History of economic thought

The term *economics* was coined around 1870 and popularized by Alfred Marshall, as a substitute for the earlier term political economy which has been used through the 18-19th centuries, with Adam Smith, David Ricardo and Karl Marx as its main thinkers and which today is frequently referred to as the "classical" economic theory. Both economy and economics are derived from the Greek *oikos*- for "house" or "settlement", and *nomos* for "laws" or "norms".

Economic thought may be roughly divided into three phases: Premodern (Greek, Roman, Arab), Early modern (mercantilist, physiocrats) and Modern (since Adam Smith in the late 18th century). Systematic economic theory has been developed mainly since the birth of the modern era.

Premodern economic thought

Several ancient philosophers made various economic observations. Among them Aristotle is probably the most important.

Mediaeval Arabs also made contributions to the understanding of economics. In particular, Ibn Khaldun of Tunis (1332-1406) wrote on economic and political theory in his *Prolegomena,* showing for example, how population density is related to the division of labour which leads to economic growth and so in turn to greater population in a virtuous circle.

Early Western precursors of **economics** engaged in the scholastics theological debates during the middle ages. An important topic of discussion was the determination of the just price of a good. In the religious wars following the Reformation in the 16th century, ideas about free trade appeared, later formulated in legal terms by Hugo de Groot or Grotius (*Mare liberum*).

Economic policy in Europe during the late middle ages and early renaissance treated economic activity as a good which was to be taxed to raise revenues for the nobility and the church. Economic exchanges were regulated by feudal rights, such as the right to collect a toll or hold a faire, as well as guild restrictions and religious restrictions on lending. Economic policy, such as it was, was designed to encourage trade through a particular area. Because of the importance of social class, sumptuary laws were enacted, regulating dress and housing, including allowable styles, materials and frequency of purchase.

Niccolo Machiavelli was the first author to give economic policy advice, stating that princes and republics should limit their expenditures, and prevent either the wealthy or the populace from despoiling the other. In this way a state would be seen as "generous" because it was not a heavy burden on its citizens.

Early modern economic thought

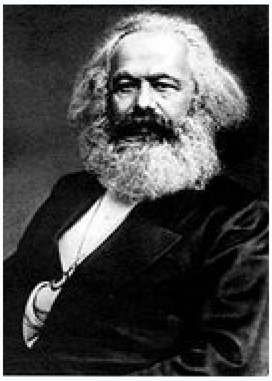
During the Early Modern period, mercantilists came closer to establishing an economic theory. This diverse school mirrored the emergence of nation states in Western Europe and they emphasized keeping a positive balance of payments.

During the Enlightenment, the French physiocrats were among the first to consider economics in and of itself. The most important physiocrat was arguably Francois Quesnay. Other French thinkers of that period include Richard Cantillon and Anne Turgot. In his *Austrian Perspective on the History of Economic Thought*, Murray Rothbard argued that the modern history of economics should properly begin with the physiocrats rather than with Smith.

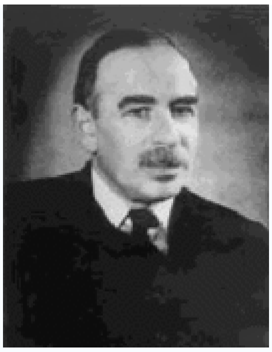
Modern economic thought

David Ricardo, one of the most influential classical economists, is often credited with systematising economics.

Adam Smith wrote *The Wealth of Nations*.



Karl Marx analysed history in terms of class conflict and technological change.



John Maynard Keynes pioneered the modern study of macroeconomics.

Modern economic thought is usually considered to have begun with Adam Smith in the late 18th century, although earlier thinkers such as the Spanish Scholastics and the physiocrats made important contributions. Modern mainstream economics can be said to begin with Mill focusing on what was then called "political economy" on "wealth" which he defined exclusively in relation to the exchange value of objects, or what would now be called price. "Classical Economics," as the economic work of the period is called, forms the foundation of micro-economics.

In Sweden an early pioneer Anders Chydenius had successfully argued for free trade already in 1765 during Diet in Stockholm. In his essay The National Gain he formulated the essential principles of free markets. The work was written in Swedish and it did not gain wider reputation.

The physiocrats were soon overshadowed by Adam Smith's *Wealth of Nations*, published in 1776. Today it is customary to consider Smith the founder of economic theory - and the classical economics that developed after him to be the beginnings of formal economic study.

The central idea promoted by Smith was that the competition between various suppliers and buyers would produce the best possible distribution of goods and services, because it would encourage individuals to specialize and improve their capital, so as to produce more value with the same labor. Smith's thesis rests on the belief that large systems can be self-regulating by the activity of their parts, without specific direction. Smith's formulation is called the "invisible hand" and is still the centerpiece of market economics, and capitalism in particular.

In the 19th century, Karl Marx synthesized a variety of schools of thought involving the social distribution of resources, including the work of Adam Smith, as well as socialism and egalitarianism, and used the systematic approach to logic taken from philosopher Hegel to produce "Das Kapital". His work was the most widely adhered-to critique of market economics during much of the 19th and 20th centuries. The Marxist paradigm of economics is not generally held in high regard by market economists, though some concepts from his work are occasionally used in mainstream contexts, particularly in labor economics and in political economy. The term Marxian is in some contexts used to describe work which accepts concepts from his work but does not necessarily subscribe to the political thrust of Marxist thought.

The late 19th century also saw the "marginal revolution" or neo-classical economics, which altered the basis of economic reasoning to include concepts such as marginalism and opportunity cost. In addition to Marshall, the work of Carl Menger was influential in disseminating the framework of economics as the opportunity cost of decisions made at the margins of economic activity.

In the early 20th century, economics became increasingly statistical, and the study of econometrics became increasingly important. Statistical treatment of price, unemployment, money supply and other variables, as well as the compiling of these statistics, became more and more central to economic writing and disputes within the field of economics.

Macroeconomics diverged from microeconomics with Keynes in the 1920s, and was codified in the 1930s by Keynes and others, particularly John Hicks. It grew in popularity as a reaction to the Great Depression. Keynes had been an influential exponent of the importance of central banking and government involvement in economic affairs, as well as a critic of the political economy of the post World War I period. His "General Theory" encapsulated both criticisms of classical theory that had been levelled by Thorstein Veblen and others, as well a method for economic management of aggregate demand. For an overview of a number of competing schools, see macroeconomics.

Many economists use a combination of Neoclassical microeconomics and Keynesian macroeconomics. This combination, sometimes known as the *Neoclassical synthesis*, was dominant in Western teaching and public policy in the years following World War II and up to the late 1970s. The neoclassical school was challenged by monetarism, formulated in the late 1940's and early 1950's by Milton Friedman and associated with the University of Chicago and also by supply-side economics.

In principle, economics can be applied to any type of economic organization. However. the majority of economic theory centers around systems where goods are exchanged in the market - where buyers and sellers seek to maximize their results by trading. The dominant form of market economics focuses on societies where property is owned by individuals, money has a rational basis, and profit comes from utilizing labor and capital to produce goods to be sold in the market - or capitalism. However, economic theory is also applied to markets where the control of capital is in the hands of the state or society, which include socialism and mercantilism, and to societies where the allocation of resources is not through the market, but through political mechanisms, generally referred to as command economies, which includes communism and forms of totalitarianism. Many economists assert that it is impossible to avoid the "Invisible Hand" of the Market, and hence all societies can be modelled through market dynamics, though this viewpoint has vehement opponents across the political spectrum.

The development of economics as a field of study is closely related to the rise of capital as the primary determining factor of production and trading, hence its most detailed and precise work has dealt with the institutions belonging to market societies, and most specifically to capitalist and socialist societies. To what extent economics must be adjusted to be applied to earlier forms of social organization has been the source of discussion. Generally, mainstream economists mostly feel that the basic framework of economics is relevant and flexible enough to be applied to virtually any form of society. Marxist economics asserts that history is divided into eras which are determined by which two classes, which are struggling to control the means of production - that is slaves and masters, peasants and royalty, wage workers and capitalists - and that mainstream economics only applies to those societies which are "objectively" industrial, that is to say, societies which are capable of industrial production based on their own knowledge and resources. (See Marxism, particularly "The Hegelian Roots of Marxism".)

In the late 20th Century three of the areas of study which are producing change in economic thinking are: risk based rather than price based models, imperfect economic actors, and treating economics as a biological science, based on evolutionary norms rather than abstract exchange.

The study of risk has been influential, which viewed variations in price over time as more important than actual price. This particularly applies to financial economics where risk-return tradeoffs are the crucial decisions to be made.

The most important area of growth has been in the study of information and decision. Examples of this school include the work of Joseph Stiglitz. Problems of asymmetric information and moral hazard, both based around information economics, profoundly affect modern economic dilemmas like executive stock options, insurance markets, and third-world debt relief.

Finally, there are a series of economic ideas rooted in the conception of economics as a branch of biology, including the idea that energy relationships rather than price relationships determine economic structure, and the use of fractal geometry to create economic models. (See Energy Economics)

In its infancy is the application of non-linear dynamics to economic theory, as well as the application of evolutionary psychology. So far the most visible work has been in the area of applying fractals to market analysis, particularly arbitrage. (See Complexity in Economics)

Another infant branch of economics is neuroeconomics. This combines neuroscience, economics, and psychology to study how we make choices.

Overview of Various Economic Schools of Thought

The history of the various schools of thought in economics can be loosely categorised as follows:

- Schoolmen, mercantilism, physiocrats, utilitarianism
- Classical economics, developed by David Ricardo, Thomas Malthus and John Stuart Mill in the 19th century.
- Neoclassical economics, arising from the Neoclassical Revolution which incorporated the marginal theory of value in the late 19th century. It is associated with e.g. Alfred Marshall
- Marxist economics is usually classified as a variant of classical economics and is based on the writings of Karl Marx, Friedrich Engels and others.
- The Austrian school, with its stress on Economic subjectivism and its rejection of economic modelling, developed by Carl Menger, Friedrich Hayek and Ludwig von Mises.
- German Historical School and institutionalists, mainly American (Thorstein Veblen, Commons, Mitchell and followers; 1899-)

For an overview of macroeconomic schools, see macroeconomics. In brief, this includes mainly,

- Keynesian economics
- Monetarism

- New classical economics
- New Keynesian economics
- Supply-side economics

Contemporary alternative schools outside the mainstream of economic thought include:

- Post-Keynesian economics, which regards neoclassical economics as fundamentally flawed and develops a radically different analysis.
- Green economists, a loose group of theories associated with feminism, postmodernism, and the ecology movement.
- Modern variants of Marxist economics, such as Marxian and Post Marxist economics.

Neoclassical economics dominates in undergraduate textbooks. The core of contemporary economics rests on the microeconomic theory of neoclassical economics, but on many topics there is little agreement on which schools to develop to usefully explain existing economies. Outside mainstream economics more widely-divergent views abound.

Some extremely important tools, such as game theory, econometrics, and linear programming, do not easily fall unambiguously into only one of the schools listed above.

Economics and political thought

Throughout the history of economic thought, different political ideas have often been associated with different schools of thought about how economies operate. For example, Adam Smith used his theories of trade and of the division of labour to argue for laissez-faire government economic policies, particularly against mercantilism. Similarly, Marx developed his theories, which focus on production and labor, to advocate socialism and communism.

An example of another economic system which has recently been advocated is the participatory economics model. This uses neither market methods nor centralised methods for allocation, but incorporates many local positive and negative feedback loops in order to respond to the most positive human values. The participatory economics model is neither communist nor capitalist. One example of this school of thought is the Post Autistic Economics movement.