Chapter 1. Defining the Economy

What is economic epistemology?

Before answering that question, we must distinguish between economy and economics:

- Economy is an area of social life. Economies have always existed, in any society. They can take many forms: market economies, traditional economies, domestic economies, planned economies.
- Since the 18th century, a field of knowledge has been elaborated study this economic part of social life: economics, or economic science, or political economy. That's what you study.

Studying the economic epistemology means wondering what makes *economics* a science. Before, a preliminary question concerns the field studied by economics: the field of economy. How do you define an economy? What are economic activities? i.e. what area of social life constitutes an economy?

Chapter divided in two parts. First, we study 2 opposite answers to that question, i.e. 2 definitions of economy: substantive definition / formal definition.

Second, we study a third way of thinking economies, not opposed to the previous ones, but linked to market economies.

I. Substantive and Formal Definitions of the Economy

This distinction is formulated by Polanyi in a posthumous text, *The Livelihood of Man*, 1977. "The Place of the Economy in History and Society". (In French: https://www.cairn.info/revue-du-mauss-2007-1-page-63.htm)

Polanyi identifies two major definitions of the economy within economic thought, two possible meanings of the term when activities are described as economic

1. Substantive Definition

i) Definition

The economy studies the *material conditions for human existence and satisfaction of needs*.

This definition is shared by many economists but also in sociology, anthropology and history. Human beings depend both on nature and on other human beings, to satisfy their needs, starting with the needs related to their survival.

- The case of Robinson Crusoe, alone on his island, shows that for each human being, subsistence and well-being depend on himself and on the resources provided by his natural environment.
- When there is a social division of labor, subsistence and well-being also depend on others. Everyone is therefore in interaction with nature and with others for their subsistence and well-being. The forms these interactions take (man-nature or man-man) fall within the scope of the economy.

Note: the substantive definition focuses on material *resources*. The economy enables the satisfaction of all needs, not only material needs relating to survival (food, clothing, shelter), but also needs for art, for culture, etc. The needs are not only materials but the means used to satisfy needs are material. That is the field of economy.

ii) Examples

- A. Smith, *Wealth of nations*, Introduction

> Among the savage nations of hunters and fishers, every individual who is able to work is more or less employed in useful labour (…) to provide (…) the necessaries and conveniences of life, for himself, and such of his family or tribe as are either too old, or too young, or too infirm, to go a hunting and fishing.

In savage nations, all those who are able to work actually work.

> Such nations, however, are *so miserably poor*, that (…) they are frequently reduced, or at least think themselves reduced, to the necessity sometimes of directly destroying, and sometimes of abandoning their infants, their old people, and those afflicted with lingering diseases, to perish with hunger, or to be devoured by wild beasts.

Their poverty is so strong that the survival of the most vulnerable is at risk. This is the opposite in civilized nations.

> Among civilised (…) nations, on the contrary, though a great number of people do not labour at all, many of whom consume (…) frequently of a hundred times more labour than the greater part of those who work;

Many people are idle, and there are strong inequalities in the distribution of wealth, in favour of the idle.

> Yet the produce of the whole labour of the society is so great that *all* are often abundantly supplied, and *a workman*, even of the lowest and poorest order, if he is frugal and industrious, *may enjoy a greater share of the necessaries and conveniences of life than it is possible for any savage to acquire*.

This text is an argument in favor of developed nations, whose economies are organized to best satisfy needs. But forget this aspect. What remains is the *underlying conception of the economy*: *producing the material resources necessary to satisfy needs*, providing the necessaries and conveniences.

- Marshall, 1890, *Principles of Economics* (https://www.marxists.org/reference/subject/economics/marshall/index.htm)

> 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 the *material requisites of wellbeing*.

- Keynes, "Economic Possibilities for our Grandchildren," 1930 (https://www.marxists.org/reference/subject/economics/keynes/1930/our-grandchildren.htm)

> … mankind is solving its economic problem. I would predict that the standard of life in progressive countries one hundred years hence will be between four and eight times as high as it is today. (…) the economic problem may be solved, or at least be within sight of solution, within a hundred years. This means that the economic problem is not, looking into the future, the permanent problem of the human race. (…) It is startling because – if, instead of looking into the future, we look into the past – we find that the economic problem, the struggle for subsistence, always has been hitherto the primary, most pressing problem of the human race – not only of the human race, but of the whole of the biological kingdom from the beginnings of life in its most primitive forms.

Let's put aside the prophecy about economic evolution, actually wrong. The text defines the fundamental economic problem as the problem of the *material conditions of subsistence*.

Marx can also be associated to this tradition.

iii) A Definition associated to a Threat, to a danger: From Smith to Deaton

When the economy is viewed first through the questions of subsistence and its material conditions, above all, it confronts the threat of poverty, and poverty may lead to death. Economy deals with a danger of death.

Smith: the place of the economy in human life comes from an anthropology, explained in the *Lectures on Jurisprudence* (1766). He exposes a conjectural history: not the history of historians, the history of a philosopher (since Smith was first a philosopher). This history tells that every human society has passed, or will pass, inevitably, through four successive stages of development. Each stage is defined by a specific mode of subsistence.

- The first stage is hunting and gathering. In WN, deer and beavers:

> If among a nation of hunters, for example, it usually costs twice the labour to kill a beaver which it does to kill a deer, one beaver should naturally exchange for (…) two deer.

- The second stage is pastoralism: animals are no longer killed for food; they are captured, they become domestic animals and provide food not only once but for a long time.
- The third stage is agriculture, which goes with a sedentary lifestyle

- The last stage is the commercial stage: industrial mode of production and capitalist market economy.

The first stage is important because it shows a feature in an economy that remains, that persists, in the following stages: this feature is *scarcity*, scarcity of the resources essential for life, called necessaries.

The human condition in this first stage is precarious. Other animals, not human animals, find in nature everything they need. Human beings have a weaker constitution. Their basic needs require artifice for their survival: food requires fire; protection against the cold weather, and the natural environment, hostile, requires clothing and shelter (some kind of house).

Humanity in the first stage begins with a lack of the resources needed for survival. That's why economic development is highly desirable. This development requires that a part of what is produced, in each stage, is not consumed: it is accumulated. For economic development, there must be a surplus of production that is not consumed. For example, the second stage requires that all the animals are not eaten immediately. It requires a fortunate combination of circumstances, to allows this surplus.

This anthropology underlies the *Wealth of Nations* (previous text). At the origin of societies, life is invaded by the search for the means of survival, by the scarcity of the resources essential for life (necessaries). In the first stage, human being has to improve his condition, because he may die.

But this scarcity does not vanish with the 1st stage: the desire to improve our condition persists in later stages: human beings never cease to desire the enjoyment of a greater quantity of goods. Scarcity or resources is the fundamental model of human motivation.

The logic of want does not stop at need; it proliferates endlessly: from need to desire, from subsistence to enjoyment, from necessaries to conveniencies. Desires inherit the logic of needs. Human beings take (and mistake) their desires for needs, they act as if their desire were as imperious as needs. The desire for new goods expresses a want similar to the want for goods essential for survival in the first stage.

This analysis of want is still present in the follwinf analysis, including those of the economists or the 21st century. An example:

- Angus Deaton, 2013, *The Great Escape*

> THE GREATEST ESCAPE in human history is the escape from poverty and death. For thousands of years, those who were lucky enough to escape death in childhood faced years of grinding poverty. Building on the Enlightenment, the Industrial Revolution, and the germ theory of disease, living standards have increased by many times, life spans have more than doubled, and people live fuller and better lives than ever before. The process is still going on.

iv) A Definition That Places Production at the Center

The fundamental categories of the economic sphere are:

- production: the manufacture of goods and services through labor activity and on the material basis of natural or transformed elements

- allocation or distribution: the social assignment of individual rights to the product. Examples: in classical and Marxist thought, the distribution among wages, rent, and profit. In neoclassical thought, the remuneration of factors of production (or inputs).

- circulation (not always distinct from distribution, but conceptually different): the reallocation among individuals of products already appropriated. Example: circulation through exchange.

- consumption: the individual enjoyment (and objective destruction) of products.

In the substantive definition, the essential element of economic analysis is production, subject to the constraint of reproduction.

Subject to the constraint of reproduction = mankind has to finding the resources of material reproduction. That implies existence of an economic sphere, in every human society.

Production comes first because consumed goods must be produced. It must be produced in greater quantity in order to accumulate, so as to prevent possible shortages and, ideally, to increase well-being.

2. Formal Definition

i) The Economy as the Science of Rational Choice

Economic refers to a particular type of human disposition. The economic agent makes the “best” use of his means to achieve his ends. The economy is a form of the human mind that extends beyond the domain of material means. It concerns every choice, whatever the means employed, whatever the ends involved. An economic choice is a rational choice, whatever the domain in which it is made.

Definition proposed by Robbins, 1932, *An Essay on the Nature and Significance of Economic Science*.

Robbins raises objections to the substantive definition: Cannan (working within the substantive definition) imagines Robinson Crusoe's economy, and distinguishes between ‘economic’ activities (producing potatoes) and ‘non-economic’ activities (talking to his parrot). Robbins says there is an economic problem to solve: choosing between these two activities. This choice itself is economic. Robinson desires both goods (potatoes) and leisure (talking to his parrot). He evaluates these desires, and he chooses to allocate his time between these two activities.

He has to choose because he does not have enough of either to fully satisfy his desire for each.

For Robbins, the conditions of human existence have 4 fundamental characteristics that require choice:

(1) Ends are numerous: if there is only one desirable end, there is no choice.
(2) Means used to achieve ends may have alternative application. If each means can achieve only a single end, no choice is possible in its use. But time, at least, is capable of different uses: labour or leisure.
(3) Ends are of varying importance: if the ends are of equal importance, one cannot choose. The paradox of Buridan's donkey (âne de Buridan): a donkey placed at equal distance from food and would die of hunger, for he is not able to choose.
(4) Time and the means of achieving these ends are limited.

ii) Characteristic (4). Scarcity of Means

The multiplicity of ends is interesting for the economist only if means are lacking. We can imagine a situation where all needs and completely satisfied. Robbins calls it Nirvana. In such a situation, no choice is required, there is no economic science.

But ii is not the human condition, which implies limited means:

> “Life is short. Nature is niggardly [does not provide what we desire]. Our fellow men have purposes other than our own. And yet we can use our lives to do different things, to use our means and the services of others to achieve different ends.”

The importance attached to scarcity is explained by the fact that this is not merely a primordial scarcity of essential resources for life, as in Smith's primitive state. Scarcity is permanent and concerns every domain of human life, not only that of material resources.

> “We have been turned out of Paradise. We have neither eternal life nor unlimited means of gratification. Everywhere we turn, if we choose one thing we must relinquish others [give up other things] which, in different circumstances, we would wish not to have relinquished. *Scarcity of means to satisfy given ends is an almost ubiquitous [general, permanent] condition of human behaviour*.”

That feature of human condition is at the basis of economic science:

> “The unity of economic science thus lies in the forms taken by human behavior in the disposal of scarce means. *Economics is the science that studies human behavior as a relationship between ends and scarce means with alternative uses*.”

Every kind of behavior (the production of philosophy just as much as the production of potatoes) falls within the scope of economic generalizations. Insofar as either of these kinds of activity entails giving up other desired alternatives, it has an economic aspect.

The scarcity of means is relative to ends. There is scarcity because there is no satiety. If means exceed ends, the economy disappears.

iii) The Ends

Ends are diverse, and possibly infinite. Human beings never reach complete satiety.

Economics is absolutely neutral about ends. Ends are the motives for action. The economist does not study ends and does not judge them. He studies the way in which human beings follow their own ends or objectives, conditioned by the scarcity of means.

No end is economic in itself.

- *Robbins*

He imagines a

> "… community of sybarites, their pleasures gross and sensual, their intellectual activities preoccupied with the "purely material". (…) economic analysis can provide categories for describing the relationships between these ends and the means which are available for achieving them.

Then he supposes that this community is visited by a Savonarola who tells them how he despises, how he condemns their lifestyle. And the community changes his lifestyle.

> The pleasures of the senses are banished. The sybarites become ascetics. Surely economic analysis is still applicable. There is no need to change the categories of explanation.

Or course, demands change. The demand for wine decreases, the demand to resources to build churches increases.

> That is all. The distribution of time between prayer and good works (feeding the poor) has its economic aspect equally with the distribution of time between orgies and slumber (between drinking wine and sleeping).

- Microeconomics, consumer's theory

Ends are indicated by the utility function, which ranks the different ends. Assuming two consumers A and B, whose utility functions are respectively

$U_A(q_{1A}, q_{2A}) = q_{1A}^2 \, q_{2A}$ and $U_B(q_{1B}, q_{2B}) = q_{1B} \, q_{2B}^2$, with $q_1 > 1$, $q_2 > 1$

The ranking of the two ends (consuming good 1 or good 2) is not the same for each. Agent A prefers good 1, agent B prefers good 2. This does not rule out agent A wanting to consume good 2, and vice versa.

The economist does not have any judgement on these utility functions. He takes them as given. He can say nothing about the utility functions. But he can say something about the choice to use of means to satisfy these ends of varying importance specific to each individual.

- Becker (*The Economic Approach to Human Behavior*, 1976)

He generalizes this definition of economics to all human behavior: everyone calculates all the time about everything. All human action is thus reduced to a cost/benefit calculation (trade-off). He proposes the economics of crime, of marriage, etc.

iv) A Definition That Places Individual Choice at the Center

The fundamental element is rational choice, in order to maximize satisfaction. This involves a trade-off between different forms of consumption, including the consumption of time as leisure time. Exchange (circulation) results from this trade-off. Production itself results from a trade-off because it is an exchange with nature: it involves the use of resources and time to produce the goods we desire.