

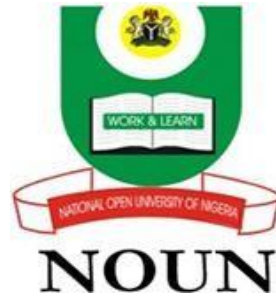


NATIONAL OPEN UNIVERSITY OF NIGERIA

FACULTY OF SOCIAL SCIENCES

COURSE CODE: ECO 324

COURSE TITLE: HISTORY OF ECONOMIC THOUGHT



NATIONAL OPEN UNIVERSITY OF NIGERIA

HISTORY OF ECONOMIC THOUGHT

ECO 324

SCHOOL OF ARTS AND SOCIAL SCIENCES

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CONTENT

Introduction- - - - -	4
What you learn in this course-	4
Course Content- - - - -	5
Course Aims- - - - -	5
Course Objectives- - - - -	6
Working Through This Course-	7
Course Materials- - - - -	7
Study Units - - - - -	7
References and Other Resources-	8
Assignment File- - - - -	8
Presentation Schedule-	8
Assessment- - - - -	9
Tutor-Marked Assignment (TMAs)-	10
Final Examination and Grading-	10
Course Marking Scheme- - - - -	10
Course Overview- - - - -	10
How to Get the Most From This Course-	12
Tutors and Tutorials-	14
Conclusion- - - - -	14

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 Faculty of 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 assignments (TMAs). 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
- History of Economic Thought: John Maynard Keynes
- History of Economic Thought: Joseph Schumpeter
- History of Economic Thought: Milton Friedman
- History of Economic Thought: Modern Day

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 historical and 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.
- (vi) To instruct you on the history of economic thought through the perspectives of John Maynard Keynes, Joseph Schumpeter, Milton Friedman and Modern-Day approaches.

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.
- Analyzing 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
- Analyzing the mathematical school of economic thought
- Discussing the Keynesian economics
- Explaining welfare economics
- Identifying modern theories of growth
- Identifying modern theories of development
- Instructing on the history of economic thought through the perspectives of John Maynard Keynes, Joseph Schumpeter, Milton Friedman and Modern-Day approaches.

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 as 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: Physiocracy

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

MODULE 5

Unit 1: History of Economic Thought: John Maynard Keynes

Unit 2: History of Economic Thought: Joseph Schumpeter

Unit 3: History of Economic Thought: Milton Friedman

Unit 4: History of Economic Thought: Modern Day

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 5 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).
5. History of Economic Thought through John Maynard Keynes, Joseph Schumpeter, Milton Friedman and Modern-Day approaches (units 1,2,3 and 4 of Module 5).

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 indicates 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 304).

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		1 st 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		2 nd 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		3 rd 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		4 th Assignment
23.	History of Economic Thought: John Maynard Keynes		
24.	History of Economic Thought: Joseph Schumpeter		
25.	History of Economic Thought: Milton Friedman		
26.	History of Economic Thought: Modern-Day approaches		5 th 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 diary, 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.

TABLE OF CONTENT**MODULE 1**

Unit 1: Nature and Significance of History of Economic Thought -----	16
Unit 2: The Evolution of Societies -----	24
Unit 3: The sociology of knowledge and economic thought-----	31
Unit 4: Ancient Economic Thought-----	39
Unit 5: Medieval Economic Thought-----	46

MODULE 2

Unit 1: The Founders of Economic thought (Plato, Aristotle, etc.) -----	54
Unit 2: Mercantilism -----	63
Unit 3: Pre-classical Economists -----	74
Unit 4: Physiocracy -----	84
Unit 5: Commercial Capitalism and The Classical Schools -----	92

MODULE 3

Unit 1: The Rise of Socialist thought and the Marxian school of Economic Thought-----	101
Unit 2: The Marxian Stages of Societal Development -----	110
Unit 3: The Marxian Economic Theories -----	118
Unit 4: Marx's Theories of Capitalist Crisis and the State -----	125
Unit 5: The Marginalist School-----	133

MODULE 4

Unit 1: The Monetary School of Economic Thought-----	141
Unit 2: The Mathematical School of Economic Thought-----	150
Unit 3: The Keynesian economics -----	161
Unit 4: Welfare Economics -----	168
Unit 5: Modern Theories of Growth -----	176
Unit 6: Modern Theories of Development -----	185

MODULE 5

Unit 1: History of Economic Thought: John Maynard Keynes-----	220
Unit 2: History of Economic Thought: Joseph Schumpeter-----	231
Unit 3: History of Economic Thought: Milton Friedman-----	244
Unit 4: History of Economic Thought: Modern Day-----	255

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 4: Medieval Economic Thought

Unit 1: Nature and Significance of History of Economic Thought

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 Definition And Meaning of History of Economic

1.3.1 Approaches to the Study of History of Economic Thought

1.4 Significance of History of Economic Thought

1.5 Difficulties in the Study of History of Economic Thought

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

1.6 Summary

1.7 References/Further Reading/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

1.1 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.

1.2 Learning Outcomes

By the end of this unit, you will be able to:

- Discuss history of economic thought;
- Analyze history of economic thought;
- Write the approaches to the study of history of economic Thought;
- Evaluate the significance of history of economic thought; and
- Enumerate the difficulties in the study of history of economic Thought.

1.3 Definition and Meaning of the History of Economic Thought

The history of economic thought encompasses various thinkers and theories, from ancient times to the present day, focusing on the origin and development of economic ideas and their interrelations. It is a historical account of economic doctrines and has had significant contributions from various thinkers. Economic thought encompasses opinions and desires regarding economic subjects, public policies, and economic problems. It also traces historical attitudes and approaches to economic problems. The history of economic thought is a critical account of the development of economic ideas, their origins, interrelations, and manifestations.

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 and 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).

History of economic thought and Economic History are distinct branches of study, as they focus on the development of economic ideas and the economic development of a nation or country. Economic History studies the science of economics, while History of Economic

Thought deals with the development of economic ideas. Both branches are closely related, as ideas and environment are both important factors in evaluating industrial economies and evaluating economic theories and models. The close relationship between these branches ensures a comprehensive understanding of economic processes and their impact on modern economies. **Self-Assessment Exercise 1**

1. In your own words, define history of economic thought.

1.3.1 The Approaches to the Study of History of Economic Thought

You should be aware that the History and development of economic ideas can be studied under three (3) periods, namely; 1. Ancient 2. Medieval and 3. Modern Ancient Greek writers such as the philosopher Aristotle examined ideas about the art of wealth acquisition, and questioned whether property is best left in private or public hands. In medieval times, with its root *medi* – meaning “Middle”, and *ev* – meaning “Age” that is the period in the history of Europe, the middle Age period from the 5th to the 15th (500 to 1500) century. It started with the fall of the great Western Roman Empire and merged into the Renaissance and the Age of discovery. That is after the “rebirth” of culture that we call Renaissance. Scholastics such as Thomas Aquinas argued that it was a moral obligation of businesses to sell goods at a just price.

You should also be aware that the history of Economic Thought may be broadly divided 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;

- i. Chronological approach
- ii. Conceptual approach
- iii. Philosophical approach
- iv. Deductive (or) Classical approach
- v. Inductive approach
- vi. Neo-classical approach
- vii. Welfare approach
- viii. Institutional approach
- ix. Keynesian approach

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

- i. **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 according to their year of development for study. You should note that in this approach, we can define continuity in the economic ideas of different economists.
- ii. **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.
- iii. **Philosophical Approach:** Plato, a Greek philosopher, adopted a philosophical approach to economic thought, focusing on the origin of the state and its various needs. He identified the producing class as the first class, followed by the guardian and ruling classes. The producer class, consisting of farmers, blacksmiths, fishermen, carpenters, shoemakers, weavers, laborers, merchants, retailers, and bankers, lives easier than the rulers or guardians, following familiar patterns of home, property, family, work, rest, and recreation.
- iv. **Deductive Approach:** It was the classical economists who adopted this method. They believed in the universal application of economic laws.
- v. **Inductive Approach:** The Historical School emphasized the inductive method. These economists believed that the laws of economics are not universal in nature.
- vi. **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.”
- vii. **Welfare Approach:** This approach aims at providing the basis for adopting policies which are likely to maximize social welfare.
- viii. **Institutional approach:** The institutionalists questioned the validity of classical ideas and gave importance to psychological factors.
- ix. **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.

Self-Assessment Exercise 2

In this approach, economic ideas are discussed in order of time.			MC
	Answers	Hints/Feedback	Grade

In this approach, economic ideas are discussed in order of time.			MC
	Answers	Hints/Feedback	Grade
	Keynesian Approach:		
	Welfare Approach		
	Neo-classical Approach		
	Chronological approach		

1.4 The Significance of History of Economic Thought

Jhingan et al (*ibid*) stated that there 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*).

- i. 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;
- ii. the study of History of Economic Thought will help us to understand the origin of economics;
- iii. Economic ideas have been instrumental in shaping the economic and political policies of different countries;
- iv. Economic ideas are conditioned by time, place and circumstances;
- v. A study of History of Economic Thought provides a broad basis for comparison of different ideas. It will enable a person to have a well-balanced and reasonable judgment;
- vi. Through the study of Economic Thought the student will realize that economics is different from economists because the former is a subject while the latter is an object;
- vii. The study of the subject helps us to avoid the mistakes committed by earlier economic thinkers because we would know the cause of such mistakes and how to avoid them.
- viii. The study of History of Economic Thought will enable us to know the person responsible for the formulation of certain important principles.

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

1.5 Difficulties in the Study of History of Economic Thought

History of Economic Thought is selective and interpretative, with authors selecting topics they are interested in and explaining facts in their own way. Biased judgments can arise when authors leave out important facts. A complete History of Economic Thought should include modern contributions from Marshall, A.C. Pigou, and J.M. Keynes. Alexander Gray's "The Development of Economic Doctrine" is incomplete. Despite these defects, studying History of Economic Thought helps understand the subject clearly.

1.5.1 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;

- i. Necessary labour and surplus labour;
- ii. Surplus labour and surplus product;
- iii. The labour process;
- iv. The productive forces;
- v. Social relations of production
- vi. The economic system;
- vii. The socio-economic formation;

Self-Assessment Exercise 3

List seven (7) basic concepts for the study of the economy and socio-economic formations

1.6 Summary

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 of 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. The ground is now prepared to sow the seeds of concepts of evolution of societies in the next unit.

1.7 References/Further Reading/Web Sources

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1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self- Assessment 1

History of economic thought traces how people have understood and tried to improve the production and distribution of wealth. Ancient thinkers like Plato, Aristotle, Kautilya, and Confucius explored ethical, political, and social aspects of economic activity

Answer to Self- Assessment 2

In this approach, economic ideas are discussed in order of time.			MC
	Answers	Hints/Feedback	Grade
	Keynesian Approach:		0
	Welfare Approach		0
	Neo-classical Approach		0
	Chronological approach		100

Answer to Self- Assessment 2

These key concepts are;

- i. Necessary labour and surplus labour;
- ii. Surplus labour and surplus product;
- iii. The labour process;
- iv. The productive forces;
- v. Social relations of production
- vi. The economic system;
- vii. The socio-economic formation;

UNIT 2: THE EVOLUTION OF SOCIETIES

Unit Structure

1.1 Introduction

1.2 Objectives

1.3 The Origin of Modern Human Societies

1.3.1 The Darwinian Models of Cultural Evolution

1.3.1 The Evolution of Institutions of Complex Societies

1.4 The Tribal Social Instincts Hypothesis

1.5 Competing Hypotheses

1.6 Summary

1.7 References/ Further Readings/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

1.1 Introduction

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.

1.2 Learning Outcomes

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.

1.3 The Origin of Modern Human Societies

Human societies are adaptive mechanisms that satisfy diverse needs and desires. They have evolved over time, with modern societies being more complex than other animal species. For most of the 100,000 years since their first appearance, humans lived in small-scale, egalitarian foraging societies. Around 10,000 years ago, plant domestication increased human carrying capacity, leading to agricultural societies becoming larger, densely populated, and more complex. Institutions of formal coercive power arose, and innovations in social organization led to the first states with unprecedented levels of cooperation, coordination, and division of labor.

However, these innovations, particularly deep social hierarchies, generated enormous conflict. Today, we live in vast societies, organized and regulated by many complex institutions. The evolution of complex human societies is a complex and ongoing puzzle, with debates over whether it is voluntary or coercive, and whether the right unit of analysis is the individual or the social institution.

Self-Assessment Exercise 1

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

1.3.1 Darwinian Models of Cultural Evolution

Two approaches to applying Darwinian Theory in contemporary social sciences are applied to human behavior. The first involves applying fitness optimizing models to generate testable hypotheses about human behavior, which often endorses common dogmas in evolutionary biology. The second approach, pioneered by Campbell (1965) and first put in mathematical form by Cavalli-Sforza and Feldman (1973), suggests that culture is a system of inheritance, with individuals acquiring culture through imitating others and being sensitive to expressions of approval and disapproval. This docile animal can shape behavior quickly and easily, and once children acquire language, parents and peers can communicate new ideas economically. The diversity of cultural traits across cultures is great, but the commonness or rarity of genes or culture in the population is a product of what happens to individuals who reproduce or are imitated. Population biologists have developed a formidable kit of empirical and theoretical tools to analyze this intricate interplay between the individual and population level, making the macro-micro problem tractable.

1.3.2 The Evolution of Institutions of Complex Societies

The evolution of complex societies is a fascinating subject in social sciences, with questions about how species adapt to small egalitarian groups to evolve revolutionary new social institutions, why the progressive trajectory of increased complexity started around 10,000 years ago, and why societies moved more swiftly in certain regions. The progressive trend's multilinear diversity and acceleration of change are complex questions that have defied definitive solutions. Darwinian biologists' theory is based on their correct conception of evolution processes and inclusive, synthetic, and systemic commitments. Despite a century and a half of work, Darwinian biology remains a vibrant field with many unsolved puzzles, many of which are fundamental.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Which is one of the most interesting questions in all the social sciences?			MC
	Answers	Hints/Feedback	Grade
	The evolution of complex societies		
	The evolution of simple societies		
	The evolution of old societies		
	The evolution of new societies		

1.4 The Tribal Social Instincts Hypothesis

The tribal social instincts hypothesis suggests that group selection significantly influences culturally transmitted variation, resulting in high levels of cooperation in human development. The simplest model of group selection on cultural variation is based on conformist bias, which reduces variation within groups and protects against migration. However, group selection does not work on genes for cooperation, as it cannot build variation as quickly as selection against cooperators within groups. Therefore, selection on cultural variation is a more likely mechanism for promoting cooperative institutions than selection on genes.

Self-Assessment Exercise 3

Why is conformity a useful rule to follow in imitating others?

1.5 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.

1.7 Summary

This unit explores the evolution of societies, Darwinian models, and complex institutions. It argues that human societies evolved through cumulative cultural evolution, leading to gene-culture co-evolution and larger, more cooperative societies. The Pleistocene-Holocene boundary marks a significant transition point in human social evolution.

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

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1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self- Assessment 1

The Pleistocene-Holocene transition was a rapid, universal event revealing variations in

institutional evolution rates. The trend towards more complex societies has not reached equilibrium, suggesting limiting factors slowing competition-driven progress. Human subsistence systems evolved into hunting and gathering regimes.

Answer to Self- Assessment 2

Multiple Choice Questions (MCQs)

MCQ1

Which is one of the most interesting questions in all the social sciences?			MC
	Answers	Hints/Feedback	Grade
	The evolution of complex societies		100
	The evolution of simple societies		0
	The evolution of old societies		0
	The evolution of new societies		0

Answer to Self- Assessment 2

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

UNIT 3: THE SOCIOLOGY OF KNOWLEDGE AND ECONOMIC THOUGHT

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 The Sociology of Knowledge

1.4 The Social Environment

1.4.1 The Social Order

1.5 The Economic Thought

1.6 Summary

1.7 References/ Further Readings/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

1.1 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.

1.2 Learning Outcomes

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;

1.4 The Sociology of knowledge

Sociology of knowledge examines the connections between ideas, beliefs, social and political forces, and their impact on social processes. It identifies three types of thought: practical,

ideological, and utopian. Practical thought focuses on constructive change, while ideological thought is unrealistic and driven by conservative interests. Utopian thought advocates unrealized ideas, influencing intellectual history and future economic history.

Self-Assessment Exercise 1

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

1.4.1 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 following elements:

Social 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, the degree and the mechanisms by which such effects take place are a matter of dispute.

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.

Agency: 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.

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.

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 solely or collectively, to self-consciously resist environmental influences.

Social Order: Self-production is a social enterprise that involves creating a human environment with socio-cultural and psychological formations. Human existence is rooted in order, direction, and stability, which is derived from biologically intrinsic world-openness and ongoing human production. Social order is not biologically given or derived from biological data, but rather a product of past human activity. Externalization is an anthropological necessity, as humans cannot exist in a closed sphere of quiescent interiority.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Empirically, human existence takes place in a context of order, direction, and ____.			MC
	Answers	Hints/Feedback	Grade
	Instability		
	Stability		
	evolution		
	Chance		

1.5 Economic Thought

Economic thought is a dynamic science that develops theories, doctrines, laws, generalizations, and analysis to study and solve economic phenomena and problems. Its emergence dates back to Mercantilism and physiocracy, with Adam Smith's book and Richard Cantillon's work being the first systematic works on economic problems. Cantillon's contributions to economic thought include wealth, social organization, labor wages, value theory, population use, gold and silver, barter, prices, money circulation, interest rate, foreign trade, and banking and credit.

Self-Assessment Exercise 3

Akpakpan (1999) in this respect observed that in the book of Richard Cantillon, his contributions to economic thought are organized in three parts' List them.

1.6 Summary

The text covers sociology of knowledge, economic thought, social environment, and social order. It examines the relationships between ideas, beliefs, and social and political forces. Social environment theory focuses on interrelated social environments, including groups, institutions, hierarchies, and societies. Economic thought encompasses theories, doctrines, laws, and analysis for studying and solving economic phenomena and problems. 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.

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1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content**Answer to Self- Assessment 1**

Karl Mannheim identified three types of thought in sociology of knowledge: practical, ideological, and utopian. Practical thought is based on understanding change as inevitable and guiding it towards constructive change. Ideological thought is unrealistic and driven by conservative interests, while utopian thought is unrealistic and impractical, driven by wishful thinking about a future utopian yet incapable of realization.

Answer to Self- Assessment 2**Multiple Choice Questions (MCQs)****MCQ1**

Empirically, human existence takes place in a context of order, direction, and ____.			M C
	Answers	Hints/Feedback	G r a d e
	Instability		0
	Stability		1 0 0
	evolution		0
	Chance		0

Answer to Self- Assessment 3

(i) 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; (ii) barter, prices, circulation of money, and interest rate; and (iii) foreign trade, foreign exchange, and banking and credit.

UNIT 4: ANCIENT ECONOMIC THOUGHT

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 Importance of Studying Ancient Economic Thought

1.3.1 Importance of Studying Ancient Economic Thought

1.3.2 Economic Thought of Hebrews

1.3.3 Economic Ideas of Hebrews

1.4 Greek Economic Thought

1.5 Roman Economic Thought

1.5.1 Economic Views of Romans

1.6 Summary

1.7 References/ Further Readings/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

1.1 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.

1.2 Learning Outcomes

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.

1.3 Ancient Economic Thought

Studying Ancient Economic Thought offers a comprehensive understanding of economic theories and institutions, providing insight into ancient communities' life, habits, and customs. It also provides a wider spectrum of modern economic growth, highlighting the origin of economic thought and factors responsible for its development. The study bridges ancient and modern economic thought, bridging accidental and oriental thought, and understanding the interaction of ideas in their proper relationships. It is a vital link between the old and the new, East and West, and ethics and economics.

1.3.1 The Importance of Studying Ancient Economic Thought

The study of ancient economic thought offers valuable insights into the life, habits, and customs of ancient communities, providing a wider spectrum of modern economics growth. It sheds light on the origin of economic thought and its factors responsible for its development. The study of ancient economic thought bridges the gap between ancient and modern, as well as between Western and Eastern world economic thought. It provides continuity of ideas and understanding of their proper relationship, linking old and new, East and West, and ethics and economics.

1.3.1 Economic Thought of Hebrews

The origins of economics and economic institutions can be traced back to the Hebrew and Jewish periods, dating back to 2500 B.C. The Hebrews, an ancient civilization, were known for their simple economic philosophy and interconnected society. They valued religion and ethics, controlled economic life by priests, and emphasized agriculture. The Hebrews had distinct economic ideas on interest rates, price, labor, wages, agriculture, seventh and Jubilee years, money, Sabbath, property, trade, and taxes. This simple society influenced the development of social theories and economic institutions.

1.3.3 Economic Ideas of The Hebrews

- i. **Interest** – The Mosaic Law prohibited interest taking or usury, but only applied to the Hebrews. The Hebrews allowed borrowing at interest to strangers, but not from the poor, as they borrowed money for consumption. King Solomon modified the rule, allowing low-interest rates and well-defined security for loans..
- ii. **Just Price** – Hebrews and Hindus enacted laws prohibiting false weights, measures, and adulteration of consumption articles. They disapproved speculative price raising, set a $1\frac{2}{3}$ percent profit ceiling, prohibited exporting food grains, and prohibited hoarding during scarcity. Just price included correct weight,

- competitive price, and reasonable profit rate.
- iii. **Labour and wages** - The Hebrews recognized labor, but prioritized agricultural labor. They did not regulate employer-employee relationships, but focused on mercy and justice. Lawgivers aimed to fix settled agricultural life, disregarding trade and the mercantile community. They encouraged farmers and farm owners. Payments were made in kind.
 - iv. **Money** – The Hebrews seemed to have understood the functions of money. Money was used mainly in the form of bullion. There was no question of stamped money.
 - v. **Seventh and jubilee year** - The Hebrews had a unique seventh and jubilee year tradition, where they worked for six years and rested after cultivating land for six years. In the seventh year, slaves were freed and debts were forgiven. In the fiftieth year, land was returned to its original owner, aiming to prevent inequality in wealth and prevent small lands from being acquired by larger owners.
 - vi. **Sabbath** - The Sabbath was the foundation of Hebrew economic thought, providing rest, relaxation, and good living for masters and households, a social invention unique to ancient civilizations.
 - vii. **Property** – The Hebrews valued property in land, slaves, talents, silvers, and precious metals. The owner of land owned all above and below it, including natural resources. According to inheritance law, land goes to the first son, with absence to the first daughter and other relatives.
 - viii. **Trade** – In those days only surplus was sold in the market. The Hebrews wives were craft – women who used spin wool and flax. Commerce flourished in the reign of King Solomon. He made successful voyage to distant lands including India.
 - ix. **Taxes** – The Hebrew economy was simple, dominated by the priestly class, with labor services for bridges, roads, and public utility services. Toll taxes were collected for temple maintenance. Hebrew laws provided assistance to dependents, fatherless, and widows, while the education system was heavily influenced by religion and ethics. Despite being simple and scattered, their ideas had significant influence on people's minds.

Self-Assessment Exercise 1

What were the Hebrews' main economic ideas?

1.3 Greek Economic Thought

5,000 years ago, the Mediterranean region had civilizations like Egypt, Mesopotamia, Syria, and Persia, but their worldview did not allow for autonomous political or economic thought. The Greeks were the first to develop an economic theory, but their ideas were not significant due to a lack of demarcation between politics, economics,

and ethics. Plato and Aristotle were the first reformers and analytical economists.

1.4 Roman Economic Thought

Greek culture in the second century BC influenced Latin thought, with Roman legions and government in the Eastern Mediterranean boosting self-consciousness and self-expression. Latin literature flourished, with Cicero, Lucretius, and Virgil achieving great glories. Greek philosophy impacted ethics and economics, while Romans built institutions affecting law and politics.

1.4.1 Economic Views of Romans

The Romans had the following economic views;

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.

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.

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.

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.

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.

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.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

The Romans were mainly interested in the improvement of _____.			MC
	Answers	Hints/Feedback	Grade
	Culture		
	Trading		
	Exchange		
	Agriculture		

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 this idea laid the foundation stone for Smith and Physiocrats.

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.

Self-Assessment Exercise 3

Discuss the term "Natural Order" in the Romans economic thought

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

1.7 References/Further Readings/Web Sources

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1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self-Assessment 1

The Hebrews' economic philosophy was simple, with economic problems interconnected with politics, ethics, and philosophy. Religion and ethics were given greater importance, and economic life was controlled by priests. They had distinct ideas on interest rates, property, and taxes.

Answer to Self-Assessment 2

Multiple Choice Questions (MCQs)

MCQ1

The Romans were mainly interested in the improvement of _____.			MC
	Answers	Hints/Feedback	Grade
	Culture		0
	Trading		0
	Exchange		0
	Agriculture		100

Answer to Self-Assessment 3

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 this idea laid the foundation stone for Smith and Physiocrats.

UNIT 5: MEDIEVAL ECONOMIC THOUGHT

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 The Middle Ages

1.3.1 Germanic Contributions to Economic Thought

1.3.2 The Influence of Christianity and The Church

1.3.3 Scholasticism and Canon Law

1.4 Value And Just Price

1.4.1 Value of Money: Usury

1.4.2 Monasteries

1.5 General Significance of Medieval Period

1.6 Summary

1.7 References/ Further Readings/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

1.1 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.

1.2 Learning Outcomes

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.

1.4 The Middle Ages

The Middle Ages, which began with the fall of the Roman Empire in 476 AD, is not well-defined. Its ending is unclear, with Dr. Ingram suggesting it ends around 1300 AD. The Middle Ages can be divided into two periods: the first from 400 AD to 1200 AD, when Christian theology opposed Roman institutions and Germanic customs were superposed. From 1200 to 1500 AD, the world of thought settled, with Feudalism and scholasticism becoming dominant. Thomas Aquinas' fusion of Aristotle's philosophy with Christian theology marked the turning point between the sub-periods.

1.4.1 Germanic Contributions to Economic Thought.

The early Germanic tribes' economic ideas were influenced by their village community, which was a democratic and wealth-based unit. The community prioritized brotherhood and regulated exchanges, with no money economy. The tribes distinguished themselves from the Romans by focusing on community and individual rights, while the Teutons had a more flexible property system. The Germanic tribes emphasized personal rights, with their laws focusing on personal rights rather than property rights. However, their industrial stage relied heavily on landed property, which was the basis of their society.

1.4.2 The Influence of Christianity and the Church

Christianity and the Church were the main factors in determining medieval thought. Christianity taught natural equality of men, embracing all classes and races, condemning slavery, and promoting a natural community of property. It also upheld the dignity of labor, emphasized charity and almsgiving, and promoted family life. Christianity introduced elements that were deficient in Roman jurisprudence, such as the personality of man and moral and humanitarian ideas. These ideas expanded individualism while increasing the rights of many individuals. The fidelity, relative freedom, greater equality,

and emphasis on the personal element made the Teutonic people a ready medium for the enhancement of the new religion.

Self-Assessment Exercise 1

Analyze the Germanic contributions to economic thought.

1.4.3 Scholasticism and Canon Law

Scholasticism, influenced by Christianity and Aristotle, was dominant in medieval ecclesiastics and Middle Ages scholarship. It focused on applying absolute rules of conduct to existing conditions, rather than explaining phenomena. Medieval scholars in economic thought often underestimated their progress due to their different methods and conclusions. Roscher believed that scholastics, particularly Scotus, made more progress than commonly believed, particularly in the sacrament of confession. However, economics was not a distinct line of thought, and monks only knew Aristotle's writings.

1.4.4 Value and Just Price

The doctrine of *justum pretium*, based on the scholastics' notion of value, emphasized that every commodity had an objective and absolute value determined by the common estimation of production costs. This ethical doctrine was formulated by Albertus Magnus and Thomas Aquinas, who believed that value should equal the expenditure of labor and other costs. This generalization allowed for lawful charging of goods due to improvements, price changes, or danger. However, this generalization was limited to costs incurred in producing goods satisfying normal or natural wants, and the labor element was weighted according to the social rank of the laborer.

1.4.5 Value of Money; Usury.

Usury, now defined as interest, was initially forbidden for clergy only, but extended to laity by the twelfth century. As late as 1311, it was declared illegal due to the belief that taking interest for loans was unjust. The Medieval church of fathers also prohibited interest-taking.

- i. The holy writ forbids it: The Mosaic law prohibits usury-taking from a brother; Christ said, "Lend, hoping for nothing again." (Luke VI, 35.)
- ii. Aristotle says money is barren and cannot breed money, therefore, to demand usury for its use is unjust.
- iii. 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.

- iv. 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. In other words, the civil law believed that one loses ownership of money when it is lent and charging interest on the lent money is unfair.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

What is money according to the civil law?			MC
	Answers	Hints/Feedback	Grade
	a Rea Fungibilis, or "consumptible"		
	a Res Fungibilis, or "consumptible"		
	a Ros Fungibilis, or "consumptible"		
	a Rus Fungibilis, or "consumptible"		

1.5 General Significance of the Middle Ages Period

The Middle Ages marked a significant shift in economic thought, with Roman institutions, Christian religion, Germanic customs, and Aristotle's philosophy combining. This period saw a transition from materialism to Christianity's modified idealism, with the Church dissociating from politics and industry. The economy shifted from land-based to personal relations, with strong protection ideas. This period was marked by custom, regulation, and monopoly, and the doctrine of just price.

Self-Assessment Exercise 3

“Between these rather opposite views lay the Middle Ages.” Discuss.

1.6 Summary

This unit explores Medieval economic thought, including the Middle Ages, Germanic contributions, Christianity, and the Church's influence. It covers Scholasticism, Canon

Law, and its significance. The Middle Ages period was divided into two periods, with Christian theology opposing Roman institutions and Germanic customs superimposed. 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.

We shall now go to the next unit which is Unit 1 of Module 2 which talks about founders of economic thought.

1.7 References/ Further Readings/Web Sources

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1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self-Assessment 1

Roman law focused on individual rights, while Germanic customs emphasized relative and changing property rights. Roman law made property rights absolute and rigid, while Germanic customs recognized relative rights. For instance, the Genossenschaften recognized private property in dwelling places, gardens, arable lands, and waste lands, while the community's plans affected fields and commons. Property rights varied depending on the object involved.

Answer to Self-Assessment 2

Multiple Choice Questions (MCQs)

MCQ1

What is money according to the civil law?			MC
	Answers	Hints/Feedback	Grade

What is money according to the civil law?			MC
	Answers	Hints/Feedback	Grade
	a Rea Fungibilis, or "consumptible"		0
	a Res Fungibilis, or "consumptible"		100
	a Ros Fungibilis, or "consumptible"		0
	a Rus Fungibilis, or "consumptible"		0

Answer to Self-Assessment 3

The text transitions from paganism's materialism to Christianity's modified idealism, focusing on a society broader than the Greek city state. It shifts from natural inequality and slavery to ideals of brotherhood and freedom. The Church also becomes more dissociated from politics and industry, separating morals from economics. The transition from a land-based economy to a personal-oriented one influenced economics, with industries and money evolving from imperfectly understood to over appreciated.

MODULE 2

Unit 1: The Founders of Economic Thought (Plato, Aristotle, Etc.)

Unit 2: Mercantilism

Unit 3: Mercantilist Policies and Factors Shaping Mercantilism

Unit 4: Pre-Classical Economists

Unit 5: Physiocrats

Unit 6: Commercial Capitalism and The Classical Schools

Unit 1: Founders of Economic Thought

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 Plato

1.3.1 Plato's Idea on Origin of State

1.3.2 Plato's Idea on Division of Labour

1.3.3 Plato's Idea on Size of Population

1.4 Aristotle

1.4.1 Aristotle's Idea of the State

- 1.4.2 Aristotle's Idea on Private Property
- 1.4.3 Aristotelian Economic View Aristotle (384-322 B.C.)
- 1.4.4 Aristotle's Idea on Money
- 1.4.5 Aristotle's Idea on Interest
- 1.4.6 Aristotle's Idea on Slavery
- 1.4.7 St. Thomas Aquinas
- 1.5 Ibn Kaldun's Islamic Economic Thought
- 1.6 Summary
- 1.7 References/Further Readings/Web Sources
- 1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

1.1 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.

1.2 Learning Outcomes

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 Kaldun's Islamic Economic Thought

1.3 Plato (427-347)

Plato, a Greek philosopher, was born in Athens and studied under Socrates. He taught mathematics and philosophy at the Academy, where his famous writings, *The Republic* and *The Laws*, are crucial sources of his economic thought. Plato aimed to provide a systematic exposition of society's principles, the origin of the city state, and a plan for the ideal social structure. He viewed economics as a branch of ethics and politics. Plato's economic thought focused on various aspects of society, including state origin, division of labor, production size, money, interest, value, agriculture, wealth, poverty, slavery,

communism, and education.

1.3.1 Plato's Idea on Origin of State

Plato believed that a state arises from human needs, as no one is self-sufficient. The state supplies necessary commodities, with two classes: rulers and ruled. The ruling class is educated in philosophy and war, while those who cannot pass an examination are responsible for administrative duties. Plato distinguished five types of government. They are;

- i. Aristocracy - Rule by the best.
- ii. Timocracy - Rule by the Soldiers
- iii. Oligarchy - Rule by a Few
- iv. The rule by the Wealthy 5. Democracy

Self-Assessment Exercise 1

Plato distinguished five types of government. List them.

1.3.2 Plato Ideas on Division of Labour

Division of Labour: P Plato's main contribution was the division of labour, which he believed aided social organization and led to the origin of the state. He believed that essential needs for mankind were food, clothing, and shelter, and that every individual should do their job suitable for them. This led to large-scale production of products or commodities, but he did not consider the need for a wider market.

Thus, Plato's idea of division of labour is different from that of Adam Smith in the following ways;

- i. Adam Smith's Division of Labour is determined by the market, but Plato's division of labour determines the market.
- ii. To Adams Smith the advantages of division of labour go to only the employers, but to Plato it is beneficial to the entire society.
- iii. The cost of division of labour according to Plato is the difference in skill and talent. But according to Adams Smith division of labour leads to differences in skill and talent.

1.3.3 Plato Ideas on Size of the Population

Size of the Population: Plato analyzed population size based on division of labor and suggested a 5040 population for a state to maintain stability and promote self-

sufficiency. If population growth decreases, prizes should be offered, and new colonies must be established if the number exceeds 5040.

Money: Plato favored money as a medium of exchange, opposing gold and silver, and advocated for a common Hellenic currency for travelers, ambassadors, and visitors.

Interest: Plato prohibited interest taking for loans in the ancient Greek. But later on, the permitted interest taking as a penalty for delayed payment.

Value: Plato considered value as an inherent quality of the commodity. To him a man should not attempt to raise his price, but simply ask the value of the commodity.

Agriculture: Plato and the Greeks like the Hebrews considered agriculture as the most desirable occupation.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Plato prohibited interest taking for loans in the ancient ____.			MC
	Answers	Hints/Feedback	Grade
	Roman		
	Greek		
	Hebrew		
	German		

1.4 Aristotle

Aristotle, a student of Plato and tutor to Alexander, laid the foundation for economics. His ideas on private property, usury, and the just price influenced Middle Ages writers. Aristotle was a conservative, more practical thinker, and his main ideas were found in Politics and Ethics, which aimed to define economics as a science of household management. His contributions to economic thought include the development of the medium of exchange in a society called money.

1.4.1 Aristotle's Idea of the State

Aristotle believed the State originated from mankind's needs, originating from households satisfying family members' desires. The State, as a social animal, promotes good life and is attributed to economic and political causes. In Aristotle's ideal state, there would be two classes: the ruler and the ruled. The ruling class would be classified as military, statesmen, magistrates, or priests, with their duties based on age.

1.4.2 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.

1.4.3 Aristotelian Economic View Aristotle (384-322 B.C.)

Aristotle, a Greek philosopher, developed the theory of economics, which focuses on household management and the consumption of wealth for personal satisfaction. He identified two types of exchange: natural and unnatural, and introduced the concepts of value-in-use and value-in-exchange. Aristotle's work laid the foundation for the concepts of value-in-use and exchange, which were later popularized by Adam Smith. He analyzed human ends and means, arguing that means are valuable because their end products are useful to people. Aristotle derived economic ideas from axiomatic concepts, such as the necessity of human action, the pursuit of ends, and the reality of human inequality and diversity.

He believed that economics is concerned with both the household and the polis, focusing on the use of necessary resources for the Good Life. As a pragmatic and moral science, economics is aimed at the good and moral. Aristotle's view of economics is embedded in politics, suggesting that the study of political economy began with him. Economics is a practical science that fosters habits that expedite actions and helps individuals obtain and use necessary resources for living.

1.4.4 Aristotle's Idea on Money

Aristotle's theory of money explains its necessity, functions, and role in a non-communist society. He advocates for a store of value and measure of value, and believes money came into existence through legislation. Schumpeter calls Aristotle's theory the Metalist theory, in contrast to Plato's Cartel theory.

1.4.5 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.

1.4.6 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 3

List out all Aristotle's ideas

1.4.7 St. Thomas Aquinas

St. Thomas Aquinas, a medieval theologian and philosopher, is a significant figure in the history of economic thought. He understood economic ideas like the law of supply and demand, subjective value theory, and the theory of time preference. However, he also had misunderstandings in his philosophy of society and global trade. Aquinas applied his economic understanding to determine justice in economic matters like pricing and usury. The just price theory, rooted in ancient Greek philosophy, aims to set standards of fairness in transactions.

Aquinas was a scholastic philosopher and scholastic philosopher, known for his extensive writings, including *Summa Theologica*, which summarized economic ideas of his time. He successfully classified laws into eternal, natural, human, and divine, focusing on natural law and human law. Aquinas made significant contributions to economic thought,

codifying and improving on these ideas, and his theory of 'just price' was a significant contribution.

1.5 Ibn Khaldun's Economic Thought

Ibn Khaldun, a prominent jurist and influential figure in Arab-Islamic economic thought, was a prominent figure in the development of Muslim economic thought. His work, *Muqaddimah*, primarily focused on history but also included theories of production, value, distribution, and cycles. Khaldun's understanding of Muslim economic behavior was based on the writings of those with access to this knowledge. He identified two social milieus: "umran al-badouri" (nomad civilization) and "umran al-hadhari" (urban civilization). The difference between these social groups is based on their *ma'ah*, which encompasses the means of subsistence and relationships between man and nature.

This concept is central to Ibn Khaldun's philosophy, which recognizes the qualitative and quantitative differences between natural economies focusing on the accumulation of unnecessary goods and those pursuing profit. Khaldun's view was dynamic, encompassing the totality of human society in its historical development.

On your own, read about Nicole Oresme's contributions to 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. 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. Ibn Khaldun's thought was a dynamic one and embraced the totality of human society in its historical development.

1.6 Summary

This unit covers Plato's ideas on state origin, division of labor, population size, and money, Aristotle's ideas on state origin, private property, economic scope, money, interest, and slavery, St. Thomas Aquinas, and Ibn Khaldun's contributions to economic thought. Nicole Oresme's contributions to economic thought are discussed. Plato made significant progress in economic thinking, while Aristotle laid the foundation for economics with his inductive method, private property, and the distinction between value-in-use and value-in-exchange. We shall now go to the next unit, which is unit 2, which talks about Mercantilism.

1.7 References/Further Readings/Web Sources

Ibn Khaldūn. (1958). *The Muqaddimah : An introduction to history*. Translated from the Arabic by Franz Rosenthal. 3 vols. New York: Princeton.

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1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self-Assessment Exercise 1

. Plato distinguished five types of government. They are;

- i. Aristocracy - Rule by the best.
- ii. Timocracy - Rule by the Soldiers
- iii. Oligarchy - Rule by a Few
- iv. The rule by the Wealthy 5. Democracy

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Plato prohibited interest taking for loans in the ancient _____.			MC
	Answers	Hints/Feedback	Grade
	Roman		0
	Greek		100
	Hebrew		0
	German		0

Answers to Self-Assessment Exercise 3

- i. Aristotle's Idea of the State
- ii. Aristotle's Idea on Private Property
- iii. Aristotelian Economic View Aristotle (384-322 B.C.)
- iv. Aristotle's Idea on Money
- v. Aristotle's Idea on Interest

- vi. Aristotle's Idea on Slavery
- vii. St. Thomas Aquinas

Unit 2: Mercantilism

Unit Structure

- 1.1 Introduction
- 1.2 Learning Outcomes
- 1.3 Meaning Of Mercantilism
 - 1.3.1 Main Economic Assumptions, Ideas and Economic Policy Proposals Of Mercantilism
 - 1.3.2 Critique of Mercantilism
 - 1.3.3 Neo-Mercantilism
 - 1.3.4 Relevance of Mercantilism to the Underdeveloped Countries
- 1.4 Mercantilist Policies
- 1.5 Contributions By Individual Thinker to Mercantilisms
- 1.6 Summary
- 1.7 References/Further Readings/Web Sources

1.1 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 as well as those of Ibn Kaldun.

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

1.2 Learning Outcomes

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
- Discuss Mercantilist's Policies
- Describe contributions by Individual Thinker to Mercantilisms

1.3 Meaning of Mercantilism

Between 1500 and 1750, European nations like England, France, Portugal, and Spain established colonies and adopted a monarchy-centered economic approach called Mercantilism. This theory posits that a nation's prosperity depends on its supply of capital, represented by bullion (gold, silver, and trade value), and is best increased through a positive balance of trade with other nations. The ruling government played a protectionist role, encouraging exports and discouraging imports through tariffs. Mercantilism emerged during the decay of feudalism and spanned from the late Middle Ages to the rise of liberalism in the 18th century. It reflected problems of the 17th and 18th centuries, such as strong gold imports, trade expansion, and the rise of communism.

Mercantilism was at its peak in the 17th and 18th centuries, with economic policies aiming to maximize wealth in terms of gold rather than production. Colonies restricted foreign trade and subsidies to encourage raw material production, facilitating self-sufficiency and specialization.

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

Mercantilism is an economic perspective that focuses on an active state and its sovereignty. It assumes that an economy has unemployed resources, and an increase in demand leads to the use of idle productive capital, land, or workers, increasing GDP without affecting the price level. Mercantilists also emphasize the importance of an active balance of trade, which is sometimes confused with bullionists or monetarists. Most mercantilists recognize the effect of an export surplus on employment through its effect on price, and a favourable balance of trade leads to increased money supply, enhancing trade and employment. They also believe that low interest rates are a monetary phenomenon and that increasing the money supply is necessary to lower interest rates.

Most mercantilists favor a low wage policy, which reduces costs and prices, encourages wage/product demand in foreign markets, and has a positive effect on domestic production and employment. Full employment can be achieved through increased labor force productivity.

Self-Assessment Exercise 1

What are the main economic assumptions, ideas, and economic policy proposals of mercantilism?

1.3.2 Critique of Mercantilism

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

- i. They gave too much importance to gold and silver and neglected the importance of other commodities;
- ii. They exaggerated the importance of commerce and undermined the usefulness of agriculture and other branches of human history;
- iii. They were wrong in believing that a favourable balance of trade was the only source of prosperity;
- iv. Their belief that the gain of one nation was necessarily the loss of another was wrong;
- v. Their ideas regarding 'utility' and 'value' were vague and abstract;
- vi. Their ideas about capital and interest were imperfect; and
- vii. They lacked broad-mindedness.

Mercantilism's economic policy lacks universal application and guidance, as statesmen overemphasize bullion and wealth and labor as the ultimate goals, confusing means and ends.

1.3.3 Neo-Mercantilism

Neo-mercantilism is a policy regime that encourages exports, discourages imports, controls capital movement, and centralizes currency decisions in the hands of a central government. Its objective is to increase foreign reserves, allowing more effective monetary and fiscal policy, but at the cost of lower living standards. Neo-mercantilist countries like China, Japan, and Singapore are considered neo-mercantilists due to their shift from classical mercantilism to economic development and market-based price fixing. Neo-mercantilism differs from 17th-century mercantilism in two key aspects: it emphasizes social planning and relies on accurate trade, industry, and price statistics.

Although 17th-century mercantilism required government regulation, modern objectives of economic and social control were still distant from it.

1.3.4 Relevance of Mercantilism to Under-Developed Countries

The economic ideas of mercantilists are relevant to under-developed countries today, as they believed in official intervention as a corrective to evil. In both under-developed and developed countries, the State plays a key role in economic growth. In developing countries, the State must regulate production and distribution to promote growth with justice.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Neo-Mercantilism was a sharp reaction against the doctrine of _____.			MC
	Answers	Hints/Feedback	Grade
	lazy faire		0
	laissez faire		100
	laiss faire		0
	laissez faith		0

1.4 Mercantilisms Policies

Mercantilist ideas were the dominant economic ideology of all of Europe in the early modern period, and most states embraced it to a certain degree. Mercantilism was centred on England and France, and it was in these states that mercantilist policies were most often enacted.

The policies have included:

- i. High tariffs, especially on manufactured goods.
- ii. Forbidding colonies to trade with other nations.
- iii. Monopolizing markets with staple ports.
- iv. Banning the export of gold and silver, even for payments.
- v. Forbidding trade to be carried in foreign ships, as per, for example, the Navigation Acts.
- vi. Subsidies on exports.
- vii. Promoting manufacturing and industry through research or direct subsidies.
- viii. Limiting wages.
- ix. Maximizing the use of domestic resources.

- x. Restricting domestic consumption through non-tariff barriers to trade.

1.5 Contributions 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;

Antonio Serra

Antonio Serra, an Italian mercantilist writer, argued that the high exchange rate was causing money scarcity. He refuted de Santis' claim and emphasized the importance of gold and silver for trade and people. Serra's systematic version of mercantilist doctrine was crucial for addressing national wealth and promoting trade.

Jean Bodin

Jean Bodin, a French lawyer, made significant contributions to understanding inflationary rise in prices in his publication, *Response*. He analyzed the phenomenon of inflation, which was unknown before the 16th century, and attributed it to the influx of precious metals from South America. Bodin's analysis focused on the relationship between the quantity of goods and money in circulation, which laid the foundation for the quantity theory of money. Other factors included population increase, trade, economic migration, and profligate consumption.

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 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.

Sir Josiah Child

Sir Josiah Child (1630-1699) advocated for a surplus balance of trade and exporting specie to increase imports. He believed international trade could not be unidirectional and emphasized a nation's focus on the general trade balance. He emphasized the importance of low interest rates for trade expansion.

Sir John Law

Sir John Law proposed supplying the nation with money in 1705, supporting trade and commerce. He proposed a note-issuing bank, similar to William Paterson's plan. Law's plan failed in France due to no limit on note issuing. In England, the Bank of England was established with limited security-backed issues, proving successful.

Self-Assessment Exercise 3

There were many notable contributors to Mercantilism. List them.

5.0 Summary

Learned Mercantilism's economic assumptions, ideas, and policy proposals, examining its critique and relevance to underdeveloped countries like Nigeria. Mercantilism emerged in Europe from 16th-18th century, but has been criticized for declining practices.

This unit 6 concluded our module 1. We now proceed to the next unit, that is, Unit 3, which examines the Mercantilist policies and factors shaping Mercantilism.

1.7 References/ Further Readings/Web Sources

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1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self- Assessment Exercise 1

Mercantilism is an economic perspective focusing on an active state and its sovereignty. It assumes an economy with unemployed resources, where increased demand leads to the use of idle productive capital, land, or workers, increasing GDP without affecting price levels. Growth is often seen as functional to make a country independent of imports and strengthen the sovereign's military power. Power and plenty are often considered separate aims.

Answer to Self- Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Neo-Mercantilism was a sharp reaction against the doctrine of _____.			MC
	Answers	Hints/Feedback	Grade
	lazy faire		0
	laissez faire		100
	laiss faire		0
	laissez faith		0

Answer to Self- Assessment Exercise 3

- i.** Antonio Serra
- ii.** Jean Bodin
- iii.** Thomas Mun
- iv.** Sir Josiah Child
- v.** Sir John Law

Unit 3: Mercantilist Policies and Factors Shaping Mercantilism

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 Mercantilist's Policies

1.3.1 Factors Shaping Mercantilism

1.4 Mercantilism's Demise

1.5 Main Ideas or Characteristics of Mercantilism

1.6 Summary

1.7 References/Further Readings/Web Sources

1.1 Introduction

In the preceding unit, which is Unit 2, we discussed about the 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 Mercantilist's policies and factors shaping Mercantilism.

2.0 Learning Outcomes

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 Locke's contributions to history of economic thought
- Discuss John Law's contributions to history of economic thought
- Clarify 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 thought

1.3 Mercantilist Policies

Mercantilism includes a national economy aimed at accumulating monetary reserves through a positive balance of trade, especially of finished goods. Historically, such policies frequently lead to war and also motivate colonial expansion. Mercantilist theory varies in sophistication from one writer to another and has evolved over time. High tariffs, especially on manufactured goods, are an almost universal feature of mercantilist policy. Other policies have included:

- i. Building overseas colonies;
- ii. Forbidding colonies to trade with other nations;
- iii. Banning the export of gold and silver, even for payments;
- iv. Forbidding trade to be carried in foreign ships;
- v. Export subsidies;
- vi. Promoting manufacturing with research or direct subsidies;
- vii. Limiting wages;
- viii. Maximizing the use of domestic resources;
- ix. Restricting domestic consumption with non-tariff barriers to trade.

Mercantilism, a popular economic theory in the mid-16th and late 17th centuries, emphasized the importance of money as wealth and the accumulation of gold and silver for prosperity. It was supported by economists like Gerard de Malynes, Edward Misselden, Sir Thomas Mun, Jean Baptiste Colbert, and Antonio Serra. The Mercantilists believed that a country's strength was tested by its wealth, particularly gold and silver. Countries with gold mines and silver mines could obtain gold and silver through trade, while those without mines could obtain them through trade. The state played a crucial role in regulating economic life, exploiting natural resources and regulating economic life.

Bullionism, the simplest form of Mercantilism, emphasized the circulation of money and rejected hoarding. During the 16th to 18th century, European countries hoarded gold and accumulated gold bullion in their treasuries.

1.3.1 Factors Shaping Mercantilism

Some economic, political, religious and cultural factors were responsible for the emergence of mercantilism.

- i. **Economic Factors:** In the 15th century, the domestic economy transitioned to an exchange economy, with agriculture transitioning to industry. Trade became crucial, transforming the Middle Ages' socio-economic structure. Gold and silver money became essential, leading to improvements in transport, agriculture, and population.
- ii. **Political Factors:** Towards the end of the Middle Ages, nationalism emerged as a

powerful force, leading to significant political changes in Europe. Renaissance led to the rise of strong nations like England, France, and Spain, ending feudalism and enabling Mercantilists to regulate political and economic activities..

- iii. **Religious Factors:** The Reformation Movement revolted against the Roman Catholic Church, challenging its authority over political and economic activities.
- iv. **Cultural Factors:** Europe underwent significant cultural change during the Renaissance, emphasizing worldly life's importance over heavenly ones, leading to the importance of money in human activities.
- v. **Scientific Factors:** Science and technology advancements, such as the compass and printing press, revolutionized navigation, led to new countries, raw materials, and markets, and facilitated the spread of ideas and knowledge.

Self- Assessment Exercise 1

List five (5) factors responsible for the emergence of mercantilism.

1.4 Mercantilism's Demise

Mercantilism's decline was influenced by classical economists like David Hume and Adam Smith, who believed real wealth was linked to full employment and increased production. Keynes revived the dogma, stating that surpluses in the balance of trade stimulate demand, increasing national wealth. In the past, mercantilism caused foreign policy stress and conflict between nations.

Self- Assessment Exercise 2

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Who coined the term “mercantilism?”			MC
	Answers	Hints/Feedback	Grade
	David Hume,		
	Adam Smith		
	Carl Marx		
	David Ricardo		

3.4 Main ideas or Characteristics of Mercantilism

You should take note of the main ideas or characteristics of Mercantilism:

- i. **Wealth:** The mercantilists aimed to strengthen their country by focusing on its wealth, particularly precious metals like gold and silver. They believed that gold was the basis of wealth and power, leading to the slogan "more gold, more wealth and more power." This approach drew inspiration from ancient Greek, Roman, and Middle Ages power and commerce, as Columbus emphasized the importance of gold as a master of desires and a means to attain paradise.
This greatest importance given to precious metals may be attributed to the following reasons:
 - (a) In the 16th century, the only form of wealth, most useful and generally acceptable was gold and silver. Naturally the mercantilist attached more importance to gold and silver.
 - (b) With the rise of absolute monarchy, taxation could be possible only if money was used as measure of value. Thus, on the political side also money came to occupy greater importance.
 - (c) For conducting wars money was essential. Three things were required for war—money, more money and still more money.
 - (d) Mercantilists believed that trade depended on plentiful of money.
 - (e) Money was also needed for development of exchange economy.
- ii. **Money in those days was identified with capital.** Mercantilists held high regard for money, emphasizing gold's importance in the economic system. Keynes argued that increasing money's quantity affected price and employment.
- iii. **Foreign Trade:** The Mercantilist theory of foreign trade, also known as the balance of trade theory, aimed to obtain precious metals like gold and silver from foreign countries. It believed that nations without their own gold and silver mines could become rich by acquiring these resources through trade. The mercantilists advocated for a favorable balance of trade, encouraging exports and discouraged imports. However, this theory has no validity in modern times, as it does not distinguish between particular and general balances of trade. Furthermore, the mercantilists were unaware that a favourable balance of trade cannot be maintained for ever, as increasing gold imports would lead to inflation.
- iv. **Commerce and Industry:** Mercantilists viewed commerce and industry as crucial for national economy growth, aiming to regulate them and increase productivity. They believed that trade and commerce were the most productive occupations, while agriculture was considered insignificant. However, they believed that agriculture did not directly contribute to the country's strength.
- v. **Population:** Mercantilists favored large populations for military strength and productivity, believing labor supply and immigration would lower production costs and lower international market prices. They believed people were the real strength of

- a country.
- vi. **Natural Resources:** Mercantilists sought to maximize natural resources, increase production, export, and import, emphasizing agriculture for food security. Colonies were established to supply raw materials, with exports restricted to the mother country.
 - vii. **Wages and Rent:** The mercantilists discussed the problems of production only. So, they did not give much importance to the problems of distribution, especially to wages and rent.
 - viii. **Interest:** Mercantilist writers, like Sir Thomas Mun, disagreed on interest rates, believing it helped poor merchants and widows. Mun and his followers believed interest rates depended on industrial conditions.
 - ix. **Taxation:** The views of the mercantilists on taxation were interesting because they were more scientific and ahead of their time. Broadly speaking the mercantilists favoured a multiple tax system based on the principle of “each should pay according to the benefits received from the state”.
 - x. **Theory of Value:** Prior to mercantilists, value was an intrinsic quality of a commodity, different from price. Market value was recognized, and scarcity determined commodity value, with normal value based on production cost.
 - xi. **Factors of Production:** Mercantilists recognised three important factors of production, namely, land, labour and capital. Here we can quote Sir William Petty’s saying “Labour is the father and active principle of wealth as land is the mother”. The Mercantilists emphasised the cultivation of agricultural waste lands so that food production might increase and the country might become self-sufficient and imports might be reduced.
 - xii. **Commercial Regulation:** Mercantilists believed that commercial regulations were essential for maximising social welfare. Commercial laws were passed to restrict the import of food materials. But no regulation was applied to the import of raw materials because they were required for the industrial development of the country. The state supported the export industries and shipping which would secure a favourable balance of trade.
 - xiii. **Role of State:** Mercantilists believed the state was the supreme power, controlling people's activities and ensuring a strong nation for war success. They suggested a policy of protection, focusing on exports and industry development to maintain a favorable balance of trade. State policies were shaped accordingly, ensuring the state's power was increased.
 - xiv. **Land Banking Schemes:** Mercantilists ideas regarding money gave rise to the establishment of Land Banking Schemes. Land Bank Schemes were introduced by Chamberlin and Barbon.
 - xv. **Occupation:** Mercantilists believed merchants were the most profitable members of society, with occupation increasing a country's wealth. Critics, particularly in France, criticized mercantilist theories and practices, culminating in Adam Smith's "The Wealth of Nations" book.

Self-Assessment Exercise 3

Greatest importance given to precious metals by the Mercantilist were attributed to certain factors. List five (5) of them.

1.6 Summary

In the present unit, we discussed about Mercantilist's policies and factors shaping Mercantilism. 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 next unit, which is unit 4, we are going to study the contributions of the pre-classical economists to economic thought.

1.7 References/Further Readings/Web Sources

Jhingan, M. L., Giriya, M. and Sasikala, L. (2003). *History of Economic Thought*, 3rd Edition. Delhi: Virinda Publications (P) Ltd.

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content**Answer to Self-Assessment Exercise 1**

- i. Economic factors
- ii. Political factors
- iii. Religious factors
- iv. Cultural factors
- v. Scientific factors

Answer to Self-Assessment Exercise 2**Multiple Choice Questions (MCQs)****MCQ1**

Who coined the term “mercantilism?”			MC
	Answers	Hints/Feedback	Grade

Who coined the term “mercantilism?”			MC
	Answers	Hints/Feedback	Grade
	David Hume,		0
	Adam Smith		100
	Carl Marx		0
	David Ricardo		0

Answer to Self-Assessment Exercise 3

This greatest importance given to precious metals may be attributed to the following reasons:

- i. In the 16th century, the only form of wealth, most useful and generally acceptable was gold and silver. Naturally the mercantilist attached more importance to gold and silver.
- ii. With the rise of absolute monarchy, taxation could be possible only if money was used as measure of value. Thus, on the political side also money came to occupy greater importance.
- iii. For conducting wars money was essential. Three things were required for war—money, more money and still more money.
- iv. Mercantilists believed that trade depended on plentiful of money.
- v. Money was also needed for development of exchange economy.
- vi. Money in those days was identified with capital. Thus, the Mercantilists had a high regard for money. If we consider the circumstances of the day, Mercantilists were justified in attaching greater importance to gold. According to Keynes, “the Mercantilists understood the important role of money in the economic system. They studied the effects of an increase in the quantity of money on the price level and employment.”

Unit 4: Pre-Classical Economists**Unit Structure**

- 1.1 Introduction
- 1.2 Learning Outcomes
- 1.3 The Quality and Nature of The Contributions of Pre-Classical Economists
 - 1.3.1 Sir William Petty's Contributions to History of Economic Thought
 - 1.3.2 John Locke's Contributions to History of Economic Thought
- 1.4 John Law's Contributions to History of Economic Thought
 - 1.4.1 Richard Cantillon's Contributions to History of Economic Thought
 - 1.4.2 David Hume's Contributions to History of Economic Thought
- 1.5 Sir James Denham Steuart's Contributions to History of Economic Thought
- 1.6 Summary**
- 1.7 References/Further Readings/Web Sources**
- 1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

1.1 Introduction

In the preceding unit, which is Unit 2, we discussed about Mercantilist's policies and factors shaping Mercantilism. 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.

1.2 Learning Outcomes

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 Locke's contributions to history of economic thought
- Discuss John Law's contributions to history of economic thought
- Clarify 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 thought

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

The development of economic thought and life is closely linked to mercantilism, driven by merchant capitalists seeking state protection. As trade developed, industry development became necessary, leading to a shift in capitalism from commercial to industrial. England led in this shift, focusing on free-trade and laissez-faire. However, changing circumstances led to divergence and conflict between profit and state intervention. Labor was uprooted, and foreign trade was viewed more realistically. The mercantilist philosophy outlived its usefulness as a theoretical system and policy recommendations, leading to reactions and revolts.

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

Sir William Petty, the founder of political economy, was a member of the Royal Society and founded the science of statistics and empiricism. His analysis covered value, wages, profit, rent, interest, and foreign exchanges. Petty's most important contributions to economic theory were his theory of natural par, which included views on rent and value. Petty's theory of natural par has three variations:

- i. Natural Par Between land and Labour:** Petty argued that land and labour were the two primary factors of production, generating value. He linked land value to labor value, using a 'day's food' measure, converting land value into labor value and making parity between the two.
- ii. Natural Par Between Rent and Money;** Petty discovered that value was not food but money, and sought to determine the money value of the surplus product, known as rent. Rent is the difference between land production and production costs.
- iii. 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.

Petty's systematic treatise on public finance included six heads: defending the country, maintaining rulers, ensuring justice, supporting educational institutions, helping orphanages, and maintaining public works. He believed rent tax was the most suitable

revenue source, as it affected different classes differently. Petty also developed theories on wages, money, and income, such as the normative subsistence theory of wages and the velocity of money based on pay periods.

$$Y = C + I.$$

Petty's Treatise of Taxes and Contributions has analytical flaws but remains a great work due to its scientific character, orderliness, and consistency in analysis, making it a pioneer in scientific economics (Jhingan et al, 2003).

1.3.2 John Locke's Contribution to History of Economic Thought

John Locke, a philosopher and economist, introduced the psychological basis for pain, pleasure, utility, and disutility in economic reasoning. He emphasized the relationship between human happiness and wants, leading to the theory of saving and interest. Locke introduced the concept of market demand, which represents individual demands expressed through money expenditure. He also argued that market value changes are proportional to the velocity of circulation of money, making his work as clear as Irving Fisher's.

Self-Assessment Exercise 1

Multiple Choice Questions (MCQs)

MCQ1

His publication titled <i>An Essay Concerning Human Understanding</i> (1690)			MC
	Answers	Hints/Feedback	Grade
	John Locke		
	Irving Fisher		
	Adam Smith		
	David Hume		

1.4 John Law's Contribution to History of Economic Thought

John Law, a practical affairs expert, made a significant contribution to the theory of money by distinguishing between use value and market value of a commodity. He argued that use value is necessary for a good to command a market value, but it does not determine its market value. John Law's examples of water and diamonds demonstrate this, with water having a high use value but low market value due to its abundant supply. He also believed that money has no imaginary value and its value depends on its uses and service to society. He was known for his suggestions for paper

money, which led to severe inflation and ruin, ultimately resulting in land as the most important property. Law was also the founder of a subjective theory of value, rejecting the idea that money had an imaginary value.

1.4.1 Richard Cantillon's Contribution to History of Economic Thought

Richard Cantillon's theory of value and price emphasizes the impact of labor and land on supply and demand, distinguishing between intrinsic and market value. He introduced the term 'entrepreneur' and argued that production involves risk-taking, with profit being the reward for organizers. Cantillon also analyzed the impact of money supply changes on the economy, showing that increased money supply increases purchasing power and stimulates economic activities. Although criticized for not subscribing to the quantity theory of money, Cantillon's analysis suggests that doubling money supply doesn't always double product and merchandise prices, indicating a complex relationship between money supply and price levels.

Self-Assessment Exercise 2

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

1.5.2 David Hume's Contribution to History of Economic Thought

Sir David Hume, a philosopher and economist, greatly influenced Adam Smith and his followers. He had analytical power and was a liberal mercantilist. Hume's *Political Discourses*, a collection of economic essays, emphasized the importance of money for stimulating trade. He followed Locke's view that money was a symbol and not a nation's possession. Hume discarded the balance of trade argument and advocated for free trade, focusing on money, price, and interest.

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

Sir James Denham Steuart, the last of the Mercantilists, was the chief English Mercantilist Writer of the 18th century. He lived in France, Germany, Holland, and Italy after the Stuarts' exile in 1745. Steuart's book, *An Inquiry into the Principles of Political Economy*, was the first use of the term in an English book. He defined political economy as the art of providing for family wants, controlled by the state, and encouraging domestic demand to maintain economic equilibrium.

Self-Assessment Exercise 3

Summarize the contributions of Sir David Hume to economics

1.6 Summary

Unit 3 explores the contributions of pre-classical economists, including Sir William Petty, John Locke, John Law, Richard Cantillon, David Hume, and Sir James Denham Steuart. The Mercantilist philosophy's usefulness waned, leading to a revolt in France and England, ultimately forming classical economics.

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

1.7 References/ Further Readings/Web Sources

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

Jhingan, M. L., Girija, M. and Sasikala, L. (2003). *History of Economic Thought, 3rd Edition*. Delhi: Virinda Publications (P) Ltd.

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self-Assessment Exercise 1

Multiple Choice Questions (MCQs)

MCQ1

His publication titled <i>An Essay Concerning Human Understanding</i> (1690)			MC
	Answers	Hints/Feedback	Grade
	John Locke		100
	Irving Fisher		0
	Adam Smith		0
	David Hume		0

Answer to Self-Assessment Exercise 2

Richard Cantillon's contribution to History of Economic Thought are:

- Theory of value (intrinsic and market value)

- ii. Theory of price
- iii. Influence of a labour and land on supply and demand
- iv. Entrepreneur as risk-taker
- v. Interest as reward for risk
- vi. External trade

Answer to Self-Assessment Exercise 3

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.

Unit 5: Physiocracy

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 Origin and Meaning of Physiocracy

1.3.1 Individual Physiocrats

1.4 The Distinguishing Features of The Physiocrats

1.5 The Physiocratic Concepts

1.5.1 The Physiocratic Concept of Natural Order

1.5.2 The Physiocratic Concept of Net Product

1.5.3 The Physiocratic Concept of Circulation of Wealth

1.5.4 The Physiocratic Concept of Taxation

1.5.5 The Physiocratic Concept of Trade and Laissez Fair

1.6 Summary

1.7 References/Further Readings/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(S) Within the 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.

1.2 Learning Outcomes

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.

1.3 Origin and Meaning of Physiocracy

Physiocracy, also known as the 'Agricultural System', is a collective of economic principles and policies developed in France in the 18th century. Known as the founders of economic science, the Physiocrats were the first to grasp the general principles underlying economic phenomena and evolve a theoretical system. The Physiocratic school, which operated from 1756 to 1776, was founded by François Quesnay and the Marquis de Mirabeau in 1757. The school's birth was influenced by the publication of Richard Cantillon's *Essai sur la nature du commerce en général*, which is considered the first complete treatise on political economy. Physiocrats revolted against Mercantilism and believed in the existence of natural law, which governs the universe. Their emphasis on agriculture earned their system of thought the name agricultural school.

1.3.1 Individual Physiocrats

Physiocrats were a group of influential philosophers who contributed to the development of physiocratic ideas. Dr. François Quesnay, a peasant physician, was considered the leader of the physiocrats, who studied medicine and became a court physician to Madame de Pompadour and King Louis XV of France. He was also a philosopher who conceived the idea of a united society. Pierre Samuel Dupont de Nemours, another prominent physiocrat, wrote the famous *Physiocratie* in 1768, which is derived from the term physiocracy. Marquis de Mirabeau, father of the famous Honoré, Comte de Mirabeau, published works like *L'Ami des homes, ou traite la population*, but did not directly contribute to the physiocratic doctrine.

Anne Robert Jacques Turgot, the most illustrious member of the physiocratic school, became the intendent of Limoges in 1761 and later became the finance minister. Turgot's work included letters on the grain trade, a treatise on interest, and his most important work, *Reflexions sur la formation et la distribution des richesses*.

Self-Assessment Exercise 1

In your own words, define Physiocracy

1.4 The Distinguishing Features of the Physiocrats

- i. 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).

- ii. They had a strong belief that only agriculture was the most productive sector that produces surplus rather than trade and manufacturing.
- iii. 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.
- iv. In their desire for capital accumulation, they were opposed to the consumption of luxury goods.
- v. Their view of an economy was more holistic as they attempted to show wealth circulated from one sector to another.
- vi. 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.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

In their desire for capital accumulation, they were opposed to the consumption of ____ goods.			MC
	Answers	Hints/Feedback	Grade
	Foreign		
	Cheap		
	Giffen		
	Luxury		

1.5 The 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.

1.5.1 The Physiocratic Concept of Natural Order

The physiocrat philosophy, based on optimism, individualism, self-interest, and a blend of ideal and material aspects of social life, led to the discovery and recommendation of the natural order. Philosophers believed that advancements in physical and other sciences would equip the human race to solve problems and develop moral and social attitudes. They also believed in the existence of an Almighty benevolent God, who believed that the system of nature and human faculties would be in harmony with each order. This conception of a "natural order" or system of natural-scientific, ethical, and social-scientific laws was ordained by a wise and benevolent God to ensure harmonious functioning in both the non-human natural universe and human societies.

1.5.2 The Physiocratic Concept of Net Product

The central economic hypothesis in physiocratic reasoning and policy was the origin of net product (product net). Physiocrats believed that wealth originated in agriculture and consisted of real produce. Product net was an excess of output over inputs, indicating that industry and trade were unproductive. This differed from mercantilism, which believed wealth came from foreign trade and precious metals.

1.5.3 The Physiocratic Concept of Circulation of Wealth

The physiocrats were the first to analyze the circulation of wealth in an economy, with Quesnay being the credit for presenting this idea in a systematic and coherent form. Quesnay's book, *Tableau Economique*, presented the circular flow of wealth, which laid the foundations for future fields of study in economics. The physiocratic theory of circulation of wealth made a significant contribution to the development of economic thought, as it provided a comprehensive description of the whole economy and demonstrated the interdependence of different sectors.

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

1.5.4 The Physiocratic Concept of Taxation

The physiocrats theory of taxation focuses on the net product of land, advocating a single tax on the net product of land to cover government expenditure. They believed that the establishment of natural order would ensure harmony of interests and a single direct tax. The scheme of wealth circulation covered three classes: farmers, landowners, and the industrial class. However, the state still needs revenue, and *laissez-faire* principles were prominent. Physiocrats believed that farmers and artisans had only bare

subsistence, so any tax imposed on them must be passed on to the net product. The physiocrats believed that the net product was the only fund suitable for taxation, as they did not have the means to pay taxes.

1.5.5 The Physiocratic Concept of Trade and Laissez Faire

The physiocrats believed that exchange and industry were unproductive, leading to a decline in foreign trade. They believed that wealth creation was a material substance, not utility. Trade and industry were considered sterile and unproductive, with no surplus. This contrasted with the Mercantilists' view that foreign trade was the source of national wealth, which included gold and silver. However, the physiocrats acknowledged the importance of trade, as it was essential for farmers and artisans to prevent produce from being perished. They advocated for free trade, focusing on goods that a country could produce and those excess of consumption.

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

Self-Assessment Exercise 3

Summarize the physiocratic concept of trade and laissez faire

1.6 Summary

This unit explores the origin and meaning of physiocracy, the first structured school of thought in economic matters in France during the third quarter of the 18th century. The term physiocracy, meaning rule or government of nature, reflects the members' interest in proposing a complementary interpretation of the world. Its sphere was social science, not economics alone. The physiocrats proposed a theory of value, advanced important economic concepts like capital and economic interdependence, and proposed the construction of a Royaume Agricole as an alternative to mercantile republics or manufacturing nations. Physiocracy is one of the ancestors of present-day economics, and its ideas, such as economic interdependence of sectors, circular flow of income, and the concept of capital, remain relevant today.

1.7 References/Further Readings/Web Sources

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

Jhingan, M. L., Girija, M. and Sasikala, L. (2003). *History of Economic Thought*, 3rd

Edition. Delhi: Virinda Publications (P) Ltd.

Taylor, O. H. (1960). *A History of Economic Thought*. McGraw Hill Book Co.

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self- Assessment Exercise 1

The term "physiocracy" refers to all of the economic theories and practices that emerged in France in the middle of the 18th century (Jhingan, M. L. et al. 2003). The "Agricultural System" is another name for physiocracy, according to the writers. Physiocrats are economists who made contributions to the expansion and advancement of the physiocracy.

Answer to Self- Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

In their desire for capital accumulation, they were opposed to the consumption of ____ goods.			MC
	Answers	Hints/Feedback	Grade
	Foreign		0
	Cheap		0
	Giffen		0
	Luxury		100

Answer to Self- Assessment Exercise 3

The physiocrats believed that exchange was unproductive and that foreign trade produced no real wealth. They believed that a country should exchange only those goods which it cannot produce and those which are in excess of consumption, and advocated free trade. However, they did concede the importance of trade if the produce was not to perish in the hands of farmers and artisans.

Unit 6: Commercial Capitalism and The Genesis of Classical Schools

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 Meaning and Distinctive Features of Classical School of Economics Thought

1.4 Adam Smith (1723-1790)

1.4.1 Division of Labour

1.4.2 Invisible Hand (Laissez Faire)

1.4.3 The Economic Law of a Free Enterprise Society

1.4.4 Theory of Value

1.4.5 Theory of Market Price

1.4.6 Theory of Wages

1.4.7 Theory of Profit and Interest

1.4.8 Theory of Money

1.5 Theory of Economic Growth

1.5.1 Theory of Economic Development

1.6 Summary

7.0 References/Further Readings/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

1.0 INTRODUCTION

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.

1.2 Learning Outcomes

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

- Explain the meaning and distinctive features of classical school of economic 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 and Interest, Theory of Money, Theory of Economic Growth and Theory of Economic Development.

1.3 Meaning and Distinctive Features of Classical School of Economic Thought

The classical school in economic thought emerged in England in the late 18th century, led by Adam Smith and his followers. This school included famous economists like Ricardo Malthus, J.S. Mill, and Adam Smith, who contributed significantly to the development of political economy. The term "classic" has three meanings in economic literature: the economic writings of Adam Smith to J.S. Mill, the teachings of Alfred Marshall and his followers, and the original work of Schumpeter between 1750 and 1850.

The following are characteristics features of classical school:

- i. The classical economists believed in *laissez faire* and that Government is best which govern least.
- ii. The Classical advocated a market economy based on perfect competition. They emphasized that production, exchange and distribution are guided by market forces.
- iii. 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.
- iv. They believed in the existence of harmony of interest.
- v. The classical economists put emphasis on the importance of all economic activities.
- vi. They believed in the universality of economic laws
- vii. The classical were the first economists who paid attention to the problems of economic growth and development.
- viii. They looked at the economy as a whole. Their approach was macro in nature.
- ix. Lastly, the classical economists believed in *Say's* law of market.

Self-Assessment Exercise 1

Briefly explain the word “Classic”

1.4 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*.

1.4.1 Division of Labour

Smith's famous example of division of labour involved pin production, where 18 workers produced 18 times as much pins as a single worker using the same technique. This resulted in more than 18 times the output of a single worker.

According to Jhingan, M. L. et al. (2003:61) 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 argued that division of labour is limited by market extent and capital availability. He emphasized the importance of large-scale production and individual actions based on self-interest, rather than external forces. He emphasized free international trade,

which focuses on producing goods at lower costs, leading to increased welfare and political consequences like no tariffs or non-tariff barriers.

1.4.2 Invisible Hand (Laissez Faire)

Adam Smith believed that society would benefit in the long run if individuals could pursue their personal interests and choose what to produce and consume. He argued that nations should focus on their own welfare and exchange goods and services for other nations' welfare. Smith advocated for the 'invisible hand', allowing the government to regulate society while focusing on territorial protection, justice administration, public works, business environment, and taxation.

1.4.3 The Economic Law of a Free Enterprise Society

Free enterprise in economics refers to the private sector that operates at will without government interference. Also referred to as free trade and free-market enterprise, this means an economy where companies can trade, operate, and set prices without restrictions. In other words, the business owners set the regulations themselves.

A free enterprise offers the citizens the freedom to utilize their money as they wish and pursue job opportunities they want. Moreover, unlike the government-controlled systems, which limit people to start business opportunities, a free market enables multiple companies to compete with each other.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Another term for “Free Enterprise”			MC
	Answers	Hints/Feedback	Grade
	Free selling		0
	Free bargaining		100
	Free-market		0
	Free buying		0

Features of Free Enterprise



The following are structures of a free enterprise:

- i. Free enterprise is the freedom of general economic activity within a nation.
- ii. Free enterprise examples include a private restaurant chain run without government interference or a person starting an online business.
- iii. Its characteristics include market competition, private property, specialization, voluntary exchange, a price system, and entrepreneurship.
- iv. Some common types of free enterprises are liberal market economies, coordinated market economies, and mixed market economies.

1.4.4 Theory of Value

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

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

Jhingan et al. (2003) argues that 'value in use' refers to the utility of a commodity, while 'value in exchange' is the power of purchasing other goods. Smith's concept of

the "diamond-water paradox" explains that commodities with the greatest value-in-use have little value-in-exchange. Smith's work on the exchange value of commodities was later developed into the labour theory of value by Ricardo and Marx. However, Smith's followers remained largely reliant on the labour theory of value, with marginal utility being a more logical approach.

1.4.5 Theory of Market Price

Smith argues that market commodities have a natural and actual price, which are determined by labor-command values. The natural price is the lowest an entrepreneur will continue to sell at, while the actual price is the level at which a commodity is sold. The natural price is not fixed forever, as society's general circumstances, wealth or poverty, and advancing or declining conditions can change. The relative natural prices of goods are only proportional to the labor-cost of production, indicating that the natural price is dynamic and flows with prevailing conditions in productive activities.

1.4.6 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:

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

1.4.7 Theory of Profit and Interest

Smith believed profit was a cover for eventuality and risk in business, and a higher rate of profit was necessary. Interest rates were to cover lending risks, but low enough to encourage borrowing. In brisk business conditions, competition kept profit low due to increasing wages, while in slack business conditions, wages decreased, resulting in higher profits. (Jhingan, et al.2003).

1.4.8 Theory of Money

Smith believed money facilitated the circulation of goods but did not add to society's wealth due to its gold and silver form. He advocated for paper money, which was backed

by gold. Smith emphasized money's two important functions: medium of exchange and store of value. He rejected bullionist policies and suggested that money quantity was determined by internal economic activity. (Jhingan, et al. 2003).

1.5 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 returns to scale because he did not assume diminishing marginal productivity.

Smith's theory focuses on the growth of the labor force and the supply of labor, with the rent of land being a monopoly price. The rate of population growth depends on human sustenance funds and the prevailing wage rate. Capital accumulation plays a strategic role in the growth process, with fixed capital stock causing stagnation. Smith believes that progress in agriculture, industry, and commerce leads to capital accumulation, population growth, market expansion, division of labor, and profit rise. However, scarcity of natural resources ultimately stops growth.

1.5.1 Theory 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 stored 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 3

In Smith's theory, capital accumulation has been assigned a strategic role in the growth process. Discuss

1.6 Summary

You learned classical school of economics, Adam Smith's contributions, including the Division of Labour and Invisible Hand, and his Economic Law of a Free Enterprise Society. Smith's theories on value, market price, wages, profit, interest, money, economic growth, and development remain relevant today..

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.

7.0 References/Further Readings/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

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

Jhingan, M. L., Girija, M. and Sasikala, L. (2003). *History of Economic Thought, 3rd Edition*. Delhi: Virinda Publications (P) Ltd.

Taylor, O. H. (1960). *A History of Economic Thought*. New york: McGraw Hill Book Co.

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self-Assessment Exercise 1

In economic writing, the word "classic" has been employed to convey three different ideas. It is first used to refer to the economic literature from Adam Smith to J.S. Mill during that time. Second, J. M. Keynes used the phrase to refer to Alfred Marshall's and his followers' teachings. Finally, by "classic," Schumpeter meant previously published original works. In this context, the term "classical school" refers to economists who produced works between 1750 and 1850.

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Another term for “Free Enterprise”	MC
------------------------------------	----

	Answers	Hints/Feedback	Grade
	Free selling		0
	Free bargaining		100
	Free-market		0
	Free buying		0

Answer to Self-Assessment Exercise 3

Smith's thesis emphasizes the strategic significance of capital accumulation in growth, arguing that investment rate and growth are functionally tied. He believes that growth in a nation's capital stock leads to increased output due to the expanding division of labor. Smith believes that progress in agriculture, manufacturing, industry, and commerce leads to affluence.

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

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 The Origin of Socialist Thought

1.4 Karl Heinrich Marx (1818-1883)

1.4.1 Marxism or Scientific Socialism

1.4.2 The Main Characteristics of Marxism

1.4.3 Chief Tenets of Marxian Thought

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

1.5 Marxian Method of Approach

4.0 Conclusion

5.0 Summary

6.0 Tutor Marked Assignment

7.0 References/Further Readings/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

1.1 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.

1.2 Learning Outcomes

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

1.3 The Origin of Socialist Thought

The industrial revolution led to severe problems for European societies, including increased unemployment, overproduction, and enslavement of workers. This led socialist scholars to advocate for improved welfare for factory workers and expose the flaws of the laissez-faire system. Marxist-Leninist socialism emerged in the 18th century, rejecting the harmony of interest doctrine, advocating collective action and co-operative production, and believing that rational individuals could pursue collective interests. Early socialism stands include Utopian Socialism, Christian Socialism, and Anarchism, but this discussion focuses on Marxism.

1.4 Karl Heinrich Marx (1818-1883)

Karl Marx, born in 1818 in Germany, was a middle-class Jewish man who studied law, history, and philosophy. He was influenced by Hegelian philosophy and revolutionary journalism, leading to expulsion from Germany, Belgium, and France. He spent most of his life in London, where he spent most of his time. His friend and disciple Engels helped him financially and collaborated on the development of Marxian thought. Marx's main works include "Das Kapital," which was published in 1867 and 1885 and 1894 after his death.

He was influenced by various factors, including economic and political conditions in Germany, British industrialism, trade unionism, the French Revolution, utilitarianism, socialism, and German radicalism. Despite being impressed with Hegelian philosophical ideas, Marx felt they were too conservative for societal change (*ibid*).

Self-Assessment Exercise 2

Who was Karl Marx?

1.4.1 Marxism or Scientific Socialism

Karl Marx introduced scientific socialism, also known as Marxism, to the economic doctrines. This comprehensive system of thought encompasses philosophy, economics, history, and politics. Marxism's organic unity and logical connection make it difficult to distinguish between Marxian economics and Marxism. It believes theory and practice go hand in hand, has originality and initiative, and has a high degree of logical consistency.

1.4.2 The Main Characteristics of Marxism

The following are the main characteristics of Marxism:

- i. Marxism is international in character. It is different from State socialism which is national in character.
- ii. Marxism is a working-class gospel. Marxists advocate for workers' organization and class struggle to eliminate capitalism, promoting socialism and a shift from equitable distribution to class war, involving workers against capitalists and the poor versus the rich.
- iii. 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.
- iv. Marxism is scientific socialism which demonstrates how capitalism will gradually give place to socialism.
- v. Marxism is purely revolutionary in character. The revolution will be peaceful.
- vi. Marxism is purely materialistic and not idealistic. It attaches much importance to economic facts.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)**MCQ1**

The phrase “Class war” contributed much to the success of ____.			MC
	Answers	Hints/Feedback	Grade
	Marxism.		
	Socialism		
	Capitalism		
	Utopianism		

1.4.3 Chief Tenets of Marxian Thought

Jhingan, et al (2003:185) divided the chief tenets of Marxian thought into two sections. The 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.

1.4.4 Marxian Philosophy (Marx’s Materialistic Interpretation of History)

Marx, a philosopher trained in Hegelian philosophy, criticized Hegelian philosophy for its reliance on dialecticism, which asserts that history moves on the basis of ideas. This dialectic approach, which involves conflict between the thesis and antithesis, leads to synthesis, which can take many possible courses. Marx argued that ideas do not move independently or according to God's will, but rather are shaped by deeper elements in the economy. He called this dialecticism materialistic dialecticism, as ideas follow materialistic advantages and conflicts rather than vice versa.

The Communist Manifesto by Karl Marx and Engels highlights class struggle, making it the dominant feature of social life. In ancient times, class conflict was the dominant feature of social life. Modern capitalism creates a system where workers are enslaved to capitalists, machines, supervisors, and masters, with exploitation of laborers inherent in the capitalist system. The Communist Manifesto called for workers to unite, organize, and liberate themselves from capitalists, believing that a revolution was inevitable and socialism would be established. However, capitalism itself creates conditions for its own destruction.

1.4.5 Marxian Method of Approach

Marxian method of analysis is a coherent and logical approach to understanding economic activity, focusing on four broad divisions: production, consumption, exchange, and distribution. These divisions are interrelated and are subject to natural laws and social laws. Marx argued that production and consumption are complementary, with production providing the material for consumption and consumption providing wants.

Marx's method is not a neatly categorized historical, deductive, or institutional approach, but rather a mixture of these factors within a scientific framework. He drew upon historical facts to support his hypotheses, and the institutional framework of a society plays a central role in his system.

Marx's objective of study was to lay the laws of motion of society, focusing on the material conditions of social life. He argued that social production necessitates the creation of corresponding social production relations, which take various forms and change with the degree of development of social productive powers. The economic structure of a society is a correspondence to these relations, which are based on the mode of production.

The dialectical materialism in Marxian methodology runs through the analysis, as the existing mode of production eventually becomes replaced by a new one. This dialectical materialism is characterized by class conflict, where new social relationships bring benefits to oppressed classes but also expose the exploitative nature of some classes.

Marx's method of analysis runs in terms of class conflict, as labor is the only factor of production capable of producing more than what goes in to produce itself. Throughout history, there has been a struggle regarding the appropriation of surplus value, but in capitalism, it becomes an open one in terms of surplus value. You should on your own study Marx's concepts of money and division of labour.

Self-Assessment Exercise 3

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

1.6 Summary

You learned the origin of socialist thought, Karl Heinrich Marx's biography, Marxism, and its characteristics. You also, studied Marx's philosophy, method of approach, and materialistic conception of history. Marx viewed capitalism as a passing phase in history, evolving from past experiences and carrying its own destruction seeds. Overcame its

inner contradictions for a better society. We shall continue with our discussion on Marxism in the next unit which is Unit 2 by considering Marxian stages of societal development.

1.7 References/Further Readings/Web Sources

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

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1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self-Assessment Exercise 1

Karl Marx was born into a middle-class Jewish family in south-eastern Germany and studied law, history and philosophy. He submitted his doctoral thesis to the University of Jena and was influenced by Hegelian philosophy, leading to his expulsion from Germany, Belgium and France and his exile to London.

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

The phrase “Class war” contributed much to the success of ____.			MC
	Answers	Hints/Feedback	Grade

The phrase “Class war” contributed much to the success of _____.			MC
	Answers	Hints/Feedback	Grade
	Marxism.		
	Socialism		
	Capitalism		
	Utopianism		

Answer to Self-Assessment Exercise 3

Production, consumption, exchange, and distribution are the four main categories of economic activity that Karl Marx initially broke down. These four divisions, in his opinion, are connected. Production brought the items required to satisfy human needs, distribution disseminated them in accordance with societal norms, exchange distributed, and during consumption, the product directly served individual needs.

UNIT 2: THE MARXIAN STAGES OF SOCIETAL DEVELOPMENT**Unit Structure****1.1 Introduction****1.2 Learning Outcomes****1.3 Primitive Communism****1.3.1 Slave Society****1.3.2 Feudalism****1.4 Capitalism****1.5 Socialism And Communism****1.6 Summary****1.7 References/Further Readings/Web Sources****1.8 Possible Answers to Self-Assessment Exercise(S) Within The Content****1.1 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.

1.2 Learning Outcomes

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

1.3 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;

- i. Shared property: there is no concept of ownership beyond individual possessions. All is shared by the tribe to ensure its survival.
- ii. Hunting and gathering: tribal societies have yet to develop large-scale agriculture and so their survival is a daily struggle.
- iii. 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.

Primitive communism emerged after humanity's dawn, with societies ranging from a few hundred to a few hundred members, influenced by the environment. These societies were small and unaltered by nature, similar to animals.

1.3.1 Slave Society

The second stage, Slave Society, marks the beginning of class society, where private property and a slave culture emerge. As population increases, human labor becomes the most important resource for income, with those with the most slaves becoming the most powerful.

The characteristics of the Slave society are;

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

Self-Assessment Exercise 1

Discuss the terms democracy, authoritarianism and fascism.

1.3.2 Feudal or Estate Property

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

- i. Aristocracy: the state is ruled by monarchs who inherit their positions, or at times marry or conquer their ways into leadership.
- ii. 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.
- iii. 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.
- iv. 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.

1.4 Capitalism

Marx focused on human development, exploring capitalism's mechanisms, which emerged from feudal society's revolution. Capitalism is considered the fourth stage in the sequence, following the bourgeois revolution.

Capitalism is characterized by the following: In capitalism, the entire economy is guided by market forces, with little or no government intervention. Capitalists control private property through commercial enterprises, and they govern through a centralized parliament or congress. This democracy excludes certain groups, such as women, slaves, and those on low income, and acts on behalf of the capitalists through various methods. Workers are rewarded according to their contract with their employer, but this is exploitation and alienation from their work. Capitalism spreads from wealthiest countries to the poorest through warfare, threats of war, or capital exports.

Financial institutions, such as banks and stock exchanges, direct unused capital to where it is needed, improving class mobility. Monopolistic tendencies are created by natural, unrestrained market forces, creating monopolies from the most successful commercial entities.

Capitalism, like slave society and feudalism, has critical failings, including the working class, which is not paid the full value of their work. This leads to class consciousness and

class struggles. Capitalists exploit the working class by accepting money as the universal equivalent, hiding the real equivalent behind any monetary exchange: labour. Marx argues that the more labor it takes to produce a product, the greater its value. However, in a capitalist society, people tend to believe power and value are inherent in the money-form rather than the labor producing goods and services, leading to "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**).

The Industrial Revolution and French Revolution promoted scientific ideas and values, leading to innovations and new technology in various sectors. Agriculture experienced increased productivity, displacing labor, while textile and mineral sectors shifted from rural to urban areas. As productivity increased, land needed decreased, and capital owners became more influential.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Is the "grave digger" of capitalism			MC
	Answers	Hints/Feedback	Grade

Is the "grave digger" of capitalism			MC
	Answers	Hints/Feedback	Grade
	The marxian class, towich the capitalist class gave birth in order to produce commodities and profits		
	The working class, towich the capitalist class gave birth in order to produce commodities and profits		
	The working class, towich the communist class gave birth in order to produce commodities and profits		
	The working class, towich the Socialist class gave birth in order to produce commodities and profits		

1.5 Socialism and Communism

After the working-class gains class consciousness and revolutions against capitalists, socialism, considered the Fifth Stage, is achieved. Lenin divided communism into two stages: first socialism and stateless communism or pure communism. Socialism is characterized by a decentralized planned economy, common property, council democracy, and labor vouchers. After socialism is established, society moves forward, with classes abolished and class society ended. Communism spreads worldwide, and eventually, stateless communism or pure communism is established, with statelessness, classlessness, and propertylessness. This stateless state is where all social classes disappear, and all goods are free to be consumed by anyone who needs them.

Self-Assessment Exercise 3

Highlight eight (3) features of stateless communism or pure communism, which may be considered the sixth stage.

1.6 Summary

This unit explores Marx's societal development stages, including Primitive Communism, Slave society, Feudalism, Capitalism, and Communism. Marx identified historical epochs, with oppressors and oppressed groups, and predicted that working-class proletariats would revolt against capitalists and opt for a socialist society. The next unit which is Unit 3 considers Marx's economic theories such as labour theory of value, surplus value, rent, etc.

1.7 References/Further Readings/Web Sources

Lenin, V. (1917). State and Revolution. Moscow

Wikipedia (17 October 2013). Marx's Theory of History. Retrieved on October 21, 2013 from http://en.wikipedia.org/wiki/Marx%27s_theory_of_history#cite_ref-3

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self-Assessment Exercise 1

Totalitarianism, authoritarianism, and fascism are political systems with a powerful central authority controlling citizens' lives through compulsion and repression. Each country has a recognized form of government, but descriptions are often inaccurate. For example, the former Soviet Union was a socialist republic, while elections were not "free and fair." Distinctions between different types of government are often hazy or ill-defined, often sharing traits.

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Is the "grave digger" of capitalism			MC
	Answers	Hints/Feedback	Grade
	The Marxian class, to which the capitalist class gave birth in order to produce commodities and profits		0
	The working class, to which the capitalist class gave birth in order to produce commodities and profits		100
	The working class, to which the communist class gave birth in order to produce commodities and profits		0
	The working class, to which the Socialist class gave birth in order to produce commodities and profits		0

Answer to Self-Assessment Exercise 3

Stateless communism, the sixth stage, consists of statelessness, classlessness, and propertylessness, with no governments, laws, or nations, and free consumption of goods.

UNIT 3: THE MARXIAN ECONOMIC THEORIES

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 The Marxian Labour Theory of Value

1.3.1 The Marxian Theory of Surplus Value

1.3.2 The Marxian Theory of Capitalist Exploitation

1.4 The Marxian Law of Capitalist Accumulation

1.5 The Marxian Theory of Rent

1.6 Summary

1.7 References/Further Readings/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

1.1 Introduction

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.

1.2 Learning Outcomes

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

1.3 The Marxian Labour Theory of Value

Karl Marx's theory of value is based on Ricardian labour theory, which he borrowed to avoid undue deviations and state the whole theory more precisely. Marx believed that a commodity is a carrier of use value and exchange value, satisfying human wants and having a quantitative relation with other commodities. He argued that a commodity must have exchange value and something common, called "Abstract human labour." The value of a commodity is simply the amount of crystallized human labor it contains, and it differs in value according to the quantities of socially necessary labour required to produce it. Marx emphasized that the value of a commodity would remain constant if the labour-time required for its production remained constant.

1.3.1 The Marxian Theory of Surplus Value

The theory of surplus value is the foundation of Marxian economic theory, which posits that production in capitalism is production of surplus value, with the worker producing for the capitalist. Marx divided labor into necessary and surplus labor, with the capitalist paying only wages to purchase means of subsistence. This creates surplus value, which is the difference between the selling price of the commodity and the actual wages paid to the laborer. In a capitalist society, workers are exploited by the capitalists, who classify capital as constant capital and variable capital. Marx's theory identifies three components of the value of a commodity: constant capital, variable capital, and 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 $S = S/V$.

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

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, the annual rate of surplus value (as') will be;

$$as' = S_n/v$$

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 differentiated between absolute and relative surplus value, with absolute surplus value arising from increased working hours and relative surplus value from reducing real wages. Capitalists can increase exploitation by increasing labor productivity, reducing real wages, and increasing working days.

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

Self-Assessment Exercise 1

List three (3) ways that the capitalists can raise the rate of exploitation

1.3.2 The Marxian Theory of Capitalist Exploitation

Marx identifies two classes in a capitalist society: capitalists and workers. Capitalists own production means, while workers sell their labor-power to them. Large-scale production creates employment opportunities and surpluses, leading to exploitation. Overproduction in capitalism causes unemployment and labor-power shortages. In Marxian economics, capital means money used for exploitation. In a pre-capitalist society, producers sell their commodities for money and buy other producers' commodities for consumption. 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-M₁** in which **M** stands for money or capital, **C** for commodity and **M₁** for money. You should note that the difference between **M** and **M₁** 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).

1.4 The Marxian Law of Capitalist Accumulation

Marx argues that capital accumulation is caused by surplus value, which capitalists use to increase labor productivity and maximize profits. This accumulation leads to large-scale production controlled by a few, a concentration of rural populations, declining

profits, industrial crises, overproduction and under-consumption, unemployment, and pauperism. Technological improvements reduce labor demand, creating an industrial reserve army. Joint stock companies and banking facilities accelerate capital concentration, indicating a cumulative process. The higher the accumulation, the greater society's wealth, industrial reserve army, concentration of power, and misery accumulation.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

According to Marx, it is the _____ that creates capital accumulation			MC
	Answers	Hints/Feedback	Grade
	surplus value		
	surplus rate		
	surplus ratio		
	normal value		

1.5 The Marxian Theory of Rent

The concept of rent arises from the idea that a capitalist can make an extra profit by producing a commodity at a lower price than its value. This profit is wiped out under competition, but if a capitalist retains this advantage in cost of production, they continue to enjoy this extra profit, which becomes a rent. This advantage is more so in the case of gifts of nature and differential rent, which arises due to the higher fertility of certain lands. Landed classes, through their monopoly of land ownership, can earn a rent due to the monopoly price of agricultural produce. However, even if the law of diminishing returns does not apply to land, agricultural lands can bring an extra profit to their owners, which assumes the character of rent.

There are possible theories of the rent of land, including monopoly rent, differential rent, interest income earned on capital invested in land, and the Marxian theory of rent. The Marxian theory of rent covers absolute, monopoly, and differential rents as special cases.

Self-Assessment Exercise 3

Summarize the Marxian theory of rent

1.6 Summary

Marxian economic theories, including labour theory of value, surplus value, capitalist exploitation, capitalist accumulation, and rent, have high internal logical consistency. They provide a comprehensive, harmonious world outlook, unconcilable with bourgeois suppression. Marxism has become a religion, providing salvation for millions and a popular gospel for the working class and radical thinkers. 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.

1.7 References/Further Readings/Web Sources

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

Jhingan, M. L., Girija, M. and Sasikala, L. (2003). *History of Economic Thought, 3rd Edition*. Delhi: Virinda Publications (P) Ltd.

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self-Assessment Exercise 1

The capitalists can raise the rate of exploitation by the following ways:

- i. By increasing the working days of labourers.
- ii. By increasing the productivity of labour.
- iii. By reducing real wages (*ibid*).

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

According to Marx, it is the _____ that creates capital accumulation			MC
	Answers	Hints/Feedback	Grade

According to Marx, it is the _____ that creates capital accumulation			MC
	Answers	Hints/Feedback	Grade
	surplus value		100
	surplus rate		0
	surplus ratio		0
	normal value		0

Answer to Self-Assessment 3

Rent is the extra profit a capitalist can make by producing a commodity at a lower price than its value, which is not wiped out by competition. It is particularly significant in natural gifts like differential rent. Landed classes earn rent through monopoly ownership of land, while agricultural lands can bring extra profit due to natural advantages. Marx proposed four theories of rent: monopoly, differential, interest income, and surplus profit.

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

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 Law Of Falling Tendency of Rate of Profit

1.3.1 Crisis Arising from Disproportionality

1.3.2 Crisis Arising from Under-Consumption Theory

1.4 Marx's Theories of The State

1.5 An Evaluation of Marxism

1.6 Summary

1.7 References/Further Readings/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

1.1 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.

1.2 Learning Outcomes

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

1.3 Law of Falling Tendency of Rate of Profit

Marxian growth theory emphasizes capital accumulation and focuses on economic development as a central theme, addressing societal changes and explaining the laws of change. Separating this theory from the rest of his analytical framework is challenging.

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

- i.* c : fixed capital used in the production of goods
- ii.* v : wages (labour value) paid to the employees
- iii.* l : value of employees' work
- iv.* $l > v$ = surplus of employees' work over the cost of employment: m
- v.* $w = c + l = c + v + m$: value of the new product
- vi.* profit rate: $r = \frac{m}{c+v} = \frac{\frac{m}{v}}{\frac{c}{v} + 1}$
- vii.* m/v : surplus rate; c/v : rate of organic capital composition
- viii.* 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

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

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

$$\begin{aligned} & \frac{S}{V} \cdot \frac{V}{C+V} \\ &= \frac{S}{V} + \frac{V}{C+V} V \\ &= \frac{S}{V} \cdot \frac{1-C}{C-V} \end{aligned}$$

This is because $\frac{V}{C+V} = \frac{1-C}{C+V}$ { }

$\frac{S}{V}$ 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.

1.3.1 Crisis Arising from Disproportionality

Marx argues that capitalist systems create disproportionality between production branches due to rough market estimates. This leads to output being sold at lower or higher prices, leading to a general economic crisis. Disproportionality Theory, advocated by Tugan-Baranowsky and Hilferding, was popularized by Marx but not extensively discussed.

1.3.2 Crisis Arising from Under-Consumption Theory

Karl Marx argued that consumption is the basis of production in a capitalist society, but social relations impede its expansion due to subsistence wage and proletarianization. This fundamental contradiction prevents the growth of productive power and the law of distribution from aligning with production laws. The capitalist system prevents the masses from participating in productivity benefits and consumes at a lower rate, leading to under-consumption and a general crisis.

Self-Assessment Exercise 1

Highlight crisis arising from under-consumption theory

1.4 Marx's Theories of The State

Karl Marx argued that the State is an instrument of class used for subjugating and dominating one class over another. He believed that the State originated from slavery and that its management has evolved in the capitalist State. Marx saw the State as an executive committee for the bourgeoisie class, serving their material interests while using its organs of coercion to subjugate the peasantry. He concluded that the State cannot be considered impartial and will continue to exist as long as class exists in society. Marx identified the Socialist State as the transitory stage between capitalism and communism, where the working class captures State power to erase capitalists and extinguish antagonistic class relations until communism is achieved.

Self-Assessment exercise 2

Multiple Choice Questions (MCQs)

MCQ1

when society was sharply divided into two classes with antagonistic and irreconcilable differences			MC
	Answers	Hints/Feedback	Grade

when society was sharply divided into two classes with antagonistic and irreconcilable differences			MC
	Answers	Hints/Feedback	Grade
	the majority workers over the minority chiefs		
	the majority peasants over the minority bourgeoisie		
	the minority bourgeoisie over the majority peasants		
	the majority peasants over the minority workers		

1.5 An Evaluation of Marxism

Marx was a powerful and original intellectual who analyzed the capitalist system, revealing its inner contradictions and revealing the laws of motion from era to era. He was an institutionalist, combining social and economic thought with history and theory. Marx's Marxian system is based on dialectical materialism, which contrasts with Hegel's dialecticism of ideas. He believed that capitalism evolved out of past history and carried the seeds of its own destruction. Marx's analysis of value, surplus value, and historical evolution is considered comprehensive and rigorous. However, he did not provide a theory of price. His analysis of surplus value is penetrating, revealing the mechanism of capitalist development and labor exploitation. However, his theory of surplus value has a major flaw: the inconclusive demonstration that the rate of surplus value cannot counteract the tendency to falling profit rates. Marx's predictions about the future are criticized for failing to visualize how capitalism could change its character and solve its inner contradictions. However, it is important to note that Marxian analysis could not provide a detailed account of the future, as it was based on the natural movements and directions of laissez-faire capitalism.

Marx's contributions include a theory of trade cycles, suggesting that the length of the cycle might depend on the life and replacement of fixed capital. He also analyzed the concentration of wealth and means of production, leading future economists to explore areas of imperfect competition. Marx also conveyed the role of the credit system in facilitating the process of concentration of capital. Socialist thought has been as dynamic as other aspects of economic thought, with Lenin, Hobson, and others taking steps towards pursuing economic investigations of capitalism into the realms of imperialism. German revisionism, French Syndicalism, Soviet Marxism, British Fabianism, and Guild Socialism emerged from Marxian theories and

predictions.

Self-Assessment exercise 3

Make a critique of Marxism

1.6 Summary

This unit covers Marx's theories on capitalist crisis, the State, and the law of falling profit rate. Marx developed insights into modern industrialization and is considered a great thinker. His work, *Das Capital*, is considered the doomsday book of capitalism. In the next unit which is Unit 5 and last unit of Module 3, we shall discuss the Marginalist School of economic thought.

1.7 References/Further Readings/Web Sources

Bell, J. F. (1953). *A History of Economic Thought*. New York: The Ronald Press

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1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self-Assessment exercise 1

Karl Marx argued that consumption is the basis of production, but the social relations in a capitalist society impede the expansion of consumption. This is due to the subsistence wage and the increasing proletarianization of society, which prevents the masses from participating in the benefits of increasing productivity. This leads to under-consumption and a general crisis.

Answer to Self-Assessment exercise 2

Multiple Choice Questions (MCQs)**MCQ1**

when society was sharply divided into two classes with antagonistic and irreconcilable differences			MC
	Answers	Hints/Feedback	Grade
	the majority workers over the minority chiefs		0
	the majority peasants over the minority bourgeoisie		0
	the minority bourgeoisie over the majority peasants		100
	the majority peasants over the minority workers		0

Answer to Self-Assessment exercise 3

Some democratic socialists and social democrats disagree with the idea that class strife and a proletarian revolution can lead to socialism. Anarchists also disagree on the necessity of a temporary state phase. Some intellectuals disregarded Marxist theory's core concepts, such as historical materialism and labor theory of value, and instead used different justifications to criticize capitalism and promote socialism. Proponents of Marxism may blend Marxist principles with those of other theorists, such as Max Weber, to promote socialism.

UNIT 5: The Marginalist School of Economic Thought

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 Rise of Marginalism

1.3.1 Distinguishing Features of Marginalism

1.4 Alfred Marshall (1842-1924)

1.4.1 Marshall's Major Contributions to Economic Thought

1.5 Important Marginal Concepts

1.5.1 Marginality

1.5.2 Marginal use

1.5.3 Marginal utility

1.5.4 Law of Diminishing Marginal Utility

1.5.5 Paradox of Water and Diamonds

1.6 Summary

1.7 References/ Further Readings/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

1.1 Introduction

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.

1.2 Learning Outcomes

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

1.3 Rise of Marginalism

In 1870, the adoption of marginalism emerged in economics, a new trend that challenged classical economics' dogmatism and lack of adaptability to time and places. This school of thought was influenced by renowned economists like Heinrich Heine, Hermann Heinrich Gossen, Karl Menger, Leon Walras, Alfred Marshall, Stanley Jevons, and J.B. Clark. Marginalists focused on partial micro-analysis rather than macro-analysis, analyzing interest rates, money, price levels, and business activities. Until the Keynesian revolution in 1936, marginalist economists remained dominant.

The classical school was criticized for overemphasizing the objective side of value and excluding subjective factors. Marginalist economists offered a subjective approach to economic theory, focusing on individualism and the individual as the focal point in utility concepts. Their approach was characterized by mathematical tools like geometry and differential and integral calculus, with a deductive and abstract method of analysis.

Self-Assessment Exercise 1

What do you understand by the terms 'objectivity' and "subjectivity"?

1.3.1 Distinguishing Features of Marginalism

- i. 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.

- ii. 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.
- iii. 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.
- iv. 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.
- v. 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.
- vi. 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.
- vii. 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.
- viii. The marginalist school followed an abstract and deductive method.
- ix. The marginalist analysis is subjective and psychological.

1.5.1 Alfred Marshall (1842-1924)

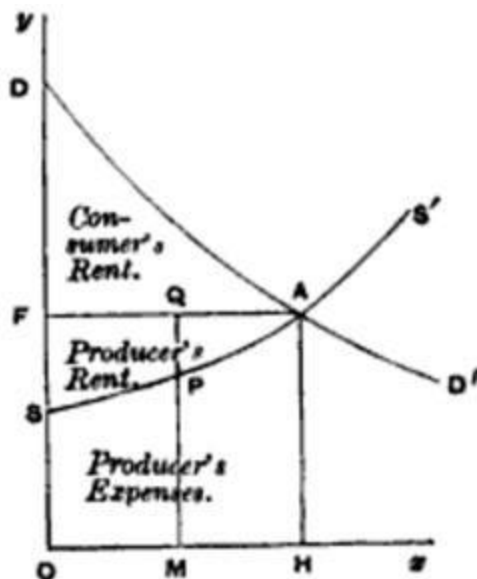
Alfred Marshall, a London-born marginalist, defined economics as the study of mankind in everyday life, focusing on individual and social action related to material wellbeing. He shifted from classical economics, which emphasized profit maximization, to focusing on material needs and social needs. Marshall believed in discovering human social laws that could be quantified and measured by financial prices, demonstrating his love for exactitude in his analysis.

1.4.1 Marshall's Major Contributions

Marshall's major contributions to economic thought are:

- i. **Marginal utility of demand:** Alfred Marshall, a London-born marginalist, was credited with the most comprehensive definition of economics. He defined economics as the study of mankind in the ordinary business of life, examining individual and social action closely connected with attainments and material requisites of wellbeing. Marshall shifted from classical economics, which emphasized profit maximization, to focusing on material wellbeing and social needs. He believed that economics should seek to discover human social laws that could be quantified and measured by financial prices. Marshall's analysis showed that marginal utility diminishes with every additional unit consumed, and the law of demand balancing marginal utilities. He advocated for narrowing income differentials in society to raise the marginal utility of the entire society. He also introduced the concept of consumer surplus, arguing that consumers enjoy a surplus and that this surplus was obtained through marginal utility analysis.

Diagram 1: Marshall's Demand and Supply Graph



Source: Spiegel (1952)

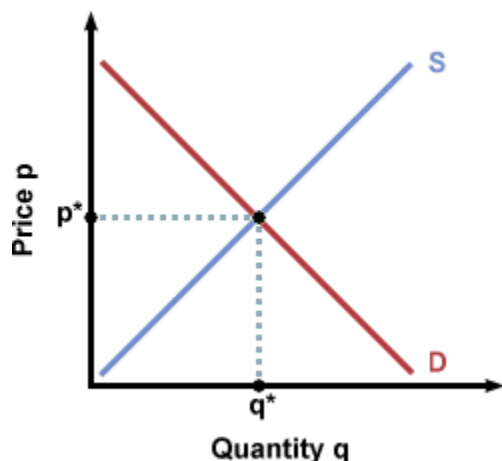
From diagram 1 above, consumer rent is in triangle **DFA**, while producer rent is in triangle **AFS** and Producers' expenses is trapezium **ASOH**. Since **DD¹** is also **MU**, it indicates declining marginal utility for the consumer as he consumes more of the same commodity.

- ii. **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.

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

- iii. **Supply and Market Prices;** Alfred Marshall believed supply was influenced by the cost of production, with real determinants of quantity supplied being the actual cost. He developed an upward-sloping supply curve, suggesting that higher commodity prices increase suppliers' willingness to supply, such as tailors charging higher prices during festive periods.
- iv. **Equilibrium Price:** Given his background in Mathematics, Marshall was able to combine the determinants of demand and supply and arrive at equilibrium price, as that price where supply matches demand.

Diagram 2: Equilibrium Price



Source: Author (2013)

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

- v. **Short-run and Long-run Concepts:** Marshall introduced short-run and long-run concepts in economic analysis, arguing that shorter periods have greater influence on value and price. Short-run refers to supply's inability to respond to sudden demand increases, while long-run allows for changes in supply and demand.
- vi. **Distribution:** Marshall argued income distribution in a competitive economy is determined by production factors, with supply and demand for labor being

- the key factors. He argued that increasing labor supply leads to lower wages.
- vii. **Interest Rate:** Marshall argued that interest rates tend towards equilibrium, where aggregate demand for capital equals aggregate supply, with falling rates causing more consumption and saving.
 - viii. **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.
 - ix. **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 Marginalism 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 Austria (1840-1921) and Leon Walras (1834-1910) of Switzerland but born in France.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

He is NOT a Marginalist			MC
	Answers	Hints/Feedback	Grade
	Gossen		
	Menger		
	Friedman		
	Marshall		

1.5 Important Marginal Concepts

1.5.1 Marginality

Marginality refers to the concept of constraints as a border or margin, where an individual's endowment, including opportunities, is determined by physical laws, natural accidents, and past decisions. Marginal values hold true under specific constraints, while changes affecting them are marginal changes. Neoclassical economics often assumes that marginal changes are infinitesimals, but this assumption may not be operationally true. Marginalism aims to explain unit prices in terms of marginal values, as decisions are often made in terms of

units.

1.5.2 Marginal use

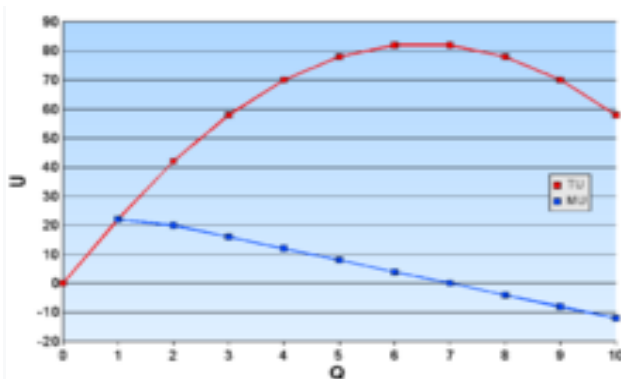
Marginal use refers to the specific use an agent would put an increase to or abandon in response to a decrease in a good or service. Marginalism assumes economic rationality and an ordering of possible states-of-the-world, with choice governed by the distinctions among those outcomes. On this basis, each increase is allocated to the feasible, previously unrealized use of greatest priority, while each decrease results in abandonment of the lowest priority use among the used goods or services.

1.5.3 Marginal Utility

Marginal use refers to the specific use an agent would put an increase to or abandon in response to a decrease in a good or service. Marginalism assumes economic rationality and an ordering of possible states-of-the-world, with choice governed by the distinctions among those outcomes. On this basis, each increase is allocated to the feasible, previously unrealized use of greatest priority, while each decrease results in abandonment of the lowest priority use among the used goods or services.

1.5.4 Law of Diminishing Marginal Utility

The law of diminishing marginal utility, also known as Gossen's First Law, states that as more resources are added, their marginal utilities decrease. This law is not a tautology, proven by introspection, or an instrumental assumption, but it has a basis in prior observation. Individuals can partially order potential uses of a good or service, and if there is scarcity, rational agents prioritize wants of highest priority. In the absence of complementarity across uses, the priority of using any additional amount will be lower than established uses. This principle is crucial in making economic decisions, as it helps determine the utility of resources and the value of goods or services.



Diminishing marginal utility, given quantification

In cases of complementarity across uses, adding or subtracting amounts can increase marginal

utility of a good or service. Diminished marginal utility is not an arithmetic subtraction but rather a shift from higher to lower priority. When quantification is assumed, diminishing marginal utility corresponds to a utility function with a continuously or continuously decreasing slope. Neoclassical economics often uses indifference curves, which can be produced without quantification, but are often treated as axiomatic. In the absence of complementarity, diminishing marginal utility implies convexity of indifference curves, which can also be derived from quasiconcavity of the utility function. When goods and services are discrete, the least favorable rate at which an agent would trade A for B will usually be different from that at which she would trade B for A:

1.5.5 Paradox of Water and Diamonds

The law of diminishing marginal utility is attributed to the paradox of water and diamonds, where water is essential for survival, while diamonds are valuable ornamentation or engraving bits. Marginalists argue that the marginal usefulness of a given quantity matters, rather than the usefulness of a class or totality. People trade based on their marginal utilities, and prices develop constrained by these utilities.

Self-Assessment Exercise 3

The law of diminishing marginal utility is said to explain the paradox of water and diamonds. Discuss.

1.6 Summary

The law of diminishing marginal utility is attributed to the paradox of water and diamonds, where water is essential for survival, while diamonds are valuable ornamentation or engraving bits. Marginalists argue that the marginal usefulness of a given quantity matters, rather than the usefulness of a class or totality. People trade based on their marginal utilities, and prices develop constrained by these utilities. This Unit 5 is the last in our Module 3. We shall begin Module 4 in the next unit by examining monetary economics.

1.7 References/Further Readings/Web Sources

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

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1.8 Possible Answers to Self-Assessment Exercise(S) Within the Content

Answer to Self-Assessment Exercise 1

The terms “objectivity” and “subjectivity,” in their modern usage, generally relate to a perceiving subject (normally a person) and a perceived or unperceived object. The object is something that presumably exists independent of the subject’s perception of it.

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

He is NOT a Marginalist			MC
	Answers	Hints/Feedback	Grade
	Gossen		
	Menger		0
	Friedman		0
	Marshall		100
			0

Answer to Self-Assessment Exercise 3

Although it was acknowledged by earlier philosophers, the dilemma of water and diamonds is believed to be explained by the law of diminishing marginal utility, which is most frequently associated with Adam Smith. Humans cannot even survive without water, yet diamonds were used as ornamental or engravable bits in Smith’s Day. Yet, diamonds were highly expensive and water was quite cheap. The utility of any specific quantity, as opposed to the usefulness of a class or of a totality, is what matters, according to marginalists. For the majority of people, water was abundant enough that the loss or gain of a gallon would only withdraw or add a very small amount of use, if any at all, whereas diamonds were in much more limited supply, therefore the loss or gain was much more significant.

MODUE 4

Unit Structure

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

Unit 1: The Monetary School Of Economic THOUGHT

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 Meaning of Monetary Economics

1.4 Monetarist School of Economic Thought

1.4.1 Johann Gustave Knut Wicksell (1851-1926)

1.4.2 An Evaluation of Wicksell's Contributions to Economic Thought

1.5 Milton Friedman

1.5.1 A Theory of the Consumption Function by Milton Friedman

1.6 Summary

1.7 References/Further Reading/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

1.1 Introduction

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.

1.2 Learning Outcomes

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
- Discuss Milton Friedman and his contributions to Economic Thought

1.3 Meaning of Monetary Economics

Monetary economics is a branch of economics that analyzes money as a medium of exchange, store of value, and unit of account. It examines the effects of monetary systems, including regulation of money and financial institutions, and international aspects. Modern analysis aims to provide a micro-based formulation of the demand for money and distinguish valid nominal and real monetary relationships for micro or macro uses. Research areas for monetary economics include empirical determinants, debt-deflation and balance-sheet theories, asset-price/macroeconomic relations, quantity theory, monetarism, monetary impacts on interest rates, monetary/fiscal policy relationship, neutrality of money, rational-expectations theory, monetary implications of imperfect and asymmetric information, game theory, the political economy of financial regulation and monetary policy, and potential advantages of following a monetary-policy rule to avoid inefficiencies and time inconsistency from discretionary policy.

Self-Assessment Exercise 1

What is monetary economics?

1.4 Monetarist School of Economic Thought

1. Monetarism is a theory that suggests economic variations, such as inflation rates, are primarily caused by changes in the money supply. It is a policy that aims to regulate an economy by increasing the domestic money supply moderately but steadily. The conventional analytical approach in economics focused on the dichotomy between physical and monetary aspects, with absolute prices establishing the link between the two. Knut Wicksell's work

placed the relationship between the two dimensions more realistically. Monetarists draw inspiration from classical economists, emphasizing the importance of monetary policies, particularly fiscal policies. They share classical economists' positions but are bound together by specific positions.

2. 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 represents full employment equilibrium.

3. They further believe that the quantity of money in circulation is 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.
4. They also 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.
5. Other areas monetarists emphasized on include 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 Samuelson (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-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

What is the monetarist equation that represents full employment?			MC
	Answers	Hints/Feedback	Grade

What is the monetarist equation that represents full employment?			MC
	Answers	Hints/Feedback	Grade
	$GDP = C + Inv + G + (eX - I)$		
	$GDP = M + Inv + G + (eX - I)$		
	$GDP = X + Inv + G + (eX - I)$		
	$GDP = N + Inv + G + (eX - I)$		

1.4.1 Johann Gustave Knut Wicksell (1851-1926)

Knut Wicksell, born in Stockholm in 1869, is a significant figure in the history of economic thought. He provided a synthesis of existing economic thought and established a school based on his economic reasoning. Wicksell's academic career began as an Assistant Professor in Law at the University of Upsala and later as a full professor at Lund University. His major publications include *Über Wert Kapital und Rente*, *Finanztheoretische Untersuchungen*, *Vorlesungen über Nationalökonomie*, and *Geldzins und Güterpreise*. He made significant contributions to interest rate stability, capital, interest, monetary theory, and economic fluctuations. Wicksell's contributions were based on Tooke's income theory of prices, which he found that prices and interest rates moved together during 1873-1895. Wicksell's contributions are discussed in detail as follow:

i. Capital and Interest

Wicksell's contribution to economics is significant, as he borrowed Bohn-Bawerk's time-element and incorporated it into his framework. He argued that capital is stored-up labor and land, separated from current labor and land through the time element. Wicksell's 'period concept' suggests that current year's labor and land cooperate with previous year's stored-up labor and land for production. He argued that there is a difference in marginal productivity between current year's land and labor and previous year's land and labor, which is due to the time element.

ii. Interest and Prices

Wicksell differentiated between natural and money rates of interest, stating that natural rates represent the expected yield on capital, while money rates are the average of banks advancing loans to potential investors.

iii. Savings and Investment

Wicksell's analysis on savings and investment improved Walrasian general equilibrium analysis by introducing period analysis and making the system dynamic. He differentiated between natural and market rates of interest, highlighting the relationship between these entities in any theory. Wicksell also considered the equality between savings and investment in an ex-ante sense, arguing that decisions between these entities are made by different sets of people. He believed that the relative position between savings and investment could be regulated by the use of Bank Rate, which sets the level of other market rates of interest. Wicksell integrated interest, savings, and investment in his theory, enhancing its dynamism and involving mutual dependence of variables.

1.4.2 An Evaluation of Johann Gustave Knut's Contributions to Economic Thought

Wicksell is widely considered an important figure in the history of economic thought due to his eclectic and original work. He made significant contributions to monetary economics, integrating interest and price theories with savings, investment, and business fluctuations. His analysis was a comprehensive system that integrated monetary theory, breaking away from classical theories that had a dichotomy between physical and monetary economics. Wicksell's dynamic analysis focused on price movements, secular and cyclical, and credit's role in the economy. He also emphasized the importance of uncertainty and expectations, which are now recognized by modern economists. Although Wicksell's analysis is abstract and employs mathematics, it is still amenable to mathematical treatment but poses intractable problems in statistical testing.

1.5 Milton Friedman

Milton Friedman, an American economist and statistician, received the 1976 Nobel Memorial Prize in Economic Sciences for his research on consumption analysis, monetary history, and the complexity of stabilization policy. He was a leader of the Chicago school of economics, which rejected Keynesianism in favor of monetarism. Friedman's ideas on consumption smoothing, unemployment, and stagflation were influential in the 1960s and 1970s. He promoted a macroeconomic viewpoint called monetarism, advocating for a steady, small expansion of the money supply. Friedman's ideas influenced government policies, particularly during the 1980s, and the Federal Reserve's monetary policy in response to the global financial crisis of 2007-2008.

After retiring from the University of Chicago in 1977, he became an Emeritus professor in economics in 1983. Friedman's political philosophy emphasized the virtues of a free market economic system with minimal government intervention in social matters. His support for school choice led to the founding of the Friedman Foundation for Educational Choice, later renamed EdChoice.

1.5.1 A Theory of the Consumption Function by Milton Friedman

Milton Friedman's A Theory of the Consumption Function questioned Keynesian assumptions about family consumption and income. It reanalyzed the relationship between aggregate consumption and income, highlighting the concept of permanent income. Friedman's work influenced consumer behavior and forecasted consumption smoothing, despite presenting contentious opinions that diverged from Keynes's. His work was cited as justification for the Sveriges-Riksbank Prize in Economic Sciences.

Self-Assessment Exercise 3

Summarize the theory of consumption function by Milton Friedman

1.6 Summary

This unit explores the monetarist school of economic thought, studying Johann Gustave Knut Wicksell's contributions and understanding monetary economics' current state. Monetary history is diverse, with debates between metallists, chartalists, currency schools, and monetarism versus Keynesianism. The literature on monetary systems remains varied and fascinating. It is a wonderful literature, and most of what we know about money we have learned from our study of it. In the next unit which is Unit 2, we shall discuss mathematical economics.

1.7 References/Further Reading/Web Sources

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

Bell, J. F. (1953). *History of Economic Thought*. New York: The Ronald Press

1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

Answer to Self-Assessment Exercise 1

Monetary economics is a field of economics that studies the role of money as a medium of exchange, store of value, and unit of account. It looks at the consequences of monetary systems, international issues, and regulation of money and related financial institutions. Its techniques include micro-based formulation of the demand for money and differentiation between nominal and real monetary relationships.

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

What is the monetarist equation that represents full employment?			MC
	Answers	Hints/Feedback	Grade
	$GDP = C + Inv + G + (eX - I)$		100
	$GDP = M + Inv + G + (eX - I)$		0
	$GDP = X + Inv + G + (eX - I)$		0
	$GDP = N + Inv + G + (eX - I)$		0

Answer to Self-Assessment Exercise 3

Milton Friedman's "A Theory of the Consumption Function" questioned conventional Keynesian assumptions about the family and popularized the term "permanent income". He developed a formula to determine income, where p stands for the permanent component and t for the transitory component, and his work significantly influenced research on consumer behavior and further outlined how to forecast consumption smoothing. His work on the Permanent Income Hypothesis was cited as justification for the Sveriges-Riksbank Prize in Economic Sciences.

Unit 2: Mathematical School of Economic Thought

Unit Structure

- 1.1 Introduction
- 1.2 Learning Outcomes
- 1.3 Meaning of Mathematical Economics
 - 1.3.1 History of Mathematical Economics
- 1.4 Marginalists and the Roots of Neoclassical Economics in Mathematics
 - 1.4.1 Augustin Cournot's Contributions to Mathematical Economics
 - 1.4.2 Léon Walras's Contribution to Mathematical Economics
 - 1.4.3 Francis Ysidro Edgeworth's Contribution to Mathematical economics
- 1.5 Modern Mathematical Economic
- 1.6 Summary
- 1.7 References/Further Reading/Web Sources
- 1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

1.1 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 economic thought.

1.2 Learning Outcomes

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

1.3 Meaning of Mathematical Economics

Mathematical economics is the application of mathematical methods to represent economic theories and analyze problems. It allows for the formulation of theoretical relationships with rigor, generality, and simplicity. Mathematical methods include differential calculus, differential equations, matrix algebra, and mathematical programming. They enable economists to form meaningful propositions about complex subjects and make specific, positive claims about controversial subjects. Mathematical economic models are used in economic theory for optimization problems, static analysis, comparative statics, and dynamic analysis. The use of mathematical models for human behavior has been criticized by some economists, such as John Maynard Keynes, Robert Heilbroner, and Friedrich Hayek, who argue that some human choices are irreducible to mathematics.

Self-Assessment Exercise 1

Itemize the broad applications of mathematical economics

1.3.1 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.

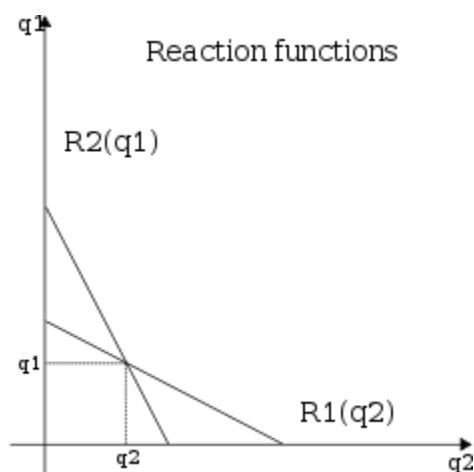
1.4 Marginalists and the Roots of Neoclassical Economics in Mathematics

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).

1.4.1 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: Cournot (1838)

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.

Mathematical economics is the application of mathematical methods to represent economic theories and analyze problems. It allows for the formulation of theoretical

relationships with rigor, generality, and simplicity. Mathematical methods include differential and integral calculus, difference and differential equations, matrix algebra, and mathematical programming. Mathematical economic models are used in various applications, including optimization problems, static analysis, comparative statics, and dynamic analysis. The use of mathematical models for human behavior has been criticized by some economists, such as John Maynard Keynes, Robert Heilbroner, and Friedrich Hayek.

The Cournot duopoly model assumes that both sellers have equal access to the market and can produce goods without cost. However, this assumption is not always accurate, as decision-makers operating in the same market over an extended period tend to have similar views of market demand and cost structures. Given these assumptions, one firm reacts to what it believes the other firm will produce. In other words, if firm B produces q_B of output, what quantity should firm A produce? The Cournot reaction function describes the relationship between the quantity firm A produces and the quantity firm B produces. Here's how it works.

The market demand curve faced by Cournot duopolies is:

$$P = 120 - 0.5Q_D$$

where Q_D is the market quantity demanded and P is the market price in dollars.

Assuming firm A has a constant marginal cost of \$20 and firm B has a constant marginal cost of N34, the reaction function for each firm is derived by using the following steps:

Note that the market quantity demand, Q_D , must be jointly satisfied by firms A and B.

Thus,

$$Q_D = q_A + q_B$$

Substituting the equation in Step 1 for Q_D in the market demand curve yields;

$$P = 120 - 0.5(q_A + q_B) = 120 - 0.5q_A - 0.5q_B$$

For firm A, total revenue equals price multiplied by quantity.

$$TR_A = P \times q_A = (120 - 0.5q_A - 0.5q_B) \times q_A = 120q_A - 0.5q_A^2 - 0.5q_Bq_A$$

1. Firm A's marginal revenue is determined by taking the derivative of total revenue, TR_A , with respect to q_A .

Remember to treat q_B as a constant because firm A can't change the quantity of output produced by firm B.

$$MR_A = \frac{dTR_A}{dq_A} = 120 - q_A - 0.5q_B$$

2. Firm A maximizes profit by setting its marginal revenue equal to marginal cost.

Firm A's marginal cost equals \$20.

$$MR_A = 120 - q_A - 0.5q_B = 20 = MC_A$$

3. Rearranging the equation in Step 5 to solve for q_A gives firm A's reaction function.

$$120 - 20 - 0.5q_B = 100 - 0.5q_B = q_A$$

4. Repeat Steps 3 through 6 to determine firm B's reaction function.

Remember that firm B's marginal cost equals N34.

$$TR_B = P \times q_B = (120 - 0.5q_A - 0.5q_B) \times q_B = 120q_B - 0.5q_Aq_B - 0.5q_B^2$$

$$MR_B = \frac{dTR_B}{dq_B} = 120 - 0.5q_A - q_B$$

$$MR_B = 120 - 0.5q_A - q_B = 34 = MC_B$$

$$120 - 34 - 0.5q_A = 86 - 0.5q_A = q_B$$

5. Substituting firm B's reaction function for q_B in firm A's reaction function enables you to solve for q_A .

$$100 - 0.5q_B = 100 - 0.5(86 - 0.5q_A) = q_A$$

$$100 - 43 + 0.25q_A = q_A$$

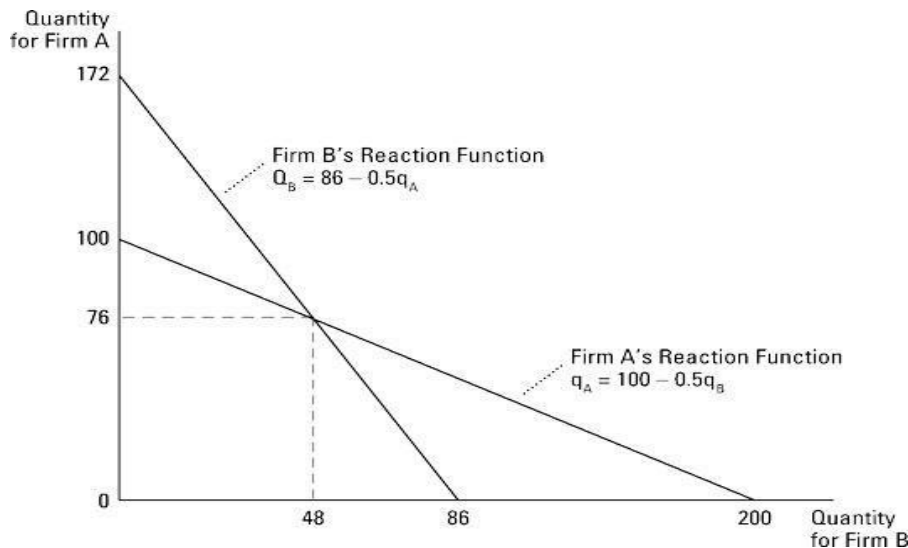
$$57 = 0.75q_A \quad \text{or} \quad q_A = 76$$

6. Substituting $q_A = 76$ in firm B's reaction function enables you to solve for q_B .

$$86 - 0.5q_A = 86 - 0.5(76) = 48 = q_B$$

Thus, in the profit maximizing Cournot duopolist, firm A, produces 76 units of output while firm B produces 48 units of output.

Diagram 2: Cournot's Profit Maximization Empirical Graph



Source: Cournot (1838)

In the Cournot duopoly model, both firms determine the profit-maximizing quantities simultaneously.

In the last example, firms A and B had different marginal costs. If the firms have the same marginal costs ($MC_A = MC_B$), each firm produces half the market output.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Let the inverse demand function and the cost function be given by $P = 50 - 2Q$ and $C = 10 + 2q$ respectively, where Q is total industry output and q is the firm's output. First consider first the case of uniform-pricing monopoly, as a benchmark. Then in this case $Q = q$ and the profit function is:			MC
	Answers	Hints/Feedback	Grade
	$\pi(Q) = (50 - 2Q)Q - 10 - 2Q = 48Q - 2Q^2 - 2.$		
	$\pi(Q) = (50 - 2Q)Q - 10 - 2Q = 48Q - 2Q^2 - 10.$		
	$\pi(Q) = (50 - 2Q)Q - 10 - 2Q = 48Q - 2Q^2 - 1.$		
	$\pi(Q) = (50 - 2Q)Q - 10 - 2Q = 48Q - 2Q^2 - 50.$		

1.2.1 Léon Walras's Contribution to Mathematical Economics

Mathematical economics is the application of mathematical methods to represent economic theories and analyze problems posed in economics. This approach allows for the formulation of theoretical relationships with rigor, generality, and simplicity. Mathematical methods include differential and integral calculus, difference and differential equations, matrix algebra, and mathematical programming. Mathematical economic models are used in various applications, including optimization problems, static analysis, comparative statics, and dynamic analysis.

Formal economic modeling began in the 19th century with the use of differential calculus to represent and explain economic behavior. However, the rapid systematization of economics alarmed critics and noted economists, such as John Maynard Keynes, Robert Heilbroner, and Friedrich Hayek. The Cournot duopoly model assumes that both sellers have equal access to the market and can produce their goods without cost. The model is used when firms produce identical or standardized goods and don't collude.

Léon Walras attempted to formalize discussion of the economy as a whole through a theory of general competitive equilibrium. He presented four separate models of

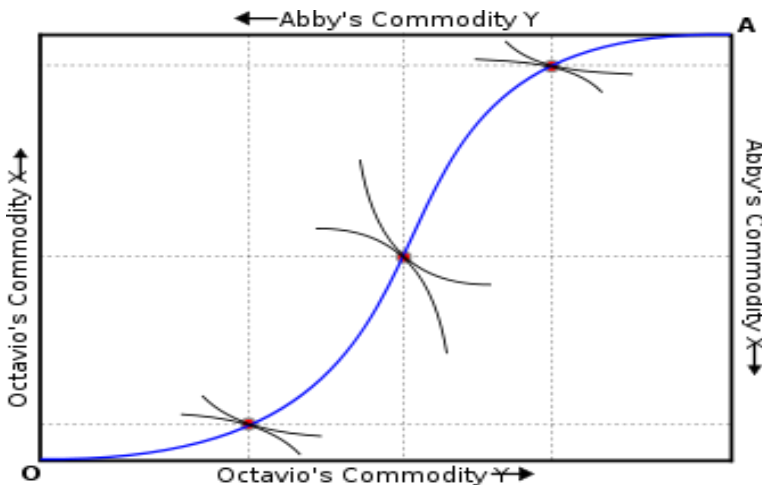
exchange, each recursively included in the next. The solution of the resulting system of equations is the general equilibrium.

Walras' law and the principle of tâtonnement are two famous results in economics. Walras' law was introduced as a theoretical answer to the problem of determining the solutions in general equilibrium. He assumed that in equilibrium, all money would be spent on all goods, and if there were n markets and $n-1$ markets cleared, the n th market would clear as well. This statement is commonly used today to illustrate market clearing in money markets at the undergraduate level.

1.2.2 Francis Ysidro Edgeworth's Contribution to Mathematical Economics

Edgeworth introduced mathematical elements to Economics in 1881, adopting Bentham's felicific calculus to economic behavior. He built a model of exchange based on three assumptions: individuals are self-interested, act to maximize utility, and can recontract independently. The Edgeworth Box describes the set of solutions where both individuals can maximize utility. Edgeworth noticed that a monopoly producing a good with jointness of supply but not jointness of demand might lower the price for consumers. Seligman argued that the paradoxical predictions were a quirk of his mathematical formulation, but Harold Hotelling later demonstrated that the same result could occur with discontinuous demand functions and large changes in tax rates.

Diagram 1: 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.

1.3 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-output, mathematical optimization, non-linear programming, variational calculus and optimal control, functional analysis, game theory and agent-based computational economics.

i. Differential Calculus

Vilfredo Pareto analyzed microeconomics by treating decisions by economic actors as attempts to change a given allotment of goods to another, more preferred allotment. Sets of allocations could then be treated as Pareto efficient (Pareto optimal is an equivalent term) when no exchanges could occur between actors that could make at least one individual better off without making any other individual worse off. Pareto's proof is commonly conflated with Walrassian equilibrium or informally ascribed to Adam Smith's Invisible hand hypothesis. Rather, Pareto's statement was the first formal assertion of what would be known as the first fundamental theorem of welfare economics. These models lacked the inequalities of the next generation of mathematical economics.

ii. Linear Models

Restricted models of general equilibrium were formulated by John von Neumann in 1937.^[44] Unlike earlier versions, the models of von Neumann had inequality constraints. For his model of an expanding economy, von Neumann proved the existence and uniqueness of an equilibrium using his generalization of Brouwer's fixed point theorem. Von Neumann's model of an expanding economy considered the matrix pencil $A - \lambda B$ with nonnegative matrices A and B ; von Neumann sought probability vectors p and q and a positive number λ that would solve the complementarity equation along with two inequality systems expressing economic efficiency.

$$p^T (A - \lambda B) q = 0,$$

In this model, the (transposed) probability vector p represents the prices of the goods while the probability vector q represents the "intensity" at which the production process would run. The unique solution λ represents the rate of growth of the economy, which equals the interest rate. Proving the existence of a positive growth rate and proving that the growth rate equals the interest rate were remarkable achievements, even for von Neumann.

iii. Input-Output Economics

Wassily Leontief developed a model of input-output analysis in 1936, based on Soviet 'material balance' tables. It analyzed production and demand processes, predicting how changes in demand would influence production in different sectors. Leontief's models, known as "Leontief technologies," produce outputs using constant input proportions, making them easier to estimate. In contrast, the von Neumann model requires estimation for each technology.

On your own read the following topics under modern mathematics:

- i. Mathematical optimization
- ii. Linear optimization
- iii. Nonlinear programming

Self-Assessment Exercise 3

What do you understand by the term, "Differential Calculus"?

1.6 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. Mathematical economics deserves support due to its history of theoretical advances, such as game theory, which provides the foundations for applied economics, from statistical decision theory to econometrics. In the next unit which is Unit 3, we shall discuss Keynesian economics.

1.7 References/Further Reading/Web Sources

Cournot, A.A. (1838). *Researches Into the Mathematikal Principles of the Theory of Wealth*. Trans. by N.T. Bacon, New York: Macmillan, 1929; reprinted, New York: Augustus Kelley, 1971.

Nicola, PierCarlo (2000). *Mainstream Mathematical Economics in the 20th Century*. New York: Springer.

1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

Answers to Self-Assessment Exercise 1

Broad applications include:

- i. optimization problems as to goal equilibrium, whether of a household, business firm, or policy maker
- ii. 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
- iii. comparative statics as to a change from one equilibrium to another induced by a change in one or more factors
- iv. dynamic analysis, tracing changes in an economic system over time, for example from economic growth.

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Let the inverse demand function and the cost function be given by $P = 50 - 2Q$ and $C = 10 + 2q$ respectively, where Q is total industry output and q is the firm's output. First consider first the case of uniform-pricing monopoly, as a benchmark. Then in this case $Q = q$ and the profit function is:			MC
	Answers	Hints/Feedback	Grade
	$\pi(Q) = (50 - 2Q)Q - 10 - 2Q = 48Q - 2Q^2 - 2.$		0
	$\pi(Q) = (50 - 2Q)Q - 10 - 2Q = 48Q - 2Q^2 - 10.$		100
	$\pi(Q) = (50 - 2Q)Q - 10 - 2Q = 48Q - 2Q^2 - 1.$		0
	$\pi(Q) = (50 - 2Q)Q - 10 - 2Q = 48Q - 2Q^2 - 50.$		0

Answers to Self-Assessment Exercise 3

Vilfredo Pareto evaluated microeconomics by modifying product allocations to achieve desired outcomes. Pareto optimal allocations were considered efficient when no exchanges could make at least one person better off without making others worse off. Pareto's statement made the first fundamental theorem of welfare economics, removing inequalities from later mathematical economic models.

Unit 3: The Keynesian Economics

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 Meaning of Keynesian economics

1.3.1 The Keynesian Theory

1.3.2 Keynesian Concept on Wages and Spending

1.4 "Multiplier Effect" and Interest Rates

1.5 IS/LM model

1.6 Summary

1.7 References/Further Reading/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(s) Within the 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 Keynesian economics.

1.2 Learning Outcomes

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

1.3 Meaning of Keynesian economics

Keynesian economics, or Keynesianism, posits that short-run economic output is heavily influenced by aggregate demand, particularly during recessions. Keynes' theories, first presented in 1936, contrasted the classical economics of the time. Keynesian economists argue that private sector decisions can lead to inefficient macroeconomic outcomes, requiring public sector responses like monetary and fiscal policies. Keynesian economics advocates a mixed economy, primarily private sector, with government intervention during recessions. Keynesian economics served as the standard economic model in developed nations during the Great Depression, World War II, and post-war expansion, but lost some influence after the oil shock and stagflation of the 1970s.

Self-Assessment Exercise 1

What do you understand by Keynesianism?

1.3.1 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:

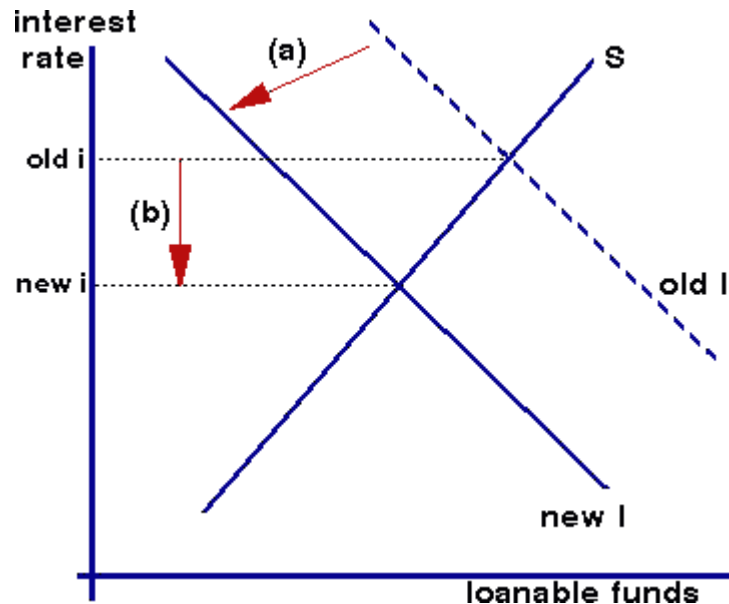
- i. A reduction in interest rates (monetary policy), and
- ii. Government investment in infrastructure (fiscal policy).
- iii. By reducing the interest rate at which the central bank lends money to commercial banks, the government sends a signal to commercial banks that they should do the same for their customers.

Government infrastructure investment creates business opportunities, employment, and demand, reversing imbalances. Governments borrow funds through government bonds, creating a fiscal deficit. Keynesian economics suggests no strong automatic mechanism moves output and employment towards full employment levels.

1.3.2 Keynesian Concept on Wages and spending

During the Great Depression, classical theory attributed mass unemployment to rigid real wages. Keynes argued that nominal wages are set in negotiations between employers and workers, and that cutting wages would be difficult due to laws and wage contracts. He rejected the idea that cutting wages would cure recessions and concluded that it would worsen recessions. He also believed that falling wages and prices could cause the economy to spiral downward, as people would wait for falling prices to make it more valuable.

Diagram 1: Excessive saving



Source: Author (2013)

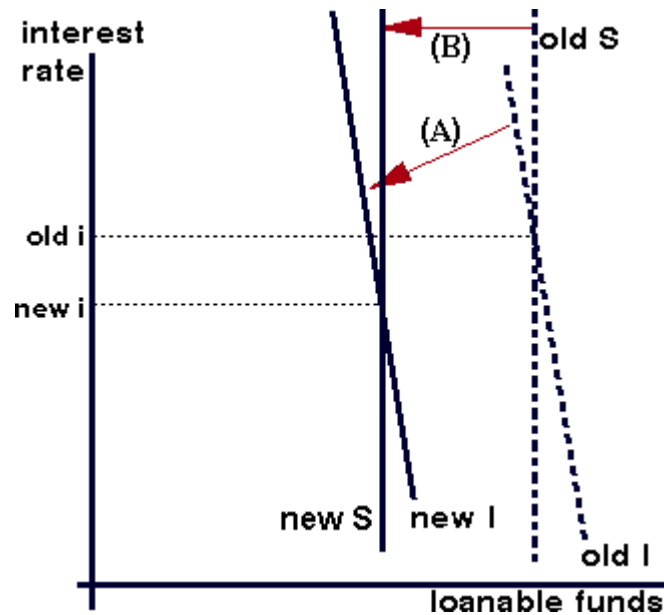
To Keynes, excessive saving, i.e. saving beyond planned investment, was a serious problem, encouraging recession or even depression. Excessive saving results if investment falls, perhaps due to falling consumer demand, over-investment in earlier years, or pessimistic business expectations, and if saving 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 2) 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 2: Effect of Negative Interest Rate



Source: Author (2013)

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 change 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 bondholders (fearing rises in interest rates and hence capital losses on their bonds) to sell their bonds to attain money (liquidity).

In the diagram (figure 2), 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.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Keynes suggested that, because of fear of capital losses on assets besides money, there may be a ___ setting a floor under which interest rates cannot fall			MC
	Answers	Hints/Feedback	Grade
	"liquidity trap"		
	"liquidity gap"		
	"money trap"		
	"cash trap"		

1.4 "Multiplier Effect" and Interest Rates

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

The Keynesian multiplier, developed by Richard F. Kahn in 1931, explains that exogenous increases in spending increase total spending by a multiple of that increase. This process allows businesses to hire more people and pay them, leading to increased consumer spending. The multiplier process tapers off as spending decreases, allowing equilibrium. Keynes also re-analyzed the effect of interest rates on investment, arguing that long-term profit expectations and interest rates determine investment. This approach allows for monetary policy regulation, although it may be ineffective in times of economic crisis.

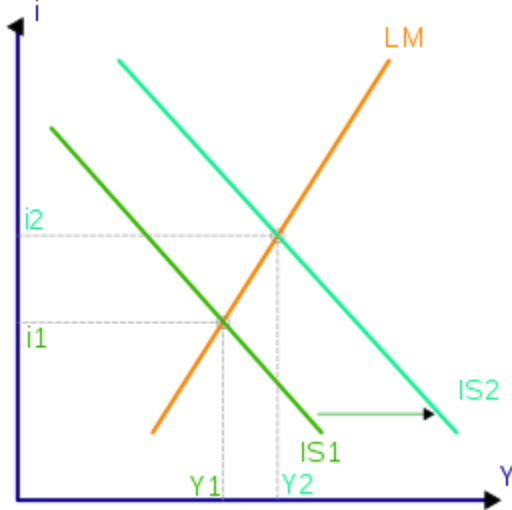
Self-Assessment Exercise 3

Summarize Keynes' discussion on "multiplier effect" and interest rates

1.5 IS/LM model

The IS/LM model, influential in policy and economics teaching, relates aggregate demand and employment to money in circulation, government budget, and business expectations. It gained popularity after World War II due to its general equilibrium theory. The IS-LM model, also known as the Hicks-Hansen model, illustrates the connection between interest rates and asset markets. It can explain variations in national income and explain changes in aggregate demand curves, suggesting potential stabilization interventions and economic volatility analysis.

Diagram 3: IS/LM Curve



Source: Author (2023)

The IS curve moves to the right, causing higher interest rates (i) and expansion in the "real" economy (real GDP, or Y)

1.6 Summary

Keynesian economics is a theory focusing on consumption, investment, and the multiplier effect. Keynesians posited a Phillips curve linking nominal wage inflation to unemployment rate and supported their theories through introspection and statistical evidence. In the next unit which is Unit 4, we shall discuss welfare economics.

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1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

Answer to Self-Assessment Exercise 1

Keynesian economics, introduced by John Maynard Keynes in 1936, posits that economic output is influenced by aggregate demand, not the economy's productive capacity. It contends private sector decisions can cause inefficient macroeconomic outcomes, necessitating public sector policy responses.

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Keynes suggested that, because of fear of capital losses on assets besides money, there may be a ____ setting a floor under which interest rates cannot fall			MC
	Answers	Hints/Feedback	Grade
	"liquidity trap"		100
	"liquidity gap"		0
	"money trap"		0
	"cash trap"		0

Answer to Self-Assessment Exercise 3

Keynes's model has implications for policy, such as the "Keynesian multiplier", which increases total spending by a multiple of the increase in government outlays. This process tapers off as imports and tax payments reduce the amount of induced consumer spending and the size of the multiplier effect. Keynes re-analyzed the effect of the interest rate on investment, which is determined by long-term profit expectations and the interest rate, allowing for monetary policy to regulate the economy

Unit 4: Welfare Economics

Unit Structure

- 1.1 Introduction
- 1.2 Learning Outcomes
- 1.3 Meaning of Welfare Economics
 - 1.3.1 Approaches to Welfare Economics
- 1.4 Conditions for Efficiency
 - 1.4.1 Conditions for Inefficiency
 - 1.4.2 A simplified Seven-equation Model
- 1.5 Efficiency between production and consumption
 - 1.5.1 Social welfare maximization
- 1.6 Summary
- 1.7 References/Further Reading/Web Sources
- 1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

1.1 Introduction

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.

1.3 Learning Outcomes

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

- i. Explain the meaning of welfare economics
- ii. Describe approaches to welfare economics
- iii. Discuss the conditions for efficiency
- iv. Discuss the conditions for inefficiency
- v. Give a simplified seven-equation model
- vi. Explain efficiency between production and consumption
- vii. Discuss social welfare maximization

1.3 Meaning of Welfare Economics

Welfare economics evaluates well-being using microeconomic techniques to assess social welfare in terms of economic activities of individuals within a society. It takes individual preferences as given and suggests a welfare improvement in Pareto efficiency terms if at least one person prefers B. Social welfare refers to the overall welfare of society and can be measured either cardinally in terms of "utils" or dollars or ordinally in terms of Pareto efficiency. The capabilities approach to welfare argues for the inclusion of freedom in welfare assessments, which has been influential in development policy circles. Other terms in welfare economics include externalities, equity, justice, inequality, and altruism.

1.3.2 Approaches to Welfare Economics

There are two mainstream approaches to welfare economics: the early *Neoclassical approach* and the *New welfare economics approach*. The early *Neoclassical approach* was developed by Edgeworth, Sidgwick, Marshall, and Pigou. It assumes the following:

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

The New Welfare Economics approach, based on Pareto, Hicks, and Kaldor, constructs a social welfare function by summarizing utility functions. It differentiates efficiency and distribution aspects, using Pareto efficiency and Kaldor-Hicks compensation tests, and replacing cardinal utility measures with ordinal utility.

Self-Assessment exercise 1

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

1.4 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:

- i. 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.
- ii. 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.
- iii. 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.
- iv. 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.

1.4.1 Conditions for Inefficiency

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

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

Two compensation tests have been developed to determine if an activity contributes to Pareto efficiency. The Kaldor criterion states that an activity contributes to Pareto optimality if the maximum amount the gainers are willing to pay is greater than the minimum amount the losers are willing to accept. The Hicks criterion, from the losers' perspective, states that if both conditions are satisfied, both gainers and losers agree that the activity will move the economy towards Pareto optimality.

1.4.2 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:

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

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

$$X = X(K^x L^x) \text{ (The production function for product X)}$$

$$Y = Y(K^y L^y) \text{ (The production function for product Y)}$$

$$U^1 = U^1(X^1 Y^1) \text{ (The preferences of consumer 1)}$$

$$U^2 = U^2(X^2 Y^2) \text{ (The preferences of consumer 2)}$$

The solution to this problem yields a Pareto optimum.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

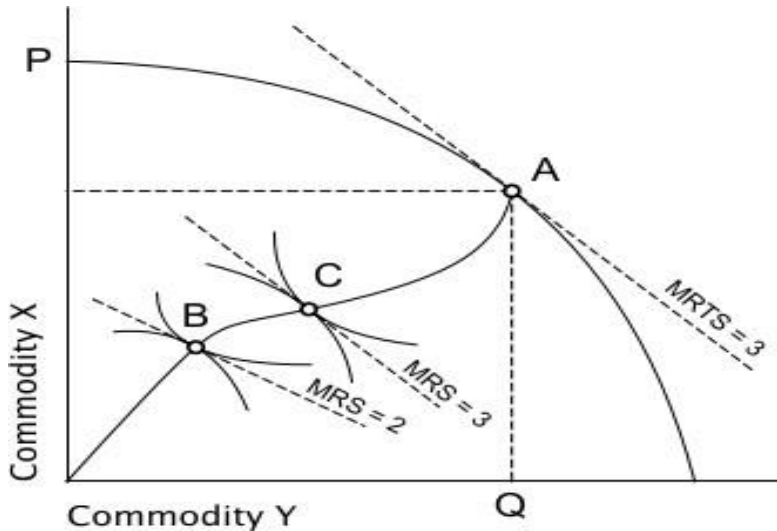
The basic welfare economics problem is to find the ____ of a social welfare function			MC
	Answers	Hints/Feedback	Grade
	empirical maximum		
	empirical minimum		
	theoretical maximum		
	theoretical minimum		

1.5 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 1: An Edgeworth Box Diagram of Consumption



Source: Author (2013)

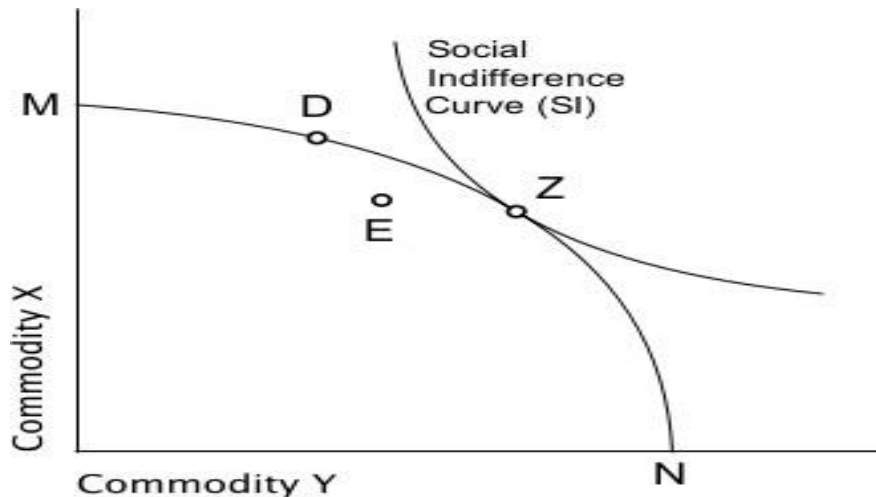
Point **A** defines the boundaries of an Edgeworth box diagram of consumption. That is, the same mix of products that are produced at point **A**, can be consumed by the two consumers in this simple economy. The consumers' relative preferences are shown by the indifference curves inside the Edgeworth 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 **OBCA** (often called the contract curve) inside the Edgeworth box defines the locus of points of efficiency in consumption (**MRS¹=MRS²**). 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.

1.5.1 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 possibility frontier (indicating inefficiency) because the **MRS** at point **C** is not equal to the **MRT** at point **A**.

Diagram 2: Social Indifference Curve



Source: Author (2013)

Although all the points on the grand social possibility 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 possibility frontier **MN** is tangent to the highest possible social indifference curve labeled **SI**.

Self-Assessment Exercise 3

What is Social Welfare Maximization?

1.6 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. The capabilities approach to welfare is an attempt to construct a more comprehensive approach to welfare economics, focusing on functioning, happiness and capabilities as the three key aspects of welfare outcomes.

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

1.7 References/Further Reading/Web Sources

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Arrow, K. J., and Gérard D. (2002). *Landmark Papers in General Equilibrium Theory, Social Choice and Welfare*(ed.). Massachusetts: Edward Elgar Publishing.

Atkinson, A. B. (1975). *The Economics of Inequality*. London: Oxford University Press.

1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

Answer Self-Assessment Exercise 1

The early Neoclassical approach to welfare economics assumes utility is cardinal, preferences are stable, and all individuals have comparable utility functions. The New Welfare Economics approach recognizes efficiency and distribution differences, using criteria like Pareto efficiency and Kaldor-Hicks compensation tests.

Answer Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

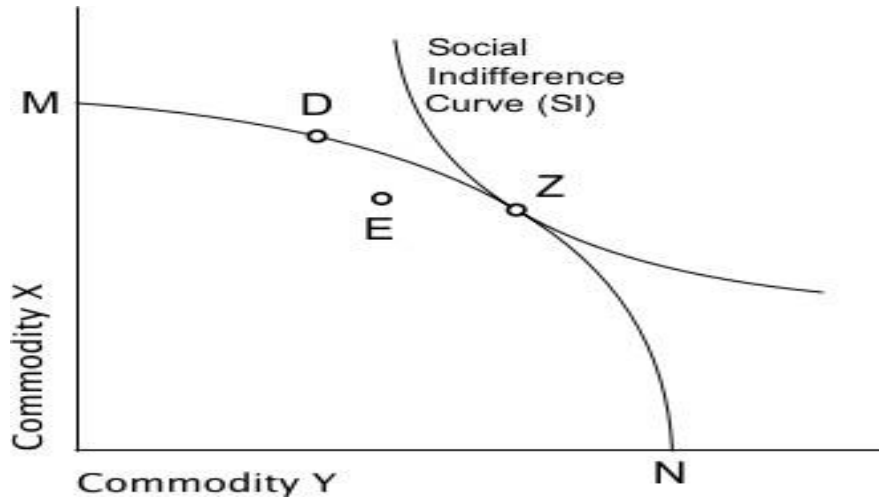
The basic welfare economics problem is to find the ____ of a social welfare function			MC
	Answers	Hints/Feedback	Grade
	empirical maximum		
	empirical minimum		0
	theoretical maximum		0
	theoretical minimum		100
			0

Answer Self-Assessment Exercise 3

Deriving utility functions from contract curve points on production potential frontiers can lead to a social utility frontier, or grand utility frontier. This Pareto optimum identifies optimal resource

allocation in an economy, ensuring supply and demand balance.

Diagram 2: Social Indifference Curve



Source: Author (2013)

The curve MN represents the frontier of social utility in the diagram above. The prior diagram's point C and point D are the same. Point D is near the border of social utility. The marginal rate of substitution at point C is equal to the marginal rate of transformation at point A, placing point D on the social value frontier. Because the MRS at point C is not equal to the MRT at point A, point E, which corresponds to point B in the previous picture, is inside the social possibility frontier (inefficiency).

Unit 5: Economic Growth Theories

Unit Structure

- 1.1 Introduction
- 1.2 Learning Outcomes
- 1.3 Meaning of Economic Growth
 - 1.3.1 Factors Affecting Economic Growth
- 1.4 Theories of economic growth
 - 1.4.1 Classical growth theory
 - 1.4.2 The neoclassical growth model
 - 1.4.3 Linear Stages of Economic Growth
 - 1.4.4 Salter cycle
- 1.5 Endogenous growth theory
 - 1.5.1 Unified growth theory
 - 1.5.2 The Big Push growth theory
 - 1.5.3 Schumpeterian growth theory
- 1.6 Summary
- 1.7 References/Further Reading/Web Sources
- 1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

1.1 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.

1.2 Learning Outcomes

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

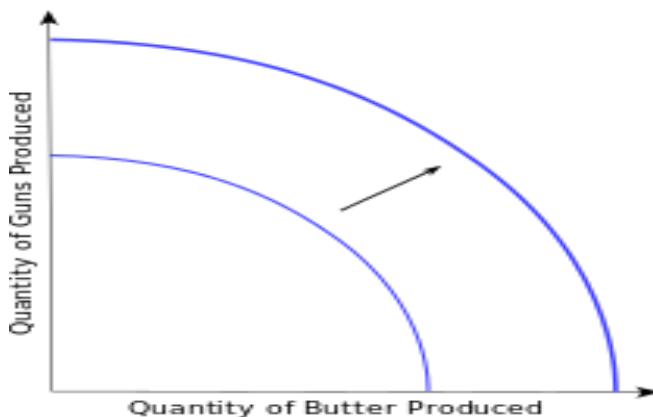
- Discuss the meaning of economic growth
- State the factors affecting economic growth
- Explain classical growth theory
- Explain the neoclassical growth model

- 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

1.3 Meaning of Economic Growth

Economic growth refers to the increase in goods and services produced over time, measured by real GDP. It is more important than GDP per capita, or per capita income. Intensive growth involves increasing per capita income, while extensive growth is caused by population or territory increases. Growth is typically measured in real terms, excluding inflation, and focuses on potential output growth.

Diagram 11: The production-possibility frontier



Source: Author (2013)

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

1.3.1 Factors Affecting Economic Growth

Productivity is the driving force of economic growth, affecting output to inputs like capital, labor, energy, materials, and services. Increased productivity lowers goods' costs, leading to a shift in supply. The real price of many goods fell by over 90% in the 20th century, resulting in increased aggregated demand. Demographic factors, natural resource quality, and improved products also contribute to growth.

Self-Assessment Exercise 1

What do you understand by the acronym KLEMS?

1.4 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.

1.4.1 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.

1.4.2 The Neoclassical Growth Model

The Solow-Swan Growth Model, developed in the 1950s, examines long-run growth by examining labor-time, capital goods, output, and investment. It emphasizes technological change and decline in capital returns as labor increases. Poor countries with less capital per person grow faster, but eventually reach a steady state where capital increases no longer generate growth. New technology creation leads to increased investment and growth.

1.4.3 Linear Stages of Growth Model

The linear stages of growth model, inspired by the Marshall Plan, suggests that economic growth in developing nations can be achieved through industrialization. However, constraints like local institutions and social attitudes can hinder growth. Rostow's model, based on five stages, has flaws, such as assuming a basic sequence, measuring development solely by GDP per capita, and neglecting causal factors. Economic modernization theories are influenced by the Harrod-Domar model, heavy state

involvement, and Arthur Lewis' dual-sector model.

1.4.4 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.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Economic modernization theories such as Rostow's stages model have been heavily inspired by the ____ model which explains in a mathematical way the growth rate of a country in terms of the savings rate and the productivity of capital			MC
	Answers	Hints/Feedback	Grade
	Harrod-Domar		
	Herrod-Domar		
	Hirrod-Domar		
	Harod-Domar		

1.5 Endogenous Growth Theory

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

In the 1980s, economists developed the endogenous growth theory, which incorporates human capital, skills, and knowledge. This model shows constant returns to capital, but growth depends on the types of investments made. Research focuses on increasing human capital through education or technological change.

1.5.1 Unified growth theory

Unified growth theory was developed by Oded Galor and co-authors to explain key empirical regularities in individual and global economies. Endogenous growth theory only accounts for developed economies' growth over the past century, not qualitatively different growth processes over longer time horizons. Unified growth theories are consistent with the entire development process, particularly the transition from Malthusian stagnation to sustained economic growth.

1.5.2 The Big Push

In theories of economic growth, the mechanisms that let growth take place and its main determinants are abundant. One popular theory in the 1940s, for example, was that of the *Big Push* developed by Paul Narcoz Rosenstein-Rodan (1902-1985), 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.

1.5.3 Schumpeterian Growth

Schumpeterian growth, named after Austrian economist Joseph Schumpeter, is an economic theory that explains growth by innovation as creative destruction. Schumpeter's approach captures the dual nature of technological progress, where entrepreneurs introduce new products or processes with the hope of temporary monopoly profits, making old technologies obsolete. The Aghion-Howitt model illustrates Schumpeterian growth.

Self-Assessment Exercise 3

Highlight the Schumpeterian growth theory

1.6 Summary

This unit covers economic growth, factors affecting it, and various growth theories. GDP measures economic growth, but it has limitations, such as overstating market economy during transitions from farming to household production. Modern development theories will be examined in Unit 6 and This unit covers economic growth, factors affecting it, and various growth theories. GDP measures economic growth, but it has limitations, such as overstating market economy during transitions from farming to household production. Modern development theories will be examined in Unit 6 which is the last unit for this course.

1.7 References/Further Reading/Web Sources

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1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

Answer to Self-Assessment Exercise 1

KLEMS = capital, labour, energy, materials and services.

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Economic modernization theories such as Rostow's stages model have been heavily inspired by the ____ model which explains in a mathematical way the growth rate of a country in terms of the savings rate and the productivity of capital			MC
	Answers	Hints/Feedback	Grade
	Harrod-Domar		100
	Herrod-Domar		0
	Hirrod-Domar		0
	Harod-Domar		0

Answer to Self-Assessment Exercise 3

The economic theory known as "Schumpeterian growth" was developed by the Austrian economist Joseph Schumpeter in the 20th century. In contrast to other theories of economic growth, his theory explains growth by innovation as a process of creative destruction that captures the dual nature of technological advancement: in terms of creation, entrepreneurs introduce new products or processes in the hope that they will experience temporary monopoly-like profits as they seize markets. They thereby render outdated goods or technologies useless.

This is the destruction that Schumpeter alludes to, which is also known as the annulment of earlier technologies, rendering them obsolete and "...destroys the rents earned by earlier advances." 2002:855-822; Aghion. The Aghion-Howitt model is a prominent example of how Schumpeterian growth is portrayed (Aghion and Howitt, 1992).

Unit 6: Modern Theories of Development

Unit Structure

- 1.1 Introduction
- 1.2 Learning Outcomes
- 1.3 Introduction to Development Theories
 - 1.3.1 The Basic Need Approach
 - 1.3.2 Structural Change Theory
 - 1.3.3 Dependency Theory
- 1.4 Post-development Theory
 - 1.4.1 Neo-Liberalist Theory
 - 1.4.2 Sustainable Development
 - 1.4.3 Human Development Theory
- 1.5 Contemporary Theories of Development
- 1.6 Summary
- 1.7 References/Further Reading/Web Sources
- 1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

1.1 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.

1.2 Learning Outcomes

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
- Analyze contemporary development theories

1.3 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*, 1986).

1.3.1 The Basic Needs Approach

The basic needs approach, introduced by the International Labour Organization in 1976, aims to define the minimum resources needed for long-term physical well-being and the poverty line. It is applied in development assistance to determine subsistence needs and help poor populations rise above the poverty line. While it does not focus on investing in economically productive activities, it can be used as an absolute measure of poverty. Critics argue that the approach lacks theoretical rigor, practical precision, conflicts with growth promotion policies, and may leave developing countries in permanent backwardness.

1.3.2 Structural Change Theory

Structuralism is a development theory that emphasizes the structural aspects that hinder economic growth in developing countries. It focuses on the transformation of a country's economy from subsistence agriculture to a modern, urbanized manufacturing and service economy. Structuralist policy prescriptions include Import Substitution Industrialization (ISI), which aims to create a self-sustaining growth by ending reliance on primary goods exports and pursuing inward-oriented development. This is achieved by shielding the domestic economy from developed economies, minimizing trade with advanced economies, and encouraging domestic substitute production of formerly imported

industrial products. Structurists argue that Third World countries can only develop through state action, pushing industrialization and reducing their dependence on trade with the First World and among themselves.

Self-Assessment Exercise 1

What is the focus of a development theory called structuralism?

1.3.3 Dependency Theory

Dependency theory is a follow-up to structuralist thinking, focusing on the idea that development can occur with external links to developed parts of the world. This type of development is considered dependent, as it lacks internal domestic dynamics in developing countries and is highly vulnerable to the economic fluctuations of the world market. Dependency theory argues that not all societies progress through similar stages of development, and primitive states have unique features and institutions. Underdeveloped countries remain economically vulnerable unless they reduce their connectedness to the world market. Dependency theory also shares similarities with Neo-Marxism and World Systems Theory, as reflected in Immanuel Wallerstein's work, which rejects the notion of a Third World and argues for a single world connected by economic relations.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

There is only one world which is connected by economic relations:			MC
	Answers	Hints/Feedback	Grade
	World Systems Theory		
	Structural Systems Theory		
	Dependency Systems Theory		
	National Systems Theory		

1.4 Post-development Theory

Post-development theory challenges the concept of national economic development, arguing that it is a mental structure that leads to a hierarchy of developed and underdeveloped nations. Post-development theorists argue that the Western lifestyle may not be realistic or desirable for the world's population, as it may lose a country's culture and perception of itself. They call for a broader cultural involvement in development

thinking and a critical view against established sciences. Post-development focuses on local culture and knowledge, promoting grassroots movements and structural change to achieve solidarity, reciprocity, and traditional knowledge involvement.

1.4.1 Neo-Liberalist Theory

Neoliberalism, an economic philosophy emerged in the 1930s as a middle way between classical liberalism and collectivist central planning. It aimed to avoid repeating economic failures and promoted a market economy under a strong state. The term was reintroduced in the 1980s in connection with Augusto Pinochet's economic reforms in Chile, causing a shift in its meaning from a moderate form of liberalism to a more radical and laissez-faire capitalist set of ideas. The term has since spread to the English-language study of political economy, with new scholarship critiquing neoliberalism and seeking developmental alternatives. The financial crisis of 2007-08 was one of the ultimate results of this shift.

1.4.2 Sustainable development

Sustainable development is economic development that meets present needs without compromising future generations' ability to meet their own needs. It can be divided into environmental, economic, and sociopolitical sustainability. The 1997 Kyoto Accord aims to cap greenhouse-gas emissions. Opponents argue that the environmental Kuznets curve suggests that as an economy grows, pollution output increases until it reaches a threshold where production becomes less resource-intensive and more sustainable. However, evidence for this is weak, and people tend to consume more environmentally friendly products when their income increases. Some argue that future technological developments will resolve future problems.

1.4.3 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).

1.5 Contemporary Theories on Development

Erikson and Psychosocial Theory: Erik Erikson's psychosocial theory, based on eight developmental stages, provides a framework for understanding life's changes. He argues that social relationships foster development, and each period of life has unique psychosocial crises. Successful development involves resolving these crises positively, allowing individuals to progress to later stages. For example, the person who does not develop a sense of trust (Erikson's first stage) may find it challenging as an adult to form a positive intimate relationship (Erikson's sixth stage). Or an individual who does not develop a clear sense of purpose and identity (Erikson's fifth stage) may become self-absorbed and stagnate rather than working toward the betterment of others (Erikson's seventh stage). However, most individuals are able to successfully complete the eight stages of his theory (See Table 1).

Table 1: Erikson's Psychological Stages.

Age Range	Psychosocial crisis	Positive resolution of crisis
Birth to 12 to 18 months	Trust versus Mistrust	The child develops a feeling of trust in his or her caregivers.
18 months to 3 years	Autonomy versus shame/doubt	The child learns what he or she can and cannot control and develops a sense of free will.
3 to 6 years	Initiative versus Guilt	The child learns to become independent by exploring, manipulating, and taking action.
6 to 12 years	Industry versus inferiority	The child learns to do things well or correctly according to standards set by others, particularly in school.
12 to 18 years	Identity versus role confusion	The adolescent develops a well-defined and positive sense of self in relationship to others
19 to 40 years	Intimacy versus isolation	The person develops the ability to give and receive love and to make long-term commitments
40 to 65 years	Generativity versus stagnation	The person develops an interest in guiding the development of the next generation, often by becoming a parent
65 to death	Ego integrity versus despair	The person develops acceptance of his or her life as it was lived.

irth to 12 to 18 months	Trust versus Mistrust	The child develops a feeling of trust in his or her caregivers.
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Erikson's theory is criticized for focusing on stages and social expectations, but it works well in middle-class cultures like the US, but not in cultures with puberty transitions and limited adult roles.

Learning Theory: Behaviorism, a theory that suggests psychologists should focus on behavior, is based on the belief that it is impossible to objectively study the mind. Burrhus Frederick Skinner, a famous behaviorist, expanded the principles of behaviorism and introduced them to the public. Skinner used stimulus and response to train animals and develop theories for teaching children and creating peaceful societies. Their ideas contributed to understanding the nature-nurture debate and free will, making behaviorism fundamental to psychology.

Social Learning Theory, Albert Bandura (1977) argues that actions are learned through imitation rather than conditioning, and that we are not just products of our surroundings. He suggests that there is an interplay between the environment and the individual, with reciprocal determinism. Parents influence their children's environment through reinforcement, while children influence parents as well. This concept highlights the interplay between our environment and our own behavior.

Other social influences: TV or not TV? Bandura et al. (1963) began a series of studies to look at the impact of television on the behavior of children. Bandura began by conducting an experiment in which he showed children a film of a woman hitting an inflatable clown or “bobo” doll.

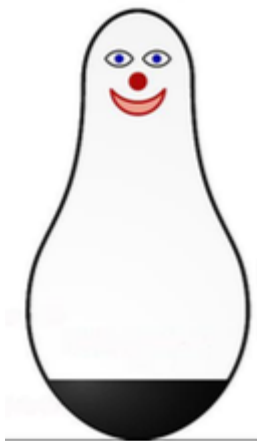


Figure 1.10: The Bobo Doll. Source.

Then the children were allowed in the room, where they found the doll and during their play they began to hit it. The children also demonstrated novel ways of being aggressive toward the doll that were not demonstrated by those children who did not see the aggressive model. Bandura's research raised concerns about the impact of violence on young children. Since then, considerable research

has been conducted on the impact of violent media on children's aggression including playing video games.

On your own, study cognitive theories which focus on how our mental processes or cognitions change over time. Three important theories are Jean Piaget's, Lev Vygotsky's, and Information-processing.

Self-Assessment Exercise 3

Discuss Erikson and psychosocial theory

1.6 Summary

This unit covers modern development theories, including linear growth models, structural change, dependency, post-development, Neo-liberalist, sustainable, and human development theories. These theories analyze modernization processes in societies, focusing on beneficial and obstacles for economic development. Scientists from various disciplines contribute to these theories. In the next unit which is Unit 1 of Module 5 and the last module for this course, we shall examine John Maynard Keynes's contribution to the History of Economic Thought.

1.7 References/Further Reading/Web Sources

Campbell Jones, Martin Parker, Rene Ten Bos (2005). *For Business Ethics*. Routledge. ISBN 0415311357. p. 100:

Sen, A. (1999). *Development as Freedom*. London: Oxford University Press.

Taylor C. Boas, Jordan Gans-Morse (June 2009). "Neoliberalism: From New Liberal Philosophy to Anti-Liberal Slogan". *Studies in Comparative International Development* 44 (2): 137–161

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1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

Answer to Self-Assessment Exercise 1

Structuralist theory analyzes structural issues preventing developing nations' economies

from growing. It suggests Import Substitution Industrialization (ISI) as a policy recommendation to achieve self-sustaining growth by reducing reliance on exports and isolating the local economy from the developed nation.

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

There is only one world which is connected by economic relations:			MC
	Answers	Hints/Feedback	Grade
	World Systems Theory		100
	Structural Systems Theory		0
	Dependency Systems Theory		0
	National Systems Theory		0

Answer to Self-Assessment Exercise 3

Let's now discuss Erik Erikson, a less debatable psychodynamic thinker. Erikson lists eight stages of development that cover the entire lifespan. This is why a lot of what we talk about when it comes to psychosocial development is based on Erikson's psychosocial theory. A helpful framework for considering the changes we go through in life is offered by Erikson's (1950) model of lifetime development. Erikson disagreed with Freud's emphasis on sexuality as the foundation of social-emotional development and argued that social interactions facilitated growth instead. In his theory of psychosocial crises, Erikson postulated that each stage of life presents its own set of problems or crises for the person who reaches it. Managing and resolving the objectives and demands of each of these, in Erikson's view, is necessary for successful development.

MODULE 5

Unit 1: History of Economic Thought: John Maynard Keynes

Unit 2: History of Economic Thought: Joseph Schumpeter

Unit 3: History of Economic Thought: Milton Friedman

Unit 4: History of Economic Thought: Modern Day

Glossary

End of the Module Questions

Unit 1: History of Economic Thought: John Maynard Keynes

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 Keynes Versus the Classical School

1.3.1 Are Workers Irrational?

1.3.2 Keynes' Idea on Consumption

1.4 To Save, Or Not to Save

1.4.1 The Role of Government and The Multiplier Effect

1.4.2 Stagflation and A Fall from Grace

1.5 Stagflation and A Fall from Grace

1.5.1 The Re-Rise of Keynesianism

1.5.2 Keynes' Legacy

1.6 Summary

1.7 References/Further Readings/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

1.1 Introduction

In Module 5, we explore the evolution of economic thought, focusing on John Maynard Keynes' General Theory and the contributions of Joseph Schumpeter and Milton Friedman. Keynes, a British economist, challenged the Classical Economic "Free Market" status quo and advocated for increased government involvement in the economy. He also questioned workers' irrationality, argued on consumption, and explored the role of government and the multiplier effect. Keynes' work, *The General Theory of Employment, Interest, and Money*, was published in 1936 and was a significant contribution to the field.

1.2 Learning Outcomes

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

- Discuss John Maynard Keynes
- Compare Keynes vs. the Classical School
- Answer if workers irrational?
- Discuss the Keynes's idea on consumption,
- Argue whether to save, or not to save...,
- Explain the role of government and the multiplier effect,
- Explain stagflation and a fall from grace
- Enlighten on the re-rise of Keynesianism, and
- Discuss Keynes' legacy

1.3 Keynes Versus the Classical School

In Module 5, we discussed the evolution of economic thought through the lens of key contributors, including John Maynard Keynes' General Theory, Joseph Schumpeter, and Milton Friedman. Keynes, a British economist, challenged the Classical Economic "Free Market" status quo and advocated for increased government involvement in the economy. He was most active in the early 20th century, attending the Versailles Peace Talks and lobbied against excessive sanctions against Germany. Keynes' defining work, *The General Theory of Employment, Interest, and Money*, was first published in 1936. Keynes' ideas on consumption, saving, government role, and the multiplier effect were also discussed. The re-rise of Keynesianism and the fall from grace of Keynesianism are

also discussed.

To quote Keynes once more:

Labour is not more truculent in the depression than in the boom—far from it. Nor is its physical productivity less. These facts from experience are a *prima facie* ground for questioning the adequacy of the classical analysis. (Keynes, 1936, p. 14)

1.3.1 Are Workers Irrational?

Keynes argued that workers would contest money wage cuts while passively accepting the impact on real wages, the cost of inflation. This contradiction is evident in today's record inflation rates. Keynes acknowledges this contradiction by stating that trade unions may resist cuts in wages, but they do not hinder aggregate employment growth, as they would not strike on every occasion of a rise in the cost of living.

1.3.2 Keynes's Idea on Consumption

Keynes believed that economic activity and employment levels are based on the degree of consumption within an economy. Aggregate demand, or total demand, represents the number of people willing and able to purchase a good or service at its market price. Opportunities for employment are limited by aggregate demand, which can be derived from present consumption or future provision. Keynes emphasized the importance of saving income for emergency funds, future family expenses, inheritance, and pure miserliness. A healthy economy prioritizes spending over saving.

Self-Assessment Exercise 1

Multiple Choice Questions (MCQs)

MCQ1

The key point is that any income that is not consumed (or spent) by an individual is ____.			MC
	Answers	Hints/Feedback	Grade
	Tithed		
	Stored		
	Donated		
	Saved		

1.4 To Save, or Not to Save...

At the core of Keynes' economic philosophy is the conflict between an individual's propensity to spend vs. save. The key to a healthy economy is a happy marriage between both opposing forces. If nobody is willing to spend, demand must fall, and so, in turn, must the production. The demand for labour – or persons – to produce said goods and services must fall also. With the logical outcome of a fall in Investment, thus ultimately being increased unemployment.

One Person's Saving is Another's Lost Income

While Keynes' understood people's inclination or desire to save, he argued that one person's spending by necessity represents another's income. The act of saving directly reduces the income of other persons in the economy. Ultimately reducing the overall level of economic activity.

This notion marked a pronounced departure from the existing Classical school of thought, adherents to whom, according to Keynes, believed that: "every act of increased saving by an individual necessarily brings into existence a corresponding act of increased investment" (Keynes, 1936, p. 89).

1.4.1 The Role of Government and The Multiplier Effect

Keynes advocated for increased government involvement in economic times of difficulty or economic contraction, arguing that the government should invest directly to stimulate spending and increase demand, ultimately leading to employment. This policy's effectiveness was determined by the "Multiplier Effect," which states that an initial injection of government investment creates more employment opportunities. If a population's consumption psychology is high, increased investment can lead to substantial gains. However, if the population has a greater propensity to save than consume, the effect of increased investment is significantly reduced.

(i) A Word of Caution

Keynes argued that increased government investment and the multiplier effect are beneficial, but warned against reckless abandon. He believed excessive government investment would lead to diminishing returns and inflation. He argued that when full employment is reached, further investment would cause money prices to rise without limit, resulting in true inflation.

(ii). A Subject of Interest

Keynes' general insight into the role of interest rates in the economy was to introduce the notion of what he termed "liquidity preference". Terming the interest rate "the reward for parting with liquidity for a specified period" (Keynes, 1936, p. 84). As the interest rate itself represents the cost of borrowing, it can effectively be said to represent the cost of money. In accordance with the basic principles of Supply and Demand, an increase in the money supply should therefore reduce the effective price of money, i.e., the interest rate. A lower interest rate should be logically expected to spur increased investment.

Liquidity preference amounts to a preference for people to hold cash savings over long-term investments such as government bonds. An increase in the interest rate would reduce the price of assets such as bonds (effectively a government I.O.U. which promises a financial return at a fixed rate of interest at a future date). Thus, if the interest rate remains low for an extended period, investors may logically elect to hold their cash close to their chest, in the anticipation of a future hike in interest rates.

(iii). Collective Uncertainty and Animal Spirits

For all of his equations and hyper-academic prowess, Keynes ultimately qualified his theories against a background of uncertainty, over absolute predictability. Memorably evoking the notion of "animal spirits" to describe the ultimate unpredictability of economic performance and behaviours. Outcomes are ultimately being driven by the somewhat intangible expectations of the wider populace.

Most, probably, of our decisions to do something positive, the full consequences of which will be drawn out over many days to come, can only be taken as a result of animal spirits—of a spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities. (Keynes, 1936, p. 81)

(iv). Uncertainty as the Driver of Liquidity Preference

Keynes' notion of liquidity preference is driven by uncertainty, as people react differently based on their market expectations. Individuals who believe future interest rates will be above market rates tend to keep liquid cash, while those who differ from the market borrow for short periods to purchase longer-term debts. This "mass psychology" suggests that people may prefer to hold cash or liquid resources to profit from changes in market conditions.

Self-Assessment Exercise 2

One person's saving is another's lost income. Discuss.

1.5 Stagflation and a Fall from Grace

Having been the dominant school of economic thought in the aftermath of World War II, Keynes' credit took a severe hit during the 1970s. Rising “stagflation” – a previously un-envisaged scenario where economic growth remained low amidst rising inflation levels – occurred across many advanced economies. This greatly reduced Government's willingness to spend, and general support of Keynesian doctrine diminished accordingly.

1.5.1 The Re-Rise of Keynesianism

The Keynesian theory gained popularity after the 2009 financial crisis, leading to significant interest rate cuts and market investment. The US Federal Reserve's Quantitative Easing policy bolsters the money supply through long-term financial securities. Keynes' influence is evident in the ongoing Covid-19 response, with governments implementing fiscal and monetary stimulus. Direct government intervention is necessary during crises, as the market is not self-correcting.

1.5.2 Keynes' Legacy

John Maynard Keynes was a revolutionary force in the field of economics. By challenging the prevailing economic conventions of his time he brought a renewed vigour to a field that had grown stale and impotent in the face of unforeseen circumstances. Economics is a field of study in a constant state of flux, and lively debate rages to this day on the merits of Keynes' theories vs. those of a more openly free-market persuasion. His influence and continued relevance in the area of global economic policymaking, however, remains utterly undeniable.

Self-Assessment Exercise 3

What were John Maynard Keynes' key legacies?

1.6 Summary

Learned John Maynard Keynes' ideas on consumption, government role, stagflation, Keynesianism's re-rise, and his legacy, addressing irrationality, workers' behavior, and government role.

In the next unit which is Unit 2 of Module 5, we shall discuss Joseph Schumpeter and his contributions to the History of Economic Thought.

1.7 References/Further Readings/Web Sources

Keynes, J. (1936). *The General Theory of Employment, Interest, and Money*

1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

Answer to Self-Assessment Exercise 1

Multiple Choice Questions (MCQs)

MCQ1

The key point is that any income that is not consumed (or spent) by an individual is _____.			MC
	Answers	Hints/Feedback	Grade
	Tithed		0
	Stored		0
	Donated		0
	Saved		100

Answer to Self-Assessment Exercise 2

Despite his understanding of people's propensity for saving, Keynes maintained that one person's expenditure out of necessity represents another person's income. Saving money directly lowers other people's incomes in the economy, thereby lowering the degree of economic activity overall. The Classical school of economic thought, whose members, according to Keynes, had the following belief: "Every act of increased saving by an individual invariably brings into existence a commensurate act of greater investment," was markedly disregarded by this idea (Keynes, 1936, p. 89).

Answer to Self-Assessment Exercise 3

In the realm of economics, John Maynard Keynes was a groundbreaking figure. He revitalized a field that had gotten old and powerless in the face of unforeseeable situations by questioning the dominant economic conventions of his time. The merits of Keynes' theories vs those of a more overtly free-market leaning are still hotly contested in the dynamic field of economics that is today. Yet, his influence and continuous relevance in the domain of developing global economic policy remain completely undisputed.

Unit 2: History of Economic Thought: Joseph Schumpeter

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 Entrepreneurship and Capitalism

1.3.1 The Fleeting Nature of Entrepreneurship

1.3.2 Creative Destruction, Capitalism's Constant State of Evolution

1.4 The Fleeting Nature of Entrepreneurship

1.4.1 Creative Destruction, Capitalism's Constant State of Evolution

1.4.2 Business Cycles and The Entrepreneur as Driver

1.5 Schumpeter on The Fall of Capitalism

1.5.1 The Trouble with Perfection and The Death of Inspiration

1.5.2 Schumpeter's Legacy

1.6 Summary

1.7 References/Further Reading/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(S) Within The Content

1.1 Introduction

In the preceding unit, that is, Unit 1 of Module 5, you learnt John Maynard Keynes, Keynes vs. the Classical School, and could answer if workers are irrational? You also learnt the Keynes's idea on consumption, whether to save, or not to save..., the role of government and the multiplier effect, stagflation and a fall from grace, the re-rise of

Keynesianism, and Keynes' legacy.

In the present unit which is Unit 2 of Module 5, we shall discuss Joseph Schumpeter and his contributions to the History of Economic Thought. We shall, therefore, discuss entrepreneurship and capitalism, analyze the fleeting nature of entrepreneurship, elucidate on the creative destruction, explain capitalism's constant state of evolution, enlighten on business cycles and the entrepreneur as driver. We shall also discuss Schumpeter on the fall of capitalism, analyze the trouble with perfection and the death of inspiration, as well as Schumpeter's legacy. Joseph Schumpeter, an influential 20th-century Austrian economist, influenced entrepreneurship, business cycles, and the fall of capitalism. (Britannica, The Editors of Encyclopaedia 2022).

1.2 Learning Outcomes

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

- Discuss entrepreneurship and capitalism
- Analyze the fleeting nature of entrepreneurship
- Elucidate on the creative destruction
- Explain capitalism's constant state of evolution
- Enlighten on business cycles and the entrepreneur as driver
- Discuss Schumpeter on the fall of capitalism
- Analyze the trouble with perfection and the death of inspiration,
- Discuss Schumpeter's legacy

1.3 Entrepreneurship and Capitalism

Schumpeter's contribution to economics was highlighting the importance of the Entrepreneur in the functioning of the Capitalist system. The Classical Economic school of thought emphasized stability, but Schumpeter saw a world in constant flux and viewed capitalism as an ever-renewing cycle. He argued that an entrepreneur does not exist in the ordinary circular flow of the economy, but rather maintains the status quo through heads of firms or business managers. Schumpeter's view of the Entrepreneur was distinct from the classical doctrine, likening the functions of capitalist and entrepreneur to landowner and farmer, who create and render value from the essential capital resource. (Schumpeter, 1949, P. 77).

Self-Assessment Exercise 1

In two paragraphs, summarize the phrase, "Entrepreneurship and Capitalism"

1.3.1 The Fleeting Nature of Entrepreneurship

Schumpeter argues that an entrepreneur is someone who initiates change and creates new combinations, rather than just managing. This role is fleeting and unsustainable, as an entrepreneur loses that character when they have built up their business and settle down to running it as others do. Schumpeter believes that entrepreneurs are motivated by the potential for entrepreneurial or monopoly profit, which allows them to set a "monopoly price" without competition. This concept operates under certain assumptions, such as the absence of stealing an entrepreneur's idea and legal enforcement. Patents, for example, serve as an example of this principle in action, providing exclusive rights to production and potential profits for entrepreneurs. However, upon patent expiry, fresh competitors enter the market, driving the price downward, restoring normal market conditions in favor of consumers.

1.3.2 Creative Destruction, Capitalism's Constant State of Evolution

Schumpeterian economics differs from classical and neo-classical schools by assuming that capitalism is unstable and constantly changing. Schumpeter calls this process "Creative Destruction" and highlights the destruction of the pre-existing Feudal order by the Capitalist system itself. This observation is crucial to the field of economics and has practical applications in everyday life, such as the rise of smartphones, which offer various functions and have led to the destruction of producers of previously specialist items.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Schumpeter labels this process____, describing it as, “the essential fact about capitalism.”			MC
	Answers	Hints/Feedback	Grade
	“Creative Construction”		
	“Uncreative Destruction”		
	“Creative Reconstruction”		
	“Creative Destruction”		

1.4 The Fleeting Nature of Entrepreneurship

Schumpeter argues that entrepreneurs initiate change and create new combinations, rather than just managing. They are motivated by the potential for monopoly profit, setting a "monopoly price" without competition. This concept operates under assumptions like patents, which provide exclusive production rights and potential profits. However, upon patent expiry, new competitors enter, driving the price downward, restoring normal market conditions for consumers.

1.4.1 Creative Destruction, Capitalism's Constant State of Evolution

The major break that Schumpeterian economics makes from the pre-existing classical and neo-classical schools of thought, is in the inherent assumption that Capitalism is not, and never can be stable. In Schumpeter's own words "Capitalism, then, is by nature a form or method of economic change and not only never is but never can be stationary" (Schumpeter, 1942, P. 82) For Schumpeter the capitalist system is one that "incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one." (Schumpeter, 1942, P. 83).

Schumpeter labels this process "Creative Destruction", describing it as, "the essential fact about capitalism." (Schumpeter, 1942, P. 83). Schumpeter directly provides many examples of this process in action. Perhaps the most poignant being the destruction of the pre-existing Feudal order by the advent of the Capitalist system itself. This simple, yet profound observation is arguably Schumpeter's most important and tangible contribution to the field of economics, with no end of practical application in everyday life. The advent of smart phones as a contemporary technological Swiss army knife serves as an excellent example. Even a basic smartphone model today offers the functions of calculator, stopwatch, alarm clock, camera, torch, and of course phone, all in one. Alongside a great many more. Naturally, this has served to the detriment, and ultimate "destruction" of a great many producers of these previously specialist items.

1.4.2 Business Cycles and The Entrepreneur as Driver

Schumpeter's theory of "Business Cycles" emerged from the observation of recurring crises throughout economic history. The classical notion of a "static" economy allowed for continuous and predictable growth, but Schumpeter's view of economic growth as irregular and unstable energy is counter to this notion. Schumpeter's economic vision emphasizes the role of entrepreneurs in driving innovation, which initiates the business cycle. This innovation leads to increased productivity and reduced unemployment, but also a period of contraction. As competition increases, firms must adapt to compete with new products, processes, markets, and innovations.

This process of entrepreneurial "creative destruction" undoes initial gains, leading to

increased unemployment and reduced consumer purchasing power. Schumpeter's notion of economic growth being cyclical and recessions as inevitable as expansive growth was counter to the prevailing ideas of the time. Many of Schumpeter's counterparts active in the early goings of the 20th century "believed economic fluctuations could and should be managed by the government" (Sobel and Clemens, 2020, P. 32). A view perhaps best and most notably espoused by [John Maynard Keynes](#).

1.5 Schumpeter on the Fall of Capitalism

Schumpeter shared Karl Marx's view of capitalism as a doomed system, predicting that it would eventually collapse through a socialist revolution. However, he did not assume that Socialism would replace the Capitalist system by default. He argued that the ultimate fall of capitalism might occur through excess of success rather than failure. He foresaw an inevitable migration of economic activity from private to public sphere, driven by efficiencies in centralized governance of industries. Capitalism, rooted in the pursuit of efficiency, must adapt to these changes.

1.5.1 The Trouble with Perfection and the Death of Inspiration

Schumpeter believed that capitalism would be at odds with itself if it were to achieve perfection in the production process. He believed that capitalism is a system of constant evolution, and a stationary state would be a death knell for entrepreneurs. Schumpeter believed that the death of the entrepreneurial class would be a disaster for the Bourgeoisie, who relies on the entrepreneur and lives and will die with him. Schumpeter saw the potential fall of capitalism as the death of individuality, which he believed would flow from inspiration. As innovation became more centralized, the prevailing structural order would change, leading to a house of cards where the entrepreneur's spark of ingenuity was no longer required, and the prevailing owner class lost not only their income but also their function. Schumpeter believed that the fall of capitalism would come from within, as capitalist enterprise tends to automatize progress and make itself superfluous under the pressure of its own success. (Schumpeter, 1942, P. 134).

1.5.2 Schumpeter's Legacy

Joseph Schumpeter was a truly extraordinary economic thinker whose legacy and ideas remain as vital as ever in the economic environs of today. Though his innovations and theoretical concepts may one day fall prey to the process of creative destruction which he so eloquently espoused. From this current vantage point, that day still appears a very long way off.

Self-Assessment Exercise 3

Discuss Schumpeter's idea on the fall of capitalism

1.6 Summary

You have learnt Joseph Schumpeter and his contributions to the History of Economic Thought. You can now discuss entrepreneurship and capitalism, analyze the fleeting nature of entrepreneurship, elucidate on the creative destruction, explain capitalism's constant state of evolution, enlighten on business cycles and the entrepreneur as driver. You can also discuss Schumpeter on the fall of capitalism, analyze the trouble with perfection and the death of inspiration, as well as Schumpeter's legacy.

In the next unit which is Unit 3 of Module 5, we shall discuss Milton Friedman and his contributions to the History of Economic Thought.

1.7 References/Further Readings/Web Sources

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1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

Answer to Self-Assessment Exercise 1

Schumpeter argued that capitalism is not stable, but rather an ever-renewing cycle in which the entrepreneur is an agent of change and disruptor. Schumpeter compared the functions of capitalist and entrepreneur to that of landowner and farmer, arguing that the classical school of economists had missed this point.

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

Schumpeter labels this process____, describing it as, “the essential fact about capitalism.”			MC
	Answers	Hints/Feedback	Grade
	“Creative Construction”		0
	“Uncreative Destruction”		0
	“Creative Reconstruction”		0
	“Creative Destruction”		100

Answer to Self-Assessment Exercise 3

Schumpeter believed that perfecting the production process would lead to capitalism at odds with itself. He believed that capitalism is an ever-evolving system, and stagnant states would be its doom. Schumpeter argued that the Bourgeoisie, a class dependent on the entrepreneur, would be devastated if the entrepreneurial class perished due to perfection. Schumpeter believed that the impending demise of the entrepreneur would equate to the death of uniqueness, from which inspiration derives. As innovation becomes more centralized, it becomes produced by bureaucratized industrial units, leading to a change in the current structural order. Schumpeter believed that the breakdown of capitalism would occur from within, contrary to Marx's prediction.

Unit 3: History of Economic Thought: Milton Friedman**Unit Structure****1.1 Introduction****1.2 Learning Outcomes****1.3 Friedman's Critique of Keynesian Consumption Theory****1.4 Monetary Policy, The Great Depression and The Tyranny Of****Inaction****1.4.1 Impact on Future Economic Policymaking, Rules Instead Of Authorities****1.5 Social Views and Controversies****1.5.1 Friedman's Legacy****1.6 Summary****1.7 References/Further Readings/Web Sources****1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content****1.1 Introduction**

In Unit 2, we discussed Joseph Schumpeter's contributions to economic thought, including entrepreneurship, capitalism, creative destruction, and business cycles. In Unit 3, we discussed Milton Friedman's contributions to economic thought, including his critique of Keynesian consumption theory, monetary policy, great depression, and the tyranny of inaction. Friedman's impact on future economic policymaking, social views, and controversies are discussed. He was awarded the 1976 Nobel Prize in Economics for his contributions to consumption analysis and monetary history and theory.

1.2 Learning Outcomes

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

, monetary policy, the great depression and the tyranny of inaction, impact on future economic policymaking, rules instead of authorities, social views and controversies, Friedman's legacy.

- Discuss Friedman's critique of Keynesian consumption theory
- Explain monetary policy
- Analyze the great depression and the tyranny of inaction
- Examine impact on future economic policymaking
- Consider rules instead of authorities
- Discuss social views and controversies
- Enumerate Friedman's legacy

1.3 Friedman's Critique of Keynesian Consumption Theory

Friedman, an opponent of Keynesian economic doctrine, argued that temporary changes in income would not significantly impact consumer spending. He proposed that Keynes' proposed changes in consumer spending habits would only come about through changes in "permanent income." This notion ran counter to Keynes' Multiplier Function, which posited that temporary changes in income would not have a significant impact on consumer spending. Friedman argued that a horizon of around three years characterized the outlook of US consumers, which reduced the extent to which a given economy was reliant on government expenditure for managing and stimulating economic activity. He also clarified his views on anticipated consumer expenditure, stating that the answer depends on how the change affects the consumer unit's evaluation of its longer-term income prospects. (Friedman, 1963, P. 1).

Self-Assessment Exercise 1

Summarize in four sentences, Friedman's Critique of Keynesian consumption theory

1.4 Monetary Policy, the Great Depression and the Tyranny of Inaction

Friedman's greatest economic legacy lies in his work on monetary policy. The Keynesian school emphasized the importance of fiscal policy over monetary policy, with monetary policy being a distant second. Friedman argued that the Great Depression was caused by government mismanagement rather than inherent instability in the private economy. The US Federal Reserve's inaction turned a moderate to severe economic contraction into a full-blown depression. Fears of a widespread banking system failure led to widespread

withdrawals, and the failure to bolster the money supply led to the collapse of the wider banking system. Friedman argued that the failure of the system was a failure of will, not power, and that the most severe banking panic in American history occurred due to the failure of the system. (Friedman, 1962, P. 163).

1.4.1 Impact on Future Economic Policymaking, Rules Instead of Authorities

Friedman's analysis of the monetary causes of the Great Depression emphasized the importance of a government of law rather than a few men. He proposed a legislated rule instructing the monetary authority to achieve a specified rate of growth in the stock of money, reducing the potential for human error. The Federal Reserve, under Ben Bernanke, acknowledged Friedman's assessment and emphasized the importance of consistent, stable, rule-governed growth of the money supply. However, Friedman may have argued that if the Federal Reserve had followed Friedman's guidelines, the crisis may not have occurred.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

What was Friedman's greatest economic legacy?			MC
	Answers	Hints/Feedback	Grade
	His contribution to the field of monetary policy.		
	His contribution to the field of fiscal policy.		
	His contribution to the field of central bank policy.		
	His contribution to the field of merchant bank policy.		

1.5 Social Views and Controversies

Milton Friedman's contributions to economic thought include his famous text *Capitalism and Freedom*, which emphasized the social responsibility of businesses to increase profits through open competition. He defended individual freedoms and non-interventionist government policies, advocating for the legalization of drugs and prostitution. Friedman's influence on Libertarian Political philosophy remains influential, advocating individual

freedoms and reduced government intervention.

1.5.1 Friedman's Legacy

If Karl Marx represents one necessary extreme on the spectrum of economic thought, then Milton Friedman surely represents the other. A defender to his dying day of individual freedoms and the value of free market functioning. Friedman is best remembered from an economics perspective for his re-thinking, and in turn re-popularization of Monetary and Consumption Theory, his contributions to the field immortalized by his 1976 Nobel Prize. His legacy in terms of wider society meanwhile lives on through his advocates, and his critics, in equal measure.

Self-Assessment Exercise 3

In attempting to summarize Milton Friedman's vast contribution to the History of Economic Thought, it is important to consider his wider social relevance. discuss

1.6 Summary

You have learnt Milton Friedman and his contributions to the history of economic thought. You can, therefore, now discuss Friedman's critique of Keynesian consumption theory, explain monetary policy, analyze the great depression and the tyranny of inaction. We shall also examine impact on future economic policymaking. consider rules instead of authorities, discuss social views and controversies and enumerate Friedman's legacy

In the next unit which is Unit 4 of Module 5, we shall discuss Modern Day's contributions to the History of Economic Thought.

1.7 References/Further Readings/Web Sources

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1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

Answer to Self-Assessment Exercise 1

Friedman argued that increasing consumer income as an economic stimulus depends on the population's "propensity to consume." Keynesian doctrine was used to justify government spending until the 1970s, when stagflation declined. Friedman's 1957 text, "A Theory of the Consumption Function," argued that temporary income changes did not significantly impact consumer spending.

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

What was Friedman's greatest economic legacy?			MC
	Answers	Hints/Feedback	Grade
	His contribution to the field of monetary policy.		100
	His contribution to the field of fiscal policy.		0
	His contribution to the field of central bank policy.		0
	His contribution to the field of merchant bank policy.		0

Answer to Self-Assessment Exercise 3

Milton Friedman's contributions to the History of Economic Thought are significant due to his belief that business has a single social responsibility to increase profits, as stated by Adam Smith in *Capitalism and Freedom*. Friedman, a supporter of individual freedoms and economic liberalism, expressed concern about increased corporate social

responsibility, arguing that it would extend the political apparatus to all human endeavors. He advocated for non-interventionist government policy, supporting individual liberties and minimal government involvement.

Unit 4: History of Economic Thought: Modern Day

Unit Structure

1.1 Introduction

1.2 Learning Outcomes

1.3 Income Inequality

1.4 Modern Monetary Theory (MMT)

1.5 Inflationary Times

1.6 Summary

1.7 References/Further Readings/Web Sources

1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

1.1 Introduction

In the preceding unit, that is Unit 3 of Module 5, you learnt Milton Friedman and his contributions to the history of economic thought. You can, therefore, now discuss Friedman's critique of Keynesian consumption theory, monetary policy, the great depression and the tyranny of inaction. You also learnt impact on future economic policymaking, rules instead of authorities, social views and controversies and enumerate Friedman's legacy.

Having provided a brief overview of the key contributions of some of the greatest minds in the long history of Economics to date, the final entry in this course material will aim to provide a snapshot of some of the key policy debates and discussions currently active in the field today. In other words, we shall conclude this study by discussing Modern Day's contributions to history of economic thought in this present unit, which is Unit 4 of Module 5. We will, therefore, discuss income inequality, explain Modern Monetary Theory (MMT) and finally

analyze inflationary times.

1.2 Learning Outcomes

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

- Discuss income inequality
- Explain Modern Monetary Theory (MMT)
- Analyze inflationary times

1.3 Income Inequality

Thomas Piketty, along with his economic colleagues Emmanuel Saez and Gabriel Zucman, has been working to raise awareness about global income inequality. Piketty's proposal is a progressive "wealth tax" targeting individuals' net holdings rather than their present income. The idea gained traction during the US Presidential election when Democratic candidate Elizabeth Warren made it a key campaign slogan. The goal is to redistribute funds for a more equal society, with the revenue generated being re-invested in sectors like education and healthcare. However, the imposition of such a tax is challenging due to concerns about potential relocation of funds elsewhere.

Piketty's native France implemented a wealth tax called "Impôt sur la fortune" (ISF) in 2000 and 2016, but was repealed in 2017. A global wealth tax could work, but the main obstacle is the global income inequality it seeks to target.

Self-Assessment Exercise 1

Highlight Thomas Piketty's idea on income inequality

1.4 Modern Monetary Theory (MMT)

Modern Monetary Theory (MMT) is a contemporary economic theory that explores the relevance of high national debt levels for independent economies producing their own currency. Advocates argue that governments can spend freely, while critics argue that printing excess money fuels false economic growth. MMT advocates acknowledge the risk of inflation, but argue that it is the biggest risk. A study by Cambridge University Press suggests that MMT advocates for a more orthodox reversal of the existing taxation-spending paradigm, allowing for the supply of funding at a keystroke, countering inflation's threat to economic growth and stability.

1.4.1 Expansionary Fiscal and Monetary Policy

Keynesianism, which fell out of popularity in the 1970s due to stagflation, has re-emerged in the aftermath of the 2009 financial crisis, with the US Federal Reserve's Quantitative Easing policy being a prime example. The EU embarked on the "Austerity Era" to reduce public deficits, leading to reduced spending on healthcare, social welfare, and infrastructure projects. This led to high unemployment, financial security issues, and reduced living standards. The global response to the Covid-19 pandemic has been similar, with governments worldwide agreeing on fiscal and monetary policy responses. The EU has pledged €1.074 trillion in ongoing recovery funds, and the US has committed \$4.57 trillion to Covid relief. Similar levels of economic stimulus have been employed in countries like Albania and Turkmenistan.

Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

High levels of inflation in combination with low levels of economic growth			MC
	Answers	Hints/Feedback	Grade
	Stagflation		
	Hyperinflation		
	Consumer price index		
	unemployment		

1.5 Inflationary Times

The global economy has experienced a surge in inflation due to the Covid pandemic and the excessive spending on government expenditure. The primary response to rising inflation is to raise interest rates, which represent the cost of borrowing for businesses, banks, governments, and private individuals. Turkey has experienced extraordinary inflation rates, with a year-on-year increase of 54.4% in February 2022. Despite calls for Turkey to raise interest rates, these calls have remained unheeded. The US Federal Reserve has been reluctant to raise interest rates, despite the US Consumer Price Index rising 7.9% year on year for February 2022.

The threat of rising prices is endemic to the global economy as a whole, and the impact of Covid-19 policies threatens to overwhelm the stability they were originally intended to

preserve. The economic fall-out from the Russian Ukrainian conflict has created a different kind of economic conundrum, and how to navigate these challenges remains to be seen. Economics, once branded "the dismal science," remains vibrant, divisive, and relevant, but a consensus on a one-size-fits-all economic system is unlikely to be desirable. The world's diverse economy and the ongoing issues of climate change and income inequality make it unlikely that economic policymakers will find a consensus anytime soon.

Self-Assessment Exercise 3

What do you understand by inflation times?

1.6 Summary

Having provided a brief overview of the key contributions of some of the greatest minds in the long history of Economics to date, the final entry in this course material provided a snapshot of some of the key policy debates and discussions currently active in the field today. In other words, we concluded this study by discussing Modern Day's contributions to history of economic thought in this present and final unit, which is Unit 4 of Module 5. We therefore, discussed income inequality, explained Modern Monetary Theory (MMT) and finally analyzed inflationary times.

1.7 References/Further Reading/Web Sources

Rose, S. J., (2018). *How Different Studies Measure Income Inequality in the US*. Urban Institute. Retrieved from https://www.urban.org/sites/default/files/publication/99455/how_different_studies_measure_income_inequality_1.pdf

1.8 Possible Answers to Self-Assessment Exercise(s) Within the Content

Answer to Self-Assessment Exercise 1

Piketty and Saez's 2003 study revealed income inequality rose significantly between 1979 and 2002, with the top 10% experiencing 91% of growth. Piketty proposes a global wealth tax to create an equal society by reinvesting in education and healthcare. However, the imposition of such a tax faces challenges due to global income inequality and the need for low taxation in developing nations.

Answer to Self-Assessment Exercise 2

Multiple Choice Questions (MCQs)

MCQ1

High levels of inflation in combination with low levels of economic growth			MC
	Answers	Hints/Feedback	Grade
	Stagflation		100
	Hyperinflation		0
	Consumer price index		0
	unemployment		0

Answer to Self-Assessment Exercise 3

Governments have spent excessively to avoid economic contraction, leading to rising global inflation. Turkey's government has failed to raise interest rates, causing the highest inflation rate in 20 years. The US Federal Reserve has resisted raising interest rates, despite the Consumer Price Index rising 7.9%. The Russian-Ukraine conflict has created a new economic conundrum, with global policymakers struggling to navigate a post-covid world. A one-size-fits-all economic system is counterproductive to climate change and income inequality.

