

ECON 400: History of Economic Thought

Lecture Slides 1

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First weeks' topics

- What do economists do?
- Pre-classical economics

What do economists do?

Definition of economics as a science

- Sandmo (2011) on the word's origin: *The word economy comes from Greek, where **oikonomia** can be taken to mean “domestic management” or “management of a household” (oikos means house, while nomia is derived from nemein- to manage.)*
- J. S. Mill (1844): *The science which traces the laws of such of the phenomena of society as arise from the combined operations of mankind for the production of wealth...*
- A. Marshall (1890): *Economics is a study of man in the ordinary business of life.*
- L. Robbins (1932): *Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses.*

What do economists do?

The Dismal Science: Why does economics not bring any joy?

- Another description was made by Thomas Carlyle in 1849:
 - ... which finds the secret of this universe in supply-and-demand, and reduces the duty of human governors to that of letting men alone.
 - ... a dreary, desolate, and indeed quite abject and distressing one; what we might call, by way of eminence, **the dismal science**.
- This was mostly due to Carlyle's frustration against contemporary economic ideas and fellow thinkers such as J. S. Mill thinking that all men are equal and defending the end of slavery.
- However, the term got stuck and has been used to describe often gloomy picture of the world painted by the economists.
- Even without the coined term, one common takeaway by early thinkers was that humankind's living conditions cannot be substantially improved as a whole (what could be more depressing?).

What do economists do?

Early thinkers tried to explain the economics as a whole and failed.

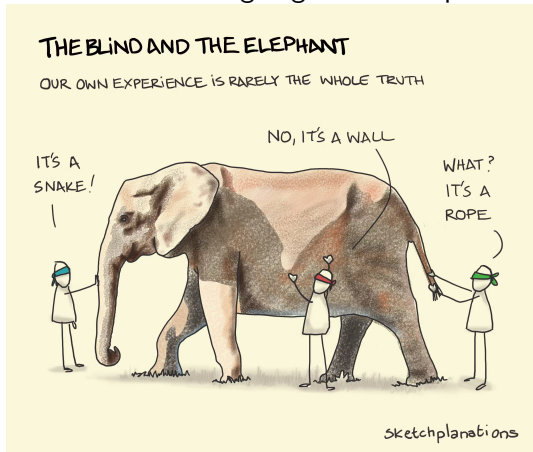
Some challenges past thinkers faced were:

- **One size fits all:** Economic thinkers were burdened themselves with the task of explaining everything about everything (“holy grail”).
- **Principal-agent problem:** They view(ed) themselves as “truth seekers” but their agents are “happiness seekers”.
- **Conflict of interests:** They were often conflicted between explaining the world as “it is” and as “it should be”.
- **Unbearable attraction of simplicity:** They were expected to explain very intricate phenomena in a very simple way (Occam’s Razor).

What do economists do?

We now explain economic phenomena “partially”.

After a series of failures on building systems that explain everything, economists started going after the “pieces”.



What do economists do?

Can we find a silver lining in all this?

- This global “zooming in” in economics profession eventually created “localized” success stories in explaining economic phenomena but also created a collection of disjointed ideas.
- Kearl et al. (1979) shows that in the 1970s, there was a higher degree of consensus about micro-economic issues than those of macro-economic nature.
- Geide-Stevenson and La Parra-Perez (2021) finds that share of economists who agree on macroeconomic issues has increased in recent decades.

What do economists do?

Are the pieces coming together or are we just too tired to argue?

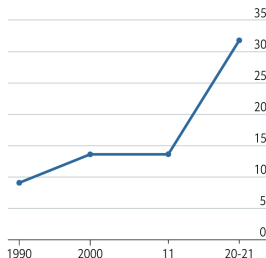
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Finding common ground

United States, survey of economists

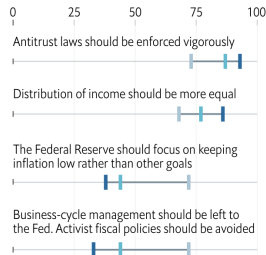
Share of economic propositions with
"strong" consensus, %



Source: "Consensus among economists 2020—a sharpening of the picture", by D. Geide-Stevenson and A. La Parra Perez, Dec 2021 (working paper)

Share of economists agreeing, %

■ 2000 ■ 2011 ■ 2020-21



What do economists do?

Why should we learn about economists' (mostly failed) past missions?

Chapter 1, Sandmo (2011):

- ① Accumulating general knowledge is fun – lots of interesting stories of the past. You'll get to quote Aristotle, Adam Smith, and the like.
- ② You will finally put a face on concepts such as “Pareto optimality” and “Marshallian Demand”.
- ③ You will better understand the current economic thinking after seeing the ways past theories failed and changed over time. This will open up the doors for you to better judge the current ideas.

First weeks' topics

- What do economists do?
- Pre-classical economics

Pre-Classical Economists

- Early Scholastics: Aristotle, St. Thomas Aquinas, School of Salamanca.
- Bullionism and Mercantilists: Mun, Petty, Locke.
- Physiocrats: Cantillon, Quesnay, Turgot.
- Misfits: Mandeville.

Pre-Classical Economic Thought

Ancient Greeks and Scholastics

- Should probably start with the advent of hunting and gathering but Ancient Greeks will also do.
- Not so humble beginnings: We will explore the journey of early scholars as they attempt to capture the essence of price.
- A normative take on economics: Just (natural) price and condemnation of interests (usury).

Pre-Classical Economic Thought

Aristotle (384-322 BC)

- A Greek philosopher who wrote on society and order.
- Discussed economic issues in his *Politics, Book I* and *Nichomachean Ethics, Book V*.
- Household management (economics), exchange, money and wealth creation are the themes discussed in these works.
- His works include some core ideas we still use but some were dismissed very early on.
- **Key aspect:** First extensive discussion on what the (just) price is.

Pre-Classical Economic Thought

Aristotle (384-322 BC)

- In *Book I of Politics*, household and its management, seen as the building block of society, are at the center of discussions.
 - ... *and the management of a household, and the mastership of slaves, and the political and royal rule, as I was saying at the outset, are all the same.*
- Households and villages are defined to be formed by blood (kinship) and self-sufficient. And this is why early Hellenic states were ruled by kings.
 - ...*Each one gives laws to his children and to his wives.*
- However, a state builds upon entities that are not self-sufficing and that's why justice must be its cornerstone.
 - *But the justice is the bond of men in states...*
- This serves the basis to his idea that economic exchange, and therefore prices must be just.

Pre-Classical Economic Thought

Aristotle (384-322 BC)

- **Art of household management (oikonomia):**
 - concerns sustaining life and satisfying human needs
 - includes subsistence given by nature or obtained from a barter in exchange of possession
 - hinges upon the idea that *amount of property which is needed for a good life is not unlimited* (first glimpse of diminishing marginal utility)
- **Art of money-making (chrematistics):**
 - includes the same instruments as oikonomia (e.g. a shoe can be used for wear or for exchange).
 - deemed as unnatural as objects are used outside of primary purpose.
 - seen as limitless because it is only possible under the notion that “No bound to riches has been fixed for man.” Otherwise, this kind of exchange would cease when they had enough.
 - *of no use but it begins to be useful when the society increases.*

Pre-Classical Economic Thought

Aristotle (384-322 BC)

- Barter is *necessary and honorable* assuming that everyone is given something but for any object *while some have too little, others too much*.
- **Example:** You grow oranges (what he implies is you are given oranges) but you also need bread. You exchange goods with one another.
- Two caveats: (I) Aristotle acknowledges that the other party may not want the good now or not enough of it to give you his possession. (II) He never discusses the “just” ratio between values of goods.

Pre-Classical Economic Thought

Aristotle (384-322 BC)

- Aristotle also justifies the use of money:
 - *The other or more complex form of exchange grew, as might have been inferred, out of the simpler. When the inhabitants of one country became more dependent on those of another, and they imported what they needed, and exported what they had too much of, **money necessarily came into use.** For the various necessities of life are not easily carried about, and hence men agreed to employ in their dealings with each other something which **was intrinsically useful and easily applicable to the purposes of life**, for example, iron, silver, and the like.*
- On the other hand, retail trade is condemned as being *unnatural, and a mode by which men gain from another.*
- Misses the point that exchange surplus can be rented for productive uses because interests on loan were prohibited:
 - *Arts of getting wealth and retail trade are concerned with coin...it is worthless, and because it is not useful as a means to any of the necessities of life.*

Pre-Classical Economic Thought

Aristotle (384-322 BC)

- Aristotle's idea of justice is reciprocity in exchange.
 - *...exchange, or trade, can only come about if there is a potential surplus from the transaction in which both parties can share.*
 - *This is why all things that are exchanged must be somehow comparable. It is for this end that money has been introduced, and it becomes in a sense an intermediate; for it measures all things, and therefore the excess and the defect – how many shoes are equal to a house or to a given amount of food.*
- Never answers the burning question: How much is the just price?
 - *Now in truth it is impossible that things differing so much should become commensurate, but with reference to demand they may become so sufficiently. There must, then, be a unit, and that fixed by agreement (for which reason it is called money); for it is this that makes all things commensurate, since all things are measured by money.*
- He argues that one should find an equitable way to share the benefit from exchange but misses the point that valuations of object, and thus gains can be subjective and hard to measure.

Pre-Classical Economic Thought

St Thomas Aquinas (1225-1274)

- A Catholic priest who wrote on moral philosophy – a leading figure of the scholastic period.
- Followed Aristotle's ideas but sophisticated the idea of “just” price.
- Still considered “unjust” trade as sinful but elaborated on the definition in his work, *Summa Theologica*.
- **Key aspect:** With a little goodwill, we can count his as an early attempt to build a “theory of value”.

Pre-Classical Economic Thought

St Thomas Aquinas (1225-1274)

Let's pause for a minute and think:

**What was Aristotle missing on the “just” price
based on what we know about the market prices today?**

Pre-Classical Economic Thought

St Thomas Aquinas (1225-1274)

- Still believes the basic exchange is the pure and *commendable* form and one cannot adjust the price based on other party's needs but opens up the just price for debate:
 - ... *ought not to raise the price, because the advantage accruing to the buyer, is not due to the seller, but to a circumstance affecting the buyer.*
 - *Now no man should sell what is not his, though he may charge for the loss he suffers.*
- Still argues that it is unlawful to sell something for more than **it is worth** but he argues that one should be able to sell something for more than **one paid for it** if:
 - ① *he bettered the thing*
 - ② *the value of the thing has changed with the change of place or time*
 - ③ *for the danger he incurs in transferring the thing from one place to another*

Pre-Classical Economic Thought

St Thomas Aquinas (1225-1274)

- First to mention the value of labor, which caused him to be seen as a forerunner of Marxism by some:
 - ... *trading which seeks gain as a last end. This is especially the case where a man sells something at a **higher price without its undergoing any change**. For if he sells at a higher price something that has changed for the better, he would seem to **receive the reward of his labor**.*
- What Marxist writers was missing is that he left some wiggle room for price setting:
 - *I add this condition, because the **just price of things** is not fixed with mathematical precision, but depends on a kind of estimate, so that a slight addition or subtraction would not seem to destroy the equality of justice.*
- Much more flexible and also more sophisticated than Aristotle's approach but still no mention of market forces.

Pre-Classical Economic Thought

School of Salamanca (1500s-1600s)

- By the 16th and 17th centuries, many thinkers have challenged the just price and the just exchange argument.
- Most of these counter-arguments highlight the importance of market forces, thereby paving the way for modern economic theories of price.
- One interesting group of thinkers is called Spanish Scholastics or School of Salamanca, a group of Spanish theologians.
- **Key aspect:** These thinkers collectively argued that the just prices cannot be determined by the cost but by the people's own perceptions of the goods and by the "common estimation".

Pre-Classical Economic Thought

School of Salamanca (1500s-1600s)

- Diego de Covarrubias defended the subjectivity of value of objects:
 - *The value of an article does not depend on its essential nature but on **the estimation of men**, even if that estimation be foolish. Thus, in the Indies wheat is dearer than in Spain because men esteem it more highly, though the nature of the wheat is the same in both places.*

Pre-Classical Economic Thought

School of Salamanca (1500s-1600s)

- Luis Saravia de la Calle argued that the cost is irrelevant to the just price:
 - *Those who measure the just price by the labor, costs, and risk incurred by the person who deals in the merchandise or produces it, or by the cost of transport or the expense of traveling... or by what he has to pay the factors for their industry, risk, and labor, are greatly in error, and still more so are those who allow a certain profit of a fifth or a tenth. **For the just price arises from the abundance or scarcity of goods, merchants, and money... and not from costs, labor, and risk.** If we had to consider labor and risk in order to assess the just price, no merchant would ever suffer loss, nor would abundance or scarcity of goods and money enter into the question. Prices are not commonly fixed on the basis of costs. Why should a bale of linen brought overland from Brittany at great expense be worth more than one which is transported cheaply by sea?... Why should a book written out by hand be worth more than one which is printed, when the latter is better though it costs less to produce?... The just price is found not by counting the cost but by **the common estimation.***

Pre-Classical Economic Thought

School of Salamanca (1500s-1600s)

- Domingo de Soto reasoned that if the just price reflects just the cost, then producers would just sell their goods based on their costs and not bother to buy and provide them cheaply:
 - *It would be a most fallacious rule if, whenever a merchant bought an article, he added on to its price the value of his labour and risk, and then expected to sell it at this increased value. In fact, if a merchant ignorantly buys some article at more than the proper price, or if he suffers ill fortune... **he cannot justly extort the costs which he has incurred.** On the other hand, another merchant may be more industrious or more fortunate; perhaps he has been able to buy cheaply, or perhaps he has been lucky enough to see the goods come into short supply after he has bought them.*