ROUTLEDGE REVIVALS

The Making of Neoclassical Economics

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Foreword

Mainstream economics in the twentieth century has been primarily neoclassical economics. That this predominance has come to pass is something that has to be explained – and not merely on that school's own terms. Actually, the situation is far more complex. Neoclassicism predominates but is itself heterogeneous; moreover, there are diverse schools of heterodox economic thought. Contrary to the evident tendency of some economists to equate economics with neoclassical economics, economics is thoroughly heterogeneous. And this heterogeneity also has to be explained.

The origins of twentieth-century economics, in all its diversity but with the predominance of neoclassicism, reside principally in the period 1870–1900 or 1914. It was then that economics exhibited a major crisis of identity, in which every fundamental aspect of the discipline was contested, from its very name ('political economy' or 'economics') to the status of the English founding fathers, its central analytical problem, its scope and methodology and, *inter alia*, the content and place of the theory of value. The fact that one hundred years later these same issues remain controversial signifies that the complex question of identity is a continuing problem not resolved once and for all time.

The study of the origins, and indeed the nature, of twentieth-century economics is complicated by the fact that economics has come to serve three functions: to provide knowledge of the economy, of economic 'reality'; to serve as social control in the continuing legitimation and (re)construction of the economy; and, simultaneously and interactively, to serve as psychic balm, to set minds at rest that all is fundamentally well in matters economic. Such study is further complicated by the fact that economists have been motivated to pursue several distinct and partially reinforcing but also partially conflicting goals: the status and prestige of objective scientist; the role of technical expert in matters of economic policy in the continuing (re)construction of the economy; and the advocacy role of high priest in the legitimation of the market, if not also (however selectively) in the status quo structure of power, the delegitimation of government *per se* and the selective legitimation and delegitimation of various government policies. Any explanation of the genesis and predominance of neoclassical economics must willy nilly come to grips with these considerations.

The foregoing means that any interpretation of the making of neoclassical economics must draw upon insights not only from the traditional sociology of knowledge and standard history of economic thought, but also from the fields of intellectual history, the sociology of economics, the professionalization of intellectual disciplines, and such recondite areas as deconstruction, hermeneutics and the analysis of discourse in general.

It is important to note that the definition of 'neoclassical economics' is not perfectly self-evident. It has meant different things to different writers, some practicing neoclassical economics as they understood it, and others studying the history of neoclassical economics. These different meanings include (1) the subjective marginal utility theory of the 1870s and beyond; (2) the economics of Alfred Marshall; (3) the work of twentieth-century writers working in the tradition, or mould, established by Marshall and some others, most notably Leon Walras; (4) some combination of the foregoing; and, *inter alia,* (5) the Samuelsonian neoclassical synthesis of microeconomic price and resource allocation theory and Keynesian macroeconomics. The argument of the present volume is applicable to all of these definitions.

Neoclassicism has also had a variety of technical meanings as to its central problem: the mechanics of utility, price determination, or operation of the price mechanism; the working of the free enterprise system; the operation of pure markets; the mechanics of the pure theory or logic of choice; constrained maximization decision-making; the allocation of resources; and so on. Not all these meanings are mutually exclusive; indeed, many of them are mutually reinforcing. My own general view is that neoclassical economics comprises work in the tradition of Marshall, Walras and others on how the price mechanism of the market allocates resources in a context of the constrained maximizing choice from within individual opportunity sets. The argument of the present volume, however, is applicable to a variety of formulations of the central problem of neoclassical economics.

The foregoing discussion necessarily has had to allude to the concept of 'marginalism.' This concept, too, has had diverse meanings, and this also is part of the history of the practice as well as of the interpretation of neoclassicism. Marginalism has meant (1) the subjective marginal utility theory of value, (2) the economy as a process of adjustment at the margin, (3) the practice of constrained maximization by economic actors (for example, equating marginal cost and marginal revenue), and, *inter alia*, (4) price and resource allocation.

A related question concerns the so-called 'marginal revolution': whether such a revolution actually took place, and of what it consisted; and whether the so-called revolution took place in the 1870s, as is so often understood, or a short time later, (say) with the pre-eminence of Marshallian economics, or somewhat later, with the more firm establishment of an Austrian school, or (as George Stigler argues) much later, perhaps the 1960s, with the adoption of the now more-or-less conventional practice of using utility functions to formulate research problems. It will be perhaps obvious that each of these possibilities may presume something different as to the content of marginalism.

The question of the marginal revolution of the 1870s raises the larger question of whether or not there was a major paradigmatic shift between classical and neoclassical economics. In some respects there appears to be significant differences between the two, involving, for example, the change from the labor theory of value to a demand and supply price theory, and the change from macroeconomic growth and distribution theory to microeconomic static resource allocation theory. But in other respects, there appears to be significant continuity, for example in the focus on markets, in the rationalization of middle-class values and so on, perhaps even in the theory of market price as distinct from the metaphysics of value theory.

The period 1870–1900 or 1914, and the rise to predominance of neoclassicism therein, has become one of the, if not *the*, new leading areas of study in the field of the history of economic thought. Contemporary scholars such as James F. Becker, A. W. Coats, John Creedy, Mary Furner, Alon Kadish, Gerard Koot and John Malony have examined such divers topics as the role of expertise, the growth of professionalization concomitant with orthodoxy, the English historical school, the status of economics in the 1870s, the sociology of the discipline, the Oxford economists, the conflict between advocacy and objectivity, and such eminent figures as Alfred Marshall and Francis Ysidro Edgeworth. Among the other cognate topics that have recently come under historical and analytical scrutiny are the analysis of economics as a mode of discourse, by writers such as Michel Foucault, S. Todd Lowry and Keith Tribe, and the ongoing contest between internalist and externalist (absolutist and relativist) explanations of disciplinary change.

John F. Henry's study is a contribution of no small substance to this quest to understand the origins, driving force and rise to predominance of neoclassicism in economics. He perceives neoclassicism to be an emanation from the reigning capitalist system – not merely its explanation, and not merely a mode of its self-nationalization but its product. As Professor Henry puts it, his question is '*why* theory develops and why theories of a certain type develop when they do. To attempt any answer to this question requires an examination into the relation between society and theory.' Professor Henry does not consider his to be the final word in the attempt to understand the emergence of twentieth-century neoclassical economic theory. It is, of course, not the final word; but any effort at a complete, or at least more encompassing, explanation will have to deal with his explanation and, indeed, to have a place for it. Henry's argument, or some transformation of it, will be part of an eventual more complex and more encompassing explanation. No one is likely to agree with all the elements of his interpretation, but everyone will have to reckon with what he has to say. To have provided such a contribution, and I believe Professor Henry to have done so, is no slight accomplishment.

Modern economics, especially contemporary neoclassical economics, is distinguished by its emphasis on technique and by its particular paradigm of how pure markets operate in conjunction with economic agents practicing constrained maximization. Most contemporary economists know these techniques and the associated body of theory very well. What they do not appreciate are the origins and cultural premises of the predominant neoclassical paradigm and how their techniques give effect to those origins and premises, often with unknowing selectivity. In a certain sense, the techniques and the theories stand on their own independent bottoms. But in another respect, they are both conduits for certain premises and are functional as social control in the service, however selectively, of the regnant economic order and the status-quo structure of power and ideology. This is the case whether or not one likes that order or that power structure or that ideology. The same would be true, *mutatis mutandis*, if another school of thought were to have become predominant in economics.

It will be especially valuable to the reader if he or she systematically critiques the author's argument during the reading of this book. What are the author's questions, and what are his answers? What materials and lines of reasoning are brought to bear in support of the argument? What alternative questions and what alternative answers might be posed? What would a 'more complete' explanation of the making and the rise to predominance of neoclassicism take from Professor Henry's argument? On what grounds can one accept or dismiss his claims and his interpretations? If the reader will consider these questions seriously, Professor Henry's project in this study will be vindicated. For the subject is a serious one, and Professor Henry treats it seriously.

Finally, the reader should be cautioned that Professor Henry treats certain delicate or sensitive subjects, subjects that are part of the mind-set of most of us, in a very straightforward and often critical manner. Economists have long been noted for their candor. Adam Smith wrote that 'Civil government, so far as it is instituted for the security of property, is in reality instituted for the defense of the rich against the poor, or of those who have some property against those who have none at all'; and he lectured that the 'very end [of government] is to secure wealth and to defend the rich from the poor.' Vilfredo Pareto firmly believed that economics, no less than religion, was part of the total system of 'force and fraud' by which society was governed. And Frank Knight opined that, if religion were the opiate of the masses, it was also the sedative of the (upper) classes. All of which is to suggest that Professor Henry's account of the making of neoclassical economics is conducted at a very deep, and therefore sensitive, level indeed.

Warren J. Samuels

I dedicate this work to Tom Asimakopulos, Harold Wright, and Jack Weldon – three who made a difference.

In every cry of every man,
In every infant's cry of fear,
In every voice, in every ban,
The mind-forged manacles I hear.

William Blake

To him who does not know the world is on fire, I have nothing to say.

Berthold Brecht

Things are in the saddle and ride mankind.

Ralph Waldo Emerson

After all, if a man's salary is good enough, surely he can believe in anything.

Stephen Leacock

Preface

What follows is not to be read as a normal excursion into the history of economic theory. There is no attempt to examine all the major and many minor theorists, nor is there an investigation into the details of the work of these figures. Moreover, I am not interested in undertaking a systematic analysis of, or doing battle with others who are engaged in, this particular area of economic inquiry. Rather, this study tries to develop a general theory of the development of general theory itself.

The normal position taken by historians of science is to focus on the contributions of one or another figure, showing how these contributions were based on previous thought and led to subsequent analysis. As well, we usually find some degree of comparative analysis. More important, the standard adopted for the critical evaluation contained therein is that which is currently fashionable – in the case of economic thought, the neoclassical point of view. What I attempt here is an explanation of *why* the standard itself unfolded; why the neoclassical perspective, resting on a utility theory of value, became increasingly prominent, then dominant, in the nineteenth century. The argument rests on the underlying economic changes undergone by capitalist society during the period and the nature of capitalism as a minority ruling-class society.

By way of general argument, let us consider several points. First, we observe that the dominant ideas held by society undergo change. One aspect of this change is that of modification within a given ideological structure: an established theory is accepted as true, but specific parts of this theory are adjusted to accommodate changed circumstances or the development of new data. More significant than this, however, is that periodically we find a change in the general theory itself: Newtonian physics is replaced by atomic physics. It is this latter type of change that creates the greater upheaval in whatever field of inquiry is being studied, and which requires the more significant explanation as to why such change occurs.

What is termed 'neoclassical economics' was not always the prevailing view of the discipline. To reach its current position, it had to wrest ideological domination from the older, classical general theory. Why did this occur? What were the mechanisms by which this victory was won? While the argument contained herein may be found faulty, it is nevertheless true that such a change did occur, and that this change does require explanation.

Second, it is observed that established institutional structures are more or less taken for granted, are not subjected to critical scrutiny. We accept a price system, money, privately owned production facilities. To be sure, there is always some call for reform of given institutions, but only within the institutional framework itself. This is equivalent to the modifying type of change to which ideological structures are constantly subjected. Suggestions that the institutions themselves are the cause of problems and should be scrapped altogether are, under normal circumstances, held to be outside the pale and not worthy of serious consideration.

So it is with ideological formations. As long as ideas are contained within the dominant theoretical perspective, they may be entertained. Those challenging that structure are dismissed out of hand, regardless of merit. That is, just as institutional arrangements are accepted because they exist, so are ideas. And, clearly, there is a relationship between institutional arrangements and ideological formation, given that ideas about society must be concerned with the institutions of society. Thus, for example, in capitalist society, the vast majority of the population accepts the basic institutions of such a social organization – private property, exchange, etc. – and, consequently, accepts the general theory that supports those institutions. Calls for money *reform* will be heard (and such calls can indeed be scientifically silly – witness Major Douglas), while the suggestion that an economic system centering on exchange be eliminated will be met with, at best, silence.

What we find, then, is that society's position on normalcy or decency will be determined largely by the social institutions and ideas that are dominant. These ideas form the basic judgment as to what is rational. Yet these same ideas, as they establish the criteria of criticism, are themselves held to be sacrosanct, beyond criticism.

Last, given the monopoly of the prevailing ideological formation, theories fundamentally opposed to the dominant set of ideas are held in contempt. As the basis of judgment is determined by the ruling ideas, those notions that are in opposition to the ruling set are deemed invalid solely on the criteria established by the socially acceptable, normal view of things. Thus, say, communism is 'wrong' simply because capitalism is 'right.' All ideas are *not* treated equally.

The task set forth here, then, is to examine the historical evolution of the neoclassical standard, attempting to demonstrate its relation to institutional changes within capitalist society itself. What will be shown is that the theory reflects the dominant relationships within capitalist society and has been developed and modified to accommodate changes within this form of social organization. Hence, neoclassicism does not stand above or apart from society, but is, as with all social ideas, conditioned by that society. This calls into question the claim of scientific neutrality, held to be a hallmark of neoclassical economics.

Studies of this sort appear during periods of crisis: crisis in the underlying economic organization of society, which then generates crisis in the theoretical apparatus of that society. If an economy is reasonably well functioning, little attention is paid to the prevailing ideology which arises to defend that economy and which, increasingly, appears to have a life of its own, to exist within a social vacuum. During periods of social travail, however, questions are raised which the dominant ideology cannot answer – indeed, usually cannot even address. Then, the various fields of inquiry go through a paroxysm. We witnessed this in the 1930s and again in the 1960s. Currently, there appears to be renewed stability, an appearance encouraged, no doubt, by the renewed vigor of the neo-Walrasian theorists and the various fractures within the Keynesian and Marxist camps.

I think, though, that this apparent stability is just that – apparent. Everywhere we see economic dislocation, growing unease among astute politicians, major capitalists and even some economists. One of the effects of this unease is the renewal of the debates in economic philosophy and the appearance of a journal specifically dedicated to these debates.

Thus, while the surface phenomena appear relatively calm, the fundamental cracks in both society and theory which were laid bare in the 1960s continue to widen; theory becomes increasingly separated from practice and, thus, incapable of addressing those cracks. And, with the imminent crisis in the social order, economic theory will once again enter a period of turmoil. Tumultuous times raise questions concerning the very essence of the theories being questioned. Rather than accept doctrine as a matter of faith, the whole of the argument is brought under scrutiny and held up for critical evaluation. The present work may be considered one small contribution in the historically rather long critical evaluation to which neoclassical theory has been subjected.

In what follows, readers will see little that is new. To a large extent, I have followed the path already laid by critics such as Marx, Veblen and Dobb. For those who have not read the original accounts of the great neoclassicists, there may be some surprises. And for those who are not aware of the criticisms already set forth, some insights into the approach of Marx may be gained. But all the evidence has been already established. And, in the recitation of this evidence, there is nothing new.

What I have attempted is to take existing information and apply it in a particular way. My question was *why* theory develops, and why theories of a particular type develop when they do. To attempt any answer to this question, we must examine the relation between society and theory. Given that theory consists of a set of ideas, those ideas must come from somewhere. In the final analysis, society itself throws up and controls the dissemination of those ideas. Hence one must identify the relationship between social formation and change, and theory.

Readers will observe that this study places the development of general neoclassical perspective into a framework established by the specific 'periods' of capitalist evolution. Attempts at periodization are never neat: one period flows into another; there are questions of lags, uneven development and so forth. Thus, it is true that the flow of ideas does not match exactly the flow of history. So be it: that is the way the world works. Rather than appearing as a tidy, compartmentalized structure, the world economy, scientific development – whatever – is somewhat messy. Problems exist, and one cannot force the world to behave as one would like merely because it would be more comfortable were that the case.

Yet, in broad outlines, we do observe change. And change occurs sequentially. As this is true, then, again in broad outlines, the sequence of change can be segmented into wholes that can be differentiated by degree and type.

It is readily seen (though not always admitted) that the industrial structure of modern capitalism is not the same as that of 1700. Small-scale producing units have given way to large organizations as the dominant form of structure. And, while it may be possible to place this transition into periods of only a rough-and-ready nature, yet the transition has occurred, and it has occurred as a periodic movement.

Thus, while there may be valid quarrels with the dating of various epochs and the specific time relationship of theory to institutional change, I think that the assertion that a relationship does exist is not arguable. Further, and more important, evidence is brought forward to defend this position.

In the course of this examination, many points will be made, some of which are outside the purview of most economists. There is a strong temptation to prove every point made, as this would provide the strongest case for the argument. And, as the argument is in a decidedly minority position, this would provide a more comfortable position for the author. Yet, such a task would require a work probably ten to twenty times longer than that which is offered. And in the process, the main argument would probably get lost.

Thus, what is presented is a rather abbreviated, straightforward account. Where I think the information is well known, I let it stand on its own; where it appears that the average reader is unaware of the argument and historical fact behind the position, reference is made to authority to which the reader can then turn.

There are two last items by way of general introduction. First, I do not view this study as the final work in the attempt to understand the development of economic theory. Rather, it should be viewed as one contribution to that understanding. It is hoped that this examination will provoke criticism, further study, and – in the long run – a more complete analysis of the relationship between society and theory.

Second, I ask readers to read some rather long quotations from the authorities selected to represent the general position set forth. Some forbearance is requested in this task, but it does provide some rewards. More important, these quotations provide some of the evidence for the argument contained herein; in order both to capture the flavor of these positions and to provide some assurance that I am not quoting out of context – an intellectual crime that makes its appearance more often than one would like to admit – some extended quotations are necessary.

And a technical note: unless otherwise specified, all emphasized words or statements in the quoted remarks are in the original.

Finally, I would like to extend my sincere thanks to those who helped make this a better work than it otherwise would have been. Excellent and necessary criticism was received from Joseph Furey, Alessandro Roncaglia, Warren Samuels, Noel Thompson, Larry Randall Wray and Nancy Wulwick. As well, I would like to include in this list J. C. Weldon, one of the most clear-headed of our profession, who died before he could attend to my request for comments. He is missed.

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J. F. H.