

# The Three Great Thinkers Who Changed Economics

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The New York stock exchange traders' floor (1963). Courtesy of Library of Congress.

Spanning three centuries of history, from the dawn of the Industrial Age to modern times, three diverse thinkers developed their own landmark theories on commerce, labor, and the global economy.

It is said that “economics is a study of mankind in the ordinary business of life.” What choices do you face in the ordinary business of your life? You buy clothing, decide what to eat, look for a job. When you make such decisions, you must consider cost, scarcity, and various options. These are economic decisions.

Now imagine decisions like that happening all the time, all over the world. Modern society is formed by individual choices that form a complex network. The choices we make have local, national, and even global implications.

The field of economics seeks to analyze, interpret, and understand these decisions. Governments, businesses, and even individuals use economics to understand how people produce and consume goods and services.

The three economists profiled in this article — Adam Smith, Karl Marx, and John Maynard Keynes — contributed to the development of economics as a science. Still, thinking about economics was around long before these men. This thinking goes back to the earliest days of humankind.

## **The economics of the hunt**

According to one economic historian, “Economics does not have a beginning or a ‘founder.’ People have always thought about questions that we now consider part of economics.”

Early humans, for example, spent a lot of time and energy tracking and killing large game. The meat needed to be distributed, and each individual would have to decide whether to save it or use it right away.

Even without a “civilization,” effective economic decision-making was necessary for survival.

As hunter-gatherer groups formed into more organized societies, decisions about distributing resources and designating jobs became more complicated.

Hunter-gatherers lived in relatively egalitarian societies — everyone was roughly equal and everyone worked together to survive. Today we are more individualistic.

But, for many thousands of years, humans were neither egalitarian nor individualistic. People worked according to “custom” or “command.” Custom means people did work that was passed down from previous generations. Command means people worked to avoid violence or punishment.

Neither the medieval European blacksmith, the Indian farmer, or the pyramid-building Egyptian slave worked for his own goals, dreams, or riches.

Today, it seems almost everyone wants to be rich. But early economies had more complex attitudes toward the pursuit of wealth. The idea of personal gain was foreign to the lower and middle classes of Egypt, Greece, Rome, and the majority of Eastern civilizations.

Those who worked with money (merchants, lenders, and even craftsmen with specialized skills) were often viewed suspiciously and sometimes even punished for innovating within their trades. As a result, skills and technology advanced gradually and similar jobs and standards extended across many generations.

Several major changes were set in motion around 1500. Overseas trade established new networks and boosted collective learning and commercialization. Globally-traded currency created an easy way to trade goods and store wealth. Individual markets, once places to buy and sell physical goods, began to merge into the market system. The market system isn't just a way to exchange goods, it is a mechanism that sustains and maintains an entire society.

By the 1600s and 1700s, both custom and command were weakening. Rather than survival, obedience, or tradition, people began to be motivated by obtaining personal wealth. It was in this era, on the verge of the Industrial Revolution, that Adam Smith lived and worked.

## **Adam Smith**



An etching of Adam Smith

When the Scotsman Adam Smith (1723–1790) was born, industrialization and a profit-driven market system were replacing custom and command-driven economic systems across Europe. These changes reflected an intellectual shift toward rationality, progress, liberty, and secularism — generally referred to as the Enlightenment.

Smith studied in Glasgow, Scotland, and Oxford, England. He had many jobs: professor and lecturer, private tutor to the children of European royalty, government economic adviser, and customs commissioner for Scotland. This gave him a comprehensive understanding of economics. His ideas are captured most powerfully in *An Inquiry Into the Nature and Causes of the Wealth of Nations*, usually known as *The Wealth of Nations*.

Composed at the dawn of the Industrial Revolution, *The Wealth of Nations* describes a world increasingly dominated by commerce and capitalism. Here, Smith gives his observations of a visit to a pin-making factory:

*One man draws out the wire, another straightens it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving the head; to make the head requires two or three distinct operations; to put it on is a peculiar business, to whiten the pins is another; it is even a trade by itself to put them into the paper; and the important business of making a pin is, in this manner, divided into about eighteen distinct operations.... [An average factory of ten workers] could make among them upwards of forty-eight thousand pins in a day. Each person, therefore...might be considered as making four thousand eight hundred pins in a day. But if they had all wrought separately and independently, and without any of them having been educated to this peculiar business, they certainly could not each of them have made twenty, perhaps not one pin in a day.*

In other words, the division of labor allowed one man to be as much as 4,800 times more productive than if he worked alone! In addition, Smith argued that people have a natural drive to improve their own lives. This self-interest, he suggested, propels markets to satisfy individual demands by producing the goods and services people want. He called this the “invisible hand,” and wrote, “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.”

He suggested that competition between businesses ensures fair prices and quality products. Competition also drives innovation and satisfies consumer demand. In short, competition keeps everyone honest, because customers treated unfairly by one business can always go to another one instead.

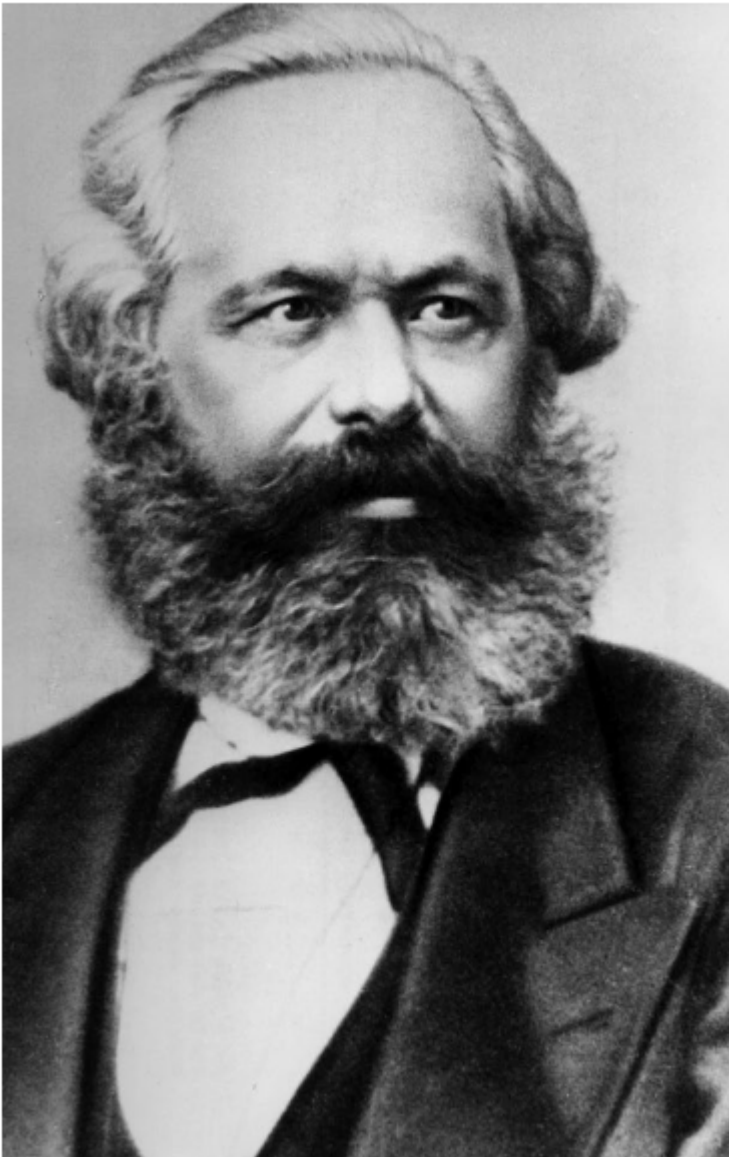
Smith argued that the complex functions of society and economy emerged from the self-interested actions of each individual. This view must have been reassuring and liberating to a world undergoing a great transition. It was certainly popular: the first edition of *The Wealth of Nations* sold out within 6 months.

Smith’s remarkable insights not only captured his own time accurately. They also foresaw much of the economic future. Free-market capitalism has survived as the world’s foremost economic model for the last 200-plus years. Today, we call this arrangement “economic liberalism.” The liberalization of economies continues around the world.



Though Smith predicted many of the successes of industrial capitalism, he lived too early in the Industrial Revolution to see its worst side effects. It would take several more decades to produce a critic whose cynicism toward capitalism matched Smith's optimism. That critic was Karl Marx.

## **Karl Marx**



Karl Marx, January 1870

Karl Marx (1818–1883) was born in the midst of the Industrial Revolution, into a middle-class family in Prussia (a former German kingdom straddling parts of present-day Germany and Poland). He led an eventful life: He was jailed for public drunkenness as a college student. His home and personal appearance were unkempt. He spent money frivolously, causing his family to frequently live on the brink of poverty. For most of his

professional life, Marx was a writer for a variety of liberal, radical, and foreign newspapers. He moved between Prussia, France, Belgium, and England because he was continually blacklisted or deported for his radical views.

Marx's attitude toward capitalism was extremely critical. The Industrial Revolution had created a factory system. Factory owners were the new ruling class. In this system, Marx saw injustice and inequality. He felt things were bound to change.

Marx and his frequent co-author, Friedrich Engels, were outraged at the hardships faced by the working classes of industrial European cities. They channeled this anger into two monumental written works that formed the basis of modern communism: *The Communist Manifesto*, published in 1848, and a four-volume, 2,500-page work, *Das Kapital*, published in 1867.

Marx saw the history of all societies as the history of class struggle. He regarded human history as a series of eras that was defined by systems for producing goods. These systems created classes: the rulers and the ruled. This process had already progressed from slavery to feudalism to capitalism and, in Marx's view, would eventually lead to a classless society called communism.

Why did Marx object to capitalism? He saw two groups operating in capitalism: the owners and the workers. The "capitalists" owned the machines, property, and infrastructure used to make things. The workers, or "proletariat," owned nothing but the right to sell their labor in exchange for wages.

Marx theorized that capitalists, competing for profits, would squeeze as much work as possible out of the workers, paying them as little as possible.

Furthermore, competition would cause some capitalists' firms to fail, increasing unemployment (and, thus, misery and poverty) among the proletariat.

He was skeptical of innovations in technology. New machines could add to unemployment by making human workers obsolete. Machines could also make work dull, repetitive, and alienating.

Still, Marx saw capitalism as a necessary stage for building a society's standard of living. But he felt the proletariat would become unhappy under capitalism, and eventually overthrow the ruling class to create a more equal society.

The new, more equal society would at first be socialist — the state would control the economy and distribute resources more evenly. Then it would become purely communist — a stateless, classless, egalitarian society without private property or nationality.

Marx's beliefs, theories, and predictions represent a school of thought called Marxism. Marxism is a theory of economics, politics, sociology, and ethics. For some, it is also a call to action.

As a call to action, Marxism was most influential in the twentieth century, when it inspired various brands of revolutionary activity. This includes the Russian Revolution in 1917 and the rise of communist governments in China, Vietnam, and Cuba, as well as in many Eastern European and African nations. It has since fizzled out, with the U.S.S.R. collapsing in the early 1990s, China shifting toward a market-friendly economy, and smaller communist countries that depended on them adopting more market-oriented systems.

As a theory, Marxism is more durable. Some believe that communism's decline disproves Marx. Others have built on his approach of critiquing economic systems on social grounds. Even though capitalism is dominant around the world, Marx taught us to seriously examine and criticize capitalism when necessary.

In other words, Marx's skepticism about capitalism started a conversation about its weaknesses and how it can be improved. While he was no Marxist, our third economist, John Maynard Keynes, was highly influential in confronting the dilemmas of capitalism in the early twentieth century.

## John Maynard Keynes



John Maynard Keynes, 1940

John Maynard Keynes (1883–1946, last name rhymes with “rains”) was born into an educated family. During his life, he worked in academia, economic publishing, private financial advising and management, currency speculation, and as an official in the British Treasury.

Keynes made many contributions to economics, but he is most famous for his ideas about the Great Depression, the major economic crisis of the twentieth century. The worldwide Depression lasted roughly from the early 1930s to the mid-1940s. Unemployment in the United States increased from 3 to 25 percent during this time. The national income was cut in half.



Keynes's analysis of the Great Depression focused on the role of savings. He explained his theories in his 1936 book, *The General Theory of Employment, Interest and Money*.

Keynes argued that excessive savings could lead to economic ruin. In a weak economy, businesses wouldn't hire as many people. Without jobs, people didn't have money that would stimulate the economy. People would save more money, expecting tough times ahead. But the savings would run out after a long time without a job.

Rational decisions by individuals (saving in hard times) could lead to collective irrational results (an unbreakable cycle of economic decline).

Keynes believed the government should support the economy. Keynes generally endorsed free-market capitalism, but he felt the Depression's unique challenges required unique solutions. Keynes argued that only the government had the resources to spend the money that individual consumers and businesses could not, and so break the cycle.

This approach proved relevant in the 1930s and 1940s. The New Deal government relief programs of President Franklin D. Roosevelt were designed to stimulate the economy in the early 1930s. Cuts to the federal budget in the late 1930s caused an immediate economic downturn. Extensive government spending to fund World War II coincided with the end of the Depression.

While some Keynesian policies had mixed results, the overall picture seemed to confirm Keynes's arguments. Until the 1970s, Keynesianism predominated American economics. "Great Society" domestic social programs — like Medicare and education funding — reflected Keynesian thinking. Institutions such as the International Monetary Fund and the World Bank also are based on the Keynesian model.

The 1980s and 1990s saw a renewal of "classical" economic theories that went back to some of Adam Smith's ideas. The "Great Recession" of the 2000s presents a new opportunity to debate whether Keynes's ideas are still viable.

## **The power of economics**

Let's return to our initial question: What choices do you face in the ordinary business of your life? Smith, Marx, and Keynes all explained how individual choices fit into a higher order. Our decisions affect not only us, but also our families, communities, countries, and even the world. Over time, many other thinkers have developed their own theories for explaining and managing economic activity.

Economics is powerful because it can reveal the complex workings of society. As society moves about the ordinary business of life, economics always hums along in the background. It is observed by some, influenced by others, yet it affects everybody.

**Quiz**

1 Which two of the following sentences from the article include central ideas of the article?

1. *Spanning three centuries of history, from the dawn of the Industrial Age to modern times, three diverse thinkers developed their own landmark theories on commerce, labor, and the global economy.*
2. *As hunter-gatherer groups formed into more organized societies, decisions about distributing resources and designating jobs became more complicated.*
3. *In short, competition keeps everyone honest, because customers treated unfairly by one business can always go to another one instead.*
4. *As society moves about the ordinary business of life, economics always hums along in the background.*

- (A) 1 and 2  
(B) 3 and 4  
(C) 1 and 4  
(D) 2 and 3

2 Read the following paragraph from the section "John Maynard Keynes":

*Keynes believed the government should support the economy. Keynes generally endorsed free-market capitalism, but he felt the Depression's unique challenges required unique solutions. Keynes argued that only the government had the resources to spend the money that individual consumers and businesses could not, and so break the cycle.*

Why does the author include this paragraph in the article?

- (A) to demonstrate the damage that the Depression did to the economy  
(B) to prove that Keynes favored the capitalist system over any other option  
(C) to explain the consequences of the rational decision to save in hard times  
(D) to show the connection of capitalist and socialist ideas in Keynes's theory

- 3 Which statement would be MOST important to include in a summary of the section "Karl Marx"?
- (A) Marx theorized that capitalists would try to get more work from people for less pay.
  - (B) Marxism is more durable as a critique of capitalism than as a system for governing.
  - (C) Marx's idea about communism influenced the Russian Revolution in 1917.
  - (D) Marx thought that machines would make life dull and repetitive.
- 4 Read the introduction [paragraphs 1-5] of the article. What purpose does the introduction serve in developing the main idea?
- (A) It connects economic questions to the individual's everyday life.
  - (B) It illustrates the history of economic theories.
  - (C) It compares the theories of influential economic thinkers.
  - (D) It shows how different governments have run economies.