HISTORY OF ECONOMIC THOUGHT

Lecture Notes for Week 1

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Table of Contents

Introduction to the Course

As an introduction to the course, let us think about three questions:

Why ought one to study the history of economic thought? Studying the history of economic thought is valuable for several reasons:

- **Understanding the Evolution of Ideas**: It provides insight into how economic theories and concepts have evolved over time. By examining the development of economic thought, one can appreciate the context in which ideas emerged and how they influenced contemporary economic policies and practices.
- **Contextual Awareness**: Knowledge of historical economic thought offers context for current economic systems and policies. Many modern economic issues and debates have roots in historical ideas, and understanding these origins can help in comprehending contemporary discussions.
- **Critical Thinking**: Engaging with a diverse range of economic theories encourages critical thinking. Analyzing different perspectives helps to question assumptions, identify biases, and understand the strengths and limitations of various economic models.
- **Diverse Perspectives**: The history of economic thought encompasses a wide range of viewpoints, including those that may not be prominent in current mainstream economics. Exploring these perspectives can broaden one's understanding and encourage the exploration of alternative solutions to economic problems.
- **Intellectual Heritage**: Recognizing the contributions of key thinkers in economics, such as Adam Smith, Karl Marx, John Maynard Keynes, and others, connects students and scholars to the intellectual heritage of the discipline. This understanding fosters a deeper appreciation for the field and its impact on society.
- **Policy Implications**: Historical economic theories often inform current policy-making. By understanding these theories and their historical applications, one can better evaluate the potential outcomes and implications of different economic policies.
- **Interdisciplinary Connections**: The history of economic thought is intertwined with philosophy, politics, sociology, and history. Studying it can enrich one's appreciation of these disciplines and their relationships with economics.

- **Inspiration for Innovation**: Historical economic theories can inspire new ideas and innovations. By revisiting past concepts, scholars and practitioners may find novel applications or insights relevant to today's economic challenges.

Overall, studying the history of economic thought equips individuals with a deeper and more nuanced understanding of economics, enhancing both academic inquiry and practical application in the field.

Why does economic thought develop? Economic thought reacts to changes in the real space and to changes in the epistemic space – in the space of the general knowledge. Some development is endogenous – economic thinkers react to the ideas of other economic thinkers.

- **Changes in the real space:**
    - **Changes in the political environment:** Changes in political ideology or frameworks can impact economic policies, thus necessitating a change in economic thought. For example, changes in leadership or government structures can lead to shifts in economic policies, affecting how economists analyze policy impact.
    - **Changes in the social environment:** Changes in societal attitudes, cultural practices, or demographic shifts can impact economic behaviors and thus drive the evolution of economic thought. For instance, as societies become more concerned about environmental sustainability, new economic models are emerging to address these issues (like the circular economy or green economics). Significant historical events, like wars, political revolutions, or periods of rapid industrialization, often require a rethinking of prevailing economic theories and models, leading to the development of economic thought.
    - **Changes in the economic and technological environment:** As the economy changes, economic thought adapts to reflect these new realities. For example, the Great Depression led to the development of Keynesian economics, which focused on the government's role in stabilizing the economy. With each new technological revolution, economic thought must evolve to

account for new industries, market behaviors, and economic dynamics. Consider how the advent of the internet revolutionized businesses and markets, necessitating new economic thinking around digital economies, e-commerce, and sharing economy.

- **Changes in the epistemic space:** Advances in related scientific fields, such as mathematics, chemistry, psychology, or computer science, can influence economic thought by providing new tools, methodologies, or theories that can be applied to the study of economics.
- **Endogenous development of economic thought:** Economic thought also evolves due to the ongoing debates and discussions among economists. These debates lead to the testing and refining of existing theories, the disproving of old ones, and the development of new ideas and paradigms.

In essence, economic thought develops in response to changes in the world – whether real or intellectual – and in the process of scholarly inquiry and debate. Thus, it is an evolving field always adapting to better understand the complexities of economic dynamics.

Aside of the Western tradition of economic thought, that we are interested in in this course, what other roots can be named?

- **Confucianism**: The philosophy of Confucius (c. 441 – 479 BCE), specifically his emphasis on ethics, order, and hierarchical relationships, laid the foundation for much of traditional Chinese economic thinking. Confucian thought encourages social harmony, which can in turn affect economic behaviors and decisions. More concrete advices are:
    - Tax only agriculture
    - Adjust government spending to government revenue
    - Living standards are to be determined by a person's social status, but should be modest.
    - The ruler's primary responsibility is the well-being of his people.
    - Government should provide assistance to produce and maintain equality when needed but should generally stay out of economic affairs.

- **The *Arthashastra*** is an ancient Indian treatise on statecraft, economic policy, and military strategy. It was written by Kautilya, also known as Chanakya, who was a scholar at Takshashila University and later the Prime Minister of the emperor Chandragupta Maurya. The text dates to the 4th century BC, though some scholars argue it may have been written a few centuries later. Some key points from the *Arthashastra* include:
    - **Statecraft and Administration**: *Arthashastra* emphasizes that the welfare of the state depends on efficient administration. It provides guidelines on the role, responsibilities, and conduct of a king (ruler). It also details the organizational structure of the state, division of duties among ministers, and systems of co-operation and checks and balances among different departments.
    - **Economic Policy**: The text presents the state as an entrepreneur, playing an active role in production and distribution of wealth. It details revenue administration, suggesting that taxes should be fair, equitable, and dependent on the income and expenditure of the citizen.
    - **Ethics and Duty**: *Arthashastra* also includes suggestions on ethical duties of a king, such as protecting the citizens, promoting their material and spiritual welfare, and maintaining order and justice.

- Ibn Khaldun (1332 – 1406): is often considered a founding figure in the social sciences, including economics, sociology, and historiography. This Arab Philosopher was born in Tunis and served in various political roles throughout the Muslim world. His most well-known work, *Muqaddimah* (also known as Prolegomena), laid out his notable ideas on economics and society. Below are some of Ibn Khaldun's key economic ideas:

    - **Labor Theory of Value**: Ibn Khaldun proposed that value comes from labor and costs of production. This was a precursor to the labor theories of value developed later by classical economists like Adam Smith and David Ricardo.

- **Supply and Demand**: He suggested early ideas related to supply and demand, noting that prices tend to rise with increased demand or reduced supply.
- **Population and Resources**: Ibn Khaldun recognized the connection between population and resources, observing that abundant resources can support a larger population.
- **Role of Government**: He argued for limited government intervention in the economy. He proposed that heavy taxes discourage work and production and can lead to economic decline.
- **Social Cohesion (Asabiyyah)**: A significant part of Ibn Khaldun's work focuses on the role of social cohesion, or Asabiyyah, in economic and political success. He argued that groups with stronger social solidarity have more substantial economic growth and political power.
- **Dynamic View of Economy**: Ibn Khaldun viewed economies as dynamic and changing, influenced by factors like population, natural resources, and social values. This view was novel in contrast to the largely static view of economies prevalent in his time.
- **Urban and Rural Economics**: He emphasized the importance of understanding the economic differences and relationships between urban and rural areas. He noted that rural areas, with their focus on agriculture and basic necessities, play a fundamental role in sustaining the luxury trades of urban areas.

Ibn Khaldun's economic ideas were progressive for their time and continue to be influential for contemporary economic thought. They provide valuable insights into economic phenomena like value, supply and demand, the role of taxation, and the importance of social factors in economic success.

From Ancient Greece to the 16th Century

During these almost two thousand years, thoughts on economic affairs were dispersed in philosophical and theological works. Economic thinking was firmly based on ethical fundamentals. The basic question was: What is just behavior of participants in economic affairs?

Let us distinguish the period of classical antiquity, the patristic and scholastic era of the Middle Ages, and the Renaissance that effectively ended the Middle Ages.

Classical Antiquity

General background: Political environment was changing from the City States in the old Greece to huge empires.

Alexander the Great, who was a king of Macedonia, conquered an empire that stretched from the Balkans in Europe to modern-day Pakistan. His reign lasted from 336 to 323 B.C., a period during which he became known as one of history's greatest military leaders. Alexander's conquests have had a lasting impact, spreading Greek culture and ideas across the Middle East and beyond.

The Roman Empire was a powerful political and socio-economic entity that started in the 1st Century BC and lasted until the 5th Century AD, originating from the city of Rome in Italy. Spanning roughly 500 years, it marked one of the most critical periods in Western Civilization and had far-reaching influence on modern western culture, language, politics, society, and infrastructure.

Basic social and economic units were households. They were varied and complex, often influenced by factors such as social status, wealth, and location. These households usually consisted of a nuclear family and occasionally extended family members. Slaves were commonly part of higher-status households, performing domestic tasks and labor. The households were typically patriarchal, with the eldest male holding considerable authority. Urban households often differed from rural ones, with limited space leading to apartment-style living in cities, while the country saw larger estates. A family's wealth determined living conditions, with the rich enjoying luxuriously decorated homes and the poor living in more modest, often crowded conditions. Men typically worked outside the home, while women conducted domestic duties, although this division could vary among the lower classes. In wealthier households, children received education at home, focusing on subjects like reading, writing, literature, philosophy, and music. Markets existed for surpluses and for imported goods.

Both Greek and Roman societies believed in a societal structure that was hierarchical. The prevalent attitude was that the elite, such as aristocrats in Greece or patricians in Rome, were deservedly in positions of power because of their birth, character, or virtues. Slavery was forming the base layer of society's pyramid, with slaves most often being prisoners of war. Women, who had limited rights, relied on the status of their fathers or husbands for their own social standing. Citizenship, which offered important political and legal rights, played a significant role in determining social status, though the requirements and privileges varied over time and between institutions. Lastly, an occupational hierarchy existed, with professions like farming or warfare seen as more respected than those in commerce or banking. This social stratification was a cornerstone guiding life, laws, and culture in these historical societies.

In classical antiquity, knowledge was multifaceted, integrating philosophical, scientific, and legal concepts. Plato and Aristotle, who respectively believed in innate knowledge and empirical learning, profoundly influenced epistemology. The Sophists, with their focus on rhetorical skills and relative knowledge, alongside mathematicians like Euclid and Pythagoras, made significant strides in their fields. Ethics and political philosophy saw rigorous discussions on life, virtue, justice, and governance. Furthermore, Roman Law, which centered on the principles of justice and the rights of the individual, constituted a significant part of Roman knowledge. Its influence was immeasurable, providing the groundwork for many modern legal systems and contributing to our understanding of notions like citizenship, legal rights, and the rule of law.

Economic thought: The term "economics" comes from the Greek word "oikonomia," which means "household management" or "management of household affairs." It is derived from "oikos," meaning "house" or "home," and "nomos," meaning "law" or "custom." Xenophon (430 – 354 BCE), the ancient Greek philosopher, is often credited with first using the term "economics," or its Greek equivalent, in his work *Oikonomikos*, instructing men on how to manage a household's resources, duties, and labor.

Plato (428 – 348 BCE) presented some economic thoughts in his work *The Republic.* His thoughts were deeply interconnected with his views on an ideal society and justice. Plato proposed that an efficient society would be one where there is a division of labor. Each person should specialize in a specific occupation for which they are naturally suited and that they have been specially educated and trained for. Plato's ideal society was stratified into three co-dependent classes - producers (labor class), protectors (guardian class), and rulers (philosopher kings). Plato suggested communal sharing of property and goods in the ruling classes (philosopher-kings and guardian class). He believed private property would lead to greed and corruption. He advocated for simplicity and temperance in consumption and discouraged luxury, because he feared that excessive wealth could be a hindrance for developing virtues. Plato recognized the importance of money for facilitating trade. He also believed in the value of international trade and commerce, as long as it was beneficial to society. It is important to note that Plato's economic ideas were predominantly related to his conception of an ideal society and ethical considerations, rather than being a practical guide to economic policy.

Aristotle (384 – 322 BCE) made considerable contributions to economic thought, even though he did not write a specific treatise on the subject. His view on "oikonomia," or household management, emphasized the prudent use of resources for the household's and community's benefit. While he acknowledged private property, he also stressed its use for the common good, thereby enriching many future debates on economics, ethics, and justice. He suggested that a good's value is tied to its utility and the labor put into its creation. He laid significant emphasis on just pricing and fair exchange (commutative justice), underlining the need for equity in transactions. Aristotle also made a clear distinction between "natural" wealth acquired through activities like farming and craftworks, which he saw necessary and just, and "unnatural" wealth gained through trade or interests (usury), which he deemed unethical. He thought also about distributive justice and taxation.

Aristotle: *Nicomachean Ethics*, Book 5, Part 5:

- "It is by exchange that men hold together."
- "There will be reciprocity when the terms have been equated so that the amount of the shoemaker´s work is equal to the amount of the farmer´s work."
- "There can be a barter exchange and an exchange with money."
- "Money has been introduced to make all things that are exchanged somewhat comparable."
- "Money exists not by nature but by law."
- "Just action is intermediate between acting unjustly and being unjustly treated."

Aristotle*: Politics*, Book 1, Parts 8 – 11:

- "Nature has made all animals for the sake of man."
- "The art of household management is not identical with the art of getting wealth."
- "Two uses of everything which we possess: for use and for exchange"
- "Men are right when they seek after a better notion of riches than the mere acquisition of coin."
- "There are more sorts of wealth-getting than just retail trade, the latter being justly censured."
- "Getting wealth by usury is the most unnatural."
- "Creation of monopoly is a way of making money."

Aristotle: *Politics*, Book VII:

In this book, Aristotle closely analyzed some pragmatic yet vital factors necessary for the prosperity of political entities, such as the size and reach of the territory, the population size, accessibility to the sea, and the impact of climate. In addition to these, a flourishing state requires a reliable source of food, a proficient workforce, weaponry for defense, monetary resources, and a religion with a committed priesthood. It should also have a decision-making and dispute resolution system, and a ruling class with sufficient wealth. The objective of a commendable state is to nurture the virtues of its citizens; however, this necessitates virtuous individuals to both rule and be ruled in return by such a state.

Aristotle: *Politics*, Book VII, Chapter 1:

"...external goods have a limit, like any other instrument, and all things useful are of such a nature that where there is too much of them, they must either do harm, or at any rate be of no use, to their possessors. "

Middle Ages

General background: The patristic phase of European history, also known as the Patristic Period or the Age of the Church Fathers, runs roughly from the late 1st century to the mid-8th century AD. It is named after the early Christian scholars and theologians known as the Church Fathers, who greatly influenced Christian doctrine and philosophy during this period. This era is marked by the development and consolidation of Christian theology, the spread of Christianity across Europe, and its increasing institutionalization in the forming Holy Roman Empire. The Scholastic Period, often referred to as Scholasticism, lasted from the 9th to the 14th centuries AD during the Middle Ages in Europe and is recognized for its systematic and critical use of reason. Mainly employed by clergy scholars in universities and ecclesiastical schools, it aimed to harmonize Christian theology with classical philosophy, primarily using logic and reason to interpret faith and scriptures.

In the Middel Ages, it was generally believed that social stratification was created by God and as such is intrinsic to human nature. But, the slave system with slaves was changing to the feudal system. In the feudal society of medieval Europe, a monarch or a lord would make a grant of land, a fief, to a vassal, who in return pledged his loyalty and military service. The vassal became a tenant of the lord, obliged to provide homage, offering, and allegiance. The granting of fiefs was a common practice used to build, reward, and maintain loyalty within the hierarchical and contractual relationships that defined feudal society. The people living on the land, typically serfs, owed their labor to the vassal in return for protection and the right to work the land. Markets existed for surpluses and for imported goods. Market towns were gaining significant importance in economic and social development. They served as vital trade and economic hubs, with designated market days stimulating local economies and fostering regional trade. Acting as crucial links connecting urban and rural economies, they provided farmers an outlet to sell or trade their produce and livestock while offering urban residents access to fresh agricultural products. They also provided unique employment opportunities beyond farming and agricultural labor, including work for craftsmen, merchants, and innkeepers. Beyond their economic importance, market towns were hotspots for cultural and social interaction, disseminating news and cultural practices while also hosting special events, festivals, and fairs. Over time, the prosperity of these market towns often led to their growth and expansion, contributing to broader urban development and growth.

Law's evolution during the Middle Ages was a multifaceted process, marked by various socio-political transformations and cultural influences. After the fall of the Western Roman Empire, much of the Roman legal tradition, was lost in many regions, only to be rediscovered from the 11th century onwards. Concurrently, the establishment of feudalism saw the rise of feudal law, a localized, unwritten law system based on customary practices. Alongside this, Canon law, the law of the Catholic Church, governed the clergy's behavior and various social issues like marriage, divorce, and wills. England witnessed the development of common law, a system based on judicially set precedents rather than pre-existing written legal codes. The revival of trade brought about merchant law (Lex Mercatoria), providing a standardized set of customs and practices across different regions. As the monarchy and central governments gained power, statutory law emerged through the issuance of various statutes, influencing different aspects of life. All these comprehensive developments significantly diversified legal systems, laying the groundwork for many modern-day legal principles and systems.

Thomas Aquinas, is considered the greatest scholastic philosopher and theologian He developed a profound philosophy of natural law, seen as the embodiment of rational creatures in God's eternal law governing the universe. He considered natural law to be a moral law innate in humans, functioning independently from human-made laws, which defines what is inherently good or evil. Aquinas postulated that humans' unique reasoning ability allows them to understand this natural law, realize their inherent ends or purposes, and grasp moral values. He underlined four principal precepts of natural law - preserving life, procreating and educating offspring, pursuing knowledge, and living harmoniously in society. According to Aquinas, moral actions align with these principles, helping actualize human potential and fulfill natural ends, while actions contradicting these principles are deemed 'bad.' Furthermore, he stated that human-made or positive laws must align with natural law to be valid. Therefore, any human laws inconsistent with natural law are not genuine laws and aren't binding. Aquinas' philosophy of natural law thereby offers an influential perspective on morality, law, and human nature.

The problem of universals, a long-standing debate in philosophy, continued to be debated. It revolves around the question of whether properties, types, or categories, known as 'universals,' exist independently of their individual instances. This issue has polarized philosophers into two main viewpoints: Realism and Nominalism. Realists, like Plato, believe in the independent existence of universals, positing them as entities in their own right distinct from individual instances. On the contrary, Nominalists deny the independent existence of universals, insisting that only individual objects exist and universals are merely names or labels we use to categorize and group these instances. Aquinas held that universals don't exist independently as Plato believed, nor are they merely names or labels as nominalists argued. Instead, they exist in the mind as concepts abstracted from our experience of individual things in reality. Aquinas believed that while individual things are fundamentally real, our minds can grasp the shared characteristics or 'universals' between different individuals by a process of abstraction, forming general concepts or ideas.

Economic Thought: Basic question related to economics of all thinkers in this period was: What is just behavior of a Christian during his life in the matters of production, distribution, exchange, and consumption? Usury is broadly discussed and condemned. Just price is broadly discussed.

St. Augustin from Hippo (354 – 430), an influential figure in early Christian philosophy and theology, did not formally delve into economic thought. Nevertheless, his writings offer insights on economically relevant topics like wealth, poverty, property, and justice. Augustine upheld the Christian preference for poverty and cautioned against the spiritual pitfalls associated with wealth. He identified not wealth itself, but the excessive desire for wealth (avarice or greed) as a major moral issue. He promoted charitable acts and generosity towards those in need, underlying the importance of fair resource distribution, moral obligations of the affluent towards the underprivileged, and the societal and state responsibility to care for the less fortunate.

He presented following case study: “An expert in rare books found a valuable manuscript for sale at a low price because the seller is unaware of its rarity and value. Ought a virtuous buyer inform the seller of its true worth? “

Saint Thomas Aquinas (1225 – 1274), an influential 13th-century philosopher and theologian, significantly impacted economic thought, embedding most of his economic insights within his theological and moral teachings. Contrary to some early Church fathers who held a dim view of private property, Aquinas defended its right but emphasized viewing it as a trust from God for the common good's benefit. He extended the idea of "just price," advocating for prices that reflected a product's true cost, including labor costs to ensure transactional fairness. Aquinas was firmly against usury, the practice of charging interest on loans, considering it to violate money's natural purpose as a medium of exchange. He emphasized the importance of charity and almsgiving, asserting that the affluent had a moral obligation to serve the less fortunate as resources were God-given to be shared for everyone's well-being. Value was attached to work and labor as essential to society, while maintaining the importance of leisure for spiritual and intellectual growth. The state, he believed, had authority over economic affairs to regulate the economy, safeguarding the weak and guaranteeing justice. Though Aquinas did not compile a uniform economic theory in today's sense, his philosophical contemplation on these topics formed the basis of scholastic economics and continues to shape Catholic social teaching and current discussions on ethics and economics.

He presented following case study: :A grain merchant brought food to a town that had recently been stricken by famine. The merchant knows something the townspeople do not: more grain merchants are on their way and will soon arrive. Is it morally justifiable for the merchant to charge the elevated prevailing market price? Or, must he reveal the knowledge that others are coming, and harm himself by receiving a lower price? “

Aquinas: *The Summa Theologica*, Second Part of the Second Part, Questions 77, 78

- “It is sinful to sell a thing for more than its just price.”
- “If a seller is aware of a hidden fault in the thing he is selling, he is guilty of a fraudulent sale, so that the sale is rendered unlawful.”
- “If a defect in a thing sold is manifest, then the seller is not bound to state the defect to the buyer.”

- “Gain in trading does not, in itself, connote anything sinful or contrary to virtue.
- “To take usury for money lent is unjust in itself.”
- “It is lawful to expect compensation for a loan in respect or benevolence or love for the lender.”
- “If a man has by usury extorted from another his house, he is bound to restore both the house and the fruits accruing to him therefrom.”
- “It is by no means lawful to induce a man to sin, yet it is lawful to make use of another's sin for a good end.”
- “It is not lawful to borrow for usury from everybody and for any purpose.”

The Renaissance

General background: The Renaissance, a period of cultural, artistic, and intellectual rebirth, began in Italy in the 14th century, with the city of Florence often considered its epicenter. The period marked a transition from the Middle Ages to modernity. Florence during the Renaissance was a thriving hub of trade, finance, and industry, particularly in textiles and wool. This created a wealthy class of merchants and bankers who became patrons of the arts, fueling a cultural revolution.

The Renaissance era, also known as the Age of Discovery, was marked by significant geographical exploration and discovery from the end of the 15th century. In 1492, Christopher Columbus, funded by Spanish monarchs, set off westward to find a route to Asia but instead landed in the Americas, marking the first sustained contact between the Old World and the New World. Meanwhile, Portuguese explorer Vasco da Gama discovered a direct ocean route from Portugal to the East in 1498, sailing around the southern tip of Africa (the Cape of Good Hope) into the Indian Ocean. This paved the way for direct trade with India and the Far East, breaking the Venetian and Ottoman monopoly on the spice trade.

The seeds of Protestantism, a significant branch of Christianity, were sown during the Renaissance period in the 16th century, known as the Protestant Reformation. Its initiation is credited to Martin Luther, a German monk and theology professor dissatisfied with the Roman Catholic Church’s practices and doctrines. Luther's Ninety-Five Theses, penned in 1517, critically examined the Church's teachings, igniting widespread debate and eventually leading to his excommunication. However, his ideas - emphasizing the Bible as the sole source of religious truth and introducing the doctrine of justification by faith alone - had already gathered momentum. While Lutheranism evolved in Germany, parallel movements emerged elsewhere in Europe. In Switzerland, John Calvin and Huldrych Zwingli launched the Reformed tradition, focusing on God's absolute sovereignty and salvation through grace alone. In England, King Henry VIII's political motivations led to the English Reformation, with the monarch separating from the Catholic Church and establishing himself as the head of the newly formed Church of England.

All these events started the transition from the feudalism to capitalism that was marked by significant economic and social shifts.

Economic Thought: The School of Salamanca was a Renaissance intellectual movement. Its theologians, philosophers, and jurists made significant contributions to various fields, economics, law and ethics included. It originated in the Spanish city of Salamanca during the 16th century.

Key figures such as Francisco de Vitoria or Luis Saravia de la Calle addressed foundational issues related to natural law, human rights, and the legitimacy of political power. They explored just war theory, the rights of indigenous peoples in the Americas, and the ethical implications of economic practices such as trade, currency exchange, and interest rates, effectively laying the groundwork for modern economic thought.

Luis Saravia de la Calle, 1544:

- "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.... For the just price arises from the abundance or scarcity of goods, merchants, and money...and not from costs, labor, and risk.... 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. "

- "…The just price is found not by counting the cost but by the common estimation. "

Common estimation is given on a market, in other words just price is the market price (on competitive markets, but not on monopolistic markets - but competitive markets did not exist for the most goods). In these citations we can smell the new broad current – the switch from rationalism to empiricism – and the birth of social science.

Summary

During the classical antiquity, political environments evolved from the city-states of ancient Greece to vast empires. Alexander the Great, the king of Macedonia, conquered an extensive empire from the Balkans to modern-day Pakistan, spreading Greek culture and ideas across the Middle East and beyond. Similarly, the Roman Empire, which originated in Rome in the 1st century BC and lasted until the 5th century AD, profoundly influenced Western civilization in terms of culture, language, politics, society, and infrastructure. During this period, households were the basic social and economic units, varying based on social status, wealth, and location. These typically patriarchal households included nuclear families, and often slaves, with urban and rural living conditions differing significantly. Greek and Roman societies were hierarchical, with the elite holding power due to birth, character, or virtues, while slaves formed the societal base. Both societies placed significant importance on citizenship and had an occupational hierarchy that respected farming and warfare over commerce. Philosophical thought in classical antiquity was rich, integrating diverse fields like philosophy, science, and law, with significant contributions from Plato and Aristotle shaping epistemology and ethics. Roman Law also played a crucial role, influencing modern legal systems. The term "economics," derived from the Greek word "oikonomia," meaning household management, was first used by Xenophon. Plato's economic ideas, presented in *The Republic,* emphasized the division of labor and communal sharing among the ruling class for societal justice, while Aristotle's views on "oikonomia" focused on the prudent use of resources, the labor theory of value, just pricing, and the distinction between natural and unnatural wealth. He also stressed the importance of private property for the common good and criticized the unethical use of money. Aristotle's works further analyzed the necessary elements for a prosperous state, including resources,

workforce, and governance, and highlighted the balance required for virtuous governance.

During the Middle Ages, social stratification was viewed as divinely ordained, transitioning from the Roman slave system to feudalism. In feudal society, monarchs or lords granted land to vassals in exchange for loyalty and military service, while serfs worked the land for protection and sustenance. Market towns emerged as central hubs for trade, economic activity, and cultural exchange, facilitating urban growth and development.

The evolution of law in the Middle Ages was multifaceted. Roman law was rediscovered, feudal law emerged based on customary practices, and Canon law governed ecclesiastical matters. Merchant law standardized trade practices. England developed common law based on judicial decisions. These legal developments diversified systems and laid the foundation for modern legal principles.

The patristic phase of European history, also known as the Age of the Church Fathers, spanned from the late 1st century to the mid-8th century AD. During this period, early Christian scholars like Augustine of Hippo extensively influenced Christian doctrine, theology, and philosophy. This era saw the consolidation of Christianity and its institutionalization, notably in the forming Holy Roman Empire. The subsequent Scholastic Period, from the 9th to the 12th centuries, focused on harmonizing Christian theology with classical philosophy through systematic reasoning and was dominated by scholars like Thomas Aquinas, who developed a profound natural law philosophy. Aquinas posited that natural law, understood through human reason, defined moral principles and should guide human-made laws.

The problem of universals—whether properties and categories exist independently of individual instances—was actively debated during this period. Aquinas, taking a moderate realist stance, argued that universals exist as concepts abstracted in the mind from real individual instances, bridging the divide between realism and nominalism.

In economic thought, Augustine warned against avarice and emphasized fair resource distribution and charity. Aquinas expanded on economic ethics, advocating for just pricing, condemning usury, and stressing the moral obligations of the affluent toward the less fortunate. He emphasized that economic activities should align with common good principles and justice, influencing Catholic social teaching.

The Renaissance, beginning in Italy in the 14th century with Florence as its epicenter, marked a cultural, artistic, and intellectual rebirth transitioning from the Middle Ages to modernity. Florence's thriving trade, finance, and textile industries created a wealthy merchant and banking class that patronized the arts, sparking a cultural revolution. The era, also known as the Age of Discovery, was notable for significant geographical exploration. In 1492, Christopher Columbus, funded by Spanish monarchs, sought a route to Asia but landed in the Americas, establishing sustained contact between the Old and New Worlds. Meanwhile, in 1498, Portuguese explorer Vasco da Gama found a direct ocean route to the East, opening trade with India and the Far East and breaking the Venetian and Ottoman spice trade monopoly. The 16th century saw the rise of Protestantism during the Protestant Reformation, initiated by Martin Luther’s Ninety-Five Theses in 1517, challenging Catholic Church practices and doctrines. This period also witnessed the emergence of parallel Reformation movements like Calvinism in Switzerland and the English Reformation under King Henry VIII. These religious and cultural shifts contributed to the transition from feudalism to capitalism, marked by significant economic and social changes.

The School of Salamanca, a Renaissance intellectual movement in 16th-century Spain, made substantial contributions to economics, law, and ethics. Thinkers like Francisco de Vitoria and Luis Saravia de la Calle addressed issues such as natural law, human rights, just war theory, indigenous peoples' rights, and ethical economic practices. In 1544, Luis Saravia de la Calle argued that the just price should be determined by market factors - abundance or scarcity of goods, merchants, and money - rather than production costs, labor, or risk. This perspective indicated a shift from rationalism to empiricism and heralded the birth of social science by emphasizing that just price, or market price, reflects common estimation in competitive markets.

Roots of Current Relations between Ethics and Economics – Selected Topics

Positive and Normative Economics

Positive and Normative Economics are two distinct approaches to economic analysis:

- Positive Economics:
  - Definition: Positive economics deals with objective analysis and facts about the economic behavior. It describes and explains economic phenomena without making value judgments.
  - Focus: It focuses on "what is" and "what will be" if certain conditions are met. Positive statements can be tested and validated or refuted through empirical evidence.
  - Example: "Increasing the minimum wage will lead to higher unemployment among low-skilled workers."
  - Purpose: The goal is to develop theories and models that accurately explain the economy and predict outcomes of economic policies.
- Normative Economics:
  - Definition: Normative economics involves subjective judgments about what the economy should be like or what particular policy actions should be recommended. It deals with values and ethical considerations.
  - Focus: It focuses on "what ought to be" and includes opinions and prescriptions for economic policy based on personal or societal values.
  - Example: "The government should increase the minimum wage to ensure a fairer distribution of income."
  - Purpose: The aim is to advocate for economic policies and actions that align with desired economic goals and ethical standards.

By distinguishing between positive and normative economics, economists can separate objective analysis from subjective advocacy, ensuring clarity in both empirical research and policy recommendations.

John Neville Keynes (1852-1949) was a prominent British economist and logician known for his influential work in the methodology of economics. He was the father of the famous economist John Maynard Keynes. In his seminal book, *The Scope and Method of Political Economy* (1891), he distinguished between positive economics (descriptive and objective) and normative economics (prescriptive and value-based), as well as a third category, the "art of economics," which involves applying economic principles to policy. This distinction remains foundational in economic methodology.

Max Weber (1864 – 1920), a prominent German sociologist and economist, made significant contributions to economic methodology and philosophy. His views on positive and normative economics reflect a nuanced understanding of the distinction between descriptive, objective analysis and value-laden, prescriptive judgment. Weber's principle of "Wertfreiheit" (value neutrality) was central to his methodology. He maintained that social scientists should strive to maintain objectivity and avoid injecting their personal values into their research. This does not imply that social sciences, including economics, are free of normative aspects, but rather that the normative dimensions should be explicitly addressed and distinct from factual analysis. In summary, Max Weber advocated for a clear distinction between positive and normative economics, emphasizing the need for objective, value-free analysis while recognizing the role and necessity of normative considerations in economic policy discussions.

The Second Struggle over Method in Economics: Max Weber´s opinion on positive and normative economics differed from the opinion of his contemporaries from the German Historical School. On the beginning of the 20ies century, the differences were broadly discussed and the discussions are known as the Second Struggle over Method in Economics.

The German Historical School, a major economic thought tradition in the 19th and early 20th centuries, emphasized the importance of historical context, empirical analysis, and an interdisciplinary approach in understanding economic phenomena. It advocated studying the economy as an evolving entity shaped by historical, social, and cultural factors, rather than through timeless, universal laws. The school prioritized empirical and descriptive research, relying on data and historical case studies to inform economic understanding, and often integrated insights from sociology, law, and political science. Key figures in the Old German Historical School, like Wilhelm Roscher and Bruno Hildebrand, focused on descriptive economic history and were skeptical of universal economic laws, while leaders of the Young German Historical School, such as Gustav von Schmoller and Lujo Brentano, were more interventionist and reform-oriented, advocating for social and economic reforms. The German Historical School significantly contributed to developing economic history as a discipline and laid the foundation for later movements, including institutional economics and economic sociology, challenging the abstract theorizing common in classical economics.

Gunnar Myrdal (1898-1987) was a Swedish economist and sociologist renowned for his contributions to normative economics, which involves value judgments and policy recommendations based on ethical considerations. Myrdal's work often intersected economics with social issues, reflecting his commitment to addressing inequality and promoting social justice. He got the Nobel Prize in Economics in 1974 (together with Friedrich von Hayek) for "their pioneering work in the theory of money and economic fluctuations and for their penetrating analysis of the interdependence of economic, social and institutional phenomena."

- Key Contributions:
  - *An American Dilemma: The Negro Problem and Modern Democracy* (1944): Myrdal’s influential study on race relations in the United States, highlighted the profound economic and social disparities faced by African Americans and advocated for significant policy reforms to address these injustices.
  - Development Economics: His work in development economics emphasized the role of values and social factors in economic development, stressing the

importance of addressing inequality and poverty through comprehensive social policies.

- Social Democracy: Myrdal was a strong advocate for social democracy, arguing for government intervention and welfare policies to ensure equitable distribution of resources and opportunities.

The Nobel Prize in Economics: The correct name of the Nobel Prize in Economics is the "Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel." This prize was established in 1968 by the central bank of Sweden, Sveriges Riksbank, to commemorate its 300th anniversary. Although it is commonly referred to as the Nobel Prize in Economics, it is not one of the original prizes endowed by Alfred Nobel in his will, but it is administered alongside them by the Nobel Foundation.

Amartya Sen (1933 -), an Indian economist and philosopher, is renowned for his contributions to normative economics, focusing on welfare economics, social choice theory, and economic and social justice. By integrating ethical considerations into economic analysis, Sen's work has guided the formulation of the Human Development Index (HDI) and influenced global development policies, promoting a focus on human freedoms and capabilities. His approach to economics, emphasizing human welfare, justice, and ethical dimensions, has profoundly impacted both academic thought and practical policy-making in economic development and welfare. In 1998, he got the Nobel Prize in Economics for "his work in welfare economics".

Utilitarianism, Rawls, and Justice

Utilitarianism was presented in its extreme form by **Jeremy Bentham (1748-1832),** a British philosopher and social reformer.

Bentham defines utility as the net balance between the intensity and duration of pleasure and the intensity and duration of pain. He believes utility maximization has a natural biological basis, meaning it is an inherent aspect of human psychology (psychological hedonism). He was especially a social reformer; his ideas are foundational for political philosophy. According to Bentham, a just government's role is to maximize utility for the greatest number of people, aiming to ground politics in scientific principles. His reasoning is consequentialist, focusing on outcomes rather than intentions when evaluating actions.

Bentham believes utility is quantifiable, a belief now referred to as cardinal utility. He introduces a unit for measuring utility, called a "util." The number of utils depends on factors such as intensity, duration, probability, and the remoteness of pleasure and pain. Bentham posits that interpersonal comparisons of utility are possible because all humans share the same psychology. However, developments in economics have since led to the abandonment of cardinal utility in favor of ordinal utility and a general rejection of interpersonal utility comparisons, as exemplified by economists from the Austrian school.

To address the question of what are just actions of government, we can illustrate Bentham's perspective in Figure 1.1, where we compare Bentham's and Rawls's approaches.

The curve c-d represents the utility possibility frontier. Starting from a point on the line a-b, such as point y, the utility for both individuals can be increased by redistributing primary goods in a way that moves us to a point northeast of y. These points can be reached through voluntary exchanges. More generally, we can increase total utility by redistributing primary goods to reach points above the a-b line, where the 45-degree slope indicates that the utilities of individuals A and B are comparable. The points in the areas a-y-l-c or g-b-d-n cannot be achieved through voluntary exchanges; to get there requires government redistribution. From Bentham´s point of view, even the redistribution to a-y-l-c or g-b-d-n is just, because the total utility increases.

John Rawls (1921–2002), a renowned American political philosopher, published *A theory of justice* in 1971. He introduced there the concept of "justice as fairness," offering principles of justice aimed at ensuring a fair and equitable society.

Rather than focusing on utility, Rawls analyzed the just distribution of resources such as liberties, opportunities, income, and wealth. This aligns him with *resourcists*, a philosophical approach to distributive justice that prioritizes fair access to resources while respecting individual freedom of choice, without guaranteeing equal outcomes.

Rawls utilized a hypothetical social contract in which rational individuals would agree on principles of justice under a *veil of ignorance*. Behind this veil, individuals do not know the attributes of their society or their personal characteristics, creating equality among the bargaining parties. This procedural approach aligns with Kant's universalizability principle. Rawls argued that justice can only be justified through a hypothetical contract, as actual contracts often face challenges related to fairness and moral force.

Rawls's Principles of Justice:

1. Equal fundamental rights and liberties
2. Fair equality of opportunity
3. Difference principle: Income and wealth disparities are acceptable only if they benefit the least well-off (maximin principle).

These principles are *lexicographically ordered*: the first principle must be fulfilled before the second, and the second must precede the third.

Rawls proposed these principles:

- As being suitable for societies with moderate scarcity,
- As being superior to alternative principles, such as utilitarianism, under the veil of ignorance.

His principles do not logically follow from the hypothetical contract, which serves just as an expository tool.

His approach contrasts with that of Bentham, as illustrated in Figure 1.1.

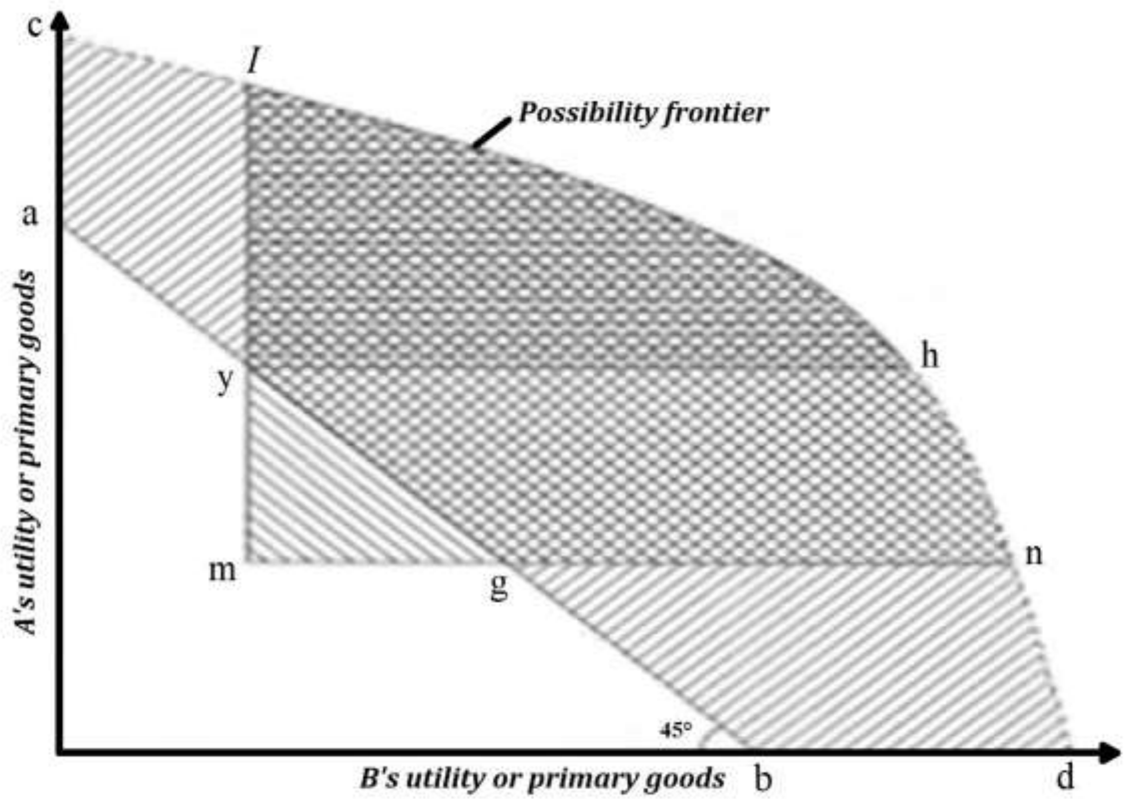

Figure 1.1: Rawls and Bentham

Starting from point y, Rawls considers redistribution to the hatched triangle y-m-g just, as it increases the utility of the least advantaged. This diagram is just an expository device for the comparison, Rawls focuses on redistributing resources rather than utility.

Self – Interest and Public Benefit

Adam Smith (1723 – 1790), considered the grounder of modern economics, wrote two basic works:

- *The Theory of Moral Sentiments* (1759)
- *The Wealth of Nations* (1776)

The Theory of Moral Sentiments examines the foundations of human morality and ethical behavior. Smith posits that moral judgments are rooted in innate human sympathy - the capacity to understand and share the feelings of others. He argues that our sense of right and wrong is influenced by the *impartial spectator,* an imagined viewpoint that enables objective evaluation of our own and others' actions.

In *The Wealth of Nations,* Adam Smith emphasizes the importance of self-interest as a driving force for economic activity and societal prosperity. He argues that when individuals pursue their own self-interest, they inadvertently contribute to the overall economic well-being of society through a mechanism he famously describes as the "invisible hand." This principle suggests that individuals seeking to maximize their own gains - such as producers aiming for higher profits or consumers striving for the best value - lead to competitive markets, efficient resource allocation, innovation, and wealth creation. According to Smith, this self-regulating nature of the free-market economy - if accompanied with reasonable institutions - ensures that the pursuit of personal gain translates into collective benefits, fostering economic growth and development.

Before Adam Smith, Bernard de Mandeville (1670 – 1733) wrote *The Fable of the Bees: or, Private Vices, Public Benefits.* It is a satirical poem first published in 1705 and later expanded into a book in 1714. In this work, Mandeville provocatively argues that private vices, such as greed and selfishness, can result in public benefits. Through the allegory of a beehive, he illustrates that the pursuit of self-interest and indulgence in vices drive economic prosperity and social improvement. The bees in his fable engage in various unethical behaviors, yet these actions collectively lead to a thriving, prosperous society. Mandeville challenges the conventional moral views of his time, suggesting that selfish behavior may, but would not necessarily lead to collective good, thereby sparking significant debate about the role of morality in economic behavior. Nevertheless, those in power must channel different passions in the right direction.