

Part IIA Paper 8

History and Philosophy of Economics

Course co-ordinator: Ha-Joon Chang

The paper is intended to help the students fully appreciate the strengths and weaknesses of the economic theories contained in other courses in the Tripos. It aims to do so by teaching them: (i) the major theoretical innovations and debates that have marked the evolution of economics (history of economics); and (ii) the key issues involved in the assessment of different methods of economic investigation (philosophy of economics).

At the end of the Paper, students will acquire: (i) the knowledge of the main innovations in economic theory and how they have emerged and evolved in response to real world problems as well as to intellectual debates; (ii) the knowledge of how economic theories have affected the world, not just by reforming economic policies but also by changing the way people look at the world; (iii) the understanding of relative strengths and weaknesses of different methods of investigation in economics; (iv) the appreciation of the importance – and also the blind spots – of the economic theories that they learn in the rest of Tripos; and (v) a more sophisticated understanding of the current debates in economics, based on the knowledge of the historical roots and the philosophical underpinnings of different economic ideas.

The paper consists of 30 lectures (16 for the history of economics and 14 for the philosophy of economics). It will be examined by a 3-hour written examination. There will be 6 questions for the History of Economics part and 6 questions for the Philosophy of Economics part. The students will be asked to answer 3 questions, at least one from each part.

Indicative Readings

Chang, H-J., *Economics: The User's Guide*, ch. 4

Deane, P., *The State and the Economic System: An Introduction to the History of Political Economy*

Hausman, D. (ed.), *The Philosophy of Economics: An Anthology*

Heilbroner, R., *The Worldly Philosophers*

Landreth, H. and Colander, D., *The History of Economic Thought*

Lawson, T., *Essays on the Nature and State of Modern Economics*

Medema, S., *The Hesitant Hand*

Reiss, J., *Philosophy of Economics: A Contemporary Introduction*

Roncaglia, A. *The Wealth of Ideas*

Rodrik, D., *Economics Rules: Why Economics Works, When It Fails & How to Tell the Difference.*

Sample examination questions

Question 1

- (a) In what ways are Adam Smith's theories different from those of David Ricardo?
- (b) How much of this difference was due to the differences in the real world between the times in which the two economists lived?

Question 2

- (a) Discuss the key features of the general equilibrium theory as initially proposed by Walras.
- (b) Discuss what kinds of economic problems the theory is most suited to tackle.

Question 3

- (a) How did Keynes's theory depart from the existing consensus of his time?
- (b) How did the prevailing economic situation of his time influence the way in which Keynes departed from it?

Question 4

- (a) Discuss the key analytical elements of New Keynesian economics.
- (b) How are they different from those of the economics of John Maynard Keynes?
- (c) How do these differences influence the way in which Keynes himself and the New Keynesians analyse real world economic problems?

Question 5

"The falsity of assumptions in a model is no obstacle to its power." Discuss.

Question 6

Should economics make assumptions about values? If yes, which ones? If no, why not?

Question 7

What is money and where does it come from?

Question 8

Why should economists be concerned with social ontology?

The Details

HISTORY OF ECONOMICS (16 Lectures: 8 in Michaelmas; 8 in Lent)

Ha-Joon Chang (Faculty) and Ivano Cardinale (Goldsmiths, London)

Why History of Economics?

In the History of Economics part of the paper, you will develop a historical and analytical framework to contextualise the economic theories you have encountered and will encounter in the Tripos programme, while getting acquainted with some key theories that are not typically covered in the programme.

For each broad phase of the history of economics, we will study the economic problems that societies faced, the analytical structure of the economic theories that were devised to understand those problems, and the relevance they have for today's economics and debates about the economy.

For example, Classical political economists (Adam Smith, Thomas Malthus, David Ricardo) witnessed the initial stages of industrialization and developed a body of theory that studied the "grand dynamics of capitalism". Its unit of analysis were social classes, defined on the basis of the type of income (wage, profit, rent). It studied how economic development depended on issues such as division of labour, scarcity of natural resources, and population dynamics. Contemporary approaches inspired by classical theories have proved useful to understand a range of issues, including the early phases of industrialization, problems of scarce resources, and the long-term changes in the industrial structure of developed economies.

The "Marginal Revolution" is at the origin of Neoclassical economics, which forms the basis of most of the microeconomic theory studied in your degree. This Revolution took place during a more mature phase of capitalism. The focus of economics shifted from the dynamics of capitalism to the (static) conditions under which exchange attains desirable properties. The emphasis moved from classes to individuals, and established individual choice as the foundation of economics – which has since remained a key part of modern economics.

To give one last example, the "Keynesian revolution" took place at an even more mature stage of capitalism, in which private investment could not be taken for granted. It had deeply new policy implications, providing new theoretical arguments for state intervention in the economy. At the analytical level, it combined the Classical economists' emphasis on aggregate concepts such as national product, and the Marginalists' attention for individual choices – although Keynes's behavioural assumptions were radically different from the Marginalist ones. Therefore, understanding the historical circumstances, analytical structure and evolution of Keynesian theory are crucial for current debates on macroeconomic theory and policy.

Lecture Plan

Lectures 1-2: Overview

These lectures will explain how students will benefit from learning the history of economics. It will be emphasised that the lecturers do not teach history of economics as an exercise in ‘intellectual archaeology’ but as an attempt to understand the roots and the evolution of modern debates in economics and economic policy. These lectures will discuss the importance of understanding the historical contexts in which each theory was developed as well as the underlying moral and political assumptions of each theory.

Lecture 3: The formation of economics

Mercantilism and Physiocracy: the formation of the economy as an object of study. Debates on the role of the State in the economy.

Lectures 4-5: Classical Political Economy

Industrial revolution and sustained economic development. Adam Smith: division of labour and the extent of the market. David Ricardo and Thomas Malthus: scarcity and rents.

Lecture 6: Karl Marx

The economic and socio-political conditions of economic development.

Lectures 7-8: The Marginal Revolution

The origins of neoclassical economics. Theory of choice: from William Stanley Jevons to John Hicks and Paul Samuelson. General equilibrium: from Léon Walras to Vilfredo Pareto, Kenneth Arrow, Gérard Debreu and Frank Hahn. Alfred Marshall and the analysis of markets.

Carl Menger and the Austrian school (Ludwig von Mises and Friedrich Hayek).

Lectures 9-10: John Maynard Keynes

Stagnation, public and private investment, and the role of the state: the origins of modern macroeconomics.

Lecture 11: Joseph Schumpeter

Innovation, business cycles and economic development.

Lectures 12-13: Post-WWII developments in Macroeconomics

Monetarist, New Classical, Real Business Cycle, New Keynesian, and Post-Keynesian approaches.

Lectures 14-16: Post-WWII developments in Microeconomics

Social choice, market failure and government failure, risk and uncertainty, behavioural economics, institutional economics, and development economics.

Supervision Essay Questions

Why did Ricardo and List disagree on international trade? To what extent is the modern debate informed by similar principles?

Readings

Bhagwati, J., *Free Trade Today*, ch. 1

Chang, H.-J., 'Kicking Away the Ladder: Infant Industry Promotion in Historical Perspective', *Oxford Development Studies*, 2003, vol. 31, no. 1

Hirschman, A. O., 'The Political Economy of Import-Substituting Industrialization in Latin America', *The Quarterly Journal of Economics*, 1968, vol. 82, no. 1

List, F., *The National System of Political Economy*, ch. 26

Ricardo, D., *On the Principles of Political Economy and Taxation*, ch. 7 (OR Mill, J. S., *Principles of Political Economy*, Book III ch. 17)

Samuelson, P. A., 'Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream Economists Supporting Globalization', *The Journal of Economic Perspectives*, 2004, vol. 18, no. 3

Optional reading

Lin, J. and Chang, H.-J., Should industrial policy in developing countries conform to comparative advantage or defy it? - A debate between Justin Lin and Ha-Joon Chang, *Development Policy Review*, 2009, vol. 27, no. 5

What are the origins of utility maximization as a theory of economic choice? How is it reflected in modern economics? What are its limitations?

Readings

Dasgupta, A.K., *Epochs of Economic Theory*, ch. 6 (OR Roncaglia, A., *The Wealth of Ideas*, ch. 10)

Hicks, J., *Value and Capital*, ch. 1

Hirschman, A. O., 'Against Parsimony: Three Easy Ways of Complicating Some Categories of Economic Discourse', *The American Economic Review*, 1984, vol. 74, no. 2

Jevons, W. S., *The Theory of Political Economy*, Chapter 3

Robbins, L., *An Essay on the Nature and Significance of Economic Science*, ch. 1

Sen, A. K., *Rational Fools: A Critique of the Behavioral Foundations of Economic Theory*, *Philosophy & Public Affairs*, 1977, vol. 6, no. 4

How did the concept of natural rate of unemployment challenge the prevalent understanding of the relationship between inflation and unemployment? Is it a useful concept?

Readings

Friedman, M., 'The Role of Monetary Policy', *American Economic Review*, 1968, vol. 58, no. 1

Froyen, R. T., *Macroeconomics*, ch. 10

Galbraith, J. K., 'Time to Ditch the NAIRU', *The Journal of Economic Perspectives*, 1997, vol. 11, no. 1

Phelps, E., 'The Origins and Further Development of the Natural Rate of Unemployment', in R. Cross (ed.), *The Natural Rate of Unemployment. Reflections on 25 years of the hypothesis*

Phillips, A. W., 'The Relation Between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861–1957', *Economica*, 1958, vol. 25, issue 100
Stiglitz, J., 'Reflections on Natural Rate Hypothesis', *The Journal of Economic Perspectives*, 1997, Vol. 11, No. 1

How do the views on choice under uncertainty proposed by behavioural economics differ from those in the Austrian, Keynesian, and Subjective Expected Utility (SEU) traditions?

Readings

Kahneman, D., Slovic, P., and Tversky, A., *Judgment Under Uncertainty: Heuristics and Biases*, Preface

Keynes, J. M., *The General Theory of Employment, Interest and Money*, ch. 12

Lachmann, L., 'From Mises to Shackle: An Essay on Austrian Economics and the Kaleidic Society', *Journal of Economic Literature*, 1976, vol. 14, no. 1

Menger, C., *Principles of Economics*, ch. 1, section 4

Savage, L., *The Foundations of Statistics*, ch. 2

Shackle, G. L. S., *Epistemics and Economics*, chs. 6 and 7

PHILOSOPHY OF ECONOMICS (8 Lectures: in Michaelmas)

Anna Alexandrova (Department of History and Philosophy of Science)

Why Philosophy of Economics?

Economics is to some ‘the dismal science’ and to others ‘the queen of social science’. But before it can be either criticized or defended it should be understood. The guiding question of this course is: what sort of science is economics? We explore two key projects of contemporary economics – model-building and social evaluation.

The first project is positive, aiming at providing explanation and understanding of social phenomena by means of simple models, typically involving ideally rational agents. Can such models provide explanations despite their apparent falsity? If so, how? If not, what else are these models good for?

The second project is normative – to evaluate different social states and policies for their effect on human welfare. We shall see that typically economists define welfare as efficiency, and efficiency as the optimal satisfaction of preferences of all involved. Is this a defensible theory of well-being? What should happen when preference satisfaction conflicts with other values such as justice and equality? If welfare economics is a project that assumes certain ethical and political values, what does this mean for objectivity of economics as a science?

As we explore these questions, we touch on such classic topics in philosophy of science, such as: what it takes to confirm a theory or a model?; the nature of scientific progress; whether explanations must state the facts (and even better fundamental facts); and whether science should be free of values.

Lecture Plan

Lecture 1: Introduction to Philosophy of Science

Topics covered: course preview, what is scientific method, what we should expect from philosophy of science.

Lecture 2: What is special about Social Science?

Topics covered: two cultures in social science (naturalism and interpretivism), how economic method looks from the perspective of other natural and social sciences.

Lecture 3: Basics of Rational Choice Modelling

Topics covered: basic assumptions of utility theory (and game theory), how rational choice models are built.

Lecture 4: Empirical objections to RCT

Topics covered: critique from psychology and behavioural economics, Milton Friedman's response (assumptions need not be realistic).

Lecture 5: Moral objections to RCT

Topics covered: value presupposition of RCT, Sen's critique of revealed preference, definitions of welfare.

Lecture 6: Need Economics be value neutral to be objective?

Topics covered: value-freedom versus value-ladenness, objectivity, happiness economics as an example.

Lecture 7: Methodological Individualism and the Quest for Micro-foundations

Topics covered: reductionism in science, the autonomy (or not) of macro-explanations, need macroeconomics microfoundations?

Lecture 8: Social Measurement

Topics covered: nature of measurement in social science, economic (axiomatic) tradition versus the psychological (psychometric) tradition, conclusions of the whole course.

Supervision Essay Questions

If assumptions of rational choice theory are false, does it matter?

Readings

- Elster, J. (1985) "The nature and scope of rational-choice explanations" in Ernest LePore and McLaughlin, B. (eds.), *Actions and Events: Perspectives on the philosophy of Donald Davidson*, Blackwell, pp. 60-72.
- Friedman, M. (1953) "The methodology of positive economics" in *Essays in Positive Economics*, University of Chicago Press, pp. 3-43.
- Hausman, D. (1994) "Why Look Under the Hood." in D. Hausman (eds.), *The Philosophy of Economics*, Cambridge University Press, pp. 217-221.
- Kahneman, D. (2002) "Maps of Bounded Rationality: Psychology for Behavioral Economics" Nobel Prize
Lecture http://www.nobelprize.org/nobel_prizes/economics/laureates/2002/kahneman-lecture.html
- Reiss, J. (2013) "Models, Idealization and Explanation", chapter 7 of *Philosophy of Economics: A Contemporary Introduction*, Routledge, pp. 119-142. (E-book: <https://www.dawsonera.com/readonline/9780203559062/startPage/2262>)

Should economics strive for value-freedom?

Readings

- Anderson, E. (2004). "Ethical assumptions in economic theory: Some lessons from the history of credit and bankruptcy", *Ethical Theory and Moral Practice* vol. 7, no. 4, pp. 347 - 360. <http://www.jstor.org/stable/27504325>
- Hausman, D. and McPherson, M. (2006) "Normative Economics: Two Examples" in *Economic analysis, moral philosophy and public policy*. Cambridge University Press.
- Reiss, R. (2013) "Markets and Morals", chapter 13 of *Philosophy of Economics: A Contemporary Introduction*, Routledge, pp. 233-253. (E-book: <https://www.dawsonera.com/readonline/9780203559062/startPage/226>)
- Sen, A. (1977) "Rational Fools: A Critique of Behavioural Foundations of Economic Theory" *Philosophy and Public Affairs*, vol. 6, no. 4, pp. 317-344. <http://www.jstor.org/stable/2264946>.

ISSUES IN SOCIAL ONTOLOGY (6 Lectures: in Lent)

Tony Lawson (Faculty)

Why Social Ontology?

The last few years have seen a significant turn to social ontology in the social sciences. In economics, Cambridge has been at the heart of this, and indeed Cambridge researchers are leaders in the field in general. But what is social ontology, and why should economists be interested?

‘Onto’ means ‘being’ and ‘ology’ means ‘study of’. So social ontology is basically the study of the *nature* of social reality. The question is not really why should economists be interested in social ontology but why have they avoided the topic for so long. In physics, for example, researchers have always been concerned with the basic nature of the stuff with which they deal, with earlier contributors addressing the nature of heat, light, matter, sound, change, the universe, time, and so on. Modern examples include the nature of dark matter, dark energy, quantum fields, space time, quarks, tanon-neutrinos mass, Higgs boson particles, and the like.

Economists used to do the same. Aristotle studied the nature of value and money, as did Adam Smith, David Ricardo, Karl Marx. John Maynard Keynes. But for some reasons (worth analysing) the subject has been neglected for the last 50 years or so. Now it is back on the agenda, and, to repeat, Cambridge is at the forefront. Just as physics advances only by repeatedly studying and revising its understanding of the basic constituents of the non-social world, so economics, to advance, needs a better understanding of its own material.

The course will look at the basic nature of social material, and its mode of being. It will also examine the nature of its numerous particular manifestations, amongst which are money, the firm (including the corporation), the market, technology, capitalism, gender, social relations, value, an institution, and so on, even including the nature of economics itself, and in particular Neoclassical economics.

If an understanding of reality is the goal (as opposed to mere mathematical proficiency), this ‘option’ is not an option at all.

Lecture Plan

Lecture 1: Introduction to Social Ontology

What is social ontology? What is its relevance to economics? Ontology and the possibility of social science.

Lecture 2: The Nature of Social Being in General

Theorising the basic nature of social reality. Collective practice, norms, rules, rights and obligations, etc. Philosophical and Scientific Ontology. Methods, concepts and results.

Lecture 3: Topics in Scientific Ontology 1. The Nature of the Firm

Looking at the nature of the firm and the corporation. Examining notions like legal personhood, legal fictions, and multi-national companies and transfer pricing.

Lecture 4: Topics in Scientific Ontology 2. The Nature of Money

Looking at the nature of money. Contrasting competing conceptions. Examining the nature of value and of debt.

Lecture 5: Topics in Scientific Ontology 3. Change and Stability. The Nature of Technology and Institutions. Looking at the nature of technology and institutions, and how the latter facilitate stability and developments in the former result in perpetual change

Lecture 6: Topics in Scientific Ontology 4. The Nature of Neoclassical Economics

Questioning the nature of neoclassical economics. Examining why so many different and conflicting accounts exist. Exploring whether it is a category worth maintaining

Supervision Essay Questions

“In the case of commodity money the stuff is a medium of exchange because it is valuable, in the case of fiat money the stuff is valuable because it is a medium of exchange” (Searle, 1995, p. 42). Critically evaluate the foregoing assessment.

Readings

- Ingham, G. (2011) ‘The Ontology of Money’, *Twill*, no. 14, pp. 15-22, http://www.twill.info/wp-content/uploads/2013/03/The_ontology_of_money.pdf
- Innes, A. (1913) ‘What is Money?’ *Banking Law Journal*, May, p. 377-408
- Lawson, T. (2017) ‘Social Positioning and the Nature of Money’, *Cambridge Journal of Economics*, (forthcoming).
- Marx, K. (1974) *Capital: A Critical Analysis of Capitalist Production, Volume I, Chapter 3* (on money). Translated from the third German edition by S. Moore and E. Aveling and edited by Frederick Engels, Lawrence and Wishart.
- Searle, J. (1995), *The Construction of Social Reality*, The Free Press, especially chapter 2
- Searle, John (2010), *Making the Social World*, Oxford University Press, especially Chapter 5

Additional Background Readings

- Graeber, David (2011) *Debt: the first 5000 years*, Melville House.
- Ingham, Geoffrey (2004) *The Nature of Money*, Polity Press.

What is a corporation? In answering this question address at least one of the following claims:

- a) the corporation is a fictitious entity,**
- b) the corporation is a person**
- c) the corporation is merely a nexus of contracts**

Readings

- Coase, R. (1937) The Nature of the Firm, *Economica*, vol. 4, no. 16, pp. 386–405.
- Deakin, S. (2012) ‘The corporation as commons: rethinking property rights, governance and sustainability in the business enterprise’, *Queen’s Law Journal*, vol. 37, no. 2, pp. 339–81.
- Hart, O. (1989) ‘An Economist’s Perspective on the Theory of the Firm’, *Columbia Law Review*, Vol. 89, No. 7, Contractual Freedom in Corporate Law, pp. 1757-74.
- Jensen, M. C. and Meckling, W. H. (1976) ‘Theory of the firm: managerial behavior, agency costs and capital structure’ *Journal of Financial Economics*, vol. 3, no. 4, pp. 305–60.
- Lawson, T. (2015) ‘The nature of the firm and peculiarities of the corporation’, *Cambridge Journal of Economics* 2015, vol. 39, no. 1, pp. 1–32
- Searle, J. (2010), *Making the Social World*, Oxford University Press, especially Chapter 5.