Government Arts College for Women, Salem-8

Department of Economics

Unit- I

Nature and Scope of Economic Thought

Class: III B.A Economics

Meaning of History of Economic Thought:

History of Economic Thought as the title implies deals with the origin and development of economic ideas and their interrelations. It is a historical account of economic doctrines. Prof. Haney has defined it as “a critical account of the development of economic ideas, searching into their origin, interrelations and manifestations”. According to Prof. Bell, “It is the study of the heritage left by the writers on economic subjects”. Prof. Schumpeter holds that “economic thought is the sum total of all the opinions and desires concerning economic subjects especially concerning with public policies of different times and places”. Schumpeter further says that the history of economic thought traces the historical change of attitudes. It also speaks about the economic problems and the approaches to those problems. History of Economic Thought is different from Economic History and History of Economics. While History of Economic Thought deals with the development of economic ideas, Economic History is a study of the economic development of a country. On the other hand, History of Economics deals with the science of economics.

Even though Economic History and History of Economic Thought constitute separate branches of study, they are closely related. Economic ideas are directly and indirectly motivated by the economic conditions and environment of the country. Ideas and environment are equally important and hence close relationship between History of Economic Thought and Economic History.

History of the development of economic ideas can be studied under three periods, namely: 1. Ancient,

2. Medieval and

3. Modern.

Further the history of Economic Thought may be broadly divided into two parts. The first part deals with the origin and the development of economic ideas before the development of economics as a science. The second part deals with the economic ideas after the development of economics as a science.

History of economic thought can be studied and analysed by adopting different approaches: 1. Chronological approach

2. Conceptual approach

3. Philosophical approach

4. Deductive (or) Classical approach

5. Inductive approach

6. Neo-classical approach

7. Welfare approach

8. Institutional approach and

9. Keynesian approach.

1. Chronological approach: In this approach, economic ideas are discussed in order of time. The economic ideas of different economists can be presented year-wise and can be studied. In this approach we can find a continuity in the economic ideas of different economists.

2. Conceptual approach: It speaks about the evolution of different economic concepts (ideas) and the interdependence of these concepts. Conceptual approach can also be called as ideological approach.

3. Philosophical approach: This was first adopted by the Greek philosopher, Plato. In the past, economics was considered as a hand maid of ethics. Naturally philosophical approach was adopted by the early writers to discuss the economic ideas.

4. Deductive approach: The classical economists adopted deductive method. They believed in the universal application of economic laws.

5. Inductive approach: The Historical School emphasised the inductive method. These economists believed that the laws of economics are not universal in nature.

6. Neo-classical approach: This approach aims at improving the classical ideas by modifying them. Neo-classical approach was first adopted by Marshall. The Neo-classical approach believed that “Induction and Deduction are necessary for the science of economics just as the right and left feet are necessary for walking”.

7. Welfare approach: It aims at providing the basis for adopting policies which are likely to maximise social welfare.

8. Institutional approach: The institutionalists questioned the validity of classical ideas and gave importance to psychological factors.

9. Keynesian approach: A major development in modern economics is associated with the name of J.M. Keynes. His approach is new and different from the classical school. It takes into consideration the operation of business cycles that affect the entire economic policies. Keynesian approach deals with the problem of the economy as a whole.

Significance of History of Economic Thought: There are two views with regard to the importance of study of History of Economic Thought. One group of economists believed that there is no need to study the history of Economic Thought because it is a history of errors. Whereas another group believed that one cannot possess knowledge of any economic doctrine until one knows something of its history.

So a study of History of Economic Thought is important for the following reasons: 1. The study of History of Economic Thought clearly shows that there is a certain unity in economic thought and this unity connects us with ancient times.

2. The study of Economic Thought will help us to understand the origin of economics.

3. Economic ideas have been instrumental in shaping the economic and political policies of different countries.

4. Economic ideas are conditioned by time, place and circumstances.

5. A study of Economic Thought provides a broad basis for comparison of different ideas. It will enable a person to have a well-balanced and reasonable judgement.

6. Through the study of Economic Thought the student will realise that economics is different from economists.

7. The study of the subject helps us to avoid the mistakes committed by earlier economic thinkers.

8. The study of History of Economic Thought will enable us to know the person responsible for the formulation of certain important principles.

In short, the significance of the study of History of Economic Thought can hardly be overemphasized. It is an important tool of knowledge.

Difficulties in the Study of History of Economic Thought: However, it must be remembered that History of Economic Thought is selective and interpretative in nature. In other words the authors select those topics in which they are interested. They also explain the facts in their own manner.

If authors leave out certain important facts and emphasize others, their judgements are biased. For example, the famous book, "A History of Economic Doctrines"—written by Gide and Rist leaves out discussions on ancient economic ideas, medieval economic thought and the contributions made by Mercantilists.

Further, complete history should deal with modern economic thought also. That means it should include the contributions made by Marshall, A.C. Pigou, J.M. Keynes etc. In this respect it can also be said that Alexander Gray's "The Development of Economic Doctrines" is incomplete. Inspite of the above defects, the study of History of Economic Thought enables one to understand the subject clearly.

Meaning of Physiocracy: Physiocracy is the collective name of those economic principles and policies which developed in France in the middle of the 18th century. Physiocracy is also known as the 'Agricultural System'. Economic thinkers who contributed to the growth and development of physiocracy have been called as physiocrats.

The Physiocrats have been regarded as the founders of economic science because they were the first to grasp the general principles under-lying the economic phenomena and to evolve a theoretical system. Physiocracy is also remarked as the first school of economic thought. The term physiocracy means “Rule of Nature’.

Physiocracy may be defined as a reaction against Mercantilism and its concepts. The physiocrats believed that the mercantile policies instead of doing any good have done great harm to the nations. So they revolted against the mercantile policies.

According to Gide and Rist, “Physiocrats must be credited with a foundation of the earliest school of economists in the fullest sense of the term. The entrance of this small group of men into the arena of history is a most touching one”. The influential French School of thinkers of the early 18th century was led by “Quesnay and Turgot”. They believed in the existence of natural law which governs the universe. Their emphasis on agriculture has earned for their system of thought, the name agricultural school.

The Factors That Gave Rise to Physiocracy: In 1750, France provided a favourable climate for the emergence of physiocratic ideas. There were many economic, political and social factors that were responsible for the rise of physiocracy. Firstly, physiocracy was essentially a revolt of the French against Mercantilism. Under Colbert the famous Finance Minister of France, Mercantilism was carried to an extreme degree.

As a result, there was neglect of agriculture and lot of government regulations. So there was need for an economic theory to prove that the mercantile policies were not favourable for the progress and wealth of a nation. The Physiocrats provided the theoretical basis to attack Mercantilism.

Secondly, the tax system of France was corrupt, inefficient and unjust. The nobles and the clergymen, who owned nearly 2/3rd of the lands, were exempted from direct taxation. On the other hand, the burden of taxation on the poor was very heavy. The poor were affected by taxes like salt tax, poll tax, etc.

Thirdly, the finance of the French government was in a bad condition. The unnecessary wars and the luxurious court life of King Louis the XIV and XV made the government bankrupt. So the government started borrowing loans.

Fourthly, the French farmers were exploited by the nobles and landlords in a number of ways. The landlords took large share of the produce. The government levied heavy taxes upon the farmers.

Even the markets for agricultural commodities were restricted because Mercantilism was in favour of industrial goods.

Fifthly, the general economic conditions of France were also unfavorable. Britain had already realised that it was a wrong policy to develop trade and industry at the expense of agriculture. Agricultural revolution was taking place in England. So in France also attention was diverted to agriculture.

Lastly, there were other forces working for the change. The political and moral philosophers emphasised the importance of individual rather than wealth. They told that man must be the centre of study.

Thus as Eric Roll says, "With the physiocrats we enter an era of schools and systems in Economic Thought".Physiocrats are important in the history of economic thought because they represented the first school of economists. The mercantilists were ordinary people who emphasised only foreign trade. But the physiocrats realised the importance of various economic activities and their relation. In the physiocratic system all social factors like production and distribution are connected. In short, the physiocrats were reformers.

Critical Estimate of Physiocracy: Physiocracy was the revolt of the French people against Mercantilism. It is, from this angle, we have to judge the economic ideas of the physiocrats. While the mercantilists were occupied with gold, the physiocrats emphasized "Real wealth" in the form of raw produce.

The Mercantilists aimed at maximising exports and minimising imports with an object of securing a favourable balance of trade. But the physiocrats in general regarded foreign trade as an evil. While the mercantilists believed in the regulation of trade and Industry, the physiocrats suggested freedom of trade and Industry.

In spite of the above merits, the physiocrats were wrong in considering agriculture alone as the productive occupation. Commerce and industry are equally important and productive. The physiocrats had a wrong idea of production. They regarded manufacture as unproductive although it creates utility. Further the physiocrats were mainly responsible for their wrong classification of labour into productive and unproductive.

The greatest defect in the physiocratic doctrine is the absence of any reference to value. The physiocrats suggested complete freedom of trade and industry. But absolute freedom of trade is not advisable. The aim of the physiocrats was to develop agriculture. They regarded land, as the only source of wealth.

So it followed that the landlords should pay the taxes. But this idea is against the interest of the agricultural class. The weakest point in the physiocratic system is the theory of distribution.

physiocrats made some important contributions to economic thought: 1. They put economics on a scientific basis by applying scientific methods.

2. Economic development was a major concern of the Physiocrats. They realised the importance of agriculture which give surplus for capital formation.

3. The physiocrats were the first school of economists to analyse capital and capital formation.

4. The physiocrats realised the interdependence of different classes in the economy.

5. The physiocrats insisted that the government should restrict its functions.

6. They advocated direct taxes rather than indirect taxes.

7. Lastly, the physiocrats must be given a high place among those who prepared the ground for French Revolution.

Mercantilism

Definition: Mercantilism is an economic theory where the government seeks to regulate the economy and trade in order to promote domestic industry – often at the expense of other countries. Mercantilism is associated with policies which restrict imports, increase stocks of gold and protect domestic industries. Mercantilism stands in contrast to the theory of free trade – which argues countries economic wellbeing can be best improved through the reduction of tariffs and fair free trade. Mercantilism involves

• Restrictions on imports – tariff barriers, quotas or non-tariff barriers. • Accumulation of foreign currency reserves, plus gold and silver reserves. (also known as bullionism) In the sixteenth/seventeenth century, it was believed that the accumulation of gold reserves (at the expense of other countries) was the best way to increase the prosperity of a country. • Granting of state monopolies to particular firms especially those associated with trade and shipping. • Subsidies of export industries to give a competitive advantage in global markets. • Government investment in research and development to maximise the efficiency and capacity of the domestic industry. • Allowing copyright/intellectual theft from foreign companies. • Limiting wages and consumption of the working classes to enable greater profits to stay with the merchant class. • Control of colonies, e.g. making colonies buy from Empire country and taking control of colonies wealth. Examples of mercantilism

• England Navigation Act of 1651 prohibited foreign vessels engaging in coastal trade.

• All colonial exports to Europe had to pass through England first and then be re-exported to Europe. • Under the British Empire, India was restricted in buying from domestic industries and were forced to import salt from the UK. Protests against this salt tax led to the 'Salt tax revolt' led by Gandhi. • In seventeenth-century France, the state promoted a controlled economy with strict regulations about the economy and labour markets • Rise of protectionist policies following the great depression; countries sought to reduce imports and also reduce the value of the currency by leaving the gold standard. • Some have accused China of mercantilism due to industrial policies which have led to an oversupply of industrial production – combined with a policy of undervaluing the currency. • However, the extent of mercantilist policies are disputed – See – Is China Mercantilist? NBER Modern Mercantilism

In the modern world, mercantilism is sometimes associated with policies, such as:

• Undervaluation of currency. e.g. government buying foreign currency assets to keep the exchange rate undervalued and make exports more competitive. A criticism often levelled at China. • Government subsidy of an industry for unfair advantage. Again China has been accused of offering state-supported subsidies for industry, leading to oversupply of industries such as steel – meaning other countries struggle to compete. • A surge of protectionist sentiment, e.g. US tariffs on Chinese imports, and US policies to 'Buy American.' • Copyright theft Criticisms of Mercantilism

• Adam Smith's "The Wealth of Nations" (1776) – argued for benefits of free trade and criticised the inefficiency of monopoly. • Theory of comparative advantage(David Ricardo) • Mercantilism is a philosophy of a zero-sum game – where people benefit at the expense of others. It is not a philosophy for increasing global growth and reducing global problems. Trying to impoverish other countries will harm our own growth and prosperity. By contrast, if we avoid zero-sum game of mercantilism increasing the wealth of other countries can lead to selfish benefits, e.g. growth of Japan and Germany led to increased export markets for UK and US. • Mercantilism which stresses government regulation and monopoly often lead to inefficiency and corruption. • Mercantilism justified Empire building and the poverty of colonies to enrich the Empire country. • Mercantilism leads to tit for tat policies – high tariffs on imports leads to retaliation. • The growth of globalisation and free trade during the post-war period showed possibilities from opening markets and respecting other countries as equal players. • Economies of scale from specialisation possible under free trade.

Justification for neo-mercantilism

Despite many criticisms of mercantilism, there are arguments to support the restriction of free trade in certain circumstances.

• Tariffs in response to domestic subsidies. Supporters argue that since China's steel is effectively subsidised leading to a glut in supply, it is necessary and fair to impose tariffs on imports of Chinese steel to protect domestic producers from unfair competition. US tariffs on imports of steel from China 266%. In Europe, tariffs are 13%. • Protection against dumping. If some countries have an excess supply of goods, they can sell at a very low price to get rid of the surplus. But, this can make domestic firms unprofitable. Protectionism can be justified to protect against this dumping. Examples, include EEC dumping excess agricultural production on world agricultural markets and China's dumping of steel. • Infant industry argument. For countries seeking to diversify their economy, tariffs may be justified to try and develop new industries. When the industries have developed and benefited from economies of scale, then the tariffs and protectionism can be dropped.

Unit- II

Classical Economic Thought

ADAMSMITH

Adamsmith On March 9, 1776, "An Inquiry into the Nature and Causes of the Wealth of Nations"— commonly referred to simply as "The Wealth of Nations"—was first published.1 Smith, a Scottish moral philosopher by trade, wrote the book to describe the industrialized capitalist system that was upending the mercantilist system. Mercantilism held that wealth was fixed and finite, and that the only way to prosper was to hoard gold and tariff products from abroad. According to this theory, nations should sell their goods to other countries while buying nothing in return. Predictably, countries fell into rounds of retaliatory tariffs that choked off international trade. Smith's Primary Thesis The core of Smith's thesis was that humans' natural tendency toward self-interest (or in modern terms, looking out for yourself) results in prosperity. Smith argued that by giving everyone freedom to produce and exchange goods as they pleased (free trade) and opening the markets up to domestic and foreign competition, people's natural self-interest would promote greater prosperity than with stringent government regulations.

Smith believed humans ultimately promote public interest through their everyday economic choices. "He (or she) generally, indeed, neither intends to promote the public interest nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention," he said in "An Inquiry into the Nature and Causes of the Wealth of Nations."2

This free-market force became known as the invisible hand, but it needed support to bring about its magic. In particular it was the market that emerged from an increasing division of labor, both within production processes and throughout society that created a series of mutual interdepencies, promoting social welfare through individual profit motives. In other words, once you specialize as a baker and produce only bread, you now must rely on somebody else for your clothes, somebody else for your meat, and yet somebody else for your beer. Meanwhile the people that specialize in clothes now must rely on you for their bread, and so on.

The Invisible Hand The automatic pricing and distribution mechanisms in the economy—which Adam Smith called an "invisible hand"—interact directly and indirectly with centralized, topdown planning authorities. However, there are some meaningful conceptual fallacies in an argument that is framed as the invisible hand versus the government.

The invisible hand is not actually a distinguishable entity. Instead, it is the sum of many phenomena that occur when consumers and producers engage in commerce. Smith's insight into the idea of the invisible hand was one of the most important in the history of economics. It remains one of the chief justifications for free-market ideologies.

The invisible hand theorem (at least in its modern interpretations) suggests that the means of production and distribution should be privately owned and that if trade occurs unfettered by regulation, in turn, society will flourish organically. These arguments are naturally competitive with the concept and function of government.

The government is not serendipitous—it is prescriptive and intentional. Politicians, regulators, and those who exercise legal force (such as the courts, police, and military) pursue defined goals through coercion. However, in contrast, macroeconomic forces— supply and demand, buying and selling, profit and loss occur voluntarily until government policy inhibits or overrides them. In this sense, it is more accurate to suggest that government affects the invisible hand, not the other way around. Government Response to the Invisible Hand However, it is the absence of market mechanisms that frustrates government planning. Some economists refer to this as the economic calculation problem. When people and businesses individually make decisions based on their willingness to pay money for a good or service, that information is captured dynamically in the price mechanism. This, in turn, allocates resources automatically toward the most valued ends.

When governments interfere with this process, unwanted shortages and surpluses tend to occur. Consider the massive gas shortages in the United States during the 1970s. The then newly formed Organization of Petroleum Exporting Countries(OPEC) cut production to raise oil prices. The Nixon and Ford administrations responded by introducing price controls to limit the cost of gasoline to American consumers. The goal was to make cheap gas available to the public.

Instead, gas stations had no incentive to stay open for more than a few hours. Oil companies had no incentive to increase production domestically. Consumers had every incentive to buy more gasoline than they needed. Large-scale shortages and gas lines resulted. Those gas lines disappeared almost immediately after controls were eliminated and prices were allowed to rise.

While it is tempting to say the invisible hand limits government, that wouldn't necessarily be correct. Rather, the forces that guide voluntary economic activity toward large societal benefit are the same forces that limit the effectiveness of government intervention. The Elements of Prosperity Boiling the principles Smith expressed regarding the invisible hand and other concepts down to essentials, Smith believed a nation needed the following three elements to bring about universal prosperity.

1. Enlightened Self-Interest Smith wanted people to practice thrift, hard work, and enlightened self-interest. He thought the practice of enlightened self-interest was natural for the majority of people.

In his famous example, a butcher does not supply meat based on good-hearted intentions, but because he profits by selling meat. If the meat he sells is poor, he will not have repeat customers and, thus, no profit. Therefore, it's in the butcher's interest to sell good meat at a price that customers are willing to pay, so that both parties benefit in every transaction. Smith believed the ability to think long-term would curb most businesses from abusing customers. When that wasn't enough, he looked to the government to enforce laws.

Extending upon self-interest in trade, Smith saw thrift and savings as important virtues, especially when savings were used to invest. Through investment, the industry would have the capital to buy more labor-saving machinery and encourage innovation. This technological leap forward would increase returns on invested capital and raise the overall standard of living. 2. Limited Government Smith saw the responsibilities of the government as being limited to the defense of the nation, universal education, public works (infrastructure such as roads and bridges), the enforcement of legal rights (property rights and contracts), and the punishment of crime.

The government would step in when people acted on their short-term interests and would make and enforce laws against robbery, fraud, and other similar crimes. He cautioned against larger, bureaucratic governments, writing, "there is no art which one government sooner learns of another, than that of draining money from the pockets of the people."

His focus on universal education was to counteract the negative and dulling effects of the division of labor that was a necessary part of industrialization.

3. Solid Currency and Free-Market Economy The third element Smith proposed was a solid currency twinned with free-market principles. By backing currency with hard metals, Smith hoped

to curtail the government's ability to depreciate currency by circulating more of it to pay for wars or other wasteful expenditures.

With hard currency acting as a check on spending, Smith wanted the government to follow free-market principles by keeping taxes low and allowing free trade across borders by eliminating tariffs. He pointed out that tariffs and other taxes only succeeded in making life more expensive for the people while also stifling industry and trade abroad. Division of Labour

Definition: Division of labour is an economic concept which states that dividing the production process into different stages enables workers to focus on specific tasks. If workers can concentrate on one small aspect of production, this increases overall efficiency – so long as there are sufficient volume and quantity produced. This concept was popularised by Adam Smith in An Inquiry into the Nature and Causes of the Wealth of Nations (1776). Famously, he used the example of a pin factory. Adam Smith noted how the efficiency of production was vastly increased because workers were split up and given different roles in the making of a pin. Why is the division of labour more efficient?

1. Workers need less training as they only have to master a small number of tasks 2. It is faster to use one particular tool and do one job. 3. No time is wasted with a worker dropping a tool and then picking up another. 4. Workers can gain loyalty and a sense of achievement from their branch of production. 5. There is no need to move around the factory; the half-finished good comes to them. 6. Workers can concentrate on those jobs which best suit their skills and temperament. When production has very high volumes, the division of labour is necessary to get economies of scale. Potential problems of division of labour

7. If workers are highly specialised, then the job can become very boring and repetitive. This can lead to low labour morale. 8. If workers lose the motivation to concentrate and do a good job, mistakes may creep in as they get bored.

9. An assembly line could grind to a halt if there is a blockage in one particular area. 10. Adam Smith himself recognised this potential problem and advocated education of the workforce so that they wouldn't get too demoralised by their repetitive job.

ALFRED MALTHUS

The Malthusian Theory of Population is a theory of exponential population growth and arithmetic food supply growth. Thomas Robert Malthus, an English cleric and scholar, published this theory in his 1798 writings, An Essay on the Principle of Population. Malthus believed that through preventative checks and positive checks, the population would be controlled to balance the food supply with the population level. These checks would lead to the Malthusian catastrophe.

1. Population and Food Supply

Thomas Malthus theorized that populations grew in geometric progression. A geometric progression is a sequence of numbers where each term after the first is found by multiplying the previous one by a fixed, non-zero number called the common ratio. For example, in the sequence 2, 10, 50, 250, 1250, the common ratio is 5. Additionally, he stated that food production increases in arithmetic progression. An arithmetic progression is a sequence of numbers such that the difference between the consecutive terms is constant. For example, in series 2, 5, 8, 11, 14, 17, the common difference of 3. He derived this conclusion due to the Law of Diminishing Returns. 2. Population Control

Malthus then argued that because there will be a higher population than the availability of food, many people will die from the shortage of food. He theorized that this correction would take place in the form of Positive Checks (or Natural Checks) and Preventative Checks. These checks would lead to the Malthusian catastrophe, which would bring the population level back to a ‘sustainable level.’

A. Positive Checks or Natural Checks

He believed that natural forces would correct the imbalance between food supply and population growth in the form of natural disasters such as floods and earthquakes and human-made actions such as wars and famines.

B. Preventative Checks

To correct the imbalance, Malthus also suggested using preventative measures to control the growth of the population. These measures include family planning, late marriages, and celibacy.

Malthusian Trap

The Malthusian Trap (or "Malthusian Population Trap") is the idea that higher levels of food production created by more advanced agricultural techniques create higher population levels, which then lead to food shortages because the higher population needs to live on land that would have previously used to grow crops.

Even as technological advancement would normally lead to per capita income gains, theorizes Malthus, these gains are not achieved because in practice the advancement also creates population growth. Once the population exceeds what food supplies can support, this supposedly creates a Malthusian crisis with widespread famine as well as rampant disease. This ends up decreasing the population to earlier levels.

Criticism

1. Population Growth

The gloom and doom forecasts put forward by Malthus have not played out. In Western Europe, populations have grown (not at the rate Malthus predicted) and food production has also risen because of technological advancements.

2. Food Production

Thanks to many technological advancements, food production has dramatically increased over the past century. Often, the food production rate has grown higher than the population growth rate. For example, during the 1930s in the US, 25% of the population worked in the agricultural sector while the total GDP was less than $100 billion to the GDP. Today, less than 2% of the population works in the agricultural sector, while the total GDP is over $14 trillion.

3. Global Trade

The limited availability of land at the time was the basis for Malthus' theory on food production constraints. However, thanks to globalization, we can trade goods and services for food, which increases the amount of food a country can consume. 4. Calculations

Malthus did not provide calculations for the geometric growth of populations and the arithmetic growth of food. Since then, experts have pointed out that the growth rates are not consistent with Malthus' prediction chief factors of production. Capital is the secondary agent of production.

Organisation is just a sort of labour. As a result, land and labour are the primary factors of production. Man being active, is the central force behind all activities relating to production and consumption, but nature plays a significant role as he is moulded by his surroundings and environment.

Unit –III

Neo-Classical Economic Thought

ALFRED MARSHALL

Alfred Marshall Alfred Marshall was the dominant figure in British economics (itself dominant in world economics) from about 1890 until his death in 1924. His specialty was MICROECONOMICS—the study of individual markets and industries, as opposed to the study of the whole economy. In his most important book, Principles of Economics, Marshall emphasized that the price and output of a good are determined by both SUPPLY and demand: the two curves are like scissor blades that intersect at equilibrium. Modern economists trying to understand why the price of a good changes still start by looking for factors that may have shifted demand or supply, an approach they owe to Marshall. Some of the contributions are: 1. Definition and Laws of Economics 2. Marshall Method 3. Wants and Their Satisfaction 4. Marshallian Utility and Demand 5. Consumer's Surplus 6. Elasticity of Demand 7. Supply and Cost 8. Factors of Production and Others. 1. Definition and Laws of Economics: Marshall defined Economics as, "Political Economy or Economics is a study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of material requisites of well-being. Thus it is on the one side a study of wealth and on the other and more important side, a part of the study of man." Marshall classified human activities into activities that contribute to material welfare and activities that do not contribute to material welfare. Marshall shifted the emphasis from wealth to man. Wealth is only a means to welfare. Hence he has given primary importance to man and secondary importance to wealth.

Economic laws are the statements of economic tendencies and are hypothetical. Since economic laws deal with man's actions which are numerous and uncertain, they are to be compared with the laws of tides rather than with the simple and exact law of gravitation. 2. Marshall Method: As far as the method of study is concerned, Marshall considered both induction and deduction as useful for economics. Both are complementary to each other. He says, "Induction and deduction are both needed for scientific thought as the left and right foot are both needed for walking". Marshall was the great interpreter of the method of partial equilibrium. The forces influencing an economic phenomenon are too numerous and it is very difficult to analyse all of them to arrive at a complete explanation of the phenomenon. Therefore, the best method is to keep other forces constant, and study the forces influencing the phenomenon. Thus all the other forces are reduced to inaction by the phrase "other things being equal". 3. Wants and Their Satisfaction: Marshall fully analysed the characteristics of wants and distinguished between necessaries, comforts and luxuries. He believed that consumption was the beginning and end of all economic activities and so he discussed consumption first and production afterwards. 4. Marshallian Utility and Demand: Price of a commodity is determined not by supply alone as the classical economists believed and not by demand alone as the utility theorists believed but by both demand and supply curves. Marshall takes up the theory of demand to analyse consumer behaviour. A rational consumer aims at maximising satisfaction from his consumption. The amount of satisfaction is closely related to the quantity of that commodity consumed by the consumer. Thus demand is based on the law of diminishing marginal utility. Marshall stated the law thus, “the additional benefit which a person derives from a given increase of the stock of a thing, diminishes with every increase in the stock that he already has”. 5. Consumer’s Surplus: Marshall added the term consumer’s surplus to economic literature. According to him, “The excess of price which he would be willing to pay rather than go without the thing, over that which he actually does pay, is the economic measure of this surplus satisfaction. It may be called consumer’s surplus”. The consumers are generally prepared to pay a higher price for a commodity rather than go without it. But they actually pay less for it. As a result the consumer enjoys a surplus satisfaction and it is known as consumer’s surplus. The concept of consumer’s surplus has become the basis of welfare economics. 6. Elasticity of Demand: It is another important concept which Marshall gave to economics. In Marshall’s own words. ‘The elasticity of demand in a market is great or small according as the amount demanded increases much or little for a given fall in price and diminish much or little for a given rise in price.

He distinguished between five degrees of elasticity—absolutely elastic, highly elastic, elastic, less elastic and inelastic. He laid down that the demand for luxuries was highly elastic, for comforts elastic and for necessaries inelastic. 7. Supply and Cost: Marshall developed his theory of supply on the lines similar to his analysis of demand. Just as the consumers obtain utilities or satisfaction from the consumption of commodities, it also involves,costs. Just as the marginal utility diminishes as a consumer increased his consumption of a commodity, the marginal cost rises as the production of a commodity expands. 8. Factors of Production: According to Marshall, land and labour are the two chief factors of production. Capital is the secondary agent of production. Organisation is just a sort of labour. As a result, land and labour are the primary factors of production. Man being active, is the central force behind all activities relating to production and consumption, but nature plays a significant role as he is moulded by his surroundings and environment.

A.C.PIGOU

Meaning of Welfare: According to Pigou, welfare resides in a man’s state of mind or consciousness which is made up of his satisfactions or utilities. The basis of welfare, therefore, is necessarily the extent to which an individual’s desires are met. Social welfare is regarded as the summation of all individual welfares in a society. Since general welfare is a very wide, complicated and impracticable notion, Pigou delimits the range of his study to economic welfare. As he himself observes, economic welfare is by no means an index of total welfare because many other elements in the latter, like the quality of work, one's environment, human relationships, status, housing, and public security are absent from economic welfare. Pigovian Welfare Conditions: Pigou regard economic welfare and national income as essentially coordinate. It is on this basis that he lays down two conditions for maximisation of welfare. The first condition states that welfare is said to increase when national income increases. Given the same tastes and income distribution, an increase in the national income represents an increase in welfare. Pigou contends that in most cases the national income would increase even though the disutility of work also increases. Second, for welfare maximisation the distribution of the national income is equally important. If national income remains constant, transfers of income from the rich to the poor would improve welfare. According to Pigou, such transfers mean less to the wealthy than to the poor, as a result the economic position of the latter is raised. This welfare condition is based on the dual Pigovian postulates of 'equal capacity for satisfaction and diminishing marginal utility of income.' Dual Criterion:

First, an increase in the national income 'brought about either by increasing some goods without dimishing others or by transferring factors to activities in which their social value is higher,' is regarded an improvement in welfare without reducing the share of the poor. Second, any reorganization of the economy which increases the share of the poor without reducing the national income is also considered an improvement in social welfare. Assumptions of Pigovian Conditions:

(1) Each individual tries to maximise his satisfaction from his expenditure on different goods and services.

(2) Satisfactions are comparable both interpersonally and interpersonally.

(3) The law of diminishing marginal utility of income applies. It means that the marginal utility of income falls, as income increases. As a result, the gain in utility of an additional amount of income to a poor man is greater than the loss of utility to a rich man from the same amount of income.

(4) There is equal capacity for satisfaction. It implies that different people derive the same satisfaction out of the same real income. Given these assumptions, it is possible to satisfy the Pigovian conditions of maximum social welfare on the basis of his dual criterion.

Its Criticism:

(1) The Notion of Maximisation is not clear: Pigou lays emphasis on the maximisation of welfare, but he does not clarify the notion of maximisation. His ‘maximum’ is in fact the ‘optimum’, but it is a stable point. But this is not a correct view because the ‘optimum’ is not stable. It changes with the increase or decrease of national income.

(2) Pigou measures ‘welfare’ cardinally: According to Pigou, welfare is measured in terms of utility or satisfaction. He regards social welfare as the summation of utilities of exchangeable goods and services to individuals. Economists do not agree with this view because quantitative measurement of utility is not possible. It is for this reason that modern economist’s measure utility ordinally.

(3) National Income is not an Accurate Measure of Welfare: Pigou’s welfare conditions are related to the national income. But it is not easy to calculate national income. Again, social welfare does not increase by a mere increase in national income. It is possible that national income may increase due to inflationary rise in prices and the poor may become worse-off than before.

(4) According to Professor Robbins, Pigou’s assumption of man’s equal capacity for satisfaction does not make his notion of welfare a positive study. In his words, “This assumption rests on ethical principle rather than upon scientific demonstration; it is not a judgement of value.”

(5) Pigou does not clarify the ethical relation of welfare: Welfare economics is closely related to ethics but Pigou does not clarify it. Welfare economics is essentially a normative study in which value judgements and interpersonal comparisons are made.

By not relating these concepts with his notion of welfare, Pigou’s economics of welfare is not considered as an objective study of the causes of welfare