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The Historical Development of Economic and Financial Theories and Strategies*

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Beáta Farkas:
A közgazdasági gondolkodás rövid története
(*A Brief History of Economic Thought*)
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Outstanding in the extremely rich oeuvre of university professor *Beáta Farkas*, this book is an academic, synthesising, theoretical-historical work unique in our generation (also available on the Internet), which presents the historical development of economic thought from its beginnings to the present day. It also provides important lessons on economic policy, international economics and finance. From the Hungarian literature on the subject, the timeless and valuable works of *Antal Mátyás* and *Zsuzsa Bekker* come to mind. In the important areas of science, every generation must do their groundwork. Farkas' work is an excellent summary of the history of economic thought and unparalleled in its field in Hungarian and international literature.

I would like to invite the reader to read, study and reflect on the fifteen chapters, which are structurally interlinked. My review is not an abstract; I would instead like to present the original responses of the various authors of our time to many of the problems that still exist today, based on the book, in which the author has taken great care in processing the original sources.

Chapter 1 is titled "Reflections on the economy before capitalism". Economics is considered to be a young science, counting as an independent academic discipline since *Adam Smith*'s work "The Wealth of Nations", published in 1776. Economic issues have been dealt with since ancient times; the word 'economics' is of Greek origin. The practical questions of the state, the trade in and use of land, and the functioning of households always had to be answered. In his work "The Republic", *Plato* also expressed his thoughts on ideal economy. He pointed out the need

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for a division of labour as it increases efficiency. *Aristotle*, in his work “Politics”, described bartering on the basis of needs as useful and acceptable, while he condemned speculative money-making for unlimited wealth and Crematism, and in “Nicomachean Ethics” he wrote in detail about social justice, distinguishing between two main forms thereof: distributive and corrective justice.

In Chapter 2, Farkas points out that the modern capitalist spirit has two important components: the pursuit of material goods and economic rationality. In his “The Spirit of Law”, *Montesquieu* formulated the separation of powers and assumed that the spirit of commerce brings with it the spirit of moderation, management, restraint, work, prudence, tranquillity, order and rule. (It would be ideal if they were implemented in reality!)

Chapter 3 is entitled “Mercantilism and the precursors of classical political economy”. *Thomas Mun’s* major work was published in 1664, entitled “England’s Treasure by Foreign Trade”. He argued for the development of trade, and recognised that foreign trade surpluses should not be achieved with each individual country, but with all countries. French mercantilism is largely associated with *Jean-Baptiste Colbert*. Industry was developed through state subsidies, tax benefits, the granting of monopoly rights and tariff protection. The big loser of Colbert’s forced industrialisation was agriculture. The Austrian and Swedish version of mercantilism is called Cameralism, which also aimed at industrial protection, protective tariffs and a foreign trade surplus.

The emergence of quantitative monetary theory is interesting. After the discovery of America, large quantities of precious metals flowed into Europe, causing a dramatic increase in prices. The quantitative theory of money was popularised in the 16th century by *Jean Boldin*, who identified five factors as the cause of price increases: the abundance of gold and silver, the existence of monopolies, the scarcity of goods, which is also caused by exports, the luxuries of kings and nobles, and debasement. He considered the abundance of gold and silver to be the fundamental reason for this.

Chapter 4, entitled “The intellectual background of 18th century economic thought”, provides important context on the issues of natural law, empiricism and rationalism. The next chapter provides an analysis of “The Enlightenment and economic thought”. The name physiocrats comes from the words nature (phýsis) and power (kràtos). Their predecessor, *Boisguilbert*, argued that the source of the wealth of nations is not money, but rather the totality of their possessions.

The Chapter on “Classical political economy” is an overview of key importance. The Industrial Revolution began in 1769 with James Watt’s invention of the steam engine. The use of steam led to breakthroughs in the textile, iron and steel and transport industries (steam ships and steam locomotives). The pioneer of classical political economy was *Adam Smith*, a moral philosopher and professor. In 1759 he wrote "The Theory of Moral Sentiments". Adam Smith can be considered as the father of economics, although he had no intention of founding a new discipline. His work which established the science of economics is entitled "An Inquiry into the Nature and Causes of the Wealth of Nations". Smith argues that the opposing forces of self-interest and empathy combine to create social order from the actions of individuals. The metaphor of the invisible hand referred to divine providence. Man is driven by the pursuit of wealth and power, but these do not provide real satisfaction and happiness. According to Smith, nature deceives us, but it is still beneficial because it awakens the human drive to work and increase productivity. In this way, the self-interest of individuals can ultimately lead to a harmony between the individual and social interest. He traced back trade relations to absolute benefits. It should be stressed, and Farkas is right to point out that Smith gave the state essential tasks such as justice, defence, the building and maintenance of schools and roads, and regulating the issue of banknotes. It is clear from the book, and the author summarises well, why Smith is the father of economics. In short, because he systematised the economic context, explored the correlation between economic growth and development, and developed a scientific methodology, his work gave rise to a new discipline, classical political economy.

Jean-Baptiste Say, Thomas R. Malthus and *David Ricardo* are prominent representatives of classical economics. Jean-Baptiste Say's name reminds us of Say's dogma, according to which every supply in the market creates its own demand, and therefore he rejected the possibility of general overproduction. He also assumed that savings would be immediately converted into investments. These theories have clearly been disproved by the economic crises of history. Malthus became famous for his population theory, according to which the population, if not restrained, grows geometrically, while food supply grows only arithmetically. The theory is repeatedly put forward in the context of demographic crises in developing countries but the direction of migration has reversed: in Malthus's time, emigration from Europe was the main direction to the colonies; now it is the other way round, from developing countries to Europe.

David Ricardo's major work was published in 1817 under the title "On the Principles of Political Economy and Taxation". Ricardo explained that the main task of political economy is to explain the laws of the distribution of income between the owners of land, capital and workers. He sought to formulate a pure theoretical model. It is commendable that when his own personal interests and his convictions of principle clashed several times in his life, Ricardo always chose the latter. He was a shareholder in the Bank of England, but protested against the bank's excessive profits. He benefited from high grain prices through his vast land holdings, yet he fought against corn duty. Ricardo developed his theory of ground rent, according to which, as the demand for agricultural products increases, more and more land of poorer quality has to be brought under cultivation. The amount of work done on the worst land that has not yet been cultivated determines the price of corn.

Chapter 7 is titled "Rebellion against capitalism". It gives a summary, based on original sources, of the utopian socialists, who were essentially non-violent, peaceful reformers. The names of *Owen, Saint-Simon* and *Fourier* are well known from history. According to the latter, in a well-organised society, the division of labour may serve to enable people to find jobs that are attractive and enjoyable in production communities established on a voluntary basis, the phalanstère. It reminds us all of Madách's "The Tragedy of Man", in Act XII, Michelangelo, in the phalanstère, carving a chair leg.

Chapter 8 discusses neoclassical economics. *Bentham* outlined action utilitarianism and rule utilitarianism, although he did not use these concepts, that individual actions should be judged and considered good or bad according to their consequences. *Mill*, on the other hand, took the view that an action is right or wrong according to whether it complies with the rule that everyone in similar circumstances should follow. In this field, much later, in the second half of the 20th century, *János Harsányi*, the Hungarian Nobel Memorial Prize recipient in Economic Sciences in 1994, developed the theory of preference utilitarianism, which assumes general goodwill and human compassion, and therefore excluded antisocial preferences. He was awarded the Nobel Prize for his work in game theory.

Alfred Marshall is a prominent exponent of neoclassical economics. According to him, economics should be concerned with the individual and social actions that lead to the creation of the material conditions for wealth. Marshall wanted to create a synthesis between the work value theory of the classics and the utilitarian theory of value. His famous analogy was that we can argue as intelligently about whether cost or utility determines value just as we can about whether the upper or lower blade of the scissors cuts the paper. Marshall also made important points in his theory of money. He demonstrated that the use of credit instruments increases the amount of money in circulation.

Irving Fisher is best known for his work in econometrics and statistics, in "the making of index numbers", which is what the Fisher Price Index is a reminder of. According to Fisher, interest rates are influenced by two forces: on the one hand, the preferences of economic agents, i.e. how much they prefer present goods and income over future ones; on the other hand, they weigh investment opportunities, i.e. the return that can be achieved. By this he meant the rate of return over costs. Fisher is also a forerunner of adaptive expectations. Importantly today, he pointed out that present consumption also depends on future prospects.

A prominent representative of the Lausanne school is *Vilfredo Pareto*, whose name is marked by the development of the Pareto theory of efficiency, or Pareto optimality. The Pareto optimality describes a scenario in which the situation of one economic agent cannot be improved without at least one other economic agent's situation deteriorating.

Chapter 9 is about "(The) challengers of mainstream economics". In contrast to mainstream economics, the German historical school broke new ground. Its forerunner was *Friedrich List*, who advocated state intervention in the interests of industrialisation and catching up with England, and a trade policy that promoted industrialisation and protected the economy. He saw protective tariffs (in his words "educative tariffs") as an important means of achieving this.

The *German historical school* is extremely rich and heterogeneous, with important common features. They rejected the existence of a universal law of nature in economics, focusing on the process of historical development. Building on historicity, induction and statistical historical data collection and time series analysis were valorised by them. They argued that the individual can only be understood in a historical and cultural context. A nation is not a mere concept, but a real being, a living organism. They did not accept that free competition and the pursuit of self-interest would lead to social welfare.

Alongside historicism, the role and impact of institutions became the focus of research by *Thorstein Veblen*, who became the founder and proponent of institutional economics. According to Veblen, events in the historical past partly underpin and partly limit the path of development that can be followed in the future. In doing so, he established the idea of path dependence, which is also very important in today's institutional economics, although he did not yet use this concept. A late representative of the trend analysed in the 20th century is *John Kenneth Galbraith*, whose main work is illustrated by the titles of his three seminal works: "American Capitalism: The Concept of Countervailing Power" in 1952, "The Affluent Society" in 1958 and "The New Industrial State" in 1967. Several of his main claims have proved to be enduring. In a society of plenty, companies themselves generate needs through advertising, consumer sovereignty does not exist. In a joint-stock company, the owners of the capital are no longer able to exercise any meaningful control over the companies, the real control is in the hands of technostructure.

Chapter 10 is entitled "The triumphal appearance of macroeconomics: Keynes and his contemporaries". This is one of the most exciting and richest chapters in the book, providing a wealth of new information and in-depth analysis even for those familiar with the subject. *John Maynard Keynes* was a dominant figure in 20th century economics, comparable to the influence of Smith in the 18th century and

Ricardo in the 19th century. Keynes took part in the peace negotiations after World War I and wrote “The Economic Consequences of the Peace”, in which he argued that the peace treaty would destroy Europe’s international trade and financial cooperation, destabilise and cripple Germany, and that the fragmentation of the Central European region would cause serious damage to Central Europe and Europe as a whole. Keynes was a leading figure in the economic debates after World War I. He explained that a return to the gold standard brings on the threat of deflation and crisis. As is well known, this indeed happened in 1929. The Great Depression broke out and Britain had to abandon the gold standard system in 1931. Keynes’ major work was published in 1936 under the title “The General Theory of Employment, Interest and Money”. Farkas summarises well the main connections of the general theory, efficient and aggregate demand, the Keynesian investment function and especially Keynes’ views on the active role assumed by the state. In addition to the theoretical-historical context, Keynes provides an in-depth analysis of the economic policy tools of the state and their application. Keynes played an important role in the 1944 Bretton Woods negotiations on the post-war international financial system and the founding of the International Monetary Fund and the World Bank.

Friedrich von Hayek is a prominent figure in the conservative movement of the 1980s. His cycle theory is fundamental to his work. According to him, economic agents’ decisions are not influenced by the price level, but by price ratios and interest rate changes.

Joseph Alois Schumpeter started from the Austrian school. He focused on the phenomenon of innovation. Progress is made when the entrepreneur innovates by creating a new combination of factors of production. Innovation is financed by credit from another important player, the banker. Adaptation to innovation is achieved, in Schumpeter’s famous phrase, by “creative destruction”, which eliminates uncompetitive firms and their production.

Chapter 12 discusses “The (German) social market economy”. From a theoretical and economic-political point of view, this is of paramount importance both for post-World War II development and for addressing the problems of our time. Farkas summarises the historical processes and the emergence of the social market economy very well and expressively. The fundamental starting point for the developers of the social market economy was the need to find a new way out of the bankruptcy of the abandoned free market, ‘Manchester’ capitalism and centralised state dirigiste economy. The theoretical foundations of *Walter Eucken* and the Freiburg School provided the integrated approach that established and developed the system of the social market economy. In addition to Eucken, *Franz Böhm* and *Hans Grossmann-Doerth* were among the founding fathers, and *Wilhelm Röpke* and *Alexander Rüstow*, whose thinking involved deep social-scientific terms, were also among the system’s developers. The economic policy and practical concept of the social market economy model was developed under the leadership of *Ludwig Erhard*. Central to Erhard's economic policy were fair competition, the regulatory role of the state free from the influence of interest groups and the guarantee of the stability of the value of money. The economy cannot be made independent of moral values. In the social market economy model, the word social is not an adjective but an integral part of the system. Society and the economy must build jointly on freedom and responsibility. At the same time, social assistance should help the individual to regain independence (Hilfe zur Selbsthilfe). The basic principle is subsidiarity, i.e. the principle of mutual aid, whereby decisions should always be taken at the lowest level of the citizen where the capacity to solve a problem exists. This has been the organising principle of the European Union since 1993, when the Maastricht Treaty came into force, but it is increasingly being violated today.

Chapter 13 is titled "Economic theory after Keynes". The neoclassical synthesis was largely created by *John Hicks*. Hicks considered the classical theory one-sided because it focused only on income in determining money demand, while Keynes focused only on the interest rate. He demonstrated that the equilibrium of the commodity and money markets should be considered together as a function of income and interest rate.

Paul Samuelson 's major work is "Foundations of Economic Analysis", published in 1947. In his work he discussed that the most fundamental assumption of economics is that of a maximising and optimisation-based behaviour. According to the duality principle, optimisation problems always occur in pairs. The defining work of Samuelson's life is his work "Economics", published in 1948, which became a successful economics textbook worldwide, translated into 41 languages. *William Nordhaus* co-authored the revised editions from 1985. One of the most enduring achievements of the renowned Hungarian-born economist *Béla Balassa* is the theory of international economic integration and the phasing of integration. According to the Balassa-Samuelson effect, there is a distinction in international trade between tradable and non-tradable goods, typically local goods and services. Productivity differences are higher for goods that enter international trade than for goods that do not.

The theme of Chapter 14 is "Return to neoclassical roots". The Chicago School was already active between the two World Wars and was marked by *Milton Friedman* and *Georg Stigler* in the new post-World War II era. Friedman is the central figure of monetarism. According to his now famous theory of the consumption function, households adjust their consumption expenditure to their so-called permanent income. In his analysis of money supply, Friedman distinguished five forms of wealth: money, bonds, equities, physical non-human goods and human capital. On monetary policy, he argued that there can be many delays in its application, causing distortions. According to him, money is the overall engine of the economy, and if it fails, the other mechanisms of the economy will also fail. *Georg Stigler* discussed the relationship between the market and state regulation. He developed the economics of information acquisition. He attributed persistent price differences to the costs and demands of obtaining information. (The same products can and do have very different prices in different stores and from different suppliers).

The last chapter of the book, Chapter 15 is: "At the frontiers of mainstream economics". I consider Farkas' analysis to be a courageous, well-founded and valuable analysis, which presents two very different, but parallel trends in new institutional economics and behavioural economics, and the claims of their representatives, in a balanced and in-depth way.

Farkas' impressive, highly valuable work traces in detail the historical arc of the development of economic thought from antiquity to the present day. The book is not only a work of theoretical history, but also a comprehensive presentation of how economics has judged and judges the relationship between the economy, society and the individual in different ages and today, in which value system, what answers it has given to the basic questions of the functioning of the economy, the relationship between production and consumption, the state and the market, the relationship between the real and the monetary economy, and the driving forces of human activity.

By presenting and analysing the original line of arguments of the different views, the author provides an authentic overview of the development process in which different, often opposing, viewpoints and their representatives sought and are seeking the theoretical, strategic and economic policy options for building a better functioning economy that serves people better and functions more efficiently.

Farkas' book is a complex work covering hundreds of fundamental works, a basic scientific work, in which the author draws important lessons on strategic issues of finance and lending by analysing real and financial processes together. A detailed index is provided to help readers browse the content and search. It can be used as a textbook for teaching the history of economic theories, as well as for doctoral training and the preparation of researchers.

Professor Beáta Farkas' book represents a new value, both in Hungarian and international dimensions. It would be ideal if it were also published in English, so that its values could be recognised in international academic and university circles.