UNIT-I

Nature and Importance of Economic thought – Approaches of Economic Thought – Mercantilism – Thomas Munn – Physiocracy – Quesnay.

Unit-I
The Nature and Importance of Economic Thought

I. The Nature of Economic Thought

The subject, the History of Economic Thought, may be defined as a critical account of the development of economic ideas, searching into their origins, interrelations, and, in some cases, their results. The history of economic thought concerns thinkers and theories in the field of political economy and economics from the ancient world right up to the present day. Economics was not considered a separate discipline until the nineteenth century. For example, Aristotle, the ancient Greek philosopher, in his works on politics and ethics have thought of 'art of wealth acquisition'. He also considered the question whether property is best left in private or public hands. In medieval times, scholars like Thomas Aquinas argued that it was a moral obligation of businesses to sell goods at a just price. Economic thought evolved through feudalism in the Middle Ages to mercantilist theory during the Renaissance (when people were concerned to orient trade policy to further the national interest). The modern political economy of Adam Smith appeared during the industrial revolution, when technological advancement, global exploration, and material opulence that had previously been unimaginable was becoming a reality. All these and further developments are subject matter of history of economic thought.Changes in economic thought have always accompanied changes in the economy, just as changes in economic thought can propel change in economic policy. Economic thought has at times focused on the aspects of human nature such as greed and selfishness that generally work against the good of all; at other times, economic behaviour has been seen as self-regulating and working toward a common purpose. As contemporary economic thought deals with the issues of globalization and the emergence of a global economy, economists have turned to the multitude of other disciplines which, like economics, developed independently. Building on their discoveries, and united with them in pursuit of the common goal of benefiting human society, economic thought may be on the road to achieving a new level of understanding.

There are several ways to present the history of economic thought. (i) to analyse the changing nature of economic theory in conjunction with the social and economic development of society (ii) to emphasize economic thinking as part of the main currents of philosophical and political ideas (iii) to emphasize the internal dynamics of the science where new insights and results emerge as a consequence of economists' awareness of the shortcomings of the present state of the subject.

Economic History

Economic history is different from history of economic thought. Economic history is the study of the economic aspects of societies in the past; the history of the economic use of resources land, labour and capital; or the examination of the past performance of economies. It is concerned with how people lived most of their lives, how many were born and died, how they earned and spent, worked and played.

Such variants, however, reveal little more than the definition which once said simply that it was the sort of history which required a knowledge of economics; though they are an advance on that which defined an economic historian as one who wrote as little history as possible for as much money as possible

Economic history asks economic questions – be they about the demand and supply of goods and services, about costs of production, levels of income, the distribution of wealth, the volume and direction of investment, or the structure of overseas trade – it inevitably deals with large numbers, with aggregates. A study of economic history is important because the historical economic phenomena to be examined in any given period have no existence independent of the social, political, cultural, religious and physical environment in which they occurred.

II. Significance of History of Economic Thought:

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. Whereas another group believed that one cannot possess knowledge of any economic doctrine until one knows something of its history.

So a study of History of Economic Thought is important for the following reasons:

1. 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.

2. The study of Economic Thought will help us to understand the origin of economics.

3. Economic ideas have been instrumental in shaping the economic and political policies of different countries.

4. Economic ideas are conditioned by time, place and circumstances.

5. A study of Economic Thought provides a broad basis for comparison of different ideas. It will enable a person to have a well-balanced and reasonable judgement.

6. Through the study of Economic Thought the student will realise that economics is different from economists.

7. The study of the subject helps us to avoid the mistakes committed by earlier economic thinkers.

8. The study of History of Economic Thought will enable us to know the person responsible for the formulation of certain important principles.

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

Chapter-II

APPROACHES OF ECONOMIC THOUGHT

History of economic thought can be studied and analysed by adopting different approaches:

1. Chronological approach

2. Conceptual approach

3. Philosophical approach

4. Deductive (or) Classical approach

5. Inductive approach

6. Neo-classical approach

7. Welfare approach

8. Institutional approach and

9. Keynesian approach.

1. Chronological approach:

In this approach, economic ideas are discussed in order of time. The economic ideas of different economists can be presented year-wise and can be studied. In this approach we can find a continuity in the economic ideas of different economists.

2. Conceptual approach:

It speaks about the evolution of different economic concepts (ideas) and the interdependence of these concepts. Conceptual approach can also be called as ideological approach.

3. Philosophical approach:

This was first adopted by the Greek philosopher, Plato. In the past, economics was considered as a hand maid of ethics. Naturally philosophical approach was adopted by the early writers to discuss the economic ideas.

4. Deductive approach:

The classical economists adopted deductive method. They believed in the universal application of economic laws.

5. Inductive approach:

The Historical School emphasised the inductive method. These economists believed that the laws of economics are not universal in nature.

6. Neo-classical approach:

This approach aims at improving the classical ideas by modifying them. Neo-classical approach was first adopted by 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".

7. Welfare approach:

It aims at providing the basis for adopting policies which are likely to maximise social welfare.

8. Institutional approach:

The institutionalists questioned the validity of classical ideas and gave importance to psychological factors.

9. Keynesian approach:

A major development in modern economics is associated with the name of J.M. Keynes. His approach is new and different from the classical school. It takes into consideration the operation of business cycles that affect the entire economic policies. Keynesian approach deals with the problem of the economy as a whole.

Chapter-III

Mercantilism

Mercantilism is economic nationalism for the purpose of building a wealthy and powerful state. **ADAM SMITH** coined the term "mercantile system" to describe the system of political economy that sought to enrich the country by restraining imports and encouraging exports. This system dominated Western European economic thought and policies from the sixteenth to the late eighteenth centuries. The goal of these policies was, supposedly, to achieve a "favorable" balance of trade that would bring gold and silver into the country and also to maintain domestic employment. In contrast to the agricultural system of the physiocrats or the laissez-faire of the nineteenth and early twentieth centuries, the mercantile system served the interests of merchants and producers such as the British East India Company, whose activities were protected or encouraged by the state.

The most important economic rationale for mercantilism in the sixteenth century was the consolidation of the regional power centers of the feudal era by large, competitive nation-states. Other contributing factors were the establishment of colonies outside Europe; the growth of European commerce and industry relative to agriculture; the increase in the volume and breadth of trade; and the increase in the use of metallic monetary systems, particularly gold and silver, relative to barter transactions.

During the mercantilist period, military conflict between nation-states was both more frequent and more extensive than at any other time in history. The armies and navies of the main protagonists were no longer temporary forces raised to address a specific threat or objective, but were full-time professional forces. Each government's primary economic objective was to command a sufficient quantity of hard currency to support a military that would deter attacks by other countries and aid its own territorial expansion.

Most of the mercantilist policies were the outgrowth of the relationship between the governments of the nation-states and their mercantile classes. In exchange for paying levies and taxes to support the armies of the nation-states, the mercantile classes induced governments to enact policies that would protect their business interests against foreign **COMPETITION**.

These policies took many forms. Domestically, governments would provide capital to new industries, exempt new industries from guild rules and taxes, establish monopolies over local and colonial markets, and grant titles and **PENSIONS** to successful producers. In trade policy the government assisted local industry by imposing tariffs, quotas, and prohibitions on imports of goods that competed with local manufacturers. Governments also prohibited the export of tools and capital equipment and the emigration of skilled labor that would allow foreign countries, and even the colonies of the home country, to compete in the production of manufactured goods. At the same time, diplomats encouraged foreign manufacturers to move to the diplomats' own countries.

Shipping was particularly important during the mercantile period. With the growth of colonies and the shipment of gold from the New World into Spain and Portugal, control of the oceans was considered vital to national power. Because ships could be used for merchant or military purposes, the governments of the era developed strong merchant marines. In France, Jean-Baptiste Colbert, the minister of finance under Louis XIV from 1661 to 1683, increased port duties on foreign vessels entering French ports and provided bounties to French shipbuilders.

In England, the Navigation Act of 1651 prohibited foreign vessels from engaging in coastal trade in England and required that all goods imported from the continent of Europe be carried on either an English vessel or a vessel registered in the country of origin of the goods. Finally, all trade between England and its colonies had to be carried in either English or colonial vessels. The Staple Act of 1663 extended the Navigation Act by requiring that all colonial exports to Europe be landed through an English port before being re-exported to Europe. Navigation policies by France, England, and other powers were directed primarily against the Dutch, who dominated commercial marine activity in the sixteenth and seventeenth centuries.

During the mercantilist era it was often suggested, if not actually believed, that the principal benefit of foreign trade was the importation of gold and silver. According to this view the benefits to one nation were matched by costs to the other nations that exported gold and silver, and there were no net gains from trade. For nations almost constantly on the verge of war, draining one another of valuable gold and silver was thought to be almost as desirable as the direct benefits of trade. Adam Smith refuted the idea that the wealth of a nation is measured by the size of the treasury in his famous treatise ***The Wealth of Nations***, a book considered to be the foundation of modern economic theory. Smith made a number of important criticisms of mercantilist doctrine. First, he demonstrated that trade, when freely initiated, benefits both parties. Second, he argued that specialization in production allows for economies of scale, which improves **EFFICIENCY** and growth. Finally, Smith argued that the collusive relationship between government and industry was harmful to the general **POPULATION**. While the mercantilist policies were designed to benefit the government and the commercial class, the doctrines of laissez-faire, or free markets, which originated with Smith, interpreted economic welfare in a far wider sense of encompassing the entire population.

While the publication of *The Wealth of Nations* is generally considered to mark the end of the mercantilist era, the laissez-faire doctrines of free-market economics also reflect a general disenchantment with the imperialist policies of nation-states. The Napoleonic Wars in Europe and the Revolutionary War in the United States heralded the end of the period of military confrontation in Europe and the mercantilist policies that supported it.

Despite these policies and the wars with which they were associated, the mercantilist period was one of generally rapid growth, particularly in England. This is partly because the governments were not very effective at enforcing the policies they espoused. While the government could prohibit imports, for example, it lacked the resources to stop the smuggling that the prohibition would create. In addition, the variety of new products that were created during the **INDUSTRIAL REVOLUTION** made it difficult to enforce the industrial policies that were associated with mercantilist doctrine.

By 1860 England had removed the last vestiges of the mercantile era. Industrial regulations, monopolies, and tariffs were abolished, and emigration and machinery exports were freed. In large part because of its **FREE TRADE** policies, England became the dominant economic power in Europe. England's success as a manufacturing and financial power, coupled with the United States as an emerging agricultural powerhouse, led to the resumption of protectionist pressures in Europe and the arms race between Germany, France, and England that ultimately resulted in World War I.

The End of Mercantilism

Democracy and free trade destroyed mercantilism in the late 1700s. American and French revolutions formalized large nations ruled by democracy. They endorsed capitalism.

Adam Smith ended mercantilism with his 1776 publication of "The Wealth of Nations." He argued that foreign trade strengthens the economies of both countries. Each country specializes in what it produces best, giving it a comparative advantage. He also explained that a government that put business ahead of its people would not last. Smith's laissez-faire capitalism coincided with the rise of democracy in the United States and Europe.

In 1791, mercantilism was breaking down, but free trade hadn't yet developed. Most countries still regulated free trade to enhance domestic growth. U.S. Treasury Secretary Alexander Hamilton was a proponent of mercantilism. He advocated government subsidies to protect infant industries necessary to the national interest. The industries needed government support until they were strong enough to defend themselves. Hamilton also proposed tariffs to reduce competition in those areas.

Fascism and totalitarianism adopted mercantilism in the 1930s and 1940s.[10] After the stock market crash of 1929, countries used protectionism to save jobs. They reacted to the Great Depression with tariffs. The 1930 Smoot-Hawley Act raised tariff rates up to 60% on 900 imports. When other countries retaliated, global trade fell 65 percent, prolonging the depression.

CHAPTER-IV

Thomas Mun

Thomas Mun, (baptized June 17, 1571, London, England—died *c.* July 21, 1641), English writer on economics who gave the first clear and vigorous statement of the theory of the balance of trade.

Mun came into public prominence in England during the economic depression of 1620. Many people had blamed the East India Company for the economic downturn because the company financed its trade by exporting £30,000 in bullion on each voyage.

In *A Discourse of Trade, from England unto the East Indies* (1621), Mun argued that as long as England's total exports exceeded its total imports in the process of visible trade, the export of bullion was not harmful. He pointed out that the money earned on the sale of reexported East Indian goods exceeded the amount of originally exported bullion with which those goods were purchased. The argument may have been made in self-interest: Mun was affiliated with the East India Company and was appointed to the standing commission on trade in 1622.

Mun was one of the first mercantilists. In other words, he believed that a nation's holdings of gold are the main measure of its wealth and that governments should regulate trade to produce an excess of exports over imports in order to gain more gold for the country. Later economists, from Adam Smith on, showed that trade is self-regulating and that governments that seek to hoard gold or other hard currencies will make their countries worse off. A further development of Mun's ideas appears in *England's Treasure by Forraign Trade*, a book that was not published until 1664—decades after his death.

CHAPTER-V

Physiocracy

Meaning of Physiocracy:

Physiocracy is the collective name of those economic principles and policies which developed in France in the middle of the 18th century. Physiocracy is also known as the 'Agricultural System'. Economic thinkers who contributed to the growth and development of physiocracy have been called as physiocrats.

The Physiocrats have been regarded as the founders of economic science because they were the first to grasp the general principles under-lying the economic phenomena and to evolve a theoretical system. Physiocracy is also remarked as the first school of economic thought. The term physiocracy means "Rule of Nature'.

Physiocracy may be defined as a reaction against Mercantilism and its concepts. The physiocrats believed that the mercantile policies instead of doing any good have done great harm to the nations. So they revolted against the mercantile policies.

According to Gide and Rist, **"Physiocrats must be credited with a foundation of the earliest school of economists in the fullest sense of the term. The entrance of this small group of men into the arena of history is a most touching one".**

The influential French School of thinkers of the early 18th century was led by "Quesnay and Turgot". They believed in the existence of natural law which governs the universe. Their emphasis on agriculture has earned for their system of thought, the name agricultural school.

The Factors That Gave Rise to Physiocracy:

In 1750, France provided a favourable climate for the emergence of physiocratic ideas. There were many economic, political and social factors that were responsible for the rise of physiocracy. Firstly, physiocracy was essentially a revolt of the French against Mercantilism. Under Colbert the famous Finance Minister of France, Mercantilism was carried to an extreme degree.

As a result, there was neglect of agriculture and lot of government regulations. So there was need for an economic theory to prove that the mercantile policies were not favourable for the progress and wealth of a nation. The Physiocrats provided the theoretical basis to attack Mercantilism.

Secondly, the tax system of France was corrupt, inefficient and unjust. The nobles and the clergymen, who owned nearly 2/3rd of the lands, were exempted from direct taxation. On the other hand, the burden of taxation on the poor was very heavy. The poor were affected by taxes like salt tax, poll tax, etc.

Thirdly, the finance of the French government was in a bad condition. The unnecessary wars and the luxurious court life of King Louis the XIV and XV made the government bankrupt. So the government started borrowing loans.

Fourthly, the French farmers were exploited by the nobles and landlords in a number of ways. The landlords took large share of the produce. The government levied heavy taxes upon the farmers. Even the markets for agricultural commodities were restricted because Mercantilism was in favour of industrial goods.

Fifthly, the general economic conditions of France were also unfavorable. Britain had already realised that it was a wrong policy to develop trade and industry at the expense of agriculture. Agricultural revolution was taking place in England. So in France also attention was diverted to agriculture.

Lastly, there were other forces working for the change. The political and moral philosophers emphasised the importance of individual rather than wealth. They told that man must be the centre of study.

Thus as Eric Roll says, **“With the physiocrats we enter an era of schools and systems in Economic Thought”.** Physiocrats are important in the history of economic thought because they represented the first school of economists.

The mercantilists were ordinary people who emphasised only foreign trade. But the physiocrats realised the importance of various economic activities and their relation. In the physiocratic system all social factors like production and distribution are connected. In short, the physiocrats were reformers.

Critical Estimate of Physiocracy:

Physiocracy was the revolt of the French people against Mercantilism. It is, from this angle, we have to judge the economic ideas of the physiocrats. While the mercantilists were occupied with gold, the physiocrats emphasized “Real wealth” in the form of raw produce.

The Mercantilists aimed at maximising exports and minimising imports with an object of securing a favourable balance of trade. But the physiocrats in general regarded foreign trade as an evil. While the mercantilists believed in the regulation of trade and Industry, the physiocrats suggested freedom of trade and Industry.

In spite of the above merits, the physiocrats were wrong in considering agriculture alone as the productive occupation. Commerce and industry are equally important and productive. The physiocrats had a wrong idea of production. They regarded manufacture as unproductive although it creates utility. Further the physiocrats were mainly responsible for their wrong classification of labour into productive and unproductive.

The greatest defect in the physiocratic doctrine is the absence of any reference to value. The physiocrats suggested complete freedom of trade and industry. But absolute freedom of trade is not advisable. The aim of the physiocrats was to develop agriculture. They regarded land, as the only source of wealth.

So it followed that the landlords should pay the taxes. But this idea is against the interest of the agricultural class. The weakest point in the physiocratic system is the theory of distribution.

CHAPTER-V

François Quesnay

François Quesnay (1694 – 1774), a French surgeon, born in *Méré* to a family of laborers. Quesnay was orphaned at thirteen. He learned to read from a household medical companion and quickly acquired a voracious appetite for more books and more learning. After a brief apprenticeship, some schooling at *Saint-Côme*, and marrying a Parisian grocer's daughter, Quesnay a huge step up in social status and became a surgeon in *Mantes*. Through his rapid self-education and skills, he gradually climbed up and finally entered into the service of local aristocrats. He became physician in King Louis XV's court and the leader of a sect of ***'enlightenment'*** thinkers also known as ***'physiocrats'***and ***'économistes'***.

Quesnay's interest in economics arose in 1756, he was asked to contribute several articles on farming to the *Encylopèdie* of Diderot andd'Alembert. Quesnay delved into the works of the Maréchal de Vauban, Pierre de Boisguilbert and Richard Cantillon and, mixing all these ingredients together, Quesnay gradually came up with his famous economic theory. In 1758, Quesnay wrote his *Tableau Économique* -- renowned for its famous "zig-zag" depiction of income flows between economic sectors. It became the founding document of the Physiocraticsect -- and the ancestor of the multisectoral input-output systems of Marx, Sraffa and Leontief and modern general equilibrium theory.

Quesnay's Tableau set out three classes of society, and showed how transactions flowed between them. The three classes were:

(a) landowners,
(b) the farmers and farm-labourers, and
(c) others, called 'sterile class'

According to him, only the agricultural sector produced any surplus value, the rest only reproducing what it consumed. He anticipated Malthus'sfear of under consumption arising from excessive savings. Net income would be reduced if the flows in the Tableau were interrupted by delays in spending. This was the first attempt to construct a macroeconomic input-output model of the economy. In fact, progress in this field had to await the application of matrix algebra and computerization. Quesnay suggested a single tax, *'l'impôt unique'*, on the net income from land, arguing that the nation would thereby save tax-collecting costs. Only agriculture yielded a surplus, and therefore ultimately it bears all taxes anyway.