

THE APPLICABILITY OF ECONOMIC GENERALISATIONS
AND THEIR LIMITATIONS

The limitations of Economic Laws

In the preceding Section it was seen what Robbins meant by the inevitability of economic law. However Robbins pointed out that the applicability of economic laws has limits. Essentially these limits are to be found in the nature of economic analysis and the relation to its given data. Given certain data, economic analysis enables the working through of inevitable corollaries. However, when the data change, economic analysis does not enable explanation of this very change. Given technical conditions and relative valuations, economic laws can point to certain inevitable relationships that follow. Changes in these given technical conditions and relative valuations, however, cannot be explained with the aid of economic analysis.

This is not to deny the importance of changes in values which Robbins acknowledges as the main preoccupation of theoretical Economics. The economist can explain changes due to changes in the data or the consequences of changed technical conditions and a different set of relative valuations but the economist cannot explain changes in the data themselves. Changed data give a new set of relative valuations and technical conditions. From this point only is it possible to proceed with the analysis.

Robbins demonstrates the validity and utility of the Austrian distinction between endogenous and exogenous changes to establish what is within the scope of the economist's explanatory framework and what lies outside.

Robbins cites two examples where this distinction is easily drawn. The first will be outlined here. In connection with the theory of money and endogenous change following from certain assumptions concerning the demand for money, would be that an increased currency volume would lead to a fall in its external value. Endogenous changes conform to the property of the inevitability in economic laws. However what is not inevitable is that a fall in the exchange rate should be followed by inflation. A decision to start printing money does not follow inevitably from a fall in the exchange rate. This is not an endogenous change following from within the body of assumptions, but can be attributed to deliberate exogenous human action.

With reference to the practical applications of this distinction, exogenous changes must be considered but with the distinction in mind all the time. This is because economic generalisations are capable of achieving a high degree of ^{Certainty} probability as against those "generalisations of the sociological penumbra". It is important to be able to point out the limits of the economists' certainty.

Robbins stresses that underestimation rather than overestimation of certainty gives the economist the power to convince.

The Possibility of a Theory of Economic Development

If it is not possible to predict changes in the data themselves, therefore the question arises as to whether it is at all possible to formulate a complete theory of economic development using the term in the sense of the nature of the changes forthcoming. Robbins says that this is doubtful because there are no constants in the economic system. Constants could only be derived if it were possible to calculate for all time elasticities of demand and supply for all commodities and all factors. It is not possible to predict changes in the data. The difficulties of predicting technological change are at once apparent.

No technique of economic analysis could predict the trend of inventions resulting in the coming of ^{the} railway engine or the internal combustion engine.

It might be possible to speculate about hypothetical changes. However it is really beyond the economists scope or capacity to foretell a process of change that depends on data the economist himself must accept as given.

The next four subheads deal with the statistical aspects of economic theory. Robbins made an attempt to evaluate the collection, interpretation and significance of quantitative data in the light of modern economic theory. The theoretical language used can be recognized as early Austrian Marginalist.

The Meaning of Economic Statistics

Economic statistics are expressed in terms of physical units and in terms of value units.

The evaluation of economic statistics expressed in terms of physical units is made with reference to the concepts of scarcity and the economic good.

We might recall briefly that Robbins said earlier that whether a good or a service is an economic good depended solely on its relation to valuations. Thus here he points out that calculation in physical units in the light of economic theory have no significance except as relative valuations. The meaning of a series of figures could only be determined in relation to the background of relative valuation.

The significance of statistics in terms of value units is assessed in relation to modern price theory.

Modern price theory demonstrates that commodity prices and factor prices are determined by marginal valuations. These prices are a reflection of relative scarcity and express in money the many goods and services coming into the market in an order.

The significance of a price to the economic theorist does not however lie in its price taken in isolation, but in the relationship between this quantity of money and other quantities of money. The stress here is on the word relationship. The valuation which the price system expresses are not absolute quantities but arrangements in a certain order. "Value is a relation not a measurement". Robbins says that it is fundamental to recognize as Menger and Pareto did that an implicit assumption in price is the ordinal nature of valuations.

Prices, as an expression of an order of preferences, as the theorist sees the case, make them incapable of addition.

This forces the background for an assessment of first the process of aggregating individual increases and prices, and second, the attempts to use these aggregates to determine the impact of changes in distribution.

Prices as an expression of an order of preference as the theorist sees it, are incapable of addition. Being incapable of addition, prices collected into social aggregates have no real meaning to the economic theorist. Robbins mentions but does not develop that aggregates of money prices and incomes may have a significance for monetary theory. Beyond this, these aggregates, have only what is termed a conventional significance. By this is meant, that given the arbitrary assumptions, it is possible to derive some meaning from movements in aggregates. These arbitrary assumptions are that preference and distribution do not change within short periods and that certain price changes are significant for the majority of economic subjects. Robbins emphasizes that essentially these assumptions are arbitrary in nature because they do not follow from pure theory.

Going on to the practical uses of these statistics, Robbins says, in so far as such estimates are used to determine the initial distribution of Income, they are valuable.

However, it would be futile to use this information to effect an actual redistribution of Income. This is because a redistribution itself would change relative valuations. Thus with these changed set of relative valuations, which cannot be

predicted or taken into account by economic theory, the estimate would grossly overestimate the amounts of productive power that would be available after a redistribution.

A redistribution of money income would not be able to take into account the way factors on the relative scale would be changed because although the technical efficiency of the factors would be the same, the economic efficiency would be dampened.

Developing this idea of the technical efficiency of factors, Robbins says that only a insignificant proportion of the population now producing real income for the "rich" would be diverted to producing real income for the "poor". Any attempt at greater accuracy in calculation in terms of money would only result in exaggeration. How exactly this follows logically from the foregoing, we are not told. However the general conclusion is that the greater the degree of initial inequality of incomes, the greater will be the exaggeration of the possibility of the success of a redistribution campaign. Therefore we are left to conclude, that if the degree of inequality in income is taken as an indication of the need to reduce the inequalities, the less are the chances of attaining the desired end of an equitable distribution of income.

In brief, Robbins is willing to allow only a conventional significance to a computation of social aggregates. However Robbins shows that it follows from pure theory that relative valuations change with an actual redistribution of income. It is not possible to ascertain the precise impact of a redistribution of income on the direction in which

factors of production would tend to flow. Therefore to attempt a redistribution of Income on the arbitrary assumption that changes in relative valuations do not follow, is unrealistic.

The Significance of Time Series

Developing a further implication of this conception of value as an expression of an order of preferences, Robbins goes on to evaluate the process of the comparison of prices. He says that such comparison is only possible if exchange was possible between the two commodities whose prices are being compared.

To compare the prices of a commodity in two different years and to note the change is a process that has no significance. The only significant comparison is between the price of a commodity and all other prices in the same year.

Robbins gives credit to the Classical economist Samuel Bailey for having pointed this out long ago. Samuel Bailey wrote:

when we say that an article in a former age was of a certain value, we mean that it is exchanged for a certain quantity of some other commodity. But this is an inapplicable expression in speaking of only one commodity at 2 different periods⁽¹⁵⁾.

Robbins develops this further by admitting of what he terms intertemporal price relationships.

(15) Samuel Bailey A Critical Dissertation on Value. Quoted in Robbins op.cit., pp.61-62.

In essence this is the recognition that expectations of probable future prices do affect present prices. However, past prices are irrelevant in relation to present prices. Thus prices relationships through time are not symmetrical but asymmetrical.

As to the significance of price series Robbins admits of the value of the index number technique for applied Economics, and the interpretation of history. However what is stressed is the fact of the arbitrary nature of conventional assumptions as in the aggregation of individual prices and incomes.

Statistical Laws of supply and demand

With regard to the attempt to derive Quantitative laws of supply and demand from elaborate statistical calculations, it is pointed out that it is not possible to give permanent numerical content to supply and demand. It is of course possible to establish numerically a given state of supply and demand conditions. But to extend this to the status of laws, is to Robbins, empty of meaning. Demand and supply are determined by individual relative valuations and technical facts and these cannot be reduced to uniformity.

Neither is there reason to suppose that uniformities can be discovered. To estimate the elasticity of demand of a particular market in a particular time will not give a permanent elasticity in that market for all time, because it is bound to change. Besides, the factors giving rise to this change are not such as to be able to be reduced to a standard.

Robbins admits of the usefulness of such computation for particular problems in specified short periods of time. What is vehemently denied is the possibility of deriving laws from statistical investigations.

Quantitative Economics

Having demonstrated that it is not possible to attach permanent numerical values to elementary concepts such as demand and supply functions, Robbins turns to assess the attempts of the Quantitative Economists to derive laws of not just demand and supply, but other more complex relationships such as cost dispersions, price fluctuations and business cycles. The significance of this sort of work is dismissed as being doomed to futility from the start. Robbins points out that the theory of probability which forms the basis of modern mathematical statistics, does not allow averaging where no homogenous factors are in operation.

Of Professor Wesley Mitchell's Business Cycles, Robbins admits of the tremendous utility of the large collection of data concerning businessmen fluctuations. However what Robbins finds empty is the derivation of the average length of all cycles in various countries with a logarithmic normal curve which is fitted by Davies Method to the frequency distribution of the 100 observations recorded. Such a relationship has no significance at all. Professor Mitchell is chided for his belittling of the methods and results of traditional analysis and imagining that his complicated curve is significant.

The Function of Empirical Studies

What therefore finally did Robbins consider the function of empirical studies after his soundings on the significance of economic statistics, time series, statistical laws of supply and demand, attempts at the redistribution of Income and the work of the Quantitative economists?

It has been seen that in relation to these activities, with the exception of the attempts to redistribute income and the 'laws' of the Quantitative economists, Robbins explicitly stated no ultimate limitation. The point that he stresses strongly is the necessity to recognize what strictly follows from and what is strictly relevant to pure economic theory. He was not even advocating that all economists be pure economic theoreticians. On the contrary, he attached the greatest importance to the role of empirical studies as a vehicle towards the scientific progress of theory.

Robbins saw empirical studies as having four important functions.

Firstly, empirical studies provide a check on the applicability to given situations of different types of theoretical constructions. The necessity for this, Robbins considers, lies in the fact that the terminology of theory and the terminology of practice although apparently identical may in fact cover different areas. As an example, Robbins ascribes the failure of the other-wise superior theory of the Currency School, to the fact that they did not include bank credit in their conception of money. Empirical study would therefore be useful as a means of checking as to whether technical words and concepts used in economic theory had their counterpart in reality.

The second function of empirical studies would be the suggestion of auxiliary postulates. Only a close study of the facts in any given situation would reveal which subsidiary assumptions are needed in order to relate the whole construction to reality.

The third function of empirical studies is to show up those areas in existing economic theory which need to be reformulated and extended.

Here is Robbins exhorting economists to undertake studies of real situations in order to suggest where economic theory is lacking.

Robbins held that realistic studies would only suggest a problem. They cannot provide the solution themselves. It is "theory and theory alone" which can provide the solutions.

The fourth function of empirical studies comes from the fact of the inevitability of economic law. Empirical studies provide the changing facts which make prediction in any given situation possible. Robbins here by no means meant that an empirical study made once and for all could provide the facts for prediction in all situations. The data ~~is~~ are continually changing and therefore the validity of the results of any one empirical study is limited.

Robbins says that there are no laws to be discovered from empirical studies. They can only suggest in different situations what formal analysis is appropriate and can provide for that moment only some content for formal analysis.

His main quarrel with the Quantitative economists is clear. Robbins objected to the tendency of that group to attempt to formulate empirical laws. Robbins would rather see the facts of empirical studies, incorporated into formulate economic theory.

Interpersonal Comparisons of Utility

We now come on to that part of Robbins' book which contains what is popularly regarded as his most controversial idea. This was the idea that the process of interpersonal comparison of utility was a scientifically illegitimate procedure and therefore certain aspects of the theory of public finance dealing with 'Social Utility' ^{is} was necessarily meaningless.

The Law of Diminishing Marginal Utility, Robbins points, has been used as a criterion for all forms of political and social activity affecting distribution. Any action conducive to greater equality and which does not adversely affect production is said to be justified by this law. Robbins judges that this argument rests on the extension of the law into a field where it is not applicable. To extend it in this way is not only illegitimate, but it also does not follow from the concept of an economic good. Also, it makes extra assumption that can never be verified by observation or introspection.

Robbins states exactly where the limits of the law lies. The law implies that the more one has of anything, the less one values additional units. This is as far as comparisons can go. It is only possible to say that a man will prefer a higher income to a lower one. However, it is wrongly claimed, according to Robbins, that since the Marginal Utility of a rich man's income is less than the Marginal Utility of a poor man's

income, transfers, if they do not affect production, are economically justified because they increase total utility. This proposition, according to Robbins, seems to ignore the metaphysical question of the scientific comparability of different individual experiences.

It is possible to compare one individual's scale of ordered preferences with that of another's and thus build up a theory of exchange. However it is quite a different thing to say that it is possible to attach magnitudes for comparisons. As far as the theory of equilibrium is concerned it is not needed, and neither is it implied.

Robbins exhorts that it must be recognized that the assumption of equality of capacity for experiencing satisfaction, as between economic subjects, is only a conventional assumption that does not rest on ascertainable fact, and nor has ^{no} any place in a positive science.

The Neutrality of the Theory of Equilibrium

In the same way as the law of diminishing marginal utility is held to be a criterion for social and political action, so is the theory of economic equilibrium.

Robbins points out that the pure theory of equilibrium only shows that given the valuations of the various economic subjects and legal and technical facts, it is possible to conceive a situation where maximum satisfaction and optimum distribution of resources is achieved. But this is all.

Any extension of this is not scientific. Just because equilibrium describes the situation where maximum satisfaction is achieved, this does not necessarily make it a criterion for policy.

After all a state of affairs in which the individual enjoys maximum freedom to choose as is part of the conditions assumed in equilibrium analysis, may not be thought to be desirable in relation to social ends.

Therefore to use the theory of equilibrium to justify certain courses of action is again an illegitimate extension of theory. Such an extension should not be treated as if it were implied in the original theory of equilibrium. It should be recognized by economists that such an assumption comes from outside the assumptions of economic analysis.