



HISTORY OF ECONOMICS

Thought, Theory, and the Market.

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**"The only way to do great work is to love what you do."
– Steve Jobs**

Economics

- Economics is the study of various **economic processes** such as the **production, distribution, and consumption of resources**.
- The term Economics is derived from the **Greek word 'Oikonomia'**. The meaning of this word is '**household management**'.
- The word '**Oikonomia**' is derived from the Greek words **Oikos and Nomos**.
- Economics is the study of how limited resources can be used to satisfy the needs of the population.

Production

- The process of manufacturing **goods and services** to satisfy **human needs**
- Humans fulfill their needs through the **consumption of goods and services** (Consumption)
- The remuneration obtained by participating in the production process is what is spent for consumption. Therefore, production, distribution, and the consumption of products and services are interconnected.

Economy

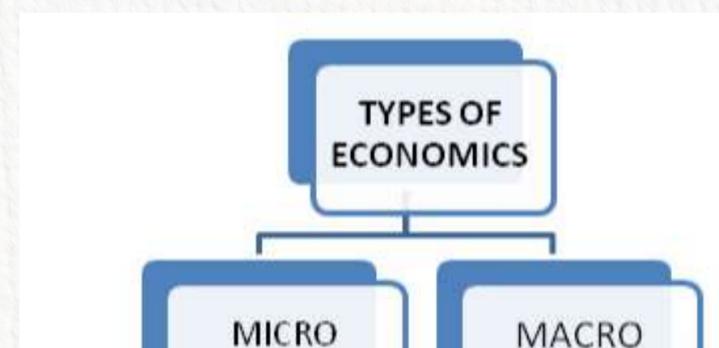
- The production and consumption of goods and services, and the distribution of **money in a region** is generally called the **economy**.
- **Adam Smith** defined **Economics** as the **study of wealth**.
- However, **the study of wealth** is known as **Oikonomology or Plutology**.
- Adam Smith laid the **foundation** for **Economic Science**.
- Adam Smith is known as the **father of Economics**.



- "An Enquiry into the Nature and Causes of Wealth of Nations" - "An Enquiry into the Nature and Causes of the Wealth of Nations" was written by Adam Smith in 1776.

Various Fields of Economics

Micro Economics



- **Micro Economics** is also known as **Price Theory**.
- Micro Economics deals with **individual units in the economy**.
- **Example:** A person's income/expenses/job
- Micro Economics studies individuals' **demand and supply**.

- Those considered practitioners of Micro Economics - Alfred Marshall, Arthur C. Pigou, David Ricardo
- **Father of Micro Economics** - **Alfred Marshall**
- It is also known as **worms eye view**

Main Areas:

- **Supply and Demand:** How the price and quantity of goods and services in the market are determined.
- **Consumer Behavior:** How individuals decide what to buy based on preferences, income, price, etc.
- **Production and Cost:** How companies decide the quantity and price of their goods and services production.
- **Market Structures:** Different types of market structures exist such as perfect competition, monopoly, monopolistic competition, oligopoly.
- **Factor Markets:** The study of how production factors (labor, land, capital) are priced and used.

Macro Economics

- It is also known as **General Theory** or the **Theory of Income and Employment, Aggregate Economic Science**.
- It **deals** with the **economy** as a whole.
- The classical approach was that as long as there are workers willing to work and factories willing to operate at full capacity, full employment will always exist.
- Following the Great Depression (1929 Great Economic Depression), large-scale job cuts occurred in **North America** and **Europe**, so the 1929 Great Depression invalidated this theory.
- The Great Economic Depression influenced other countries in the world as well. Following this, in 1936, **JM Keynes** put forward **Macro Economics** through the book "The General Theory of Employment, Interest, and Money" (1936).
- It is also known as **birds eye view**

Main Areas:

- **Production Sector**
- **Domestic Sector**
- **Government**
- **Foreign Sector**
- **National Income Determination:** The total income and production level in an economy.
- **Inflation and Deflation:** The general increase or decrease in the price level of goods and services.
- **Unemployment:** The study of unemployment in the economy, its types, causes, etc.
- **Monetary Policy, Fiscal Policy:** Government policies that control the money supply, taxes, government expenditures to influence economic conditions.
- **International Trade:** How countries trade goods and services, including payment balance and exchange rates.
- **Economic Growth:** Factors and policies that influence the long-term growth of the economy.

Export & Import

- Export means a nation sells products produced in its domestic economy to other nations.
- Products necessary for the economy are purchased from other nations. This is called import.

Economic Agents

- Individuals or institutions that primarily make economic decisions are known as **economic units/economic agents**.
- They can be producers or consumers.
- Institutions such as government, corporations, banks that make various economic decisions like how much money to spend, what interest rate to charge on loans, how much tax to collect, etc., are also included.

Economic Science Thinkers

Adam Smith

- **Father of Economics:** He is considered the father of **modern economics**.
- **Division of Labor:** Emphasizes the importance of division of labor in improving productivity.
- **Laissez-Faire Economics:** The theory that advocates limiting government intervention in economic activities and giving more importance to individual freedom.
- The central principle of the free market economy from Smith's Wealth of Nations - "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages."

- "An Enquiry into the Nature and Causes of the Wealth of Nations" was written in 1776.
- The Theory of Moral Sentiments (1759), The Invisible Hand (1759)

Alfred Marshall

- Wrote the book "**Principles of Economics**" (1890).
- He is the father of the **Law of Demand**.
- Analysis of **supply and demand**.
- **Demand Price Elasticity**: Alfred Marshall introduced the concept of elasticity. It measures how demand changes according to changes in price.
- He is known as the **father of modern microeconomics** or **micro economic science**.

JM Keynes

- **Father of Macro Economics**: He developed the foundation of macroeconomics.
- Formulated Keynesian Economics.
- **Aggregate Demand**: Demonstrated the role of aggregate demand in determining overall economic activity.
- **Fiscal Policy**: Emphasized the use of government expenditures and taxes to stabilize the economy.
- JM Keynes's book that predicted the failure of the post-war peace treaty - **Economic Consequences (1919)**
- JM Keynes is an economist who argued for the theory of government intervention in the economic sector. He opined that economic problems can be resolved to some extent through government intervention.
- "The General Theory of Employment, Interest, and Money" (1936) was written by Keynes.

Karl Marx

- **Criticism of Capitalism:** Provided a comprehensive criticism of capitalism and advocated for class struggles necessary for it.
- According to Marx, the basis of production is the labor of workers.
- He is known as the **father of the socialist economy**.
- He propagated the **idea of a society** without difference between the haves and have-nots.
- **Surplus Value Theory:** Introduced the concept of surplus value and discussed the difference between labor value and wages.
- Karl Marx characterized the situation where only a portion of the product value is given to workers and the major remaining portion is turned into profit by the capitalist as surplus value.
- **Class Struggle:** Emphasized the conflict between the bourgeoisie (capitalists) and the working class (workers).
- **Revolutionary Ideas:** Fought for the working class to overthrow the capitalist system and establish a classless society.
- Wrote the book "Das Kapital" (1867).

Thomas Gresham

- Another economist who introduced the idea "**Bad money drives good money out**" is Thomas Gresham.

Ragnar Frisch

- Ragnar Frisch was the first to use the terms Micro Economics and Macro Economics.
- He is a **Norwegian economist**.
- In January 1969, he shared the Nobel Prize in Economics with Jan Tinbergen.

David Ricardo

- British economist David Ricardo brought the theory that trade between two countries can increase welfare in both countries.
- He is known as the father of the **Comparative Advantage Theory**.

- The Comparative Advantage Theory is an economic principle. It explains how countries (or firms) benefit from trade.
- It explains that even if one resource is scarce, compared to another, it is possible to efficiently produce all goods.
- His 'Theory of Rent' regarding land rent is very famous.

Lionel Robbins

- Lionel Robbins spoke about the relationship between unlimited needs and limited resources.
- Lionel Robbins clarified that "We need to prioritize our needs to use limited resources effectively."

Paul A. Samuelson

- American economist Paul A. Samuelson opined that a country's economic welfare is the result of better economic planning and proper resource utilization.

J. A. Schumpeter

- The idea invented by J. A. Schumpeter, a Czech Republic descendant, is 'Creative Destruction'. Industries and technologies create new opportunities and growth through innovation (Innovation).



Fig. 4.8 •
Adam Smith



Fig. 4.9 •
Alfred Marshall

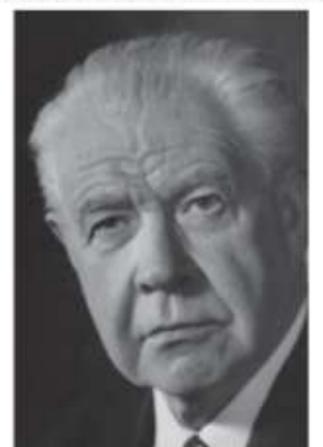


Fig. 4.10 •
Lionel Robbins

Definitions

- Adam Smith - Study of wealth
- Karl Marx - Importance to workers
- Alfred Marshall - Wealth is ultimately for human welfare
- Lionel Robbins - Unlimited needs and limited resources
- Paul A Samuelson - Economic welfare is the result of better economic planning and proper resource utilization
- Definition of Growth - P A Samuelson
- Definition of Scarcity - Lionel Robbins



Fig. 4.11 • David Ricardo

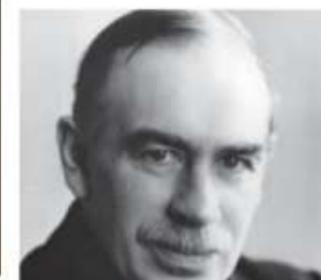


Fig. 4.13 • J.M. Keynes

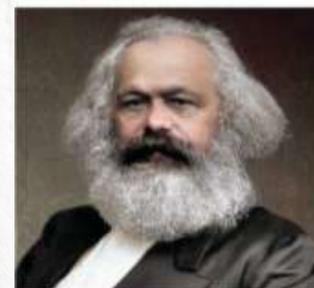


Fig. 4.12 • Karl Marx



Fig. 4.14 • I A Schumeter

IMPORTANT SOURCES USED

- Class XI → Economics (Statistics for Economics)
- Class XI → Introductory Microeconomics

PREVIOUS YEAR QUESTIONS FROM THIS TOPIC

1. Who is regarded as the father of modern economics? (UPSC CSE Prelims 2013)

- (a) Adam Smith
- (b) David Ricardo
- (c) James Mill
- (d) None of the above

Correct ans: (a) Adam Smith

2. "An Enquiry into the Nature and Cause of the Wealth of Nations" book is written by? (UPSC CSE Prelims 2015)

- (a) Adam Smith
- (b) John Maynard Keynes
- (c) Sir Richard Simon
- (d) Karl Marx

Correct ans: (a) Adam Smith

3. Which one of the following sets of economists strongly favoured a market economy? (UPSC CSE Prelims 1996)

- (a) Adam Smith, Keynes, Hicks
 - (b) Adam Smith, Marx, Strumlin
 - (c) Adam Smith, Mill, Keynes
 - (d) Adam Smith, Ricardo, Marx
- Correct ans: (c) Adam Smith, Mill, Keynes

4. In the context of Keynesian Economics, what does the term 'multiplier' refer to? (UPSC CSE Prelims 2018)

- (a) The ratio of the increment in income to the increment in investment
- (b) The ratio of the increment in savings to the increment in investment
- (c) The ratio of the increment in consumption to the increment in income
- (d) The ratio of the increment in income to the increment in consumption

Correct ans: (a) The ratio of the increment in income to the increment in investment

PRACTICE QUESTIONS

1. Examine the statements and select the correct one.

- a. The Greek word 'Oikonomia' means 'household management' and is the fundamental study subject of economics.
- b. The failure of the classical approach's concept of 'full employment' (due to the 1929 depression) was a major backdrop for the macroeconomic theory presented by J.M. Keynes in 1936.

- A) Statements a and b are correct.
- B) Statement a is correct, and b is incorrect.
- C) Statement b is correct, and a is incorrect.
- D) Statements a and b are incorrect.

Answer: A

Explanation: According to the provided context, (a) the meaning of Oikonomia is household management, and (b) Keynes's theory came after the failure of the classical approach.

2. Facts related to Alfred Marshall (Microeconomics):

- i. His main work is 'Principles of Economics' (1890).
- ii. He is considered the 'Father of the Law of Demand'.
- iii. He described microeconomics through the 'Worms Eye View'.
- iv. The concept of Price Elasticity of Demand was introduced by J.M. Keynes.

Options:

- A) i and ii are correct.
- B) i, ii, and iii are correct.
- C) i, ii, iii, and iv are correct.
- D) ii and iv are correct.

Answer: B) i, ii, and iii are correct.

Explanation: (iv) is incorrect; the Price Elasticity of Demand was introduced by Alfred Marshall. (i, ii, iii) are correct.

3. Which is the correct pairing between economic thinkers and their main ideas?

- i. Karl Marx - Laissez-faire principle
- ii. J. M. Keynes - Aggregate Demand
- iii. Thomas Graham - Theory of Comparative Advantage
- iv. Adam Smith - Labor of workers is the basis of production

Options:

- A) i and ii are correct.
- B) ii and iv are correct.
- C) i, iii, and iv are correct.
- D) ii only

Answer: D) ii only

Explanation: (i) Incorrect (Smith); (iii) Incorrect (David Ricardo); (iv) Incorrect (Marx). (ii) is correct; Keynes emphasized aggregate demand.

4. Examine the Assertion (A) and Reason (R):

Assertion (A): Adam Smith, the author of 'An Enquiry into the Nature

1. and Causes of Wealth of Nations', argued that government intervention in economics should be limited.

2. Reason (R): According to Smith, private self-interests in the market lead to the common good of society through the 'Invisible Hand', thus government regulations are unnecessary.

Codes:

- A) Both (A) and (R) are true, and (R) is the correct explanation for (A).
- B) Both (A) and (R) are true, but (R) is not the correct explanation for (A).
- C) (A) is true, but (R) is false.
- D) (A) is false, but (R) is true.

Answer: A

Explanation: Both A and R correctly state Smith's views. R accurately explains the 'Laissez-faire' approach mentioned in A.

5. Which of the following statements are correct regarding 'Creative Destruction'?

- i. It describes the process where new technologies and inventions replace existing industries.
- ii. This concept was put forward by Karl Marx.
- iii. Economic growth and new opportunities are created through this process.

Options:

- A) i, ii, and iii are correct.
- B) i and iii only are correct.
- C) ii and iii only are correct.
- D) i only is correct.

Answer: B) i and iii only are correct.

Explanation: (ii) is incorrect; this concept belongs to J. A. Schumpeter. (i) and (iii) are characteristics of Schumpeter's theory. (Tough)

6. Which economist is famous for the idea that 'Bad money drives out good money'?

- A) David Ricardo
- B) Thomas Gresham
- C) Lionel Robbins
- D) Paul A. Samuelson

Answer: B) Thomas Gresham

Explanation: This is known as Gresham's Law, introduced by Thomas Gresham.

7. Which of the following is NOT included among the main areas of Microeconomics?

- A) Consumer Behavior
- B) National Income Determination
- C) Supply and Demand
- D) Market Structures

Answer: B) National Income Determination

Explanation: National Income determination and inflation are main areas of Macroeconomics. The others are Microeconomic areas.

8. Among the definitions of economics, who argued that 'proper planning and efficient resource allocation are essential for economic well-being'?

- A) Karl Marx
- B) Lionel Robbins
- C) Paul A. Samuelson
- D) Alfred Marshall

Answer: C) Paul A. Samuelson

Explanation: This concept was put forward in Paul Samuelson's definition.

9. Which of the following statements is correct regarding Ragnar Frisch?

- A) He is known as the Father of Macroeconomics.
- B) He first used the terms 'Microeconomics' and 'Macroeconomics'.
- C) He developed the Theory of Comparative Advantage.
- D) He wrote 'Das Kapital' criticizing capitalism.

Answer: B) He first used the terms 'Microeconomics' and 'Macroeconomics'.

Explanation: Ragnar Frisch first introduced these two terms.

10. Examine the statements and select the correct one.

a. The reward received by participating in the production process is what is spent on consumption.

b. The term 'Oikonomia' is divided into 'Oikos' (house/household) and 'Nomos' (rule/management).

Options:

- A) Statements a and b are correct.
- B) Statement a is correct, and b is incorrect.
- C) Statement b is correct, and a is incorrect.
- D) Statements a and b are incorrect.

Answer: A) Statements a and b are correct.

Explanation: Both statements align with the information provided regarding production/consumption and the origin of the Greek words.