Legacies of Great Economists

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Professor Taylor has taught introductory economics in a number of contexts. At Stanford University and the University of Minnesota, he has taught large lecture courses of 300-500 students. At Stanford, he was winner of the award for excellent teaching in a large class (more than 30 students) given by the Associated Students of Stanford University. At Minnesota, he was named a Distinguished Lecturer by the Department of Economics. He has also been a guest speaker for groups of teachers of high school economics, visiting diplomats from eastern Europe, talk radio shows, and community groups. He has recorded several courses for The Teaching Company, including “Economics: An Introduction,” “Legacies of Great Economists,” and “A History of the U.S. Economy in the 20th Century.”

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Legacies of Great Economists

Scope:

This series of ten lectures discusses the "Legacies of Great Economists." Its purpose is to acquaint you with the thoughts, theories, and lives of great economists, ranging from the predecessors of Adam Smith in the eighteenth century to twentieth century giants like John Maynard Keynes and Milton Friedman.

Evaluating thinkers of the past is an inherently difficult business. Their use of terms and concepts is often unfamiliar. Their sense of important issues may seem peculiar, because issues have changed between their time and our own. They may lay great emphasis on ideas that, from a modern perspective, seem obvious or unimportant, or both. They make misjudgments and mistakes that provide grist for later writers. Great economists of the past always labor from the severe disadvantage that, unlike us, they did not have the legacy of their own writings from which to learn and upon which to build.

But we can learn lessons from these great thinkers, both when their insights have held up over time, and when their theories have turned out to need revision. Opening a window into the mind of genius offers a fresh breeze of new ideas and perspectives. In listening to these lectures, you will learn how economic thought has evolved over time. This should help you to perceive the roots of the current level of economic understanding. You will also perceive that some current disputes over economic policy have been continual sources of argument over the last several centuries.

The first lecture focuses on the backgrounds, key figures, and impacts of the Mercantilists and the Physiocrats. In this period prior to 1750, the beginning concepts of economics are discussed which set the stage for Adam Smith, who is the focus of the next lecture.

In Lecture Two, we discuss Smith and the birth of economics. By examining his building blocks for The Wealth of Nations we begin to understand such concepts as the division of labor, trade, and the “invisible hand,” and their tremendous impact on society.

Lecture Three introduces what we know as the “dismal science” and the work of Thomas Robert Malthus and David Ricardo. We examine in-depth Malthus and his population principle. Although these two men often disagreed on major economic issues, they were close friends.

Lecture Four deals with John Stuart Mill and Utilitarianism. We study the tenets and foundations of the classical school of economics, the rise of homo economicus, and Mill’s impact on our society today.

In Lecture Five we look at Karl Marx and the advent of socialism. This includes a look at the impulse of socialist thought and the capitalist law of motion. We also look at Marxist economics in retrospect to determine how his predictions played out in the real world.

Lecture Six examines Alfred Marshall and marginalist thought. We begin by looking at the marginalist revolution and how it developed both a theory of value and of productivity. Next we study Marshall’s principles of economics and their influence on neoclassical economics and social justice.

Lecture Seven examines the debate between the scientific socialists and the Austrian school of economics. We look at the development of both schools of thought and how they responded to each other.

In Lecture Eight, we are introduced to Joseph Schumpeter and the concept of entrepreneurialism. Schumpeter looked at the relationship between the entrepreneur and the business cycle and commented on the viability of socialism and capitalism.

Lecture Nine focuses on John Maynard Keynes and the Keynesian Revolution. We look at his stepping stones and theses of his book The General Theory. We then look at how Keynes altered economic thinking and the still surviving offspring of Keynesian thought.

In the tenth and final lecture, we study Milton Friedman and the rebirth of classical economics. This includes at look at Friedman’s work on the permanent income hypothesis and on far-sighted expectations as well as his study on both monetary matters and history. Finally we look at how he brought market-oriented thinking into public discourse through a variety of measures.
Lecture One
Before Economics: Mercantilists and Physiocrats

Scope: This opening lecture begins by outlining the worthwhile reasons for studying past economists. We look at the origins of economics from the Middle Ages up to the seventeenth century. This includes a description of Mercantilist thought as well as a closer look at four Mercantilist thinkers. The lecture ends with a look at the tenets and impacts of the Physiocrats.

Outline

I. Why should we study past economic thinkers?
   A. This study helps us to explain and teach the idea of economics.
   B. The thoughts of brilliant people always contain worthwhile insights.
   C. We understand our own thought patterns better by studying the development of thought.

II. Economics as a subject of thought first emerged during the Middle Ages.
   A. National political units emerged, united by a shared national identity.
   B. The modern idea of individuality also began to emerge.
      1. Prior to this period, people were tied to certain social and occupational roles.
      2. It very gradually became possible for individuals to change the social status and role into which they were born.
   C. Commerce also expanded.
      1. Populations grew and people and groups began to specialize.
      2. Geography determined trade patterns.
   D. People became more accepting of material acquisition.
      1. Previously, avarice was feared as one of the deadly sins.
      2. The goal of human behavior was to fill a niche and win eternal salvation.
      3. Now, people began to pursue material enrichment.
   E. Systematic thought and invention became more prevalent.
      1. Scientists looked for natural patterns in physical reality.
      2. Maps, the printing press, the windmill, bookkeeping, and contracts were invented.
      3. People became more confident in their ability to unravel the world’s mysteries.

III. Mercantilism was the main school of economic thought at the time.
   A. Mercantilism spanned various viewpoints and thoughts over a period of 200 years.
   B. Mercantilist tenets and thoughts included an emphasis on developing national power, building exports, and accumulating bullion.
      1. Economic policy emphasized the goal of national power.
      2. National power depended on the accumulation of bullion.
      3. Mercantilists encouraged exports and discouraged imports in order to build the nation’s supply of precious metal. They enlisted the government to support this effort.
      4. Mercantilists favored a large population of low-wage workers to build exports, which brought in more gold.
      5. Gold collection stimulated the economy because it expanded the supply of money and credit.
   C. Certain mercantilist concerns mirror those of today’s society.
      1. Mercantilists favored having a large trade surplus, subsidizing big business, and keeping wages low.
      2. Their ideas are still alive today.

IV. We now examine four mercantilist figures from various backgrounds.
   A. Josiah Child was a seventeenth-century mercantilist.
      1. Essentially a defense contractor, Child wrote *Circumstances on the Discourse on Trade*, which he published anonymously.
2. His argument, while not iron-clad, suggested that Britain should lower interest rates since Holland had done so.
3. His self-interested recommendations did not have much economic foundation.

B. Jean-Baptiste Colbert was the French minister of finance from 1661 until 1683.
   1. Mercantilist considerations led Colbert to advocate war as an instrument of economic policy.
   2. He regulated the minute details of industry.
   3. He wanted to increase work, exports, and child labor.
   4. This extreme government control still lives in France today.

C. Bernard Mandeville, a social satirist, wrote *The Fable of the Bees*.
   1. This satire preached the themes of hard work and the beneficial social consequences of private self-interested behavior.
   2. It linked avaricious behavior to increased trade.

D. David Hume questioned mercantilist assumptions in his essays.
   1. He denied that money and gold were equivalent to wealth. Instead, they had merely instrumental value.
   2. He thought that accumulating precious metals would result in higher prices.
   3. Hume believed that imports as well as exports were beneficial.
   4. He suggested that trade was not equivalent to warfare, since both parties to the transaction benefit.

V. Physiocracy, the first systematic school of economics, represented a reaction to mercantilism.
   A. The Physiocrats arose in reaction to Colbert and were led by Francois Quesnay.
   B. The *Tableau Economique* highlighted key tenets of Physiocratic thought.
      1. The Physiocrats held a *laissez-faire* attitude, which contradicted the absolute government control of the economy advocated by the mercantilists.
      2. The *Tableau Economique* was an economic model that portrayed society as divided into three classes.
   D. The Physiocrats had an important social impact.
      1. The French finance minister, a Physiocrat, reduced government controls on the economy, but he was soon fired.
      2. From the modern perspective, the Physiocrats had certain things confused.
      3. Their division of society into classes represented useful structural analysis.
      4. Adam Smith recognized the importance of the *Tableau Economique*.

Essential Reading:
Heilbroner, Robert L., *The Worldly Philosophers*, New York: Simon & Schuster, 1986. Chapter 1, "Introduction," and Chapter 2, "The Economic Revolution." As noted in the introductory material, the essential readings for this lecture course draw heavily upon this book. The first chapter offers a spirited argument for why it is worth studying the great economists; the second chapter offers a broad-ranging discussion of why economics as we understand it did not exist in the Middle Ages, and discusses some of the early attempts to grapple with economic issues.

Supplemental Reading:

Mandeville, Bernard, The Fable of the Bees. Harmondsworth, Penguin Books, Ltd., 1970. Edited and with an introduction by Philip Harth. The Fable has been published in a number of editions over the last few centuries, so there is no particular need to get this specific edition. It originally consisted of a poem, telling the story, which is then followed by pages of commentary, which were extended and amended over time to draw out the economic morals. My recommendation is to read the fable, which is only about ten pages, and then skip through some of the commentary to get a feel for the rest of his argument.

Rotwein, Eugene, David Hume: Writings on Economics. Edinburgh: Thomas Nelson and Sons, Ltd., 1955. This is a full collection of Hume's economic writings, including essays and correspondence, which is probably more than the novice reader really wants. I'd recommend starting with "Of Commerce" (pp. 3-18) and "Of Money" (pp. 33-46), and then if you want more, the surrounding essays.

Questions to Consider:
1. Review the main themes of the mercantilist thinkers. Focus first of all on identifying themes. Then, consider whether the issues they raise come up today, either as proposals to be supported or to be opposed. Of course, modern discussions may often use somewhat different terms in discussing these issues.
2. Explain what so impressed thinkers of the time about the Tableau Economique.
Lecture Two
Adam Smith and the Birth of Economics

Scope: This second lecture opens with a review of Adam Smith’s educational and employment background. We then discuss his book *The Wealth of Nations* and its examination of the building blocks of a nation’s economy. We also look at Smith’s shortcomings (although they were few), and we examine his views on various economic issues that are still relevant today. Finally, we recap his extraordinary qualities and his tremendous impact on economic thought.

Outline

I. Adam Smith is considered the father of economics.
   A. Smith’s biographical background
      1. Smith harbored strong feelings about education from his time at Oxford University.
      2. He quit his job as a professor to become a private tutor.
      3. Although an advocate of free trade, he served as the Commissioner of Customs.
   B. Smith was a professor of moral philosophy in the department of logic. His first book was *The Theory on Moral Sentiments*.

II. Smith published *The Wealth of Nations* in 1776. In it he described the building blocks of national economic wealth.
   A. The starting point of the wealth of nations is the division of labor, which allows people to specialize.
      1. In his example of the pin factory, each worker performs a separate operation.
      2. Productivity rises due to improvements in dexterity, use of time, and application of machinery.
      3. The division of labor leads to an interconnected economy.
   B. The propensity to trade is his second building block.
   C. Trade leads people to act in their own self-interest.
      1. Smith perceived that in the real world, most people are motivated by self-interest.
      2. The notion of benevolence is admirable, but in most cases people expect to be paid for their goods or services.
   D. Smith thought the “invisible hand” would guide people who act in their own self-interest to produce benefits for each other and for society.
   E. Smith attacked the mercantilists.
      1. He emphasized that bullion is not equivalent to wealth.
      2. He argued that trade benefits all parties involved; it is not zero-sum.

III. Despite his tremendous success, Smith fell short on certain points.
   A. Economists questioned where value came from and how prices were determined.
      1. Smith separated value in use from value in exchange.
      2. He believed that labor was the source of value.
   B. Smith searched for the natural price of goods and services.
   C. He discussed the development of an economy including landlords, workers, and capitalists.
      1. Capitalist accumulation conflicted with rising birthrates.
      2. Smith held to a logical long-run pessimism, but he was optimistic about the medium-term situation.

IV. Smith is rewarding to read because he avoids formulas, is blunt, and is not an ideologue.
   A. Smith discusses the many appropriate roles of government.
      1. He is not a compete believer in *laissez-faire* economics.
      2. He believes that government should implement certain public works projects, public education, and certain trade regulations.
   B. Smith’s skepticism is utterly consistent, and he does not duck the hard questions.
1. He understood that the division of labor could also injure workers.
2. Smith described the ignorance of landlords.
3. He distrusted businessmen since they often exploited others and created monopolies.
4. Smith also distrusted government.

V. In summary, Smith’s ideas and writing still have influence today.

A. Smith had certain extraordinary qualities.
   1. His honesty was admirable.
   2. He was extremely accurate in his observations.
   3. Like the quintessential academic, he was quite absent-minded.
   4. He was gentle, kind, and had a sense of humanity.

B. His ideas in *The Wealth of Nations* are still discussed today.

Essential Reading:

Heilbroner, Robert L., "The Wonderful World of Adam Smith," which appears as chapter 3 of his book *The Worldly Philosophers*, (New York: Simon & Schuster, 1986). This chapter gives a brief account of Smith's life. It frames the genesis of his thought in its time and place, including a brief mention of how he was influenced by the Physiocrat school described in Lecture 1. It also provides a useful outline of the main building blocks of Smith's economic theories, and how Smith built upon those theories to construct a view of where the world was headed.

Supplemental Reading:

Smith, Adam, *The Wealth of Nations*. University of Chicago Press, Chicago, 1976. Originally published 1776. Adam Smith's writing is vivid and accessible. A voice speaks to you off the printed page. But as noted in the lecture, this book is extremely long, and some parts of it are wrapped up in historical or theoretical digressions that will be boring and inaccessible to novice readers. So let me suggest a few chapters that will give a good flavor of his style. Book I, Chapters 1-3. These three opening chapters concern the division of labor. Book I, Ch. 9, Conclusion of the Chapter. These last few pages lay out Smith's notion of the underlying conflicts between landlords, laborers, and employers, and offers some appropriately cynical comments on the motivations of all three. Book III, Chapters 1-4. These chapters are Smith's sketch of the relationship between towns and countrysides, and how trade between them can lead to a developing and flourishing economy. Book IV, Chapter 1. Smith's criticism of the mercantilists. Book IV, Chapter 2. Smith discusses the issue of restraining those imports from other countries that could conceivably be produced at home. Book V, Ch. 1, Part III, Art. II. This section discusses Smith's views on the education of youth. Book V, Chapter 2, Pt. 2. These few pages offer Smith's famous "maxims of taxation," his principles of what determines a fair and practical set of taxes.


Ross, Ian, *The Life of Adam Smith*. Oxford: Clarendon Press, 1995. This book is the first major biography of Adam Smith in almost a century, so it seems worth mentioning here. It has the advantages and disadvantages of being scholarly and exhaustive, both on Smith's life and his works.

Questions to Consider:

1. Think about the division of labor as it affects your own life. Consider an item of food or clothing or houseware that you purchased at a store, and imagine how the division of labor helped to produce it. Think about your own job, or a job of someone in your family, and what role it plays in producing goods for others.

2. In his early work, *The Moral Sentiments*, Adam Smith wrote about the reasons that people have concern for others. In *The Wealth of Nations*, he writes about how much of human behavior is selfish. Did Smith view these ideas of human behavior as fundamentally contradictory? Do you agree?

3. One sometimes hears remarks like these: “Adam Smith was a supporter of big business and an enemy of workers. He believed in total laissez-faire, and refused to recognize that government could ever do anything right.” Comment.
Lecture Three
The Dismal Science: Thomas Robert Malthus and David Ricardo

Scope: Thomas Robert Malthus, an insider, and David Ricardo, an outsider, became great friends. Both were classical economic thinkers who shared Adam Smith’s legacy. Malthus theorized about overpopulation, which he predicted would lead to famine if not restrained. Ricardo wrote about inflation and developed the concept of comparative advantage as it related to international trade. Despite their disagreements on many issues, Malthus and Ricardo sustained a long and fruitful discussion of economic and intellectual topics.

Outline

I. Thomas Robert Malthus and David Ricardo followed Smith in the line of classical economists.
   A. Malthus (1766-1834) was the consummate insider.
      1. He studied at Cambridge.
      2. He became a minister of the Church of England and a professor of history and political economy.
   B. In contrast, Ricardo (1772 -1823) was an outsider.
      1. He was son of Jewish immigrants from Holland.
      2. His formal schooling ended at age fourteen.
      3. He learned the stockbroker trade from his father.
      4. He was disowned by his family, yet he made a fortune in the stock market.
   C. This insider and outsider became the best of friends.

II. Malthus wrote about and discussed mainly his principles on population.
   A. In his Essay on the Principle of Population, Malthus demolished the cheerful view of utopians.
   B. Malthus began with two postulata (postulates).
      1. The first postulate stated that food is necessary.
      2. The second postulate stated that the affection between the sexes would continue.
      3. Malthus believed that population and the food supply would grow at different rates: the former geometrically and the latter only arithmetically.
      4. Therefore population would outstrip the food supply, and mass starvation would result.
   C. Malthus predicted several different outcomes from this scenario.
      1. This growth in population would lead to misery and famine.
      2. Although vices such as prostitution and birth control would contain this population increase, Malthus did not recommend these options.
      3. Malthus suggested “moral restraint” to inhibit population growth.
      4. Malthus believed that public education, especially for the poor, would also help to solve this problem.
   D. Malthus criticized the poor laws, which resembled current welfare programs.
      1. He felt the poor laws encouraged people to have more children.
      2. He encouraged the abolition of the poor laws, but he believed in workfare and in giving people land.
   E. The “Malthusian” thesis has not stood up well over time.
      1. Population has not outstripped food, and famine has not wiped out the world’s population.
      2. Malthus overlooked changes in social customs, such as the use of birth control.
      3. Malthus did not take into account the interaction of economic growth and the birth rate.

III. Ricardo’s economic career focused on inflation and the distribution of income.
   A. Ricardo believed that increasing the money supply during the bullion controversy caused inflation.
      1. He believed that landlords possessing good lands would make increasing amounts of money.
      2. He wrote that wages would be set in accordance with the minimum that people needed to live.
      3. He thought profits would equalize over time.
IV. Malthus and Ricardo had differing world views.

A. The two economists disagreed on the nature and causes of gluts and recessions.
   1. Ricardo adopted Say’s Law, which stated that supply created its own demand.
   2. Malthus predicted that rich people would produce but not consume, which would lead to higher levels of saving.
   3. The two never reached agreement, and people discuss these concepts still today.

B. Malthus and Ricardo also argued over the Corn Laws.
   1. The Corn Laws protected British farmers by restricting imports of corn from France.
   2. Malthus supported the Corn Laws, since they would support and expand the income of British landlords.
   3. Ricardo opposed the Corn Laws because they hurt the interests of workers and consumers.
   4. Ricardo developed the concept of comparative advantage, which governs how economists view trade today.

C. Malthus and Ricardo argued over value and price.
   1. They argued over the natural underlying yardstick of value and price.
   2. The economists struggled to find a sensible framework.

D. Malthus and Ricardo were prototypes of intellectual styles.
   1. Ricardo wrote down theories and examples, but he did not write well.
   2. Malthus, a preacher, used inductive reasoning.

Essential Reading:
Heilbroner, Robert L., "The Gloomy Presentiments of Parson Malthus and David Ricardo," which appears as chapter 4 of his book The Worldly Philosophers, (New York: Simon & Schuster, 1986). This chapter gives some personal background for Malthus and Ricardo. It gives an overview of their most important works and their disputes, touching on the population principle, the corn laws, views about landlords and distribution, and more.

Supplemental Reading:
Dorfman, Robert, "Thomas Robert Malthus and David Ricardo," Journal of Economic Perspectives, Summer 1989, 3:3, pp. 153-164. This article offers a nice overview of the personal relationship between Malthus and Ricardo; of the intellectual disputes between them over the corn laws, gluts, and value; and concerning the differences in background and intellectual temperament that kept them from agreement.
Ricardo, David, "Chapter VII: On Foreign Trade," Principles of Political Economy. Everyman's Library, Dutton; New York, 1973, pp. 77-93 "Schools Brief: The miracle of trade," The Economist, January 27, 1996, pp. 61-62. Ricardo is almost unreadable for the novice, unless you're really, really willing to grind away. He uses terms in ways that sound unfamiliar, and argues through examples in exquisite detail. If you'd like to give it a try, despite this warning, you might begin by reading this recommended chapter from Ricardo along with the short article from the Economist magazine.

Questions to Consider:
1. Explain why Malthus believed that population would inevitably outstrip food supply. It clearly has not happened as quickly as he expected. In your view, was his prediction of doom misguided, or only premature?
2. What were the Corn Laws? What positions did Malthus and Ricardo take? Explain Ricardo’s theory of comparative advantage, and in general how the theory applies to policy arguments over trade like the Corn Laws.
Lecture Four
John Stuart Mill and Utilitarianism

Scope: This lecture begins with a look at John Stuart Mill’s extraordinary upbringing and his study of utilitarianism, which laid the foundation for his future thought. The last great economist from the Classical School, he developed the concepts of supply and demand, economies of scale, international trade, and government intervention. Mill also studied “economic man.” Finally we look at Mill’s impact on both economics and economists.

Outline

I. We begin by discussing the biography of John Stuart Mill (1806-1873).
   A. James Mill raised his son John Stuart as a child prodigy who would carry the flag for a new type of economics.
      1. John Stuart Mill studied Greek and Latin at a young age.
      2. He read with his father many of the great books.
      3. Despite this upbringing, the younger Mill maintained humility.
   B. Mill wrestled with Jeremy Bentham’s utilitarianism.
      1. Utilitarianism believed that the goodness or badness of something should be measured in terms of its contribution to people’s happiness.
      2. Utilitarians emphasized the importance of the individual.
      3. Utilitarians favored universal suffrage, a secret ballot, support for the poor, jobs for the unemployed, and prison reform.
      4. This philosophy did not take into account love and justice.
      5. These concepts, as well as his upbringing, led Mill to a nervous breakdown.
   C. During his recovery, he fell in love with Harriet Taylor, a married woman.
      1. They traveled and spent time together for twenty years before her husband died.
   D. Mill wrote important economic and non-economic books.
      1. He wrote On Liberty and other political essays.
      2. He wrote Principles of Political Economy, one of the great texts of classical economics.

II. Mill was the last great economist of the “Classical” school of economics.
   A. The classical school held the following tenets.
      1. It advocated minimal government involvement.
      2. It felt that self-interested behavior was part of human nature.
      3. In the classical view, social harmony resulted when individuals pursued their own interests.
      4. The classical economists thought that all economic resources and activities added value.
      5. They established numerous economic laws.
   B. Mill laid out the foundations of supply and demand.
      1. He clearly articulated how supply and demand would equalize as prices rose or fell.
      2. He thought about what happened when the supply did not change, or when the supply changed repeatedly.
      3. He studied the short- and long-term effects of economic decisions.
   C. Mill recognized the problems of economies of scale and market breakdown.
      1. He understood that as production increased, costs decreased.
      2. Mill also explored the possibilities of monopolies and their effects on markets.
   D. Mill clarified prevailing ideas regarding international trade.
      1. He supported free trade.
      2. He built an international model based on comparative advantage.
      3. Mill analyzed how different producers benefited under various circumstances.
      4. Although he supported free trade, Mill advocated government assistance for infant industries.
E. Mill recognized the advantages of the stationary state.
   1. The stationary state occurred when things leveled out in an economy.
   2. He studied judicial foresight, oversight of technological inventions, and equal distribution of wealth.

F. Mill was open to government intervention under certain circumstances.
   1. He thought that government should perform certain tasks and accomplish certain goals.
   2. However, he criticized government on certain accounts.

G. Although he did not completely believe in laissez-faire, Mill had a deep understanding of competition.
   1. Mill wrote that competition, although imperfect, was necessary and good.
   2. He felt that without competition, people would not work hard.

III. Mill developed the idea of Homo Economicus, or the economic man.
   A. The idea of the economic man was based on an examination of people’s goals.
      1. These goals included building up wealth, enjoying luxuries, desiring leisure, and wanting to procreate.
      2. The idea of homo economicus rested on the assumption that people based their actions on these goals.
   B. Mill saw this idea as a sort of liberation.
      1. People in differing social institutions and contexts were motivated by the same goals.
      2. Although this model rested on a restrictive vision of human nature, it powerfully explained economic decisions.

IV. Mill influenced both utilitarianism and utopianism.
   A. He broadened the subject of economics.
   B. He separated production and distribution.
      1. One market determined production, and another determined distribution.
      2. He found that an efficient economy, using supply and demand, could coexist with the support of others.
   C. Mill considered an ideal of reformed capitalism as a defense against utopian socialism.
      1. He thought a new and improved capitalism was preferable to socialism.
      2. He believed in doing what was expedient.
   D. Mill offered a spirit of radical moderation.
      1. He emphasized the importance of understanding the hard realities of markets and economics.
      2. Yet he also believed in considering other possibilities to improve the situation.
      3. We should regard Mill as a hardworking reformer rather than as an unhealthy revolutionary.

Essential Reading:
Heilbroner, Robert L., "The Visions of the Utopian Socialists," which appears as chapter 5 of his book The Worldly Philosophers, (New York: Simon & Schuster, 1986). John Stuart Mill was raised as a strict utilitarian, and on a classical diet of Smith, Ricardo, and Mill. Although he challenged these beliefs in various ways, he never escaped them. Instead, much of his career involved humanizing those beliefs, and finding himself ever more drawn to the visions of utopian socialists. In this chapter, Heilbroner paints a picture of the utopians, and then sets Mill in that context.

Supplemental Reading:
Mill, John Stuart, Principles of Political Economy. London: Longmans, Green and Co., 1929. Originally published in 1848. This epic work is about one thousand pages long, so its sheer length makes it better to sample than to swallow whole. Mill is an unusually clear and accessible writer, so one reasonable approach is simply to look at the table of contents, see what interests you, and sample. However, let me offer a few more definite suggestions. For a few examples, Chapter VIII of Book I discusses Smith's idea of the division of labor and how the idea has developed. The beginning of Book II lays out Mill's separation between production and distribution, and Chapter XII and XIII discusses remedies for low wages, like the minimum wage laws and welfare reform arguments of his day, where Mill argues that supporting the existing poor is a social imperative, but only if their population growth is controlled. Book III focuses on supply and demand, and Chapter II of that book is a good starting point. Chapter XVII of that book focuses on the arguments for international trade. In Book IV, Chapter VI offers Mill's discussions about a stationary state, and Chapter VII a discussion of the
future of labor. Book V discusses the role of government and taxation. A good starting point is Chapter X and XI, which discuss cases where it is wrong for the government to intervene, and offer Mill's arguments against government interference.


Persky, Joseph, "Retrospectives: The Ethology of Homo Economicus," *Journal of Economic Perspectives*, Spring 1995, pp. 221-231. This article describes the idea of "economic man," or homo economicus: how it developed in the work of Mill, criticisms the idea has encountered since, and a brief defense of the usefulness of a structured way of thinking about human behavior.

**Questions to Consider:**

1. Describe the main tenets of the classical school of economics. Discuss how Mill upheld these ideas, and also how he questioned them.

2. How do you react to Mill’s views about the attractiveness of the stationary state? Was he being humane? Unrealistic? Some combination?
Lecture Five
Karl Marx and Socialism

Scope: We begin this lecture by discussing the ideas and events that led to socialism. We discuss the Industrial Revolution and the utopians and scientific socialists who criticized its social consequences. We then study Marx’s background, his professional work, and his thought on the capitalist law of motion relating to the bourgeoisie and the proletariat, the labor theory of value, and the exploitation of workers. Finally, we examine how Marxist economics have stood the test of time. While Marx was a brilliant thinker whose ideas still resonate to this day, his scientific analysis of the economy has not held up over time.

Outline

I. We begin by examining the origins of socialism.
   A. We have studied the intellectual trajectory of the classical economists.
      1. This trajectory began with Adam Smith and went through John Stuart Mill.
      2. These economists believed that natural propensities drove people toward a certain natural harmony.
   B. The Industrial Revolution disrupted these assumptions.
      1. The building of factories for new manufacturing changed social structures of the city and country.
      2. Karl Marx criticized capitalism and the new and often dreadful working conditions that it produced.
   C. The utopian socialists responded by giving up on capitalism.
      1. They objected to capitalism on moral grounds.
      2. They set up detailed plans to run peoples’ lives, but these plans lacked realism.
   D. Scientific socialists such as Marx responded that capitalism was doomed for scientific reasons.

II. We turn now to the biography of Karl Marx (1818-1883).
   A. Marx had a relatively uneventful but literarily productive life.
      1. He was born in Prussia.
      2. He studied in Germany and was exiled first to Paris and then to Brussels.
      3. He wrote The Manifesto of the Communist Party in 1848.
      4. He was exiled to London in 1849 and lived there the rest of his life.
      5. He published Capital in 1867.
   B. A prototypical scholar, Marx sent mixed messages.
      1. He both read and disagreed with everything.
      2. He had many negative qualities, including difficulties in dealing with other people.
      3. He was sick and impoverished for most of his life.
   C. Was Marx responsible for Soviet totalitarianism?
      1. Some have tried to hold Marx responsible for Stalin and totalitarianism.
      2. Although he may have been wrong and unpleasant, he cannot be held responsible for many of the uses to which his ideas have been put.

III. Marx tried to formulate a capitalist law of motion.
   A. The relations of the bourgeoisie and the proletariat evolved over time.
      1. The landlords were no longer an important factor in industrial capitalism.
      2. Marx felt that society was dividing into two conflicting groups.
      3. He had enormous respect for the productive power of the bourgeoisie, but he decried its ruinous impact on workers’ lives.
   B. Marx emphasized the labor theory of value, according to which labor is the source of all value.
   C. The labor theory of value assumed a linkage between surplus value and capital accumulation.
      1. Marx argued that workers needed to produce more than they were paid.
      2. The bourgeoisie’s need for ever-rising profit led it to exploit the workers so that it could appropriate surplus value for itself.
      3. Marx thought that the workers should retain all the value they created.
D. This thinking had certain implications.
1. Marx’s ideas implied that the rate of profit would fall.
2. He believed that big companies would concentrate both capital and wealth, and undercut smaller producers.
3. He predicted that economic instability and class conflict would ensue.

E. Marx predicted the ultimate establishment of a socialist utopia.
1. He thought that the number of capitalists would dwindle as the proletariat grew.
2. He did not clearly lay out how this would all happen.

IV. Marx does not look especially prescient to us, who enjoy the benefit of 20-20 hindsight.
A. The proletariat has not become isolated and immiserated.
1. Poverty and income inequality remain.
2. Yet the crushing poverty of which Marx wrote is not evident today.
3. Technology has created more jobs than it has eliminated.

B. The labor theory of value is also open to criticism.
1. Other factors and people also contribute to value.
2. Demand also plays a role in contributing to value.
3. At times, market forces boost wages.
4. Workers are not always brutally exploited.

C. Profit rates have not collapsed.
D. Scale has increased, but not continually.
E. Economic instability does not seem to grow continuously.
F. Marx did not think that the political system would adapt, as it has done in numerous cases over time.
G. Marx failed to accept market dynamics at a gut level.
1. He did not understand how a free economy created new jobs.
2. He did not understand that employers have a vested interest in treating workers well.
3. He thought that markets would break down.

V. Marxist economics summarized.
A. Economists must separate social and economic analysis.
1. Marx recognized the importance of this separation.
2. He saw himself as advocating the interests of the working man.
3. He was scientific rather than sympathetic.

B. Although Marx purported to be a scientific thinker, his theories rested on weak scientific foundations.
1. He held to the labor theory of value.
2. His “scientific” economic analysis was not borne out by events.

C. Nevertheless, Marx was a brilliant thinker.
1. He touched the hearts and emotions of many of his readers.
2. Many of his ideas remain with us today.
3. He set the intellectual agenda for social science for nearly a century.

Essential Reading:
Heilbroner, Robert L., "The Inexorable System of Karl Marx," which appears as chapter 6 of his book The Worldly Philosophers, (New York: Simon & Schuster, 1986). Marx believed that capitalism was doomed by economic forces that capitalism created. This chapter offers useful background on Marx's relationship with Engels, Marx as a person, and the development of the Marxist combination of economics, sociology, and history.

Supplementary Reading:
Marx, Karl, *Capital*. International Publishers: New York, 1967. Edition published on one hundredth anniversary of first German edition. This work is hard reading. However, let me suggest a few chapters that will give a sense of Marx's passion for social justice and his economic arguments. Part I, Chapter 1, the first couple of sections lay out Marx's labor theory of value. The discussion then becomes theoretical and lengthy. In Chapter III, sec 2, he lays out his sense of why the circulation of money can break down, leading the economy to stall. Part III, Chapter X is a famous chapter on "The Working Day," describing the harsh working conditions of the time. Perhaps start with Sections 3 and 4. In Part IV, ch. XV, he lays out the conflict between machinery and working people: perhaps start with section 5. Part VIII is Marx's view of the historical process by which capitalism became established; Chapter XXXII offers the famous "expropriators are expropriated" scenario.

Mandel, Ernest, *An Introduction to Marxist Economic Theory*. Pathfinder Press: New York, 1970. Some listeners may feel (or fear) that Marx isn't getting a fair shake in this lectures, because of the emphasis on the modern view that Marx's economics don't hold up very well. This brief (78 page) book offers a summary defense of Marxist economic thinking from a writer who did much to popularize Marx's thought, especially during the social upheaval of the late 1960s. The book does a good job of presenting Marx's views, and how they hang together, from a modern perspective. It is also a deeply one-sided book, agreeing with Marx almost unquestioningly on every point.

**Questions to Consider:**

1. Define how Marx used the following terms, and how the terms relate to each other: bourgeoisie and proletariat, labor theory of value, surplus value, exploitation, capitalist accumulation and centralization, “the expropriators are expropriated.”

2. Describe some of the main predictions of Marxist economics about how the economy will evolve. How accurate did many of those predictions look for the fifty or so years after Marx’s death? How accurate do they look today?
Lecture Six
Alfred Marshall and Marginalist Thought

Scope: This lecture begins with a discussion of how the marginalists revolutionized economics by using scientific concepts to better understand the concepts of supply and demand. We also look at Alfred Marshall’s background and how it affected his economic thinking. We then look at Marshall’s principles of economics, in which he focused on human behavior and developed a modern economic vocabulary. Finally we examine Marshall’s combination of neoclassical economics and social justice.

Outline

I. The marginalists revolutionized economics.
   A. Marginalism applied the concept of physics to economics.
      1. Marginalists focused on events that occurred on the margin.
      2. A whole group of thinkers had the same “marginalist” insights at roughly the same time.
   B. Marginal thinking affected incentives in buying and working.
   C. The marginalists theorized about how people valued and demanded goods and services.
      1. William Stanley Jevons made utility a central focus of the marginalist framework.
      2. Economic actors (such as consumers and workers) balanced utility and price.
      3. Marginalists measured utility by studying people’s behavior.
      4. Jevons challenged the labor theory of value.
   D. The marginalists theorized about the productivity of inputs.
      1. John Bates Clark confronted the challenge of Marx’s labor theory of value.
      2. In marginalist thinking, all workers did not contribute equally to productivity.
      3. The value of what was produced was distributed according to people’s contributions.

II. Alfred Marshall (1842-1924) combined various aspects of marginalist thinking.
   A. First we examine Marshall’s early life and educational pursuits.
      1. His father was a taskmaster.
      2. He began by studying ethics, moved on to mathematics, then on to physics, and finally ended up in economics.
   B. Marshall shrank from publishing his ideas.
      1. Marshall developed ideas but it took him longer to perfect and publish them.
      2. Marshall was quirky regarding his intellectual pursuits.
      3. He was progressive in his treatment of women, even though he opposed admitting them to Cambridge.
   C. In his later career, Marshall built the modern economics profession.
      1. He taught generations of economists at Bristol and Cambridge.
      2. He developed the British economics profession.

III. We turn now to Marshall’s principles of economics and his accomplishments.
   A. Marshall focused on human behavior rather than on the wealth of nations, relationships between classes, or analytical problems.
      1. Marshall regarded economics as a social science.
      2. He believed that work shaped people’s lives.
      3. He wrote about the impact of poverty upon economics and upon people’s lives.
   B. Marshall brought mathematical clarity to economic terms.
   C. Marshall’s analysis was based on a systematized theory of supply and demand.
      1. Marginal thinking led to the formulation of the demand curve.
      2. Marginal costs of production led to formulation of the supply curve.
      3. Marshall’s writings ended the dispute over value.
      4. Marshall thought that both supply and demand contributed to the determination of value.
      5. Marshall developed economic diagrams still in use today.
D. Marshall built the vocabulary of modern economics.
   1. He developed the idea of measuring price elasticity.
   2. He broke costs into fixed and marginal costs.
   3. He wrote about substitution among different objects of consumption and labor.
   4. He spoke about the long and short run and about how the passage of time affected economic analysis.
   5. He discussed economies of scale and external economies.

E. Marshall offered a gentle defense of competition and selfishness.
   1. He strongly defended competition but also saw an important role for government and educational institutions.
   2. He wanted to use economics as a tool.

IV. Marshall was neoclassical economist with a concern for social justice.
   A. Marshall offered a direct critique of Marx.
      1. He did not think Marx’s scientific thoughts worked in practice.
      2. He did not agree that the state would wither away.
   B. Marshall felt it was important to deal with human beings as they actually behave, rather than as we would prefer them to behave.
   C. Marshall launched an economic counterattack in support of social justice.
      1. He regarded both apathy and exaggeration as evils.
      2. He made an honest effort to devise sensible ways to improve society.

Essential Reading:
Originally published in Economic Journal, September 1924, 34, pp. 311-72. One economist summed up the common feeling about this biographical essay in this way: "It is one of the finest short lives of a man of science ever written."

Schumpeter, Joseph, "Alfred Marshall, 1842-1924," American Economic Review, June 1941, 31:2. The Keynes essay emphasizes Marshall as a person, and the development of his career. This essay focuses more on Marshall's intellectual legacy. This essay includes a few economic terms and a few references to past economists that may be a little hard for the novice reader, but it's not too difficult.

Supplementary Reading:
Heilbroner, Robert L., "The Victorian World and the Underworld of Economics," which appears as chapter 7 of his book The Worldly Philosophers, (New York: Simon & Schuster, 1986). By the end of the chapter, there is some discussion of Alfred Marshall. His thinking has come down to us as central to mainstream economics, as explained in the lecture. But Marshall was a less provocative writer, not an outsider, not a rebel, so he gets less of Heilbroner's attention.

Marshall, Alfred, Principles of Economics. London: The MacMillan Company, 1920. Originally published in 1890. This book served as the basic economics textbook for half a century, and it would still work today as the text for many introductory or even intermediate courses in microeconomics. For our purposes, the most interesting elements are the specifically economic breakthroughs, like the formal discussion of supply and demand, and the general perspective on what it means to be an economist that shines through. Book I, Chapters I and II, offers a sense of Marshall's approach to the study of economics. Book V is Marshall's famous exposition of supply and demand; the interested reader can begin with Chapters I-III, and then see how much further it seems desirable to proceed. In the last chapter of the last book, Chapter XIII of Book VI, offers Marshall's view of economic progress and evolving standards of living.

Heilbroner, Robert L., "The Savage Society of Thorstein Veblen," which appears as chapter 8 of his book The Worldly Philosophers, (New York: Simon & Schuster, 1986). For the sake of completeness, and for staying with the flow of Heilbroner's book, and because it's fun, it may be worth reading this chapter.

Groenewegen, Peter, A Soaring Eagle: Alfred Marshall, 1842-1924. Cheltenham: Elgar, 1995. 874 pages. This is the first full-length biography of Alfred Marshall. It is recent and comprehensive; in fact, it probably tells more than the typical beginner wants to know. As a biography, it is clearly above average, if not of the absolutely top
rank. For novices, the best use of such a work is usually to look up subjects of interest in the index and then scan a few pages or a chapter.

Questions to Consider:

1. In the late eighteenth century, Edmund Burke wrote in his *Reflections on the Revolution in France*, “The Age of Chivalry had gone; that of sophists, economists, and calculators has succeeded.” Consider the outlook of Mill, Marx, and Marshall, as presented in the last three lectures. In what sense was Burke accurate in forecasting that they represent a stage after the age of chivalry? In what sense was Burke less accurate in implying that economists were no more than calculators?

2. One often reads scientific disputes over who was first to discover or to publish a certain result. With Alfred Marshall’s example in mind, reflect on the underlying scientific value of such disputes.

3. Explain how marginalist ideas about utility are related to demand for a given product, and how marginalist ideas about production are related to supply of a given product.
Lecture Seven

The Socialist Calculation Debate

Scope: This lecture begins with a discussion of how the socialists used science and markets to deal with their ensuing crisis. We then study how the Austrian school of economics led by Mises and Hayek responded to the socialists, and then how the socialists responded to the Austrians. Oscar Lange led this socialist response. We end by attempting to determine which side was the winner in this debate.

Outline

I. Socialists used capitalist calculators to rethink their ideas.
   A. By the beginning of the twentieth century, socialism faced an intellectual crisis.
      1. In theory, marginalism demolished socialism.
      2. Empirically, Marx’s predictions did not come true.
   B. Socialists seized the opportunity to rethink their ground.
      1. The socialists looked to John Stuart Mill for inspiration.
      2. They discussed the viability of managing the economy scientifically.
      3. They blended neoclassical economics with social planning.
   C. In 1908 Enrico Barone proposed the possibility of putting these ideas into practice.
      1. Barone proposed the concept of market socialism.
      2. He replaced the invisible hand with the ministry of planning.
      3. Barone proposed the establishment of a planned society in which markets would operate.

II. The Austrians Ludwig von Mises (1881-1973) and Friedrich Hayek (1899-1992) offered a critique of this new socialism.
   A. Mises and Hayek led the Austrian school of economics.
      1. The Austrian point of view focused on a step-by-step analysis of individual actions.
      2. Despite his combativeness, Mises agreed with Barone on certain issues.
      3. Hayek was the leading Austrian economist of the twentieth century.
   B. The Austrians responded to the concept of market socialism.
      1. Mises and Hayek saw the market as the best mechanism for calculating and coordinating choices.
      2. The Austrians saw markets and competition as a method for discovering information.
      3. In the Austrian view, prices were an information signal in the market.
      4. The Austrians thought that competition led to desirable, decentralized social planning.
      5. They worried about the problem of who would watch the planners.

III. The socialists responded to the tough questions of the Austrians.
   A. The market socialists proposed an evolved version of pure socialism.
      1. The market socialists believed that free markets would determine both buying and selling and the labor market.
      2. Yet they thought that the means of production would be socially controlled.
   B. Oscar Lange (1904-1965) epitomized this new market socialism.
      1. He restated the logical possibility of market socialism.
      2. Lange’s case for market socialism described how it reached the market price faster, distributed income more fairly, took social costs into account, avoided monopoly capitalism, and led to greater economic stability.
      3. Lange thought revolutionary change should override the potential problems of capital markets, bureaucracy, and incentives.

IV. We must take various factors into account in trying to decide which side prevailed in this debate.
   A. Our determination of a winner in this debate depends upon who we ask, upon semantics, and upon timing.
      1. Each side thought that it had prevailed over the other.
      2. The dispute turned upon how success was calculated.
3. The feelings about winners and losers were based on timing.

B. Surprisingly, the Austrians and the market socialists had some important things in common.
   1. Both the Austrians and the market socialists criticized neoclassical economics, but from different perspectives.
   2. They both identified many of the same problems with capitalism.
   3. They both wanted to get down into the nitty-gritty problems and see how the market resolved them.

C. From today’s perspective, capitalism scored an incomplete victory over socialism.
   1. Many versions of capitalism exist in the world today.
   2. Yet the concerns of the socialists are still relevant to modern-day capitalism.

D. What is the modern consensus on free markets vs. socialism?
   1. Markets have demonstrated their power over the years.
   2. Nevertheless, various sorts of government intervention are beneficial in various circumstances.

Essential Reading:
Lange, Oskar, "On the Economic Theory of Socialism." In Lange, Oskar and Fred M. Taylor (edited by Benjamin E. Lippincott), On the Economic Theory of Socialism. University of Minnesota Press, Minneapolis, 1938, pp. 57-129. This volume presents the material of earlier published journal articles, slightly updated and amended. Along with the intellectual flow of the argument, it's especially fun to watch Lange quote Adam Smith, Marshall, Mises, and others when they offer some support for his thesis. Also, you should note the echoes of Marx's arguments as they appear in the text.
Hayek and Mises both wrote a lot, but they rarely summarized their arguments in a compact form.
Persky, Joseph, "Lange and von Mises, Large-Scale Enterprises, and the Economic Case for Socialism," Journal of Economic Perspectives, Fall 1991, pp. 229-236. This article emphasizes one element of the debate over market socialism. It points out that both von Mises and Lange claimed to be fighting monopoly. Their disagreement was not over the evils of monopoly, but how best to avoid it.

Supplementary Reading:
Von Mises, Ludwig, "Economic Calculation in the Socialist Commonwealth." In Hayek, F.A. Collectivist Economic Planning. Routledge and Kegan Paul Ltd; London, 1935. This volume contains several of the key essays relevant to this lecture. It has Hayek's translation of the 1908 Enrico Barone essay, and his translation of the 1920 challenge to that thesis from von Mises. The Barone essay is a very tough read, unless you are mathematically inclined, but most readers should be able to handle the Mises essay.
Lavoie, Don, Rivalry and Central Planning: The Socialist Calculation Debate Reconsidered. Cambridge, Cambridge University Press, 1985. The author of this book is a modern Austrian economist. The book is not easy reading, but if you are interested in a modern view of how the dispute has evolved, it's the right place to turn.
Stiglitz, Joseph, Whither Socialism? Cambridge, The MIT Press, 1994. Stiglitz is one of the most brilliant and multi-faceted economists of the later part of the twentieth century. Like the previous entry, this book will also be something of a tough read for the novice. But the bulk of his discussion in Chapters 1 and 2 should make interesting reading. A hint: when Stiglitz says that something is a "technical digression," it pays to skip it!

Questions to Consider:
1. Review the arguments in favor of market socialism, and the arguments against. Which particular arguments do you find especially persuasive on each side?
2. Economists sometimes say that prices are a signal. What are they a signal of? How do firms perceive and act upon that signal? How do consumers perceive and act upon it?
Lecture Eight

Joseph Schumpeter and Entrepreneurialism

Scope: In this lecture, we first discuss the background, characteristics, and roots of Joseph Schumpeter and his ideas. We then discuss his ideas concerning the entrepreneur and innovation and the impact of entrepreneurship upon the business cycle. We then examine Schumpeter’s ideas regarding the viability of capitalism and socialism. Finally we examine his legacy and its relation to both growth economics and socialism.

Outline

I. We begin by examining the background and personal characteristics of Joseph Schumpeter (1883-1950).
   A. Tangled patterns wove throughout Schumpeter’s early life.
      1. He was born in Moravia in 1883.
      2. He worked in government and finance during the 1920s.
      3. He settled at Harvard University.
   B. Schumpeter’s characteristics were evident in his actions and writings.
      1. He both dressed and wrote flamboyantly.
      2. He was extremely well read.
      3. He had a streak of contrariness.

II. Schumpeter believed that entrepreneurs were central to the business cycle.
   A. Schumpeter believed that the “creative destruction” of entrepreneurs drove economic growth.
      1. He believed that innovation was central to capitalism
      2. He thought that new production functions served to shake up the system.
      3. He believed that new business and new firms were central to the economy.
   B. Schumpeter thought entrepreneurs should think up new things and devise new ways of doing things.
      1. Schumpeter thought people acted as entrepreneurs only occasionally, not continually.
      2. He believed that entrepreneurs were buried inside institutions.
      3. He thought that entrepreneurs were driven by the will to create a dynasty.
   C. The Schumpeterian story of the business cycle included an upside and a downside.
      1. On the upside, innovation led to new investment opportunities, which had a ripple effect.
      2. Yet this welcoming investment climate led people to overbuild and borrow, thinking that the good times would continue indefinitely. The result was a decline in the business cycle.
      3. Schumpeter saw these shifts as cycles of innovation.
      4. He found that the availability of profits signaled where money should be invested.
   D. Schumpeter categorized these waves into three types.
      1. Large entrepreneurial innovations caused “Kondratieff waves” that lasted for decades.
      2. Smaller inventions caused “Juglar waves” that lasted for approximately ten years.
      3. “Kitchin waves” were shorter still.
      4. These waves did not appear with the regularity that Schumpeter had predicted.
   E. Schumpeter offered the following explanation for the Great Depression.
      1. The Depression occurred when all three cycles hit a downturn at the same time.
      2. In Schumpeter’s view, the Depression was part of a necessary process.

III. Schumpeter mused on capitalism and socialism.
   A. Schumpeter did not think capitalism would survive.
      1. He argued that with pure productive power, capitalism would continue.
      2. He believed that over time, large firms would make entrepreneurs obsolete.
      3. He thought that the political weakness of entrepreneurs would undermine the roots of capitalism.
      4. He believed that intellectual complainers would become disgruntled and more powerful, and that they would undermine the moral sustainability of capitalism.
   B. Schumpeter claimed that socialism could work.
1. He concluded that it was possible to plan the economy.
2. He regarded central planning as unfortunate but also as inevitable.

C. Although Schumpeter and Marx agreed on certain issues, they disagreed on the process.
1. Marx and Schumpeter believed that capitalism was doomed and that socialism would prevail.
2. Marx thought that the poor would lead the revolt against capitalism.
3. Schumpeter thought that the intellectuals would lead the assault on capitalism.
4. Schumpeter admired Marx’s intellect but recognized his limitations.

IV. Schumpeter’s legacy is evident in economics today.

A. Schumpeter had a truly free mind that transcended ideology.
1. He was difficult to characterize and was a tremendously deep thinker.
2. He was bold enough to predict a future which did not appeal to him.
3. He sought to open doors rather than to close them.

B. Schumpeter discussed the boundaries of socialism and capitalism.
1. He thought that socialism would collapse for political rather than economic reasons.
2. Schumpeter anticipated the large government structure that we have today.

C. Schumpeter also developed the field of growth economics.
1. New technology was the primary source of economic growth.
2. Growth accounting focused on the source of growth.
3. Real business cycle economists argued that technology and changes in production moved the economy.
4. New growth economists discussed modeling the process of developing technology.

D. These ideas of economic growth are extraordinarily important.
1. Schumpeter underestimated people’s desire for economic growth.
2. In actuality, people are greedy concerning economic growth and entrepreneurialism.

Essential Reading:
Heilbroner, Robert L., "The Contradictions of Joseph Schumpeter," which appears as chapter 10 of his book *The Worldly Philosophers*, (New York: Simon & Schuster, 1986). The alert reader will notice that this chapter is assigned out of order: in Heilbroner's book, chapter 9 on Keynes comes first; in this series of lectures, Schumpeter comes first. Since Keynes and Schumpeter wrote roughly at the same time, there is some discretion in choosing which will come first.

Supplementary Reading:
Schumpeter, Joseph, *Capitalism, Socialism, and Democracy*. New York, Harper and Row, 1942. This book is Schumpeter's argument for why capitalism is doomed. Schumpeter's prose style is a little florid and verbose, but it is also vigorous and fairly accessible. In Part II, one can jump from the Prologue to chapter VII on "The Process of Creative Destruction," to Chapters XII and XIII on how capitalism will destroy the entrepreneur, and thus its soul. Part III of the book discusses the rise of socialism, and the discussion in chapters XVI and XVII goes over the ground of the market socialism debate.

Haberler, Gottfried, "Joseph Alois Schumpeter, 1883-1950," *Quarterly Journal of Economics*, August 1950, 64, p. 333-72. This obituary offers a good sketch of what Schumpeter was like as a person, a colleague, and an intellectual, as well as an overview of his intellectual legacy.


Questions to Consider:
1. Discuss the reason behind Schumpeter’s prediction for whether capitalism would survive, and compare it with the reasons behind Marx’s prediction.
2. In the sense that Schumpeter and many others of his time used the term “socialism,” do you think it is correct to argue that the United States is a Socialist country today? If not, what do you think are the minimum qualities that would define a socialist state?
Lecture Nine
John Maynard Keynes and the Keynesian Revolution

Scope: In this lecture we begin by examining the extremely busy life of John Maynard Keynes. We then examine his *General Theory of Employment, Interest and Money*. Keynes believed in economic progress in the long run and in the need for government to create demand to help the economy. We then look at how Keynes altered economic thinking in respect to the detriments of saving, the importance of macroeconomic analysis, government’s responsibility for the economy, and the philosophy of correctable capitalism.

Outline

I. John Maynard Keynes (1883-1946) lived as if he had more than 24 hours per day. Keynes kept himself busy with a variety of jobs and tasks.
   A. Keynes had a golden touch as an investor and raised money for himself and various causes.
   B. He wrote and edited economic articles and books.
   C. He was a great teacher.
   D. Overall, he was extraordinary person.

II. Keynes’ stepping stones to *The General Theory Of Employment, Interest, and Money* help explain his outlook.
   A. World War I was followed by a sense of economic stagnation and instability.
   B. Keynes perceived that the economy, the world, and especially the capitalist institutions were breaking down.
   C. He believed that in the very long run, economic progress would endure.
      1. Keynes believed the economy would grow at two percent annually.
      2. He concluded that, barring wars, the economic problem would be solved within one hundred years.
      3. Although he believed that the short-run outlook was terrible, he was confident that things would improve in the long run.
   D. Economists balanced these contrary issues.
      1. In the long run, innovation grew the economy, but in the short run there was a grinding of gears.
      2. Keynes believed that we need to be concerned about the processes and the immediate difficulties.
   E. Keynes’ ideas are open to some criticism.
      1. All economic problems are not solved today, as Keynes had predicted.
      2. Growth does not actually look after itself, as Keynes had thought.

III. In the *General Theory*, Keynes attempted to explain the reasons for the Great Depression.
   A. Keynes distinguished between the decision to save and the decision to invest.
      1. In practice Keynes thought people generally saved the same amount regardless of interest rates.
      2. Yet he also thought that business investment fluctuated greatly depending on the interest rates.
      3. Therefore savings and investment would be out of sync.
   B. Keynes criticized stock market investors and the disease of speculation.
      1. He thought that stock market investing was merely a game, based on anticipation rather than on logic or sense.
      2. He proposed a tax on speculation to slow it down.
   C. Keynes found that a lack of effective demand caused economic problems.
      1. He believed that when savings increased and investment was discouraged, buying power, and in turn production, would decrease, causing a vicious circle to develop.
      2. He found that as an economy became richer, people saved their money, which also slowed down the economy.
   D. Keynes felt that businesses had two choices when demand fell.
1. He believed that businesses could respond to the lack of demand by cutting wages or laying off workers.
2. He argued it was easier for workers to accept a rise in inflation than a personal cut in pay.

E. Keynes defended the government’s ability to pump up demand.
1. He wanted the government to inject money into the economy.
2. He encouraged the government to do something other than watch the economy sink into a depression.

IV. Keynes altered economic thinking.
A. He referred to his predecessors and used their work.
1. He acknowledged Mandeville, the mercantilists, and Malthus.
2. Keynes was not wholly original in his ideas.
3. Keynes moved from one equilibrium to another equilibrium.

B. Keynes highlighted the negative aspects of saving.
1. He showed the effects of too much savings on the government deficit.
2. He thought that the government needed to encourage investment and spending.

C. Keynes brought macroeconomic analysis to the fore.
1. Macroeconomics did not exist prior to the 1930s.
2. Keynes focused on the overall system and the aggregate demand in the economy.

D. Keynes conceived the idea that government had the responsibility and power to manage the economy.
1. Due to Keynes, we hold the president accountable for the economy.
2. His analysis focused on solving current economic problems.
3. He understood both the policies and the theories of economics.

E. Keynes developed a philosophy of correctable capitalism.
1. Keynes thought that capitalism could coexist with some forms of government intervention.
2. He defended capitalism, but he believed that at times the government must monitor the overall economic “weather.”

V. Keynes inspired numerous groups of modern economic followers.
A. The “Old Keynesians” believed that government should ensure a certain level of aggregate demand, low interest rates, and abundant credit.

B. The “New Keynesians” focused on wages, prices, and problems of information.

C. The “Post Keynesians” argued that the economy was full of monopolistic tendencies. They favored wage and price controls.

Recommended Reading:
Heilbroner, Robert L., "The Heresies of John Maynard Keynes," which appears as chapter 9 of his book The Worldly Philosophers, (New York: Simon & Schuster, 1986). This chapter begins with the Great Depression, and then segues into Keynes' life and work. Note especially the evidence of Keynes' extraordinary range as an intellectual, a public figure, and a person.

Supplemental Reading:
Keynes, John Maynard, Essays in Persuasion. Harcourt, Brace and Company: New York, 1932. This is a collection of Keynes' writings that he assembled from other sources. All are written in a lively and accessible way; in fact, some first appeared as newspaper articles, while others are excerpted from more academic books or articles. The first section, "The Treaty of Peace," offers some parts from his book written in 1919, when he foretold the disastrous effects of forcing Germany into impossibly high reparations payments for WWI. Two other essays worth reading are the second essay in section IV, "The End of Laissez-Faire," and the second essay in section V, "Economic Possibilities for our Grandchildren." But you can dip in and out of this book, and always find something interesting and stimulating.

Keynes, John Maynard, The General Theory of Employment, Interest, and Money. Harcourt, Brace, Jovanovich: New York, 1964. Originally published 1936. Keynes could write like an angel -- although this particular angel was in a hurry much of the time, and also had an extremely strong grounding in advanced economic theory. Thus, many of his writings are a strange jumble of memorable and accessible fresh images, together with
detailed technical explorations of an economic term or theoretical connection. In that spirit, let me suggest some places where an interested reader might dip a toe into the General Theory. If you have some background in economics, you might try Chapter 2, which compares classical economics with a sketch of Keynes' alternative view. The comments on burying bank notes underground and other ways of stimulating the economy appear in part VI of chapter 10. The comments on the evils of speculation appear in parts V and VI of chapter 12. A summary description of how the economy cycles in and out of recession, according to Keynes, appears in the first couple of sections of chapter 22. The very readable Chapter 24 is entitled, "Concluding Notes on the Social Philosophy Toward Which the General Theory Might Lead," and it gives a nice sense of the mature Keynesian social philosophy.

Schumpeter, Joseph, "John Maynard Keynes 1883-1946," *American Economic Review*, September 1946, pp. 495-518. Since Keynes died before Schumpeter, this is the obituary that was written. I would have loved to have seen the obituary Keynes would have written for Schumpeter, had Keynes lived longer! Schumpeter does an especially good job in describing Keynes' earlier work and life, without too heavy a focus on the General Theory. He is clearly skeptical of Keynesian economics, but respectful of it.

Samuelson, Paul, "Lord Keynes and the General Theory," *Econometrica*, July 1946, pp. 187-200. Samuelson, later to become an economics Nobel laureate in his own right, is perhaps best known among the general public for having written a classic textbook in introductory economics. In this obituary, he reflect on the meaning of Keynes' General Theory and how it was already changing economics in the mid-1940s.

**Questions to Consider:**

1. Explain Keynes’ view of how savings and investment could be mismatched, and an economy could end up with a shortfall of demand. Then explain why this would cause unemployment, not lower wages.

2. Explain how Keynesian economics tends to separate the question of unemployment from the question of whether capitalism should be encouraged in many parts of the economy. Would Marx have agreed with this separation? How reasonable do you find it?

3. Imagine that the economy keeps growing at two percent a year, as it has over time. Do you agree with John Stuart Mill and John Maynard Keynes that in a century of so, people will no longer be deeply concerned with economic issues?
Lecture Ten
Milton Friedman and the Rebirth of Classical Economics

Scope: We begin this final lecture by discussing the background of Milton Friedman and his interest in statistics. We then examine his work on both the permanent income hypothesis statement and far-sighted expectations. Friedman developed a monetary history in which he discussed the quantity theory of money, the responsibility of monetary policy for bringing about the Great Depression, and the implication of monetary policy for unemployment and inflation. Finally, we look at the many examples in everyday life of Friedman’s market-oriented thinking, such as an all volunteer army, flexible exchange rates, and school vouchers.

Outline

I. Milton Friedman is the only living economist that we examine in these lectures.
   A. Friedman did not have a gilded pedigree or a global presence.
   B. He worked in think tanks and in government jobs.
   C. Much of Friedman’s work focused on statistics.
      1. He was a brilliant statistician.
      2. Friedman developed sequential sampling for statistics.
   D. Friedman spent his professorial career at the University of Chicago.
      1. He won the Nobel Prize in Economics in 1976.
      2. He was a key player in the Chicago school of economics.
   E. He has a recognizable public image and is a professional economist.

II. Friedman worked on the permanent income hypothesis and studied far-sighted expectations.
   A. Friedman explained the difference between annual income and “permanent” income.
      1. He found that current consumption also depended on expectations of future income.
      2. Friedman believed that people would spend extra income on an investment good, such as a car or a major appliance.
   B. Friedman studied income and consumption patterns over time and over a cross-section of the population.
      1. He found that as income rose over time, ninety percent of income went to consumption.
      2. In cross-section analysis, Friedman found that poor families spent a larger percentage of their incomes than rich people did.
      3. Friedman concluded that people looked ahead in life to determine spending patterns, and therefore consumption patterns depended on expectations of income.
   C. This study had harsh implications for Keynesian thought, theories of expectations, and the methodology of economics.
      1. Friedman’s work brought Keynesian assumptions into question by showing that the economy was working more smoothly than Keynes had expected.
      2. Theories of rational expectations were developed.
      3. The consumption study changed the methodology of economics.
      4. Friedman combined theoretical underpinnings with his empirical background.

III. Friedman changed how the economic profession regarded money matters.
   A. Despite the importance of balancing the money supply, economists did not think much about money.
      1. Economists saw money as a tool to help goods and services circulate better in the economy.
      2. This was evident in Keynesian economic government policies.
   B. Friedman set out to write a complete monetary history.
      1. He did this at a time when others thought it was useless.
      2. This was modern social science research at its finest.
   C. From his monetary history, Friedman developed the quantity theory of money.
1. He found additional money led either to economic growth, inflation, or a change in people’s consumption patterns.
2. This summary became known as the quantity theory of money.

D. From his historical research, Friedman found that money affected the economy in four ways.
E. Friedman argued that incompetent monetary policy caused the Great Depression.
   1. He saw the Great Depression as a great contraction.
   2. He argued that the Federal Reserve was unwilling to act.

F. Friedman’s monetary history affected monetary policy.
   1. Friedman found that money was a useful social convention.
   2. He believed that money worked mechanistically.
   3. He found that monetary policy could prevent money from causing economic problems.
   4. Friedman argued that the Federal Reserve should expand the money supply at a steady rate over time.

G. Friedman’s ideas had implications for the unemployment-inflation tradeoff.
   1. Friedman argued that the level of unemployment was determined by many different factors.
   2. He believed that the economy would move to a natural level of unemployment.
   3. Understanding that the economy would move to this natural level of unemployment, Friedman argued that the country needed to decide if it wanted high inflation or low inflation when this happened.
   4. He said there would be a given amount of unemployment, unless the government got out of the way.

IV. Friedman brought market-oriented thinking and economic freedom into public discourse.
   A. There are numerous examples of Friedman’s ideas in today’s discourse.
      1. He believed that the system of fixed exchange rates would not work.
      2. In 1952 he argued for an all-volunteer army, which was later adapted.
      3. He argued for school vouchers in 1962.
      4. He proposed both replacing welfare with cash payments and instituting a negative income tax.
      5. He supported a flat-rate income tax.
      6. He proposed that government should cease printing money.
      7. Friedman opposed social security because he thought that people took it for granted.
   B. Overall, economic freedom and the way markets work have an important value.

V. In conclusion, there are four strands of contemporary economics.
   A. Economists agree on many important economic issues and concepts.
   B. The market socialism debate looks at how markets will work.
   C. The debate on technology and entrepreneurialism, and how they affect the cycles of the economy and long-run growth, continues today.
   D. The legacy of Keynes is evident in contemporary discussions of why the macroeconomic economy might be unstable, how investment might not measure up to demand, and why labor markets might not adjust well.
   E. The New Classicalists argue that the macroeconomic economy is fairly stable, that markets work fairly well, and that they work better when the government does not intervene.

Essential Reading:
Friedman, Milton and Rose D., Free to Choose. Harcourt Brace Jovanovich, New York, 1980. This book is written for a popular audience, and it is easily accessible. From the point of view of this lecture, three chapters are of particular interest. Chapter Three gives Friedman's description of how the ineptitude of the Federal Reserve helped lead to the Great Depression; of course, this is based on the more detailed work in the Monetary History. Chapter nine discusses Friedman's cure for inflation, and explains his view that faster money growth will, in the long run, produce only more inflation without reducing the unemployment rate. Overall, anyone interested in understanding the case for free markets and limited government could do a lot worse than start off by reading this book.
Supplemental Reading:


Heilbroner, Robert L., "Behind the Worldly Philosophy," which appears as chapter 11 of his book *The Worldly Philosophers*, (New York: Simon & Schuster, 1986). If you have been reading Heilbroner's book as an accompaniment to these lectures, you might as well finish it off. In fact, some of the themes of Heilbroner's discussion in this chapter are mirrored in the lecture.

Questions to Consider:
1. Explain what the "permanent income" theory is, and why the theory presented a challenge to received Keynesian thought.
2. Explain Friedman's case for a fixed rate of growth in the money supply. Discuss where extra money could possibly go, and why it might be good if the government had less discretion in setting policy. What do you see as the weaker spots in his argument?
3. How many of Friedman's market-oriented reforms do you find yourself in sympathy? Any? All? Can you explain why you feel more strongly about some than others?
**Glossary**

**Business Cycle:** Fluctuations in the aggregate economic activity of nations.

**Comparative Advantage:** If a country exports those goods that it produces relatively more efficiently and imports those goods that another country produces relatively more efficiently, then there will be gains to trade that could benefit both countries. Even if one country is absolutely more efficient (i.e. incurs the lowest cost) in producing all goods, it should specialize in those goods in which it has a “comparative advantage.”

**Consumption:** Household expenditures on final goods and services required for current use.

**Consumption function:** The relationship between consumption and income.

**Corn Laws:** A series of trade laws in England between 1400 and 1846 that intended to protect the domestic grain (“corn”) industry by imposing import tariffs on grain to keep domestic grain prices high.

**Depression:** A prolonged period of very low economic activity associated with negative growth rates of real Gross National Product and high unemployment.

**Economics:** A social science that attempts to explain the behavior and interactions of economic actors in terms of the items of value that they exchange.

**Inflation:** An increase in the general price level.

**Keynesian Economics:** The economic theory of John Maynard Keynes explains the determinants of total expenditures in the economy and the resulting level of income.

**Laissez-faire:** From the French meaning “allow (them) to do.” It came to mean the nonintervention by government in economic affairs and is associated with classical economists.

**Macroeconomics:** The branch of economics that studies relationships among economic aggregates such as output, the price level, interest rates, exchange rates, and unemployment.

**Marginal propensity to consume:** The proportion of an additional dollar of income that is consumed.

**Marginal propensity to save:** The proportion of an additional dollar of income that is saved.

**Mercantilism:** A political and economic doctrine, held predominantly by merchants in the sixteenth and seventeenth centuries, that maintained that a country should try to maximize its wealth by regulating trade so that it would have a trade surplus and thus an inflow of money.

**Monetary policy:** Control of the money supply and credit by manipulating short-term interest rates or bank reserves in order to affect the economy.

**Permanent-income theory of consumption:** This theory developed by Milton Friedman argued that people gear their consumption behavior to their permanent or long-term consumption opportunities, not to their current level of income.

**Quantity theory of money:** This theory argued that the level of nominal income is determined solely by the quantity of money.
Biographical Notes

Child, Josiah (1630-1699). Child was a prominent figure of the mercantilist times. He wrote *Circumstances of the Discourse on Trade* in 1690.

Colbert, Jean Baptiste (1619-1683). Colbert became finance minister to Louis XIV. He believed in firm government control over the economic life of the country and successfully reformed its finances. He encouraged commerce and internal improvements.

Friedman, Milton (1912- ). Friedman is an American economist and a professor of economics at the University of Chicago. He is a leading monetarist, and his work includes the permanent income theory of consumption and the role of money in determining events, particularly the Great Depression. His ideas have been influential with a number of conservative governments.

Hume, David (1711-1776). Hume was a Scottish philosopher who influenced skepticism and empiricism. He also was an historian and an economist of the mercantilist times.

Keynes, John Maynard (1883-1946). Keynes was a British economist who lectured in economics and served as an advisor to the Treasury during both world wars. The unemployment crises inspired his two great works: *A Treatise on Money* and *The General Theory of Employment, Interest and Money* in 1936. His views on a planned economy influenced Roosevelt’s New Deal administration.

Malthus, Thomas Robert (1766-1834). Malthus was a British economist who published anonymously the *Essay on the Principle of Population*, which argued that the population has the natural tendency to increase faster than the means of subsistence, and that efforts should be made to cut the birth rate, either by self restraint or birth control.

Mandeville, Bernard (1670-1733). Mandeville was known mainly for his *Fable of the Bees* which he wrote in 1705, during the mercantilist times.

Marshall, Alfred (1842-1924). Marshall was a British educator and the most influential economist of his day. In *Principles of Economics*, he concluded that the value or a price of a good was determined both by its cost and its utility. He also believed that a self-regulating economy would lead to better social conditions, a fairer distribution of income, and full employment. His emphasis on consumer welfare led to the development of welfare economics.

Marx, Karl (1818-1883). Marx was a German philosopher, social scientist, and revolutionary agitator. He was the chief founder of socialism and revolutionary communism. In *Das Kapital*, Marx described the free enterprise system as he saw it. Although he considered it the most efficient, dynamic system ever, he thought its flaws would cause severe bouts of inflation and depression. The basis of Marxism is the inevitability of socialism. He believed socialism was the only alternative to a doomed capitalism.

Mill, John Stuart (1806-1873). Mill became the leader of the utilitarian movement. He tried to promote measures that would lead to more equal division of profits. He favored a cooperative system of agriculture and increased rights for women.

Quesnay, Francois (1694-1774). Quesnay was the leader of the Physiocrats, who emerged in reaction to mercantilism.

Ricardo, David (1772-1823). Ricardo was a British political economist who acquired a self-made fortune in business. He wrote *Principles of Political Economy and Taxation* in 1817 on which his reputation chiefly rests. In 1819 he became a minister of parliament where he was influential in the free trade movement.

Schumpeter, Joseph (1883-1950). Schumpeter gained prominence for his studies of economic growth, business cycles, and the conflict between socialism and capitalism. He believed that entrepreneurs caused growth in the economy and that new developments came in bunches which caused business cycles.
Smith, Adam (1723-1790). Smith was the British economist, philosopher, and professor of logic. He published *An Inquiry into the Nature and Causes of the Wealth of Nations* in 1776, the first major work of political economics. In it he examined in detail the consequences of economic freedom, such as division of labor, the function of markets, and the international implications of *laissez-faire* economics. He argued that individualism led to order and progress. He also believed that labor, not land or money, was both the source of and the final measure of value. Finally, Smith thought that free trade and a self-regulating economy would result in social progress.
Bibliography

Essential Reading:

Supplementary Reading:


