Paul Samuelson on the History of Economic Analysis

Selected Essays

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kind of imperfection of competition? Such aberrations as these, to which I point in horror, are taken by some modern writers as signs of Marshall's genius and erudite wisdom about the facts of life. "It's all in Marshall," they say, failing to add, "All the words of economics are in Webster's dictionary or in the fingertips of monkeys in the British Museum." But just as it takes more than monkeys to find the Michaelangelo statues that lurk in any old cube of marble, so it takes more than can be learned in Marshall to isolate the good sense that is embalmed therein. Marshall's crime is to pretend to handle imperfect competition with tools only applicable to perfect competition.

Third, Marshall was a victim of what the modern Freudians call self-hate. He was a good chess player who was ashamed of playing chess, a good analytical economist who was ashamed of analysis. He well understood Cournot's insistence that the marginal cost curve must not be falling for any maximizing pure competitor, but balked at simple acceptance of the fact. All of his prattle about the biological method in economics – and the last decades' genuine progress in biology through the techniques of physics has confirmed my dictum of 20 years ago that talk of a unique biological method does mostly represent prattle – cannot change this fact: any price taker who can sell more at the going price than he is now selling and who has falling marginal cost will not be in equilibrium. Talk of birds and bees, giant trees in the forest, and declining entrepreneurial dynasties is all very well, but why blink at such an elementary point?

Fourth, this leads to the further confusion by Marshall of *external* effects with increasing *returns* phenomena. Because Marshall (*Principles*, Book V, Ch. XIII, pp. 467–470) made an elementary mistake in his graphical reckoning of consumers' surplus, forgetting to take into account producers' surplus – an odd omission for a chap who always insisted correctly that there are two blades in the scissors of supply and demand – he came up with what seems like an exciting policy theorem: *Tax to contract increasing cost industries; subsidize to expand decreasing cost industries.*

As we congratulate ourselves that commonsense economics has for once produced fruit, we are brought up short by the realization that this is quite wrong. It merely sounds like a couple of other things that are right. Increasing returns industries are likely to be somehow monopolized, and a monopoly markup of price over marginal cost does create a *prima facie* case for public expansion of that industry. Futhermore, under increasing returns, marginal cost is below average cost; and hence marginal cost pricing would require a state subsidy. But wait: it was a *competitive*