad.”¹ Alternatively, if humans are basically bad, it is necessary to constrain their behavior. Much of Western 1 Godwin’s daughter, Mary Wollstonecraft Shelly wrote Frankenstein [1816] that tells the tale of technology and individuals’ relationship to society in which a man created by Frankenstein, who was basically good, became bad after mistreatment by society. Religion accepts the doctrine of original sin. Humans are by nature born with evil tendencies and some method of altering behavior is necessary. The second is whether “human nature” is fixed by nature (genetics or...) or is the result of the environment. Thomas Malthus [1766-1834], the first person employed as an economist, is well known for his view of the nature of humans with respect to population growth. Human behavior is the result of natural traits and cannot be altered by welfare, working conditions or other factors. Alternatively, Robert Owen [1771-1858] risked his fortune investing in New Lanark and later New Harmony to show that individuals who are treated well will change. It is the ideological underpinnings that shape perceptions of economic processes. It is differences in ideology that produce different schools of thought in economics. The history of economic thought attempts to identify these schools and to determine the forces that contribute to their creation, evolution and ultimate “success” or “failure” an intellectual construct that explains, predicts or justifies the world we have created.

An understanding of the different approaches to economics, the causes for those differences and how they have evolved over time provides a historical and philosophical context that encourages a more critical analysis of current economic tools and their applications. This critical approach has three advantages. First, it provides a more complete understanding of the current state of economic analysis and second, it may suggest alternative perspectives that will extend, improve or alter the tools and analysis. Third, through an increased awareness of our own perspective of the

economic process, it encourages a degree of humility and respect for others. Most importantly, the study of the history of economics thought can be fun and reveal many things about ourselves.

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