

* CHAPTER 1 *

A Science and Its History

THIS IS A BOOK about the history of economic thought and the thinkers behind it. It is natural to begin such a history with some reflections on the nature of economics as a scientific discipline: What is the essential nature of economics as a field of research and study? Over the years several attempts have been made to formulate a definition of the subject that would capture its essence in a single sentence, at once striking and deep. Possibly the most famous example of such a definition was proposed by the English economist Lionel Robbins in the 1930s according to which economics was the study of human behavior as a relationship between given ends and scarce means that have alternative uses. The formulation is a perceptive one that clearly goes to the core of a set of problems that economists are interested in. Sixty years earlier, Alfred Marshall had written that economics was the study of men "in the ordinary business of life," another interesting definition that communicates something of the special nature of the field. Nevertheless, most economists would probably feel that if a noneconomist were to ask them the question "What is economics?" both Robbins's and Marshall's definitions would be much too abstract and obscure to provide the outsider with a helpful answer. A more informative response would be to reply that economics is the study of the functioning of economic life in society, adding some illustrations of central issues that economists are concerned with: What determines the prices of goods and services? What are the causes of unemployment? Which factors decide the distribution of income between individuals and families in society? Why are some countries rich and some poor? What are the effects of public policy such as taxes and public expenditure on prices and the distribution of income? What are the determinants of trade flows between countries? An answer of this kind, although longer and less elegant than the definitions of Robbins and Marshall, is certain to give the outsider a much better idea of what economics is all about.

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The list of specialized areas could obviously be made much longer and more detailed, and if we compare such a list with the set of topics that have engaged economists over the last two and a half centuries we will quickly discover that over time a number of interesting changes have occurred regarding the focus of economic research. On the one hand, the list of topics has expanded: with the development of analytical tools, economists discovered that their discipline could be applied to a wider set of issues than before, so that a number of specializations emerged within the field. Health economics, energy economics, and financial economics are examples of specializations that have grown up during the last decades of the twentieth century. On the other hand, with the passage of time, economics has been more sharply delimited toward other fields of science, with the result that in some respects it has become narrower. Thus the economists of the eighteenth and early nineteenth centuries did not draw any clear borderlines between economics and the field that is presently known as political science, and in general expositions of the subject they also took up many problems that we now think of as belonging to philosophy, sociology, or psychology. It is also worth noting that the relative importance of subfields has varied substantially over time. The conviction of the classical economists that the study of population movements belonged to the core of economics has left few traces in modern textbooks of economics. John Maynard Keynes's analysis of the problem of unemployment in the 1930s became so influential that it led to a change in the research agenda of economics that lasted for decades. The current interest in the economic aspects of environmental problems has no counterpart in the economics literature of the nineteenth century.

A book on the history of economic thought that was written with the ambition to cover all of the special fields within the subject could hardly be written, and certainly not as a one-man undertaking; it also seems doubtful whether it would attract many readers. A more modest and reader-friendly ambition is to give an impression of the history of ideas within the most central areas of economic theory. One such central area is the functioning of the market mechanism. The problem of price determination for goods and services and the question of whether the market mechanism can be said to work for the common good have been

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at the core of the subject throughout its existence. Another central area is the role of the public sector in the economy, its interactions with the private sector, and the determination of a rational balance between the market and the state. A third important area of research is the study of the time path of economic development: economic fluctuations between good and bad times, unemployment, inflation, and growth of productivity and the standard of living. Broad problems of this kind will be at the center of attention in the chapters that follow.

ECONOMICS AS A SOCIAL SCIENCE

The view of economics on which this book is based is that economics is one of the social sciences that study how society works. It is possible, however, to take a broader view of the subject by considering all applications of the methods of economic theory and method. In that case it would also be necessary to cover the history of applications of economics to problems that are internal to the individual business firm, but this large and important field will be left out here. The same holds true for the discipline of accounting, which is also in the nature of a tool for better decision making within firms and organizations. Although the basic theory and analytical methods of these areas have much in common with economics as usually understood, the objective of the analysis is different: in business applications the role of economic methods is to provide a more solid foundation for decisions that further the objectives of the firm, not to lead us to better understanding of the economic life of society as a whole. Of course, the borderlines between the areas are not entirely fixed. To understand the functioning of the market mechanism, it is sometimes important for economists to try to understand the internal workings of the firm. Similarly, for business economists who study the strategic decisions in firms, it is often essential to understand the properties of the markets in which the firms operate.

The term *economics* has been used in English as a name for the subject since the 1890s. Before then, the name commonly used for it was *political economy*. The older name indicated the connections between the study of the economy and the political life and institutions of society—in modern usage between economics and po-

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litical science—but it also served as a reminder that many writers on economics believed that one of its central tasks was to provide governments with a better foundation for the design of economic policy. Today, “political economy” survives partly in the name of one of the leading economic journals (*Journal of Political Economy*) and partly as a term denoting a particular approach to the study of economic policy. In several other languages there has been a similar movement away from terms that gave the impression of economics as mainly a line of inquiry in the direct service of the government.

WHY STUDY THE HISTORY OF ECONOMIC THOUGHT?

In many countries, the study of the history of economic ideas was previously considered to be an indispensable part of the training of an economist.¹ This point of view, however, has been losing ground for a number of years. Many contemporary economists take no interest in the history of their subject, and some are decidedly doubtful about the value of acquiring historical knowledge. There may be several explanations for this, but a main reason is probably that modern economists more than their predecessors regard economics as a cumulative science in which new research and new insights are based on existing knowledge that is constantly being extended and improved. In a cumulative science, therefore, new insights will always tend to make the views of earlier scientists dated and erroneous. The science as it appears today is, according to this view, the result of a systematic process of sorting whereby the valid elements of earlier thinking have been preserved, while the parts of it that were wrong or uninteresting have been discarded. If we go back fifty or a hundred years in time, however, it would have been more difficult to argue in this way. This is because, first, economic theories

¹ A British economist who got his first university position at the end of the 1940s told me that during his first interview with the department chairman he was asked, “What is your period?” In this department the position of the history of economic thought was apparently so strong that it was expected of every member of the staff that he had some kind of expertise on a particular period. However, this young economist thought that the question reflected an obsolete view of the subject and answered with great self-confidence, “It is the future!”

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were formulated with a much lower degree of logical precision than is presently the case and, second, that the opportunities for systematic empirical testing of the theories were considerably poorer. It was accordingly a much more complicated issue that it now is to decide on the exact assumptions on which a theory was based, whether its construction was logically rigorous, and if it was consistent with our knowledge of empirical reality. The old views therefore tended to live on beside the new, and a well-educated economist ought therefore to have some knowledge of the economic thought of earlier times.

The adherents of the cumulative science view of economics regard this question in a different light. They see themselves primarily as problem solvers, either because they wish to contribute to the advancement of academic research or because they have a desire to contribute to practical problems of economic policy. Whichever line of problem solving they wish to pursue, it may seem clear that what they need in the form of scientific training is knowledge of the present contents of economics. That knowledge can be obtained by reading the best modern textbooks and getting acquainted with the research literature of the last twenty to thirty years. But a study of the older literature is only likely to convince one that what is valid in it has been restated later in a better, clearer, and more general way. The American economist Kenneth Boulding (1971) has told the story of an economist who said that he had no interest in the history of thought because it was only about "the wrong opinions of dead men."

It is clearly undeniable that economics has many of the features of a cumulative science, so that it may be worth reflecting on the question of why it should be worthwhile to spend time on the study of its intellectual history. Here are some reasons why it might reasonable to use some time and effort getting to know the history of economics.

1. It is fun. Anyone with some familiarity with modern economics should find it interesting to read about the thinkers and theories of the past, and some will no doubt feel that time spent on the history of economic ideas does not need any further justification. The opinions of dead men may be fascinating to study even if one believes them to be wrong. Einstein's discoveries did not turn Newton into an irrelevant character in history; in a

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similar vein, Paul Samuelson and other twentieth-century economists did not make the life and work of Adam Smith a subject of no relevance and interest.

2. Some knowledge of the history of thought should form part of the liberal education of an economist. In books and articles—sometimes even in the popular press—one comes across terms like “Adam Smith’s invisible hand,” “Walrasian equilibrium,” “Pareto optimality,” “Pigouvian taxes,” and “Keynesian policies.” A well-educated economist clearly ought to know something about the persons that the terms refer to.
3. Some familiarity with the history of thought contributes to a better understanding of the fact that the discipline of economics is in a permanent process of change and development, thereby leading to a better understanding of the nature of economic research. The common nonhistorical way of teaching economics may easily give a false impression of the subject as one that has found its final form. The history of thought makes one realize that economic science has always progressed through the efforts of people who have seen that it contains deficiencies and errors.

These are three good reasons for studying the history of economic thought. Regarding the last of the three, there can be little doubt that economics in general and economic theory in particular have never been as well developed as they now are. Students who read modern textbooks in macro- and microeconomics, public finance, and international trade clearly acquire more solid knowledge and better analytical skills than those who read the textbooks of fifty or one hundred years ago.² One of the benefits to be gained by getting acquainted with the older literature is a better understanding of the internal dynamics of the subject. The concepts and theories that today’s students encounter during their first year are the results of the work of earlier generations of economists on the frontiers of research.

² A small reservation may be in order at this point: they get a better insight in the problems that are taken up *in today’s textbooks*. But if one goes back to a book like Marshall’s *Principles of Economics* from 1890, one will find that this book considers a number of issues that do not receive much attention in modern expositions. A comparison of then and now that focuses exclusively on the treatment of modern topics in the older literature will therefore be systematically biased in favor of the present.

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Consider the following example: one of the first theoretical concepts that one encounters in the study of economic theory is the demand curve, that is, the graphical representation of the connection between the quantity demanded and the price of a commodity. But the demand curve is not something that actually exists “out there”; it is a theoretical construction created by economists to understand how markets function. When in 1838 the demand curve was drawn (or at least appeared in print) for the first time it was a great scientific breakthrough! The realization that concepts and theories that today are regarded as elementary and obvious were once major intellectual challenges for the sharpest minds among economists gives us an important insight into the nature of the research process. It also shows that what presently appears to be simple elements in the theory may not in fact be quite as self-evident as we tend to believe, and this recognition may in turn come to deepen our insights in the modern version of economic theory.

The understanding that economics has developed as a continuous process which continues today is in itself an inspiration for those who wish to attempt to gain a better knowledge of the subject and perhaps even contribute to its further development. In addition, it could even be the case that the study of the older literature may encourage new research by the discovery and re-consideration of problems and fruitful insights that have been neglected in contemporary work.

STYLES IN THE HISTORY OF ECONOMIC THOUGHT

There are several ways to present the history of economic thought. One possibility is to analyze the changing nature of economic theory in conjunction with the social and economic development of society, while another is to emphasize economic thinking as part of the main currents of philosophical and political ideas. Yet another alternative is to emphasize the internal dynamics of the science where new insights and results emerge as a consequence of economists’ awareness of the shortcomings of the present state of the subject. The main emphasis in the following will be on the third of these perspectives, but in a number of cases it is also necessary to draw on other approaches to reach a clear understand-

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ing of why a particular theoretical reorientation took place. When in the 1930s John Maynard Keynes worked out his new analysis of the causes of unemployment it was in part motivated by what he saw as the weaknesses of existing theory but to a large extent also by the mass unemployment that he observed both in Britain and other countries. If in addition we are to understand the background of some of his policy proposals for a way out of the crisis it is also useful to have some knowledge of the attitudes to social engineering and expert rule that were so influential in the intellectual and political climate of the interwar period.

In earlier times it was common to judge the thought of previous generations of economists from what one considered to be their own preconditions without relating them to modern theory. This approach easily leads to what one may call scientific *relativism*: all theories become correct and valuable relative to the context in which the authors lived and worked. This point of view may come to imply a complete denial of the cumulative nature of economics and consequently of the possibility of progress in economics, a point of view that most people today would consider to be an unreasonable position to hold. However, as late as 1931 the historian of thought Alexander Gray was able to write that “economic science, if it be a science, differs from other sciences in this, that there is no inevitable advance from less to greater certainty; there is no ruthless tracking down of truth which, once unbarred, shall be truth to all times to the complete confusion of any contrary doctrine” (Gray 1931; 1980, pp. 2–3).

Gray’s meaning may perhaps not be entirely clear. If he simply means to say that the search for eternal truths is made difficult or impossible by the fact that the economy and its institutions are in a process of constant change, it is not difficult to agree with him in principle. But if he is to be interpreted more generally as saying that there is no scientific progress in economics, it becomes more problematic to support his view. On the contrary, the following chapters will present a number of examples of how economists have been able to achieve a more secure understanding of the assumptions underlying their theories and of the connections between their assumptions and conclusions. Moreover, there can be no doubt that great progress has occurred in regard to the production of knowledge about the empirical facts of economic life.

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Beginning in the 1960s, the common approach to the history of economic thought changed as many authors began to describe the theories of past economists in a modern theoretical framework so as to make them more easily comprehensible to modern readers.³ This makes it in a sense easier to understand the relationship between new and old economic theories and to use one's insights from the study of the history of thought to understand the modern version of the subject. At the same time, this may easily foster an attitude of scientific *absolutism*: one reads the work of the older authors as if they were exam papers written by students who have had no opportunity of getting acquainted with the contents of the reading list.

It is not practically feasible to judge the work of past economists entirely on the basis of the state of the subject in their own time; it is simply not possible for us as moderns to disregard our knowledge of all that has happened during the period between their own time and ours. A pure relativist attitude is therefore impossible. However, scientific absolutism is an approach with its own difficulties. One may to an excessive degree come to regard the past through the lenses of the present, although this might result in an incomplete understanding of the historical foundations of economic thought. It may be argued that this does not matter as long as the interpretations are interesting. But in taking this line one runs the risk of overlooking other contributions by these authors that are as interesting as the ones that can be "translated" into modern scientific language and that might possibly provide more valuable suggestions for future research. A more fruitful attitude consists of combining elements of relativism and absolutism and approaching the older literature in the same way that one ought to approach the new: understanding but critical.

THEORIES AND FACTS

An economic theory is a set of hypotheses about the functioning of parts or the whole of the economic system. A particular

³ A textbook that did much to change the literature on the history of thought in this direction is Mark Blaug's *Economic Theory in Retrospect* that appeared in its first edition in 1962.

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theory may concern a limited set of questions, like the reactions of consumer demand to changes in prices and income, or it may be a more comprehensive analysis of how prices are determined in an economy with many producers, consumers, and markets. Theoretical research aims to improve current theories in terms of generality and logical standards and to develop new theories that either concern novel aspects of economic life or types of economic activity that have so far escaped the attention of theorists. Empirical research can simply take the form of producing data or have the more ambitious aim of testing economic theories—deciding whether or not the theories fit the facts.

The history of economic thought has traditionally been a history of economic *theories*. This is not because economics is nothing but theory. Anyone who has turned the pages of Adam Smith's *Wealth of Nations* (1776) will have discovered that his arguments are based on an impressive array of historical and institutional facts, and a perusal of the most recent volumes of a selection of academic journals will show clearly that empirical analysis occupies a prominent place in modern economic research. Nevertheless, a historical review of the empirical findings of economists through the ages would easily become both excessively long and probably not very interesting. The main reason for this is that the results of empirical research are time specific and heavily dependent on the political and institutional setting of the time. Still, there is a good deal of empirical research that is of more general interest and some of this will be covered in the chapters to follow. Moreover, there is a significant degree of interaction between theory and empirical findings. Although some economic theorists have received most of their inspiration simply from reading the works of other theorists, in the last resort all theories derive from empirical observations that economists feel that they have a need to explain and understand. The theories that emerge from this process will in turn suggest new hypotheses about the functioning of the economy, which can be tested against new observations. Indirectly, therefore, empirical facts and judgments do enter into the development of economic theories, although we will not always be able to account in detail for the specific facts that have inspired the theorists.

It was not until the twentieth century that some economists began to interest themselves more systematically in the statisti-

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cal problems that arise when one tries to put economic theories to the test. Their efforts led to the recognition that the interpretation of empirical relationships involved a series of methodological problems that needed to be solved before one could draw firm conclusions from the study of the statistical material. Some of the work that was done on these problems will be reviewed in chapter 16.

A SPECIAL FIELD

From one point of view, the history of economic thought is a field of specialization within economics in the same way as are international economics, public finance, or labor economics. The literature is written partly by specialists in the field, partly by economists who primarily work in other areas but who take an interest in the history of the subject (as when a public finance specialist writes about some nineteenth-century contribution to the theory of taxation). But most of the contributors to the literature are specialists on the history of economic thought who have their own specialized journals, research conferences, and scientific organizations. There is a steady flow of new publications in the form of articles and books that contribute to new insights in the history of economics as a science.

However, the history of economic thought is a *special* special field. It encourages one to reflect on the contents and development of the subject, while a review of its historical development may serve as an introduction to economics that is different from that of the standard introductory textbook. This introduction must necessarily be organized in a particular way: instead of presenting a first view of economics in terms of the inherent logic of the subject matter, it proceeds in terms of the chronology of theoretical innovations. The chronology of course has its own internal logic by the fact that each generation of researchers relate to the body of knowledge that already exists. The study of the history of economic ideas is therefore a natural supplement to the standard program of study, while at the same time it can function as an introduction to economics for noneconomists.

Any account of the history of economic thought must be selective, not only in terms of topics but also in terms of persons: the

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number of individuals who have made significant contributions to economics is much too large for a discussion of them to be contained within a single book. In the present book, the guiding principle behind the selection of authors has been that the chief interest of modern economists lies in being informed about the thinkers that have had the greatest influence on the subject as we know it today. As an example, one of the reasons why David Ricardo is a central figure in this context is that he is regarded as the originator of the theory of comparative advantage, which is familiar to anyone with an elementary knowledge of the theory of international trade. All modern treatments of international economics refer to Ricardo as the father of the theory, although some historians of thought have argued that the basic elements in Ricardo's theory can be found in the works of earlier authors. It is an interesting research project to clarify the contributions of Ricardo's forerunners, but this type of problem will not receive much attention here. Whatever others may have thought about comparative advantage, Ricardo's name is the one that is familiar to modern economists; it is therefore the natural focus of interest for a history of thought. (In addition there are, as we shall see later, a number of other reasons to pay attention to Ricardo.)

In this book, therefore, we shall concentrate our attention on the great names in the development of economics—on individuals like Adam Smith, David Ricardo, Léon Walras, and Irving Fisher. In a more complete coverage one ought also to discuss the contributions of a series of economists whose work in a historical context may be of great interest even though they do not have the same scientific status. The neglect of some important economists becomes more glaring as we get close to our own times, above all because the number of economists who are active in research is larger than ever before. But the ambition to include more names would, in a relatively short exposition, easily lead to a situation where more elaborate discussions of individuals and ideas get crowded out in favor of brief mention of names, titles, and dates. Hopefully, the reader will be encouraged to follow up some of the references to the literature and go on to further study of particular authors or periods. In that case, maybe he or she will discover some of the pleasure in the study of economics that Keynes expresses when he describes it as, "our own most agree-

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able branch of the moral sciences, in which theory and fact, intuitive imagination and practical judgement, are blended in a manner comfortable to the human intellect" (Keynes 1933, p. 239).

FURTHER READING

There are a number of good expositions of the history of economics. The towering classic in the field is the book by Joseph Schumpeter (1954) whose work will be further considered in chapter 14. It is an impressive book, although many are likely to feel that it contains too much detail. As a reference, especially as regards the older (pre-Adam Smith) literature, it is extremely useful.

A light and entertaining exposition is Heilbroner (1999) where the emphasis is on economists' broader visions of society and the conduct of economic policy and less on their contributions to science in a more specific sense. Comprehensive treatments in modern textbooks are provided by Spiegel (1991) (which has particularly extensive references to the literature), Ekelund and Hébert (1997), Backhouse (2002), and Screpanti and Zamagni (2005). Blaug (1962; 1997) is a more analytic exposition, containing modern mathematical representations of older theories; the book also includes reader's guides to some of the great books of the past. The volume by Niehans (1990) goes further in the direction of mathematical modeling of past theories; this book has a particularly good coverage of the period 1940–80. To proceed even further along the mathematical road one may consult Negishi (1989), but this book only covers the literature until the beginning of the twentieth century. A highly personal treatment is the book by Lionel Robbins (1998), which is based on his lectures in his legendary course at the London School of Economics. The style is informal and amusing, and the lectures include advice to students about the purchase of first editions of economics books from the eighteenth century. Steven G. Medema and Warren J. Samuels have edited a volume, *The History of Economic Thought: A Reader* (2003), that contains selections from the works of a number of writers from Aristotle to Keynes.

Palgrave's Dictionary of Political Economy was first published in the 1890s, and a revised edition came out in the 1920s. A new and much enlarged edition of this important work of reference was

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published in 1987 as *The New Palgrave Dictionary of Economics*, and the second edition of this was published in 2008 under the editorship of Steven N. Durlauf and Lawrence E. Blume. This eight-volume work is available both on paper and on the internet (at www.palgrave.com) and contains numerous excellent articles on individual economists and special topics, often with a historical perspective. Leading journals in the field include *History of Political Economy*, *Journal of the History of Economic Thought*, and *European Journal of the History of Economic Thought*. A comprehensive website for the history of economic thought is operated by the Center for the History of Political Economy at Duke University; see www.econ.duke.edu/CHOPE. This site also provides numerous links to related websites.