

IV

**THE MODERN PERIOD,
1939–1980**

A History of Modern Economic Analysis © Roger E. Backhouse, 1985

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The 1930s as a Turning Point

Economic theory

Although the work of economists such as Pareto, Böhm-Bawerk, Wicksell, Fisher and Clark, the “second generation” of neoclassical economists, had established deductive, marginalist theory as the main method of economic inquiry, the streams of dissent were still extremely strong. There was American Institutionalism, Veblen’s attacks on neoclassical economics having been very effective.¹ Equally important was Marshall’s refusal to place too much weight on simple, abstract economic models, and his insistence on blending theory and history.²

The place of deductive theorizing at the centre of economic analysis was considerably strengthened in the 1930s. It was in the 1930s that the influence of Institutionalism waned,³ and that the movement away from Marshall’s value theory was completed. Robinson’s *Economics of Imperfect Competition* (1933) was based on a more abstract method, much closer to modern economics than was the method of Marshall’s *Principles*.⁴ In addition, Marshall’s consumer theory came to be superseded by that of Hicks and Allen (1934) and Samuelson (1938), whilst the attacks of Myrdal (1929) and Robbins (1932) undermined the utilitarian approach to welfare economics. With Hicks’ *Value and Capital* (1939) and Samuelson’s *Foundations of Economic Analysis* (published in 1947, but dating from the late 1930s) the establishment of an alternative to the Marshallian theory of value was complete. The new approach to economics was represented in Samuelson’s *Economics* (1948).

The 1930s also saw the appearance of Keynes’ *General Theory* (1936), on the basis of which macroeconomics was to emerge as a distinct branch of economics. In macroeconomics, as in microeconomics, there was a shift towards a more formal, abstract method, many of those involved in developing Keynesian ideas also being associated with what Shackle⁵ has called “the new establishment in value theory”: Robinson (1937), Samuelson (1938a, 1948a), and, above all, Hicks (1937, 1939a).

Econometrics

One of the main features distinguishing post-war economics from that of previous periods is the development of econometrics. The link between macroeconomics and econometrics is clear: many post-war developments were concerned with reconciling Keynes’ behavioural functions, in particular the consumption function, with empirical data. More generally, however, it is hard to imagine “positive economics” becoming as popular as it did

without the availability of econometric techniques, for even if economists have rarely rejected theories on the basis of econometric evidence, it seems reasonable to conjecture that the availability of econometric techniques provided a justification (excuse?) for developing formal mathematical models⁶: the availability of formal econometric techniques enabled economists to separate the analysis of economic theories from the analysis of empirical data more easily than might otherwise have been the case.

It was in the 1930s that the term econometrics came into use, the Econometric Society being established in 1930. There were two aspects to this. One was the use of mathematical methods to analyse economic models. Of particular importance was the use of mathematics to analyse economic dynamics, Frisch's work (1933) being particularly influential. The other aspect of econometrics was the use of statistical techniques to test and to estimate the parameters of economic models. Though there were important contributions much earlier in the century, Moore's work being particularly widely noticed,⁷ it was only by the 1930s that the conceptual problems underlying such techniques were beginning to be sorted out. With problems such as the identification problem, the nature of the disturbance term, the theory of least squares estimators and the theory of confidence intervals, for example, it was work in the late 1920s and 1930s which provided the foundations on which post-war work could build.⁸ Particularly important were Tinbergen's pioneering attempts to construct economy-wide, simultaneous-equation models, first of the Dutch economy (1935) and then of the US economy (1939).

A prerequisite to the use of econometric methods was the availability of statistical data, and here again the 1930s mark a turning point. Data collection on a large scale, as has characterized post-war economics, requires government involvement. In the US the NBER had been collecting and analysing statistical data since its foundation in 1920, but it was not until 1932, when the US Senate requested estimates of national income for 1929–1931, that the US government became involved. The resulting estimates, produced under Kuznets' direction, were published in 1934. In the UK, though Colin Clark worked on national income accounts throughout the thirties, the first officially produced national income estimates did not appear until 1941 (produced by Meade and Stone). It was only after the *General Theory* that the now familiar organization of national accounts was established.⁹

Conclusion

Although they form part of a continuous line of development going back to the 1870s and beyond, these developments, taken together, can be seen as marking a turning point in economic analysis. There was no sharp break with the past, but these developments in economic theory and in econometrics imparted to the economics of the post-war period a character very different from that of the period up to the 1920s.