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The Cost Controversies

Preliminaries

In the first three decades of the twentieth century the analysis of the laws of returns developed by Marshall and Pigou enkindled several controversies. Conceived most narrowly, they revolved around the functional relationship between costs and output and its implications for economic welfare. Regarded more broadly, they entailed important consequences for Cambridge economics. At the time of his retirement, Marshall’s *Principles* endowed his successors with several alternative profiles for the future of economics. In light of the unrivalled pre-eminence of this book – Joan Robinson called it the ‘bible’ of Cambridge economics in the 1920s (Robinson 1951, vii) – how Cambridge economics developed would depend on how his disciples interpreted it. On this point, the conception of time in Marshall’s thought was critical. Should his followers adopt the framework of comparative statics elaborated in the *Principles*? Or should they attempt to develop an evolutionary theory, using as inspiration the organic metaphors with which Marshall embellished some of his arguments? For a number of reasons, Pigou took the former course, which rested on the concept he saw as the cornerstone of economics: the national dividend. In the ensuing, we consider the cost controversies of these years in so far as they bear upon Pigou’s interventions.

In 1922, Clapham traced the genesis of the cost controversies to conversations amongst economists at Cambridge. For years, he complained, his colleagues had exercised undue restraint in abstaining from published debate over economic issues. In some measure, this was a consequence of ‘a certain very natural piety’. As a result, things ‘are said in conversation which never get into print’ (Clapham 1922a, 563).
This was an allusion to Marshall’s reluctance, following the tariff reform controversy, to further diminish the prestige of economics by indulging in public debate and the consequent acquiescence of his disciples in honouring the master’s wishes. In the same year, Pigou also seemed to endorse the idea of a hermetic oral tradition at Cambridge, writing that discussions of ‘difficulties’ concerning the laws of returns were some 25 years old, tracing them to the time he had studied the fourth edition of the *Principles* as an undergraduate (Pigou 1922a, 458). In an exchange of letters with Edgeworth in 1910, Marshall took exception to Pigou’s revisions of his treatment. In subsequent marginalia written in his personal copies of Pigou’s publications (Pigou 1910d, 1912), he made the same objection. However, these observations were not circulated. Young (1913) published an incisive critical review of *Wealth and Welfare*. But of course he was not a Cambridge economist. Clapham finally broke the silence at Cambridge in 1922 with his article ‘Of Empty Economic Boxes’, and Robertson followed with a critique in 1924.

In questioning fundamentals in the work of Marshall and Pigou, Clapham’s article marked a turn in Cambridge economics: public airing of dissent became a legitimate and institutionalized feature of its culture. Maynard Keynes’ poignant memorial essay on Marshall in 1924 was an artefact of this new era. In a biographical appreciation of Marshall, he added the critical observation that the discussion of time, which was closely linked to the treatment of the laws of returns, was the ‘least complete and satisfactory’ aspect of his work, the area ‘where there remains most to do’ (reprinted in Pigou 1925a, 43). In 1925, Sraffa published (in Italian) a seminal critique of Marshall’s account of the laws of returns, attacking the foundations of the competitive theory of value. Edgeworth, Keynes’ co-editor at the *EJ*, was much impressed, and on his recommendation Keynes invited Sraffa to write a version of his paper in English. Sraffa’s *EJ* article of 1926 radicalized the Cambridge critique of value theory. A remarkable debate ensued that included Lionel Robbins (1928), Young (1928), and Schumpeter (1928), as well as Cambridge insiders Pigou (1927c, 1928a), Robertson (1930), Shove (1930), and Sraffa (1930a, b) – for whom a position was established at Cambridge in 1927. The debate culminated in the theory of imperfect competition, developed by Kahn (1989 [1929]) and Joan Robinson (1933). Although Pigou had done foundational work on this theory – Robinson (1979, x) called her *Economics of Imperfect Competition* ‘a complete restatement of the Pigovian system with various amendments’ – he devoted his energies chiefly to tightening the logical coherence of long-run value theory under competitive conditions.