The Struggle Over the Soul of Economics: Institutionalist and Neoclassical Economists in America Between the Wars

Yuval P. Yonay

"It is universally agreed that in economics the positive investigation of the facts is not an end in itself, but is to be used as the basis of practical enquiry, in which ethical considerations are allowed their due weight." John Neville Keynes

Over one million introductory economics textbooks are sold each year in the U.S. alone. For most individuals these textbooks are their only exposure to economic theory and analysis, to the thought processes which ostensibly constitute economics. Overwhelmingly these textbooks are dominated by the neoclassical framework focused on positive rather than normative analysis and using a very simplified, narrow model of human behavior (utility maximizing, self-interest driven, price motivated, hedonistic, rational). The major question addressed by Yuval Yonay in The Struggle Over the Soul of Economics is what has led us to this current status quo? Does the current paradigm represent an evolution of economic thought? A culmination of more than two centuries of continued progress and improvement in theory and analysis? Or have we merely witnessed a political victory for a particular and tenuous school of economic thought? Do current textbooks constitute indoctrination as much as instruction? For Christian economists, who view the current minimization of ethics and the simplified model of human behavior with skepticism and alarm, Yonay’s book is extremely instructive.

The book is a fine example of a constructivist (actor-network) approach to understanding the development of a social science—in this case economics and the neoclassical-institutionalist conflict from the rise of Marshall (late 1800s) until the early 1960s. Textbooks in the history of economic thought see the institutionalist episode as a minor losing skirmish in either a Kuhnian paradigm shift between the neoclassical and

Reviewer
John E. Stapleford is Associate Professor of Economic Development, Eastern College (PA).
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Keynesian revolutions or a Lakatosian process where Keynes, as an established neoclassical economist, introduced a progressive theoretical explanation which reconciled the neoclassical foundation with the real world fact of the Great Depression. Yonay, instead, views the neoclassical-institutionalist struggle through the social relations among practitioners where innovation is a necessary but not a sufficient condition for success in the competition for recognition and resources. Success requires the more political, interpersonal issue of how to package innovations. Practitioners must decide whether to present their ideas as building on the past or as a break-away. If they decide to appear to build on the past, certainly a path of less resistance and contention, they must package their innovations in such a way as to make them appear to be logical extensions of past work. The competition among ideas then does not necessarily represent survival of the fittest; it may represent survival of the adroit.

Yonay’s careful analysis shows that the neoclassical-institutionalist struggle was not a black and white battle between opposing intellectual camps. Marshall, for example, while deductive, was supportive of historical methods and critical of the many aspects of real economic life abandoned under the simplifying assumptions of neoclassical theory. Likewise, many fine economists (through the early 1960s) who viewed themselves as in the mainstream of classical economic thought were institutionalists: J. R. Commons; Wesley Mitchell; Selig Perlman; Arthur Burns; Simon Kuznets; John Kenneth Galbraith. The eccentric Thorstein Veblen, while rightly seen as a founding father of institutionalism, was extreme among institutionalists in his rejection and denigration of orthodox theory.

Most important, the “winner” in the struggle was neither the neoclassical nor institutional schools, rather the rise of mathematical economics and its alliance with econometrics as led by such bright young graduates as Paul Samuelson, Kenneth Arrow, Milton Friedman, George Stigler, Robert Dorfman, Armen Alchian, Joe Bain and Abram Bergson. The losers were all those economists, beginning with the Christian socialist and founder of the American Economic Association, Richard Ely, who believed economics should be a normative science concerned with broad issues of social policy, politics, morality and religion. Unlike the modern neoclassicalists who labor under the constraints of the simplifying assumptions required for mathematical and econometric analysis, the institutionalists vehemently opposed the separation of positive and normative, of economics from ethics, of overall social results from economic policies, of means from ends. Economics was not physics because the focus was on human problems. While institutionalists were supportive of empirical research, it was inductive research with emphasis on the changing nature of economic institutions, habits and norms, special attention to the divergence between market prices and social values, and a belief in the ability of informed concerted action to improve human welfare. While the winners were calculus and Langrangian constraints, Yonay observes that economics was, as a result, made less rich in content and span, less interdisciplinary, less focused on theory and the human condition.

Yonay begins his book with a review of the alternative sociological approaches to understanding the development of scientific knowledge: the Kuhnian, Lakatosian, and constructivist (actor-network) methodological frameworks. In chapters two and three, with emphasis on relationships among practitioners, he presents a fresh view of the history of both the neoclassical era and the rise of institutionalism. Chapters four through seven describe in detail various components of the struggles between the neoclassicists and the institutionalists over the meaning of science, the scope of economics, the gap between reality and theory, and the importance of social relevance and values. Using the
neoclassical-institutionalist struggle as an example, chapter eight shows how the self-interest of practitioners in the competition for success is the source of claims that new schools of thought are either evolutionary or revolutionary. Chapter nine documents the defeat of both institutionalism and neoclassical theory by the alliance of mathematical economics and econometrics. According to Yonay,

"The mathematization of economics magnified the traits of economic theory which institutionalists had so fiercely criticized, and which "old-fashioned" neoclassicists had started to rectify. Economists today know less than at any time before about economic history and the history of their discipline" (p. 195).

Yonay concludes that the mathematical economists ultimately won because their work had the appearance of objectivism, a primary feature of science. This not only brought rewards to mathematical economists, but bolstered the standing of economics as a profession by making economic research less accessible to other disciplines.

In his final chapter Yonay emphasizes that there are a multitude of "independent variables" which determine the outcomes of scientific competition. In the case of economics this includes "political pressures, ideological commitments, religious beliefs, philosophical doctrines, economic booms and recessions, concrete economic and social problems, major scientific achievements, the view of prominent scholars, logic, and facts" (p. 200). And victory is often a facade behind which there lies a broad diversity of individual opinions, backgrounds, circumstances, and experiences. The gains achieved through mathematical economics, including such concepts as human capital, transaction costs, rent seeking, free riders and adverse selection, are substantial. Yet they have come at the expense of diversity and richness.

Yonay's analysis evidences that the current dominant conceptual framework is a result of a confluence of forces, many of them interpersonal, and is not the well-honed, well-tested product of a rigorous evolutionary process. The inability of mathematical economics and econometrics to deliver the goods for the purposes of private and public policy decision-making is today clearly evident both to economists and others. As the mathematical-econometric star wanes, it is time for Christian economists to seize the moment, bringing ethics and the full complexities of God's human creations back into the basic economic discourse. Let's start with an assault on the fortresses of introductory economics textbooks!

Most introductory textbooks today, for example, still retain the conceptual framework put forward by Marshall in his Principles of Economics: in a competitive market system all factors of production, including labor, will receive a return equal to their contribution to output, inputs and outputs will be allocated according to the preferences of individual consumers, and pursuit of self-interest will advance social interest. This framework, with its emphasis on self-interest over community, hedonism over charity, and meritocracy over distributive justice, does not go down easy in the light of Scripture and Judeo-Christian tradition. Moreover, man's sinfulness complicates matters further as markets tend toward the restriction of competition, monopsony and discrimination keep wages below efficiency, and simplistic socialist reforms concentrate power in the hands of imperfect and perhaps even evil persons. Let us confront Christian students with the complexity of economic reality and challenge them to be about the task of constantly reforming and transforming the system of democratic capitalism (Novak, p. 359).
ENDNOTE

1 Robert Nelson states that of the 50 persons at the first AEA meeting fully 20 were either current or former church ministers. Their focus was primarily to provide church leaders with the intellectual tools to more effectively address social problems such as slums and adverse labor market conditions. See Nelson (1998).

REFERENCES


