Part IIB Paper 18

History and Philosophy of Economics (borrowed from Part IIA)

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).

The ‘History of Economics’ part of the Paper will be examined by a 2,500-word essay (which will count for 50% of the final mark). Students will be given two essay questions and respective reading lists (providing the most basic readings and thus expecting the students to read beyond them) on the first day of the full term of the Easter term (a Tuesday). They will be expected to choose one question and submit the essay by the following Monday. The ‘Philosophy of Economics’ part of the Paper will be examined by a 2-hour examination, in which students will be expected to answer two of the four questions (which will count for the other 50%).

Indicative Readings
Chang, H-J., Economics: The User’s Guide, ch. 4
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
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

Lecture 6: Karl Marx
The economic and socio-political conditions of economic development.

Lectures 7-8: The Marginal Revolution

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

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

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

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
Froyen, R. T., *Macroeconomics*, ch. 10
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*
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
Menger, C., *Principles of Economics*, ch. 1, section 4
Shackle, G. L. S., *Epistemics and Economics*, chs. 6 and 7
**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: What is Philosophy of Economics?
Topics covered: deductive vs inductive science, John Stuart Mill, nature of social science, role of philosophy of science

Lecture 2: Rational Choice Theory as a descriptive project.
Topics covered: preference ranking, utility function, nature of utility, axioms of consistency, expected utility theory, rationality in games

Lecture 3: Is Rational Choice Theory false?
Topics covered: Sen's 'rational fools' critique, Kahneman and Tversky's heuristics and biases, bounded rationality

Lecture 4: Can a false model explain?
Topics covered: Problem of realism of assumptions. Friedman's 'as if' theory, nature of explanation, whether Prisoner's Dilemma is 'everywhere'

Lecture 5: Economics as a normative project.
Topics covered: value-ladenness of economic concepts, efficiency, free market, nature of ethical analysis.

Lecture 6: Is well-being preference satisfaction?
Topics covered: theories of well-being, objections to preferences as sole indicators of value, happiness, capabilities approach

Lecture 7: What is cost-benefit analysis good for?
Topics covered: definition and measurement of benefit, consequentialism, justice

Lecture 8: Is economics an objective science?
Topics covered: nature of objectivity, pluralism in economics, how to criticise economics and how not to
Supervision Essay Questions

If assumptions of rational choice theory are false, does it matter?
Readings
Katie Steele (2014) “Choice Models” in Philosophy of Social Science: A New Introduction (eds) Nancy Cartwright and Eleonora Montuschi, OUP.

Should economics strive for value-freedom?
Readings
**Why Social Ontology?**

The last few years have seen a significant turn to social ontology in the social sciences. 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 ‘logia’ means ‘study of’. So social ontology is basically the study of the *nature* of social reality. The question is not really ‘why should social theorists including economists be interested in social ontology?’ but ‘why have so many social theorists, not least economists, 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, tau-neutrinos mass, Higgs boson particles, and the like.

Those interested in economic phenomena as well as other social phenomena 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 social theory including 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 some of its numerous particular manifestations, amongst which are money and the corporation.

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: Comparing Competing Theories of Social Ontology
Comparing different accounts of the basic principles of social reality constitution, including those associated with the Cambridge social ontology group, John Searle and his Berkeley group, and conceptions implicit within dominant modes of modern economic reasoning.

Lecture 3: The Nature of Money
Looking at competing conceptions of the nature of money. Examining the nature of money, value and of debt.

Lecture 4: The Nature of the Firm
Looking at competing conceptions of the nature of the firm including the corporation. Examining notions like legal personhood and legal fictions, and the nature of multi-national companies and transfer pricing.

Lecture 5: 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.

Lecture 6: Development and Discussion

Supervision Essay Questions

1) “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
Searle, John (2010), Making the Social World, Oxford University Press, especially Chapter 5
2) 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

3) (i) Does economics/social theorising need social ontology?
(ii) Critically compare the Cambridge/positioning conception of social ontology with that defended by Berkeley/John Searle.
(iii) Illustrate your answer to (ii) by briefly indicating how the two groups accommodate one or more central phenomena, like money, the firm, or any other of your choosing.
(iv) Which theory fares best and why?

*Core Reading*: see ‘Social Ontology Moodle Site’, section ‘Debates in Social Ontology’, Debate 1, entries 1, 2 and 5.

4) (i) Explain the claim that Veblen coined the term neoclassical economics to express an ontological thesis.
(ii) Compare the latter thesis with Keynes’ early analysis of the preconditions for successful econometrics.
(iii) Heterodox economists, Rethinking Economics students and Cambridge pluralists tend to use the term neoclassical economics/economists when they critically comment on others. How do you assess the manner in which they do so from a Veblenian and/or Keynesian methodological perspective?

*Core Reading*: see ‘Social Ontology Moodle Site’, reading list for lecture 5, especially papers 5.1 and 5.2, and folder on ‘Keynes and Ontology’ in the Moodle Library.