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What the History of Economic Thought Can Teach Us

Abstract

The purpose of this article is to outline the perspective that the history of economic thought is an important way of looking at economic problems. The author discusses the reasons why this perspective can be more useful than others, and chooses the widely discussed concept of the human being in economics as an example. She discusses what characteristics are attributed to the human being by the different schools of economic thought. Based on attitudes to human rationality, pursued goals and the meaning of social context, the author distinguishes four basic models of economic agent: classical, neoclassical, Marxian and heterodox. The author points out the links between the changing anthropological assumptions and shifts in the dominant economic paradigm. She argues that in the current economic crisis we are witnessing a change in the perception of human behaviour towards a heterodox one.

Keywords: history of economic thought, homo economicus, economic agent

1. The Significance of Using Different Approaches to Economic Problems

Economic problems fall within the fields of interest of many sciences, being analysed by, among others, psychology, sociology, anthropology, philosophy and human biology. Each of these sciences examines a given problem from its own perspective. They focus, however, on very detailed or specific issues, such as the analysis of concrete human decisions and behaviours, measuring specific neural connections in the brain while making economic decisions, or exploring the impact of societies' economies on early development. Economists very seldom use this kind of knowledge since economics abstracts itself from the complications of real economic problems by isolating certain features and examining them from a very specific economic perspective. While the achievements of other sciences can be inspirational in bringing about a change in the ways of thinking about the essence of certain economic phenomena, it's rare that an economic theory is supplemented by the discoveries of other sciences in this field. Mainstream economists are aware of the complexity of real economic problems, but for the sake of the science they practice, they use models that emphasise only a few features that seem to determine economic life.

Looking at economic problems from the perspective of the history of economic thought leads to different results. It offers a broad approach; an overview of the problems in question, which enriches the economic analyses in a fundamental way.

2. The History of Economic Thought Provides a Broad Approach to Economic Problems

The history of economic thought provides us with a general picture of a particular theory. A historian of economic thought is interested in the origin and continuity of economic concepts, studying examples in which forgotten ideas are revived. The historian systematizes discussions in economics; identifies from the various currents of economic thought a multitude of views on certain problems. The historical perspective permits a comprehensive examination of economic problems. It demonstrates how and for what reasons certain ideas are discussed among different schools of economics in the course of the development of economic thought. It shows how economic concepts are influenced by prevailing philosophical currents and by discoveries in other sciences. This knowledge helps us to understand the basis for the emergence and development of economic ideas, as well as the reasons for their changing popularity in the present and the past.

The historical perspective also enables us to understand how some economic theories have been shaped by real economic or political events, as well as identifying the significant influence that some economic concepts have exerted on economic policy. The wide acceptance of a particular economic concept often determines the choices of concrete economic policy and the way in which they are implemented. From a practical point of view, a deep understanding of different, sometimes even contradictory economic concepts, seems fundamental.[1]

In this article I want to use just one of the methods above to show how a single economic concept differs among the various schools and why this can be important.

3. The Concept of the Human Being in the History of Economic Thought

The analysis of the concept of the human being in economics from the perspective of the history of economic thought provides a good example of the creative, and essential, contribution made by the history of economic thought to the understanding of economic problems.

The concept of the human being is a constantly recurring topic in economic literature. Many books, papers and conferences on the history of economic thought and on economics itself are devoted to this subject or focus on the different aspects of this problem. In many cases the reason that scientists become involved in analysing this problem is due to the evident differences between real human behaviour and the model as accepted by mainstream economics. It provokes attempts to supplement the theory with elements that will bring the model closer to reality, or to prove that the discrepancies between the model and reality disappear with deeper analysis. Attempts to elaborate existing concepts of the human being in economics are often also triggered by discoveries or observations of the applied sciences connected with economics, such as marketing, management, finance, the theory of insurance, the theory of investment, and the theory of decision-making. Interest in the nature of *homo economicus* has also been stimulated by logical discrepancies that become evident through attempts to combine the achievements of economists who adopt differing concepts of the human being. There have also been attempts to reconcile

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1 A more extensive argument is provided by I.A. Kerr, *The Value of the History of Economic Thought*, "Journal of Economic and Social Policy" 2002, vol. 6, no. 2.

the concept of the human being in economics with the idea of man in contemporary currents of philosophy, ethics and, because of the Western cultural basis of economics, Christian ethics.

Historians of economic thought are particularly interested in changes to the concept that result from developments in the dominant schools of thought – that is, from the ageless discussion among the different currents of economics – since they largely concern fundamental features of the human being in economics. The concept evolved both in the classical-neoclassical school, which assumes the universality of economic theory to explain the problems facing real economies; as well as in the institutional approach, which stress the importance of context in the application of economic tools. The character of the changes in this concept within the various schools of economics that accept different subject paradigms, makes the problem particularly interesting.

Moreover the change in anthropological assumptions is often accompanied by a paradigm shift. The concept of the human being in mercantilism differed from the concept in classical economics, which dominated economic thinking later on. The marginal revolution marking the end of the classical era started with a new theory of value that was closely linked to a new concept of the economic agent. One of the most famous methodological debates of 19th century economics – *Das Methodenstreit* – between representatives of the German Historical School and Austrian economists, also referred to this concept. In the 20th century both the Keynesian revolution and the return of classical economics in the seventies brought about changes in the way the nature of human actions in economic life were perceived.

A short review of the variations in the concept of the human being in economics in line with the changing paradigm of the working of the economic system, suggests that the response to the question about the anthropological basis of economics is fundamental. Without any doubt, economics, being a social science, tries to understand human behaviour. Without a concept of the human being implied or expressed explicitly, any description of an economic system has to be incomplete. Choosing the right anthropological approach is of fundamental significance to a successful theoretical model of the working of an economic system. Getting things right is even more crucial when it comes to applied economics. For example, the effectiveness of the state's shaping of the economic space – conducting economic policy, establishing economic law, creating economic institutions, which are to some extent based on economic theories – depends on the proper understanding of the key element of the economic system, namely, human behaviour.

As for the anthropological basis of economics, the concept of man is very specific, it takes into account only his economic activity. This concept represents an attempt to distinguish the universal characteristics of man that determine his behaviour in economic life in order to recognize economic laws. The perspective from which historians of economic thought examine concepts in economics permits us to discern how the different schools of economics attach different weights to the concept of man. This concept has been particularly important for neoclassical economists; however, because of the significance of the concept, all economics schools must make some assumptions concerning human nature. The lack of the concept's uniformity results from differences in the characteristics of the human being that are recognized as basic by different schools of economics, or from differing interpretations of the nature of human behaviour.

There are a number of reasons why the perspective of the historian of economic thought is essential for pointing out differences in the anthropological concepts in economics.

1. There is a popular view, shared by economists and specialists from related sciences, that the only anthropological approach in economics is the model of *homo economicus*, which is characteristic of the classical current of economics. This approach is currently also accepted, to a large extent, by economists representing other schools. In view of the frequent, critical opinions on the concept of the human being in economics, it is worth stressing that *homo economicus* is not the only one; in the history of economic thought, other anthropological concepts have also been strongly represented, even though at present, they seem to be less popular. Therefore, it is important to analyse the concept of the human being from the point of view of many economists, from which we can then distinguish a number of well defined approaches.
2. Many authors emphasize that the model of man, as developed by the classical school, has nothing to do with real human behaviour in economic life. This concept has been accused of being completely unrealistic. It is therefore important to answer the question about the extent to which this model enables us to understand the nature of the human being in economic life; whether it is possible to maintain the assumption of the universal rationality of the human being when economic and political choices have been most effectively influenced, almost exclusively, through non-rational motives and by appeals to emotions or instincts.
3. The *homo economicus* model cannot be used to represent the economic behaviours of people from cultures outside the Western world. Some scientists argue that a new model of the human being should be formulated that better explains human nature in the Western world as well as for other cultures. Offering an opposing conception to the one derived from the Enlightenment tradition would undoubtedly bring an essential contribution to this discussion. The impact of the

concept of the human being upon the theories of a particular economist is also an interesting aspect of the analysis. There is a distinct division in these concepts along the lines of divisions in the different schools of economics. It strengthens the argument that anthropological assumptions influence the vision of how the economic system functions.

The history of economic thought reveals many concepts of the human being. I would like, however, to focus on four basic ones: Classical, Neoclassical, Marxian and non-Marxian Heterodox. I selected these concepts based on their differences in such features as their attitude to human rationality, the cause of an economic agent's actions, and the relevance of social context. The proposed division of the concepts of the human being in economics does not exhaust the wealth of such ideas found in the history of economic thought, nor is it a classical division. It does, however, outline a structure into which other concepts can be placed. The classical division of theories within the realm of economics splits them into two categories: mainstream and heterodox. For the purposes of this article I have proposed an unconventional "taxonomy" that goes across the usual division. It underlines the often neglected difference in approach to anthropological assumptions between classical and neoclassical economics, as well as extracting Marxian theory from the heterodox family on the grounds that it stresses the material cause of human actions. This method dictated a similarly unorthodox inclusion in the heterodox group, that of the Keynesian take on human agents.

The concept of the human being in economics generally serves one of two functions: it is either an important supplement to, or a basic element of, a particular theory developed or created by a given economist. For classical economists, the concept of man is a pivotal element that explains the macroeconomic phenomena. Such fundamental issues as the movement of capital from less to more profitable branches of industry, the changes in market prices, or the anticipation of inflation, have been explained as outcomes of rational human decisions based on objective knowledge about the world, and driven by financial self-interest. The division of labour and its effectiveness have been treated as the product of the innate individualism of the human being. Rationality, ascribed to human beings by authors belonging to the classical school of economics such as Adam Smith, J.B. Say, J.S. Mill,[2] and also in the 20th century to some extent by M. Friedman and R. Lucas,[3] is based on the

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[2] A. Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Methuen and Co. Ltd., London 1904 (original work published in 1776); J.B. Say, *Treatise on Political Economy*, Augustus M. Kelley, New York 1971 (original work published in 1803); J.S. Mill, *Principles of Political Economy*, Longmans, Green and Co., London 1909 (original work published in 1848).

[3] M. Friedman, *Essays in Positive Economics*, The University of Chicago Press, Chicago 1953.

assumption of an objective recognition of the world. The actions of economic agents based on this, which translates into economic laws, are untouched by the human psyche. This concept arose at the end of the 18th century in the age of the Scottish Enlightenment, and clearly connects with the philosophical legacy of this epoch. Authors who adopt this concept assume that man is able to objectively perceive the world (or to act "as if" he can), and act in a logical way to obtain his own material gains according to his knowledge.

For neoclassical economists, the concept of man has been a basic element of economic analysis. According to the doctrine of cognitive individualism they adopted, the motives for individuals' acts have been recognized as the foundation of both economic processes and their analysis. They created the concept of an individual who makes decisions using scarce means to obtain a multiplicity of the individual's goals. They rejected the classical assumption of the significance of recognizing objective reality, instead viewing the human perception of reality as subjective. The neoclassical concept of man created by W.S. Jevons, A. Marshall, and developed by L. Robbins and later on by G. Becker,[4] assumes that each agent seeks to maximize his own utility. Utility – the attainment pleasure or satisfaction – is in theory, not limited to material gain, but is practically reduced to it. Human beings are not able to obtain perfect knowledge about the world around them, but they are equipped with the mechanism of consequent logical calculation, which enables them to reach their predefined goals. Neoclassical rationality is restricted to the ability to order goals and to act in a logical fashion on the basis of available information.

The neoclassical concept differs from the classical one in its attitude toward human social relations. Mainstream economics, over time, departed from Smith's typically broad analysis, which covers a comprehensive historical and social context. The new orthodoxy followed David Ricardo's approach, which simplifies complex economic realities into neat, abstract models derived from basic economic assumptions. The neoclassical school, which built upon the microeconomic analysis of the classics, continued along this path. Smith's awareness of social class differences, along with his macroeconomic approach and wider analytical perspective, was discarded. This approach was replaced by the analysis of an isolated 'Robinson Crusoe-like' decision-making process, completely detached from the social context.

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4 W.S. Jevons, *The Theory of Political Economy*, Macmillan and Co., London 1931 (original work published in 1871); A. Marshall, *Principles of Economics*, Macmillan and Co. Ltd., London 1920 (original work published in 1890); L. Robbins, *An Essay on the Nature and Significance of Economic Science*, Macmillan Co., London 1945 (original work published in 1932); G. Becker, *The Economic Approach to Human Behavior*, University of Chicago Press, Chicago 1976.

Marxian economics[5] offers another distinctive perspective. It is based on the belief that people's actions are dependent upon the will of capital. Neither capitalists nor workers freely decide on their actions, rather they are subservient to moneyed interests. The goal of capital, in accordance with which people behave, is to multiply itself. People do not consciously choose their actions, so there is no place for rational decisions. Human beings are social animals, but the capitalist economy does not allow this nature to develop. Even within families, positive emotions are suppressed. The alienation of capital causes the alienation of humanity. True human nature, which is characterized by rational action and sociality, can be developed only in a socialist system.

Marx's evaluation of economic phenomena lies in stark opposition to that of the classical economists. Private property, the division of labour, everything that, according to classical economics, contributes to universal prosperity, and therefore is moral, according to Marx leads to human destruction, and so is immoral.

The Marxian concept of man results from an attempt to project economic phenomena onto the nature of individuals. The author uses dependence on capital to explain the style of life and work of both capitalists and workers. The capitalist sets up enterprises, exploits workers and competes with other firms because it permits him to accumulate capital. The worker's health, psyche, and family is destroyed because of the subservience to the superior pressure of capital.

Finally, the heterodox concept of the human being also rejects the assumptions of both the classical and neoclassical schools concerning human rationality, and to some extent agrees with Marx in regards to external forces shaping human actions. Authors such as F. List, T. Veblen, M. Weber, J.K. Galbraith, but also J.M. Keynes, J. Schumpeter,[6] and contemporary experimental,[7] behavioural,[8] evolutional and institutional economists,[9] have argued that human behaviour is seldom an outcome of rational thought. Human behaviour is determined by a wide range of factors such as instinct,

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[5] K. Marx, *Capital*, vol. 1, Penguin, London 1976 (original work published in 1861).

[6] F. List, *Das nationale System der Politischen Oekonomie*, Verlag von Gustav Fischer, Jena 1950 (original work published in 1841); T. Veblen, *The Theory of the Leisure Class*, Macmillan, New York, London 1899; M. Weber, *Economy and Society; an Outline of Interpretive Sociology*, Bedminster Press, New York 1968 (original work published in 1922); J.K. Galbraith, *The Affluent Society*, Houghton Miffin Co., Boston 1958; J.M. Keynes, *The General Theory of Employment, Interest and Money*, MacMillan and Co. Limited, London 1946 (original work published in 1936); J.A. Schumpeter, *Capitalism, Socialism and Democracy,* Harper and Row, New York 1950 (original work published in 1942).

[7] A. Smith, op.cit.

[8] D. Kahneman, *Maps of Bounded Rationality: A Perspective on Intuitive Judgment and Choice*, Nobel memorial lecture, 2002.

[9] S. Bowles, *Microeconomics. Behavior, Institutions, and Evolution,* Princeton University Press, Princeton NJ 2004.

spirit, social milieu, tradition, habits and sometimes reason. For heterodox economists, the concept of man plays an essential role. They contradict the vision of the rational, self-interested individual, claiming that the classical concept is utopian. They focus on the true character of human behaviour: the tendency to conform to traditional patterns of behaviour; the unusual effort required to make rational decisions and the psychological conditioning of man, which induces instinctive behaviours subordinate to emotions. Behavioural economics that is based on in-depth studies recognizes that economic agents are not only self-interested, they are also inclined to reciprocate others' behaviours, seek fairness, and to act with some degree of altruism. The outcomes of behavioural research with respect to human decision making follow an institutional tradition that can be traced back to Friedrich List in the mid-19th century.

Economists of the historical-institutional school have highlighted the influence of culture and the degree of economic development of a given country, on the economic behaviour of its inhabitants. They question the universality of economic laws. Economists who have employed this concept often stress the heterogeneity of economic agents. This approach assumes that people differ fundamentally. Only a small fraction of society develops rational thought. Those who are capable of it, according to Joseph Schumpeter,[10] play an important role in society. In a capitalist economy, they become entrepreneurs.

Different concepts of the human being involve different attitudes toward the role of government in the economy. The opinion that the role of the state in the economy should be minimal is a consequence of the assumption that people are perfectly rational individualists and that the multiplication of private fortunes leads to social harmony. The authors who emphasize the influence of non-rational motives on human decisions are more inclined to treat the government as important, suggesting that it should coordinate the economic system, guide the direction of development, and enable the establishment of institutions that support social development.

Conclusions

There are many concepts of the human being in economics and many perspectives that can be used to analyse them. The historical perspective enables us to identify the essential currents of thought on this problem. It shows how different concepts in economics interweave and interact with each other, as well as how closely they correspond with the achievements of other sciences and philosophical currents that

[10] J.A. Schumpeter, op.cit.

are characteristic of the given epoch. Such a perspective permits us to outline the heterodox concept, which emphasizes the social features of the human being and non-rational motives of behaviour. It is particularly important in a situation in which economics learns an increasing amount from other social and human sciences. In addition, experimental economics has demonstrated that non-rational motives play an important role in the process of economic decision-making.

Milton Friedman[11] wrote that it is not important if a concept is true, only that it is possible to make use of it for verifiable forecasts. The ability to forecast rather than to conform to reality, justifies a concept – but is that still the case? The concept of the human being proposed by neoclassical economics and derived from the classical tradition has dominated economics for many years now. There is a lot to say for it: it is simple, and it can easily be translated into mathematics and used in models based on the type of language that prevails in contemporary economics. Today's economics is however not able to predict or even explain the current state of affairs, with the recent financial crisis being the most acute example. Prominent economists such as Joseph Stiglitz[12] stress that contemporary economics needs a new paradigm, possibly with new underlying anthropological assumptions. Can it, however, be provided by other economic traditions?

The heterodox concept of the human being is considerably closer to reality than the rest. This description of human nature agrees more closely with contemporary psychological and sociological knowledge than does the model of man developed by the classical-neoclassical school. So far it has been particularly useful in explaining economic processes during turbulent times or in countries outside the Western world. In such cases, the influence of culture, spirit, institutions, collective psyche, and emotion on economic processes is evident. They also provide a good answer to the question of why classical and neoclassical models are often the most successful in explaining economic processes in developed Western countries. In these countries, as a result of evolutionary processes leading to the prevalence of such conditions, styles of life and work have been promoted, and myths and institutions dominate that lead people who imitate them to behave as if they were rational. However, the mechanical selection of a means to obtain a particular goal, as opposed to reflection on the problem at hand, introduces essential limitations. It explains both the impression that, in many cases, people seem to behave rationally, as well as the irrational susceptibility of man (e.g. to advertisements) to the manipulations of the media in seeking to impose certain lifestyles or irrational behaviour in unusual situations such as crises.

[11] M. Friedman, op.cit.

[12] J. Stiglitz, *Needed: A New Economic Paradigm*, "Financial Times", 19.08.2010.

The historical perspective identifies the evolution within classical-neoclassical economics of the understanding of human goals and the attitudes toward the social environment in economic life. This evolution is particularly apparent when contrasted with the dominant concept of man in contemporary mainstream economics, which combines the classical and neoclassical concepts (rejecting man's non-material goals). It also illustrates a continuity of the criticism of the classical-neoclassical economic paradigm. One interesting feature of the heterodox concept of man is not its cohesion, but rather its perennial recurrence as a critique of classical and neoclassical assumptions, which given the current economic circumstances are now weaker than ever. Behavioural and experimental economics, among others, are providing new evidence for a broad gap between the real conduct of the human being in economic life and neoclassical theory. Does this mean that we are about to witness a new scientific revolution in economics? The evolution of the concept of the human being in economics, one of its pivotal assumptions, seems to be gaining a new momentum. With V. Smith, D. Kahneman and R. Shiller, being heirs to the heterodox tradition, and receiving Nobel Prizes in recent years, the process might be starting.

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