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10. Criticism and Revision of Classical Economics

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10. Criticism and Revision of Classical Economics

Abstract

The work of the classical economists was primarily one of deduction. In a sense it is a tribute to their capacity to draw corollaries and conclusions from basic principles accepted as established truths. The finely spun theoretical model which they constructed was not long immune from attack by several quarters. As we shall see in Chapter XVI, the Marxian Socialists took the labor theory of value and used it to advocate the overthrow of capitalistic society. [*excerpt*]

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Comments

This is a part of [Section XIV: The Industrial Revolution, Classical Economics, and Economic Liberalism](#). The [Contemporary Civilization](#) page lists all additional sections of *Ideas and Institutions of Western Man*, as well as the [Table of Contents](#) for both volumes.

More About Contemporary Civilization:

From 1947 through 1969, all first-year Gettysburg College students took a two-semester course called Contemporary Civilization. The course was developed at President Henry W.A. Hanson's request with the goal of "introducing the student to the backgrounds of contemporary social problems through the major concepts, ideals, hopes and motivations of western culture since the Middle Ages."

Gettysburg College professors from the history, philosophy, and religion departments developed a textbook for the course. The first edition, published in 1955, was called *An Introduction to Contemporary Civilization and Its Problems*. A second edition, retitled *Ideas and Institutions of Western Man*, was published in 1958 and 1960. It is this second edition that we include here. The copy we digitized is from the Gary T. Hawbaker '66 Collection and the marginalia are his.

Authors

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10. Criticism and Revision of Classical Economics

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* Ibid., pp. 187-190, 231.

they constructed was not long immune from attack by several quarters. As we shall see in Chapter XVI, the Marxian Socialists took the labor theory of value and used it to advocate the overthrow of capitalistic society.

Another criticism came largely from outside England, much of it from German writers who argued that the economic life of a nation is something which cannot be studied deductively, apart from its historical development. Although The Wealth of Nations was translated into German the very year in which it was first published in England, classical theory never made much headway in Germany. Here the classicists were accused of assuming that the experience of England was necessarily the pattern which all other industrializing countries would follow. What was good for England in 1870, the Germans argued, might not be good for Germany, either then or at any other time. These writers were especially critical of the individualism and cosmopolitanism of Adam Smith, reflected in his arguments for laissez-faire and free trade. To counter his argument that the worldwide division of labor was a thing to be highly desired, they proclaimed that man needs the active help of the nation state to reach his highest economic development, and beyond that his highest cultural development. To them this meant that strong national economies, with a national division of labor, had clear priority over the international economy which a universal free trade would encourage. Adam Smith would become applicable to them only when all states were as highly developed as England. In the meantime, Germany needed a vigorous national economic policy, including tariffs.

The economists who developed this line of thought are called the German historical school. First among them in point of time was Friedrich List (1789-1846), a professor and political figure who was expelled from Germany because of his liberal views. He lived in America for seven years (1825-1832), returning to his native country as a United States consul in 1832. The following brief excerpt from his most important book, appropriately titled The National System of Political Economy (1841), illustrates some of his main ideas:

The system of the [classical] school suffers, as we have already shown..., from three main defects: firstly, from boundless cosmopolitanism, which neither recognises the principle of nationality, nor takes into consideration the satisfaction of its interests; secondly, from a dead materialism, which everywhere regards chiefly the mere exchangeable value of things without taking into consideration the mental and political, the present and the future interests, and the productive powers of the nation; thirdly, from a disorganising particularism and individualism, which, ignoring the nature and character of social labour and the operation of the union of powers in their higher consequences, considers private industry only as it would develop itself under a state of free

can't consider just the individual things, but must remember "The Nation".

interchange with society (i.e. with the whole human race) were that race not divided into separate national societies.

Between each individual and entire humanity, however, stands THE NATION, with its special language and literature, with its peculiar origin and history, with its special manners and customs, laws and institutions, with the claims of all these for existence, independence, perfection, and continuance for the future, and with its separate territory; a society which, united by a thousand ties of mind and of interests, combines itself into one independent whole, which recognises the law of right for and within itself, and in its united character is still opposed to other societies of a similar kind in their national liberty, and consequently can only under the existing conditions of the world maintain self-existence and independence by its own power and resources. As the individual chiefly obtains by means of the nation and in the nation mental culture, power of production, security, and prosperity, so is the civilisation of the human race only conceivable and possible by means of the civilisation and development of the individual nations.

Meanwhile, however, an infinite difference exists in the condition and circumstances of the various nations; we observe among them giants and dwarfs, well-formed bodies and cripples, civilised, half-civilised, and barbarous nations; but in all of them, as in the individual human being, exists the impulse of self-preservation, the striving for improvement which is implanted by nature. It is the task of politics to civilise the barbarous nationalities, to make the small and weak ones great and strong, but, above all, to secure to them existence and continuance. It is the task of national economy to accomplish the economical development of the nation, and to prepare it for admission into the universal society of the future.

A nation in its normal state possesses one common language and literature, a territory endowed with manifold natural resources, extensive, and with convenient frontiers and a numerous population. Agriculture, manufactures, commerce, and navigation must be all developed in it proportionately; arts and sciences, educational establishments, and universal cultivation must stand on an equal footing with material production. Its constitution, laws, and institutions must afford to those who belong to it a high degree of security and liberty, and must promote religion, morality, and prosperity; in a word, must have the well-being of its citizens as their object. It must possess sufficient power on land and at sea to defend its independence and to protect its foreign commerce. It will possess the power of beneficially affecting the civilisation of less advanced nations, and by means of its own surplus population and of their mental and material capital to found colonies and beget new

nationalism

During the under developed stage of industrialization use the state for developmental processes. After this, use laissez-faire. Laissez-faire is the longrange goal, but not the means.

nations.

A large population, and an extensive territory endowed with manifold national resources, are essential requirements of the normal nationality; they are the fundamental conditions of mental cultivation as well as of material development and political power. A nation restricted in the number of its population and in territory, especially if it has a separate language, can only possess a crippled literature, crippled institutions for promoting art and science. A small State can never bring to complete perfection within its territory the various branches of production. In it all protection becomes mere private monopoly. Only through alliances with more powerful nations, by partly sacrificing the advantages of nationality, and by excessive energy, can it maintain with difficulty its independence. *

List's work was followed, especially after 1870, by many treatises containing factual economic information such as the classicists had usually avoided. One of the results of the work of this school was to promote the study of economic history. For some years students from the major states of the Western World flocked to German universities to learn economics as it was taught by the German historical economists.

A careful study of the corpus of classical economic theory will lead to the conclusion that it never was the complete and self-consistent body of thought which the word "classical" suggests. Almost from the very beginning it produced critics from within its own ranks who anticipated many of the lines which revisionist and other thinkers were later to take. These critics opposed the scant regard for the facts which characterized some of the classicists in their haste to generalize. In a vein similar to the general indictment of the Enlightenment already noted, they inferred that a careful study of the economy would cast serious doubt on the validity of picturing it as a simple, harmonious mechanism of smoothly working parts. They questioned whether self-interest and community interest could be reconciled in an atmosphere of laissez-faire as often as the classical economists thought; competition had a distressing way of leading to monopoly. At a time when evolution was becoming a popular doctrine, they questioned the picture of a universe in which conditions were tending toward a long-run equilibrium in which the static forces would eventually prevail over the dynamic; neither wages, rent nor profits seemed to be moving in the directions which Ricardo suggested. They questioned whether man really was the rational creature -- the "economic man" -- that he was sometimes pictured to be, a creature who always weighed things in measurable terms of pleasure and pain, and who

* Friedrich List, The National System of Political Economy, trans. Sampson S. Lloyd (London: Longmans, Green, and Co., 1885), pp. 174-176.

There was certain evidence that didn't support the classical economists.

was insensitive to any consideration that was not economic in nature, to anything which did not affect his purse.

Malthus himself, departing in numerous ways from the analysis of Ricardo, illustrates this criticism of classical theory from the inside. Even before the factory system made its appearance, there was a long record of unevenness in the level of economic activity in Western Europe. This can be traced to such factors as wars, changes in the weather, and influxes of precious metals into the money system. Now the rhythm of prosperity and depression which we know as the trade or business cycle was more pronounced than ever before. Since the proletarian was almost always completely dependent upon his wages for the support of his family, periodic depression meant untold misery and hopelessness for him. Jean Baptiste Say, who popularized and revised Adam Smith on the Continent, had formulated a law bearing his name (1803) which held that long-run overproduction was impossible. He explained that the supply of goods immediately creates its own demand for goods since people produce commodities because they want other commodities. If there is an overproduction in shoes, it means simply that an error has been made, and that there is underproduction in something else, perhaps soap. This is a temporary situation which will adjust itself quickly if there is no outside interference. The price of shoes will drop; more shoes will be bought and fewer may be produced for a time. The price of soap will increase, and a similar self-adjusting process will occur there.

In reply, Malthus declared that people's motives were not as simple as Say's law had made them, and that commodities could not be treated as "so many mathematical figures." People engage in production for a number of reasons, some of them for the purpose of saving. And, warned Malthus, if saving is excessive in an economy, and goods are not purchased, depression instead of self-adjustment might result. He urged the government to be prepared to undertake a program of public works in times of heavy unemployment. This analysis has exercised an influence on recent thought about the business cycle.

By 1870 a comprehensive resurvey of classical economic theory was in progress in England, Germany, Austria, and elsewhere. If but one name within the continuing classical tradition must be identified with this development, it should be that of Alfred Marshall (1842-1924), who was for many years (1885-1908) professor of political economy at Cambridge University. His Principles of Economics (1890) went through eight editions during his lifetime and long occupied the place as a text formerly held by John Stuart Mill's book. Marshall's work ushered in the so-called neoclassical economic theory, which with some modifications is still basically that studied by American college students today, although, as we shall see in Chapter XXI, since the 1920's it has been under strong attack in the writings of John Maynard Keynes (1883-1946) and his followers.

*boom & bust
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the equilibrium*

*Not
to imply*

Marshall tempered and expanded much of classical theory in the light of the criticisms advanced against it from many quarters. He combined the deductive and inductive approaches to economics in a way which made it possible for such related disciplines as history, psychology, and statistics to assist in arriving at economic truth. He was aware that the rise of the giant business corporation and the growing power of labor organizations had introduced new factors which greatly altered the characteristic market situations of Ricardo's time. Monopolistic conditions were becoming much more prevalent than anything resembling pure competition. They had to be taken into account as factors in explaining price determination, and in a period shorter than the long run which had so absorbed the classicists. By Marshall's time the greatly increased production of commodities, by creating a hitherto unknown abundance, had attracted the attention of economists to consumption, a branch of their discipline which, in spite of Adam Smith's admonition, they had hitherto neglected. As never before they became interested in the inequality of the distribution of income as a phase of consumption and as a source of unhappiness and social unrest. Perhaps most important of all for the future, by the end of the nineteenth century economic theory was losing some of that air of finality which had led many of its adherents to believe that man was powerless before the inflexible natural laws which had produced the status quo with all of its apparent inequities. As we shall see in Chapter XVII, the conviction that men in society acting together could really change things in the directions they wished brought a new meaning to the task of economic liberalism. As Marshall himself put it:

...Now first are we getting to understand the extent to which the capitalist employer, untrained to his new duties, was tempted to subordinate the wellbeing of his workpeople to his own desire for gain; now first are we learning the importance of insisting that the rich have duties as well as rights in their individual and in their collective capacity; now first is the economic problem of the new age showing itself to us as it really is. This is partly due to a wider knowledge and a growing earnestness. But however wise and virtuous our grandfathers had been, they could not have seen things as we do; for they were hurried along by urgent necessities and terrible disasters.

But we must judge ourselves by a severer standard. For we are not now struggling for national existence; and our resources have not been exhausted by great wars.... But the nation has grown in wealth, in health, in education and in morality; and we are no longer compelled to subordinate almost every other consideration to the need of increasing the total produce of industry.

In particular during the present generation this increased prosperity has made us rich and strong enough to impose new restraints on free enterprise; some temporary material loss being submitted to for the sake of a higher and greater ultimate gain. But these new restraints are

different from the old. They are imposed not as a means of class domination; but with the purpose of defending the weak, and especially children and the mothers of children, in matters in which they are not able to use the forces of competition in their own defence. The aim is to devise, deliberately and promptly, remedies adapted to the quickly changing circumstances of modern industry; and thus to obtain the good, without the evil, of the old defence of the weak that in other ages was gradually evolved by custom.

...gradually we may attain to an order of social life in which the common good overrules individual caprice, even more than it did in the early ages before the sway of individualism had begun. But unselfishness then will be the offspring of deliberate will, though aided by instinct individual freedom then will develop itself in collective freedom; -- a happy contrast to the old order of life, in which individual slavery to custom caused collective slavery and stagnation, broken only by the caprice of despotism or the caprice of revolution. *

The great and permanent contribution of the classical economists was to organize the discipline of economics and search for the principles which they thought explained how men make their living. Their analysis set many of the directions which students of economics have taken ever since. A considerable portion of that analysis has survived in recognizable form to the present day. The classical economists could scarcely be expected to comprehend in their day the varied impact which the Industrial Revolution continues to have on Western life. Most of them were at a loss in fully understanding the developments of their own time. Perhaps they could be expected to have amended their theories sooner. Even here, John Stuart Mill demonstrated that the classicists were capable of entertaining new ideas.

In conclusion, the student might consider the opinion of an outstanding economic historian on the nature of political economy as it has continued to develop since the time of Adam Smith. Sir William J. Ashley (1860-1927) was probably the first man to hold a professorship in economic history. He held that position at Harvard University (1892-1901) before returning to his native England and the University of Birmingham (1901-1925). The following is taken from An Introduction to English Economic History and Theory (1888):

Political Economy is not a body of absolutely true doctrines, revealed to the world at the end of the last and the beginning of the present century, but a number of more or less valuable theories and generalizations.

* Alfred Marshall, Principles of Economics (London: Macmillan and Co., 1898), pp. 47-49.

an attack on classical economics.

No age, since men began to speculate, had been without its economic ideas. Political Economy was not born fully armed from the brain of Adam Smith or any other thinker: its appearance as an independent science meant only the disentanglement of economic from philosophical and political speculation.

Just as the history of society, in spite of apparent retrogressions, reveals an orderly development, so there has been an orderly development in the history of what men have thought, and therefore in what they have thought concerning the economic side of life.

As modern economists have taken for their assumptions conditions which only in modern times have begun to exist, so earlier theories were based, consciously or unconsciously, on conditions then present. Hence the theories of the past must be judged in relation to the facts of the past, and not in relation to those of the present.

History seems to be proving that no great institution has been without its use for a time, and its relative justification. Similarly, it is beginning to appear that no great conception, no great body of doctrines which really influenced society for a long period, was without a certain truth and value, having regard to contemporary circumstances.

Modern economic theories, therefore, are not universally true; they are true neither for the past, when the conditions they postulate did not exist, nor for the future, when, unless society becomes stationary, the conditions will have changed. *

*Descriptions of immed. condition and the outlook of the man who writes them. (Change your social value and you change the laws).
Dow^{ns} that led to modifications in the laissez-faire theory.*

* W. J. Ashley, An Introduction to English Economic History and Theory (New York: G. P. Putnam's Sons, 1888), pp. x-xi.