

# ECONOMIC THEORY A Critic's Companion

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ECONOMIC THEORY  
A China's Composition

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## PREFACE

In preparing the eighth edition of my *Handboek van de Economie* (an earlier edition has been translated into English, *Economics a critical approach*), the contents have been divided into two parts. Whereas the first part deals with economic theory as such, the present publication contains the subject matter of the second part, namely, the critical comments on various economic theories. Here I have taken into consideration the opinions expressed in reviews of the aforementioned book and by several colleagues. While some indicated that 'The "appraisal" sections cater for the sceptical intelligent student' (C.D. Harbury, *Economica*, August 1972), other teachers judge that 'students who demand "relevance" from their studies are not likely to last long with a book which follows each point by a note stating that it is really pretty useless' (J.R.S. Revell, *The Economic Journal*, September 1972).

This book has no intentions of instructing fellow economists. It is intended as a complement to an introductory course on economics, which for the most part does not deal systematically with (or is even totally lacking in) critical comments. This also explains why a survey of the main trends in economic doctrine are found in the Appendix.

Many economists consider any criticism of economic theory to be a form of

*lesè-majesté*. On the other hand, a critical approach should not be the monopoly of Marxist or gauchist authors.

My thanks are due to Prof. P. Hennipman, who was kind enough to read and comment on the manuscript, but who, although I took his remarks into consideration as far as possible, shares the opinion expressed by Prof. Revell. Acknowledgments also to Mr. John Cairns, FIL, for handling the linguistic aspect of the manuscript.

I am indebted to my assistants, and especially Mr. H. Baert, for their co-operation in the production of this book. Mr. Baert also undertook to compile the indexes and to check many bibliographical details.

My thanks are also due to my wife who gave useful assistance at every stage of the project.

# CONTENTS

## Preface

v

## 1 Introduction

1. Terminology
2. Originality
3. Ideology

1  
2  
4  
4

## 2 The theory of the consumer's behaviour

1. Gossen's 'laws'
2. The indifference curves
3. The influence of the other consumers
4. Demand
5. Consumption and saving
6. Conclusion

9  
9  
10  
12  
13  
14  
15

## 3 The theory of producer's behaviour

1. Substitutability and complementarity of production factors
2. The optimum combination of factors for a given level of output

17  
17  
18

vii

3.	Optimum level of production	19
4.	Supply and revenue	20
5.	The investment decision	21
6.	Conclusion	22
<b>4</b>	<b>The theory of pricing</b>	23
1.	Marginalism	23
2.	Corporate objectives	25
3.	Instruments of corporate policy	26
	a. Price	27
	b. Quality	27
	c. Sales promotion	28
	d. Distribution	28
	e. Product range	29
4.	Price interdependence	29
5.	The 'laws' of supply and demand	29
6.	Conclusion	30
<b>5</b>	<b>The theory of income distribution</b>	33
1.	The labour market	34
	a. Unions and the wage level	35
	b. Wage differentials	37
2.	The market for loanable funds	38
3.	Conclusion	41
<b>6</b>	<b>The theory of the general level of national income and of prices</b>	43
1.	Monetary equilibrium and the level of national income	43
	a. The investment multiplier	44
	b. The accelerator	45
	c. The interaction	46
2.	Inflation	46
3.	The transactions equation and the quantity theory	47
	a. The transactions equation of exchange	47
	b. The quantity theory	48
4.	The cash-balance theory	49
5.	Conclusion	50
<b>7</b>	<b>The theory of economic growth</b>	51
1.	The Harrod-Domar theory	52
2.	The neoclassical theory	53

3.	W. Rostow's theory	53
4.	The factors of economic growth	54
	a. Population	54
	b. Natural conditions	54
	c. Capital	55
	d. Education	55
	e. Technological advance	56
5.	Conclusion	57
<b>8</b>	<b>The theory of international trade</b>	<b>59</b>
1.	The theory of comparative cost	59
2.	The Heckscher-Ohlin theory	61
3.	Trade and economic growth	62
4.	The theory of purchasing-power parity	64
5.	The theory of balance-of-payments equilibrium	65
6.	Conclusion	66
<b>9</b>	<b>The limited practicability of the theory</b>	<b>69</b>
1.	Isolation from other sciences	69
2.	Unrealistic hypotheses	71
	a. Testing and falsifying	71
	b. Nonoperational concepts	72
3.	Mathematization of economics	72
4.	Conclusion	75
<b>10</b>	<b>The significance of economic theory</b>	<b>77</b>
1.	Determinism	77
2.	Predictability	77
3.	Theory or method?	80
4.	Conclusion	81
<b>Appendix</b>	<b>Economic Doctrines</b>	<b>83</b>
1.	Ancient and Medieval times	83
2.	Mercantilism	84
3.	Physiocracy	87
4.	The classical school	89
5.	The historical school	92
6.	Socialism	93
7.	The Austrian school and the Lausanne school	99
8.	Neoclassicism and the Swedish school	101

- 9. Institutionalism
- 10. The Keynesian 'revolution'
- 11. J.A. Schumpeter
- 12. Neo-Marxism
- 13. Neoliberalism

Endnotes

Index

W. Rostow's theory	102
The factors of economic growth	104
a. Population	105
b. Natural conditions	106
c. Capital	107
d. Education	
e. Technological advance	111
Conclusion	125

9	The limited practicality of the theory	
1	Isolation from other sciences	
2	Unrealistic hypotheses	
3	Testing and falsifying	
4	Nonoperational concepts	
5	Mathematization of economics	
6	Conclusion	
10	The emergence of economic theory	
1	Determinism	
2	Predictability	
3	Theory or method?	
4	Conclusion	
Appendix	Economic doctrines	
1	Ancient and Medieval times	
2	Mercantilism	
3	Physiocracy	
4	The classical school	
5	The historical school	
6	Socialism	
7	The Austrian school and the Lausanne school	
8	Neoliberalism and the Swedish school	



# 1 INTRODUCTION

Economic science has always been the subject of criticism, especially during the depression of the thirties and after the Second World War, when I, among others, deplored that: ‘. . . so much energy was wasted in obtaining so few results, or in discussing matters of practically no importance.’<sup>(1)</sup>

In 1958, P. Hennipman stated: ‘For some time now, more and more symptoms of serious discontent and concern about the present state and recent development of economic science have been observed.’<sup>(2)</sup> This sentence, with which he opened a thorough and erudite essay on ‘Recent criticism of economic science’, applies with even greater force in the present situation. Numerous books and articles are still being devoted to the crisis. Among the most recent are the not very systematic publications of J. Robinson<sup>(3)</sup> and the less original works of A. Lowe<sup>(4)</sup> and B. Ward.<sup>(5)</sup> In our view, the most eminent work remains that by S. Schoeffler.<sup>(6)</sup>

Before embarking in the following chapters upon a critique of economic science, I shall expand upon terminological confusion and

plagiarism, ailments that afflict economics as well as other social sciences. Finally, attention shall be drawn to the relationship between ideology and economics.

## 1. TERMINOLOGY

Unfortunately, in economics the simplest concepts are defined in numerous and divergent ways. For example, one need only point to the number of different meanings of *capital* and *capitalism*; the same applies to economic structure (some authors consider technological knowledge as a structural element, others do not), national product, national wealth; and finally, endless terminological disputes have arisen from the link between *saving* and *investment*.

My complaint is by no means original. In the last century, Malthus spoke of the defective formulation of concepts in economics,<sup>(7)</sup> and in 1937 R. Miry wrote:

. . . it would be hard to dream up a bigger muddle than the terminology we employ. In many cases we do not even understand each other because we assign the most varied meanings to one and the same word. We are living in a tower of Babel . . . continuously aggravated by acrobatic terms which we forge in order to look more learned than a colleague or to have the air of saying something different from a predecessor.<sup>(8)</sup>

Ten years later, J. S. Davis was warning us:

If economics is to deserve recognition as a science, even in the modest sense of orderly arrangement of better knowledge, we need to do better in choosing and clarifying elementary concepts, standardizing terms, and becoming more explicit and consistent in our use of both.<sup>(9)</sup>

and C.F. Carter joins him when he speaks of economics as an 'immensely complex subject, with no agreed notation or set of definitions.'<sup>(10)</sup>

There is not even unanimity concerning the definitions of economics. Some authors simply put forward the view that 'Economics is what economists do' (K.E. Boulding), or 'Economics is the study of economics' (D. Seers). The controversy between the champions of

the various definitions, according to W. Eucken a 'nutzloser Streit', has, in any case, brought few results.<sup>(11)</sup>

Apparently, economic associations find it beneath their dignity to devote a congress to the matter. Even if such a gathering confined itself to bringing a certain degree of uniformity in mathematical symbols, it would have performed a useful service.

And even when there is a certain agreement on a concept, economists often lose sight of the fact that interpretation of the concept is difficult. This can be illustrated by the following examples.

International comparisons of statistics on the national product must be made with caution, not only due to the divergent relative importance of incomes of, for example, members of the armed forces and intermediaries in the distribution process, but also because the accuracy with which the national product is calculated varies considerably from country to country (and exchange rates do not accord with purchasing power parities). In most of the less-developed countries a good deal of juggling has been needed to draw up national income statistics. The less-developed countries are not as poor as the figures indicate. In those countries untraded goods are cheaper than in the developed countries. A comparison between the real income of Thailand and that of the United Kingdom has shown that the former figure is 470 percent higher than the amount that would be obtained by converting the money income of both countries into a common currency.<sup>(12)</sup>

Partial productivity (the ratio of output to a single factor, e.g. labour, both expressed in money terms) as a yardstick of economic efficiency is significant only if there has been no factor substitution (or change in the factor combination). Even then, it is doubtful whether the value of the different types of labour (which, moreover, do not remain unchanged) can be added up.

F. Schaller correctly observes that in the literature we can find the most varied formulas for measuring productivity, but that the real difficulty is to establish what productivity is, what the object of our research is, and what precise significance we ought to attribute to the information found.<sup>(13)</sup> One therefore wonders whether it would not be preferable to substitute the neutral expression 'production per unit of input of labour' for 'productivity' and 'labour productivity'.

## 2. ORIGINALITY

To avoid bringing out old theories, a better knowledge of earlier authors is required. Far too often in economics, conclusions that were already formulated a long time ago are drawn triumphantly. Ignorance—even among well-known authors—is not always the only explanation. Sometimes plagiarism is committed without the least compunction. In this connection, P.A. Sorokin speaks of ‘amnesia’ and the ‘discoverer’s complex’. He writes: ‘The younger generation of sociologists and psychologists’, (and he could just as well have added economists), ‘explicitly claims that nothing important has been discovered in their field during all the preceding centuries; . . . and that the real scientific era . . . began only in the last two or three decades with the publication of their own researches . . .’<sup>(14)</sup> Hence, the definition of the historian of economic thought as a ‘Sadist who delights in pointing out to graduate students and colleagues that their brilliant ideas are not original’.<sup>(15)</sup>

I have therefore endeavoured—often by numerous quotations—to disclaim originality concerning what has already been said by others.

By this I do not mean that only original works are of value; the desire for originality leads not only to plagiarism, voluntary or involuntary, but also to many publications that should never have seen the light of day. In this respect, G. J. Stigler is right when he states:

that we commonly exaggerate the merits of originality in economics—that we are unjust in conferring immortality upon the authors of absurd theories while we forget the fine, if not particularly original, work of others.<sup>(16)</sup>

Vauvenargues was correct in stating that ‘It is easier to put forward new ideas than to conciliate those advanced earlier’.<sup>(17)</sup>

## 3. IDEOLOGY

Marxists in particular have repeatedly charged that economics is at the service of liberal concepts and that it nurtures extreme individualism and anti-interventionism. In particular, they have in mind hypotheses such as perfect competition, upon which many economic theories are based. This does not, of course, connote economists who

because of '... their connection with definite parties and pressure groups ... shut their eyes to the remoter consequences of the policies they are advocating',<sup>(18)</sup> but the practitioners of economic science who are not at the service of any interest group.

Marx himself upbraided economists for being the scientific representatives of the bourgeoisie.<sup>(19)</sup> G. Myrdal points out the value judgments that have existed in economic literature since the early physiocrats. These value judgments determine the choice of both the problems treated and the method applied. Myrdal would like every personal preference to be expressed as such, rather than as the result of a nonevaluative economic analysis.<sup>(20)</sup> In other words, a neutral science is out of the question; F. L. Polak also holds that opinion.<sup>(21)</sup> P. Dieterlen is no less decisive: 'The economist is an ideologist who accepts or fights himself as such, but then ignores himself. The *no* with which he answers the ideologists around him is neither more nor less ideological than their *yes*.'<sup>(22)</sup> Other contemporary economists such as K. Boulding<sup>(23)</sup> and R. Harrod<sup>(24)</sup> also acknowledge value judgments.<sup>(25)</sup> According to the Soviet official textbook on economics, a neutral economic science does not exist; economics is a party science: '... only a political economy which upholds the interests of the working class can ... be objective and disinterested'.<sup>(26)</sup>

Most economists admit that observations are being influenced not only by the intrinsic characteristics of the observed phenomena, but also—unconsciously—by the mirror (our view of the world and society) through which we see the world. Thus, observations may also be influenced by social bias and education.<sup>(27)</sup> In other words, they accept the existence of an ideological bias, 'though, like Marx, they find it only in others and never in themselves; but they do not admit that it is an inescapable curse and that it vitiates economics to its core.'<sup>(28)</sup> Seeing value judgments always and everywhere makes any objective knowledge impossible. If the choice of certain subjects of study or hypotheses,<sup>(29)</sup> and the emphasis that is laid on the analysis, can eventually or immediately be explained by ideological and psychological factors, this does not mean that their scientific significance is thereby impaired. They must 'in any case ... be judged independently of those subjective elements, and according to their own tendency'.<sup>(30)</sup> Ideological factors may indeed be stimulating. K. R. Popper even argues that 'The objective and neutral

scientist . . . is not the ideal scientist. Being a scientist without motivation is no good, not even in exact sciences'.<sup>(31)</sup> Divergent points of view are not necessarily due to value judgments:

. . . often a certain unavoidable allowance for divergent personal opinions exists . . . because it is impossible to determine all relevant, and for the solution of the problem necessary, facts and relations. But then, the researchers' subjective latency is not the primary cause of such differences of opinion.<sup>(32)</sup>

According to the generally accepted view, economic science does not become involved in the definition of targets; it takes them for granted and only says how they must be achieved.<sup>(33)</sup> Prominent among those who plead for a nonevaluative economic analysis is Max Weber.<sup>(34)</sup> The critics mentioned above call this neutrality ethically objectionable: It is alleged to imply indifference to society.<sup>(35)</sup> However, this overlooks the difference between economic science and its application. Every economist has the right to have his or her own opinion on the targets of economic policy. Nevertheless, the economist is expected to state his or her value judgments clearly. A socialist and a liberal economist pursue differing aims; what one of them accepts as normal is unacceptable to the other. But liberal and socialist or Marxist economies are nonexistent.

Welfare theory sets out to study value judgments and facts in combination. The practitioners of welfare theory, who do not necessarily accept that it is part of the economist's task to state the aims of economic policy, nevertheless maintain that economics must decide which economic system will yield maximum utility or maximum welfare. A. Smith maintained that this would result from the free exchange of production factors; by seeking profits each individual helps to maximize the common good (by the working of the 'invisible hand').<sup>(36)</sup> Later on, V. Pareto proved this mathematically,<sup>(37)</sup> but proceeding from rather unrealistic hypotheses (e.g. perfect competition, a stationary economy and a given income distribution, no social wants).<sup>(38)</sup> Under perfect competition, there is no point in changing the distribution of goods: Prices of goods vary with their marginal productivity. A change in income would lessen the satisfaction of at least one consumer or the output of at least one producer. Numerous authors have elaborated on welfare theory, but since



they have further exposed its unreality, little can be done with their directives. Thus, the Pareto theorem is only valid for a given income distribution. Since one cannot prove that any given distribution is better than any other, welfare theory assumes that government will establish a scale of social preferences, which is supposed to aggregate the preferences of the whole community. But this assumption disregards social wants, and also the view that some wants should be discouraged and others encouraged.<sup>(39)</sup> Welfare theory is of little practical value. Even if, for instance, we knew all those who would benefit or be harmed by a certain measure (which we do not), it would still be impossible to compare subjective judgments of the burdens and benefits concerned (interpersonal utility comparisons being impossible). Hence, F.A. Lutz's remark: 'It is . . . no miracle that only a handful of English theorists concern themselves with this side of welfare economics'.<sup>(40)</sup>

In recent times, more and more voices have been calling for a more active approach by the economist. The latter is required to be involved in current problems. More specifically, the economist is expected to be interested in the reformation of present-day society. 'Today's fashion often hesitates between two opinions difficult to reconcile: arguing in favour of involvement but against scientists having their hands tied'.<sup>(41)</sup> Indeed, the two generally go together. F. Hartog rightly points out that there is no danger of a lack of 'involvement', but of a 'critical distance from which, free of all attachments, only the truth is aimed at'. He therefore argues in favour of a 'free, critical, fundamental and objective study of science in general and of economics in particular'.<sup>(42)</sup> From what has just been stated it follows that this attitude is not easy to adopt. More than any other science, economics must guard against the influence of political convictions on theory.





## 2 THE THEORY OF THE CONSUMER'S BEHAVIOUR

Since the theory of the consumer's behaviour is founded mainly on Gossen's 'laws' or on the indifference curves, these are discussed first, followed by demand and the consumption and saving functions.

### 1. GOSSEN'S 'LAWS'

Gossen's 'laws' are to a great extent unrealistic because the consumer does not know the amount of the marginal utility—not measurable—yielded by the consumption of the last unit of a good (quite apart from whether or not the concept is familiar). Exceptions to the first 'law' (marginal utility declines as more units are added) are not infrequent; for instance, if one drinks a second glass of beer immediately after the first then the second may provide greater utility than the first.

The second law states that the marginal utilities of the goods purchased must be proportional to the outlays needed to acquire them.