

15. Methodological shifts

HEA refers to History of Economic Analysis by Joseph A. Schumpeter, New York: Oxford, ⁸1974.

A renewal of economic method began about 1870 and gradually transformed basic concepts. An understanding of these issues is a necessary preliminary if we are to put together the views of earlier and later economists, the innovations of the MNC's, and our own circulation analysis. Cf. HEA 753 ff,

A basic clarification results from the combination of two distinctions. The first is between static and dynamic analysis which is methodological. The second is between stationary and evolutionary states which refers to objective economic processes. HEA, Index, 1252, 1257.

In static analysis all variables have the same time subscript: they are to price at time t, supply at time t, demand at time t; when supply equals demand at time t there results a simultaneous equation.

In dynamic analysis consideration of the market is not restricted to the instant but goes back to influences from earlier decisions dependent on earlier conditions and as well takes into account expected future values of variables, lags, sequences, rates of change, cumulative magnitudes and so on. HEA 963.

N. B. Note that this concept of dynamic analysis is dependent more on the preceding static view than on a study of economic actuality. Our own dynamics has the latter basis.

A stationary state is the state of an economy that year after year keeps on reproducing itself.

An evolutionary state is a non-stationary state. More narrowly, one includes among stationary states the process of growth conceived as continuous variations of rates within an unchanging framework of institutions, tastes, technological horizons. HEA 964.

HEA observes that these distinctions were gradually worked out between 1870 and 1914 but not quickly enough or rigorously enough to take effect before 1914.

The foregoing clarification is relevant to the shift in the notion of competition.

Of the period, 1870-1914, Schumpeter notes that their common viewpoint was that of J. S. Mill and even Adam Smith. "No conceptual creation of the period points to a new fact or a new slant. This may be illustrated by their treatment of competition. Their economic world was... a world of numerous independent firms. To a surprising extent they continued to look upon the competitive case... as the normal case of reality. Even the owner-managed firm survived much better in economic theory than it did in actual life...." HEA 892.

HEA relates Cournot's conception of competition as starting from the case of straight monopoly, gradually adding more and more sellers, eventually reaching the point where any one seller's product is too small to affect the price or to admit of price strategy.

To this may be added Jevons' Law of Indifference that defined the perfect market as admitting only one price.

The combination of these two, HEA takes as the equivalent of Walras' libre concurrence and Pareto's definition is pronounced as coming to the same thing.

It remains that such definitions pertain to the static viewpoint. "The mechanism of pure competition is supposed to function through everybody's wish to maximize his net advantage.. by means of attempts at optimal adaptation of the quantities to be bought and sold. But exclude strategy as much as you please, there still remains the fact that this adaptation will produce results that differ according to the range of knowledge, promptness of decision, and 'rationality' of actors, and also according to the expectations they entertain about the future course of prices, not to mention the further fact that their action is subject to the restrictions that proceed from the situations they have created for themselves by their past decisions." HEA 973.

In other words, the definitions of perfect competition regard the static case, and do not preclude the actual existence of dynamic reality.

HEA distinguishes two viewpoints in this connection.

If, he argues, we are of the opinion.. that from all the variety of market patterns pure or perfect monopoly and pure or perfect competition stand out in virtue of certain properties -- of which the most important is that both cases lend themselves to treatment by means of relatively simple and (in general) uniquely determined rational schemata -- and.. that the large majority of cases that occur in practice are nothing but mixtures and hybrids of these two, then it seems natural to accept pure monopoly and pure competition as the two genuine or fundamental patterns and to proceed by investigating how their hybrids work out. This renders the attitude of monopolistic or imperfect competition (i. e., Chamberlin and Joan Robinson, HEA 975, 1150 f.).

But instead of considering the hybrid cases as deviations from, or adulterations of, the fundamental ones we may also look upon the hybrids as fundamental and on pure monopoly and pure competition as limiting cases in which the content of actual business behavior has been refined away. This is much more like the line that Marshall took.

Should the reader feel I am endeavoring to convey a distinction without a difference, he is requested to ask himself whether the definition of pure competition that has been given above really fits what we mean when we speak of competitive business.

Is it not a fact that what we mean is the scheme of motives, decisions, and actions imposed upon a business firm by the necessity of doing things better or at any rate more successfully than the fellow next door; that it ^{is} this situation to which we trace the technological and commercial efficiency of 'competitive' business; and that this pattern of behavior would be entirely absent both in the cases of pure monopoly and pure competition, which therefore seem to have more claim to being called degenerate than to being called fundamental cases? HEA 975.

I. e., in pure competition the seller has no alternative strategy; in pure monopoly he has no competitors; and so neither gives rise to the necessity of doing things better or at least more successfully than the fellow next door.

HEA's solution is to be noted. Mathematical rigor provides a useful source for preliminary determinations of meaning, and Cournot's account of competition illustrates the point. But the economic issue arises in an ecology in which abstract relationships are complemented by concrete probabilities. And it is in accord with this reality for Schumpeter to appeal to what we mean by the technological and commercial efficiency of 'competitive business'. We shall adopt a similar procedure in treating the parallel topic of equilibrium.

In a famous paper that was destined to produce the English branch of the theory of imperfect competition, Piero Sraffa (Economic Journal, December 1926) pointed out that, "under conditions of pure competition, a firm cannot be in perfect equilibrium so long as increase in its output would be attended by internal economies." HEA 1046 f. Clearly there is some connection between pure competition and perfect equilibrium, and its precise nature we shall attempt to approach through HEA's presentation of Léon Walras' system.

"From the workshop of Walras the static theory of the economic universe emerged in the form of a large number of quantitative relations (equations) between economic elements (prices and quantities of consumable and productive goods or services) that were conceived as simultaneously determining one another. ... as soon as this Magna Charta of exact economics had been written..., a type of research began to impose itself that had been unknown in pre-Walrasian economics... The Walrasian system of simultaneous equations.. brought in a host of new problems of a specifically logical or mathematical nature that are much more delicate and go much deeper than Walras or anyone else had ever realized... They are much too difficult and especially too technical for us...." HEA 967 f.

After expounding the past and future determinants that affect a decision to buy or sell, Schumpeter notes: "... Walras was very much alive to these difficulties and in places ... he clearly saw the necessity looming in the future of constructing dynamic schemata to take account of them. For himself, however, he saw no less clearly that, absorbed in the pioneer task of working out the essentials of the mathem-

ical theory of the economic process, he had no choice but to simplify heroically." HEA 973 f.

"In this section we shall analyze the logical structure of Walras' system of the conditions or relations (equations) that are to determine the equilibrium values of all the economic variables, to wit: the prices of all products and factors and the quantities of these products and factors that would be bought, in perfect equilibrium and pure competition, by all the households and firms. Let us notice at once that, since the determination of these quantities implies the determination of individual as well as group and social incomes, this theory also includes all that is covered by the concept of Income Analysis and that the conditions or relations to be considered, though they are fundamentally microanalytic in nature (they refer fundamentally to the quantities bought and sold by individual households and firms), also include macroanalytic aspects, for example, as regards total employment in the society. It cannot be too strongly impressed upon the reader that it is not correct to contrast income or macroanalysis of, say, the Keynesian type with the Walrasian microanalysis as if the latter were a theory that neglects, and stands in need of being supplemented by, income and macroanalysis." HEA 998 f.

"Finally, the task of developing a dynamic theory is very difficult and cannot be accomplished by simply adding dynamic qualifications to static theory. It requires new techniques and raises fundamental problems of its own. An example of the new techniques required is the theory of difference equations. An example of the new fundamental problems is economic equilibrium, which, if considered from a dynamic standpoint, appears in a new light." HEA 1143.

In brief, Walras' system is conceived on a static basis. Its author was aware that dynamic considerations will have to be dealt with. But he persevered in the line he had begun: at least, it would mark a turning point in the development of economic thought.

Schumpeter though he seems everywhere to regard Walras with the highest esteem, wrote in a summary of the lectures he was to deliver at the University of Mexico of the need for new techniques and of the new viewpoint on equilibrium needed if a dynamic general theory were to be attained.

16. The Position of this Essay

While we agree with Schumpeter that Walras' system implicitly includes the aggregates commonly considered in macroanalysis, it can hardly be credited with distinctions between basic and surplus expenditure, receipts, outlay, income and much less with an account of their various dynamic relations. But until such distinctions are drawn and their dynamic significance understood, the aggregates and relations cannot be contained implicitly in any system.

Further, without further clarification Schumpeter acknowledged that dynamic analysis called for new light on equilibrium. Such new light arises when, over and above the equilibria of supply and demand with respect to goods and services, there are recognized further equilibria that have to be maintained if an economy chooses to remain in a stationary state, to embark on a long-term expansion, to distribute its benefits to the vast majority of its members, and so to return to a more affluent stationary state until such time as further expansion beckons.

Moreover, such macroequilibria are more fundamental than the microequilibria assembled by Walras. The former are the conditions of a properly functioning economy. In the measure such conditions are met, there result aggregates acceptable to the economic society in its entirety, while the Walrasian equilibria are confined to the distribution of receipts among producers and income among householders.

The existence of such prior and more fundamental equilibria does to some extent explain the extreme difficulty noted by Schumpeter in accounting for the determinateness, the equilibrium, and the stability of the Walrasian system since that system had overlooked such factors (Cf. HEA 967 f.). But there is a more radical difficulty. The period from 1870 to 1914 and later was still under the spell of classical mechanics with its ideal of exact prediction and with the complementary notion that probability was no more than a cloak for ignorance. But for us Quantum Theory has made it possible to grasp that classical laws are abstract inasmuch as they hold only caeteris paribus, and that statistical

laws provide a natural complement since they can reveal how often other things are likely to be equal. In a universe such as ours with its vast numbers and its enormous time intervals one is led to think of schemes of recurrence, whose several carriers severally follow their own classical laws, whose assembly follows the probability of [^] emergence, and whose continued functioning follows the probability of their survival. Such in a nutshell is the evolutionary view that in Insight I sketched out under the name of emergent probability and, earlier in this essay, I have applied to economics.

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For a human society, like an ecology, is an assembly of assemblies of schemes of recurrence. As interdependent they support one another. As subordinate they underpin higher orders of schemes. As higher they bring to fuller fruition their subordinates. Every scheme has had its probability of emergence, and it will last in accord with its probability of survival. How it all came about is more than we can fathom and so with Adam Smith we may speak briefly of an invisible hand.

One set of such social schemes is the economy, the myriad interlocking recurrences of activities within and between firms, between firms and households, and within households. Each of the schemes is a possibility that occurred to some one at some point of ancient or recent human history, that has been combined with other schemes in proposed possibilities, that has been chosen with greater or less probability and maintained with greater or less deliberate choice, and any set of combinations that has existed has functioned with greater or less success for a longer or shorter period of time. In brief, an economy is just part of ongoing human history. Within that process we are born and raised. By our common sense (Insight, pp. 173-81) we find our place in it and work out for ourselves our sad or happy lives and thereby make sadder or happier the lives of others.

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Any deeper understanding of this process is not to be ushered in [^] by the techniques of mathematicians defining new variables, determining their interrelations, and establishing their 'existence.' For while it is necessary to grasp the mathematical foundations of mathematical analogies employed, it is equally necessary and more important to

attend to the reality from which the analogy prescind. That reality is human history, and it is a cord woven with three strands. The first is progress which is the fruit of attention, intelligence, reasonableness, and responsibility. The second is decline, the offspring of inattention, obtuseness, unreasonableness, and irresponsibility. The third is, usually slow and long process of recovery; of removing the absurdities inflicted on the human situation by past inattention, obtuseness, unreasonableness, and irresponsibility.

Elsewhere I have distinguished between the shorter and the longer cycles of decline. The shorter cycle results from group bias, the egoism of a group that approves its own attitudes and consequent deeds. Naturally it awakens the resentment, the opposition, the hostility of other groups, and thereby creates a force for its own demise. The longer cycle results from general bias, that is, the general tendency to be content with the particular specialty, common sense, and to consider other specialties irrelevant or useless. As group bias, so too general bias awakens opposition. But the opposition is that of learned minorities and they, when no longer simply ignored, can be put out of court by massive appeals to the masses. Cf. Insight, pp. 222-38.

Now just as sustained attentiveness, insight, reasonableness, and responsibility create a situation ever more in consonance with intelligent advance and ever more responsive to it, so too every bias away from human authenticity brings about a situation ever more inhuman and intractable. It is up to man to be intelligent, act intelligently, and make his situation intelligible. On the other hand, insensitivity, oversights, the blindness of passion, the flimsy excuse, the plausible fallacy, the distortion of compromise, the waywardness of indulgence, all create a human world made in their own image and likeness.

Such is the dialectic of decline. Spontaneously it keeps making things ever worse. But reflection gives it the seven devils worse than itself. For it gives evil the status of fact. That is the way that things are, the way that things are done, the only way that one can live, indeed the way that all successful and respectable people live. One can swim against the current for a while but

sooner or later one gives up. One may start to roll a rock up a mountain side, but who gets to the top and keeps the rock from rolling back again?

Now it is important to grasp that we are touching upon a very large issue. In its fundamental form it is the tension of liberty between grace and sin (Romans 7 and 8). In its theological form it is the thought of Augustine and of his commentators and continuators: I refer you to my study of Aquinas, Grace and Freedom: Operative Grace in the Thought of St. Thomas Aquinas, edited by J. Patout Burns, New York: Herder and Herder, 1971 (now Seabury Press). In its secularist form it is the affirmation of the perfectibility of man by man; Leo Strauss conceives three of its waves as stemming from Machiavelli, Rousseau, and Nietzsche ("The Three Waves of Modernity," in Political Philosophy: Six Essays by Leo Strauss, edited by Hilail Gildin, Indianapolis/New York: Pegasus, a division of Bobbs-Merrill, Inc., 1975, with bibliography pp. 239-47). Economists move under this secularist mantle when they conceive economics on the analogy of natural science or, when that fails, hand the management of the economy over to the welfare state. Popular thought easily accepts secularism by its insistence that solutions to problems are sound if they obviously will work. But this, of course, is merely an unconscious shift back to Machiavelli: like him they are concerned with the factual, practical truth and not with fancies; like him they have no taste for imagined commonwealths and principalities which never were, because they look at how men in fact do live and not at such stuff as how men ought to live (Cf. L. Strauss, op. cit., p. 84).

HEA 259f
 Now I have been looking at the dynamic structure of the industrial exchange economy. In it I have distinguished stationary states, the increasing returns that arise when an economy is tooling up for increased production but as yet is not thereby increasing living standards, and the decreasing returns that arise for investors when tooling up is tapering off and the flow of consumer goods and services is increasing.

I beg to note that such an analysis has not been tried and found wanting. Rather, to speak with Chester ton, it has been thought hard and not tried. What has been tried

is roughly as follows:

- (1) the emergence of industrial nations as creditors and others as debtors,
- (2) the establishment of colonies and empires, their rivalries and wars,
- (3) the rise of the arch secularist, Marx, the industrial development of the USSR, its diplomatic and warlike achievements, and the moral support it enjoys from secularists elsewhere,
- (4) the welfare state with its substitutes for a properly functioning basic phase and with its crumbling foundations in economic science,
- (5) the MNC's, their flourishing but offshore economy, and the dual economies they effect not only in the UDC's but also in the U. S.

14.3 Reflections

Implicit in the foregoing account of GC's in general, GC's in the UDC's, and GC's in the U S, there is a more comprehensive view that may be described as follows:

There exists an aggregate of central economies, each consisting of a relatively small set of GC's, operating through transnational financial markets and banks, producing in lowest wage-areas, and selling wherever the highest prices may be administered.

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Central: opp. to "peri[^]eral, cf. p. 94.

Transnational: not controlled nationally or internationally

Lowest wage-areas: Taiwan, Korea, Hong Kong, Singapore,...

Administered Prices: set by sellers for buyers who have nowhere else to go.

GC's centralized

at head office in global cities (N Y, London, Paris...)

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connected by satellite telephone[^] subsidiaries, by jet flights, integrated through advanced computers that handle enormous quantities of data and offer computerized-cash-management systems deciding what is to be produced, how much, where, at what price, where to be sold, at what price

GC's empowered

by internal growth

by mergers and take-overs, by exploitation of gov't subsidized corp.

by patents

by finance capital and supportive banking

by advertising

GC's liberated

by modern accounting

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by transfer p[^]icing (intracorporate operations)

by impotence of ignorance (in UDC's, in US)

by cross-subsidization