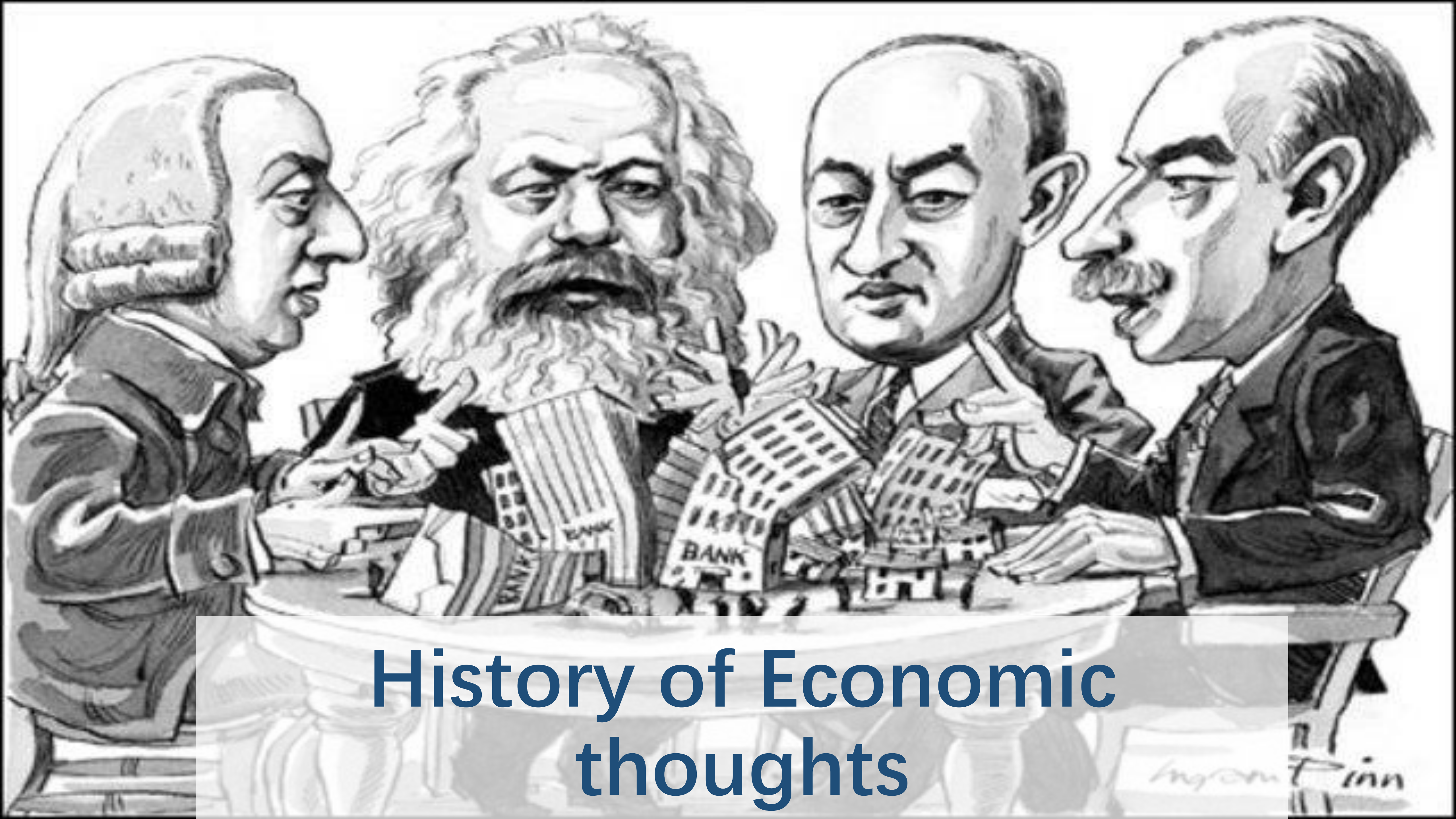



# History of Economic thoughts

# The history of Economics

- Classical Economics
  - Adam Smith and laissez faire
  - Utility theory
  - The concept of the margin
  - Say's law
- The Marxist critique of classical economics
- Keynes and Macroeconomics
- The monetarist/new classical counter-revolution
- Behavioural Economics


# Adam Smith and laissez faire

**The Father of Economics: Adam Smith (1723-1790)**

*"An Inquiry into the Nature and Causes of the Wealth of Nations"* ,1776

*" The Theory of Moral Sentiments"* ,1759

Main ideas:

- Self-interested behavior of decision-makers
- The laissez faire economy – free market without government intervention → 'The invisible hand'
- Competition vs. monopoly power
- Specialization of labour → economic growth
- Absolute advantage

## Adam Smith and the Invisible Hand

Adam Smith

Every individual . . . neither intends to promote the public interest, nor knows how much he is promoting it. . . . He intends only his own gain, and he is in this, as in many other cases, led by **an invisible hand** to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it

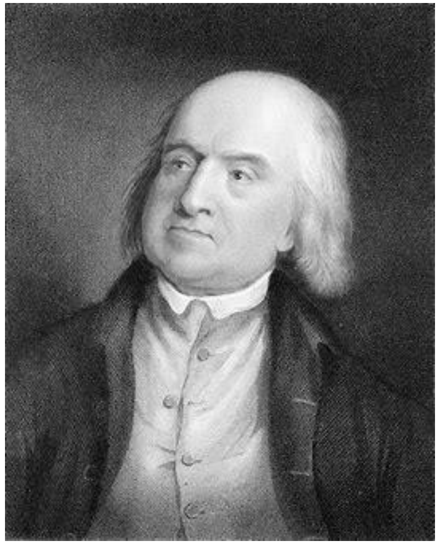
# Utility theory

<u>Jeremy Bentham:</u>

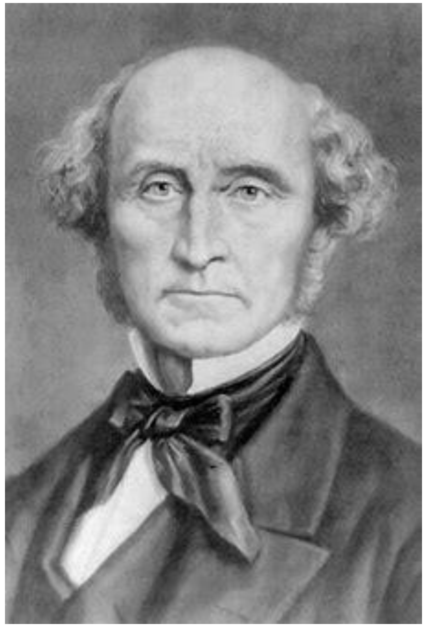
- Founder of utilitarianism: an action is right if it promotes the most happiness for the largest number of people.

<u>John Stuart Mill</u>

- The right of minorities and woman.
- Human freedom
- Happiness is pleasure and the absence of pain.



Jeremy Bentham
1748-1832



John Stuart Mill
1806-1873

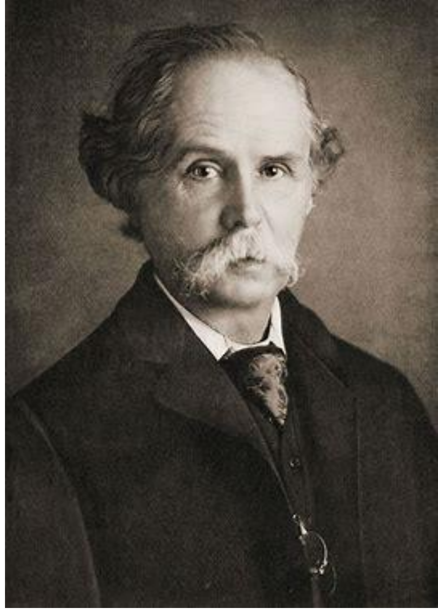
# The concept of the margin

Main ideas:

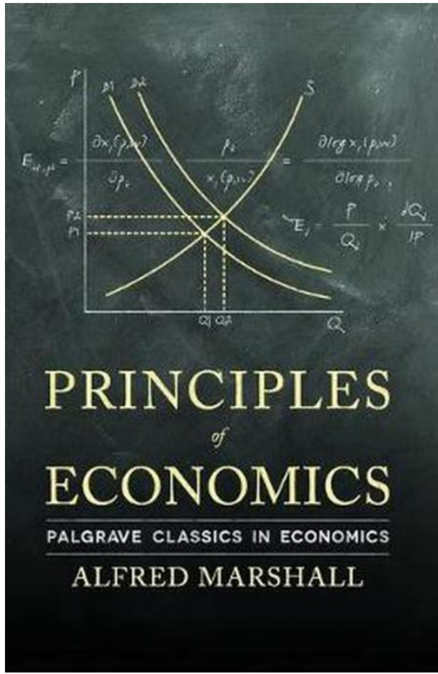
- The concept of utility, or satisfaction or pleasure derived from consuming something, is central to an idea of value that helps determine prices
- What matters is not the total utility of consuming something but rather the extra or additional utility of consuming one more unit of the good → marginal utility.

Alfred Marshall (1842-1924)

- “Principles of Economics”
- The law of demand, the law of supply
- Market equilibrium



Alfred Marshall
1842-1924



# Say's law

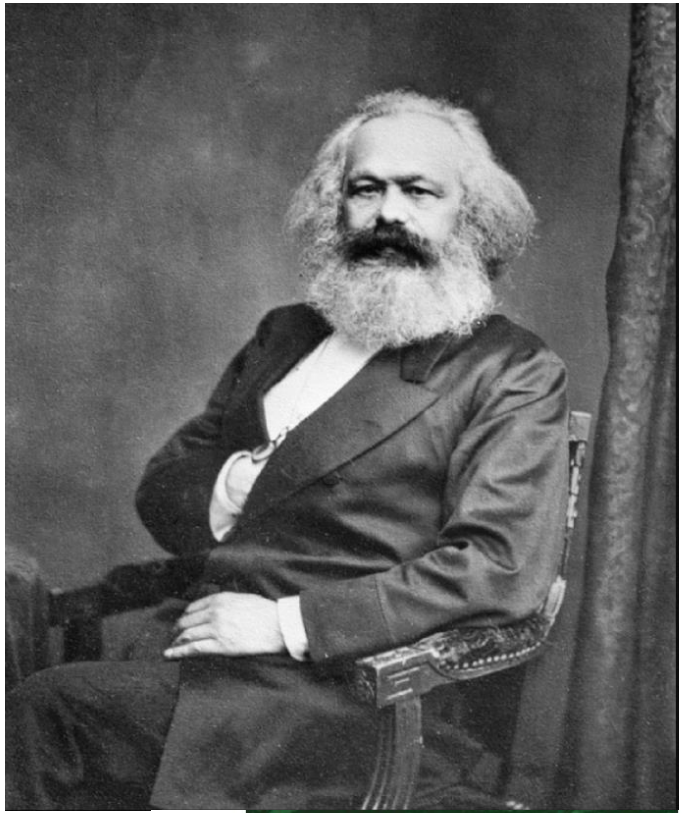
**Jean-Baptiste Say (1767-1832)**

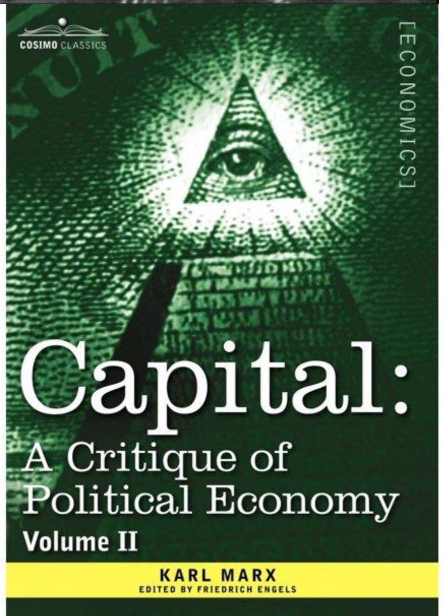
- "*A treatise on Political Economy*"
- Strongly influenced by Adam Smith
- Say's law of market – supply creates its own demand
  - The economy tends toward full employment in the absence of any government intervention.
  - The overall spending in an economy cannot fall enough to prevent all the output produced from being bought.
- The theory has be seriously questioned during the Great depression of the 1930s.

Jean-Baptiste Say
1767-1832

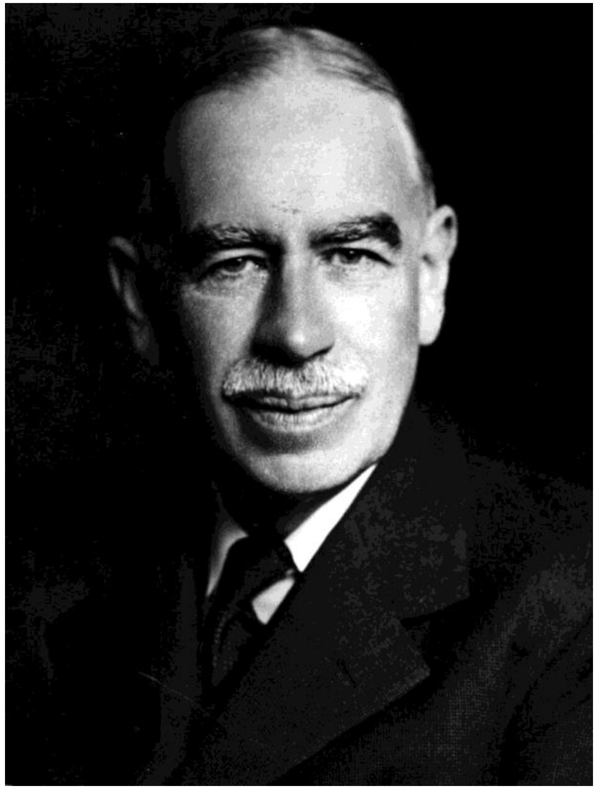
# The Marxist critique of classical economics

- Karl Marx (1818-1883) – philosopher, economist, historian, political theorist, sociologist and linguist.
- ‘*Capital: Critique of Political Economy*’,*1867*
- Main ideas:
  - Surplus value (Profit)= Price of the good – cost of labour ➔exploitation of workers by the owners of factories.
  - The innate instability of capitalism
  - Scientific account of the laws of capitalist development, which would eventually result in the downfall of capitalism and the rise of communism.
  - How capitalism works: recurrence of crises (business cycle), income inequalities, etc.





# The Keynesian revolution



## Crisis: The Great Depression of 1930s

- John Maynard Keynes (1883-1946)
- *'General Theory of Employment, Interest and Money'*
- The father of Macroeconomics

- **Main ideas:**
  - Full employment is not going to occur all the time.
  - Sticky wage → sticky price
  - The necessary of Government intervention (increasing government spending → increasing demand)
  - The idea of multiplier: if the government increased its own spending on investment like roads, schools, there would be a multiplied spending effect in the economy.

# The monetarist/new classical counter-revolution

**Crisis: The stagflation in early 1970s**

## Monetarism:

- Milton Friedman (1912-2006)
  - Emphasis the role of money in the economy. Money supply have major effects on output in the short run, and on the price level in the long run.

## New classical economics

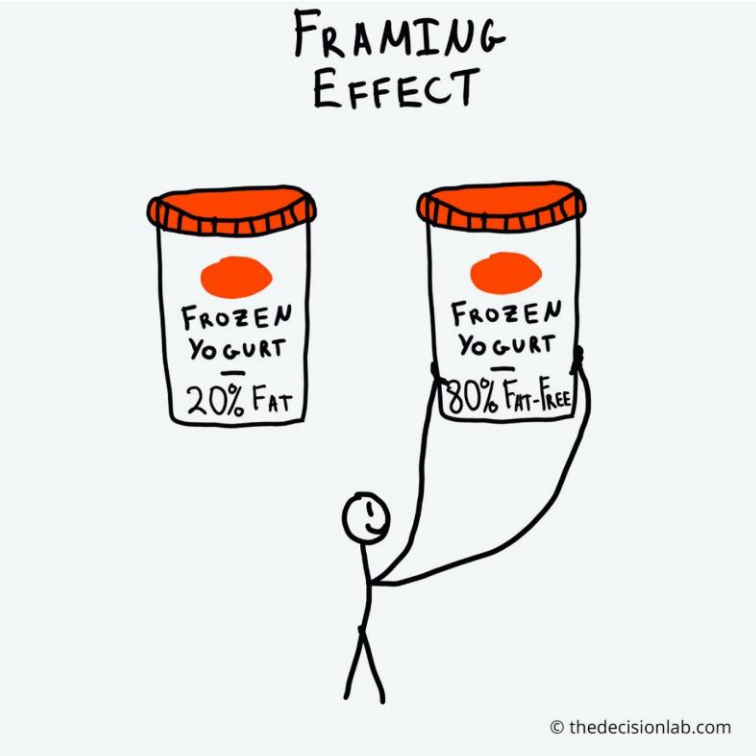
- Robert Lucas (1937 - )
  - The importance of individuals' rational expectations of inflation and government policy actions.

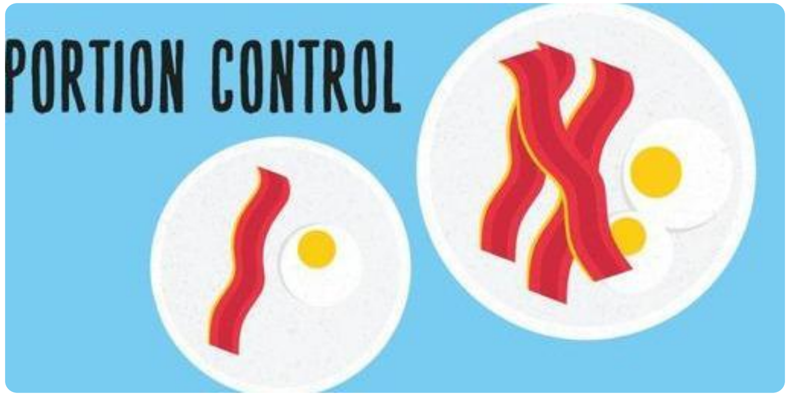
## Common thoughts:

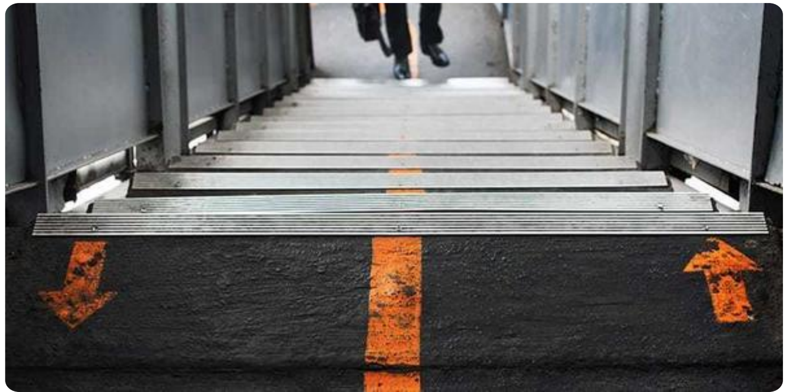
- Rejection of Keynesian economics: Government intervention is the source of "sticky wage" and "sticky price".
- The role of markets in bringing the economy back to a situation where there is full employment without any government intervention.

# Behavioural Economics

- Behavioural economics: human behavior is far more complex than consumer rationality assumes. – strongly influences by psychology, sociology and neuroscience.



Daniel kahneman

Robert j shiller

Richard Thaler