NATIONAL OPEN UNIVERSITY OF NIGERIA

SCHOOL OF ARTS AND SOCIAL SCIENCES

COURSE CODE: ECO 324

COURSE TITLE: HISTORY OF ECONOMIC THOUGHT

COURSE GUIDE

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National Open University of Nigeria 2014
First Printed
ISBN:

Printed by ……………..
For
National Open University of Nigeria *Multimedia Technology in Teaching and Learning*

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Introduction

The course, History of Economic Thought (ECO 324) is a core course which carries three credit units for third year economics students in the School of Arts and Social Sciences at the National Open University of Nigeria (NOUN). It is prepared and made available to all undergraduate students in B.Sc. Economics programme. The course is very useful to you in your academic pursuit and will help you to gain an in-depth knowledge of how the economy thoughts evolved over time and space.

This Course Guide tells you what the history of economic thought entails. It also provides you with the necessary information about the course, the nature of the materials you will be using and how to make the best use of them towards ensuring adequate success in your programme. Also included in this Course Guide are instructions on how to make use of your time and instructions on how to tackle the tutor-marked assignment (TMA). There will be tutorial session during which your facilitator will take you through your difficult areas and at the same time have meaningful interaction with your fellow learners.

What you will learn in this Course

The course is made up of twenty-one units, covering areas such as:

- Nature and Significance of History of Economic Thought
- The Evolution of Societies
- The sociology of knowledge and economic thought
- Ancient Economic Thought
- Medieval Economic Thought
- The Founders of Economic thought (Plato, Aristotle, etc.
- Mercantilism
- Pre-classical Economists
- Physiocrats

- Commercial Capitalism and The Classical Schools
- The Rise of Socialist thought and the Marxian school of Economic Thought
- The Marxian Stages of Societal Development
- The Marxian Economic Theories
- Marx's Theories of Capitalist Crisis and the State
- The Marginalist School
- The Monetary School of Economic Thought
- The Mathematical School of Economic Thought
- The Keynesian economics
- Welfare Economics
- Modern Theories of Growth
- Modern Theories of Development

Course Content

This course evaluates the development of economic thought through the eyes of Ancient, Medieval, Greek, Romans and European traditions before exploring economic thought in the context of the 20th Century. The course is historical in content and international in perspective allowing students to develop a critical understanding of the influence of evolving economic thought on contemporary global economics.

Course Aims

The overall aims of this course include:
(i) To introduce you to the development of economic ideas;
(ii) To teach you the systematic unfolding of economic ideas by different theorists in various epochs;
(iii) To expose you to the analysis of evolution of societies and production relation, the founders of economic thought like Plato, Aristotle, etc.;
(iv) To teach you history of commercial capitalism and the genesis of the classical schools, the mercantilism, physiocratic schools, the rise of socialist thought, monetary and mathematical economics;
(v) To enlighten you on the Keynesian, welfare and modern theories of growth and development economics.

Course Objectives

There are twenty-one study units in the course and each unit has its own objectives. You should read the objectives of each unit and assimilate them. In addition to the objectives of each unit, the main objective of the course is to equip you with adequate information on the history of economic thought and to enable you acquire enough professional competence to apply such knowledge to current theories and ways of thinking in economics.

The objectives of the course will be achieved by:

- Explaining the nature and significance of history of economic thought
- Tracing the evolution of societies
- Evaluate the sociology of knowledge and economic thought
- Discussing ancient economic thought
- Identifying medieval economic thought
- Discussing the founders of economic thought (plato, aristotle, etc.
- Analysing mercantilism
- Explaining pre-classical economists
- Discussing physiocrats
- Evaluating commercial capitalism and the classical schools
- Explaining the rise of socialist thought and the marxian school of economic thought
- Identifying the marxian stages of societal development
- Discussing the marxian economic theories
- Explaining marx's theories of capitalist crisis and the state
- Discussing the marginalist school
- Explaining the monetary school of economic thought
- Analysing the mathematical school of economic thought
- Discussing the Keynesian economics
- Explaining welfare economics
- Identifying modern theories of growth
- Identifying modern theories of development

Working through the Course

To successfully complete this course, you are required to read the study units, referenced books and other materials on the course.

Each unit contains self-assessment exercises in addition to Tutor Marked Assessments (TMAs). At some points in the course, you will be required to submit assignments for assessment purposes. At the end of the course there is a final examination. This course should take about 21 weeks to complete and some components of the course are outlined under the course material subsection.

Course Materials

The major component of the course, what you have to do and how you should allocate your time to each unit in order to complete the course successfully on time are listed follows:

1. Course Guide
2. Study Units
3. Textbooks
4. Assignment File
5. Presentation schedule

Study Units

There are four modules of 21 units in this course, which should be studied carefully.

Module 1

Unit 1 : Nature and Significance of History of Economic Thought
Unit 2: The Evolution of Societies
Unit 3: The sociology of knowledge and economic thought
Unit 4: Ancient Economic Thought
Unit 5: Medieval Economic Thought

Module 2

Unit 1: The Founders of Economic thought (Plato, Aristotle, etc.

Unit 2: Mercantilism

Unit 3: Pre-classical Economists

Unit 4: Physiocrats

Unit 5: Commercial Capitalism and The Classical Schools

Module 3

Unit 1: The Rise of Socialist thought and the Marxian school of Economic Thought
Unit 2: The Marxian Stages of Societal Development
Unit 3: The Marxian Economic Theories
Unit 4: Marx's Theories of Capitalist Crisis and the State
Unit 5: The Marginalist School

Module 4

Unit 1: The Monetary School of Economic Thought
Unit 2: The Mathematical School of Economic Thought
Unit 3: The Keynesian economics
Unit 4: Welfare Economics
Unit 5: Modern Theories of Growth
Unit 6: Modern Theories of Development

References and Other Resources

Every unit contains a list of references and further reading. Try to get as many as possible of those textbooks and materials listed. The textbooks and materials are meant to deepen your knowledge of the course.

Assignment File

There are many assignments in this course and you are expected to do all of them by following the schedule prescribed for them in terms of when to attempt the homework and submit same for grading by your Tutor.

There will be 4 assignments which will cover the following areas:

1. The nature and significance of history of economic thought, the evolution of societies, the sociology of knowledge and economic thought, ancient economic thought and medieval economic thought (Units 1, 2, 3, 4 and 5 of Module 1).
2. The founders of economic thought (Plato, Aristotle, etc.), mercantilism, pre-classical economists, physiocrats, commercial capitalism and the classical schools (Units 1, 2, 3, 4 and 5 of Module 2).
3. The rise of socialist thought and the marxian school of economic thought, the marxian stages of societal development, the marxian economic theories, marx's theories of capitalist crisis and the state and the marginalist school (Units 1, 2, 3, 4 and 5 of Module 3).

4. The monetary school of economic thought, the mathematical school of economic thought, the Keynesian economics, welfare economics, modern theories of growth and modern theories of development (Units 1, 2, 3, 4 and 5 of Module 4).

Presentation Schedule

The Presentation Schedule included in your course materials gives you the important dates for the completion of tutor-marked assignments and attending tutorials. Remember, you are required to submit all your assignments by the due date. You should guard against falling behind in your work.

Assessment

Your assessment will be based on tutor-marked assignments (TMAs) and a final examination which you will write at the end of the course.

Tutor-Marked Assignments (TMAs)

Assignment questions for the 21 units in this course are contained in the Assignment File. You will be able to complete your assignments from the information and materials contained in your set books, reading and study units. However, it is desirable that you demonstrate that you have read and researched more widely than the required minimum. You should use other references to have a broad viewpoint of the subject and also to give you a deeper understanding of the subject.

When you have completed each assignment, send it, together with a TMA form, to your tutor. Make sure that each assignment reaches your tutor on or before the deadline given in the Presentation File. If for any reason, you cannot complete your work on time, contact your tutor before the assignment is due to discuss the possibility of an extension. Extensions will not be granted after the due date unless there are exceptional circumstances. The TMAs usually constitute 30% of the total score for the course.

Final Examination and Grading

The final examination will be of three hours' duration and have a value of 70% of the total course grade. The examination will consist of questions which reflect the types of self-assessment practice exercises and tutor-marked problems you have previously encountered. All areas of the course will be assessed

You should use the time between finishing the last unit and sitting for the examination to revise the entire course material. You might find it useful to review your self-assessment exercises, tutor-marked assignments and comments on them before the examination. The final examination covers information from all parts of the course.

Course Marking Scheme

The Table presented below indicate the total marks (100%) allocation.

Assessment	Marks
Assignment (Best three assignment out of the four marked)	30%
Final Examination	70%
Total	**100%**

Course Overview

The Table presented below indicate the units, number of weeks and assignments to be taken by you to successfully complete the course, History of economic Thought (ECO 324).

Unit	Title of Work	Weekly Activity	Assessment End of Unit
1.	Course Guide	1	
2.	Nature and Significance of History of Economic Thought		
3.	The Evolution of Societies		
4.	The sociology of knowledge and economic thought		

5.	Ancient Economic Thought		
6.	Medieval Economic Thought		1ST Assignment
7.	The Founders of Economic thought (Plato, Aristotle, etc.		
8.	Mercantilism		
9.	Pre-classical Economists		
10.	Physiocrats		
11.	Commercial Capitalism and The Classical Schools		2nd Assignment
12.	The Rise of Socialist thought and the Marxian school of Economic Thought		
13.	The Marxian Stages of Societal Development		
14.	The Marxian Economic Theories		
15.	Marx's Theories of Capitalist Crisis and the State		
16.	The Marginalist School		3rd Assignment
17.	The Monetary School of Economic Thought		

18.	The Mathematical School of Economic Thought		
19.	The Keynesian economics		
20.	Welfare Economics		
21.	Modern Theories of Growth		
22.	Modern Theories of Development		4th Assignment

How to Get the Most from This Course

In distance learning the study units replace the university lecturer. This is one of the great advantages of distance learning; you can read and work through specially designed study materials at your own pace and at a time and place that suit you best. Think of it as reading the lecture instead of listening to a lecturer. In the same way that a lecturer might set you some reading to do, the study units tell you when to read your books or other material, and when to embark on discussion with your colleagues. Just as a lecturer might give you an in-class exercise, your study units provides exercises for you to do at appropriate points.

Each of the study units follows a common format. The first item is an introduction to the subject matter of the unit and how a particular unit is integrated with the other units and the course as a whole. Next is a set of learning objectives. These objectives let you know what you should be able to do by the time you have completed the unit. You should use these objectives to guide your study. When you have finished the unit you must go back and check whether you have achieved the objectives. If you make a habit of doing this you will significantly improve your chances of passing the course and getting the best grade.

The main body of the unit guides you through the required reading from other sources. This will usually be either from your set books or from a readings section. Self-assessments are interspersed throughout the units, and answers are given at the ends of the units. Working through these tests will help you to achieve the objectives of the unit and prepare you for the assignments and the examination. You should do each self-assessment exercises as you come to it in the study unit. Also, ensure to master some major historical dates and events during the course of studying the material.

The following is a practical strategy for working through the course. If you run into any trouble, consult your Tutor. Remember that your Tutor's job is to help you. When you need help, don't hesitate to call and ask your Tutor to provide the help.

1. Read this Course Guide thoroughly.
2. Organize a study schedule. Refer to the `Course overview' for more details. Note the time you are expected to spend on each unit and how the assignments relate to the units. Important information, e.g. details of your tutorials, and the date of the first day of the semester is available from study centre. You need to gather together all this information in one place, such as your dairy, a wall calendar, an iPad or a handset. Whatever method you choose to use, you should decide on and write in your own dates for working each unit.
3. Once you have created your own study schedule, do everything you can to stick to it. The major reason that students fail is that they get behind with their course work. If you get into difficulties with your schedule, please let your Tutor know before it is too late for help.
4. Turn to Unit 1 and read the introduction and the objectives for the unit.
5. Assemble the study materials. Information about what you need for a unit is given in the `Overview' at the beginning of each unit. You will also need both the study unit you are working on and one of your set books on your desk at the same time.
6. Work through the unit. The content of the unit itself has been arranged to provide a sequence for you to follow. As you work through the unit you will be instructed to read sections from your set books or other articles. Use the unit to guide your reading.
7. Up-to-date course information will be continuously delivered to you at the study centre.
8. Work before the relevant due date (about 4 weeks before due dates), get the Assignment File for the next required assignment. Keep in mind that you will learn a lot by doing the assignments carefully. They have been designed to help you meet the objectives of the course and, therefore, will help you pass the exam. Submit all assignments no later than the due date.

9. Review the objectives for each study unit to confirm that you have achieved them. If you feel unsure about any of the objectives, review the study material or consult your Tutor.
10. When you are confident that you have achieved a unit's objectives, you can then start on the next unit. Proceed unit by unit through the course and try to space your study so that you keep yourself on schedule.
11. When you have submitted an assignment to your Tutor for marking, do not wait for its return `before starting on the next units. Keep to your schedule. When the assignment is returned, pay particular attention to your Tutor's comments, both on the tutor-marked assignment form and also written on the assignment. Consult your Tutor as soon as possible if you have any questions or problems.
12. After completing the last unit, review the course and prepare yourself for the final examination. Check that you have achieved the unit objectives (listed at the beginning of each unit) and the course objectives (listed in this Course Guide).

Tutors and Tutorials

There are some hours of tutorials (2-hours sessions) provided in support of this course. You will be notified of the dates, times and location of these tutorials, together with the name and phone number of your Tutor, as soon as you are allocated a Tutorial group.

Your tutor will mark and comment on your assignments, keep a close watch on your progress and on any difficulties you might encounter, and provide assistance to you during the course. You must mail your tutor-marked assignments to your tutor well before the due date (at least two working days are required). They will be marked by your Tutor and returned to you as soon as possible.

Do not hesitate to contact your Tutor by telephone, e-mail, or discussion board if you need help. The following might be circumstances in which you would find help necessary. Contact your Tutor if.

• You do not understand any part of the study units or the assigned readings
• You have difficulty with the self-assessment exercises
• You have a question or problem with an assignment, with your Tutor's comments on an assignment or with the grading of an assignment.

You should try your best to attend the tutorials. This is the only chance to have face to face contact with your Tutor and to ask questions which are answered instantly. You can raise any problem encountered in the course of your study. To gain the maximum benefit from course tutorials, prepare a question list before attending them. You will learn a lot from participating in discussions actively.

Conclusion

On successful completion of the course, you would have developed critical thinking skills (from the material) for efficient and effective discussion of economic thought issues. However, to gain a lot from the course please try to apply everything you learn in the course to term paper writing in other related courses. We wish you success with the course and hope that you will find it both interesting and useful.

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MODULE 1

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Unit 2: The Evolution of Societies

Unit 3: The sociology of knowledge and economic thought

Unit4: Ancient Economic Thought

Unit 5: Medieval Economic Thought

UNIT 1: NATURE AND SIGNIFICANCE OF HISTORY OF ECONOMIC THOUGHT

CONTENT

1.0 Introduction
2.0 Objectives
3.0 Main Content
- **3.1** Definition and Meaning of History of Economic
- **3.2** Approaches to the study of History of Economic Thought
- **3.3** Significance of History of Economic Thought
- **3.4** Difficulties in the study of History of Economic thought

4.0 Conclusion
5.0 Summary
6.0 Tutor Marked Assignment
7.0 References and Further Reading

1.0 INTRODUCTION

This is the first unit among the 21 units that made up the course; History of Economic thought. This unit introduces you to the subject. You are going to spend at least two hours to go through it. This unit defines and explains the nature and significance of History of Economic Thought. While reading the unit, there are exercises designed to make you pause and reflect on what you are studying. By so doing, you will understand the units being presented to you.

At the end of the unit, there are again tutor-marked questions which are meant for you. Try your hands on them so as to be self-assured that you have a mastery of the points raised in the unit, as indicated in the objectives stated below.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Define history of economic thought;
- Explain history of economic thought;
- Describe the approaches to the study of history of economic Thought;
- Understand the significance of history of economic thought; and
- Enumerate the difficulties in the study of history of economic Thought.

3.0 MAIN CONTENT

3.1 Definition and Meaning of the History of Economic Thought

History of Economic thought deals with the origin and development of economic ideas and their interrelations (Jhingan et al, 2003). The authors argued that it is a historical account of economic doctrines. Prof. Schumpeter holds that "economic thought is the sum total of all the opinions and desires concerning economic subjects especially concerning with public policies of different times and places." Schumpeter further says that the history of economic thought traces the historical change of attitudes. It also speaks about the economic problems and the approaches to those problems. Bhatia (1978:1) argues that, "Ordinarily economic thought would be taken to cover the set of theories, doctrines, laws and generalizations, and analyses applied to the study and solution of economic phenomena and problems." He further argues that the specific contents of economic thought have normally commanded an uneven prominence- some attracting more attention than the others; and the overall composition of economic thought is also subject to a continuous variation. In the words of Haney (1949:4), the study of economic thought "may be defined as a critical account of the development of economic ideas, searching into the origins, interrelations, and manifestations."

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. Economic thought deals with different thinkers and theories relating to economics and political economics from ancient times to present day.

Reynolds (1998) defines the history of economic thought as a study of alternative perspectives and explanations of how the economic processes function. He believes that an important aspect of the study of economic thought is to identify the factors that encourage different perspectives of the economy. It is also important to trace the evolution of the tools used for analysis and understand how the different perspectives and conditions encourage the use of different tools. Mark Blaug writes:

> *"The task of the historian of economic thought is to show how definite preconceptions lead to definite kinds of analysis ant then to ask whether the analysis stands up when it is freed from its ideological foundation. It is doubtful whether Ricardo would have developed his theory of international trade without a strong animus against the landed classes; but this theory survives the removal of his prejudices.* (Blaug, 1985:5-6).

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.

You should note that the History of Economic Thought is different from Economic History and History of Economic. This is because while History of Economic Thought deals with the development of economic ideas, Economic History is a study of economic development of a country. On the other hand, History of Economics deals with the science of economics.

You should also note that even though Economic History and History of Economic Thought constitute separate branches of study, they are closely related. This is because economic ideas are directly and indirectly motivated by the economic conditions and environment of the country. You should also note that ideas and environment are equally important and hence close relationship between History of Economic Thought and Economic History.

Self Assessment Exercise 1.1

In your own words, define history of economic thought.

3.2 The Approaches to the Study of History of Economic Thought

You should be aware that the development of economic ideas can be studied under three periods, namely: 1. Ancient, 2. Medieval and 3.Modern. You should also be aware that the history of Economic Thought may be broadly into two parts. The first part deals with the origin and the development of economic ideas before the development of economics as a science. The second part deals with the economic ideas after the development of economics as a science.

According to Jhingan et al (*ibid*), economic thought can be studied and analyzed by adopting different approaches such as;

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

We are going to briefly explain each of these approaches as follows:

1. **Chronological approach:** In this approach, economic ideas are discussed in order of time. This is to say that the economic ideas of different economists can be presented year wise and can be studied. You should note that in this approach, we can define continuity in the economic ideas of different economists.
2. **Conceptual approach:** It talks about the evolution of different economic concepts (ideas) and the interdependence of these concepts. You should be aware that another name for conceptual approach is ideological approach.

3. **Philosophical Approach:** Plato, the renowned Greek philosopher was the first person to adopt this approach. You should note that in the past, economics was considered as a hand maid of ethics. As expected, philosophical approach was adopted by the early writers to discuss the economic ideas.
4. **Deductive Approach:** It was the classical economists who adopted this method. They believed in the universal application of economic laws.
5. **Inductive Approach:** The Historical School emphasized the inductive method. These economists believed that the laws of economics are not universal in nature.
6. **Neo-classical Approach:** This approach aims at improving the classical ideas by modifying them. Neo-classical approach was first adopted by Alfred Marshall. The Neo-classical approach believed that "Induction and Deduction are necessary for the science of economics just as the right and left feet are necessary for walking."
7. **Welfare Approach:** This approach aims at providing the basis for adopting policies which are likely to maximize social welfare.
8. **Institutional approach:** The institutionalists questioned the validity of classical ideas and gave importance to psychological factors.
9. **Keynesian Approach:** You should note that a major development in modern economics is associated with the name of J.M. Keynes. Of course, his approach is new and different from the classical school. His approach takes into consideration the operation of business cycles that affect the entire economic policies. Keynesian approach deals with the economy as a whole.

3.3 The Significance of History of Economic Thought

Jhingan et al (*ibid*) stated that they are two views with regard to the importance of study of History of Economic Thought. One group of economists believed that there is no need to study the History of Economic Thought because it is a history of errors. On the other hand, another group believed that one cannot possess knowledge of any economic doctrine until one knows something of its history. As a result, a study of History of Economic Thought is important for the following reasons as given by Jhingan et al (ibid).

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 of Economic Thought will help us to understand the origin of economics;
3. Economic ideas have been instrumental in shaping the economic and political policies of different countries;
4. Economic ideas are conditioned by time, place and circumstances;

5. A study of History of Economic Thought provides a broad basis for comparison of different ideas. It will enable a person to have a different a well-balanced and reasonable judgment;
6. Through the study of Economic Thought the student will realize that economics is different from economists;
7. The study of the subject helps us to avoid the mistakes committed by earlier economic thinkers.
8. The study of History of Economic Thought will enable us to know the person responsible for the formulation of certain important principles.

In short, the significance of the study of History of Economic Thought can hardly be overemphasized. It is an important tool of knowledge.

3.4 Difficulties in the Study of History of Economic Thought

You should remember that History of Economic Thought is selective and interpretative in nature. In other words, the authors select those topics in which they are interested. They also explain the facts in their own manner. If authors leave out certain important facts and emphasize others, their judgments are biased. For example, the famous book, "A History of Economic Doctrines"- written by Gide and Rise leaves out discussions on ancient economic ideas, medieval economic thought and the contributions made by Mercantilists. In addition, complete History of Economic Thought should deal with modern economic thought also. That means it should include the contributions made by Marshall, A.C. Pigou, J.M. Keynes, etc. In this respect, it can also be said that Alexander Gray's "The Development of Economic Doctrine" is incomplete. In spite of the above defects, the study of History of Economic Thought enables one to understand the subject clearly.

3.5 Basic Concepts for the Study of the Economy and Socio-economic Formations

According to Ake (1981), there are some major concepts for looking at economic conditions in an orderly manner, and with the aid of these concepts show what the economic system is. You should note that all the concepts used by Ake (ibid) for this exercise were derived from, or were closely associated with the concept of labour and the labour process. He explained why this was so. Man is above all else a worker or a labourer. Work is the primary condition of his existence. These key concepts are;

1. Necessary labour and surplus labour;
2. Surplus labour and surplus product;
3. The labour process;
4. The productive forces;

5. Social relations of production
6. The economic system;
7. The socio-economic formation;

4.0 CONCLUSION

This is our first unit to the course: History of Economic Thought. While reading the unit, you were made to understand the definition and meaning of history economic thought and the approaches to the study of history of economic thought. You were also made to understand the significance of history of economic thought as well as the difficulties in the study of history of economic Thought.

5.0 SUMMARY

In this unit, you learnt the nature and significance of history of economic thought. The ground is now prepared to sow the seeds of concepts of evolution of societies in the next unit.

6.0 TUTOR-MARKED ASSIGNMENT

1. What do you understand by the phrase 'History of Economic Thought'?

2. List all the different approaches to the study of 'History of Economic Thought'. Why the Keynesian approach is is the best?

7.0 REFERENCES

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UNIT 2: THE EVOLUTION OF SOCIETIES

CONTENT

1.0INTRODUCTION

In the first unit, we discussed the nature and significance of history of economic thought. We shall now describe how modern societies evolved. We shall also describe the Darwinian models of cultural evolution and trace the evolution of institutions of complex societies. Finally, we shall discuss tribal social instincts hypothesis and competing hypotheses.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Describe the origin of modern human societies;
- Understand the Darwinian Models of cultural evolution;
- Trace the evolution of institutions of complex societies;
- Understand tribal social instincts hypothesis; and

- Be aware of competing hypotheses.

3.0 MAIN CONTENT

3.1The Origin of Modern Human Societies

Human societies are essentially adaptive mechanisms, the means of which human populations strive to satisfy their varied needs and desires. Sometimes this is accomplished by preserving traditional ways of doing things, and sometimes by adopting new and innovative ways. In human societies we find abundant evidence of both continuity and change. Modern human societies are more complex than the societies of other animal species. Yet, for most of the 100,000 years since their first appearance, anatomically modern humans have lived in small-scale, egalitarian foraging societies (Klein, 1989). Foraging societies are simple by comparison with modern societies. Above all, in the simplest cases, tribes are held together by sentiments of common membership, expressed and reinforced by informal institutions of sharing, giving, ritual, and participation in dangerous collective exploits.

Approximately 10,000 years ago, plant domestication began to raise the human carrying capacity in several regions of the world. Agricultural societies became larger, more densely populated, and rapidly more complex than those of the Pleistocene, to which human social “instincts” are presumably adapted. Institutions of formal coercive power arose. Around 5,000 years ago, innovations in social organization led to the first states, with unprecedented levels of cooperation, coordination and division of labour emerged. Some of these innovations, especially deep social hierarchies, generated enormous conflict. People’s egalitarian impulses and love of autonomy rebel at the striking inequality and coercion present in complex societies. Nevertheless, larger, more complex societies are generally able to dominate smaller, simpler tribal societies, and a ragged but persistent trajectory of social evolution toward ever more complex social systems continues to the present.

You should note that the evolution of complex human societies is one of the oldest puzzles of the social sciences. Great debates, with roots in the political thought of Plato, Aristotle, Confucius and Marx, have raged over whether the evolution of such societies is voluntaristic or coercive, whether their operations are to be understood resulting from conflicts between individuals or as functioning wholes, and whether the right unit of analysis is the individual or the social institution (e.g., Carneiro 1970, Kirch 1984). Scholars have marshaled sophisticated arguments on both sides of these debates for a century without reaching any consensus.

Today, we live in vast societies, organized and regulated by many complex institutions. In this unit, we argue that this transition occurred in two stages: First, over the last several hundred thousand years, humans evolved the capacity for cumulative cultural evolution, which in turn, lead to the gene-culture co-evolution of larger and more cooperative societies. By the late Pleistocene, hominids evolved the social instincts necessary to create societies on the tribal scale, a level of social organization absent in other primates and, indeed, entirely unique to our species. These instincts and the social institutions that they underpinned were the pre-adaptations to complex sociality that followed.

Second, the Pleistocene-Holocene boundary, about 11,500 years ago, marks a major transition point in human social evolution. Institutional evolution in the late Pleistocene was limited by a regime of highly variable environments under which agricultural subsistence systems were *impossible*. The climate of the Holocene has been very much less variable, and agriculture is *possible* over a large fraction of the earth's land surface. Indeed, the greater efficiency of agricultural production means that agricultural populations can generally out-compete hunter-gather populations. Thus, once agriculture became possible, competitive forces made it *compulsory,* in the long-run at least. We put forward that a similar dynamic drove the evolution of social institutions. Societies with more cooperation, coordination, and division of labour can generally out-compete societies with less.

Since the Pleistocene-Holocene transition was a rapid, globally synchronous, event, variations in the rate of institutional evolution in different parts of the world represent natural experiments that should yield clues pointing to the processes that limit the rate of evolution of institutions. That is, since the progressive trend toward more complex societies characterizes almost all parts of the world, we know that the equilibrium degree of complexity has not been reached until quite recently at least. Thus, we can conceive of the problem as discovering the main limiting factors that slow the competition driven progressive trend toward greater social complexity. A number of plausible candidates exist, permitting a dim outline of the large-scale dynamics of institutional evolution. Thus, evolution of human subsistence systems during the career of anatomically modern humans seems to divide quite neatly into two regimes, a Pleistocene regime of hunting and gathering subsistence and low population density, and a Holocene regime of increasingly agricultural subsistence and relatively high and rising population densities.

Self Assessment Exercise 2.1

What do you understand by the terms; a Pleistocene regime and a Holocene regime?

3.2 Darwinian Models of Cultural Evolution

Two rather different approaches to the use of Darwinian Theory are current in the contemporary social sciences. One is to apply the substantive results of Darwinian Theory to human behaviour. This field was pioneered by Alexander (1974) and Wilson (1975) and was given a somewhat different twist by Symons (1989) under the heading of “evolutionary psychology.” Since natural selection is the most important directional force in organic evolution, these scholars use fitness optimizing models to generate testable hypotheses about human behaviour (Borgerhoff Mulder et al., 1997). Typically, such work endorses a number of common dogmas current in evolutionary biology, for example the generalization that group selection is seldom a strong force. The weakness of this approach is that it may not do full justice to the unique features of human behaviour.
We advocate a different strategy pioneered by Campbell (1965) and first put in mathematical form by Cavalli-Sforza and Feldman (1973). The work starts with the idea that culture is a system of inheritance. We acquire culture by imitating other individuals much as we get our genes from our parents. The existence of a fancy capacity for high fidelity imitation is one of the most important derived characters distinguishing us from our primate relatives, who have only relatively rudimentary imitative abilities (Tomasello, 1999).

We are also an unusually docile animal (Simon 1990) and unusually sensitive to expressions of approval and disapproval by parents and others (Baum, 1994). Thus parents, teachers, and peers can shape our behaviour rapidly and easily compared to training other animals using more expensive material rewards and punishments. Finally, once children acquire language, parents and others can communicate new ideas quite economically to those who don’t know them. This economy is only relative; although we get our genes all at once at the moment of conception, acquiring an adult cultural repertoire takes some two decades. Humans ultimately acquire a repertoire of culture that rivals the genome in size.

The existence of cultural transmission means that culture has what evolutionary biologists call “population level properties.” Individuals’ behaviour depends on the behaviours common in the population from whom they acquire beliefs just as individuals’ anatomy is dependent on the genes common in the population from whom they acquired their genes. The diversity of cultural traits across cultures is great, but for the most part we are limited to learning those extant in our culture in our time. However, in the long-run, the commonness or rarity of genes or culture in the population is a product of what happens to the individuals who reproduce or not, and are imitated or not. The analogy is more than a curiosity because population biologists have developed a formidable kit of empirical and theoretical tools to analyze this intricate interplay between the individual and population level. In the terms sociologists often use, population biologists have the means to make the macro-micro problem (Alexander et al. 1987) tractable. Several theorists, but fewer empiricists have raided the population biologists' cupboard for these tools (Cavalli-Sforza and Feldman 1981).

3.3 The Evolution of Institutions of Complex Societies

The evolution of complex societies is one of the most interesting questions in all the social sciences. Here are some posers for you to ponder .How can a species long adapted to living in small egalitarian groups evolve revolutionary new social institutions that lead them to live in very large, highly inegalitarian social systems? Tribal people often express shock and contempt at what we put up with in the name of "civilization." Why did the progressive trajectory of increased complexity start around ten thousand years ago, not thirty or five? Why did societies in some parts of the world move down the progressive path more swiftly than others? What processes regulate the tempo of institutional evolution? What gives the progressive trend its multilinear diversity? No two trajectories of complexification are identical, even in closely related societies and sub-societies, much less in remotely connected cases like Western Europe, Western Asia, India, China, and Meso-America, despite many similarities. Why has the pace of change had a tendency to accelerate as we approach the present? Why is the progressive trend punctuated, in every historical case, by more or less abrupt declines and collapses?
These are exceeding complex questions that have defied definitive solution despite much hard work—and much real progress—by social scientists, historians, and political philosophers. The development of Darwinian tools encourages a fresh cut at them. The boast of Darwinian biologists is that the power of their theory in that discipline derives first from its correct conception of the processes of evolution and from its inclusive, synthetic, and systemic commitments. Darwinian biology is a big tent housing diverse and often fractious practitioners. Even after a century and a half of work it is a vibrant field full of interesting unsolved puzzles, many of a quite fundamental character.

3.4 The Tribal Social Instincts Hypothesis

The tribal social instincts hypothesis is based on the belief that group selection plays a more important role in shaping culturally transmitted variation than it does in shaping genetic variation, and, as a result, that humans have lived in social environments characterized by high levels of cooperation for as long as culture has played an important role in human development. The simplest model of group selection on cultural variation is based on the effects of a conformist bias in cultural transmission (Boyd and Richerson, 1985: chapter 7; Henrich and Boyd, 1998). Conformity is a useful rule to follow in imitating others because many evolutionary forces conspire to make adaptive behaviour common. When in doubt, doing as the Romans do when in Rome is an easy and useful rule to follow. Using this rule has the effect of reducing variation within groups and protecting groups against the effects of migration from other groups. Other rules, such as preferring to imitate people of your own symbolically marked group or the practice of social selection against deviants may have similar effects. Group selection does not work on genes for cooperation according to most models because group selection cannot easily build variation between groups as fast as selection against cooperators within groups—and migration between groups—reduces it. Thus, selection on cultural variation is a more likely mechanism for favouring the origins of cooperative institutions than is selection on genes.

3.5 Competing Hypotheses

We have not the space to review in detail all the competing hypotheses to explain the evolution of human social organization. Broadly speaking, however, these fall into two classes: those that emphasize individual level processes and those that emphasize group functionality. These are methodological individualists' theoretical model, evolutionary biologists' model, the tribal social instincts and work-around hypotheses.

4.0 CONCLUSION

Human societies are much larger and more complex than the societies of other social mammals. In this unit, we argued that this transition occurred in two stages: First, over the last several hundred thousand years, humans evolved the capacity for cumulative cultural evolution, which in turn, lead to the gene-culture co-evolution of larger and more cooperative societies. Secondly, the Pleistocene-Holocene boundary, about 11,500 years ago, marks a major transition point in human social evolution.

5.0 SUMMARY

In this unit, you learnt the nature of the evolution of societies. You also learnt the Darwinian models of cultural evolution and the evolution of institutions of complex societies as well as the tribal social instincts and competing hypotheses.

The ground is now prepared to sow the seeds of concepts of sociology of knowledge and economic thought in the next unit.

6.0TUTOR-MARKED ASSIGNMENTS

1. Define and explain history of economic thought.
2. The evolution of complex societies is one of the most interesting questions in all the social sciences. Discuss.

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UNIT 3: THE SOCIOLOGY OF KNOWLEDGE AND ECONOMIC THOUGHT

CONTENT

1.0 INTRODUCTION

In our second unit, which is the preceding one, we discussed the evolution of societies. The present unit is going to be an extension of the first one. This is because we are still going to closely look at the sociology of knowledge and economic thought which are parts of the evolution of societies.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Describe the sociology of knowledge;
- Explain the social environment;
- Understand the social order; and
- Understand the economic thought;

3.0Main Content

3.1The Sociology of knowledge

The sociology of knowledge refers to the study of the relationships between systems of ideas and beliefs and other social and political forces, or between the history of ideas and the history of events (Hill, 1977). It is concerned with the origin and development of ideas and beliefs and with their influence on social processes and structures (Stark, 1958). Becker and Dahke define the sociology of knowledge as "the analysis of the functional interrelationship of social processes of structures on the one hand and the patterns of intellectual life, including the modes of knowing, on the other." Mannheim (1964:679-81) argues that "The proper theme of our study is to observe how and in what form intellectual life at a given historical moment is related to the existing social and political forces."

In order to facilitate the study of this sociology of knowledge, Karl Mannheim, a distinguished German Sociologist, has identified three types of thought. Mannheim's type of thought is accepted as true within a given social situation. It is the thought of practical men, who know that change is inevitable, and who want to guide and direct change into constructive rather than directions. His second type is ideological thought, which he described as unrealistic because it is determined by a conservative desire to resist change. It is the thought of the people who have vested interests in the status quo and who, therefore, want to resist the change which threatens their interest. His third type is utopian thought, which he defined as unrealistic or impractical thought dictated by wishful thinking concerning some imagined future utopian as yet incapable of realization. It is the thought of the radical reformers who would like to transform the existing socio-economic structure completely but whose plans for radical reform of the existing system is impossible to achieve at that time (Mannheim, 1936).

Realistic thought provides a basis for a pragmatic adjustment to the dynamic conditions of reality and for a solution of practical problems; therefore, realistic thought tends to cause progressive change in economic history. Ideological thought expresses a conservative desire to defend the status quo against change; therefore, ideological thought tends to resist change in economic history. Utopian thought represents an advocacy of ideas that are not currently realizable; therefore, utopian thought is incapable of influencing the course of current economic thought. Utopian thought can, however, cause a profound primary influence on current intellectuals history and, through this primary influence, an ultimate secondary influence on future economic history.

Self Assessment Exercise 3.1

What are the three traditions in the history of economic thought?

3.2 The Social environment

Social environment theory attempts to understand how social environments and the individuals who compose them are interrelated. Social environments can include social groups, institutions, social hierarchies or even entire societies and cultures. The role of individuals within such systems and how the collective actions of individuals create and maintain them are of special interest to social theorists.

According to Flamand (2013), social environment consists of the followings:

3.2.1Social Determinism

One of the primary debates surrounding social environment theory is how the social environment determines the goals, desires, personalities and behaviour of the individuals living within it. While it is generally agreed that an individual's environment affects him to some degree, that degree and the mechanisms by which such affects take place are a matter of dispute.

3.2.2 Roles and Actors

Actors are the individuals who make up any social situation. Roles are the set of goals, behaviours and norms that actors within certain situations are expected to fulfill. Roles can be affixed to gender, such as homemakers or breadwinners, or they can be place or situation specific, such as the roles lawyers, judges, defendants and juries play in the courtroom.

3.2.3Agency

Individuals are considered to have some degree of control over their choices and actions within any social setting. This is called agency. Agency is a person's ability to take action toward achieving some end. The amount of agency an individual has within his social environment might depend largely upon what kind of social environment that person inhabits. For example, a prisoner has relatively little agency because his social situation is designed to deprive him of agency.

3.2.4 Social Structures

Social structures are the relations of individuals to each other that make up social environments. They can include institutions, class hierarchies or even things as simple as families. These structures are partially the result of individuals maintaining them through some combination of their beliefs and purposive actions.

3.2.5 Social Efficacy

Social efficacy is the capacity of individuals to cause changes in their social environments. While it is generally believed that people are at least partially products of their environments, this belief does not preclude the possibility that individuals will choose, whether individually or collectively, to self-consciously resist environmental influences.

3.3 Social Order

When we say that man produces himself, it does not imply some sort of Promethean vision of the solitary individual. Man's self-production is always, and of necessity, a social enterprise. Men *together* produce a human environment, with the totality of its socio-cultural and psychological formations. None of these formations may be understood as products of man's biological constitution, which, as indicated, provides only the outer limits for human productive activity. Just as it is impossible for man to develop as man in isolation, so it is impossible for man in isolation to produce a human environment. Solitary human being is being on the animal level (which, of course, man shares with other animals). As soon as one deserves phenomena that are specifically human, one enters the realm of the social. Man's specific humanity and his sociality are inextricably intertwined. *Homo sapiens* is always, and in the same measure, *homo socius*.

Empirically, human existence takes place in a context of order, direction, and stability. The question then arises: From what does the empirically existing stability of human order derive? An answer may be given on two levels. One may first point to the obvious fact that a given social order precedes any individual organismic development. That is, world-openness, while intrinsic to man's biological make-up, is always preempted by social order. One may say that the biologically intrinsic world-openness of human existence is always, and indeed must be, transformed by social order into a relative world-closedness. While this reclosure can never approximate the closedness of animal existence, if only because of its humanly produced and thus "artificial" character, it is nevertheless capable, most of the time, of providing direction and stability for the greater part of human conduct. The question may then be pushed to another level. One may ask in what manner social order itself arises. The most general answer to this question is that social order is a human product; or, more precisely, an ongoing human production. It is produced by man in the course of his ongoing externalization. Social order is not biologically given or derived from any biological *data* in its empirical manifestations. Social order, needless to add, is also not given in man's natural environment, though particular features of this may be factors in determining certain features of a social order (for example, its economic or technological arrangements). Social order is not part of the "nature of things," and it cannot be derived from the "laws of nature." Social order exists *only* as a product of human activity. No other ontological status may be ascribed to it without hopelessly obfuscating its empirical manifestations. Both in its genesis (social order is the result of past human activity) and its existence in any instant of time (social order exists only and insofar as human activity continues to produce it) it is a human product. While the social products of human externalization have a character *sui generis* as against both their organismic and their environmental context, it is important to stress that externalization as such is an anthropological necessity. Human being is impossible in a closed sphere of quiescent interiority. Human being must ongoingly externalize itself in activity. This anthropological necessity is grounded in man's biological equipment. The inherent instability of the human organism makes it imperative that man himself provide a stable environment for his conduct. Man himself must specialize and direct his drives. These biological facts serve as a necessary presupposition for the production of social order. In other words, although no existing social order can be derived from biological *data*, the necessity for social order as such stems from man's biological equipment.

3.4 Economic Thought

Normally, economic thought would be taken to cover the set of theories, doctrines, laws and generalizations, and analysis applied to the study and solution of economic phenomena and problems. It is worth quoting Bhatia (1978) that the specific contents of economic thought have normally commanded an uneven prominence, some attracting more attention than the others; and the overall composition of economic thought is also subject to continuous variation. In addition, he argued that economic thought is not a given and fixed set of economic theories or tools and techniques of analysis.
We can consider economics as a dynamic science, a feature that it acquires on an account of various reasons. It, therefore, follows that economics brings forth a body of generalization which, as in others sciences, involve cause-effect relationships. It is stating the obvious that economic ideas have been there since time immemorial, but it is only recently that they assumed the form of a system of thought which may be termed economic science or economics. Of course, references to economic questions abound and are scattered almost everywhere in the old literature, such they are found in Plato-Aristotle, and others (Bhatia, 2006). But in all cases, we have only fragments of information and conclusion are not able to adequately generalize on these economic ideas and economic views with any great significance, we, therefore, cannot claim the emergence of economic thought.

We can safely conclude that the time when those ideas started getting crystallized into economic thought is around the time of Mercantilism. The birth of economic science might be said to have coincided with the rise of physiocracy, because it is in this system that comprehensive economic theory emerged. According to Imorsi and Sogules (2013), the widely held opinion is that, Adam Smith's book "An inquiry into the nature and causes of the wealth of nations" (published in 1776) was the first systematic work of economic problems, while now modern critics have been more and more persuaded and rightly so, to attribute that priority to Richard Cantillon, author of ***"Essia sur al nature du Commerce***, published in 1775".

Arising from the above conversations, it is obvious that economic thought is a body of economic ideas and generalization which can be seen to belong to each other, and therefore economic thought is closely related to economic environment and economic development. The growth of economic science can be traced along with the growing complexity of world economies. The development of economic science is intimately related to the development of economic environment, and the two interact with each other. This means that economic ideas of the great thinkers in economics are needed for the stimulation of economic development of any economy. This is because the exact nature of responses depends upon the institutional framework of the society and that is the more reason why the customs and behaviour get crystallized into institutions. Economic theorizing and investigation, therefore, have to be in the context of and within the framework of an economy which has a prescription of achieving economic growth and development. Akpakpan (1999) in this respect observed that in the book of Richard Cantillon, his contributions to economic thought are organized in three parts namely: the nature of wealth, social and economic organization of people, wages of labour, theory of value, populations use and the use of gold and silver; barter, prices, circulation of money, and interest rate; and foreign trade, foreign exchange, and banking and credit. Given the contributions of Richard Cantillon which covers most significant practices of economics in any country, it therefore becomes imperative to run the analysis of his economic thought in order to spot out the relevance of his contributions to the history of economic thought.

Relevant pages of literature and history of economic thought such as (Jhingan et al, 2003; Marcuzzo, 2008; Bhatia, 2004; Akpakpan, 1999; Tamuno, 2006; Okowa, 1996; Kalu, 2001; Blang, 2001; Todaro and Smith, 2004; and Samuelson and Salow 1960) have consistently revealed that the adoption and complete application of the doctrines, ideas, model, philosophy; in fact all the contributions of economists of old (chronology of the founding fathers) have led to the emergence of the discipline and without doubts equally accorded for the reason why some economies are said to be developed and others are said to be underdeveloped. Obviously, the Nigeria economy is categorized in the latter. This is because Nigeria is grossly under developed and the economy is characterized by high rate of unemployment, very low per capital income and GDP per capita, unfavourable terms of trade, balance of payment deficits, sluggish economic growth, double digit inflation rate, high lending interest rate, lack of access to credit facilities to the economic participants in the real sector, instability in the banking sector and poor socio-economic organizations.

4.0 CONCLUSION

The sociology of knowledge is the study of the relationships between systems of ideas and beliefs and other social and political forces, or between the history of ideas and the history of events. In addition, social environment theory attempts to understand how social environments and the individuals who compose them are interrelated, and that social environments could include social groups, institutions, social hierarchies or even entire societies and cultures. Finally, economic thought covered the set of theories, doctrines, laws and generalizations, and analysis applied to the study and solution of economic phenomena and problems.

5.0 SUMMARY

You have learnt the sociology of knowledge and economic thought. You have also examined the social environment and the social order. We are now ready to move into Unit 3 where we will be undertaking a comparative survey and assessment of the development of economic thought from the Bible to Mercantilism by first examining the ancient economic thought.

6.0 TUTOR MARKED ASSIGNMENT

1. List and explain the components of social environment.
2. Richard Cantillon's contributions to economic thought are organized in three parts. Name and explain them.

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UNIT 4: ANCIENT ECONOMIC THOUGHT

CONTENT

1.0 INTRODUCTION

In our first unit, we discussed the nature and significance of History of Economic Thought. In the second unit we discussed the evolution of societies while the sociology of knowledge and economic thought was the focus of unit 3. In this present unit 4, and the subsequent units 5 and 6, we will undertake a comparative survey and assessment of the development of economic thought from the Bible to Mercantilism by discussing ancient and medieval economic thoughts as well as mercantilism.

2.0OBJECTIVES

At the end of this unit, you should be able to:

- Explain the importance of studying ancient economic thought;
- Understand the Economic thought of Hebrews;
- Understand Greek economic thought; and
- Understand Roman economic thought.

3.0 MAIN CONTENT

3.1The Importance of Studying Ancient Economic Thought

Although modern students may found the study of history of economic thought less fascinating, there is no doubt that for a clear understanding of economic theories and institutions in a proper sequence, such a study has more than a mere historical value. This is because it gives an insight into the life, habits and customs of ancient communities and provides a wider spectrum of the growth of modern economics. The study of ancient economic thought sheds light on the origin of economic thought and the factors responsible for its development. You should note that ideas do not grow in isolation and are passed one from one generation to another with the necessary modifications and adaptations. Hence they have to be judged in their historical viewpoint.

You should be aware that study of ancient economic thought not only provides the necessary bridge between ancient and modern but also between occidental (Western world) and oriental (Eastern world) economic thought. You should be aware that its importance lies not only in providing a continuity of ideas but also in an understanding of the interaction of these ideas in their proper relationship. In short, this according to Jhingan et al (2003:6) "is at once a link between old and new, between East and West and between ethics and economics."

3.2 Economic Thought of Hebrews

The beginnings of the science of economics and economic institutions are often traced back to the Hebrew and Jewish times (Jhingan et al, 2003). The authors added that the society discussed in the Old Testament mentioned some of the characteristics of modern capitalism and private property. You should note that the Hebrew belong to the ancient civilizations of the world. Their period dates back to 2500 B.C. Indeed, some scholars believed that western civilization has its origin in Hebrew civilization. For instance, division of labour, market, exchange, money, etc., were the institutions of those times. It was discovered that the philosophers of those times were real founders of all social theories even though their writings were in a scattered form.

You should note that the economic philosophy of the Hebrews was simple. The society in which they lived was also a simple one. In Hebrew times, economic problems were never studied separately. It is on record that Economics, Politics, Ethics and Philosophy were interconnected. But religion and ethics were given greater importance. Economic life was controlled by priests. They gave importance to agriculture. The Hebrews had definite ideas on subjects such as interest, agriculture, property, taxation, etc. (Jhingan et al, *ibid*). The Hebrews had distinct economic ideas on interest rate, price, labour and wages, agriculture, seventh and Jubilee year, money, Sabbath, property, trade and taxes.

Self Assessment Exercise 4.1

What were the Hebrews' economic ideas?

3.3 Greek Economic Thought

About 5,000 years ago, the Mediterranean region became the cradle of a number of civilizations (Backhaus, 2012). Egypt, Mesopotamia, Syria, and Persia figure in the history books as creative incubators of our cultural heritage. Their palace and temple complexes were of an unparalleled grandeur and arouse our awe even today. Their civilizations had relatively developed economies, with surplus production efficiently mobilized and redistributed for the administrative and religious establishment. Their scribal schools produced a great number of manuals with detailed instructions for the running of the complex system. But, in their compact worldview, there was no space for an autonomous body of political thought and still less for one of economic thought (Baeck, 1997).

Classical Greece made a quantum leap in the humanization of arts and philosophy. Its rationalism came as a challenge to the mythical worldview and to the religious legends and liturgies. The Greek rhetoricians and scholars were also the first to write extensively on problems of practical philosophy like ethics, politics, and economics. This is proved by the works entitled "On wealth (peri ploutou)" and "On household economics (peri oikonomias)." In the post-Socratic demarcation of disciplines, ethics was the study of personal and interindividual behaviour; politics was the discourse on the ordering of the public sphere; and the term *oikonomia* referred to the material organization of the household and of the estate, and to supplementary discourses on the financial affairs of the city-state (polis-state) administration. Greek economic thought formed an integral but subordinated part of the two major disciplines, ethics and politics. The discourse of the organization of the Oikos and the economic ordering of the polis was not conceived to be an independent analytical sphere of thought.

Jhingan et al (2003:7) argued that, "the Greeks were the first to develop an economic theory, but it appeared in the form of incidental observations, thrown off in the pursuit of a more worthy end." Even though the Greeks were pioneers in many branches of knowledge, they did not contribute much to the growth of economic ideas. This was probably due to lack of demarcation between politics, economics and ethics. Credit however must go to Plato for paying attention to the economic aspects of social organization. You should note that the Greek philosopher who really laid the foundation of economics as a science was Aristotle. Plato was the first of a long line of reformers and his student Aristotle was the first analytical economist. We shall discuss more about Plato and Aristotle in unit 7 under 'Founders of Economic Thought.'

3.4 Roman Economic Thought

The Greek culture which was brought to the Scipionic circle, about the middle of the second century BC , by three Greek visitors – the Stoic Diogenes of Babylon, Critolaus, and the Sceptical philosopher Carneades was a leaven and a stimulus to the germination of Latin thought (Long, 1974). But it may also be said that the triumphant movement of Roman legions and Roman government into the Eastern Mediterranean, after the defeat of the Seleucid King at Magnesia in 190 and that of King Perseus of Macedonia at Pydna in 168, gave Rome a new self-consciousness and a fresh power of self-expression which were the natural and inherent consequences of her political advance (Barker, 1956). In these conditions, a Latin literature flowered; beginning with Plautus, and continued by Ennius and Terence during the first half of the second century BC, it achieved its great glories in the next century with Cicero, Lucretius, and Virgil. Greek had not, of course, disappeared entirely during the Latin centuries. The 40 books of the *Historical Library* of Diodorus Siculus (CA. 60–30 BC), and the voluminous philosophical writings of Philo Iudaeus (in the first half of the first century AD), are testimonies to its survival.
There is an agreement between many authors that there is a small contribution of the Romans to the evolution of economic thought; Roman economic ideas may be gathered from three main sources: (1) the few writers on agriculture (de re rustica); (2) the jurists and writers on legal matters; and (3) the philosophers, especially Cicero and Seneca (Backhaus, *ibid*).

The contribution of Romans to the development of economic thought is very little. Their main field of interest was jurisprudence and their writings were very much influenced by Greek thought. You should note that the Greeks were thinkers, keen and analytic, whereas Romans were men of action, warriors and statesmen. The Greeks left a philosophy which deeply affected the ethics and economics of later thinkers but the Romans built institutions which affected law and politics.

According to Jhingan et al (*ibid*), Romans economic ideas can be gathered from three sources, namely, the jurists, the philosophers and agricultural writers. They further argued that the Roman jurists were the original thinkers and the laws express the best Roman economic thought. The chief writers were Cicero, Seneca and Pliny. These philosophers praised agriculture and condemned usury. The agricultural writers like Cato, Columella, Varro and Palladius dealt with many economic aspects. While praising agriculture, they regarded it as the salvation of Rome.

3.5 Economic Views of Romans

The Romans had the following economic views;

1. **Views on agriculture**
   The Romans were mainly interested in the improvement of agriculture. They were primarily interested in improving the agricultural methods and reforming land ownership and holdings. They produce semi-technical treatises on rural economy, dealing with the production of special goods, such as wine, oil, etc., the raising of different grain crops, and grazing. Then, in the introduction or some concluding book, general principles of private economy were added.

2. **Money and Interest**
   In the past, the barter system was prevalent, but later bimetallism, that is, coins of bronze and silver was adopted. Roman jurists recognized the importance of money as a medium of exchange. They treated money just like a commodity whose value was more or less changeable and essential to its function. The Romans strongly condemned usury and money-lending. But there was no legislation to prevent this. For instance, in the city of Rome the usual rate of interest was 4 to 8 percent.

3. **Division of Labour**
   Cicero laid emphasis on division of labour, as it had several advantages. You should note that writers like Hutcheson and David Hume referred to Roman writers in their discussion of division of labour. They recognized geographical division of labour.

4. **Commercial Regulations**
   The Roman State interfered with economic matters and commercial regulations. Fines were imposed on merchants who had stored up food grains in the expectation of high prices. Goods were inspected by the authorities, and the entire quantity was confiscated if fraud was detected. In addition, the exportation of precious metals was banned.

5. **Labour**
   The Romans condemned slave labour on grounds of inefficiency. They attached more value to hired labourers than to slaves and advocated that hired labourers should be used, in place of slaves to do the work in unhealthy regions and they should be assigned more important jobs on projects employing slave labour.

6. **Value**.
   The Romans regarded utility should be the criterion for determining exchange value. Some commodities have greater value than their price. According to them, price was determined by the forces of demand and supply. However, they did not develop more about value.

8. **Natural Order**

   The Romans jurists were the original thinkers of laws. They made a distinction between human law and natural law, which had much influence on medieval and later thought. Their just **'*jus civile*'** was a national law applicable to Roman citizens, while **'*jus gentium*'**, the body of law common to different nations, gives the idea of natural law, that is to say, the idea of a body of law, which being common to all people is 'natural' to them. You should note that his idea laid the foundation stone for Smith and Physiocrats.

9. **Private Property**

   The Roman idea on property also influenced the development of economic thought. The Romans discarded the communal ownership of property. The jurists defined individual rights on property and he was free to dispose of his property. You should note that Aristotle had limited the right of property; while the Roman law of private property showed unrestricted individualism which later provided the basis for the institution of capitalism.

4.0 CONCLUSION

The study of ancient economic thought not only provides the necessary bridge between ancient and modern but also between occidental (Western world) and oriental (Eastern world) economic thought. In addition, its importance lies not only in providing continuity of ideas but also in an understanding of the interaction of these ideas in their proper relationship

5.0 SUMMARY

You have learnt the importance of studying ancient economic thought. You also studied the Economic thought of Hebrews, Greek economic thought and Romans economic thought.

We shall now go to the next unit that is unit 5, which talks about medieval economic thought.

6.0 TUTOR-MARKED ASSIGNMENT

1. Elaborate on some of the economic ideas of Roman Writers.

1. Give an account of social divisions of the society during the ancient Greek period.

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UNIT 5: MEDIEVAL ECONOMIC THOUGHT

CONTENT

1.0 INTRODUCTION

This unit, which is an extension to the preceding unit, is concerned with medieval economic thought. In the preceding unit, we learnt the importance of studying ancient economic thought. We also studied the Economic thought of Hebrews, Greek economic thought and Romans economic thought.

The above background now gives us a basis on which we can further discuss another aspect of economic thought, that is, the medieval economic thought.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Explain the Middle Ages Period;
- Describe Germanic Contributions to Economic Thought;
- Explain the Influence of Christianity and the Church;
- Discuss Scholasticism and Canon Law;
- Explain Value and Just Price;
- Describe the General Significance of the Middle Ages Period.

2.0 MAIN CONTENT

3.1The Middle Ages

You should note that the term 'Middle Ages' is not well defined. Of course, most writers agree in placing the beginning of this period at the fall of the Roman Empire in 476, but its ending is not so clear. Dr. Ingram l and others would bring it to a close with the year 1300, and it may be agreed that the Middle Ages reached a climax at about that time (Haney, 1910). The Middle-Age period does not close with Nicolas Oresme, but with Gabriel Biel, his disciple, who is sometimes called "the last of the schoolmen." If further proof were needed, it might be observed that Feudalism, a preeminently medieval institution, did not generally begin to lose its power until after 1500, the period during which it really represented the political organization of French society. It was in the early sixteenth century, too, that the English government gave the death blow to craft gilds, a medieval institution.

From the viewpoint of systems of thought rather than systems of industry, the Middle Ages may be divided into two periods. The first period is from 400 down to 1 200, or shortly thereafter. During these years, Christian theology opposed Roman institutions and Germanic customs were superposed, until, through action and reaction, all were blended. This was the reconstruction; it was the "stormy struggle "to found a new ecclesiastical and civil system. From 1200 onto 1500, the world of thought settled to its level. Feudalism and scholasticism, the cornerstones of medievalism, emerged and were dominant. The latter, springing from the fusion of Aristotle's philosophy with Christian theology, was formulated by Thomas Aquinas, who may be said to mark the turning point between the sub-periods.

3.2 Germanic Contributions to Economic Thought.

Relatively little is to be said about the economic ideas of the early Germanic tribes. Their contribution was rather a new point of view, given expression in particular customs. This is not the place to discuss the mark, the three-field system, and all the interesting phenomena of their industrial life. It will suffice to recall the fact that originally the social and economic unit was the village community (Genossenschafi), a virtually self-sufficient group of households, democratic and similar in wealth. The community came before the individual, and within it the idea of brotherhood was strong. It followed that exchange for gain was hardly tolerated within the community, but a common value was placed upon such things as were exchanged and even exchanges with other groups were regulated. There was no money economy.

The ideas and customs of the Germanic tribes sharply differentiate them from the Romans. The latter based their law upon individual rights; the former emphasized the community, though a large degree of democracy gave room for a broad individualism. Accordingly, with the Romans there was a sharp distinction between private and public rights, whereas these rights were mutually determining and faded into one another in the case of the Teutons. More specifically, Roman law made property rights rather absolute and rigid, while by Germanic custom these rights were relative and changing. For example, the Genossenschaften had several different kinds of landed property, perhaps these four: dwelling places, gardens, arable lands, waste lands. In the first two, a large degree of private property was recognized; but the fields, with their changing strips, were subject to the plans of the community, and the waste land, or "commons," as its name implies, was the property of no individual. Thus property rights had a different extent according to the nature of the object involved.

A noteworthy characteristic was the emphasis put by these peoples upon personal rights. Their laws seem to indicate that they were more concerned about such than about property rights. On the other hand, arid almost paradoxically, personal rights depended largely upon landed property, land being the basis of things in their industrial stage.

3.3The Influence of Christianity and the Church

If the Roman factor be taken for granted, Christianity and the Church may be considered next as perhaps the chief factors in determining medieval thought. It is necessary to keep these two ideas separate, for few will deny that Christianity as a religion is quite distinct from the various institutions or churches which profess it. Those principles of Christian doctrine which have any direct economic significance are:

1. The Church, in accordance with the spirit of Christianity, taught the natural equality of men. The ancients, as already seen, believed that men were different by nature: slavery, like castes, Levites, and "guardians," was natural, and corresponded to some inherent baseness. Christianity taught a brotherhood which extended beyond community or nation, embracing all classes and races.

2. Accordingly, slavery was condemned, wholly or in part, the least radical teaching being that the slaves of the laity should be freed when Christianized.

3. And closely connected with the doctrine of equality was the idea of a natural community of property. Originally, and according to the law of nature, men owned all goods in common.

4. One of Christianity's teachings, which were notably at odds with the ideas of antiquity, was that concerning the dignity of labour. This it upheld, though not without some ecclesiastical adulteration, and the ideal became a force working for a greater recognition of those who ate their bread in the sweat of their faces. The various biblical maxims concerning the merit of industry were of no small weight to the men of this credulous time.

5. Charity and almsgiving, too, were among the cardinal virtues. Not only the writings of the Old Testament, but the words and spirit of Christianity, taught the duty of giving aid to the poor.

6. Finally, Christianity was a force for purifying and perpetuating the family and family life.

Thus the Christian religion tended to introduce elements which were deficient in the philosophy of Roman jurisprudence. The personality of man was emphasized. With the increased recognition of human worth came the introduction of moral and humanitarian ideas which added new limitations upon individualism while increasing the rights of many individuals. In fact, one cannot but be impressed with the idea that, on the whole, Christianity and Germanic customs worked hand in hand. Their fidelity, their relative freedom, their greater equality, their emphasis of the personal element, all made the Teutonic folks a ready medium for the leaven of the new religion.

Self Assessment Exercise 5.1

Analyze the Germanic contributions to economic thought.

3.4 Scholasticism and Canon Law

Neither Christianity nor the Church, but part of each, with an admixture of the philosophy of Aristotle, was scholasticism. It was the system of thought which came to dominate ecclesiastics during medieval times; it was the scholarship of the Middle Ages. In it the theological element was dominant, and no advance in knowledge was considered established until the new idea was fitted into its niche in the structure whose foundation was religious. It cannot be called a science, for it did not seek to explain phenomena so much as to apply certain absolute rules of conduct to existing conditions. The last word was said after a citation from the Bible, one from the church fathers, and now and then one from profane history.

It is not improbable that the progress made by medieval scholars in economic thought has often been underestimated, largely, no doubt, because their methods and conclusions were so different from those now dominant. It was Roscher's opinion that the scholastics, and above all Scotus, made more progress than is commonly believed, though only in certain special forms. Most valuable is that part of their work devoted to the sacrament, especially the sacrament of confession. Here were investigated the conditions which must precede the absolution of the penitent sinner and how far he must make good his wrong; and that led, in the case of sins which involved economy, to an inquiry into the nature of economic institutions.

The conclusions reached will be discussed in a moment. The difficulty was that economics was not made a distinct line of thought. The monks knew little outside of Aristotle's writings, and Aristotle wrote no books on political economy.

3.4.1Value and Just Price

Passing over ideas concerning wealth and industry, which were substantially those mentioned above, one reaches the heart of their economic thought in the doctrine of *justum pretium*. This doctrine rested upon their notion of value. Briefly stated, it was that every commodity had some one true value which was objective and absolute, and was to be determined in the last analysis by the common estimation of the cost of production. The words "was to be determined" are used deliberately, for the doctrines of the scholastics are only to be understood when considered as ethical, as laying down what should be, rather than scientific conclusions as to what is.

As formulated by Albertus Magnus (1193-1280) and Thomas Aquinas (1227 or 1225-1274), theory was that value should equal the expenditure of labour and other costs. Thus, according to Aquinas, one might lawfully charge more than one had paid either because he has improved the article in some respect, or because the price of the article has been changed on account of difference of place or time, or on account of the danger to which he exposes himself in transferring the article from place to place, or in causing it to be transferred. This generalization, however, was qualified to the extent that only those costs which were incurred in producing things which satisfied normal or natural wants were determining, and the labour element was weighted according to the social rank of the labourer. This value was not necessarily expressed in price, and was independent of the estimate of buyer or seller.

3.4.2 Value of Money; Usury.

The term ‘usury’ was used to cover what we designate as interest, and, in a broader sense, to include any price in excess of the principal. At first (325 A.D.), usury was forbidden for the clergy only, but before the close of the twelfth century the prohibition was extended to the laity. As late as 1311, it was declared absolutely illegal. The broad simple ground for this action was the belief that to take interest for a loan of money was, like charging more than the just price, unjust. Jhingan et al (2003) noted that lending money for earning more wealth was considered as the worst form of earning money. They added that like the Hebrews the Medieval church of fathers also prohibited the taking of interest. A scholastic brief against usury might be drawn as follows:

1. The holy writ forbids it: The Mosaic law prohibits usury-taking from a brother; Christ said, "Lend, hoping for nothing again." (Luke VI, 35.)
2. Aristotle says money is barren and cannot breed money, therefore, to demand usury for its use is unjust.
3. It follows from the above point that to pay for money is to pay for time; but time is common property and belongs to God.
4. Money is a Res Fungibilis, or "consumptible” according to the civil law. As such it has no use distinct from itself; its use cannot be separated from the ownership of it. Therefore, to lend money is to give up ownership of it, and to ask a payment for the use of that which is sold is unjust.

3.5 General Significance of the Middle Ages Period

The general significance of the Middle Ages as a period in the evolution of economic thought is rather difficult to state by reason of its complexity. In a sense, its negative aspect is large. While the chasm left by the downfall of Rome may have been exaggerated, yet civilization, as it had been, was in ruins. As to its positive characteristics, the Middle Ages constitute, first, a period of adjustment and fusing; secondly, one of transitions. During its centuries, Roman institutions, standing for a narrow individualism and, on the whole, for a materialistic philosophy; Christian religion, teaching the brotherhood of man and idealism; Germanic customs, showing a broad and democratic individualism and leaning toward idealism; Aristotle's philosophy, emphasizing the common good and arguing for some degree of common use of property, with a correspondingly limited individualism, all these were to be combined and fused.
This was more or less consciously the work of the scholastics. Thus, Thomas Aquinas laboured to adapt Aristotle while he assailed Rome; and one Nicholas von Cusa, while deeply versed in the contemporary learning of the Occident, turned his attention to the

East: he sought to reunite the Greek and Latin churches, and studied the holy book of the Mohammedans.

As a transitional period it was during the Middle Ages that, objectively, national economy replaced independent domestic economy; that commerce and manufactures encroached upon the sole rule of agriculture; and that slavery was gradually abandoned for serfdom and free labour. But it is the world of thought which is of interest here. In it one finds a transition from the materialism of later paganism to the modified idealism of Christianity. At the same time the individualism of the Romans was succeeded by the idea, of a society broader even than the city state of the Greeks, though not so broad as the dream world-empire of the Church. We pass from systems of thought which postulate a natural inequality among men, and slavery, to ideals of brotherhood and freedom. The Church, too, became more dissociated, formally at least, first from politics, then from industry, thus making for the separation of morals from economics achieved in modern times. An economy in which land was regarded as the basis began the great transition to one in which personal relations dominated. In one, industry in manufactures and trading was despised; in the other, it was fostered; in the one, money was imperfectly understood and men generally condemned its accumulation; in the other, it was better understood, and probably came to be over appreciated. Between these rather opposite views lay the Middle Ages.

During this great transition it was well that the idea of protection was strong. It appears in the Church and Christianity, in the towns and gilds; custom, regulation, monopoly, are met everywhere. The whole economic philosophy of the Middle Ages might be summed up in the doctrine of just price. In a period of turmoil among such great opposing systems of thought, and classes and races of men, before the rise of nations, it was well that the idea of protection was strong.

4.0CONCLUSION

The Middle Ages period is very significant in the history of economic thought. It may be divided into two periods. During the first period, Christian theology opposed Roman institutions and Germanic customs were superposed, until, through action and reaction, all were blended. This was the reconstruction; it was the "stormy struggle "to found a new ecclesiastical and civil system. During the second period, the world of thought settled to its level. Feudalism and scholasticism, the cornerstones of medievalism, emerged and were dominant. The latter, springing from the fusion of Aristotle's philosophy with Christian theology, was formulated by Thomas Aquinas, who may be said to mark the turning point between the sub-periods.

5.0SUMMARY

In this unit, which is the last in Module 4, you learnt the features of Medieval economic thought with its components of the Middle Ages, Germanic contributions to economic thought, the influence of Christianity and the Church.

You also studied Scholasticism and Canon Law and the General Significance of the Middle Ages Period. We shall now go to the next unit which is Unit 1 of Module 2 which talks about founders of economic thought.

6.0 TUTOR-MARKED ASSIGNMENT

1. Give a summary of the general significance of the Middle Ages Period.

2. State the concept of value of money; usury.

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MODULE 2

Unit 1: The Founders of Economic Thought (Plato, Aristotle, etc.)
Unit 2: Mercantilism
Unit 3: Pre-classical Economists
Unit 4: Physiocrats
Unit 5: Commercial Capitalism and the Classical Schools

UNIT 1: FOUNDERS OF ECONOMIC THOUGHT

CONTENT

1.0 INTRODUCTION

This unit, which is the first in Module 2, describes the contributions of founders of economic thought such as Plato, Aristotle and St. Thomas Aquinas. In the preceding unit, which was the last unit in Module 1, we learnt about features of Medieval economic thought. The above background now gives us a basis on which we can further discuss another aspect of economic thought, that is, the founders of economic thought.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Describe Plato and his contributions to economic thought
- Explain Aristotle and his contributions to economic thought
- Describe Thomas Aquinas and his contributions to economic thought
- Explain Ibn Kaldum's Islamic Economic Thought

4.0MAIN CONTENT

3.1 Plato (427-347)

Plato, a Greek philosopher, was born in Athens in an aristocratic family. He was a student of Socrates. Plato taught mathematics and philosophy in the first great school of philosophers- the Academy, founded by him. His famous writings, *The Republic* and *The Laws* are the most important sources of his economic thought. We give credit to Plato for paying attention to economic aspects of social organizations. Roll (1956) says of Plato that "he attempted to offer a systematic exposition of the principles of society and of the origin of the city state, as well as a plan for the ideal social structure". Plato regarded economics as a branch of ethics and politics (Jhingan et al, 2003). In the following sub-sections, we shall discuss some aspects of Plato's economic thought on origin of State, division of labour, size of production, money, interest, value, agriculture, riches (wealth) and poverty, slavery, communism and education.

3.1.1 Plato's Idea on Origin of State

Plato traced the origin of the State to economic considerations. According to Jhingan et al (2003:17), Plato said "a State arises out of the needs of mankind. No one is self-sufficient. All of us have many wants." The State in order to supply the necessary commodities to satisfy human wants gathered together. The partners and helpers of this gathering are called as the State. In Plato's ideal State there were two classes, the rulers and the ruled. The rulers were the King and warriors and the ruled were artisans and unskilled workers. He advocated that the members of the ruling class must be set apart from early childhood and they should be educated in philosophy and the arts of war because they will have to protect the State against foreign attack. At the age of thirty they will have to pass an examination. This examination selects the future philosopher king and those who cannot pass are concerned with general administrative duties.

Jhingan et al (*ibid*) further added that Plato distinguished five types of government as follows:

1. Aristocracy- rule by the best;
2. Timocracy- rule by the soldiers;
3. Oligarchy- rule by a few;
4. The rule of the wealthy; and
5. Democracy.

3.1.2 Plato's Idea on Division of Labour

Many authors argue that Plato's main contribution to economic thought was in his account of division of labour. By division of labour he simply meant the division of employment as an aid to social organization. He based the origin of the State on division of labour. According to Plato the essential needs of mankind are food, clothing and shelter. Therefore a city State must include a builder, a weaver, a farmer and a shoe maker or a representative of some other similar occupation. Plato contended that every individual should do the work that is suitable for him. As a consequence, all commodities are produced more plentifully, easily and of a better quality. The division of labour into various trades was thus recognized as a necessary condition to economic welfare even though division of each trade into various tasks was not conceived by him. Moreover, he did not consider the necessity of a wider market for the application of the principles. Thus, Plato's idea of division of labour was different is different from that of Adam Smith. This is because Smith's division of labour is determined by the market, but Plato's division of labour determines the market. Secondly, to Adam Smith the advantages of division of labour go to only the employers, but to Plato it is beneficial to the entire society. Thirdly, the cost of division of labour according to Plato is the difference in skill and talent. But according to Adam Smith division of labour leads to differences in skill and talent.

3.1.3 Plato's Idea on Size of Population

The problem of population was also analyzed by Plato. The size of population in his State was assumed on the basis of the best results of division of labour. He provided a careful regulation of population to maintain stability in the economy. The right number of population suggested by Plato for a State was 5,040. Only such a number provided opportunity for everyone to be familiar with all the other persons and help the economy to achieve self-sufficiency. It also helps to reap maximum productive efficiency. If the number showed a decreasing tendency, the State should offer prizes to encourage the growth of population. But if the number exceeds 5,040 new colonies must be established.

3.1.4 Plato's Idea on Money

Plato recognized the value of money as medium of exchange. He did not favour the idea of allowing gold and silver to be used by the common man. Instead, he suggested the use of domestic coins for payment of wages and other transactions. He wanted the State to have a common Hellenic currency for the use of ambassadors, travelers, visitors, etc. Jhingan et al (2003)

On your own, study Plato's ideas on interest, value, agriculture, riches (wealth) and poverty. Also study his idea on slavery, communism and education.

3.2 Aristotle

Many writers are agreed on the fact that Aristotle was the first analytical economist who laid the foundation of the science of economics. He was the student of Plato and tutor to Alexander, the great. You should note that he did not produce any economic treatise. Nevertheless, it was from him the writers of Middle Ages got their main ideas. Though there is no continual analysis, his scattered ideas especially on private property, usury, and the just price had a greater influence on subsequent economic thought. Even though Aristotle was a student of Plato, he differed from him on important issues like the origin of the State, private property, communism, etc. You should note that Plato was a deductive thinker; Aristotle followed the inductive method and therefore a more practical one. While Plato was a radical thinker, Aristotle was conservative one. The reasoning of Aristotle is less imaginative and more logical and scientific than that of Plato. The main ideas of Aristotle were found in his publication titled *Politics* and *Ethics*, which attempted a more systematic definition of economics where he maintained that it was a science of household management. In it, Aristotle exposed how household organize production and consumption, exchange and the evolution of a medium of exchange in a society called money. We will now discuss some of the contributions of Aristotle to economic thought such as:

3.2.1 Aristotle's Idea of the State

Aristotle believed that the State originates out of the needs of mankind. He explained the origin of the State in terms of household. To him the household is an association formed to satisfy the wants of family members. He added that the village grows out of a number of households and finally the State comes into existence. Man is by nature a social animal, so the State is possible because all men live together in a society. The aim of the State is promotion of good life. Thus, Aristotle attributes the origin of the State to economic and political causes.

In Aristotle's ideal State, there would two classes- the ruler and the ruled. The former was classified as military class, statesmen, magistrates and the priest. The ruled were farmers, craftsmen, and labourers. The members of the ruling class would perform their duties according to their respective age. For example, they were soldiers when they were young and strong, statesmen in the middle age and priests in the old age.

3.2.2 Aristotle's Idea on Private Property

While Plato advocated public property, Aristotle supported the institution of private property. Aristotle argued that public property would not be looked after as carefully as private property. To him private property was superior to public property on five grounds- progress, peace, practice, pleasure and philanthropy. Private property is more productive than public property. The principle "what is everybody's business is nobody's business" can be applied here. Hence, Aristotle said that property should be private. When there is private property they will make much progress because everyone will be attending to his own business.

3.2.3 Aristotle's Idea on Scope of Economics

You should note that the word economics is of Greek origin and it means management of household. Aristotle developed the theory of economics while discussing the elements of household management. There were two elements, namely, economics and chrematistics, the former concerned with the art of consumption of wealth in the satisfaction of wants and the later with the art of acquiring wealth either by making money or by exchange. Aristotle speaks two types of exchange-natural and unnatural. Natural form of exchange satisfies the human wants. The un-natural form of exchange aims at momentary gains. Aristotle speaks about two kinds of uses. One is the proper use which is similar to economy proper or value-in-use. The other is similar to science of supply. For example, a shoe can be used for wearing and for exchange. Both are uses of the shoe. The first type of use is economic is economic proper and second one is value-in-exchange or chrematistics. By saying this, Aristotle laid the foundation for value-in-use and value-in-exchange, which were later popularized by Adam Smith. You should note that barter is also a natural branch of chrematistics. Thus, natural chrematistics concern the satisfaction of natural wants by natural uses of a commodity while exchange is an unnatural process of money making because man goes on undertaking this activity even after he has reached the point of satiety.

3.2.4 Aristotle's Idea on Money

Aristotle's theory of money explains "what money is and what money does". Aristotle explained the necessity of money while Plato explained about only one important function of money namely 'medium of exchange,' Aristotle explained the other functions of money, namely, store of value and measure of value.

Aristotle advocated a non-communist society. In such a society there would be barter, then the difficulties of barter would result in the introduction of money. He believed that money came into existence through legislations.

Aristotle's treatment of money is said to be the best part of his economic thought. He said that money came to be introduced to facilitate commercial dealings. In the opinion of Schumpeter, Aristotle's theory should be called the Metalist theory of money in contrast with Cartel theory of money propounded by Plato.

3.2.5 Aristotle's Idea on Interest

According to Aristotle, interest taking was the most unnatural of all the methods of getting wealth, said Schumpeter. Money served only as a medium of exchange, it cannot be regarded as productive. As one piece of money could not produce another, interest was unjust. Money had no business to increase from hand to hand. In those days money was borrowed by the poor persons for consumption purposes and therefore interest taking was considered unjust.

3.2.6 Aristotle's Idea on Slavery

Aristotle's views regarding division of labour, inheritance, population and slavery were more or less similar to that of Plato. Aristotle supported the institution of slavery. He however divided slaves into natural slaves and legal slaves. The natural slaves were inferior to others, both in body and mind. Those conquered in war were treated as legal slaves.

Self Assessment Exercise 1.1

List all Aristotle's ideas

3.3 St. Thomas Aquinas

St. Thomas Aquinas has been called the prince of scholastics. He was the best representative of Medieval economic thought. Aquinas has been called as scholastic philosopher. Born in Italy, he got his early education at the Benedictine monastery and University of Naples. After completion of his academic apprenticeship, he taught Theology at various places in Rome, Paris, London and Naples. He was an extensive writer and wrote as many as 60 books of which the most important was *Summa Theologica*; which presents the systematic summary of economic ideas of that time.

St. Thomas Aquinas it was who with infinite pains and ingenuity strove to weld the teachings of the Bible and of Aristotle into a harmonious body of thought. And, in the uncritical judgment of his contemporaries, he succeeded. One result of his attempt was the celebrated classification of laws into eternal, natural, human, and divine. The first is the controlling plan of the universe as conceived by God; that part of it which can be grasped by man and which enables him to distinguish good and evil is natural law; while human or customary law consists of the enactments of earthly powers. Divine law is that part of the eternal law revealed in the holy writings. Human law should be based upon natural law. It fell into two parts: civil law (Roman) and canon law (church). Canon law, or the Corpus *Juris Canonici*, was coordinated and given a systematic form about the middle of the twelfth century by the monk Gratian of Bologna. It was drawn from a mass of ecclesiastical legislation and decisions, thus containing elements of Christian doctrine, Aristotelian philosophy, and Roman law. It expressed the judgment of orthodox churchmen concerning human relations, and so contained economic ideas.

On the whole, St. Thomas Aquinas made a great impression in economic thought. He codified the ideas and made definite improvement upon them. His ideas about private property, trade, wages, division of labour, usury, etc., were greatly improved from that of his predecessors and his theory of 'just price' was a definite contribution he made to economic thought.

3.4 Ibn Khaldun's Economic Thought

The Arab-Islamic economic thought found its peak in Ibn Khaldun's work. He was both a distinguished jurist trained in traditional Islamic beliefs and a man of action closely involved with the powerful men of that time. Ibn Khaldun's (1132–1406) *Muqaddimah* (3 vols. transl. from Arabic by Franz Rosenthal, 1958) is mainly a book of history (Baloglou, 2012). However, he elaborates a theory of production, a theory of value, a theory of distribution, and a theory of cycles, which constitutes the framework for his history.

The whole presentation of the Muslim economic thought satisfies Spengler's statement – and he was one of the first economists, who did analyze Khaldun's thought that "the knowledge of economic behaviour in some Islamic circles was very great indeed, and one must turn to the writings of those with access to this knowledge and experience if one would know the actual state of Muslim economic knowledge.*"* (*ibid*:70).

According to Ibn Khaldun, two different kinds of social milieu have characterized human development, the "umran al-badouri (nomad civilization)" and the "umran al-hadhari (urban civilization)." The difference between the two is based upon their ma'ah, a synthesizing concept into which is woven both the means of subsistence and the relationships between man and man, and man and nature. The social group is made possible by the productive activities which provide man's subsistence: farming, animal breeding, hunting and fishing, fabricating goods, and exchanging products, all of which are encompassed by *ma'achu* . This conception of ma'ach is central to Ibn Khaldun's philosophy and comprehends the qualitative and quantitative differences between a natural economy oriented toward the accumulation of unnecessary goods, the eager pursuit of profit, and a propensity for luxury.

This dichotomy is reminiscent of Aristotle's distinction between *oikonomia* , the science of the acquisition of wealth oriented toward the good of the community, and *chrematistics*, the science of the unlimited accumulation of profit. But whereas Aristotle's conception is static, Ibn Khaldun's is a dynamic one. Aristotle pictured a family unit in an ideal agrarian society, whereas Ibn Khaldun's view encompassed the totality of human society in its historical development. On the one hand, Ibn Khaldun dealt with the art of managing the production and distribution of wealth, while, on the other, he developed a realistic analysis of the successive phases in the growth of human society. One can therefore understand why he had little regard for the science of tadbir or oikonomia as a branch of practical philosophy, preferring instead his science of society which had a historical dimension. On your own, read about Nicole Oresme's contributions to economic thought.

Self Assessment Exercise 1.2

Explain the meaning of *oikonomia* and *chrematistics.*

4.0 CONCLUSION

Plato's contributions made definite progress in economic thinking of his time. He recognized division of labour. However, Aristotle laid the foundation of the science of economics. He may be rightly called 'the first analytical economist'. He adopted the inductive method to explain the origin and growth of the City State. His idea on private property is valid even today. In the field of exchange also Aristotle laid the foundation for the distinction between value-in-use and value-in-exchange. Moreover, his treatment of money was his best part of economic thought.

On the other hand, St. Thomas Aquinas made a great impression on economic thought. He codified the ideas and made definite improvement upon them. He ideas about private property, trade, wages, division of labour, usury, etc., were greatly improved from that of his predecessors and his theory of "just price' was a definite contribution he made to economic thought.

5.0 SUMMARY

In this unit, you learnt about Plato and his ideas on origin of State, Division of Labour, Size of Population and Money. You have also learnt about Aristotle's ideas on Origin of State, Private Property, Scope of Economics, Money, Interest and slavery. You have in addition learnt about St. Thomas Aquinas' economic thought. You were asked to study Nicole Oresme's contributions to economic thought on your own.

We shall now go to the next unit that is unit 2, which talks about Mercantilism.

6.0 TUTOR-MARKED ASSIGNMENT

1. To Aristotle, private property was superior to public property on five grounds. Discuss
2. Distinguish between Plato's idea of division of labour and Adam Smith's division of Labour.

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UNIT 2: MERCANTILISM

CONTENT

1.0 INTRODUCTION

In the last unit we discussed the founders of economic thought. The discussion took us to the examination of Plato and his ideas on origin of State, Division of Labour, Size of Population and Money. We also learnt about Aristotle's ideas on Origin of State, Private Property, Scope of Economics, Money, Interest and slavery. In addition, we learnt about St. Thomas Aquinas' economic thought.

In this present unit, which is the second in Module 2, we shall examine Mercantilism.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Explain the meaning of Mercantilism

- Analyze the main Economic Assumptions, Ideas and Economic Policy Proposals of Mercantilism
- Make a critique of Mercantilism
- Discuss Neo-Mercantilism
- Examine the relevance of Mercantilism to the Underdeveloped Countries

3.0MAIN CONTENT

3.1Meaning of Mercantilism

In a narrow sense mercantilism describes the pattern of economic policy of the European states in the times of absolutism (Blaich, 1988). In a broader sense it means (a) an epoch of economic history, (b) an economic doctrine, and (c) a general pattern of economic policy (Schefold, 1997). It stretches over the seventeenth and eighteenth century, especially in England, but also in France where it was definitely superseded by the physiocratic movement in the middle of the eighteenth century and declined already after the death of Louis XIV in 1715.

Mercantilism was known by different names in different countries. In England it was called as commercial system or mercantile system because it emphasized the importance of commerce. It was also known as “Restrictive system” because its practical policies consisted of numerous restrictions and regulation in commerce. Mercantilism was also known as “Bullionism” because of the importance given to gold and silver. It prevailed not only in England, France, Germany and Italy, but also in countries like Russia, Spain and Scotland (Jhingan et al, 2003).

To describe the epoch of mercantilism as stretching from the late Middle Ages in the fourteenth to the rise of liberalism in the eighteenth century (Heckscher, 1935) seems too broad. In Germany, mercantilism began in 1668 with J.J. Bechers’ *Politischen Discurs*. In England, mercantilism first appeared in Misselden’s critique of the bullionist Malynes (1586–1641) after 1623. Adam Smith’s *Wealth of Nations*, first published in 1776, included an ardent critique of mercantilism and announced the ascendance of the capitalist entrepreneur and the supremacy of production over trade and the suspicion against the paternalistic state in liberalism. Juan Steuart’s *An inquiry into the principles of political economy*, first published in 1767, is the most remarkable and consistent but also the last major theoretical contribution of mercantilist thought.

Mercantilism reflects the problems of the seventeenth and eighteenth centuries: the strong gold imports to Europe, the quantitative increase and geographical enlargement of trade with the colonies, the war of 30 years and the ensuing contractive consequences on population and production, the demands by merchants and traders for more support and/or liberty by the sovereign, the scientific revolution, the birth of a national economy, and the ascendancy of individual self-interest and an autonomous goal-oriented means-ends-rationality as an impact of the Renaissance and the Reformation (Schmidt, 1994). Society at large was seen more and more as a common commercial company. "One of the main factors in this transformation process was the flow of gold from the Americas. The prices in Europe tripled from 1500 to 1650. The social consequences were enormous. On the one hand, there was a gradual impoverishment of those classes, aristocrats and clerical, who lived on incomes which, being fixed by custom, adjusted extremely slowly to the fall in the value of money. On the other hand, there was an unprecedented enrichment of the mercantile class, who lived on 'profits upon alienation… the identification of the interests of one particular social class, the merchant class, with those of the collectivity, was extremely important" (Screpanti and Zamagni 1995:19, 26). The expansion of trade promoted the figure of the merchant-manufacturer. "Already by the end of the sixteenth century the craft model of production, where the craftsman was the owner of his tools and workshop and worked as a small independent businessman, had begun to be replaced, in the export sector, by a system of working at home, the 'putting-out' system" (*ibid*).

3.2 Main Economic Assumptions, Ideas, and Economic Policy Proposals of Mercantilism

Mercantilism views the economy from the perspective of an active state and it's sovereign *and* forms the viewpoint of merchant capitalists. The essential assumption of mercantilism is an economy with unemployed resources. An increase of demand leads to the use of idle productive capital, land, or workers and increases GDP with no necessary effect on the price level. An increase of the money supply or its velocity – at that time in the form of precious metals – can induce growth with no inflationary side effects. Often, growth was not seen as conducive for higher consumption levels and general welfare per head (A. Smith's argument), but higher levels of employment and output were often seen as functional to make the country independent of the import of manufactured goods and strengthen the (military) power of the sovereign. But power and plenty were usually regarded as distinct aims, each valuable for its own sake (Viner, 1996). The opposite, a decrease in the velocity of money and the piling up of metals as a treasure (hoarding, which was a real and important phenomenon at the time) and the contractive consequences were also taken into consideration. Money should therefore always be in circulation even if it is spent for luxury goods by the rich. But these goods should consequently not be imported. Besides money and employment, some mercantilists put great emphasis on the theorem of an active balance of trade. In the literature (even by Adam Smith, as we will see) the view of the mercantilists is sometimes confused with the approach of the bullionists or monetarists, a group of economists in the fifteenth and sixteenth century who held the view that the sum of precious metals (coins and bullion) in the country is the indicator of economic well-being and wealth. Every economic transaction which was accompanied by an outflow of money was thus considered detrimental. (Consequently applied by all nations, this necessarily leads to autarky.) The ideal is a passively held large hoarded treasure.

Most of the mercantilists recognized the effect of an export surplus on employment through its effect on price. Inflow of gold through a favourable balance of trade causes the supply of money in circulation to increase, which enhances trade and promotes employment. Mercantilists stressed more on the trade-stimulating effect rather than the price-inflationary effect of increase in money supply.

Barring a few mercantilists, who held that rate of interest is determined by natural forces, the general belief was that low rate of interest was monetary phenomenon, a price for the use of money. They also believed that low rate of interest was conducive to production and employment. Thus, the supply of money in circulation must be increased to lower the interest rate.
In addition, majority of mercantilists favoured a low wage policy as it reduced costs and prices and encouraged its demand in the foreign markets. Hence, it has a favourable effect on production and employment in the domestic market. They believed that full employment can be achieved through increase in labour force and its productivity (Jhingan et al 2003).

Self Assessment Exercise 2.1

Are the main economic assumptions, ideas, and economic policy proposals of mercantilism still relevant to modern Nigeria?

3.3 Critique of Mercantilism

According to Jhingan et al (2003), the criticisms leveled against mercantilists and their policies are;

1. They gave too much importance to gold and silver and neglected the importance of other commodities;
2. They exaggerated the importance of commerce and undermined the usefulness of agriculture and other branches of human history;
3. They were wrong in believing that a favourable balance of trade was the only source of prosperity;
4. Their belief that the gain of one nation was necessarily the loss of another was wrong;

5. Their ideas regarding ‘utility’ and ‘value’ were vague and abstract;
6. Their ideas about capital and interest were imperfect; and
7. They lacked broad-mindedness.

As an economic policy, Mercantilism lacked universal application. As a body of doctrines, it could not provide right guidance to statesmen of the time. They confused the means and the ends by overemphasizing the importance of bullion. Further, in their zeal to increase the total productivity of the nation, they regarded wealth and labour as the ultimate goal of human existence.

3.4 Neo-Mercantilism

Neo-Mercantilism was a sharp reaction against the doctrine of laissez faire. It was not a movement for return to mercantilism. While Mercantilism emphasized on the development of trade under State control, neo-mercantilist policy envisaged a State activity of another kind-assistance, support, defence rather than regulation and control.

You should note that Neo-Mercantilism was different from 17th century Mercantilism in two important aspects. Firstly, these policies were dictated by the ideal of social planning. They were looked upon as temporary devices to achieve the ideal of social welfare and are to be continued as long as they are essential for planning. You should remember that the old Mercantilists had no such idea of planning in view. Secondly, modern mercantilist devices are enforced by reference to accurately kept statistics of trade, industry and prices. Though many mercantilists like Petty were conscious of the importance of statistics, most of the mercantilist States did not possess the elaborate organization, required for the collection of economic statistics, nor had the technique of statistical interpretation and analysis developed enough to enable any sensible statistical control of economic policy. Though 17th century mercantilism required a lot of government regulation of economic activity, modern objectives of economic and social control were still remote to it.

3.5 Relevance of Mercantilism to Under-Developed Countries

Economic ideas of the mercantilists have relevance to the under-developed countries of today. The countries in which mercantilism flourished resemble present day under-developed countries in some respects and different from them in others. The Mercantilists. According to Heckscher (1935) had, “a belief in official intervention as a corrective to evil”. Even today in under-developed countries, the State is assigned a key role in the process of economic growth. Economic development of England, France and Germany was made possible by the activities of millions of private entrepreneurs under the policy of non-intervention by those governments. But in the shortage of private entrepreneurial skill, the State has to play a dominant role in the developing countries. Not only that, it has to regulate production and distribution with the object of promoting growth with justice.

3.4Contributions by Individual Thinker to Mercantilisms

There were many notable contributors to Mercantilism. Among them were Antonio Serra, Jean Bodin, Thomas Mun, Sir Josiah Child, Sir John Law, Philip Von Hornick, Johannes Heinrich Gottlob von Justi and Joachim Georg Daries. We shall discuss some of these thinkers as follows;

3.4.1 Antonio Serra

Antonio Serra was an Italian and probably the first mercantilist writer giving a systematic version of mercantilist doctrine (Bhatia, 1978). The question of scarcity of money had been discussed by Marc Antonio de Santis in which he had maintained that the country's rate of exchange was too high and that this was keeping the money out. Marc on this basis advocated a regulation of the exchange to keep it down. Serra wrote to refute this contention and also brought in the wider question of national wealth. Serra, while discussing the causes which can bring about abundance of gold and silver, maintained that these precious metals were very important and helpful for both trade and the people.

3.4.2 Jean Bodin

Jean Bodin (1530-1596) was a French Lawyer. An important contribution of his was in the field of understanding inflationary rise in prices which he made in his publication titled *Response*. Bodin was not the first to point out the inflationary effect of newly discovered American mines, but he provided a very penetrating and valuable discussion of the issue and the theoretical points involved therein.

3.4.3 Thomas Mun

Thomas Mun (1571-1641) was a prominent British mercantilist writer and is known for his defence of those ideas and policies which favoured the East India Company since he was he was a member of it. Mun belongs to the Mercantilist proper in which the emphasis was on surplus balance of trade and not the restriction on exportation of specie. He was obviously defending the interests of the East India Company.

3.5.4 Sir Josiah Child

Sir Josiah Child (1630-1699) also favoured a surplus balance of trade and supported an export of specie if it could result in a greater eventual inflow of it. He believed that international trade could not be unidirectional and some imports were bound to be there. Like Mun he also insisted that a nation should direct its attention to the general rather than particular trade balance. Sir Child's main contributions, however, was in terms of the relationships between rate of interest and flourishing trade and commerce. He believed that a low rate of interest encouraged expansion of trade and therefore strongly advocated for it.

Self Assessment Exercise 2.2

There were many notable contributors to Mercantilism. List them.

3.4.4 Sir John Law

Sir John Law (1671-1729) in his publication titled, *Money and Trade Considered; with a proposal for supplying the Nation with Money* (1705) supported the view that an abundance of money was helpful to the development of trade and commerce. He submitted a plan for a note-issuing bank which was similar to a plan by William Paterson (1658-1719). Law's plan was tried in France but after some initial help to the economy it failed on account of there being no limit to the issuing of notes. In England, on the other hand, the scheme of note-issuing bank resulted in the establishment of Bank of England with limited security-backed issue and it was a success.

4.0CONCLUSION

Some economic, political, religious and cultural factors were responsible for the emergence of mercantilism. Mercantilism prevailed in Europe from the 16th and 18th century. Mercantilist theories and practices have been criticized by many writers. It declined due to many reasons. However, some economic ideas of mercantilism have relevance to the under-developed countries of today like Nigeria.

5.0SUMMARY

You have learnt the meaning of Mercantilism and its main economic assumptions, ideas and economic policy proposals. You also examined the critique of Mercantilism and Neo-Mercantilism and the relevance of Mercantilism to the Underdeveloped Countries.

This unit 6 concluded our module 1. We now proceed to the next unit, that is, Unit 3, which examines the contribution of the pre-classical thinkers to economic thought.

6.0 TUTOR-MARKED ASSIGNMENT

1. Mercantilism reflects the problems of the seventeenth and eighteenth centuries. Discuss.

2. State briefly the criticisms leveled against mercantilist ideas.

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UNIT 3: PRE-CLASSICAL ECONOMISTS

CONTENT

1.0 INTRODUCTION

In the preceding unit, which is Unit 2, we discussed about Mercantilism and the contributions of Mercantilists to economic thought. Our discussion was focused on the meaning of Mercantilism and its main economic assumptions, ideas and economic policy proposals. We also examined the critique of Mercantilism and Neo-Mercantilism and the relevance of Mercantilism to the Underdeveloped Countries.

In the present unit, we are going to study the contributions of the pre-classical economists to economic thought.

2.0OBJECTIVES

At the end of this unit, you should be able to:

- Explain the quality and nature of the contributions of pre-classical economists
- Talk about Sir William Petty's contributions to history of economic thought
- Discuss John Lockie's contributions to
- history of economic thought
- Discuss John Law's contributions to history of economic thought
- Enlighten Richard Cantillon's contributions to history of economic thought
- Discuss David Hume's contributions to history of economic thought
- Explain Sir James Denham Steuart's contributions to history of economic though

3.0 MAIN CONTENT

3.1The Quality and Nature of the Contributions of Pre-Classical Economists

As has been emphasized in unit 2 of module 1, which focused on the origin of societies, there is an intimate and close association between the development of economic thought and economic life of mankind. You should remember that mercantilism was responding to the class interests of rising merchant capitalists who wanted State protection for their benefit and whose prosperity, in turn, was helpful to the State in acquiring an ever-increasing public revenue. However, as internal and external trade developed, it was found necessary to have a corresponding development of industry also to sustain the same. This fact was realized right from the beginning and with the passage of time both the fact and need for industrial development grew. This, however, lead to a basic change in the nature of capitalism as well. It gradually shifted from commercial capitalism to industrial capitalism and found its dependence upon the State protection decreasing. While earlier, it was theorized that the State was to collect tax revenue corresponding to the paying capacity of the subjects, now the theoretical reasoning was that the best State that which governed the least.

You should note that England was leading in most of these economic changes and as a result we find that the writings reflecting a transition from mercantilism to free-trade and laissez-faire are mostly concentrated in England together with a parallel development in France where the physiocrats put forth a rival approach. Under mercantilism, the policy prescriptions suited the interests of both the State and commercial capitalism. With changing circumstances, there arose a divergence and even a conflict between the two. Profit remained the goal of the new bourgeois interests, but place of State in the total set-up changed. State was now a hindrance rather than a help with all its regulatory devices. Labour was being uprooted from its rural homes and was available in plenty at subsistence wages. State intervention could only raise the wage levels and make production costlier and less competitive. Importation of raw materials and cheap food from abroad was needed to feed the growing industries and keep labour cheap. The power of the gilds and other hindrances in the path of development of domestic economy therefore were to be removed. Foreign trade was viewed in a more realistic way wherein imports played a equally important and emphasis on a surplus on a surplus balance of trade for its own sake was reduced. All told the theoretical content in the totality of thinking increased and the analysis appeared more objective and therefore more scientific in nature than before (Bhatia, 1978).

To conclude, one may say that the mercantilist philosophy was outliving its usefulness- both as a theoretical system and as a set of policy recommendations. This led to reaction and revolt. In France, this revolt took the form of *Physiocracy*; in England, it resulted in many individual contributions which in due course crystallized into the 'classical economics'. This now lead us to consider contributions by some important pre-classical thinkers such as Sir William Petty, John Lockie, John Law, Richard Cantillon, David Hume and Sir James Denham Steuart.

3.2 Sir William Petty's Contribution to History of Economic Thought

Sir William Petty (1623-1687) is often referred to as the founder of political economy (such as by Karl Marx in his *Critique of Political Economy*). Petty had a checkered career and belonged to that group of men who founded the Royal Society. To him goes the credit of founding the science of statistics and empiricism. Petty's analysis is not well connected; but it is quite logical and coherent and covered theory of value and wages and theory of profit (or surplus) which is really a theory of rent, a theory of interest and foreign exchanges. Petty was born in Hampshire on December 16, 1623. His chief economic writings were *Treatise of Taxes and Contributions (*1662), (*A Tract Concerning Money* (1682) and *Discourse on Political Arithmetic (1660)*.

According to Jhingan et al (2003), Petty's most important contributions to economic theory was his theory of natural par which also included his views on rent and value. Petty's theory of natural par has three variations:

1. **Natural Par Between land and Labour**: petty believed that land and labour were the two original factors of production capable of generating value. Petty's next step was to relate value of land and labour by equating a piece of land producing a day's food of an average man to the day's labour of the same man. Thus, the common measure of value, that Petty singled out, was a 'day's food', and it is through this measure that he was able to convert the value of land into the value of labour and thus to make par between the two.

2. **Natural Par Between Rent and Money;** Petty realized that the commonly accepted measure of value was not a 'day's food' but money. The question that strained his mind was to determine the money value of the surplus product, which

Petty called rent. Natural and true rent is the surplus of corn over what is used by the cultivator to meet his cultivation expenses as well as his subsistence needs. Thus, rent is simply the difference between the total production of land and the cost of producing it.

3. **Natural Par Between Rent and Interest;** Petty also attempted to link rent with interest. Natural interest (net of risk premium) will be equal to the rent of so much land as the money lent will buy.

You should note that Petty was the first to pen down a systematic treatise on public finance. In fact, his all other economic ideas are inter-connected with the ideas of public finance. Petty single out six heads of public expenditure: defending the country, maintaining the rulers, ensuring justice, supporting educational institutions, helping the orphanages, and their dependants, and maintaining the public works like roads, streams, bridges, etc.

On the revenue side, Petty regarded the tax on rent as the most suitable source of public revenue. In a new country, such a tax is the best one. In this case, land tax will be immediately capitalized because the new buyers of land will certainly take the tax into their consideration. As a result of this, land price will fall. In old countries, the land tax will affect different classes of people differently. In case of short period lease, land tax will compel the landlords to step up the rent and the tenants to raise the price of corn. Thus, the ultimate burden of tax will fall on the consumers. In case of a long term lease, the landlord will not be able to pass the land tax on the tenants. On the other hand the tenants will sell the corn at the same higher price at which the short term tenants are selling. The net effect will be that the long term tenants will be better off after the imposition of land tax. The consumers are always the losers. Whether the lease is for short period or long period, the burden of land tax will fall ultimately on the consumers through higher prices.

Sir Petty was of the view that taxes should be proportional and equitable. He justified such a tax on the ground that it will not affect the relative economic position of different taxpayers and all of them will suffer the burden of tax proportionally. The revenue collected through taxes must be spent in such a way that it promotes industry and trade of the country.

Petty's other theoretical achievements were in the field of wages, money and income. Petty referred to a normative subsistence theory of wages which stated that wages should not be more than subsistence. If they are more than subsistence, the workers will prefer leisure to work. Thus Petty hinted at the backward sloping supply curve of labour. In the field of money, he regarded velocity of money as a function of people's pay periods.

Petty also realized the importance of national income in economic analysis. By making it clear that the national income is always equal to the national expenditure, he anticipated Keynes theory of income-expenditure equality symbolized in his famous equation:

Y=C + I.

A review of Petty's *Treatise of Taxes and Contributions* reveals a number of analytical flaws; but in spite of these flaws, the work continues to be great because of its scientific character. Orderliness of the outer structure and consistency of the internal analysis are two qualities which give the Treatise its status as a scientific work and rank Petty among the originators of scientific economics (Jhingan et al, 2003).

3.3 John Lockie's Contribution to History of Economic Thought

John Lockie (1632-1704) had a checkered career and was both a philosopher and an economist. His publication titled *An Essay Concerning Human Understanding* (1690) provided a psychological basis of pain and pleasure, and therefore of utility and disutility for the subsequent economic reasoning. You should remember that desire is the base of all economic activities. Lockie provided a penetrating analysis of a relationship between the satisfaction of wants and human happiness and the relationship between present and future wants. He pointed out that man always had the tendency to overemphasize the urgency of present wants over the future ones- a premise which later on was used by Bohm-Bawerk in the development of the theory of saving and interest. The idea that everyone take action to satisfy his own wants rather than for the good of the society, was adopted by Adam Smith. It was an obvious next step for Adam Smith to recommend that consumers should be free to demand what they choose and that the producers should be free to produce what was being demanded. Lockie, however, had asserted that man may not always be choosing wisely; a fact which Adam Smith ignored and therefore did not consider in the possibility of an undesirable pattern of demand and production (Bhatia, 1978).

You should note that Lockie also considered the question of value of goods which he discussed in his publication titled *Some Considerationsof the Consequencesof Lowering the Interest and Raising the Value of Money* (1692). He enumerated that demand for a commodity depends upon a number of factors including its utility, taste of the buyers, fashion, convenience of the buyers, etc. he also brought5 in the idea of market demand which was but the sum total of individual demands as expressed through their apportioning of money expenditure for that particular good. In his *Treatises* Lockie maintained that value depended on the labour cost of production. He anticipated Ricardo and Marx in stating that capital was nothing but past labour crystallized in machinery and equipment.

In addition to value, Lockie also discussed the theory of money. He developed his argument in terms of relative proportions of money and other goods, brought in the idea of the velocity of circulation of money and thus provides a basis for the quantity theory of money. He said that the change in the market value of any commodity, in relation to another commodity, is not indicative of a change in its intrinsic value, but only a change in proportion of the two commodities and the same principle applies to the proportion between money and other commodities also. In that light, "Money, whilst the same quantity of it is passing up and down the kingdom in trade, is really a standing measure of the falling and rising value of other things, in reference to one another…But if you increase, or lessen, the quantity of money, current in traffic, in any place, then the alteration of value is in money…But the value or price of all commodities, amongst which money passing in trade is truly one, consisting in proportion, you alter this, as you do all other proportions, whether you increase one or lessen the other" (Whitttaker,1960:68). Further, while bringing in the velocity, of circulation money, Lockie was able to give the statement of the quantity theory of money almost as clearly as Irving Fisher did two centuries later (Bhatia, 1978).

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3.4 John Law's Contribution to History of Economic Thought

John Law (1671-1729) is better known as a man of practical affairs. But he made an important contribution to the theory of money and made a distinction between the use value and market value of a commodity. In his publication titled *Money and Trade Considered; with a Proposal for Supplying the Nation with Money (*1705, 2nd ed., 1720), he points out that use value (which the modern terminology is 'utility' of a good) is necessary for a good to command a market value, but it does not determine the market value. The latter depends upon the relative supply and demand position. He gave the well-known examples of water and diamonds to prove his point. Water has a high use value, but on account of its abundant supply, it has a very low market value; diamonds, on the other hand, have very low use value, but command a high market value on account of their scarcity. The same idea, as extended to money, implies that money also has no imaginary value. The value of money depends upon the uses to which it is put and the service which money renders to the society similar to the service which any other commodity provides.

You should note that John law is remembered, more than anything else, for his suggestions for the issue of paper money so much prevalent in the modern times. However, as a typical mercantilist he desired that the State should have a stock of treasure and he wanted that the paper notes would only take the place of metallic money in transactions of the public and that bullion would then accumulate in the State's treasury. The issue of paper money resulted in severe inflation which caused much ruin.

Ultimately, the only property that remained was land which came to be regarded most important as envisaged in the development of French Physiocratic thought.

Furthermore, he is generally regarded as the founder of a subjective theory of value, with special reference to the value of money. He rejected definitely the idea that money had an imaginary value. According to him, nothing has any value except for the use to which one puts it. The same was true of the money commodity even in relation to its monetary uses. The service which it rendered as money was no different from its other services or from the services of any other commodity. These views clearly make John Law a forerunner of Australian School.

3.5 Richard Cantillon's Contribution to History of Economic Thought

According to Imoisi et al (2013), in the analysis of the problems so identified by Richard Cantillon, he puts forward a theory of value and price in which he emphasized the influence of labour and land on supply and demand. In trying to explain value, there is a distinction between intrinsic value and market value of a thing. Intrinsic value was determined by 'the amounts of labour and land that go into production' of the good in question, i.e., 'the cost of production, including wages and cost of materials'. He pointed out that these values –the intrinsic value and the market value–were not always equal. Often there were divergences between them due to the relative strength of the forces of demand and supply. Where supply was greater than demand, prices would fall, and where demand was greater than supply prices would rise.

Cantillon introduced the term 'entrepreneur' into economic analysis. He argued that production involved risk-taking, and that profit was the reward for the organizer of production (the entrepreneur) for taking the risk. He used the fact of profit to justify interest charges for money lent to businessmen. Interest, he maintained, was a reward for risk taken in lending since the businessman would make profit by investing the borrowed funds. Cantillon's emphasis on the role of the entrepreneur, the risk-taker, in the production process led to the inclusion of entrepreneurship in the list of factors of production. Another outstanding contribution of Cantillon was in the area of external trade. He examined the mercantilist view on eternal trade and agreed that surplus of exports over imports was good for the country. But he pointed out that a country could not maintain a surplus in its external trade indefinitely.

Bhatia (1981:44) summarizes Cantillon's analysis as: 'if a country has an export surplus, and gold flows in, the country supply will increase in the export surplus country. This will push up prices, and thus a consequent reduction in exports will restore the trade balance.' Cantillon also analyzed the effect of changes in money supply on the economy. He showed that an increase in money supply within a country would increase purchasing power throughout the system, and that this would have the effect of stimulating economic activities. He extended this argument to an explanation of the circulation of money and commodities in the economy. Most modern students of Cantillon's work have argued that he did not in fact subscribe to the quantity theory of money. That is to say, Cantillon was not prepared to accept crude monetarist view that, if the money supply increased, prices would rise proportionally (Murphy 2009:85 quoted in Imoisi et al, 2013:9). It is indeed true that the Cantillon of the Essai, as we for our purposes will have to call him, makes conscious efforts to distance his views from earlier formulations of the quantity theory, specifically those found in John Locke. He does this by examining in detail the channels through which additional quantities of money enter the circular flow. From this much-admired analysis he concluded: "that by doubling the quantity of money in a state, the prices of products and merchandise is not always doubled". A River which runs and winds about in its bed will not flow with double the speed when the amount of its water is doubled (translation Higgs 1931:177, quoted in Imoisi et al 2013:9). One might debate whether this conclusion implies merely a qualification of the quantity theory or a fundamental rejection, but it clearly does not endorse a simple view of a proportional relation between money supply and the price level.

Self Assessment Exercise 3.1

List and explain Richard Cantillon's contribution to history of economic thought.

3.6 David Hume's Contribution to History of Economic Thought

Sir David Hume, though primarily a Philosopher, is also known as an economist. He exerted a great influence upon Adam Smith and his followers. His special fields of interest were philosophy and literature. He has great analytical power and great ability to harmonize divergent views. He was endowed with great powers of clarity of expression. His ideas about economic problems were quite in advance of his times and he can be classified a liberal mercantilist. His chief work was *Political Discourses*- a collection of economic essays of which, *Of Money, Of Interest, Of Commerce* and *Of Balance of Trade* are the most important. He has over-emphasized the importance of money for stimulating trade. But on the whole he has followed the view held by Lockie that money was only a symbol and that the amount of money possessed by a nation was of no significance. In the field of quantity theory of money he discarded the balance of trade argument and held that the movements species would affect prices and hence the merchandise trade. He said the balance of trade of a country could not be permanently favourable or adverse and in the long-run the balance of trade depends on the relative economic conditions of the countries concerned. He was thus an advocate of free trade. The contributions of Hume to economic thought relates to the fields of money, price and interest.

3.7 Sir James Denham Steuart's Contribution to History of Economic Thought

Sir James Denham Steuart (1712-1780) was the chief English Mercantilist Writer of the eighteen century. Indeed, he has been called the last of the Mercantilsts. Following the Steuarts into exile in 1745, he lived in France, Germany, Holland and Italy. His book *An Inquiry into the Principles of Political Economy: Being an Essay on the Science of Domestic Policy in Free Nations* was largely a collection of his observations made during his exile. In the publication, he considered population, agriculture, trade, industry, money, coin, interest, circulation, banks, exchange, public credit and taxes. This seems to be the first use of the term Political Economy in an English book. His idea of the science has mercantilist earmarks. According to Bhatia (1981:46) Sir James Denham Steuart began with the definition of the term political economy and stated that "Economy, in general, is the art of providing for all the wants of a family… What economy is in a family, political economy is for the State." Such a political economy should be controlled by the State rather than be left free. If for example, demand falls, domestic demand must be encouraged to compensate for that deficiency and to maintain the necessary economic equilibrium of the nation as a whole (*ibid*: 46).

4.0 CONCLUSION

The Mercantilist philosophy was outliving its usefulness- both as a theoretical system and as a set of policy recommendations. This led to a reaction and a revolt. In France this revolt took the form of physiocracy; in England, it resulted in many individual contributions which in due course crystallized into the 'classical economics.' This development led us to consider contributions by some important pre-classical thinkers.

5.0 SUMMARY

In this Unit 3, you learnt the quality and nature of the contributions of pre-classical economists. You also learnt the contributions by some important pre-classical thinkers to economic thought. These were Sir William Petty, John Lockie, John Law, Richard Cantillon, David Hume and Sir James Denham Steuart.

In the next unit which is Unit 4, we shall discuss physiocracy and the contributions of physiocrats to the history of economic thought.

3.0 TUTOR-MARKED ASSIGNMENT

1. What are the most interesting contributions of Richard Cantillon to the History of Economic thought?

2. State the economic ideas of William Petty.

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UNIT 4: PHYSIOCRACY

CONTENT

1.0 INTRODUCTION

This Unit 3 describes the Physiocrats. In the preceding unit, which was the third unit in Module 2, we learnt about pre-classical thinkers and their contributions to economic thought. The above background now gives us a basis on which we can further discuss another aspect of economic thought, that is, Physiocrats.

2.0 OJECTIVES

At the end of this unit, you should be able to:

- Analyze the Origin and meaning of Physiocracy
- Discuss individual Physiocrats
- Explain the distinguishing features of the Physiocrats
- Discuss the physiocratic concepts of natural order, net product, wealth, etc.

2.0 MAIN CONTENT

3.1 Origin and Meaning of Physiocracy

Physiocracy is a collective name of those economic principles and policies which developed in France in the middle of the 18^{th} century (Jhingan, M. L. et al. 2003). The authors added that physiocracy is also known as the 'Agricultural System'. Economic thinkers who contributed to the growth and development of physiocracy have been called as Physiocrats. The Physiocrats have been regarded as the founders of economic science because they were the first to grasp the general principles underlying the economic phenomena and to evolve a theoretical system. Physiocracy is also remarked as the first school of economic thought. The term physiocracy means "Rule of Nature" (*ibid*). The Physiocratic school operated from 1756 to 1776.

The physiocrats, a group of economists whose period of greatest activity was between 1756 and 1774, the year of the death of François Quesnay, master of the group, had a short life as a school. The birth of the school can be traced to the meeting of the two founders, François Quesnay and the Marquis de Mirabeau, in July 1757. But 2 years before, in 1755, an event of the greatest importance had taken place: the publishing, some 25 years after its writing, of the masterwork of Richard Cantillon *Essai sur la nature du commerce en général* . Cantillon's work has been defined as the first complete treatise on political economy, but it also contributed to the birth of physiocracy, the first school. So our history must begin with this contribution.

Physiocracy may be defined as a reaction against Mercantilism and its concepts. The Physiocrats believed that the mercantile policies instead of doing any good have done great harm to the nations. So, they revolted against the mercantile policies. According to Gide and Rist (1948:23), "Physiocrats must be credited with a foundation of the earliest school of economists in the fullest sense of the term. The entrance of this small group of men into the arena of history is a most touching one".

You should note that the influential French School of thinkers of the early 18^{th} century was led by Quesney and Turgot. They believed in the existence of natural law which governs the universe. Their emphasis on agriculture has earned for their system of thought, the name agricultural school.

3.2 Individual Physiocrats

You should note that important Physiocrats were quite limited in number. Many writers are agreed on the fact that **Dr. Francois Quesnay (1694-1744)** is considered the leader of the Physiocrats. He came from a peasant family, studied medicine and rose to be appointed as the court physician to Madame de Pompadour and later to King Louis XV of France. He also wrote a number of books on medicine. However, he remained more interested in agriculture and was in contact with famous men of his days. As a philosopher, he was able to conceive the picture of a united society. His first economic articles namely *Less Gains and Less Fermiers* were written for *Grande Encyclopedie* in 1756 and 1757. This was followed by his most famous creation, namely, the *Tableau Economique* in 1758 while in 1760 he wrote his *Maximes generals du Gouvernement economique d'um Royaume ogricole* (Bhatia, 1978).

Another prominent Physiocrat was **Pierre Samuel Dupont de Nemours (1739-1817)** who earned a reputation at a very young age and was the only one among his colleagues who survived the French Revolution and migrated to the United States in 1799. When he was 29, he wrote in 1768 his famous *Physiocratie, ou Constitution essentialle du Gourvernment le plus avantageux au Genre humoin* from which the term physiocracy is derived. Dupont wrote about commerce and economics but was not able to make much of an original contribution. However, he was able to serve as a good propagandist for the physiocratic philosophy and principles (*ibid*).

One more renowned Physiocrat was **Marquis de Mirabeau**, father of the famous Honore, Comte de Mirabeau. The Marquis is known for his publication titled *L'Ami des homes, ou traite la population (*The Friend of Man, or a Treatise on Population) in 1756. This work, however, ignored the fundamental physiocratic doctrine, but his *La Theorie de I'impot* (The Theory of the Tax) published in 1760 and *La Philosophie rurale (Rural Philosophy)* published in 1763, were in the physiocratic tradition. Actually, *La philosophie rurale* contains the central doctrine of physiocracy.

According to Gide and Rist (1948:24), "the most illustrious member of the physiocratic school, both in respect of his talent and his position" was **Anne Robert Jacques Turgot (1721-1781)**. In 1761 he became the intendent of Limoges which was a very poor district of France. This gave him an opportunity to try his physiocratic ideas. His success there led to his appointment as the Finance Minister where his drastic measures aroused opposition and final dismissal by the King. During his intendentship he wrote letters on the grain trade, a treatise on interest and his most important work, namely *Reflexions sur la formation et la distribution des richesses* in 1766 but published in 1769.

Read about Pierre Francois Mercier de la Riviere (1720-1793), who was one of the well-knowned Physiocrats.

Self-Assessment Exercise 4.1

Who among the Physiocrats is considered their leader?

3.3The Distinguishing Features of The Physiocrats

1.They developed the idea of natural order, by this they had argued that just as the human body could function without any artificial input, so also, the economy be allowed to function without any restrictions (interference) like trade restrictions, heavy tariffs, heavy restrictions on trade, etc. They rather called for very minimal government's participation in economic activities (unlike the Mercantilist who had encouraged such restrictions on trade).
2. They had a strong belief that only agriculture was the most productive sector that produces surplus rather than trade and manufacturing.
3. The Physiocrats had also observed that the real farmer had been dispossessed of land and, therefore, advocated that landowners should be heavily taxed in order to equate such with the surplus the farmers produced. They were also of the opinion that industry, trade and all other professions were sterile since they all depended on what was produced by agricultural sector.
4. In their desire for capital accumulation, they were opposed to the consumption of luxury goods.
5. Their view of an economy was more holistic as they attempted to show wealth circulated from one sector to another.
6. With their holistic outlook of the economy, they were able to enhance the study of economics as a science and other changes that occur in economics phenomenon.

3.4The Physiocratic Concepts

The physiocratic philosophy was based upon some concepts such as natural order, net product, circulation of wealth, taxation, trade and laissez fair, value, wages, money and interest and evaluation. These concepts are treated in the following sub-sections.

3.4.1The Physiocratic Concept of Natural Order

The physiocrat philosophy was based upon the concept of natural order coupled with optimism, individualism, self-interest and a blending of the ideal and material aspects of social life. It was this basic belief in optimism that was leading the eighteenth century philosophers to the "discovery" and recommendation of the natural order. The leading thinkers were quite impressed by the advancement in physical and other sciences and they were now of the opinion that the pace of this advancement would be maintained and that this would equip the human race to solve all its problems. The capacity, further, will be supported by "rational" thinking and activities of the human beings so that people would develop right kind of "moral" and social attitudes and behavior. There was also an inherent faith in the existence of an Almighty benevolent God. The implication was that His creation –the system of nature and the faculties of man-were bound to be in harmony with each order. Therefore, if everyone did what was "naturally" expected of him, there would be heaven on earth. All the needed reforms automatically would be there.

Thus, the overall conception was that of a "natural order" or a system of natural-scientific, ethical, and social-scientific "natural laws", ordained by a wise and benevolent God, the designer "of all nature and human nature, to ensure a harmonious, orderly functioning of both the non-human natural universe and all human societies" (Taylor,1960:3-4).

3.4.2 The Physiocratic Concept of Net Product

You should be aware that the central economic hypothesis which played a fundamental role in physiocratic reasoning and policy was the one based upon the origin of net product (*product net*). Remember that mercantilism had maintained that the source of wealth lay in foreign trade and that it consisted of precious metals. However, the physiocrats differed from the mercantilists on both these counts. To the physiocrats, product was not the creation of utility; it was surplus making. Though it appears that the realization of net product was somehow connected with the market valuation of the produce, to the physiocrats surplus meant primarily a material surplus. To them the origin of all wealth lay in agriculture and this wealth consisted of real produce. *Product net* was conceived as an excess of output over the inputs which showed that industry and trade were sterile or unproductive.

3.4.3The Physiocratic Concept of Circulation of Wealth

The physiocrats were the first to attempt and analyze, in a systematic way, the circulation of wealth in an economy. You should note that the credit of putting the whole idea in a very systematic and coherent form goes to Quesnay. Quesnay has studied the Harvey's theory of blood circulation and extended this biological idea to the field of economics. By attempting an analysis of this phenomenon, a synthesis of production and distribution was attained. This laid the foundations for a number of future fields of study in economics. Quesnay presented this circular flow of wealth in his book titled *Tableau Economique* which was published in 1758. It immediately caused an unprecedented applause and was hailed as the biggest landmark in the development of economics (Bhatia, 1978).

According to Mirabeau quoted in Gide and Rist (1948:32),
"There have been, since the world began, three great inventions which have principally given stability to political societies, independent of many other inventions which have enriched and adorned them. The first is the invention of writing, which alone gives human nature the power of transmitting, without alternation, its laws, its contracts, its annals, and its discoveries. The second is the invention of money, which binds together all the relations between civilized societies. The third is the Occonomical Table, the result of the other two, which completes them both by perfecting their object; the great discovery of our age, but of which prosperity will reap the benefit."

The physiocratic theory of circulation of wealth made a solid contribution to the development of economic thought. You should remember that it was the first ever attempt at a comprehensive description of the whole economy and in which the interdependence of different sectors was clearly demonstrated.

On your own, study the physiocratic theory of circulation of wealth.

3.4.4 The Physiocratic Concept of Taxation

The physiocrats theory of taxation is connected with net product. They believed that only land produced surplus, taxes should be paid from the surplus or net product. The main thrust of the physiocratic theory of taxation was that an *impot unique* (a single tax) should be levied on the net product of land and that all the government expenditure should be met only out of this tax. The physiocratic ideas on taxation follow directly from their basic doctrine of the source of net product and their desire to bring about the natural order. They contended that the establishment of natural order would ensure an all-round harmony of interests, and the concept of net product led them to advocate a single direct tax. In their scheme of circulation of wealth, three classes are covered viz., the farmers, the landowners, and the industrial class. However, the State also has to be maintained for which some revenue is needed. In the physiocratic scheme of things, laissez faire holds a prominent place on account of which the total revenue demands by the government do not become exorbitant. But these demands shave still to be met from somewhere. And so from where is the State to collect its revenue? Physiocrats argued that the farmers and the artisans are left with only the bare subsistence. Any tax imposed upon them must therefore be passed on to the net product. The final incidence of any tax must rest upon the net product since that is the only source from which it can finally come. Farmers and artisans just do not have the wherewithal to pay the tax. Physiocrats were believers in the 'iron law' of wages whereby the agricultural and industrial classes were getting only the minimum necessary for the expenses of production and their own maintenance. Thus, the only available fund which might properly be taxed was the net product.

In summary, physiocrats advocated a single tax system on agriculture. But an objection was raised against the single tax system because the government's revenue will be less. Further, this type of taxation was not justified because it ignored the other sources of wealth to the government.

3.4.5 The Physiocratic Concept of Trade and Laissez Fair

The physiocrats thought that exchange was unproductive. Accordingly, industry and commerce were considered unproductive. So, foreign trade which which had assume so much importance under mercantilism started losing its importance. The physiocrats thought that foreign trade produced no real wealth. In physiocratic reasoning, creation of wealth was not the creation of utility but that of a material substance. Though the realization of net product was somehow connected with the market valuation of agricultural produce (a *bon prix* was needed for realization of this net product) the existence and emergence of it was analyzed in physical terms without reference to the price of agriculture. Based on these criteria, trade and industry were sterile and unproductive in the sense that they did not yield any surplus. This approach was in contrast with the one adopted by the Mercantilists according to whom foreign trade was the source of national wealth which in turn consisted of gold and silver. You should, however, note that the physiocrats did concede the importance of trade. It was essential if the produce was not to get perished in the hands of the farmers and artisans. Traders knew where the goods were required and they performed a useful task in transporting the goods to the right places (Bhatia, 1978). That is to say that the physiocrats were not entirely against foreign trade. They believed that a country should exchange only those goods which it cannot produce and those which are in excess of consumption. As a result the physiocrats advocated free trade.

On your own, read about the Physiocratic concepts of value, wages, money and interest, evaluation.

4.0 CONCLUSION

During the third quarter of the eighteenth century, economic debate in France was dominated by what can be considered the first structured school of thought in economic matters, the physiocrats. The term physiocracy, meaning rule or government of nature, reflects its members' interest in proposing a line of interpretation of the world that was complementary, but different, to the one obtained by the philosophers by means of philosophy. Its sphere was social science as a whole, not economics alone. In political matters, the term "Legal Despotism" was the physiocratic norm, but it admitted a range of interpretations: despotism based on law (that is to say, constitutionalism), or despotism protected by law (or despotism "tout court").

The core of the theoretical model included the following ideas: that agriculture was the only productive sector; the concept of *produit net*, its circulation through the *Tableau Economique* and, accordingly, the defence of a single tax and of free trade. But on the way, the physiocrats proposed a theory of value and advanced important economic concepts such as capital and economic interdependence. At the same time, the economic policy they proposed, the construction of a *Royaume Agricole* , can be seen as an alternative to the policies of the mercantile republics, or to those of the manufacturing nations (such as England) which they saw as nations of trade. Physiocracy is one of the first attempts to build economic science, and as such is one of the ancestors of present day economics. Both the complete theory and some of the tools its advocates used can be interpreted in terms of modern economic theory, and some of the ideas they developed – the economic interdependence of sectors, the idea of a circular flow of income and the concept of capital – remain with us today.

5.0 SUMMARY

In this unit, you learnt the origin and meaning of physiocracy and the individual Physiocrats as well as the distinguishing features of the Physiocrats. You also learnt about the physiocratic concepts of natural order, net product, wealth, etc.

We now proceed to the next unit that is, Unit 5 where we shall study about commercial capitalism and the classical schools.

6.0 TUTOR MARKED ASSIGNMENT

1. Physiocracy is one of the first attempts to build economic science, and as such is one of the ancestors of present day economics. Discuss.
2. Write short notes on:
    a. Views of physiocrats on “Taxation”
    b. Views of physiocrats on “Trade and Laissez Fair”

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UNIT 5: COMMERCIAL CAPITALISM AND THE GENESIS OF CLASSICAL SCHOOLS

CONTENT

1.0INTRODUCTION

In the preceding unit, we discussed physiocracy and the contributions of physiocrats to economic thought.

In the present unit, which is Unit 5 and the last in Module 2, we are going to study commercial capitalism and the classical schools.

2.0OBJECTIVES

At the end of this unit, you should be able to:

- Explain the meaning and distinctive features of classical school of economics thought.
- Analyze the contributions of Adam Smith (1723-1790) to economic thought
- Discuss Smith's Division of Labour
- Explain Smith's concept of Invisible Hand (Laissez Faire)
- Explain Smith's Economic Law of a Free Enterprise Society on Theory of Value, Theory of Market Price, Theory of Wages, Theory of Profit an Interest, Theory of Money, Theory of Economic Growth and Theory of Economic Development.

3.0 MAIN CONTENT

3.1 Meaning and Distinctive Features of Classical School of Economics Thought

After physiocracy, a body of doctrines which existed in England over a century is name as classicism in Economic Thought (Bhatia, 1978). These doctrines were propounded by Adam Smith and his followers during the latter half of the 18th century. Adam Smith has been regarded as the father and leader of British classical school. The school comprised of many famous economists. Among whom the most important were besides Adam Smith, Ricardo, Malthus and J.S. Mill. In fact, Smith, Ricardo, Malthus are considered as the pillars of classicism. These writers helped the development of the science of political economy by formulating new theories and expanding and elaborating old theories.

The classical school is said to have been born with Adam Smith's publication of 1776: *An Inquiry into the Nature and Causes of Wealth of Nations.* In the publication significant contributions were made that shaped economic thinking to the present day. This explains why Smith often referred to as the 'father of economics'.

The word 'classic' has been used in economic literature to convey three meanings. First, it is used to refer the economic writings of the period from Adam Smith to J.S. Mill. Second, J. M. Keynes has used the term to denote the teachings of Alfred Marshall and his followers. Third, Schumpeter used the term 'classic' to mean original work that went before. Here, classical school refers to the economists who wrote between the period 1750 and 1850(*ibid*).

Different reasons are given for choosing the name 'classic' for this school of thought. Because of its wide popularity, it has come to be called as classic. Secondly, the doctrines of this school brought tremendous change in economic thinking and treated the subject of economics in a scientific way. Thirdly this school is classical as it differed from other schools of thought. Finally, the doctrines of this school are followed even today by the modern economists. The following are characteristics features of classical school:

1. The classical economists believed in *laissez faire* and that Government is best which govern least.
2. The Classical advocated a market economy based on perfect completion. They emphasized that production, exchange and distribution are guided by market forces.
3. Classical economists assumed that full employment level would exist in the economy. They thought that the economy was self-adjusting and any deviation from full employment would automatically get adjusted to full employment.
4. They believed in the existence of harmony of interest.
5. The classical economists put emphasis on the importance of all economic activities.
6. They believed in the universality of economic laws
7. The classical were the first economists who paid attention to the problems of economic growth and development.
8. They looked at the economy as a whole. Their approach was macro in nature.
9. Lastly, the classical economists believed in *Say's* law of market.

3.2 Adam Smith (1723-1790)

Originally, Adam Smith was a Chair in Logic and later Chair in Moral Philosophy at the University of Glasgow (1751). He was a friend of David Hume (1711-1776), a representative of the British variant of J.J. Rousseau's enlightenment ideas. Smith's main works were *Theory of Moral Sentiments* (1759) and *The Wealth of Nations* (1776). He gave up his professorship in 1764 and became teacher and companion of the Duke of Buccleuch in France. Later, Smith became a Commissioner of Customs in Scotland. Adam Smith's four basic, interrelated fields of interest were *Division of Labour, Invisible hand (Laissez faire), Free international trade and economic development.*

3.2.1Division of Labour

His famous example of division of labour was about pin production in which he assumed a worker who produces a number of pins in 18 production steps every day. He concluded that 18 workers would produce 18 times as much of the original single worker by means of the same technique. Alternatively, if 18 workers are engaged, each of whom concentrates on a single production step, Smith's claim that the result is more than 18 times the amount of a single worker. According to Jhingan, M. L. et al. (2007:61) the advantages of division of labour as pointed out by Adam Smith are;

1. It increases the productivity of labour through specialization.

2. As work is sub-divided and done quickly, production also increases.
3. Worker's efficiency and skill increase when work is sub-divided into various parts and a worker is asked to do small part of the whole job.
4. There is saving of time and tools.
5. As production increases quickly, it forms an incentive to investors.

Adam Smith also pointed out the disadvantages of division of labour.

1. As worker is confined to one or two operations, there is no personal satisfaction of having made a full product.
2. It leads to immobility of labour because of specialization.
3. As the same work is done repeatedly, the worker gets bored which leads to mental stagnation.

Adam Smith pointed out that division of labour was limited by the extent of the market. He argued that the wider the market for a commodity, the greater the division of labour. So in order to have a high degree of division of labour, large scale production is essential. Division of labour was limited by the availability of capital also.

Adam Smith's invisible hand was that coordination of individual actions is not due to eternal forces but happens as a result of individual actions according to their own interests. According to Smith, "It is not from 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."

Adam Smith laid emphasis on free international trade. It was basically same argument as for division of labour. He argued that countries should concentrate on the production of goods which can be produced cheaper than in other countries (absolute cost advantages). Smith contended that welfare increases due to international trade. The political consequence of Smith's idea on free international trade is basically no tariffs, no non-tariff barriers.

3.2.2 Invisible Hand (Laissez Faire)

Adam Smith had contended that society stood to gain in the long-run as each individual was allowed to pursue his personal interest and so each one should be free to choose what to produce and consume. In his words, "It is not from the benevolence of the Butcher, Brewer and the Baker that we expect our dinner but from regard to their own individual interest". By this statement, Smith implied that the primary concern of Butcher, Brewer and Baker first and foremost is to feed themselves and exchange part of the articles for other goods or money. In extending this argument, he also advocated that as nations engaged in producing goods and services they needed for their consumption, the welfare of other nations could then be fostered through exchange if tariffs and other trade barriers were removed.

Smith, thus, strongly favoured that the operation of the 'invisible hand' rather than the government be allowed to regulate society while the later (government) concentrate on the following;

1. Territorial protection from external attacks while allowing economic activities to freely flourish.
2. Administration of justice within the nation State.
3. Execution and maintenance of public works (roads and bridges, etc.).
4. Creation of conducive environment for business.
5. Government to tax citizens to fund its activities.

3.2.3The Economic Law of a Free Enterprise Society

3.2.3.1Theory of Value

Smith identified that commodities had two types of value, that is, value in use and value in exchange.

1. Value in use: Smith named utility, that is, a commodity's ability to satisfy wants.
2. Value in exchange: He considered this as the ability of a commodity to exchange for another.

According to Jhingan, et al. (2003), 'value in use' refers to the utility of the commodity while 'value in exchange' is the power of purchasing other goods. This, Smith explained with the "diamond-water paradox". Smith stated that commodities like water possessing greatest value-in-use have little value-in-exchange. Even though Smith made a distinction between value-in-use and value-in-exchange, he was concerned only with the true measure of the exchangeable value.

Smith contended further that the amount of labour put into the production of a commodity determines its exchange value. For instance, if one hour labour produced an axe and 3 hours produced hoe, then three axes should be exchanged for one hoe. This idea was later developed into the 'labour Theory of Value' by David Ricardo and later by Karl Marx.

According to Bhatia, H.L. (1978:83), "He (Smith) repeats the usual type of illustration in which it is shown that the use value and exchange value need not go together as is seen in the case of diamonds and water. And he also does not make any serious attempt to establish some definite relation between the two. Actually, to step on the concept of marginal utility and using it as a regulator of demand in relation to the market price was logical from where Smith left treatment of 'value in use'. But the credit of attempting such a thing was to be taken by neo-classical economists. Smith's followers stuck to the *labour theory of value* in one way or the other. Had Smith thought of marginal utility instead of total utility of diamonds and water, the value-riddle would have been solved in an entirely different manner"

3.2.3.2 Theory of Market Price

It was also Smith's contention that market commodities had a natural and actual price. That natural price was the long-run price and is exactly equal to the labour-command value determined by 'natural' rates of its components, namely, wages, rent and profit (Bhatia, 1978). The natural price is the lowest that an entrepreneur will continue to sell at. Whereas actual price was the level at which a commodity is sold. This actual price is also referred to as market price or short-term price. This actual price could fall bellow or above the natural price, depending on the forces of demand and supply, which affected the movement of price around the natural price.

It is noteworthy that even the natural price of a commodity is not fixed forever. The 'general circumstances of the society, their riches or poverty, their advancing, stationary, or declining condition', referred to by Smith (*ibid*: 86) are subject to a change. Accordingly, the natural price would vary along with the natural rate of wages, profit and rent. At the same time, it may be emphasized that the relative natural prices of goods are only *proportional* to the amounts of labour-cost of production. This proposition-*proportionality* of relative values to relative labour-inputs in production – is consistent with the view that the profit additions included with wage-costs in the absolute prices of all goods, which (if they are equal percentage additions) do not alter or affect relative prices or exchange values (Taylor, 1960).

3.2.3.3 Theory of Wages

Here, Smith had advocated some criteria to be used for wage determination in order to avoid conflict between employers and employees. These criteria are:

1. That the most tedious and dangerous jobs should attract higher wages.
2. That the cost of acquiring the necessary skills and knowledge should be adequately taken care of in fixing wages.
3. There should be a rate of return on investment on education and training of labour.
4. The trust and responsibility that goes with an occupation or profession should determine the wage rate.

5. That the degree of risks involved in training for a job should also be taken into consideration in wage determination. E.g. Pilots, Fire-fighters, electricians, etc.

3.2.3.4 Theory of Profit an Interest

Smith considered profit as a cover for eventuality to compensate for risks in business and thus concluded that the rate of profit should be higher than the eventuality, while interest rate was to cover risks in lending which should, however, be low enough to encourage borrowers to borrow. He was of the opinion that profit was the return on capital while interest was a part of profit which was to be paid to the owner for the use of the capital borrowed. In brisk business conditions, competition kept the rate of profit low, because wages were increasing. In slack business conditions, the opposite happened. Wages decreased and profit went up (Jhingan, et al.2003).

3.2.3.5 Theory of Money

Smith saw money as facilitating the circulation of goods but that it never added to the value of the goods or to the total wealth of society because money was still held in form of gold and silver. Smith had advocated the printing of paper money though to be still backed-up by the value of gold. According to him, money developed spontaneously to remove the difficulties of barter system of exchange. Smith stressed the two important functions of money; medium of exchange and store of value. He regarded money as the nominal price of commodities. He rejected the bullionist policies of the mercantilists which aimed at keeping surplus money at home. The demonstrated clearly that the surplus money would be exported to other countries. He suggested that the quantity of money of money in circulation be determined by the level of internal economic activity (Jhingan, et al. 2003).

3.2.3.6 Theory of Economic Growth

Smith's theory of economic growth focused on production function, supply of land and the change in institutions, the growth of labour force, capital accumulation, agents on growth and the growth process.

Since Smith recognized the existence of three factors of production, namely labour, capital and land, his production function may be expressed as $Y=f(K,L,N)$, where, **K**= Capital stock, **L**=Labour force and **N**= Land. The production function is subject to increasing g returns to scale because he did not assume diminishing marginal productivity.

In Smith's theory, two factors, namely supply of land and the change in institutions are comparatively less important. The rent of land therefore considered as the price paid for the use of land, is naturally a monopoly price.

On the growth of labour force, Smith argued that the rate at which the population grows in a country largely determines the growth of labour force. According to him, rate of population growth in the long-run depends on the fund available for human sustenance and that the size of population is determined by the prevailing wage rate. If actual wages exceed the subsistence wage, population will show a tendency to increase and vice-versa. The supply of labour is normally expected to be in equilibrium with the demand for labour.

In Smith's theory, capital accumulation has been assigned a strategic role in the growth process. To him, growth is functionally related to rate of investment; with a fixed capital stock a country is bound to suffer stagnation. According to him, any increase in capital stock in a country generally leads to more than proportionate increase in the output on account of continuously growing division of labour. He believed that the rate of investment as crucial factor in economic growth is determined by the rate of saving.

Smith believed that farmers, producers and businessmen are the agents of progress and economic growth. To him, the process of growth is cumulative. When there is prosperity as a result of progress in agriculture, manufacture of industries and commerce, it leads to capital accumulation technical progress, increase in population, and expansion of markets, division of labour, and rise in profits continuously. But this process is not endless. It is the scarcity of natural resources that finally stops growth.

3.2.3.7Theory of Economic Development

Smith had undertaken to analyze economy as a whole and thus, had proffered ideas on how it could be made to grow and develop in various sectors. Some of the ways he felt these could be achieved were that industrial machines should be improved and division of labour be encouraged and by so doing, more wealth would be created. He also added that capital accumulation should grow faster than population. Smith termed as productive labour where value was created and store in a saleable or exchangeable commodity. On the other hand, he termed unproductive labour where mere offering of services was involved without storing of value into a commodity.

Self Assessment Exercise 5.1

List the main economic theories propounded by Adam Smith.

4.0CONCLUSION

Smith's contributions stand out as the first systematic attempt at analyzing the economy as a whole with laissez faire as a regulator. Such contributions really encouraged the industrial revolution though he never lived long enough to witness the attendant economic problems that went with it. e.g. business circles, depressions, over-production, etc. Nevertheless, Smith's contributions to economic thought such as division of labour and the concept of invisible hand remains relevant up till today.

5.0 SUMMARY

You have learnt the meaning and distinctive features of classical school of economics thought. You have also learnt the contributions of Adam Smith (1723-1790) to economic thought in which the discussion took you to the consideration of Smith's Division of Labour and the concept of Invisible Hand (Laissez Faire). You have equally studied Smith's Economic Law of a Free Enterprise Society on Theory of Value, Theory of Market Price, Theory of Wages, Theory of Profit and Interest, Theory of Money, Theory of Economic Growth and Theory of Economic Development.

You should remember that there was another classical economist of repute called David Ricardo (1772-1823), who is most remembered for the theory of comparative cost, rents and the law of diminishing returns, etc. Others were Robert Malthus (1766-1834), Jeremy Bentham (1748-1832) and John Stuart Mills (1806-1873). You should make an effort to study the contributions of these classical economists to economic thought.

This Unit 5 concludes our Module 2. Next is Unit 1 of Module 3 in which we shall consider the rise of socialist thought and the Marxian School of economic thought.

6.0TUTOR MARKED ASSIGNMENT

1. List and explain the characteristic features of classical school of economic thought.
2. What are the advantages of division of labour as propounded by Adam Smith?

7.0REFERENCES AND FURTHER READING

Bhatia, H.L. (1978). *A History of Economic Thought.* New Delhi: Vikas Publishing House PVT. LTD

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MODULE 3

Unit 1: The Rise of Socialist thought and the Marxian school of Economic Thought
Unit 2: The Marxian Stages of Societal Development
Unit 3: The Marxian Economic Theories
Unit 4: Marx's Theories of Capitalist Crisis and the State
Unit 5: The Marginalist School

UNIT 1: THE RISE OF SOCIALIST THOUGHT AND THE MARXIAN SCHOOL OF ECONOMIC THOUGHT

CONTENT

1.0 INTRODUCTION

In the preceding unit, that is, Unit 5 of Module 2, we learnt the meaning and distinctive features of classical school of economic thought in which we discussed the contributions of Adam Smith (**1723-1790**) to economic thought.

In this present unit which is Unit 1 of our Module 3, we shall discuss the rise of socialist thought and the Marxian school of economic thought.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Trace the origin of socialist thought
- Discuss Karl Heinrich Marx (1818-1883)
- Analyze Marxism or Scientific Socialism
- Explain the main characteristics of Marxism
- Discuss the chief tenets of Marxian thought
- Explain the Marxian Philosophy (Marx's Materialistic Interpretation of History)
- Analyze Marxian method of approach

3.0MAIN CONTENT

3.1The Origin of Socialist Thought

The industrial revolution which formed the bedrock of the capitalist economy also brought along with it severe problems for European societies. The industrial machines displaced a lot of artisans resulting to increased unemployment, over production of certain products, while employees were enslaved to the machines in the factories through long hours of work. This, along with several other social vices like the emergence of shanty towns and slums, where the workers were housed found the background for socialist scholars to start advocating improved welfare for factory workers and also attempt to expose the evil of laissez faire system. Socialist writings could be traced to as far back as the 18th century but the Marxist-Leninist's stand of socialism was the most popular and most dominant. However, a number of areas unified them all. These were:

1. They were unanimous in their rejection of the laissez faire struck harmony of interest doctrine and pointed out its inability to equitably distribute our resources.
2. They advocated strongly collective action and co-operative rather than individual ownership of production, and that this and not competition could best improve societies' welfare.
3. Furthermore, they had a strong belief that given the right environment, human beings could be rational, content and thus pursue the collective interest of society rather than the individualistic approach of Adams Smith in laissez faire system.

You should note that some earlier stands of socialism have been classified as Utopian Socialism, Christian Socialism, and Anarchism. We will, however concentrate on Marxism.

3.2Karl Heinrich Marx (1818-1883)

Karl Marx came from a middle-class Jewish family. He was born in south-eastern Germany near Coblenz. His family changed its religion to Christianity (Protestantism) when Marx was still a young boy. He attended the town school and then the universities of Bonn, Berlin and Jena where he studied law, history and philosophy. Although Marx started with law, he later changed his mind and studied philosophy instead. You should note that during Marx's period, German universities, especially those in Prussia, were dominated by Hegelian philosophy and Marx thought it fit to submit his doctoral thesis to the University of Jena from where he got his degree of doctor philosophy in1841 at the age of 23. After taking doctorate degree, he was influenced by Hegelian philosophy and took up revolutionary journalism. So he was expelled from Germany, Belgium and France. Finally, he came to London where he spent the last 30 years of his life.

In London, Marx spent most of his time in British Museum, the great library. His life was full of poverty and sufferings. His friend and disciple Engels helped him financially. Engels was also a collaborator in the development of Marxian thought. Both of them produced an impressive series of books. They had contacts with radical groups everywhere. His main works were: *Introduction to a Critique of Hegelian Philosophy of Rights* (1843); *The Poverty of Philosophy- A Criticism of Proudhon* (1847); *Discourse upon the Question of Free Exchange* (1848); *A Contribution to the Critique of Political Economy* (1859); and the famous book "*Das Kapital".* The first volume of this book was published in 1867, while the other two volumes were published by Engels in 1885 and 1894 after the death of Marx (Jhingan, et al., 2003).

Marx was influenced by his environment which shaped his ideas. For instance, the economic and political conditions of Germany mainly shaped his ideas. He had seen the economic development of three countries (Germany, France and England) during his lifetime. He drew inspiration from British industrialism and Trade unionism as well as the French Revolution. Marx was also inspired by utilitarianism, socialism and German radicalism. Though he was much impressed with Hegelian philosophical ideas, at one stage he felt that it was too conservative to effect changes in the society. Marx was also influenced by the writings of Ricardo, Quesnay and other writers. Thus, Karl Marx was the product of different influences, viz classicism, materialism, Hegelianism, etc (*ibid*).

3.2.1Marxism or Scientific Socialism

Before Karl Marx, there were different types of socialism advocated by different socialist writers. But they were not able to put forth economic and scientific arguments to substantiate their concept of socialism. It was only with the coming of Marx that socialism entered the main current of economic doctrines. Marxian socialism is called scientific socialism or Marxism.

Marxism is not merely a body of economic ideas; much more than that, it is a comprehensive system of thought embracing almost all the social sciences, such as philosophy, economics, history and politics. The chief merit of Marxism as a system lies in its organic unity. Its different aspects are so closely knit and so logically connected that the act of separating one from the other cannot be accomplished without doing injustice to the later. This explains why a great difficulty is faced when one is engaged in the task of distinguishing Marxian economics from Marxism.

You should note that Marxism has provided a new trend to the history of economic thought. It believes that theory and practice go hand in hand. Marxism has originality and initiative. It has a great degree of logical consistency.

3.2.2 The Main Characteristics of Marxism

The following are the main characteristics of Marxism:

1. Marxism is international in character. It is different from State socialism which is national in character.
2. Marxism is a working class gospel. Marxists believe in the organization of workers and class struggle to do away with capitalism. It scientifically demonstrates how capitalism will gradually give place to socialism. Prior to Marx, the struggle was for an equitable distribution and for the improvement in the working conditions of the workers. But in the Marxian doctrine, the struggle was given a new name 'class war"- workers against the capitalists, the poor versus the rich. The phrase "Class war" contributed much to the success of Marxism.
3. There is complete uniformity and full co-operation among all Marxians. If any conflict arises between labour and capital in one country, it is considered as part of international struggle.
4. Marxism is scientific socialism which demonstrates how capitalism will gradually give place to socialism.
5. Marxism is purely revolutionary in character. The revolution will be peaceful.
6. Marxism is purely materialistic and not idealistic. It attaches much importance to economic facts.

3.2.3 Chief Tenets of Marxian Thought

Jhingan, et al (2003:185) divided the chief tenets of Marxian thought into two sections. Their first section discussed Marxian philosophy, method of approach, money and division of labour while section two discussed the Marxian economic theories. For us, we will study section one of the chief tenets of Marxian thought in this Unit 1 of Module 3 and continue with section two (the Marxian economic theories) in the next unit, that is, Unit 2.

3.2.3.1 Marxian Philosophy (Marx's Materialistic Interpretation of History)

Marx was perturbed about the various ill effects of capitalism which had progressed throughout Europe. At the same time, he was a philosopher deeply trained in Hegelian philosophy. You should note that the Hegelian philosophy was one which was generally admitted to be true. Marx, however, found himself dissatisfied with that philosophy and accordingly took to the study of a criticism of it and an improvement upon it.
You should note that Hegelian philosophy asserts that history moves on the basis of ideas. It is based on what it called the dialecticism. Everything has its opposite side. If there is something which we think is true then there must be something which is false to us. Similarly, if there is something good then there must be something bad also. People act on the basis of their ideas and accordingly whatever be the current flow of ideas that would determine the course of action of the people and hence the movement of history. However, the process of dialecticism does not let anything stand still. As has been stated, according to this approach of dialecticism, thing has its opposite- this also referred to as every thesis having its antithesis. There is always conflict between the thesis and the antithesis and in due course of time the two get merged into one new idea called synthesis. But the moment this synthesis takes place, it becomes a thesis and therefore we get a new thesis and antithesis. Further, according to Hegel, this mixture of thesis and antithesis into synthesis can be in terms of various proportions of the two elements and accordingly history can take many possible courses. What exact course history will take will depend upon the exact combination of synthesis and antithesis in each case. This combination is in the hands of God, since it is, He who will let the people thinks along some lines and not the others. Thus, history is nothing but the march of God on earth-the unfolding of his will in this world (Jhingan, et al., 2003).
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Marx criticized Hegelian philosophy by saying the Hegelian interpretation of history was upside down. He maintained that ideas did not move on their own or according to the pre-determined will of God; they were also mould on the basis of some deeper elements in the economy. Marx added that all our ideas, philosophy, actions, political and religious institutions were founded upon the materialistic forces which were at the root of all these things. He stated that the dialecticism that moved the history was materialistic dialecticism. Marx was of the opinion that ideas followed the materialistic advantages

and conflicts and not the vice-versa. Hence, his approach is called the materialistic dialecticism.

The *Communist Manifesto* written by Karl Marx and Engels throws light on class struggle. In this, Marx wrote that, "The history of all existing society is the history of class struggle". Marx made the class conflict the dominant feature of social life.

You should remember that in the ancient times, there was conflict between the master and slaves. Under feudalism, there was the struggle between the lord and serf. Now under modern capitalism, the struggle is between the capitalist (bourgeoisie) and the workers (proletariat).

According to Jhingan, et al., 2003: 188, "Capitalist production created a system under which workers are enslaved to capitalists, to the machines, to the supervisor and to the master. Exploitation of labourers is inherent in the capitalist system. As exploitation increases, there will two divisions in the society; the capitalists and the workers".

The *Communist Manifesto* gave a call to the workers to unite and organize and liberate themselves from capitalists. It believed that a revolution was inevitable and ultimately socialism would be established. In fact, capitalism itself creates conditions for its own destruction.

Being influenced by the *Communist Manifesto,* a revolution broke out in France in 1848, but was not successful. It was only the "small scale dress rehearsal of a gigantic production" which was scheduled for the future (*ibid*).

3.2.3.2 Marxian Method of Approach

It is claimed in certain circles that Marxian method of analysis was hardly scientific. Critics pointed out that Marx started with a preconceived dogma that capitalism was doomed to be replaced by socialism and that he went ahead to look for an explanation in support of his belief. All the same, it is agreed that his reasoning was quite coherent and logical (Bhatia, 1978).

Karl Marx first analyzed the four broad divisions of economic activity, namely production, consumption, exchange and distribution. He believed that these four divisions are interrelated. Production brought those goods which were needed for the satisfaction of human wants; distribution shared them in accordance with social laws; exchange distributed and in consumption, the product directly became the servant of individual want.

Further, Marx said that production was subjected to natural laws and distribution to social laws. In order to explain the connection between production and consumption, he gave the example of productive consumption and consumptive production- the former shows the use of the product in a new process of production and the later the reproduction of human life. In addition, he emphasized that production, supplied the material for consumption and consumption supplied wants. Thus, production and consumption are complementary.

Marx drew extensively upon historical facts to substantiate his hypotheses. In his system, institutional framework of a society plays a central role. This framework, however, is itself subject to the laws of evolution- the discovery of these laws is a declared objective of Marxian inquiry. In that sense, Marx may be termed an institutionalist. Marxian method, therefore, is not the one which can be neatly categorized as historical (Schumpeter, : 120) or deductive or institutional. It is a mixture of all these and it goes to Marx's credit that he is able to provide an excellent blend of these. But we must emphasize that he made us of institutional and other factors within a scientific framework. For example, he could assert that interest income from capital is in essence the similar to the rent income from land. Marx never avoided working out the details of a problem or using factual illustrations, but only to support his theoretical analysis.

In order to grasp Marxian methodology we must bring in Marxian objective of study which guided his choice of the relevant variables and their ordering in his scheme. Marx was basically interested in laying the laws of motion of the society. In other words, he wanted to find out the laws according to which the society moves from one historical category to another. Hegelian philosophy has assigned the role of prime movers to ideas. According to this reasoning there are always certain ideas called theses. The theses have their antitheses or opposite ideas. A reaction takes place between theses and antitheses and the result is syntheses or new ideas, which attract their own antitheses. Marx used a similar approach, but instead of assigning ideas the role of prime movers, he came to rest on the material conditions of social life. In Marxian system, social production necessitates the creation of corresponding social production relations and these relations take various forms. Their nature is not fixed, but changes with "the degree of the development of the social productive powers" (Roll, 1950: 259). The economic structure of the society is nothing but a correspondence to these production (or social production) relations. These may collectively be called the mode of production. However, based upon the mode of production is the superstructure of political, legal and other institutions in the society (Neff, 1950). Ordinarily one would have expected mode of production and the superstructure to be in harmony with each other. But the social production relations imply the concomitant exchange and distribution patterns also. Since the production relations are based upon property relationship, therefore, the exchange and distribution patterns also follow suit. To begin with, when w new set of property relations come into being, a corresponding superstructure (which is in conformity with the mode of production) comes into being. But the very evolutionary process brings the mode of production and the superstructure into conflict with each other. And a process is set into motion by which the existing mode of production will eventually be replaced by a new one and there will be a new superstructure in harmony with the mode of production. In this manner, in Marxian system, it is the dialectical materialism in terms of which the whole analysis runs (Bhatia, 1978).

Accordingly, the members of the society have to enter into social relationship with each other for the purposes of social production. These social relationships are, to begin with, those which are appropriate to develop the productive power of the society. But it is the very increased productive power of the society which instead of being a help to the productive powers of the society, become fetters upon them and have to be cast off for further progress. It is in this sense that Marx brings the famous class conflict in terms of which the movement of social history is traced. Whenever a new mode of production comes into being, the relation brings benefit (compared with the earlier situation) to the hitherto oppressed classes (for example, slaves become serfs or serfs becomes wage labourers). But the new social relationships, in due course, bring to the notice of the society the fact that some classes are getting exploited by others. To begin with such a class consciousness is hazy, but in due course it gets crystallized. The class struggle becomes open and eventually the existing mode of production is overthrown and replaced by another. In this manner, Marxian method of analysis runs in terms of class conflict.

You should note that Marx shows that labour is the only factor of production which is able to produce more than what goes in to produce itself. In other words, labour is the only source of surplus. Throughout history there has been a struggle regarding the appropriation of this surplus, though of course in capitalism it becomes quite an open one in terms of surplus value (*ibid*).

You should on your own study Marx's concepts of money and division of labour.

Self Assessment Exercise 1.1

What were the four broad divisions of economic activity first analyzed by Karl Marx?

4.0 CONCLUSION

Marx had based his philosophy on the materialistic conception of history, tracing mode of production as forming the basis for analyzing society upon which the super structure (politics, religions, education, etc.) was been built.

It goes to the credit of Marx that unlike classical economists, he did not consider capitalism an eternal thing. To him it was a passing phase in history. It had evolved out of the past history and carried the seeds of its own destruction. Like every social system experienced in the history, capitalism had its own inner contradictions which could be resolved only by its overthrowing.

5.0 SUMMARY

You have learnt the origin of socialist thought as well as the biography of Karl Heinrich Marx (1818-1883) himself. You also learnt Marxism or Scientific Socialism and its main characteristics. In addition you have studied the chief tenets of Marxian thought such as its philosophy (Marx's Materialistic Interpretation of History) and method of approach.

We shall continue with our discussion on Marxism in the next unit which is Unit 2 by considering Marxian stages of societal development

6.0 TUTOR-MARKED ASSIGNMENT

1. The history of all existing society is the history of class struggle. Discuss.
2. Why was Karl Marx's approach called the materialistic dialecticism?

7.0REFERENCES AND FURTHER READING

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UNIT 2: THE MARXIAN STAGES OF SOCIETAL DEVELOPMENT

CONTENT

1.0 INTRODUCTION

In the preceding unit we learnt the origin of socialist thought as well as the biography of Karl Heinrich Marx (1818-1883). We also learnt Marxism or Scientific Socialism and its main characteristics. In addition we studied the chief tenets of Marxian thought such as its philosophy (Marx's Materialistic Interpretation of History) and method of approach.

We shall continue with our discussion on Marxism in the present unit which is Unit 2 by considering Marxian stages of societal development.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Explain Marx's Primitive Communism
- Describe Marx's Slave society

- Discuss Marx's Feudalism
- Enlighten on Marx's Capitalism
- Explain Marx's Socialism and Communism

3.0 MAIN CONTENT

3.1 Primitive Communism

To Marx, this was the first stage societal development started from. It was characterized by collective ownership of means of production. According to Wikipedia 2013, primitive communism has the following characteristics;

- Shared property: there is no concept of ownership beyond individual possessions. All is shared by the tribe to ensure its survival.
- Hunting and gathering: tribal societies have yet to develop large-scale agriculture and so their survival is a daily struggle.
- Proto-democracy: there is usually no concept of "leadership" yet. So tribes are led by the best warrior if there is war, the best diplomat if they have steady contact with other tribes and so forth.

The primitive communism stage most likely begins soon after the dawn of humanity itself, at the stage where fire is developed, and communal living therefore becomes more convenient. Primitive communist societies tend to be very small, consisting of a maximum of a few hundred members, with size being dependent upon the environment. In this stage humanity is no different from any other animal, in that it has not yet found ways to bend nature to its will.

3.2 Slave Society

The second stage may be called Slave Society, considered to be the beginning of "class society" where private property appears. During this stage, it is also possible to see a slave culture established, particularly as the population increases, leading to "the growth of wants" and the growth of relations with outside civilizations (through war or barter). With slave culture, we see the beginning of class society. In this stage, all the work is done by human labour like hunting, preparing shelter, finding skin of animals or bark of a tree to be used as cloths. This made the human labour the most important resource which can earn income. Those who had maximum slaves were the most powerful in the society.

The characteristics of the Slave society are;

- Class: here the idea of class appears. There is always a slave-owning ruling class and the slaves themselves.
- Statism: the State develops during this stage as a tool for the slave-owners to use and control the slaves.
- Agriculture: people learn to cultivate plants and animals on a large enough scale to support large populations.
- Democracy and Authoritarianism: these opposites develop at the same stage. Democracy arises first with the development of the republican city-state, followed by the totalitarian empire.
- Private Property: citizens now own more than personal property. Land ownership is especially important during a time of agricultural development.

Self Assessment Exercise 2.1

Define the terms democracy, authoritarianism and totalitarianism.

3.3 Feudal or Estate Property

The third stage may be called Feudalism; it appears after slave society collapses. This was most obvious during the European Dark Ages when society went from slavery to feudalism.

- Aristocracy: the state is ruled by monarchs who inherit their positions, or at times marry or conquer their ways into leadership.
- Theocracy: this is a time of largely religious rule. When there is only one religion in the land and its organizations affect all parts of daily life.
- Hereditary classes: castes can sometimes form and one's class is determined at birth with no form of advancement. This was the case with India.
- Nation-state: nations are formed from the remnants of the fallen empires. Sometimes to rebuild themselves into empires once more. Such as England's transition from a province to an empire.

During feudalism there are many classes such as kings, lords, and serfs, some little more than slaves. Most of these inherit their titles for good or ill. At the same time that societies must create all these new classes, trade with other nation-states increases rapidly. This catalyzes the creation of the merchant class.

3.4 Capitalism

Marx pays special attention to this stage in human development. The bulk of his work is devoted to exploring the mechanisms of capitalism, which in western society classically arose "red in tooth and claw" from feudal society in a revolutionary movement.

Capitalism may be considered the fourth stage in the sequence. It appears after the bourgeois revolution when the capitalists (or their merchant predecessors) overthrow the feudal system. Capitalism is characterized by the following:

- Market Economy: in capitalism the entire economy is guided by market forces. Supporters of laissez faire economics argue that there should be little or no intervention from the government under capitalism. Marxists, however, such as Lenin in his *Imperialism, the Highest Stage of Capitalism*, argue that the capitalist government is a powerful instrument for the furtherance of capitalism and the capitalist nation-state, particularly in the conquest of markets abroad.
- Private property: the means of production are no longer in the hands of the monarchy and its nobles, but rather they are controlled by the capitalists. The capitalists control the means of production through commercial enterprises (such as corporations) which aim to maximize profit.
- Parliamentary democracy: the capitalists tend to govern through an elected centralized parliament or congress, rather than under an autocracy. Capitalist (bourgeois) democracy, although it may be extended to the whole population, does not necessarily lead to universal suffrage. Historically it has excluded (by force, segregation, legislation or other means) sections of the population such as women, slaves, ex-slaves, people of colour or those on low income. The government acts on behalf of, and is controlled by, the capitalists through various methods.
- Wages: in capitalism, workers are rewarded according to their contract with their employer. Power elites propagate the illusion that market forces mean wages converge to an equilibrium at which workers are paid for precisely the value of their services. In reality workers are paid less than the value of their productivity - the difference forming profit for the employer. In this sense, all paid employment is exploitation and the worker is "alienated" from their work. Insofar as the profit-motive drives the market, it is impossible for workers to be paid for the full value of their labour, as all employers will act in the same manner.
- Warfare: capitalism spreads from the wealthiest countries to the poorest as capitalists seek to expand their influence and raise their profits. This is done directly through war, the threat of war, or the export of capital. The capitalist's control over the State can thus play an essential part in the development of capitalism, to the extent the State directs the warfare or other foreign intervention.
- Financial institutions: Banks and capital markets such as stock exchanges direct unused capital to where it is needed. They reduce barriers to entry in all markets,

especially to the poor; it is in this way that banks dramatically improve class mobility.
- Monopolistic tendencies: the natural, unrestrained market forces will create monopolies from the most successful commercial entities.

In capitalism, the profit motive rules and people, freed from serfdom, work for the capitalists for wages. The capitalist classes are free to spread their laissez faire practices around the world. In the capitalist-controlled parliament, laws are made to protect wealth.

But according to Marx, capitalism, like slave society and feudalism, also has critical failings - inner contradictions which will lead to its downfall. The working class, to which the capitalist class gave birth in order to produce commodities and profits, is the "grave digger" of capitalism. The worker is not paid the full value of what he or she produces. The rest is surplus value - the capitalist's profit, which Marx calls the "unpaid labour of the working class." The capitalists are forced by competition to attempt to drive down the wages of the working class to increase their profits, and this creates conflict between the classes, and gives rise to the development of class consciousness in the working class. The working class, through trade union and other struggles, becomes conscious of itself as an exploited class.

By accepting money as the universal equivalent, capitalism eventually manages to exploit the labourer upon whom all value ultimately inheres, according to Marx. That is, money tends to hide the real equivalent behind any monetary exchange: labour. Marx contends that the more labour it takes to produce a product, the greater its value. Marx therefore concludes that "As exchange-values, all commodities are merely definite quantities of congealed labour-time". However, what happens in a capitalist society is that people tend to believe that power and value really inherent in the money-form rather in the labour that actually produces goods and services, leading to what Marx terms "commodity fetishism."

Money in turn allows for the accumulation of capital. In commodity exchange, one exchanges a commodity for money, which one then exchanges for some other commodity. One sells in order to buy something else of use to the consumer; Marx writes this formula as ***C-M-C*** (or Commodity-Money-Commodity). Money allows this formula to be transformed, however: no one can buy in order to sell (at a higher price) or ***M-C-M***, which becomes for Marx the general formula for capital. In this second formula, "the circulation of money as capital is an end in itself, for the valorization of value takes place only within this constantly renewed movement. The movement of capital is, therefore limitless". The aim of the capitalist thus becomes "the unceasing movement of profit-making". Indeed, the formula is reduced even further in the case of usury, when one loans money in return for the same money with interest, or ***M-M.*** A similar process occurs on the stock market: money making yet more money without the purchase of a tangible commodity.

Once again, what is forgotten in this process is the labour-power upon which the whole system of profit relies: the purchasing of a person's labour-power in exchange for full ownership of the product thus produced. The product is in turn sold on the market at a profit that is controlled exclusively by the capitalist (***M-C-M***).

You should note that Industrial Revolution led to generation and spread of scientific ideas and values among people. French Revolution led to realization of the need for freedom of expression and speech. These developments led to many innovations and introduction of new technology in many sectors. Technological improvements initially benefited agriculture resulting in increasing the productivity. This led to displacement of labour from agriculture. At the same time, textile and mineral sectors developed, which were able to employ labour displaced from agriculture.

Agricultural activity was located in rural areas whereas textile and mineral companies were located in urban areas. This led to shift of population from rural areas to urban areas.

As the productivity increased in agricultural sector, lesser amount of land was needed fa feeding population. This decreased the importance of land. Starting of industrial forms needed capital, which made the owners of capital the most important and powerful section of the population.

Self Assessment Exercise 2.2

What is labour power?

3.5 Socialism and Communism

After the working class gains class consciousness and mounts a revolution against the capitalists, socialism, which may be considered the Fifth Stage, will be attained, if the workers are successful.

Lenin divided communism, the period following the overthrow of capitalism, into two stages: first socialism, and then later, once the last vestiges of the old capitalist ways have withered away, stateless communism or pure communism (Lenin, 1917). Lenin based his 1917 work, *The State and Revolution*, on a thorough study of the writings of Marx and Engels. Marx uses the terms the "first phase" of communism and the "higher phase" of communism, but Lenin points to later remarks of Engels which suggest that what people commonly think of as socialism equates to Marx's "first phase" of communism.

Socialism may be characterized by the following:

- Decentralized planned economy: rather than by market forces alone which brought the crises of capitalism, production is based on scientific planning and the democratic consensus of the workers, via communes or councils.
- Common property: the means of production are taken from the hands of a few capitalists and put in the hands of the workers. This translates into the democratic communes controlling the means of production.
- Council democracy: Marx, basing himself on a thorough study of Paris Commune, believed that the workers would govern themselves through system of communes. He called this the dictatorship of the proletariat, which, overthrowing the dictatorship (governance) of capital, would democratically plan production and the resources of the planet.
- Labour vouchers: Marx explained that, since socialism emerges from capitalism, it would be "stamped with its birthmarks". Economically this translates into the individual worker being awarded according to the amount of labour he contributes to society. Each worker would be given an amount of standardized credit verifying his contribution which he could then exchange for goods.

Sometime after socialism is established society leaps forward, and everyone has plenty of personal possessions, but no one can exploit another person for private gain through the ownership of vast monopolies, and so forth. Classes are thus abolished, and class society ended. Communism will have spread across the world and be worldwide. Eventually the State will "wither away" and become obsolete, as people administer their own lives without the need for governments or laws. Thus, stateless communism or pure communism, which may be considered the sixth stage, is established, which has the following features:

- Statelessness: there are no governments, laws, or nations any more.
- Classlessness: all social classes disappear, everyone works for everyone else.
- Propertylessness: there is no money or private property; all goods are free to be consumed by anyone who needs them.

4.0 CONCLUSSION

Marx identified historical epochs from the beginning of human existence - agrarian, feudal and industrial, and capitalist. All stages have an oppressor and an oppressed group - except in agrarian society. Marx predicted that these stages follow in order and once the working class proletariat realizes their exploitation (by gaining class consciousness) they will revolt against the capitalists and opt for a socialist society.

5.0 SUMMARY

In this unit, you have learnt Marxian stages of societal development. Our discussion took us to the examination of Marx's ideas on Primitive Communism, the Slave society, Feudalism, Capitalism and Communism.

The next unit which is Unit 3 considers Marx's economic theories such as labour theory of value, surplus value, rent, etc.

6.0TUTOR-MARKED ASSIGNMENT

1. According to Marx, capitalism, like slave society and feudalism, also has critical failings - inner contradictions which will lead to its downfall. What are these contradictions?
2. List and explain characteristics of capitalism as stated by Karl Marx.

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UNIT 3: THE MARXIAN ECONOMIC THEORIES

CONTENT

1.0INTRODUCTION

In the preceding unit we learnt the stages of societal development as propounded by Karl Marx. We shall continue with our discussion on Marxism in the present unit by considering Marxian economic theories such as labour theory of value, surplus value, capitalist exploitation, capitalist accumulation and rent.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Explain Marxian labour theory of value
- Analyze Marxian theory of surplus value
- Discuss Marxian theory of capitalist exploitation
- Discuss Marxian law of capitalist accumulation
- Explain Marxian theory of rent

3.0 MAIN CONTENT

3.1 The Marxian Labour Theory of Value

Karl Marx derived the scientific core of his theory of value from Ricardian labour theory. Marxian main contribution lies in avoiding undue deviations, and stating the whole theory in a more precise manner. Marx borrowed Ricardian approach of converting all labour into standard units as also the stand (the concept of socially necessary labour) that wasteful use of labour does not increase the value of a commodity. Marx considered the labour theory of value the necessary step to arrive at the theory of surplus value which explains the exploitative nature of the capitalist society (Bhatia, 1978, Jhingan, et al., 2003).

Marx said that in a capitalist society, a commodity is defined as a carrier of use value and exchange value. As a carrier of use value, it satisfies the human wants. As a carrier of exchange value, it possesses a quantitative relation with other commodities (Jhingan, et al., 2003). Alongside with this double character of a commodity, there is a corresponding two-fold nature of labour. The one is useful labour; the other is 'abstract' human labour. Useful labour produces commodities that satisfy human wants. Variety of human wants requires variety of use values. But labour alone cannot produce use value. Matter provides a material on which labour is to be exercised. Moreover, a thing may possess use value, but may not require labour to produce it. Airs, water, soil, are some examples of such things.

Marx argued that if a thing is to be called a commodity, it must have exchange value and to have exchange value, it should have 'something common'. In Marxian economics, this something common is "The Abstract human labour" .He argued that the value of every commodity is simply the amount of crystallized human labour which it contains, and commodities differ in value according to the different quantities of labour which are socially necessary to produce them. By "socially necessary labour', Marx meant labour-time necessary to produce any use-value with the given normal conditions of social production and the social average degree of skill and intensity of labour.

Further, Marx emphasized that the value of a commodity would remain constant, if the labour-time required for its production also remained constant. You should on your own study a critique of the Marxian Labour Theory of Value

3.2 The Marxian Theory of Surplus Value

The theory of surplus value is the cornerstone of Marxian economic theory. It provides the framework on the basis of which Marx has built up his theory of capital accumulation (Jhingan, et al., 2003). To Marx, in capitalism, production was not simply production of commodities, but was production of surplus value. The worker produces not for himself but for the capitalist. From capitalist's point of view, the labourer alone is productive who produces a surplus.

Marx argued that under capitalism, labour power itself became a commodity and is bought and sold in the market. The main aim of the capitalist is to maximize profit. It is possible for capitalist because labour power has the peculiar character of being able to create more value than is needed for its own production. In other words, the worker can produce more in a day's labour than is needed for his own subsistence. The capitalist pays only those wages with which the latter can purchase the means of subsistence. Thus, Marx divided the labour into two kinds- necessary labour and surplus labour.

Let us consider this example. If we assume that a labourer works for 8 hours a day to produce a commodity, is sufficient to maintain him. Then the exchange value of the product should be equal to 8 hours labour. But if the wages paid to the labourer are equal to 4 hours labour-this labour is the necessary labour and the remaining 4 hours is known as surplus labour. It creates surplus value which goes to the capitalist. Thus, surplus value is the difference between the selling price of the commodity and the actual wages paid to the labourer. In a capitalist society, the workers are thus exploited by the capitalists (Bhatia, 1978).

Marx classified capital as constant capital and variable capital. Capital invested in stocks or raw materials or equipments which directly assist the productivity of labour was called by Marx as constant capital. Capital spent for the purchase of labour power in the form of wages was called variable capital. According to Marx, it was only the variable capital which was capable of creating surplus value (Jhingan, et al., 2007).

According to Jhingan, et al. (2003:192), "Marx stated that there are three components of the value of commodity: (a) constant capital, (b) variable capital and (b) surplus value. Suppose '**C**' stands for constant capital, '**V**' for variable capital and '**S**' for surplus value, then the total value=**C**+**V**+**S**. the rate of surplus value will be **S**=**S⁄v**".

$$\mathbf{S} = \frac{\textbf{Surplus value}}{\textbf{Variable capital}} = \frac{\textbf{Surplus value}}{\textbf{Value of labour power}} = \frac{\textbf{Surplus labour}}{\textbf{Necessary labour}}$$

Bhatia, (1978:286) stated that, "The rate of surplus value is, therefore, an exact expression for the degree of exploitation of labour-power by capital, or of the labourer by the capitalist. The total amount of surplus value will be determined by the rate of surplus value on the one hand and the amount of variable capital employed on the other."

The annual rate of surplus value can be measured by multiplying the surplus value by the number of turnovers of the variable capital in a year '**n**'. Thus, thus the annual rate of surplus value (as') will be

$$\mathbf{as' = Sn/v}$$

The rate of profit is equal to the ratio of surplus value to total capital. It is **$S/c+v$.** Marx showed the relation of profit to the rate of surplus value as:

$P_1 + S_1V/C+V$ in which ***P_1*** stands for the rate of profit, ***S_1*** for the rate of surplus value, ***C*** for constant capital and ***V*** for variable capital.

Marx also distinguished between absolute surplus value and relative surplus value. Absolute surplus value results from an increase in the number of working hours and the relative surplus value from reducing the real wages. The extent of surplus value can be increased by raising the rate of exploitation. The capitalists can raise the rate of exploitation by the following ways:

1. By increasing the working days of labourers.
2. By increasing the productivity of labour.
3. By reducing real wages (*ibid*).

You should on your own study a critique of the Marxian Labour Theory of Surplus Value

Self Assessment Exercise 1.1

Distinguish between absolute surplus value and relative surplus value.

3.3The Marxian Theory of Capitalist Exploitation

According to Marx, in a capitalist society, there are two classes of people- capitalists and workers. In a capitalist society, all the means of production are owned by the capitalists. The workers, on the other hand sell their labour-power to the capitalists. The capitalists produce the commodity with the application of labour to machinery and raw materials. Large-scale production creates more employment opportunities to workers. The act of production creates surplus. When the wages are paid less than the market value, exploitation arises.

But overproduction is another characteristic feature of capitalism in which goods are produced for the market. So, when the market contrasts, unemployment of workers emerges. Once more, when market expands, labour-power is required again. So, such labourers who are temporarily employed form industrial reserve armies, the farmers who are expelled from land use also join.

You should note that in a Marxian economics, capital means money used for exploitation. In a pre-capitalist society, the producer sells his commodities for money. With that money, he buys the commodities of other producers for consumption purposes. So, the cycle is **C-M-C**. Here, money simply performed the medium of exchange function. It was not used for the exploitation of anyone. But under capitalism, production is done for profit. So, the equation of exchange is **M-C-M_1** in which **M** stands for money or capital, **C** for commodity and **M_1** for money. You should note that the difference between **M** and **M_1** constitutes profit or the degree of exploitation. Thus, the capitalist system grows. According to Marx, the capitalist is a vampire which thrives upon the blood of others and becomes stouter and broader the more blood it gets. But very soon in the very root of its expansion are the seeds of destruction (Jhingan, et al., 2007).

3.4 The Marxian Law of Capitalist Accumulation

According to Marx, it is the surplus value that creates capital accumulation. Capitalists chose the method of increasing productivity of labour to maximize their profit. In order to make improvements in the productivity of labour, the capitalists save the surplus value. They reinvest it (surplus value) to acquire a large stock of capital and thus accumulate capital. In this, Marx commented, “Accumulate, accumulate, that is Moses and the Prophets.” (Jhingan, et al., 2007:193).

Marx stated that the accumulation of capital gives rise to the following evil effects

1. Large scale production is controlled by a few persons.
2. There is concentration of rural population in towns which leads to an increase in the number of proletariat.
3. As a result of capital accumulation, there is a declining trend in profits.
4. Since in a capitalist system, there is no balance between production and consumption, an industrial crisis occurs. In order to compensate the falling profits, the capitalist try to increase production, but consumption does not increase at the same rate. So, there is overproduction and under-consumption.
5. There is growth of unemployment and pauperism. With the accumulation of capital, technological improvements take up which reduces the demand for labour. So, the labour class forms an industrial reserve army. Thus, there exist a large mass of casual labourers and paupers.
6. The development of joint stock companies and banking and credit facilities fasten the growth of concentration of capital.

Thus, the general law of capital accumulation shows a cumulative process the higher the degree of accumulation, the greater the wealth of society, the greater the industrial reserve army, the greater the concentration of power in a few hands, and the greater the accumulation of misery.

3.5 The Marxian Theory of Rent

The discussion of surplus value and the use of the concepts of price of production and value lead us to the concept of rent. If any particular capitalist is able to produce a commodity at a price of production lower than its value, he is able to make an extra profit. This profit will be wiped out under conditions of competition. But if a particular capitalist is able to retain this advantage in cost of production, he continues to enjoy this extra profit and it becomes a rent. This is more so in the case of gifts of nature. And this brings in the case of differential rent which arises on account of the higher fertility of certain lands. If we want to generalize, we may say that if such an advantage is there in any line of production to any particular capitalist, he is able to enjoy a rent income since it is not wiped out through a process of competition (Bhatia, 1978:).

According to Bhatia (*ibid*) If we extend this line of reasoning as between different lines of investment, we may point out the landed classes, through the monopoly of ownership of land, are able earn a rent on account of monopoly price of agricultural produce. They are able to keep the exchange value of agricultural products above their value through a natural restriction of supply caused by the law of diminishing returns in the land. But even the law of diminishing returns does not apply to land and even if production is not deliberately kept low, still agricultural lands can bring an extra profit to their owners, and these profits, being of a permanent nature, will assume the character of rent. The explanation is that as between industries, rate profit tends to be equated through the process of competition and reallocation of capital. But the landed property acts as a barrier to this process of capital movement. Investment in land, therefore, continues to enjoy higher profit or rent. This, in other words, explain the existence of what may be called absolute rent. And since agricultural capital cannot move freely as between lands also, differential rent arises on account of differences in land fertility or other natural advantages which particular land-owners may be enjoying. In a way, differential rent also becomes a variety of monopoly rent

In short, then as Marx points out, there are possible theories of the rent of land (*ibid*). The first is the monopoly rent which arises from the monopoly price of agricultural produce. You should note that the law of value does not operate in the case of agricultural goods. The second is the differential rent which is basically a form of monopoly rent in the sense that the landlord having more fertile land has a monopoly of it which cannot be competed away by others. The third theory put rent as an interest income earned on the capital invested in land. This theory however is not able to explain the existence of rent from those lands on which no capital has been invested. The fourth is the Marxian theory of rent, namely, that kind of surplus profit which cannot be competed away. It arises on account of the fact that a difference between the price of production and value is maintained in the case of an individual producer, or the commodity sells above its value for all the producers. Thus, Marxian theory of rent covers the absolute, monopoly and differential rents as special cases (*ibid*).

4.0 CONCLUSION

Marxian theories of value, surplus value, capitalist exploitation, capitalist accumulation, etc. contain a high degree internal logical consistency than those of many other post-classical theories. The Marxist doctrine is important because it is true. It is comprehensive and harmonious and provides man with an integral world outlook irreconcilable with any form of reaction or defence of bourgeois suppression.

Marx was a Prophet. Marxism became something like a religion. It provided the ways and means for the salvation of human beings. It contains a message for the millions of people. Even today, Marxian economics is a popular gospel for the working class and young men and radical thinkers.

5.0 SUMMARY

You have learnt Marxian economic theories such as labour theory of value, surplus value, capitalist exploitation, capitalist accumulation and rent.

The next unit which is Unit 4 is a continuation of the present unit because it will discuss Marx's theories of capitalist crisis and the State. Our discussion on Marxism will also be concluded in the next unit.

6. TUTOR-MARKED ASSIGNMENT

1. The Marxian theory of rent covers the absolute, monopoly and differential rents. Discuss
2. Marx stated that the accumulation of capital gives rise to the some evil effects. What are these evil effects?

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UNIT 4: MARX'S THEORIES OF CAPITALIST CRISIS AND THE STATE

CONTENT

1.0 INTRODUCTION

In the preceding unit, we learnt Marxian economic theories such as labour theory of value, surplus value, capitalist exploitation, capitalist accumulation and rent.

In this present unit which is Unit 4 and which is an extension of the preceding unit, we shall discuss Marx's theories of capitalist crisis and the State. Our discussion on Marxism will also be concluded in this present unit.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Discuss Marx's theory on law of falling tendency of rate of profit
- Explain Marx's theory on crisis arising from disproportionality
- Analyze Marx's theory on crisis arising from under-consumption theory
- Discuss Marx's theories of the State and evaluate Marxism

3.0 MAIN CONTENT

3.1 Law of Falling Tendency of Rate of Profit

Marxian theory of growth emphasizes the role of capital accumulation. As in other components of his thought, it is not an easy task to separate his theory of development from the rest of his analytical framework. However to Marx, economic development was a central theme, and not a kind of additional or subsidiary issue to be covered. To him, economic progress was accompanied by a change in the whole society and its framework- and he had the primary aim of explaining the laws of change in society (Bhatia, 1978).

In analyzing the law of the falling rate of profit, Lorenz (2012) explained that:

- ***c***: fixed capital used in the production of goods
- ***v***: wages (labour value) paid to the employees
- ***l***: value of employees' work
- ***l*** > **v** = surplus of employees' s work over the cost of employment: *m*
- ***w = c + l = c + v + m***: value of the new product
- profit rate: $r = \frac{m}{c+v} = \frac{\frac{m}{v}}{\frac{c}{v}+1}$

- ***m/v***: surplus rate; ***c/v***: rate of organic capital composition
- if *m/v* is constant, *r* decreases if *c/v* increases.

Karl Marx quoted by Jhingan et al (2003:194) argued that "the rate of profit has a tendency to fall, as the accumulation of capital goes on." This is represented as;

Total Value= C +V+S

Where **C** means constant capital which does not in the process of production, undergo any quantitative alterations of value. You should note that constant capital remains constant as machine transfers its value to the products but does not increase in value. **V** stands for variable capital meaning thus that the value of such capital increase in the process of production. Value of labour power reproduces the equivalent of its own value, and also produces an excess, a surplus value which may itself vary, may be more or less, according to circumstances. Therefore, **V** is the value paid to labour, **S** is the surplus value-excess of the value produced over value paid to labour. Value paid to labour stands for subsistence wage. **S** is the value appropriated by capitalists and is called profit. The rate of profit would be equal to

$$P \quad \frac{S}{C+V}$$

Where **P** is the rate of profit, **C+V** stands for the value invested by the capitalists. (Bhatia, 1978) added that **C** is constant capital and **V** is variable capital. Recall that the rate of profit equation is

$$P = \frac{S}{C+V}$$

The rate of profit may also be defined as

$$\frac{S}{V} \cdot \frac{V}{(C+V)}$$

$$= \frac{S}{V} + \frac{V}{C+V}$$

$$= \frac{S}{V}\left\{1 - \frac{C}{C-V}\right\}$$

This is because $\frac{V}{C+V} = \left\{1 \quad \frac{C}{C+V}\right\}$

$\frac{S}{V}$ is the rate of exploitation or rate of surplus value appropriated.

$\frac{P}{C+V}$ is the organic composition of capital, i.e. the ratio of constant capital to total capital. It may be represented by **q**. Thus, **P = q (1-e)**

Jhingan et al (2003) stated that as the accumulation of capital takes place, constant capital increases in relation to capital or **q** increases. With **e** remaining the same as **q** increases, **p** must fall. This follows from our equation. Hence, in the process of capitalist development, the rate of profit must decline. This is the falling tendency of the rate of profit. With a decline in the rate of profit, the capitalists struggle to regain their old rates of profit, and hence class conflict emerges. Therefore, crises follow in the presence of this tendency of profit rate to fall.

3.2Crisis Arising From Disproportionality

According to Jhingan et al (2003), there can arise disproportionality between various branches of production, as capitalist starts production and investment on rough estimates of the market. The capitalist system works on the basis of anticipated demand and hence it becomes difficult to maintain correct proportions between different branches of production and, therefore, output of one or other industry is sold at prices less or more than its value and this tends to spread to other branches. Hence, a general crisis in the economy emerges. The process of adjustment imposed by the forces of competition would not be smooth, but cause an all-pervasive disequilibrium

You should note that Michael Tugan-Baranowsky (a Russian economist) and Hilferding (a German economist) accepted Disproportionality Theory as the only theory of crises advocated by Marx and popularized it. But Marx devoted little space to the discussion of this theory (*ibid*).

3.3 Crisis Arising From Under-Consumption Theory

Karl Marx argued that consumption is the basis of production, but the social relations in a capitalist society are such as impede the expansion of consumption. This is the 'fundamental contradiction' of a capitalist society. The subsistence wage and the increasing proletariatisation of society keep the base for production narrow and restricted.

Karl Marx in *Capital* (Vol. III) quoted by Jhingan et al (2003:197) writes, "But to the extent that the productive power develops, it finds itself at variance with the narrow basis on which condition of consumption rests". As such, Marx believed that the laws of distribution are antagonistic to the laws of production. In the first place, the labour is paid subsistence wage and under capitalism, the masses constitute labour. By flooding the market periodically with the reserve army, the capitalist system not only prevents the masses from participating in the benefits that increasing productivity offers but also prevents consumption from rising in proportion to aggregate output, thus threatening the system with under-consumption. The capitalist class shrinks and the proletariat class expands in numbers in the process of development. Therefore, increasing production creates a problem within itself of selling all the production at given values. The price comes down and a general crisis ensues (Jhingan et al, 2003).

3.4 Marx's Theories of The State

Karl Marx had historically traced the history of the State and concluded that the State is an instrument of class used for subjugation and domination of one class by another, i.e. the class of the minority bourgeoisie over the majority peasants. He contended that State originated from the slavery mode of production when society was sharply divided into two classes with antagonistic and irreconcilable differences, and that the art of State management has kept growing and became perfected in the capitalist State.

Furthermore, that although earlier philosophers had portrayed the State and government as an impartial arbiter (mediator) that seeks to regulate conflicting interest in society and also manager of State affairs as being another personal interest to pursue or protect, i.e.

the act of governance was an act of service to the society, Marx did not see it as such. He rather saw the State as executive committee for managing the affairs of the bourgeoisie class, i.e. the State was a class instrument for the bourgeoisie to serve and advance their material interest while using its organ of coercion, such as the Army, Police, Judiciary, Prison, etc., to subjugate the peasantry. Marx has then concluded that the State could never be said to be impartial and so will continue to exist so long as class exist in the society. And that it is only at the Communist state where classes and antagonistic social relations will have withered away and that the State would invariably withered away.

You should recall that we had identified Socialist State as the transitory stage between capitalism and communism, a stage when the working class will capture State power and use it to erase hitherto capitalists to now conform to the ideals of the workers' revolution. And State power in the hands of workers, will also be used to extinguished antagonistic class relations until communism is attained, i.e. a classless society.

Self-Assessment exercise 4.1

What conclusion did Marx's theories of the State arrive at?

3.5 An Evaluation of Marxism

You should note that Marx was much more than an economist in every sense of the term. He put in his analysis a blend of numerous social and economic influences that go to work in a society. He wanted a complete and comprehensive analysis of the capitalist system, unearth its inner contradictions and at the same time lay bare the laws of motion of the society from era to era. As a thinker, Marx is considered one of the most powerful and original intellectuals. As a philosopher and expositor of a new society, he has commanded the widest influence (Bhatia, 1978). According to Bell,(1953:371), "His (Marx's) views, in accordance with his own or some others' interpretation, have been used to prove him a devil incarnate or a saviour of mankind who founded a religion even more potent than that of Christ or Mohammed." Marx has been an object of praise, abuse, criticism and all that and at the same time one who has been most vehemently discussed.

Marxian system is an appeal to reason rather than sentiments. He linked up social and economic thought with history and theory. From that angle he was an institutionalist. Marxian system is based upon dialectical materialism and is diametrically opposed to that of Hegel which is based upon dialecticism of ideas. Marx laid bare the inherent contradictions of capitalism and showed how capitalism carried the seeds of its own destruction. His was a comprehensive system. He "was single-minded fanatic who derived from the fusion of philosophy, history and economics, a message which he drove home with unrelenting zeal" (Spiegel, 1952:457). As a result, any "attempt at a simple statement of the Marxian doctrines with any pretence to accuracy is a matter of the utmost difficulty" (Fergusion, 1938:216).

It goes to the credit of Marx that unlike classical economists, he did not consider capitalism an eternal thing. To him, it was a passing phase in history. Marx believed that capitalism evolved out of the past history and carried the seeds of its own destruction. Like every social system experienced in the history, capitalism had its own inner contradictions which could be resolved only by its overthrowing, argued Marx (Bhatia, 1978).

You should note that an evaluation of Marx may be made as an economist on the basis of predictions about future. The latter course is not very desirable in ordinary cases, but to Marx, economics was not the study of a positive science. He had the objective of studying it for normative purposes. And it is the result of this normative approach that Marx has been so influential in focusing the world attention upon distributive justice on the one hand and the problem of economic crises on the other.

You should note that as an economist, Marx is chiefly known for his theories of value, surplus value and historical evolution. In his publication *Capital* he tried to present a comprehensive and complete picture of political economy and he nearly succeeded in that except on account of the fact that a few things he could not complete before his death. We have seen how comprehensive and rigorous his theory of value is. He however did not give us a theory of price. His analysis of surplus value is also very penetrating and is developed to bring out the mechanism of capitalist development and exploitation of labour. The major flaw in his theory of surplus value is the inconclusive demonstration that with the rising organic composition of capital the rate of surplus value is not able to counteract the tendency to falling rate of profit. As regards his explanation of historical evolution, two gaps may be noted. The first is with regard to the way the Asiatic or communistic societies get transformed into a system of slavery. This explanation was provided later by others by pointing out that slavery was a more efficient mode of production than the system of killing the tribes conquered in wars. The other gap was the form of imperialism which capitalism tries to take before it collapses.

On the subject of predictions, Marx is criticized on the grounds that he failed to visualize the way capitalism could change its character and try to solve its inner contradictions. It has been found that capitalism has not led to an increasing misery of the working classes. Instead, through the agency of the government and upsurge of trade unionism, it has been possible to increase the amount of purchasing power going to the working classes. There has been a shift in the production of goods in favour of those which are meant for mass consumption. The demand by the masses has gone up. And in recent times, this trend has been given the further fillip through the adoption of hire-purchase system. We may say that the Marxian predictions here did not come true but at the same time we must that capitalism is no longer capitalism in the true sense of the term. This is because there is an increasing role of the government and there is a deliberate policy of the State to undertake labour welfare measures and regulate the working of the economy.

Another criticism against Marx is that the socialist revolution did not start with the industrially advanced countries. But you should remember that by its very nature, the Marxian analysis could not be expected to provide a detailed account of future (Bhatia, 1978). Indeed, Newman (1952:168) clarified that, "His (Marx's) analysis and predictions were based on the 'natural' movements and directions of *laissez faire* capitalism, and his analysis was in the abstract Ricardian tradition. It is too much to ask of him that he foresee labour governments, potent cooperative movements, trade unions, cartels, anti-chain store legislation, and steeply progressive income taxation. In the absence of these and many other developments, his prophecies about the increasing misery of the working classes, the dropping of the wage rate and a simultaneous fall in the profit rate, might well been borne out." The quality of Marxian analysis should better be judged on the basis of its capacity to explain the past which it does admirably.

"In the light of modern economic thought, Marx, strangely enough, is more nearly the spiritual kinsman of the modern economists, than their own intellectual forebears. This is especially true of his choice of problems" (*ibid*: 169). You should remember that Marx's contributions include a theory of trade cycles. And he also throws light on the suggestion that the length of the cycle might depend on the life and replacement of fixed capital. Through the analysis of concentration of wealth and means of production, he led future economists to explore the areas of imperfect competition. Marx also conveyed the role of credit system in facilitating the process of concentration of capital.

You should note that socialist thought has proved as dynamic as other aspects of economic thought. A stimulus to this was provided by both academic pursuits of the thinkers and active life of political parties. One such step ahead was taken by Lenin, Hobson and others in pursuing economic investigations of capitalism into the realms of imperialism. Similarly, we find the emergence of German revisionism, French Syndicalism, Soviet Marxism, British Fabianism, Gild Socialism and others (Bhatia, 1978). There have been investigations arising out of Marxian theories and there have been others arising out of predictions (*ibid*).

4.0 CONCLUSION

Karl Marx developed many insights into the problem of modern industrialization. He was gifted and even called his system as scientific. He must be regarded as a great thinker.

His monumental work- *Das Capital* is, in fact, the doomsday book of capitalism- is a masterpiece where in all is great, all alike incomparable and wonderful.

5.0 SUMMARY

You have learnt in this unit, Marx's theories of capitalist crisis and the State. Our discussion on Marxism will also be concluded in this present unit. You have studied Marx's theories on law of falling tendency of rate of profit, on crisis arising from disproportionality, on crisis arising from under-consumption, of the State and an evaluation of Marxism.

In the next unit which is Unit 5 and last unit of Module 3, we shall discuss the Marginalist School of economic thought.

6.0 TUTOR-MARKED ASSIGNMENT

1. With relevant equations, analyze Marx's Law of Falling Tendency of Rate of Profit.
2. Evaluate Marx's contributions to economic thought.

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UNIT 5: THE MARGINALIST SCHOOL OF ECONOMIC THOUGHT

CONTENT

1.0INTRODUCTION

In the preceding unit, which concluded our discussion on Marxism, we learnt Marx's theories of capitalist crisis and the State.

In the present unit which is Unit 5 and last unit of Module 3, we shall discuss the Marginalist School of economic thought.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Explain the rise of marginalism
- Point out the distinguishing features of marginalism
- Discuss Alfred Marshall (1842-1924)
- Analyze Marshall's major contributions to economic thought

3.0 MAIN CONTENT

3.1Rise of Marginalism

In 1870 the appeared a new trend in economics, namely the adoption of marginalism. At this time, the reputation of classical economics had started waning due to its dogmatism and lack of adjustability to time and places (Jhingan et al, 2003). This school of thought was the product of several renowned economists like Heimann Heinrich Gossen (1810-

1858) who was considered a German genius, Karl Menger of Australia (1840-1921), Leon Walras (1834-1910) of Switzerland but born in France and Alfred Marshall (1842-1924) of England. Others include Stanley Jevons (1835-1882) and finally J.B. Clark (1847-1938).

Though their works bear a lot of resemblance with the works of classical economists, the marginalists however focused more on partial (micro-analysis) rather than the broad (macro), a product of classical. The marginalists, for instance, intensively analyzed interest rate, money, price level, levels of business activities etc. Until the Keynesian revolution of 1936 where Keynes concentrated more on the crisis management orientation the work of marginalist remained dominant off-shore of the classical economists.

You should note that the classical were given the brand name “materialists” because they overemphasized the objective side of value and excluded the subjective factors. The material and objective considerations of the classical school were questioned by many economists. Thus a marginal revolution took place simultaneously in many countries. The marginalist economists offered a new approach to economic theory and it was known as subjective approach (Jhingan et al, 2003).

You should note that subjectivity was a reaction against objectivism of the classical economists, human want is the motivating force in economic life and utility is “the manifestation of the relation between goods and the wants which they gratify.”(*ibid*:162). In the opinion of the marginalists, the objective phenomenon depends on subjective ones. Ultimately, subjectivism is nothing but individualism. It finds in the individual, the seat of pleasure and the faculty of deciding among alternative utilities. For them, the individual is the focal point in all concepts of utility. Subjectivism, thus leads to marginalism since the attention is concentrated on ‘points’ or ‘degrees.’ These subjective economists studied the behaviour of man in relation to his environment.

According to (Bhatia, 1978), the marginalist’s approach was characterized by the use of mathematical tools-geometry and differential and integral calculus. Its reasoning and notation were mathematical in nature. The method of analysis was primarily deductive and abstract, though Jevons is known for promoting the use of statistics and statistical tools also. The analysis of this new group of economists was hedonistic in nature, making use of the concepts of utility and disutility.

Self Assessment Exercise 5.1

What do you understand by the terms ‘objectivity’ and “subjectivity”?

3.2 Distinguishing Features of Marginalism

1. They emphasized the marginal, i.e. the net additional point of change as the most crucial for decision-making and possibly borrowing from Ricardo's theory of rent, for instance where he had maintained that in their investment, decisions investors always considered the marginal unit of land. They used the concept of 'margin' to explain economic phenomena.
2. They also emphasized the micro rather than macro approach of the classical. For instance, marginalists emphasize more on individual consumers, individual price levels and markets and not so much on the aggregate.
3. Their approach of an economy was from the perspective of pure competition. They believed in the existence of perfect competition. In fact, it was from them that the theory of the firm took root. It was their belief that with a purely competitive situation, it was the activities and decisions of the smallest consumer or purchaser that reflected on the aggregate situation.
4. Their analysis of consumer theory emphasized 'demand' as the most important factor in price determination, i.e. they overlooked the supply side in price determination.
5. Marginalists further believed that an economy will always attain equilibrium if all things are equal and there are no interferences. As such, the economy always is having a tendency to move towards full employment equilibrium, price equilibrium, etc. And that even when distortion arises they could only last in the short-run but in the long-run, the economy would adjust itself for equilibrium.
6. They assume rationality of individual consumers especially in the area of increasing marginal utility. They also emphasized that the individual was able to weigh alternative forgone in his consumption of consumer goods and services and so was then able to rationally allocate his resources.
7. They emphasized their classical position on *laissez faire* especially that they were disposed to pure competition, as such, they also did not support governmental intervention in economic phenomenon.
8. The marginalist school followed an abstract and deductive method.
9. The marginalist analysis is subjective and psychological.

3.3 Alfred Marshall (1842-1924)

Born in London, Alfred Marshall is rated the greatest of the marginalists. He published *Principles of Economics* in 1890. After Adam smith, it was Marshall that was credited with the most comprehensive definition of economics, as a science. Marshall defined economics as, "Political Economy or Economics is the study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with attainments and with the use of material requisites of wellbeing. Thus it is on the one side a study of wealth and on the other and more important side, a pert of the study of man." (Jhingan et al, 2003:209). From the definition we can sum-up the basic ideas as centering on individual as well as social action (corporate relations).

Marshall departed from the classical who had earlier emphasized on profit maximization as the pre-occupation of economic activity. He was able to connect his individual and corporate analysis in the attainment of material wellbeing. Economics thus was able to look beyond an individual but in addition the attainment of social needs. Implying for instance, that production was never complete until what was produced has been consumed (given that production was for consumption).

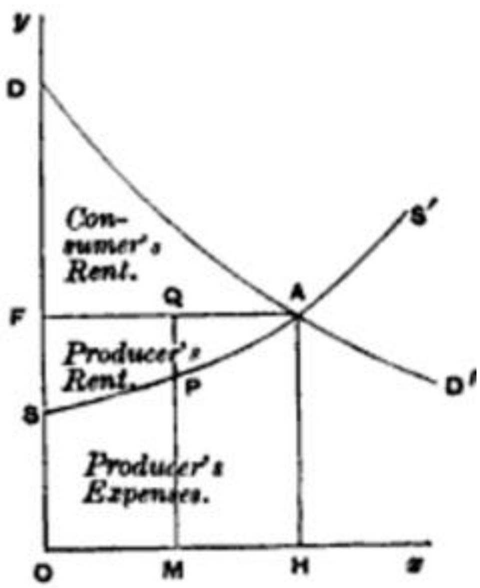
Furthermore, it was Marshall's strong belief that economics should seek to discover human social laws that relates to human conduct which could be quantified and measured by financial prices. Marshall had a love for exactitude in his analysis given that he had first studied Mathematics and Physics extensively.

3.3.1 Marshall's Major Contributions

Marshall major contributions to economic thought are:

1. **Marginal utility of demand;** in his analysis, Marshall has shown that marginal utility of a thing, any individual diminish with every additional unit of the thing consumed. He was also able to derive the law of demand, i.e. that the more the quantity of a commodity offered for sale, the lower the price and vice-versa. Furthermore, that the lower the price, the higher the desire of people to acquire it. He contended that the demand function was not necessarily based on the law of diminishing marginal utility but on balancing marginal utilities. Marshall also showed that marginal utilities are highest for low income earners than for high income earners giving that the more commodity one has at his disposal, the lesser the marginal utility of that particular commodity. He has thus advocated for a narrowing of income differentials in society, arguing that by so doing, the marginal utility of the entire society would be raised. He is also credited with the concept of consumer surplus where he has argued that consumers do enjoy a surplus and deriving from the marginal utility analysis he showed how this surplus was obtained by using this analysis.

Diagram 1: Marshall's Demand and Supply Graph



Source: Wikipedia 2009

From diagram 1 above, consumer rent is in triangle **DFA**, while producer rent is in triangle **AFS** and Producers' expenses is trapezium **ASOH**. Since **DD** is also **MU,** it indicates declining marginal utility for the consumer as he consumes more of the same commodity.

2. **Price Elasticity;** Marshall also developed a concept of price elasticity through which the percentage changes in quantity demanded of commodities are related to the percentage changes of the price of the commodity.

   The co-efficient of elasticity = $\dfrac{\textbf{\% change in qty}}{\textbf{\% change in prices}}$

3. **Supply and Market Prices;** Alfred Marshall had submitted that supply was generally governed by the cost of production of any given commodity, i.e. that real determinants of quantity supplied of a commodity was the real cost of doing it while other factors like leisure foregone do add to the cost of production but were not apparent when determining the price of the commodity. He then came up with upward-slopping supply curve which implies that the higher the price of a commodity, the higher the quantity suppliers are willing to supply (e.g. of tailor at festive periods of Chrismas, Sallah, etc.).

4. **Equilibrium Price;** Given his background from Mathematics, Marshall was able to combine the determinants of demand and supply and arrive at equilibrium price, as that price where supply matches demand.

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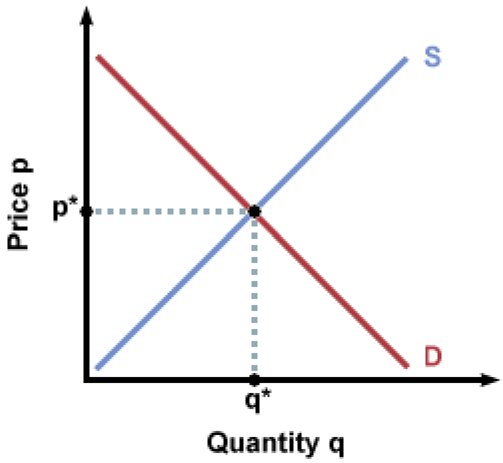
Diagram 2: Equilibrium Price



Source: Wikipedia 2009

Diagram 2 above shows the equilibrium price p* where buyers are willing to buy the same quantity of goods supplied at the same price.

5. **Short-run and Long-run Concepts:** Marshall is also credited with introducing short- run and long-run concepts in economic analysis, arguing that the shorter the period, the greater the influence of demand exerts on value and price. He thus defined the short-run as that period during which supply is not able to respond to any sudden increase in demand while he referred to long-run as that period long to allow changes in supply and demand. He was criticized by the classical that there is no short-run since even one will get there on the last).s
6. **Distribution:** It was Marshall's submission that income distribution was determined by the prices of factors of production in a perfectly competitive economy. For instance, he maintained that the supply and demand for labour was responsible for wage determination which was considered as the price for labour rather than the marginal productivity for labour and the demand for labour earlier held by the classical. Marshall illustrated that if the supply for labour increases, ceteris-paribus, the price (wages) of labour will fall.
7. **Interest Rate:** On interest rate, Marshall maintained that a fall in interest rate induces people to consume more and save less while an increase in interest rate leads to less consumption and more saving. He thus concluded interest tended

toward equilibrium where aggregate demand for capital equals to aggregate supply at the same rate.

8. **Profit:** He also defined profits as the earning of Management or the payment for the specialized form of labour, e.g. entrepreneurship and the factor of production, besides land, labour and capital.
9. **Others:** Marshall also concentrated on other areas of analysis most of which were micro in nature like the analysis on increasing and decreasing cost industries, internal and external economies of scale.

We have discussed Marshall's contributions to economic thought because Marginallism finds its comprehensive application in Marshallian economics. You should undertake further studies on other marginalists such as Heimann Heinrich Gossen (1810-1858), Karl Menger of Australia (1840-1921) and Leon Walras (1834-1910) of Switzerland but born in France.

5.0 CONCLUSION

The theory of marginal utility brought in fundamental changes in the structure of economic theory and there emerged a system quite different from the one expounded by the classical economists. The development of marginalism had been somewhat slow in the sense that its traces existed quite early in economic thought. The theory did not develop as a widespread movement on a well-prepared ground, and had to face lots of difficulties in the beginning.

Marginallism finds its comprehensive application in Marshallian economics. There, a complete integration of the principle is achieved by explaining the demand, production, supply and their interaction through the play of marginal increments.

6.0 SUMMARY

You learnt in this present unit, the marginalist school of economic thought in which you were made to know the rise of marginalism, distinguishing features of marginalism and Alfred Marshall (1842-1924) and his major contributions ton economic thought. You were also asked to undertake further reading on other marginalists such as Heimann Heinrich Gossen (1810-1858), Karl Menger of Australia (1840-1921) and Leon Walras (1834-1910) of Switzerland but born in France.

This Unit 5 is the last in Module 3. We shall begin Module 4 in the next unit by examining monetary economics.

6.0 TUTOR-MARKED ASSIGNMENT

1. List and explain features of marginalism.
2. With the aid of appropriate diagrams, analyze Marshallian contributions to economic thought.

7.0 REFERENCES AND FURTHER READING

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MODULE 4

CONTENT

UNIT 1: THE MONETARY SCHOOL OF ECONOMIC THOUGHT

CONTENT

1.0INTRODUCTION

In the preceding unit which was the last unit in Module 3, we learnt about the marginalist school of economic thought. The discussion took us to the examination of the rise of marginalism, distinguishing features of marginalism and Alfred Marshall (1842-1924) and his major contributions to economic thought.

This present Unit 1 is the first in Module 4 in which we shall examine monetarist school of economic thought.

2.0OBJECTIVES

At the end of this unit, you should be able to:

- Explain monetarist School of Economic Thought
- Define Monetary Economics
- Discuss Johann Gustave Knut Wicksell (1851-1926)
- Evaluate Wicksell's Contributions to Economic Thought

3.0 MAIN CONTENT

3.1 Meaning of Monetary Economics

Monetary economics is a branch of economics that historically prefigured and remains integrally linked to macroeconomics (Samuelson, 1968). Monetary economics provides a framework for analyzing money in its functions as a medium of exchange, store of value, and unit of account. It considers how money, for example fiat currency, can gain acceptance purely because of its convenience as a public good (Kiyotaki, N. and Wright, R., 1989). It examines the effects of monetary systems, including regulation of money and associated financial institutions (Bhattacharya, 1998) and international aspects.

Modern analysis has attempted to provide a micro-based formulation of the demand for money (Baumol, 1952) and to distinguish valid nominal and real monetary relationships for micro or macro uses, including their influence on the aggregate demand for output (Clower, 1967). Its methods include deriving and testing the implications of money as a substitute for other assets and as based on explicit frictions.

According to *Wikipedia* (2013), research areas for monetary economics include:

- empirical determinants and measurement of the money supply, whether narrowly-, broadly-, or index-aggregated, in relation to economic activity.
- debt-deflation and balance-sheet theories, which hypothesize that over-extension of credit associated with a subsequent asset-price fall generate business fluctuations through the wealth effect on net worth. And the relationship between the demand for output and the demand for money.
- monetary implications of the asset-price/macroeconomic relation.
- the quantity theory of money, monetarism, and the importance and stability of the relation between the money supply and interest rates, the price level, and nominal and real output of an economy.
- monetary impacts on interest rates and the term structure of interest rates lessons of monetary/financial history transmission mechanisms of monetary policy as to the macroeconomy.
- the monetary/fiscal policy relationship to macroeconomic stability.
- neutrality of money vs. money illusion as to a change in the money supply, price level, or inflation on output.

- tests, testability, and implications of rational-expectations theory as to changes in output or inflation from monetary policy
- monetary implications of imperfect and asymmetric information and fraudulent finance
- game theory as a modeling paradigm for monetary and financial institutions
- the political economy of financial regulation and monetary policy.
- possible advantages of following a monetary-policy rule to avoid inefficiencies of time inconsistency from discretionary policy.
- "anything that central bankers should be interested in."

3.2 Monetarist School of Economic Thought

Monetarist is a theory holding that economic variations within a given system, such as changing rates of inflation, are most often caused by increases or decreases in the money supply (*Wikipedia*, 2013). It is also a policy that seeks to regulate an economy by altering the domestic money supply, especially by increasing it in a moderate but steady manner (*ibid)*.

The conventional analytical approach in economics was that of a dichotomy between the physical and monetary aspects of the economy and the link between the two was established only through an expression of the absolute prices. Relative prices of goods and services were claimed to be determined by the tastes or demand on the one hand and production on the other. The monetary aspects of the economy could not affect the basic functioning of the physical side of the economy and vice versa. It was with Knut Wicksell that a new line of exploration started in which the relationship between the two dimensions of the economy was placed on a more realistic footing (Bhatia, 1978).

You should note that the analysis of monetarists draws inspiration from classical economists. The importance of monetary policies over and above others especially fiscal policies is emphasized, thus, explaining the name of the school. Even though monetarists generally share the position of classical economists, they are however further bound together by the following positions;

1. They share a strong belief in an economy that always tends towards equilibrium at full employment, i.e., if an economy's resources are employed fully, then, the transformation equation (formulated by John Maynard Keynes) will be;

   $$GDP = C + Inv + G + (eX - I)$$

Where **GDP** is the gross domestic product, **C** is consumer expenditures, **Inv** is total investment, **G** is government spending and (**eX - I**) is exports minus imports. And they felt that the equation represent full employment equilibrium.

2. They further believe in that the quantity of money in circulation was the most important tool for achieving stabilization in an economy i.e. ***MV = PT*** equation represent full equilibrium where **M** is Money Supply, **V** is Velocity of Circulation, **P** is price and **T** is Transactions or Output.
3. They also s believe that full employment equilibrium could be achieved only in a laissez faire economy rather than when there is government intervention, thus rather reinforcing the classical position.
4. Other areas monetarists emphasized on included the rate of profit, prices, the role of interest rate, etc. in achieving equilibrium. The movement of these parameters up and down cause inflation or deflation in an economy.

Notable monetarists included Johann Gustave Knut Wicksell (1851-1926), Arthur Cecil Pigou (1877-1959), John Maynard Keynes (1883-1946), Paul Anthony Sameulson (1915-2009) Milton Friedman (1912- 2006), James Tobin (1918 - 2002), etc. We are, however, going to discuss in this unit the contributions of Wicksell while Keynesian economics will be examined in Unit 3.

Self-Assessement Exercise 1.1

What is the monetarist equation that represents full employment?

3.1.1 Johann Gustave Knut Wicksell (1851-1926)

Knut Wicksell occupies an important position in the history of economic thought. He not along only provided a representative synthesis of the existing economic thought but also established a 'school' on the strength of his economic reasoning and laying the foundations along new lines of exploration (Bhatia, 1978). Wicksell was born in Stockholm. He studied mathematics and physics at the University of Upsala in1869 and passed his first University examination in 1872 and graduated from Upsala in 1885 with a degree in Mathematics and philosophy. In 1887 he got scholarship for European universities abroad and attended classes of C. Menger in Vienna. He completely turned towards economics in later years. His academic Career began in 1899 as an Assistant Professor in Law at the University of Upsala and later in 1900 as a full professor at Lund University. His major publications besides speeches and articles were *Uber Wert Kapital and Rente* (Value, Capital and Rent), 1893; *Finanztheoretische Untersuchungen* (Studies in Finance Theory), 1896; *Vorlesssungen uber Nationalokonomie* appeared in two parts in 1901 and 1906 and was translated in English by E. Classen as Lectures in Political

Economy and edited by Lionel Robbins as Vol. I, *General Theory* (1934) and Vol. II, *Money and Credit* (1935); his famous *Geldzins und G¨uterpreise* (Interest and Prices) appeared in 1898 and was translated in English in 1936 by R. F. Kahn. His major contributions were on interest rate as a means for price-level stability and had a vision of a limited welfare state (so-called"Svedish model"). *Ibid.*

Wicksell's contributions were in the fields of capital, interest, monetary theory and economic fluctuations (Bhatia, 1978). The starting point of Wicksell was Tooke's income theory of prices, which was enunciated in 1844. Wicksell found that during 1873-1895, contrary to the general theoretical expectations, prices and interest rate moved together.

i. Capital and Interest

Wicksell made lasting and important contribution. According to Bhatia (1978), Wicksell followed Bohn-Bawerk in borrowing his time-element and giving it an important place in his framework: To Wicksell, capital is stored-up labour and land, or stored-up productive power. It is separated from the current labour and land through time element. Wicksell here brings in his 'period concept' in which he argued that the current year's labour and land cooperate with the stored-up land and labour of the previous year for the purpose of production. In a simple model, we may say that the stored-up land and labour of the previous year are used up with the current supply of labour and land; and out of the current year's resources a part must be saved up for the next year's capital if continuity is to be maintained.

The argument is that there is a difference between the marginal productivity of current year's land and labour and that of the previous year's land and labour. This difference in productivity, according to Bohn-Bawerk was due to time element (*ibid)*. But in Wicksell this time element operates through relative marginal productivity which differs on account of the relative supplies of capital or productive power.

ii. Interest and Prices

Wicksell made a distinction between 'natural' rate of interest and 'money' rate of interest- a distinction which 'opened up a wealth of new insights' (Spiegel, 1971:503). The natural or normal rate of interest is defined by Wicksell as follows: "The rate of interest at which the demand for loanable capital and the supply of savings exactly agree, and which more or less corresponds to the expected yield on newly created capital, will then be the normal or natural real rate" (Quoted in Whittakar (1960:350).

Wicksell uses the difference between natural and money rates of interest to explain the movement in prices in the economy. The money or market rate is to be conceived as the average of the rates at which banks are advancing loans to the potential investors. You should recall that the natural rate in Wicksell is the measure of expected yield on new investment, which is therefore equivalent of the marginal efficiency of capital in Keynes and marginal productivity of capital in Bohm-Bawerk (Bhatia, 1978).

iii. Savings and Investment

Wicksell's analysis on savings and investment was an improvement on Walrasian general equilibrium analysis in which he introduced period analysis and made his system dynamic. He did this by differentiating between natural and market rates of interest. In the same vein, Wicksell differentiated between savings and investment. You should be aware of the fact that such concepts can be variously defined and the precise relationship between these entities in any theory would depend upon the way they are defined (Bhatia, 1978). In Keynes (we shall discuss Keynesian Economics in Unit 3), for example, savings and investment are always equal (in ex-post) because they have been defined in a particular manner. In Keynes, savings, in the ex-post sense, come out of the income of the period under consideration. If, as in Robertson, savings come out of previous period's income, they may well differ from the current investment figure, even both savings and investment are ex-post. Wicksell considers the equality (or its absence) between savings and investment in ex-ante sense-this was adopted by Keynes, also. Wicksell points out that the two decisions are taken by two different sets of people (in Keynes they are subject to two different sets of forces) (*ibid*).
In Wicksell's ex-ante sense, if savings exceed investment, income is reduced, consumption falls and so do the prices. Just the opposite would happen if savings fall short of investment. He believed that this relative position between savings and investment could be regulated by the use of Bank Rate (*ibid*). If we assume that the Bank Rate sets the level of other market rates of interest, it follows that by keeping the rates sufficiently low, investment can be stimulated while savings would be discouraged. Similarly, a high Bank Rate should lead to an excess of savings over investment. Equilibrium rate can be chosen through trial and error. Wicksell, therefore, integrated interest, savings and investment in his theory and imparted dynamism to it. His interest theory is a part of the general equilibrium system involving mutual dependence of variables.

3.1.2 An Evaluation of Wicksell's Contributions to Economic Thought

It is generally agreed among economists that Wicksell occupies an important place in the history of economic thought despite the fact that it is "difficult to evaluate Wicksell properly for the reason that he was both eclectic and original in his work" (Bell:1953:636). His important contributions are in the field of monetary economics, and an integration of interest and price theories with savings and investment and business fluctuations (Bhatia, 1978). In other words, Wicksell's analysis was a really comprehensive system which incorporated monetary theory (unlike) the classical theory in which there was a dichotomy between physical and monetary economics. His was a dynamic analysis involving a concept of 'period' though it can stand some refinements. You should note that it was the incapability of conventional static analysis to explain the factual correlation between price and interest rate movements which prompted Wicksell to look into this problem of dynamic adjustments in the economy and led him to develop his concepts of natural and market rates of interest- a distinction which has proved its worth in the history of economic thought (*ibid*). It was his object to develop a dynamic analysis and for this "he dwelt upon price *movements*, secular and cyclical, and tended to emphasize the part played by credit. He is a pioneer in co-ordinating theories of price and of interest with a theory of the value of money (Haney. 1949:659). Wicksell broke away from the conventional quantity theory which was defective both in its conception and in its ability to explain the actual determination and movement in prices. He found that the conventional theory was not able to explain as to why a reduction of expenditure on some goods was not compensated by an upward price movement in other goods. And here Wicksell found a distinction between savings and investment. Unlike the classical assumption that all savings are necessarily invested, Wicksell found that a divergence between them could arise because they were decided by two different sets of people and the decisions were taken on the basis of different forces. The divergence could be fed further by hoarding, dissaving and through variations in bank credit. Furthermore, the element of uncertainty and expectations was brought in by Wicksell. The importance of these elements is now well recognized by the modern economists (Bhatia, 1978).

Wicksell's analysis, for instance, was a sufficiently abstract study and he made use of a good deal of mathematics (like Marshall) in arriving at his conclusions though avoided its use in the exposition of his arguments. Nevertheless, Wicksell's theory, however, is quite amenable to mathematical treatment, but at the same time is sufficiently abstract to pose intractable problems in statistical testing.

4.0 CONCLUSION

Monetary history tells of a bewildering, yet fascinating, variety of different systems, different institutions, and different phenomena down through the ages. The history of monetary economics, being the history of attempts to think in a structured way about particular monetary systems, is no less varied, and no less fascinating. Even the literature on any particular monetary system is remarkably varied. There seems always to be debate, now between the metallists and chartalists, now the currency school and banking school, now free banking versus central banking, now monetarism versus Keynesianism. It's a wonderful literature, and most of what we know about money we have learned from our study of it.

5.0SUMMARY

You learnt in this unit, monetarist school of economic thought in which you studied Johann Gustave Knut Wicksell and his contributions to economic thought. You also learnt the meaning of monetary economics and its current state.

In the next unit which is Unit 2, we shall discuss mathematical economics.

6.0 TUTOR-MARKED ASSIGNMENT

1. Even though monetarists generally share the position of classical economists, they are however further bound together by some positions. What are these conditions?
2. Johann Gustave Knut Wicksell's contributions to economic thought were in the fields of capital, interest, monetary theory and economic fluctuations. Discuss

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UNIT 2: MATHEMATICAL SCHOOL OF ECONOMIC THOUGHT

CONTENT

1.0 INTRODUCTION

In the preceding unit we learnt monetarist school of economic thought in which we studied Johann Gustave Knut Wicksell and his contributions to economic thought. We also learnt the meaning of monetary economics and its current state.

In the present unit which is Unit 2, we shall discuss mathematical school of economics thought.

2.0OBJECTIVES

At the end of this unit, you should be able to:

- Explain the Meaning of Mathematical Economics
- Discuss the History of Mathematical Economics
- Analyze Marginalists and the Roots of Neoclassical Economics in Mathematical Economics
- Evaluate Augustin Cournot's Contribution to Mathematical Economics
- Explain Léon Walras's Contribution to Mathematical Economics
- Discuss Francis Ysidro Edgeworth's Contribution to Mathematical Economics
- Examine Modern Mathematical Economics

3.0 MAIN CONTENT

3.1 Meaning of Mathematical Economics

Mathematical economics is the application of mathematical methods to represent economic theories and analyze problems posed in economics. An advantage claimed for the approach is its allowing formulation of theoretical relationships with rigor, generality, and simplicity. It allows formulation and derivation of key relationships in a theory with clarity, generality, rigor, and simplicity. By convention, the applied methods refer to those beyond simple geometry, such as differential and integral calculus, difference and differential equations, matrix algebra, and mathematical programming and other computational methods (Chiang and Wainwright, 2005).

Mathematics allows economists to form meaningful, testable propositions about many wide-ranging and complex subjects which could not be adequately expressed informally. Further, the language of mathematics allows economists to make clear, specific, positive claims about controversial or contentious subjects that would be impossible without mathematics. Much of economic theory is currently presented in terms of mathematical economic models, a set of stylized and simplified mathematical relationships that clarify assumptions and implications.

Broad applications include:

- optimization problems as to goal equilibrium, whether of a household, business firm, or policy maker
- static (or equilibrium) analysis in which the economic unit (such as a household) or economic system (such as a market or the economy) is modeled as not changing
- comparative statics as to a change from one equilibrium to another induced by a change in one or more factors
- dynamic analysis, tracing changes in an economic system over time, for example from economic growth.

Formal economic modeling began in the 19th century with the use of differential calculus to represent and explain economic behaviour, such as utility maximization, an early economic application of mathematical optimization. Economics became more mathematical as a discipline throughout the first half of the 20th century, but introduction of new and generalized techniques in the period around the Second World War, as in game theory, would greatly broaden the use of mathematical formulations in economics.

This rapid systematizing of economics alarmed critics of the discipline as well as some noted economists. John Maynard Keynes, Robert Heilbroner, Friedrich Hayek and others have criticized the broad use of mathematical models for human behaviour, arguing that some human choices are irreducible to mathematics.

3.2 History of Mathematical Economics

The use of mathematics in the service of social and economic analysis dates back to the 17th century. Then, mainly in German universities, a style of instruction emerged which dealt specifically with detailed presentation of data as it related to public administration. Gottfried Achenwall lectured in this fashion, coining the term statistics. At the same time, a small group of professors in England established a method of "reasoning by figures upon things relating to government" and referred to this practice as Political Arithmetick (Schumpeter, 1954). Sir William Petty wrote at length on issues that would later concern economists, such as taxation, Velocity of money and national income, but while his analysis was numerical, he rejected abstract mathematical methodology. Petty's use of detailed numerical data (along with John Graunt) would influence statisticians and economists for some time, even though Petty's works were largely ignored by English scholars (*ibid*).

The mathematization of economics began in earnest in the 19th century. Most of the economic analysis of the time was what would later be called classical economics. Subjects were discussed and dispensed with through algebraic means, but calculus was not used. More importantly, until Johann Heinrich von Thünen's The Isolated State in 1826, economists did not develop explicit and abstract models for behavior in order to apply the tools of mathematics. Thünen's model of farmland use represents the first example of marginal analysis. Thünen's work was largely theoretical, but he also mined empirical data in order to attempt to support his generalizations. In comparison to his contemporaries, Thünen built economic models and tools, rather than applying previous tools to new problems.

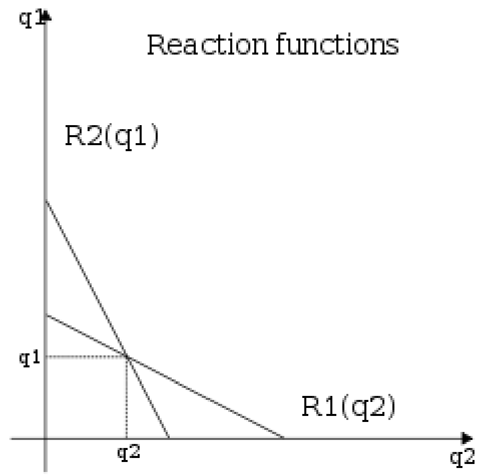
3.3 Marginalists and the Roots of Neoclassical Economics in Mathematics

Augustin Cournot and Léon Walras built the tools of the discipline axiomatically around utility, arguing that individuals sought to maximize their utility across choices in a way that could be described mathematically. At the time, it was thought that utility was quantifiable, in units known as utils. Cournot, Walras and Francis Ysidro Edgeworth are considered the precursors to modern mathematical economics (Nicola, 2000).

3.3.1 Augustin Cournot's Contribution to Mathematical Economics

Cournot, a professor of Mathematics, developed a mathematical treatment in 1838 for duopoly—a market condition defined by competition between two sellers (*ibid*). This treatment of competition, first published in Researches into the Mathematical Principles of Wealth, is referred to as Cournot duopoly.

Diagram 3: Cournot's Reaction Functions



Source: Wikipedia (2013)

The figure above depicts equilibrium quantities as a solution to two reaction functions in Cournot duopoly. Each reaction function is expressed as a linear equation dependent upon quantity demanded.

In Cournot duopoly, it is assumed that both sellers had equal access to the market and could produce their goods without cost. Further, it assumed that both goods were homogeneous. Each seller would vary her output based on the output of the other and the market price would be determined by the total quantity supplied. The profit for each firm would be determined by multiplying their output and the per unit Market price. Differentiating the profit function with respect to quantity supplied for each firm left a system of linear equations, the simultaneous solution of which gave the equilibrium quantity, price and profits.

Self-Assessment Exercise 2.1

Explain Cournot's duopoly.

3.3.2 Léon Walras's Contribution to Mathematical Economics

While Cournot provided a solution for what would later be called partial equilibrium, Léon Walras attempted to formalize discussion of the economy as a whole through a theory of general competitive equilibrium. The behaviour of every economic actor would be considered on both the production and consumption side (*ibid*). Walras originally presented four separate models of exchange, each recursively included in the next. The solution of the resulting system of equations (both linear and non-linear) is the general equilibrium. At the time, no general solution could be expressed for a system of arbitrarily many equations, but Walras's attempts produced two famous results in economics. The first is Walras' law and the second is the principle of tâtonnement. Walras' method was considered highly mathematical for the time and Edgeworth commented at length about this fact in his review of Éléments d'économie politique pure (Elements of Pure Economics).

Walras' law was introduced as a theoretical answer to the problem of determining the solutions in general equilibrium. His notation is different from modern notation but can be constructed using more modern summation notation. Walras assumed that in equilibrium, all money would be spent on all goods: every good would be sold at the market price for that good and every buyer would expend their last dollar on a basket of goods. Starting from this assumption, Walras could then show that if there were n markets and n-1 markets cleared (reached equilibrium conditions) that the nth market would clear as well. This is easiest to visualize with two markets (considered in most texts as a market for goods and a market for money). If one of two markets has reached an equilibrium state, no additional goods (or conversely, money) can enter or exit the second market, so it must be in a state of equilibrium as well. Walras used this statement to move toward a proof of existence of solutions to general equilibrium but it is commonly used today to illustrate market clearing in money markets at the undergraduate level.

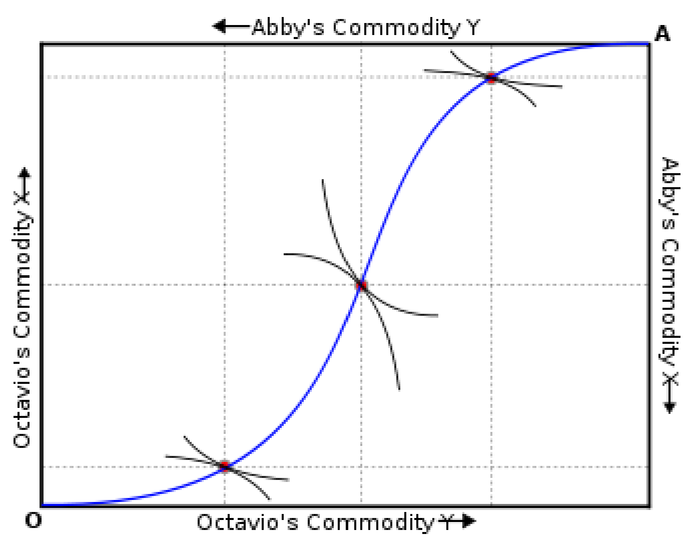
3.3.3 Francis Ysidro Edgeworth's Contribution to Mathematical Economics

Edgeworth introduced mathematical elements to Economics explicitly in Mathematical Psychics: An Essay on the Application of Mathematics to the Moral Sciences, published in 1881. He adopted Jeremy Bentham's felicific calculus to economic behavior, allowing the outcome of each decision to be converted into a change in utility. Using this assumption, Edgeworth built a model of exchange on three assumptions: individuals are self interested, individuals act to maximize utility, and individuals are "free to recontract with another independently of...any third party."

Given two individuals, the set of solutions where the both individuals can maximize utility is described by the contract curve on what is now known as an Edgeworth Box. Technically, the construction of the two-person solution to Edgeworth's problem was not developed graphically until 1924 by Arthur Lyon Bowley. The contract curve of the Edgeworth box (or more generally on any set of solutions to Edgeworth's problem for more actors) is referred to as the core of an economy.

Edgeworth noticed that a monopoly producing a good that had jointness of supply but not jointness of demand (such as first class and economy on an airplane, if the plane flies, both sets of seats fly with it) might actually lower the price seen by the consumer for one of the two commodities if a tax were applied. Common sense and more traditional, numerical analysis seemed to indicate that this was preposterous. Seligman insisted that the results Edgeworth achieved were a quirk of his mathematical formulation. He suggested that the assumption of a continuous demand function and an infinitesimal change in the tax resulted in the paradoxical predictions. Harold Hotelling later showed that Edgeworth was correct and that the same result (a "diminution of price as a result of the tax") could occur with a discontinuous demand function and large changes in the tax rate).

Diagram 4: Edgeworth box



Source: (Nicola, 2000: 14, 15, 258-261)

The figure above is an Edgeworth box displaying the contract curve an economy with two participants. Referred to as the "core" of the economy in modern parlance, there are infinitely many solutions along the curve for economies with two participants.

3.4 Modern mathematical economics

From the later-1930s, an array of new mathematical tools from the differential calculus and differential equations, convex sets, and graph theory were deployed to advance economic theory in a way similar to new mathematical methods earlier applied to physics. The process was later described as moving from mechanics to axiomatics. Other areas of modern mathematical economics are linear models, input-ouput, mathematical optimization, non-linear programming, variational calculus and optimal control, functional analysis, game theory and agent-based computational economics.

4.0 CONCLUSION

Mathematical economics deserves support just like other forms of mathematics, particularly its neighbours in mathematical optimization and mathematical statistics and increasingly in theoretical computer science. Mathematical economics and other mathematical sciences have a history in which theoretical advances have regularly contributed to the reform of the more applied branches of economics. In particular, following the programme of John von Neumann, game theory now provides the foundations for describing much of applied economics, from statistical decision theory (as "games against nature") and econometrics to general equilibrium theory and industrial organization.

5.0 SUMMARY

In this unit, you learnt the meaning of mathematical economics as well as its history. You also learnt the marginalists and the roots of neoclassical economics in mathematical economics. You studied the contributions to mathematical economics by notable economists such as Augustin Cournot, Léon Walras and Francis Ysidro Edgeworth.

In the next unit which is Unit 3, we shall discuss Keynesian economics.

6.0 TUTOR-MARKED ASSIGNMENT

1. What is mathematical economics? Which areas are the broad applications of mathematical economics?
2. With the aid of appropriate diagrams, explain Francis Ysidro Edgeworth's Contribution to Mathematical Economics.

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UNIT 3: THE KEYNESIAN ECONOMICS

CONTENT

1.0 INTRODUCTION

In the preceding unit we learnt the meaning of mathematical economics as well as its history. We also learnt the marginalists and the roots of neoclassical economics in mathematical economics. We have equally studied the contributions to mathematical economics by notable economists such as Augustin Cournot, Léon Walras and Francis Ysidro Edgeworth.

In the present unit which is Unit 3, we will discuss Keynessian economics.

2.0OBJECTIVES

At the end of this unit, you should be able to:

- Explain the meaning of Keynesian economics
- Analyze the Keynesian Theory
- Discuss the Keynesian concept
- Explain the “Multiplier effect" and interest rates
- Discuss the IS/LM model

3.0 MAIN CONTENT

3.1Meaning of Keynesian economics

The Keynesian economics (/ˈkeɪnziən/ *KAYN-zee-ən*; or Keynesianism) is the view that in the short-run, especially during recessions, economic output is strongly influenced by aggregate demand (total spending in the economy). In the Keynesian view, aggregate demand does not necessarily equal the productive capacity of the economy; instead, it is influenced by a host of factors and sometimes behaves erratically, affecting production, employment, and inflation (Blinder, 2008).

The theories forming the basis of Keynesian economics were first presented by the British economist John Maynard Keynes in his book, *The General Theory of Employment, Interest and Money*, published in 1936, during the Great Depression. Keynes contrasted his approach to the aggregate supply-focused 'classical' economics that preceded his book. The interpretations of Keynes that followed are contentious and several schools of economic thought claim his legacy.

You should note that Keynesian economists often argue that private sector decisions sometimes lead to inefficient macroeconomic outcomes which require active policy responses by the public sector, in particular, monetary policy actions by the central bank and fiscal policy actions by the government, in order to stabilize output over the business cycle. Keynesian economics advocates a mixed economy – predominantly private sector, but with a role for government intervention during recessions.

Keynesian economics served as the standard economic model in the developed nations during the later part of the Great Depression, World War II, and the post-war economic expansion (1945–1973), though it lost some influence following the oil shock and resulting stagflation of the 1970s (Fletcher, 1989). The advent of the global financial crisis in 2008 has caused resurgence in Keynesian thought (Sullivan and Sheffrin, 2003).

Self-Assessment Exercise 3.1

What do you understand by Keynesianism?

3.2 The Keynesian Theory

Keynes argued that the solution to the Great Depression was to stimulate the economy ("inducement to invest") through some combination of two approaches:

1. A reduction in interest rates (monetary policy), and

2. Government investment in infrastructure (fiscal policy).

By reducing the interest rate at which the central bank lends money to commercial banks, the government sends a signal to commercial banks that they should do the same for their customers.

Investment by government in infrastructure injects income into the economy by creating business opportunity, employment and demand and reversing the effects of the aforementioned imbalance (Blinder, 2008). Governments source the funding for this expenditure by borrowing funds from the economy through the issue of government bonds, and because government spending exceeds the amount of tax income that the government receives, this creates a fiscal deficit. A central conclusion of Keynesian economics is that, in some situations, no strong automatic mechanism moves output and employment towards full employment levels.

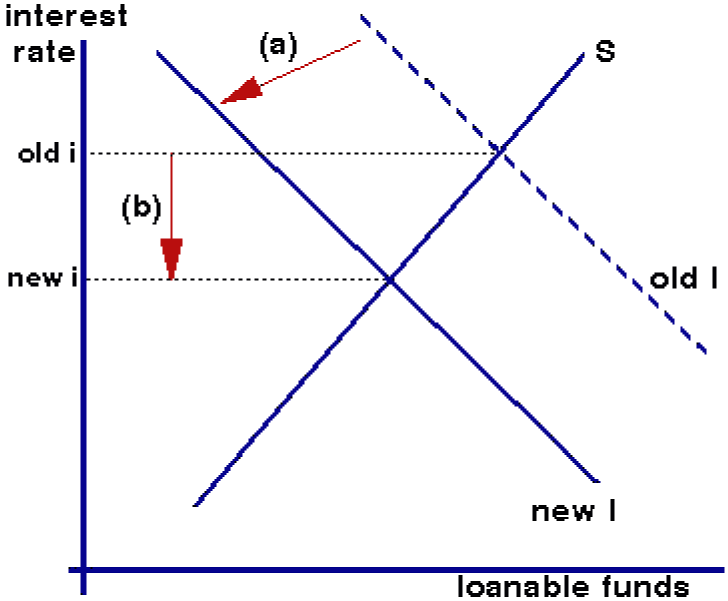
3.3 Keynesian Concept on Wages and spending

During the Great Depression, the classical theory attributed mass unemployment to high and rigid real wages (Wikipedia 2009). To Keynes, the determination of wages is more complicated. First, he argued that it is not *real* but *nominal* wages that are set in negotiations between employers and workers, as opposed to a barter relationship. Second, nominal wage cuts would be difficult to put into effect because of laws and wage contracts. Even classical economists admitted that these exist; unlike Keynes, they advocated abolishing minimum wages, unions, and long-term contracts, increasing labour market flexibility. However, to Keynes, people will resist nominal wage reductions, even without unions, until they see other wages falling and a general fall of prices.

Keynes rejected the idea that cutting wages would cure recessions. He examined the explanations for this idea and found them all faulty. He also considered the most likely consequences of cutting wages in recessions, under various different circumstances. He concluded that such wage cutting would be more likely to make recessions worse rather than better (Keynes, 1935).

Further, if wages and prices were falling, people would start to expect them to fall. This could make the economy spiral downward as those who had money would simply wait as falling prices made it more valuable – rather than spending. As Irving Fisher argued in 1933, in his *Debt-Deflation Theory of Great Depressions*, deflation (falling prices) can make a depression deeper as falling prices and wages made pre-existing nominal debts more valuable in real terms.

Diagram 5: Excessive saving



Source: Wikipedia 2009

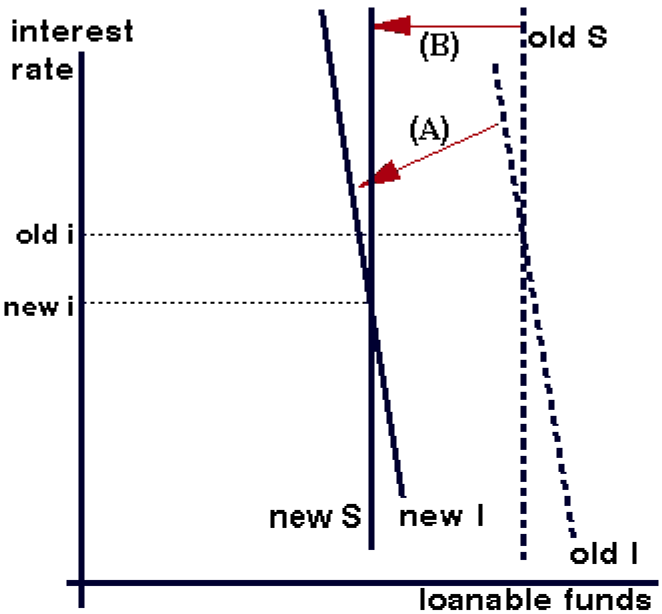
To Keynes, excessive saving, i.e. saving beyond planned investment, was a serious problem, encouraging recession or even depression. Excessive saving results if investment falls, perhaps due to falling consumer demand, over-investment in earlier years, or pessimistic business expectations, and if saving does not immediately fall in step, the economy would decline.

The classical economists argued that interest rates would fall due to the excess supply of "loanable funds". The first diagram, adapted from the only graph in *The General Theory*, shows this process. (For simplicity, other sources of the demand for or supply of funds are ignored here.) Assume that fixed investment in capital goods falls from "**old I**" to "**new I**" (step **a**). Second (step **b**), the resulting excess of saving causes interest-rate cuts, abolishing the excess supply: so again we have saving (**S**) equal to investment. The interest-rate (**i**) fall prevents that of production and employment.

Keynes had a complex argument against this *laissez-faire* response. The graph below (Figure 6) summarizes his argument, assuming again that fixed investment falls (step **A**). *First*, saving does not fall much as interest rates fall, since the income and substitution effects of falling rates go in conflicting directions. *Second*, since planned fixed investment in plant and equipment is based mostly on long-term expectations of future profitability, that spending does not rise much as interest rates fall.

So **S** and **I** are drawn as steep (inelastic) in the graph. Given the inelasticity of both demand and supply, a *large* interest-rate fall is needed to close the saving/investment gap. As drawn, this requires a *negative* interest rate at equilibrium (where the **new I** line would intersect the **old S** line). However, this negative interest rate is not necessary to Keynes's argument.

Diagram 6: Effect of Negative Interest Rate



Source: Wikipedia 2009

Third, Keynes argued that saving and investment are not the main determinants of interest rates, especially in the short run. Instead, the supply of and the demand for the stock of *money* determine interest rates in the short run. (This is not drawn in the graph.) Neither changes quickly in response to excessive saving to allow fast interest-rate adjustment.

Finally, Keynes suggested that, because of fear of capital losses on assets besides money, there may be a "liquidity trap" setting a floor under which interest rates cannot fall. While in this trap, interest rates are so low that any increase in money supply will cause bond-holders (fearing rises in interest rates and hence capital losses on their bonds) to sell their bonds to attain money (liquidity).

In the diagram (figure 6), the equilibrium suggested by the **new I** line and the **old S** line cannot be reached, so that excess saving persists. Some (such as Paul Krugman) see this latter kind of liquidity trap as prevailing in Japan in the 1990s. Most economists agree that nominal interest rates cannot fall below zero. However, some economists (particularly those from the Chicago school) reject the existence of a liquidity trap.

In sum, to Keynes there is interaction between excess supplies in different markets, as unemployment in labour markets encourages excessive saving – and *vice-versa*. Rather than prices adjusting to attain equilibrium, the main story is one of quantity adjustment allowing recessions and possible attainment of underemployment equilibrium.

3.4 "Multiplier Effect" And Interest Rates

Two aspects of Keynes's model have implications for policy:

First, there is the "Keynesian multiplier", first developed by Richard F. Kahn in 1931. Exogenous increases in spending, such as an increase in government outlays, increases total spending by a multiple of that increase. A government could stimulate a great deal of new production with a modest outlay if:

1. The people who receive this money then spend most on consumption goods and save the rest.
2. This extra spending allows businesses to hire more people and pay them, which in turn allows a further increase in consumer spending.

This process continues. At each step, the increase in spending is smaller than in the previous step, so that the multiplier process tapers off and allows the attainment of an equilibrium. This story is modified and moderated if we move beyond a "closed economy" and bring in the role of taxation: The rise in imports and tax payments at each step reduces the amount of induced consumer spending and the size of the multiplier effect.

Second, Keynes re-analyzed the effect of the interest rate on investment. In the classical model, the supply of funds (saving) determines the amount of fixed business investment. That is, under the classical model, since all savings are placed in banks, and all business investors in need of borrowed funds go to banks, the amount of savings determines the amount that is available to invest. Under Keynes's model, the amount of investment is determined independently by long-term profit expectations and, to a lesser extent, the interest rate. The latter opens the possibility of regulating the economy through money supply changes, via monetary policy. Under conditions such as the Great Depression, Keynes argued that this approach would be relatively ineffective compared to fiscal policy. But, during more "normal" times, monetary expansion can stimulate the economy.

3.5 IS/LM model

The IS/LM model is nearly as influential as Keynes's original analysis in determining actual policy and economics education. It relates aggregate demand and employment to three exogenous quantities, i.e., the amount of money in circulation, the government budget, and the state of business expectations. This model was very popular with economists after World War II because it could be understood in terms of general equilibrium theory. This encouraged a much more static vision of macroeconomics than that described above

4.0CONCLUSION

Keynesians emphasized the dependence of consumption on disposable income and, also, of investment on current profits and current cash flow. In addition, Keynesians posited a Phillips curve that tied nominal wage inflation to unemployment rate. To support these theories, Keynesians typically traced the logical foundations of their model (using introspection) and supported their assumptions with statistical evidence.

5.0SUMMARY

You have learnt the meaning of Keynesian economics as well as its overview, theory and concept. You also learnt the Keynesian “Multiplier effect", interest rates and the IS/LM model.

In the next unit which is Unit 4, we shall discuss welfare economics.

6.0 TUTOR-MARKED ASSIGNMENT

1. With appropriate diagrams, explain the Keynesian concept of wages and spending.
2. Two aspects of Keynes's model have implications for policy. Discuss

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UNIT 4: WELFARE ECONOMICS

CONTENT

1.0INTRODUCTION

In the preceding unit we learnt the meaning of Keynesian economics as well as its overview, theory and concept. We also learnt the Keynesian “Multiplier effect", interest rates and the IS/LM model. In the present unit which is Unit 4, we shall discuss welfare economics.

2.0OBJECTIVES

At the end of this unit, you should be able to:

- Explain the meaning of welfare economics
- Describe approaches to welfare economics
- Discuss the conditions for efficiency
- Discuss the conditions for inefficiency
- Give a simplified seven-equation model
- Explain efficiency between production and consumption
- Discuss social welfare maximization

3.0 MAIN CONTENT

3.1 Meaning of Welfare Economics

Welfare economics is a branch of economics that uses microeconomic techniques to evaluate well-being from allocation of productive factors as to desirability and economic efficiency within an economy, often relative to competitive general equilibrium (Arrow, 1951). It analyzes *social welfare*, however measured, in terms of economic activities of the individuals that compose the theoretical society considered. Accordingly, individuals, with associated economic activities, are the basic units for aggregating to social welfare, whether of a group, a community, or a society, and there is no "social welfare" apart from the "welfare" associated with its individual units.

Welfare economics typically takes individual preferences as given and stipulates a welfare improvement in Pareto efficiency terms from social state ***A*** to social state ***B*** if at least one person prefers ***B*** and no one else opposes it. There is no requirement of a unique quantitative measure of the welfare improvement implied by this. Another aspect of welfare treats income/goods distribution, including equality, as a further dimension of welfare (Arrow and Gérard, 2002).

Social welfare refers to the overall welfare of society. With sufficiently strong assumptions, it can be specified as the summation of the welfare of all the individuals in the society. Welfare may be measured either cardinally in terms of "utils" or dollars, or measured ordinally in terms of Pareto efficiency. The cardinal method in "utils" is seldom used in pure theory today because of aggregation problems that make the meaning of the method doubtful, except on widely challenged underlying assumptions. In applied welfare economics, such as in cost-benefit analysis, money-value estimates are often used, particularly where income-distribution effects are factored into the analysis or seem unlikely to undercut the analysis.

The capabilities approach to welfare argues that freedom - what people are free to do or be - should be included in welfare assessments, and the approach has been particularly influential in development policy circles where the emphasis on multi-dimensionality and freedom has shaped the evolution of the Human Development Index. Other classifying terms in welfare economics include externalities, equity, justice, inequality, and altruism (Atkinson, 1975).

3.2 Approaches to Welfare Economics

There are two mainstream approaches to welfare economics: the early *Neoclassical approach* and the *New welfare economics approach* (Wikipedia, 2009). The early

Neoclassical approach was developed by Edgeworth, Sidgwick, Marshall, and Pigou. It assumes the following:

- Utility is cardinal, that is, scale-measurable by observation or judgment.
- Preferences are exogenously given and stable.
- Additional consumption provides smaller and smaller increases in utility (diminishing marginal utility).
- All individuals have interpersonally comparable utility functions (an assumption that Edgeworth avoided in his *Mathematical 'Psychics*).

With these assumptions, it is possible to construct a social welfare function simply by summing all the individual utility functions. The *New Welfare Economics* approach is based on the work of Pareto, Hicks, and Kaldor. It explicitly recognizes the differences between the efficiency aspect of the discipline and the distribution aspect and treats them differently. Questions of efficiency are assessed with criteria such as Pareto efficiency and the Kaldor-Hicks compensation tests, while questions of income distribution are covered in social welfare function specification. Further, efficiency dispenses with cardinal measures of utility, replacing it with ordinal utility, which merely ranks commodity bundles (with an indifference-curve map, for example).

Self-Assessment exercise 4.1

What are the assumptions of the early *Neoclassical approach* to welfare economics developed by Edgeworth, Sidgwick, Marshall, and Pigou?

3.3 Conditions for Efficiency

Situations are considered to have distributive efficiency when goods are distributed to the people who can gain the most utility from them. Many economists use Pareto efficiency as their efficiency goal. According to this measure of social welfare, a situation is optimal only if no individuals can be made better off without making someone else worse off. This ideal state of affairs can only come about if four criteria are met:

- The marginal rates of substitution in consumption are identical for all consumers. This occurs when no consumer can be made better off without making others worse off.
- The marginal rate of transformation in production is identical for all products. This occurs when it is impossible to increase the production of any good without reducing the production of other goods.

- The marginal resource cost is equal to the marginal revenue product for all production processes. This takes place when marginal physical product of a factor must be the same for all firms producing a good.
- The marginal rates of substitution in consumption are equal to the marginal rates of transformation in production, such as where production processes must match consumer wants.

3.4 Conditions for Inefficiency

There are a number of conditions that, most economists agree, may lead to inefficiency. They include:

- Imperfect market structures, such as a monopoly, monopsony, oligopoly, oligopsony, and monopolistic competition.
- Factor allocation inefficiencies in production theory basics.
- Market failures and externalities; there is also social cost.
- Price discrimination and price skimming.
- Asymmetric information, principal–agent problems.
- Long run declining average costs in a natural monopoly.
- Certain types of taxes and tariffs.

To determine whether an activity is moving the economy towards Pareto efficiency, two compensation tests have been developed. Any change usually makes some people better off while making others worse off, so these tests ask what would happen if the winners were to compensate the losers. Using the *Kaldor criterion*, an activity will contribute to Pareto optimality if the maximum amount the gainers are prepared to pay is greater than the minimum amount that the losers are prepared to accept. Under the *Hicks criterion*, an activity will contribute to Pareto optimality if the maximum amount the losers are prepared to offer to the gainers in order to prevent the change is less than the minimum amount the gainers are prepared to accept as a bribe to forgo the change. The Hicks compensation test is from the losers' point of view, while the Kaldor compensation test is from the gainers' point of view. If both conditions are satisfied, both gainers and losers will agree that the proposed activity will move the economy toward Pareto optimality. This is referred to as Kaldor-Hicks efficiency or the Scitovsky criterion.

3.5 A simplified Seven-equation Model

The basic welfare economics problem is to find the theoretical maximum of a social welfare function, subject to various constraints such as the state of technology in production, available natural resources, national infrastructure, and behavioural constraints such as consumer utility maximization and producer profit maximization. In the simplest possible economy this can be done by simultaneously solving seven equations. This simple economy would have only two consumers (consumer **1** and consumer **2**), only two products (product **X** and product **Y**), and only two factors of production going into these products (labour (**L**) and capital (**K**)). The model can be stated as: Maximize social welfare: $W=f(U^1\ U^2)$ subject to the following set of constraints:

$K = K^x + K^y$ (The amount of capital used in the production of goods **X** and **Y**)

$L = L^x + L^y$ (The amount of labour used in the production of goods **X** and **Y**)

$X = X(K^x\ L^x)$ (The production function for product **X**)

$Y = Y(K^y\ L^y)$ (The production function for product **Y**)

$U^1 = U^1(X^1\ Y^1)$ (The preferences of consumer **1**)

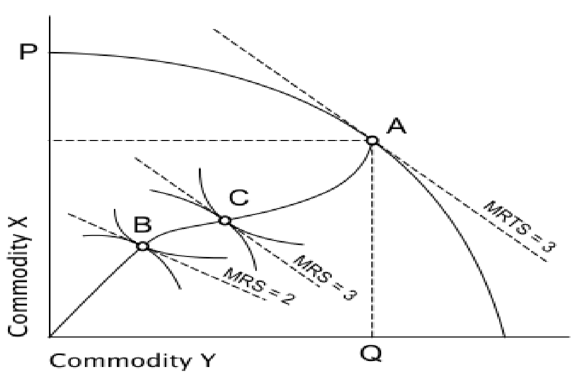
$U^2 = U^2(X^2\ Y^2)$ (The preferences of consumer **2**)

The solution to this problem yields a Pareto optimum.

3.6 Efficiency between Production and Consumption

The relation between production and consumption in a simple seven equation model (**2x2x2** model) can be shown graphically. In the diagram below, the aggregate production possibility frontier, labeled **PQ** shows all the points of efficiency in the production of goods **X** and **Y**. If the economy produces the mix of good **X** and **Y** shown at point **A,** then the marginal rate of transformation (**MRT**), **X** for **Y**, is equal to **3**.

Diagram 7: An Edgeworth Box Diagram of Consumption



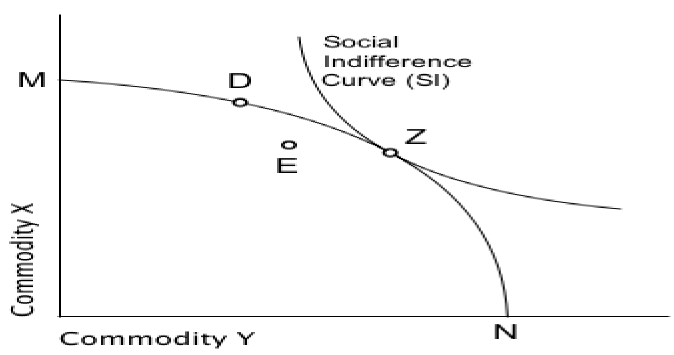
Source: Wikipedia 2009

Point **A** defines the boundaries of an Edgeworth box diagram of consumption. That is, the same mix of products that are produced at point **A**, can be consumed by the two consumers in this simple economy. The consumers' relative preferences are shown by the indifference curves inside the Edgeworth box. At point **B** the marginal rate of substitution (**MRS**) is equal to 2, while at point **C** the marginal rate of substitution is equal to 3. Only at point **C** is consumption in balance with production (**MRS=MRT**), i.e. Marginal Rate of Substitution is equal to Marginal Rate of Transformation. The curve **0BCA** (often called the contract curve) inside the Edgeworth box defines the locus of points of efficiency in consumption (**MRS^1=MRS^2**). As we move along the curve, we are changing the mix of goods **X** and **Y** that individuals 1 and 2 choose to consume. The utility data associated with each point on this curve can be used to create utility functions.

3.7 Social Welfare Maximization

Utility functions can be derived from the points on a contract curve. Numerous utility functions can be derived, one for each point on the production possibility frontier (**PQ** in the diagram above). A social utility frontier (also called a grand utility frontier) can be obtained from the outer envelope of all these utility functions. Each point on a social utility frontier represents an efficient allocation of an economy's resources; that is, it is a Pareto optimum in factor allocation, in production, in consumption, and in the interaction of production and consumption (supply and demand). In the diagram below, the curve **MN** is a social utility frontier. Point **D** corresponds with point **C** from the earlier diagram. Point **D** is on the social utility frontier because the marginal rate of substitution at point **C** is equal to the marginal rate of transformation at point A. Point E corresponds with point **B** in the previous diagram, and lies inside the social utility frontier (indicating inefficiency) because the **MRS** at point **C** is not equal to the **MRT** at point A.

Diagram 9: Social Indifference Curve



Source: Wikipedia 2009

Although all the points on the grand social utility frontier are Pareto efficient, only one point identifies where social welfare is maximized. Such point is called "the point of bliss". This point is **Z** where the social utility frontier **MN** is tangent to the highest possible social indifference curve labeled **SI**.

4.0 CONCLUSION

Value assumptions explicit in the social welfare function used and implicit in the efficiency criterion chosen tend to make welfare economics a normative and perhaps subjective field. This can make it controversial.

However, perhaps most significant of all are concerns about the limits of a utilitarian approach to welfare economics. According to this line of argument, utility is not the only thing that matters and so a comprehensive approach to welfare economics should include other factors. The capabilities approach to welfare is an attempt to construct a more comprehensive approach to welfare economics, one in which functionings, happiness and capabilities are the three key aspects of welfare outcomes that people should seek to promote and foster.

5.0 SUMMARY

In this unit you learnt welfare economics in which you studied its meaning and approaches. You also learnt the conditions for efficiency and inefficiency, income distribution, simplified seven-equation model, the efficiency between production and consumption and social welfare maximization.

In the next unit, which is Unit 5, we will study modern theories of development and growth.

6.0 TUTOR-MARKED ASSIGNMENT

1. What are the conditions for Pareto efficiency?

2. With the aid of a social indifference curve diagram, explain social welfare maximization. Which point is called the point of bliss? .

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UNIT 5: ECONOMIC GROWTH THEORIES

CONTENT

1.0 INTRODUCTION

In the preceding unit you learnt welfare economics in which you studied its meaning and approaches. You also learnt the conditions for efficiency and inefficiency, income distribution, simplified seven-equation model, the efficiency between production and consumption and social welfare maximization.

In the present unit, which is Unit 5, we will study modern theories of growth.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Discuss the meaning of economic growth
- State the factors affecting economic growth
- Explain classical growth theory
- Explain he neoclassical growth model
- List linear stages of growth model

- Analyze Salter cycle
- Discuss endogenous growth theory
- Explain unified growth theory
- Discuss the big push growth theory
- Explain Schumpeterian growth theory

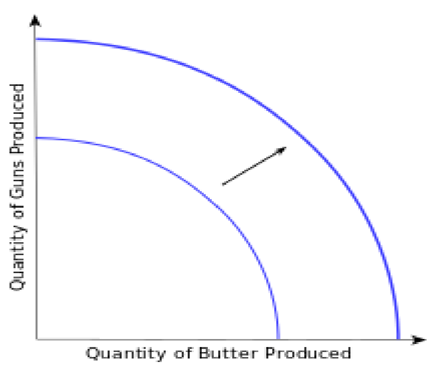
3.0 MAIN CONTENT

3.1 Meaning of Economic Growth

Economic growth is the increase in the market value of the goods and services produced by an economy over time. It is conventionally measured as the percent rate of increase in *real gross domestic product*, or *real GDP* (IMF, 2012). Of more importance is the growth of the ratio of GDP to population (GDP per capita), which is also called *per capita income*. An increase in per capita income is referred to as *intensive growth*. GDP growth caused only by increases in population or territory is called *extensive growth* (Bjork, 1999).

Growth is usually calculated in *real* terms – i.e., inflation-adjusted terms – to eliminate the distorting effect of inflation on the price of goods produced. In economics, "economic growth" or "economic growth theory" typically refers to growth of potential output, i.e., production at "full employment".

Diagram 11: The production-possibility frontier



Source: Wikipedia, 2011

In diagram 11 above, economic growth caused the production-possibility frontier to shift outward.

3.2 Factors Affecting Economic Growth

You should note that the primary driving force of economic growth is the growth of productivity, which is the ratio of economic output to inputs (capital, labour, energy, materials and services (KLEMS)). Increases in productivity lower the cost of goods, which is called a shift in supply. By John W. Kendrick's estimate, three-quarters of increase in U.S. per capita GDP from 1889-1957 was due to increased productivity (Kendrick, 1961). Over the 20th century the real price of many goods fell by over 90%. Lower prices create an increase in aggregated demand, but demand for individual goods and services are subject to diminishing marginal utility. (See:Salter cycle) Additional demand is created by new or improved products (Rosenberg, 1982; Ayres, 1989). Demographic factors influence growth by changing the employment to population ratio and the labor force participation rate (Bjork 1999). Other factors include the quantity and quality of available natural resources (Kendrick, 1980), including land (George, 1879).

Self-Assessment Exercise 4.1

What do you understand by the acronym KLEMS?

3.3 Theories of Economic Growth

In this sub-section, we shall study some theories of economic growth. These are classical, neo-classical, Salter cycle, endogenous, unified, the big push, Schumpeterian growth theories.

3.3.1 Classical Growth Theory

You should remember that we pointed out in Unit 5 of Module 2 that Adam Smith wrote *The Wealth of Nations.* As such, the formation of the classical growth theory began in the 18th century with the critique of mercantilism, especially by the physiocrats and with the Scottish Enlightenment thinkers such as David Hume and Adam Smith, and the foundation of the discipline of modern political economy. Adam Smith noted the huge gains in productivity achieved by the division of labour in the famous example of the pin factory.

David Ricardo argues that trade benefits a country, because if one can buy an imported good more cheaply, it means there is more profitable work to be done here. This theory of *comparative advantage* would be the central basis for arguments in favour of free trade as an essential component of growth.

3.3.2 The Neoclassical Growth Model

The notion of growth as increased stocks of capital goods was codified as the Solow-Swan Growth Model, which involved a series of equations that showed the relationship between labour-time, capital goods, output, and investment. According to this view, the role of technological change became crucial, even more important than the accumulation of capital. This model, developed by Robert Solow (Solow, 1956) and Trevor Swan in the 1950s, was the first attempt to model long-run growth analytically. This model assumes that countries use their resources efficiently and that there are diminishing returns to capital and labour increases. From these two premises, the neoclassical model makes three important predictions. First, increasing capital relative to labour creates economic growth, since people can be more productive given more capital. Second, poor countries with less capital per person grow faster because each investment in capital produces a higher return than rich countries with ample capital. Third, because of diminishing returns to capital, economies eventually reach a point where any increase in capital no longer creates economic growth. This point is called a *steady state*.

The model also notes that countries can overcome this steady state and continue growing by inventing new technology. In the long-run, output per capita depends on the rate of saving, but the rate of output growth should be equal for any saving rate. In this model, the process by which countries continue growing despite the diminishing returns is "exogenous" and represents the creation of new technology that allows production with fewer resources. Technology improves, the steady state level of capital increases, and the country invests and grows.

3.3.3 Linear Stages of Growth Model

The linear stages of growth model is an economic model which is heavily inspired by the Marshall Plan which was used to revitalize Europe's economy after World War II. It assumes that economic growth can only be achieved by industrialization. Growth can be restricted by local institutions and social attitudes, especially if these aspects influence the savings rate and investments. The constraints impeding economic growth are thus considered by this model to be internal to society (Khun, 2008).

According to the linear stages of growth model, a correctly designed massive injection of capital coupled with intervention by the public sector would ultimately lead to industrialization and economic development of a developing nation (Rostow – 1960).

The Rostow's stages of growth model is the most well-known example of the linear stages of growth model (*ibid*). Walt W. Rostow identified five stages through which developing countries had to pass to reach an advanced economy status: (1) Traditional society, (2) Preconditions for take-off, (3) Take-off, (4) Drive to maturity, (5) Age of high mass consumption. He argued that economic development could be led by certain strong sectors; this is in contrast to for instance Marxism which states that sectors should develop equally. According to Rostow's model, a country needed to follow some rules of development to reach the take-off: (1) The investment rate of a country needs to be increased to at least 10% of its GDP, (2) One or two manufacturing sectors with a high rate of growth need to be established, (3) An institutional, political and social framework has to exist or be created in order to promote the expansion of those sectors.

The Rostow model has serious flaws, of which the most serious are: (1) The model assumes that development can be achieved through a basic sequence of stages which are the same for all countries, a doubtful assumption; (2) The model measures development solely by means of the increase of GDP per capita; (3) The model focuses on characteristics of development, but does not identify the causal factors which lead development to occur. As such, it neglects the social structures that have to be present to foster development.

Economic modernization theories such as Rostow's stages model have been heavily inspired by the Harrod-Domar model which explains in a mathematical way the growth rate of a country in terms of the savings rate and the productivity of capital. Heavy state involvement has often been considered necessary for successful development in economic modernization theory; Paul Rosenstein-Rodan, Ragnar Nurkse and Kurt Mandelbaum argued that a big push model in infrastructure investment and planning was necessary for the stimulation of industrialization, and that the private sector would not be able to provide the resources for this on its own (Scribd.com. 2010). Another influential theory of modernization is the dual-sector model by Arthur Lewis. In this model Lewis explained how the traditional stagnant rural sector is gradually replaced by a growing modern and dynamic manufacturing and service economy (World Bank, 1994).

Because of the focus on the need for investments in capital, the Linear Stages of Growth Models are sometimes referred to as suffering from 'capital fundamentalism' (Swarthmore, 2008).

3.3.4 Salter Cycle

According to the Salter cycle, economic growth is enabled by increases in productivity, which lowers the inputs (labour, capital, material, energy, etc.) for a given amount of product (output) (Kendrick, 1961). Lowered cost increases demand for goods and services, which also results in capital investment to increase capacity. New capacity is more efficient because of new technology, improved methods and economies of scale.

This leads to further price reductions, which further increases demand, until markets become saturated due to diminishing marginal utility.

3.3.5 Endogenous Growth Theory

Growth theory advanced again with theories of economist Paul Romer and Robert Lucas, Jr. in the late 1980s and early 1990s.

Unsatisfied with Solow's explanation, economists worked to "endogenize" technology in the 1980s. They developed the endogenous growth theory that includes a mathematical explanation of technological advancement.[35][36] This model also incorporated a new concept of human capital, the skills and knowledge that make workers productive. Unlike physical capital, human capital has increasing rates of return. Therefore, overall there are constant returns to capital, and economies never reach a steady state. Growth does not slow as capital accumulates, but the rate of growth depends on the types of capital a country invests in. Research done in this area has focused on what increases human capital (e.g. education) or technological change (e.g. innovation) (Elhanah, 2004).

3.3.6 Unified growth theory

Unified growth theory was developed by Oded Galor and his co-authors to address the inability of endogenous growth theory to explain key empirical regularities in the growth processes of individual economies and the world economy as a whole. Endogenous growth theory was satisfied with accounting for empirical regularities in the growth process of developed economies over the last hundred years. As a consequence, it was not able to explain the qualitatively different empirical regularities that characterized the growth process over longer time horizons in both developed and less developed economies. Unified growth theories are endogenous growth theories that are consistent with the entire process of development, and in particular the transition from the epoch of Malthusian stagnation that had characterized most of the process of development to the contemporary era of sustained economic growth (Galor, 2005).

3.3.7 The Big Push

In theories of economic growth, the mechanisms that let it take place and its main determinants are abundant. One popular theory in the 1940s, for example, was that of the *Big Push*, which suggested that countries needed to jump from one stage of development to another through a virtuous cycle, in which large investments in infrastructure and education coupled with private investments would move the economy to a more productive stage, breaking free from economic paradigms appropriate to a lower productivity stage (Wikipedia, 2011).

3.3.8 Schumpeterian Growth

Schumpeterian growth is an economic theory named after the 20th-century Austrian economist Joseph Schumpeter. Unlike other economic growth theories, his approach explains growth by innovation as a process of creative destruction that captures the dual nature of technological progress: in terms of creation, entrepreneurs introduce new products or processes in the hope that they will enjoy temporary monopoly-like profits as they capture markets. In doing so, they make old technologies or products obsolete.

This is the destruction referred to by Schumpeter, which could also be referred to as the *annulment* of previous technologies, which makes them obsolete, and "...destroys the rents generated by previous innovations." (Aghion, 2002:855-822). A major model that illustrates Schumpeterian growth is the Aghion-Howitt model (Aghion and Howitt, 1992).

4.0 CONCLUSION

Since economic growth is measured as the annual percent change of gross domestic product (GDP), it has all the advantages and drawbacks of that measure. For example, GDP only measures the market economy, which tends to overstate growth during the change over from a farming economy with household production. An adjustment was made for food grown on and consumed on farms, but no correction was made for other household production. Also, there is no allowance in GDP calculations for depletion of natural resources.

5.0 SUMMARY

In this unit, you learnt the meaning of economic growth and factors affecting economic growth. You also learnt theories of growth such as classical, neoclassical, linear stages, Salter cycle, endogenous, unified, the Big Push and Schumpeterian.

In the next unit which is Unit 6 and the last unit for this course, we shall examine modern development theories.

6.0 TUTOR-MARKED ASSIGNMENT

1. Define and explain economic growth.

2. List all the 7 theories of economic growth you learnt in this course. Discuss the Schumpeterian theory of economic growth.

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UNIT 6: MODERN THEORIES OF DEVELOPMENT

CONTENT

1.0 INTRODUCTION

In preceding unit, we learnt the meaning of economic growth and factors affecting economic growth. We also learnt theories of growth such as classical, neoclassical, linear stages, Salter cycle, endogenous, unified, the Big Push and Schumpeterian.

In the present unit which is Unit 6 and the last unit for this course, we shall examine modern theories of development.

2.0OBJECTIVES

At the end of this unit, you should be able to:

- Discuss introduction to development theories
- Explain structural change theory
- Discuss dependency theory
- Explain post-development theory
- Clarify Neo-liberalist theory
- Describe structural adjustment
- Discuss sustainable development
- Explain human development theory

3.0 MAIN CONTENT

3.1 Introduction to Development Theories

Development theories attempt to explain the conditions that are necessary for development to occur, and weigh up the relative importance of particular conditions. Development theory is a conglomeration or a collective vision of theories about how desirable change in society is best achieved. Such theories draw on a variety of social science disciplines and approaches (Robert, 1986).

Early theories focused on understanding economic growth, and attempted to find general determinants of growth that could be applied to any instance under consideration. By looking at patterns of growth the hope was to discover some of the laws or principles which govern growth at all times and in all countries. Modern theories tend to accept that conditions for growth change over time, and are often more critical of the attempts to generate *one-size-fits-all* growth theories (*ibid)*.

Self-Assessment Exercise 6.1

Why heavy state involvement is considered necessary for successful development in economic modernization theory?

3.2 The Basic Needs Approach

The basic needs approach was introduced by the International Labour Organization in 1976, mainly in reaction to prevalent modernisation- and structuralism-inspired development approaches, which were not achieving satisfactory results in terms of poverty alleviation and combating inequality in developing countries. It tried to define an absolute minimum of resources necessary for long-term physical well-being. The poverty line which follows from this, is the amount of income needed to satisfy those basic needs. The approach has been applied in the sphere of development assistance, to determine what a society needs for subsistence, and for poor population groups to rise above the poverty line. Basic needs theory does not focus on investing in economically productive activities. Basic needs can be used as an absolute measure of poverty.

Proponents of basic needs have argued that elimination of absolute poverty is a good way to make people active in society so that they can provide labor more easily and act as consumers and savers (UNESCO, 20060. There have been also many critics of the basic needs approach. It would lack theoretical rigour, practical precision, be in conflict with growth promotion policies, and run the risk of leaving developing countries in permanent backwardness.

3.3 Structural Change Theory

Structuralism is a development theory which focuses on structural aspects which impede the economic growth of developing countries. The unit of analysis is the transformation of a country's economy from, mainly, subsistence agriculture to a modern, urbanized manufacturing and service economy. Policy prescriptions resulting from structuralist thinking include major government intervention in the economy to fuel the industrial sector, known as Import Substitution Industrialization (ISI) (Eugeniomiravete, 2001). This structural transformation of the developing country is pursued in order to create an economy which in the end enjoys self-sustaining growth. This can only be reached by ending the reliance of the underdeveloped country on exports of primary goods (agricultural and mining products), and pursuing inward-oriented development by shielding the domestic economy from that of the developed economies. Trade with advanced economies is minimized through the erection of all kinds of trade barriers and an overvaluation of the domestic exchange rate; in this way the production of domestic substitutes of formerly imported industrial products is encouraged. The logic of the strategy rests on the Infant industry argument, which states that young industries initially do not have the economies of scale and experience to be able to compete with foreign competitors and thus need to be protected until they are able to compete in the free market (Jazzapazza, 2011). The ISI strategy is supported by the Prebisch-Singer thesis, which states that over time, the terms of trade for commodities deteriorate compared to manufactured goods. This is because of the observation that the income elasticity of demand is greater for manufactured goods than that for primary products.

Structuralists argue that the only way Third World countries can develop is through action by the State. Third world countries have to push industrialization and have to reduce their dependency on trade with the First World, and trade among themselves.

3.4 Dependency Theory

Dependency theory is essentially a follow up to structuralist thinking, and shares many of its core ideas. Whereas structuralists did not consider that development would be possible at all unless a strategy of delinking and rigorous ISI was pursued, dependency thinking could allow development with external links with the developed parts of the globe. However, this kind of development is considered to be "dependent development", i.e., it does not have an internal domestic dynamic in the developing country and thus remains highly vulnerable to the economic vagaries of the world market. Dependency thinking starts from the notion that resources flow from the 'periphery' of poor and underdeveloped states to a 'core' of wealthy countries, which leads to accumulation of wealth in the rich states at the expense of the poor states. Contrary to modernization theory, dependency theory states that not all societies progress through similar stages of development. Primitive states have unique features, structures and institutions of their own and are the weaker with regard to the world market economy, while the developed nations have never been in this follower position in the past. Dependency theorists argue that underdeveloped countries remain economically vulnerable unless they reduce their connectedness to the world market (Mtholyoke.edu., 1966; Fordham.edu.,2013).

Dependency theory states that poor nations provide natural resources and cheap labour for developed nations, without which the developed nations could not have the standard of living which they enjoy. Also, developed nations will try to maintain this situation and try to counter attempts by developing nations to reduce the influence of developed nations. This means that poverty of developing nations is not the result of the disintegration of these countries in the world system, but because of the way in which they are integrated into this system.

In addition to its structuralist roots, dependency theory has much overlap with Neo-Marxism and World Systems Theory, which is also reflected in the work of Immanuel Wallerstein, a famous dependency theorist. Wallerstein rejects the notion of a Third World, claiming that there is only one world which is connected by economic relations (World Systems Theory). He argues that this system inherently leads to a division of the world in core, semi-periphery and periphery. One of the results of expansion of the world-system is the commodification of things, like natural resources, labor and human relationships (Elwell, 2006).

Self-Assessment Exercise 6.2

What is world system theory?

3.5 Post-development Theory

Post-development theory is a school of thought which questions the idea of national economic development altogether. According to post-development scholars, the goal of improving living standards leans on arbitrary claims as to the desirability and possibility of that goal. Post-development theory arose in the 1980s and 1990s.

According to post-development theorists, the idea of development is just a 'mental structure' (Sachs,1992)) which has resulted in an hierarchy of developed and underdeveloped nations, of which the underdeveloped nations desire to be like developed nations (Meadows et al.,1972). Development thinking has been dominated by the West and is very ethnocentric, according to Sachs. The Western lifestyle may neither be a realistic nor a desirable goal for the world's population, post-development theorists argue. Development is being seen as a loss of a country's own culture, people's perception of themselves and modes of life. According to Majid Rahnema, another leading post-development scholar, things like notions of poverty are very culturally embedded and can differ a lot among cultures. The institutes which voice the concern over underdevelopment are very Western-oriented, and post-development calls for a broader cultural involvement in development thinking.

Post-development proposes a vision of society which removes itself from the ideas which currently dominate it. According to Arturo Escobar, post-development is interested instead in local culture and knowledge, a critical view against established sciences and the promotion of local grassroots movements. Also, post-development argues for structural change in order to reach solidarity, reciprocity, and a larger involvement of traditional knowledge.

3.6 Neo-Liberalist Theory

Neoclassical development theory has its origins in its predecessor: classical economics. Classical economics was developed in the 18th and 19th centuries and dealt with the value of products and on which production factors it depends. Early contributors to this theory are Adam Smith and David Ricardo. Classical economists argued - as do the neoclassical ones - in favour of the free market, and against government intervention in those markets. The 'invisible hand' of Adam Smith makes sure that free trade will ultimately benefit all of society. John Maynard Keynes was a very influential classical economist as well, having written his General Theory of Employment, Interest, and Money in 1936.

Neoclassical development theory became influential towards the end of the 1970s, fired by the election of Margaret Thatcher in the UK and Ronald Reagan in the USA. Also, the World Bank shifted from its Basic Needs approach to a neoclassical approach in 1980. From the beginning of the 1980s, neoclassical development theory really began to roll out. One of the implications of the neoclassical development theory for developing countries was the Structural Adjustment Programmes (SAPs) which the World Bank and the International Monetary Fund (IMF) wanted them to adapt

3.7 Sustainable development

Sustainable development is economic development in such a way that it meets the needs of the present without compromising the ability of future generations to meet their own needs. (Brundtland Commission). There exist more definitions of sustainable development, but they have in common that they all have to do with the carrying capacity of the earth and its natural systems and the challenges faced by humanity. Sustainable development can be broken up into environmental sustainability, economic sustainability and sociopolitical sustainability. The book 'Limits to Growth', commissioned by the Club of Rome, gave huge momentum to the thinking about sustainability (Meadows et al., 1972). Global warming issues are also problems which are emphasized by the sustainable development movement. This led to the 1997 Kyoto Accord, with the plan to cap greenhouse-gas emissions.

Opponents of the implications of sustainable development often point to the environmental Kuznets curve. The idea behind this curve is that, as an economy grows, it shifts towards more capital and knowledge-intensive production. This means that as an economy grows, its pollution output increases, but only until it reaches a particular threshold where production becomes less resource-intensive and more sustainable. This means that a pro-growth, not an anti-growth policy is needed to solve the environmental problem. But the evidence for the environmental Kuznets curve is quite weak. Also, empirically spoken, people tend to consume more products when their income increases. Maybe those products have been produced in a more environmentally friendly way, but on the whole the higher consumption negates this effect. There are people like Julian Simon however who argue that future technological developments will resolve future problems.

3.8 Human Development Theory

Human development theory is a theory which uses ideas from different origins, such as ecology, sustainable development, feminism and welfare economics. It wants to avoid normative politics and is focused on how social capital and instructional capital can be deployed to optimize the overall value of human capital in an economy.

Amartya Sen and Mahbub ul Haq are the most well-known human development theorists. The work of Sen is focused on capabilities: what people can do, and be. It is these capabilities, rather than the income or goods that they receive (as in the Basic Needs approach), that determine their wellbeing. This core idea also underlies the construction of the Human Development Index, a human-focused measure of development pioneered by the UNDP in its Human Development Reports. The economic side of Sen's work can best be categorized under welfare economics, which evaluates the effects of economic policies on the well-being of peoples. Sen wrote the influential book 'Development as freedom' which added an important ethical side to development economics (Sen, 1999).

4.0CONCLUSION

Development theories are used to analyze in which way modernization processes in societies take place. The theory looks at which aspects of countries are beneficial and which constitute obstacles for economic development. The idea is that development assistance targeted at those particular aspects can lead to modernization of 'traditional' or 'backward' societies. Scientists from various research disciplines have contributed to development theories.

5.0SUMMARY

In this unit you learnt modern theories of development and growth. You also learnt the linear stages of growth model, structural change theory, the dependency theory, post-development theory, the Neo-liberalist theory, sustainable development and human development theory.

This unit concludes our course.

6.0 TUTOR-MARKED ASSIGNMENT

1. The Rostow's stages of growth model is the most well-known example of the linear stages of growth model. Discuss.
2. Discuss Human Development Theory.

7.0 REFERENCES AND FURTHER READING

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