

Perfect Competition and the Transformation of Economics. By Frank M. Machovec. New York and London: Routledge, 1995

Professor Machovec of Walford College has written what might be called a monograph in the history of economic thought, dealing with the economic profession's adoption of the general equilibrium theory as the starting point of all economic analysis. He argues that this revolution, which took place in the 1920s, radically altered the way economists would come to view economic phenomena. The acceptance of this new "paradigm" meant the abandonment of specific ideas associated with classical economics.

The importance of this book is Machovec's documentation of how the adoption of empirical methodology leads to the abandonment of key classical concepts and leads to the adoption of an anti-market bias. "The classical description of the market process—a broad tapestry which explains much but provides no concrete mathematical predictions—came to be considered useless and thus was no longer defined as a legitimate theory in the sense of positive science" (p. 269). Having abandoned the view of the market as an ongoing process of resource allocation, the way was clear for the adoption of utopian and activist policies.

Machovec discusses anti-trust law and international trade as areas where unintended and disastrous results have also occurred as a result of the link between the methodology of the economists and their policy recommendations. Quoting Hahn, "it is the models that lead people to view the economic systems as they do" (p. 309).

International trade and development economics is another area where the knowledge and wisdom of classical economists have been ignored or abandoned, leading to specific policy recommendations which, when practiced, cause disastrous, unintended results. "We should not underestimate the damage wrought by Walras's entrepreneurless and, hence, non-market vision of the economy, a vision which has made intrusions by government appear efficacious in far more areas than would otherwise be the case" (p. 305).

Those who have become dubious of the government's interference in the market will appreciate the insightful connection between the question of methodology and the type of government policies engendered by that methodology, the discussion of the intellectual history of the profession and the explanation of

how the profession has come to its current state is one of the most interesting and useful portions of *Perfect Competition*.

The adoption of general-equilibrium theory has trained economists to look at problems in a certain narrow way. Professor Machovec defines five distinct areas where adoption of the perfect-competition model has had deleterious results: an explanation of price change, modeling and predictability, the re-definition of monopoly, and the dependence on central planning in international trade. Price change, and its significance, is a key classical concept which Machovec argues was abandoned as a result of the adoption of Walras's perfect-competition model. The classical economists viewed price changes as the result of entrepreneurial initiative in the way of new products, methods, and elimination of imperfect markets by arbitrage, etc. After the adoption of Walras's model, all prices were assumed to be at equilibrium and were changed only by exogenous forces outside normal market dynamics. This assumption led to the questionable attempt to mathematically determine production levels. An additional notion of the classical economists which the neoclassical economists abandoned was the important role of the entrepreneur as the innovative force driving the economy, and the idea of the consumer as the ultimate and final source and authority for deciding through the price system which goods get produced and in what quantity.

The acceptance of Walras's equilibrium theory leads logically to the now-common practice of modeling and prediction. "For the classical case, in which information is revealed incrementally, the equilibrium price vector is solely an *ex post* phenomenon and hence cannot be determined (calculated) *ex ante*. . . . The culmination of such a process is a set of equilibrium prices and quantities *different* from those yielded mathematically by Walras's system of simultaneous equations, yet Walras erroneously believed that his model's prices were identical to the market's equilibrium prices" (p. 5).

The abandonment of the view of entrepreneurship as a benefit to society and the adoption of equilibrium, Machovec argues, redefined the role of the entrepreneur as harmful under the static models of the neoclassical economists. Machovec shows the effect this has had on anti-trust policy in the way of Supreme Court decisions. Machovec echoes Coase: "As static neoclassical models became understood by jurists, business practices whose efficiency rationales were subtle—and hence not easily explicated by defense teams—were routinely yet incorrectly imparted to the existence of monopoly power. More harm than good has flowed from the inflexible application of the perfect-competition benchmark as 'the measure against which particular [anti-trust] policy and actions are first tested'" (p. 201). The classical economists viewed the market as a self-regulating mechanism against monopoly if there was ease of entry. The substitution of a different criterion as

opposed to the “ease of entry” of the classical economists led to anti-monopoly legislation which was not in the best interest of the consumer. He quotes Baumol and Ordover, “Anti-trust can and probably does serve as a vehicle for rent seeking and as a means to prevent ‘unfair competition,’ meaning any competition that threatens to make life uncomfortable for rivals . . . To this extent, rather than promoting static efficiency, anti-trust legislation may serve to undermine it” (p. 228). The result has been anti-trust legislation which has failed to encourage competition to the detriment of the consumer.

In the same vein of anti-trust legislation, Machovec details how similar counter-productive policies have resulted in the area of international trade, and shows the important connection between methodology and policy. The overall result of Walras’s influence has been an anti-free-market prejudice and a statist activist government bias. One can only conclude that the understanding of the classical economists has to some extent become almost a body of lost knowledge. The frightful idea lurking in the background from all this is that the economics profession is filled with PhDs who view their profession as the exercise of the correct “test” from their “toolkit” but actually have little conceptual understanding of economics.

On balance, despite the excellent scholarship and informative history, the book is not without its flaws. *Perfect Competition* was sponsored in part by the Austrian economics program at New York University, and one can no doubt safely assume a fair amount of familiarity on the part of the author with the works of Carl Menger and the methodological positions of the Austrian economists. Although Professor Machovec’s criticisms may ring with resonance in the hearts of Austrian economists, it would be a mistake to count Professor Machovec among the members of the Austrian school. He explains, “As one who holds undergraduate degrees in mathematics and meteorology, I am an equivocal supporter of the value of formalism in economics. I fully concur with Jevons’s observation that in a discipline devoted to the study of small marginal effects, the widespread employment of calculus is inescapable” (p. 9). We do not have here an author who is calling for a fundamental change in the method and philosophical foundations of the discipline, but rather a reform in the de-emphasis of general-equilibrium theory. “My purpose, however, is not to criticize the abstract nature of perfect competition nor the model’s frequent employment as an analytical tool. I readily concede that equilibrium models play a cardinal irreplaceable role in the study of the process of competition. My primary objective is to demonstrate that the adoption of perfect competition as the benchmark—and the employment of static models as the only acceptable engines of market analysis—combined to transform . . . economics!” (p. 9).

The author fails to follow the force of his argument to its compelling conclusion: the rejection of empirical methodology. He is content instead to merely suggest a de-emphasis of the perfect-competition theory. But this recommendation is inconsistent, and fails to deal directly with the fundamental flaw and problem of the economics discipline and that is the adoption of the method of physics on a foundation of positivist presuppositions.

Only the Austrian school of economics has carried on the methodological tradition of the founders of economics. The problems and waning prestige of the economics profession will continue until the Austrian methodological position is once again the accepted orthodoxy.

Perfect Competition and the Transformation of Economics, despite this flaw, is a valuable and worthwhile contribution to understanding the history of economic thought and will be enjoyed for its informed insights and trenchant analysis.

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