

# History of Economic Thought and Current Approach to Economics

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# What is ECONOMICS?

- Economics is the science that studies how societies produce goods and services and how they consume them
- Economic theory has influenced global finance, business and policy making, at many important junctures throughout history and is an integral factor in our everyday lives
- The assumptions that guide the study of economics have changed dramatically throughout history. Here we take just a brief look at the history of economic thought

# Branches of Economics

## Positive Economics

- ‘What is’ branch of economics
- Focuses on the description, quantification, and explanation of economic developments
- It relies on objective data analysis, relevant facts, and associated figures

## Normative Economics

- ‘What should be’ branch of economics
- Focuses on the ideological, opinion-oriented, prescriptive, value judgments
- It often sounds political or authoritarian

# Foundation questions of economic theories

- How do we decide what to produce with our limited resources?
- How do we ensure stable prices and full employment of resources?
- How do we provide a rising standard of living both for now and the future?

# The Timeline of Modern Economic Schools

Before 1750	1750	1850	1900
<ul style="list-style-type: none"> <li>• Mercantilists</li> </ul>	<ul style="list-style-type: none"> <li>• Physiocratic Economics</li> <li>• Classical School</li> </ul>	<ul style="list-style-type: none"> <li>• Marxist School</li> <li>• Marginalist Economics</li> </ul>	<ul style="list-style-type: none"> <li>• Institutional Economics</li> <li>• Keynesian School</li> </ul>

# MERCANTILISM

Economic philosophy adopted by merchants and statesmen during the 16th and 17th centuries.

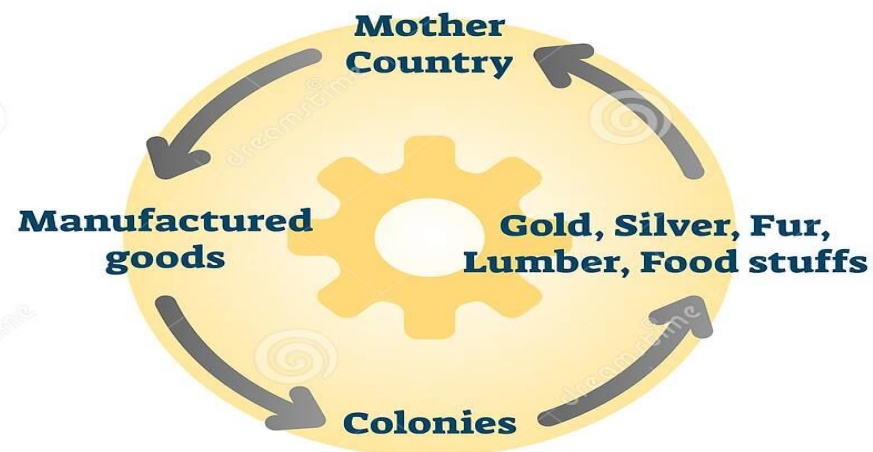
Mercantilists believed that a nation's wealth came primarily from the accumulation of gold and silver.

Nations without mines could obtain gold and silver only by selling more goods than they bought from abroad.

Mercantilism represented the elevation of commercial interests to the level of national policy.



# MERCANTILISM



# PHYSIOCRATS

Physiocrats were a group of 18th century French philosophers, who developed the idea of the economy as a circular flow of income and output.

They believed that agriculture was the sole source of wealth in an economy.

They advocated a policy of **laissez-faire**, which called for minimal government interference in the economy.

# The Classical School

It all began with the publication in 1776 of Adam Smith's monumental work, 'The Wealth of Nations'.

In Smith's view, the ideal economy is a self-regulating market system that automatically satisfies the economic needs of the populace.

He described the market mechanism as an "invisible hand" that leads all individuals, in pursuit of their own self-interests, to produce the greatest benefit for society.

Smith incorporated some of the Physiocrats' ideas, including laissez-faire, into his own economic theories, but rejected the idea that only agriculture was productive.

# Classical Economic Theories

Adam Smith

- Law of Absolute Advantage

David Ricardo

- Law of Comparative Advantage

Thomas Robert  
Malthus

- Theory of Population Growth

# Institutionalists

Institutionalist economists regard individual economic behavior as part of a larger social pattern influenced by current ways of living and modes of thought.

They rejected the narrow classical view that people are primarily motivated by economic self-interest.

Institutionalists called for government controls and social reform to bring about a more equal distribution of income.

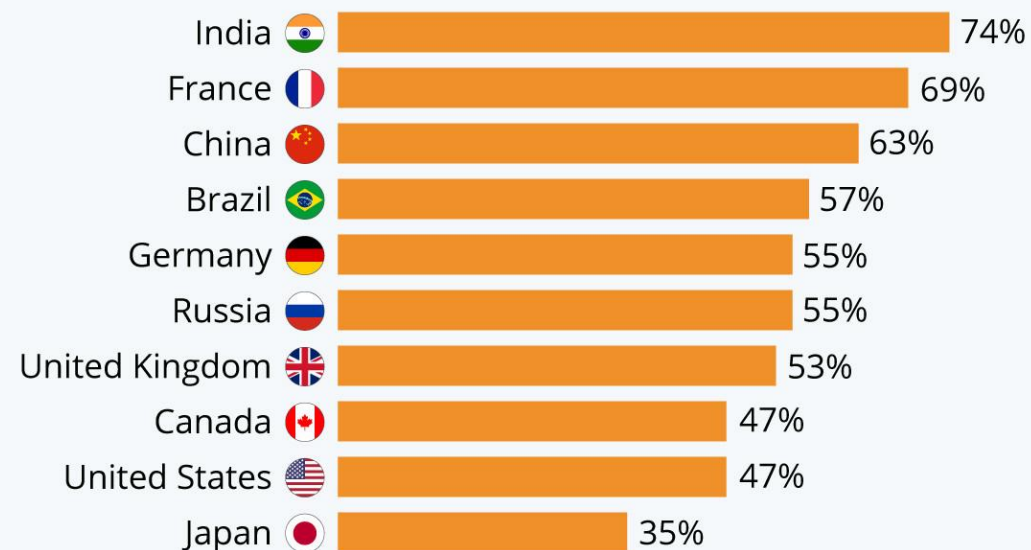
# Marxist School of Thought

- Karl Marx, during the mid-19th century, saw **capitalism** as an evolutionary phase in economic development. He believed that capitalism would ultimately destroy itself and be succeeded by a world without private property.
- An advocate of a labor theory of value, Marx believed that all production belongs to labor because workers produce all value within society.
- He believed that the market system allows capitalists, the owners of machinery and factories, to exploit workers by denying them a fair share of what they produce.
- Marx predicted that capitalism would produce growing misery for workers as competition for profit led capitalists to adopt labor-saving machinery, creating a "reserve army of the unemployed" who would eventually rise up and seize the means of production.

# MODERN-DAY CAPITALISM

## Where People Are Losing Faith In Capitalism

Share agreeing "capitalism as it exists today  
does more harm than good in the world"



n=34,000 respondents in 28 countries. (Oct 19-Nov 18, 2019).

Selected countries shown.

Source: Edelman Trust Barometer



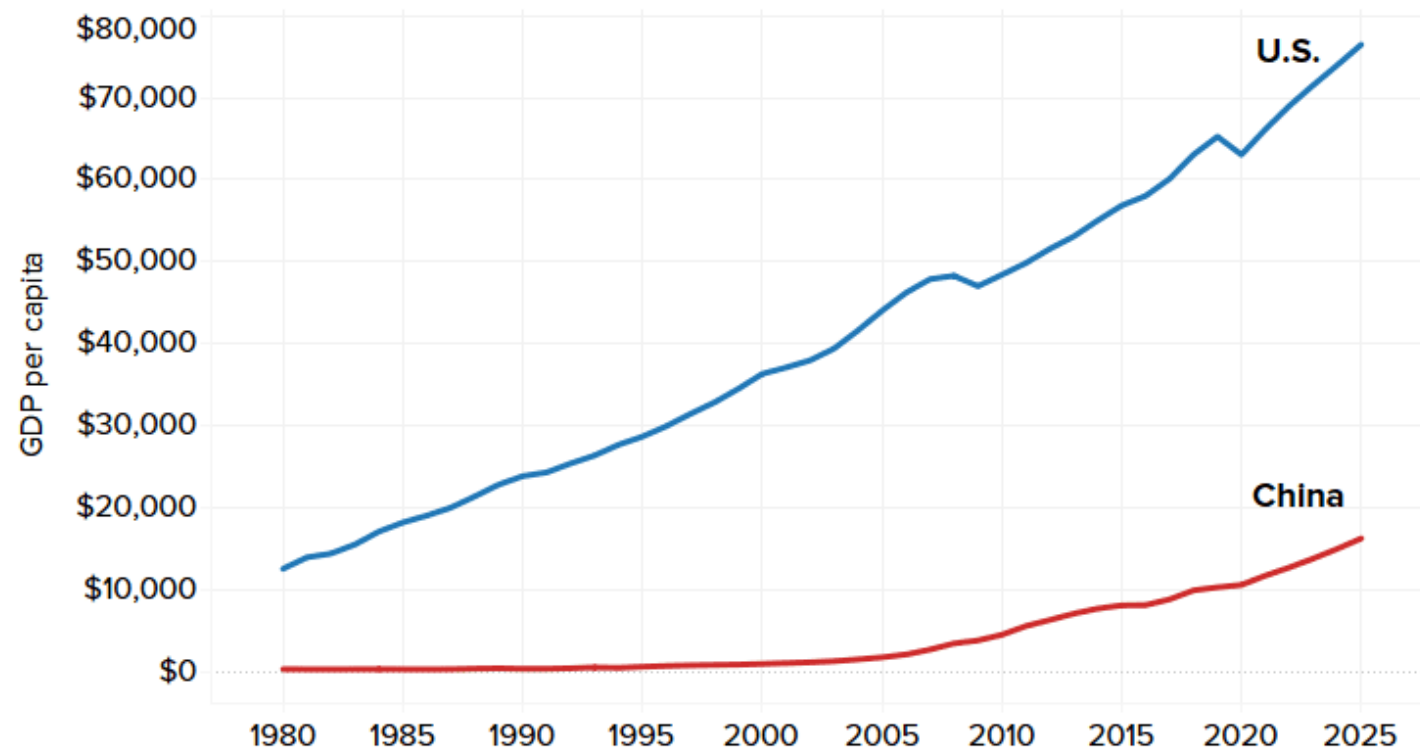
# Communism: The better approach?



# USA vs China: Comparing the capitalist and communist economies

## U.S. will remain richer than China for the years to come

International Monetary Fund's forecasts for GDP per capita through 2025



SOURCE: IMF World Economic Outlook (Oct. 2020)



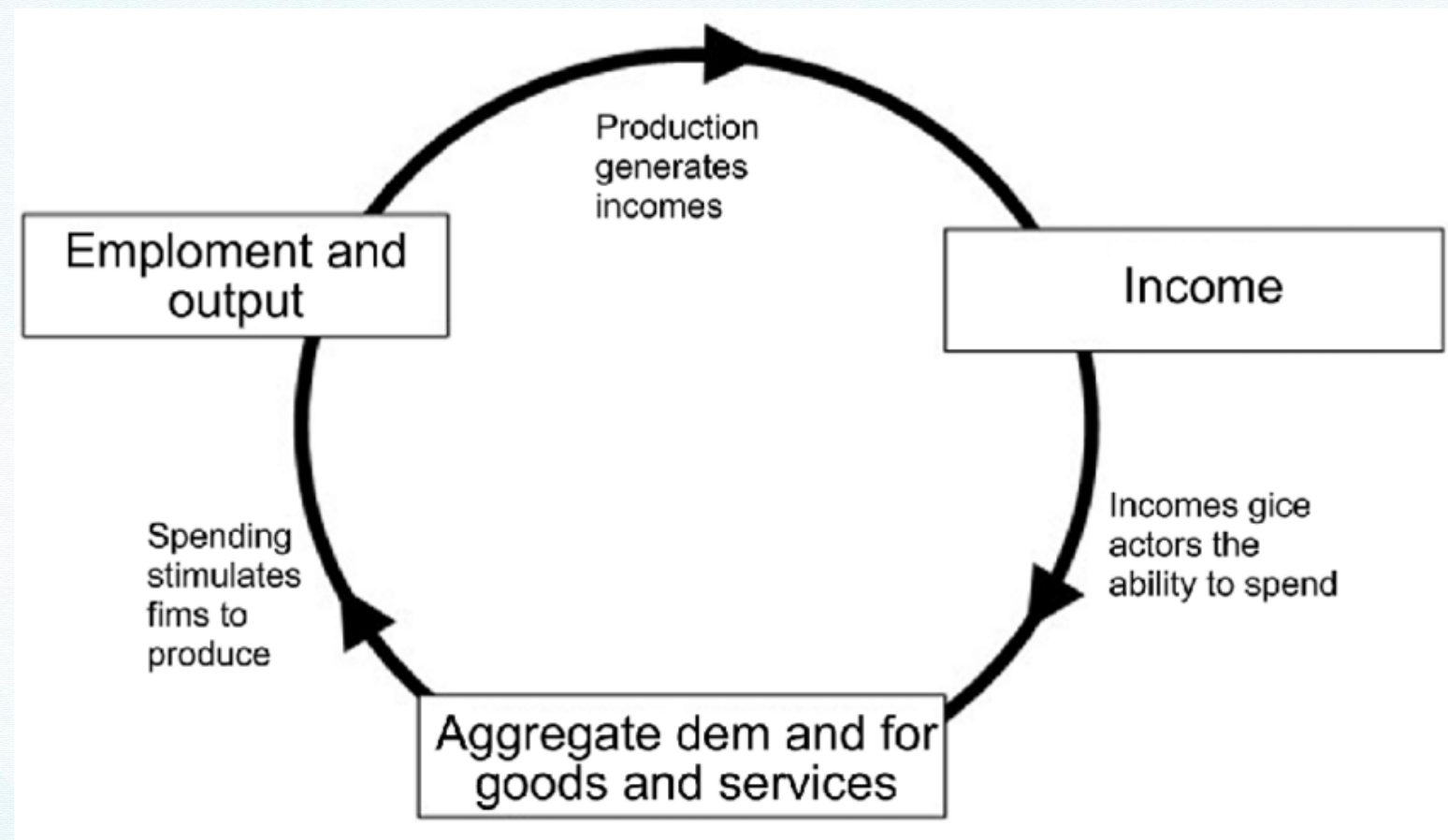
# MARGINALIST ECONOMICS

- **Marginalist economists emphasized that prices depend upon the level of demand, which in turn depends upon the amount of consumer satisfaction provided by individual goods and services.**
- **They provided modern macroeconomics with the basic analytic tools of demand and supply, consumer utility, and a mathematical framework for using those tools.**
- **Marginalists also showed that in a free market economy, the factors of production i.e land, labor, and capital, receive returns equal to their contributions to production.**

# KEYNESIAN THOUGHT

- John Maynard Keynes in 1936 broke from the Classical tradition with the publication of the General Theory of Employment, Interest, and Money.
- The Classical view assumed that in a recession, wages and prices would decline to restore full employment. Keynes held that the opposite was true. Falling prices and wages, by depressing people's incomes, would prevent a revival of spending.
- He insisted that direct government intervention was necessary to increase total spending.

# KEYNESIAN MODEL



# Keynesian Economics vs. Classic Economics

- Promotes government spending on infrastructure, unemployment benefits, and education to increase consumer demand
- Argues that government spending is necessary to maintain full employment



- Promotes laissez-faire policy
- Argues that government should play a limited role and target companies, not consumers



# New Theories

Monetarism

Rational  
Expectations  
Theory

Supply-side  
Economics

# Discussion questions

- Can there be a metric to decide the degree of government intervention in market regulation?
- What would happen if mercantilism existed in the 21<sup>st</sup> century?
- How would you assess modern-day capitalism?

# Readings

- Tubaro P (2010), History of economic thought. Rhona C. Free. *21st Century Economics: A Reference Handbook*
- Bögenhold D (2020), History of Economic Thought as an Analytic Tool: Why Past Intellectual Ideas Must Be Acknowledged as Lighthouses for the Future. *Int Adv Econ Res* **26**, 73–87.  
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