“Summary of article by Joan Robinson: The Neo-Classics: Utility” in Frontier Issues in Economic Thought, Volume 3: Human Well-Being and Economic Goals. Island Press: Washington DC, 1997. pp. 70-74

Social Science Library: Frontier Thinking in Sustainable Development and Human Well-being

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Neoclassical economics, unlike the classical school that preceded it, relies on the concept of utility for its theory of value and behavior. This selection examines the meaning of utility to the founders of neoclassical economics, and presents (and criticizes) the ways in which the early theorists dealt with some of the internal contradictions in their approach. [Note: the author's discussion of free trade policy has been omitted from this summary.]

NEOCLASSICAL METAPHYSICS

Utility is a metaphysical and circular concept: "utility is the quality in commodities that makes individuals want to buy them, and the fact that individuals want to buy commodities shows that they have utility." (48) Still, it appears to be a quantitative magnitude, allowing discussion of total and marginal utility -- as Alfred Marshall and W. Stanley Jevons independently concluded. Although Marshall surrounded the discussion with many qualifications, he argued that the law of "satiable wants," or of diminishing marginal utility of additional units of any good, was a fundamental tendency of human nature.

The problem of reliance on a metaphysical concept remains, even when utility is replaced by "revealed preference"; the newer formulation still carries the implication that it is a good thing to satisfy revealed preferences. Yet drug addicts should be cured, and children should go to school; value judgments must inevitably be made about which preferences should be satisfied.
Moreover, there is a contradiction in the notion that behavior reveals preferences, as Marshall acknowledged. If we make two observations of a person's choices of different bundles of goods, they will occur at different times; we must assume that there has been no change in preferences between the two observations. Consumption of some goods, however, changes the consumer's preference for more of the same. Listening to good music increases the taste for it -- as does drinking too much liquor. So observation of choices at two points in time may not provide information about a single set of underlying preferences.

THE VANISHING EGALITARIANISM OF UTILITY THEORY

The ideological content of utility theory was curiously double-edged. As Wicksell pointed out, it was an egalitarian perspective, valuing the satisfactions enjoyed by the working class as much as those of anyone else; in this it differed from classical economics, which had focused on accumulation of capital as the principal measure of success. Marshall observed that diminishing

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marginal utility applied to money as well as individual goods, an observation that can be used to justify unions, progressive taxation, and the welfare state.

On the other hand, the point of utility theory was to justify laisser-faire, allowing everyone to maximize individual utility by spending their income as they see fit -- and allowing competitive businesses to maximize profit, which also maximizes consumer satisfaction. Egotistical individual action leads to the social good, an idea that originated with Adam Smith, but was carried to extremes by the neoclassical economists.

Not all of the neoclassical pioneers accepted the full laisser-faire political program; Walras and, more tentatively, Marshall in his younger days had socialist leanings, while Wicksell and Pigou also expressed doubts about the virtue of unfettered competition. On a theoretical level, though, the problem remained of reconciliation between the redistributive implications of utility theory and the conservative implications of laisser-faire.

"The method by which the egalitarian element in the doctrine was sterilized was mainly by slipping from utility to physical output as the object to be maximized." (56) Marshall in his later years, recanting his early socialist tendencies, emphasized the idea that growth of material output promotes human wellbeing. Connected with this was the argument that only the rich save, so inequality is necessary for capital accumulation.
The other way of evading the egalitarian side of utility theory was to explicitly separate growth from distribution, asserting that the latter could be handled by an appropriate set of taxes and subsidies. No one takes the taxes and subsidies seriously, nor explores the effects they would have on work incentives -- but the problems of growth can now be handled as isolated logical questions, apparently free of ethical judgments.

> All the same, even economists are human beings, and cannot divest themselves of human habits of thought. Their system is saturated with moral feeling. Those within it, who have grown used to breathing its balmy air, have lost the power to smell it. (59)

PROFITS AND MORALITY

Classical economics, with its labor theory of value, made it easy to discuss exploitation. Neoclassical theory changed this, placing capital and labor on the same moral level. Workers are rewarded for their labor; what are capitalists rewarded for? The answer is, "waiting", i.e. agreeing to defer consumption and allowing their resources to be used in production. This view was elaborated in two distinct versions.

To Walras, Jevons, the Austrian school, Wicksell, and perhaps Robbins, it seemed natural to assume that the supply of all factors of production is fixed. All economic actors then seek to deploy their resources where they earn the greatest returns; the conceptual distinction between work and property has disappeared.

> Setting the whole thing out in algebra is a great help. The symmetrical relations between x and y seem smooth and amiable, entirely free from the associations of acrimony which are apt to be suggested by the relations between "capital and labour." (61)

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Marshall, on the other hand, assumed that factor supplies were not fixed; each factor had a rate of return which was required to bring an increased supply into use. Workers had to be rewarded to do more work; capitalists had to be rewarded to do more waiting. Yet each approach failed to provide an adequate explanation of capital markets and profits.

The first view cannot explain the existence of an aggregate rate of profit or rate of interest. The fixed factors of production include particular machines and inventories of goods, not abstract capital; equilibrium should imply a different rental price for the use of each type of machine. Only if capitalists are mysteriously free to change one type of machine into another can there be an equalized rate of profit throughout the economy.

Marshall's view, while avoiding this problem, fails to distinguish between the stock of existing capital and the rate of investment (i.e., the change in the existing stock). It appears that a particular rate of profit should be required to keep a given stock of capital in use, not to induce a specified rate of new investment. And it is not clear what sacrifice is involved in waiting to consume an already-existing stock of capital. Pigou addressed these problems through analysis of the hypothetical stationary state of the future, where accumulation has ceased; this makes the equations work nicely, at the cost of a loss of connection to reality.

THE SEDUCTIONS OF MATHEMATICS

The introduction of utility into economics allowed the rapid advance of mathematical models, as both Jevons and Edgworth were pleased to observe, By emphasizing the quantitative nature of utility, Edgworth was in danger of offering mathematical proof of radically egalitarian conclusions -- a fate which he avoided by suggesting that people have immeasurable differences in their capacity for happiness. Thus the utilitarian unit of happiness is ultimately the same kind of unobservable mirage as Marx's abstract labor.

Despite its mathematical sophistication, the neoclassical scheme was rather barren of results. Clapham, in a satire of the field in the 1920s, described economists who spent their lives abstractly discussing industries with increasing, constant, and diminishing returns, but never identified any existing industry as belonging in any of these categories. One reason for this sterility was that "the questions being discussed were of no practical importance. The policy recommended was laisser-faire, and there was no need to describe in any detail how to do nothing." (73) If Pigou's taxes had been taken seriously, empirical research would have been required to implement them -- but as Clapham noted, this did not occur.

Another reason for the lack of results was that the mathematics of equilibrium led the field away from testable hypotheses, since the world so clearly is not in equilibrium. "The soothing harmonies of equilibrium supported laisser-faire ideology and the elaboration of the argument kept us all too busy to have any time for dangerous thoughts." (74)

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