John Bates Clark, Distinguished Economist

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John Bates Clark (1847-1938) was the most distinguished American economist of his time. To me, he is especially interesting for two reasons. First, his career focused on the same important, difficult issue that a century later has motivated the GEM Project, i.e., the how and why of labor pricing. He used his famous wage theory chiefly to elucidate income distribution. Second, Clark observed firsthand, from an economist's perspective, the Second Industrial Revolution and the advent of large bureaucratic firms. With Clark, we have both wages and the then new problem of information-challenged workplaces; what's there not to like. The generalization of exchange theory assigns great significance to the altered production landscape that was taking shape toward the end of the 19th century, profoundly reworking the location and content of wage determination. The impact on macroeconomics has been fundamental. Did Clark sense the sea-change occurring in the academic specialty that he dominated?

Clark is most remembered for his iconic *marginal productivity theory of distribution.* He summarized his theory in *The Distribution of Wealth* (1899): "It is the purpose of this work to show that the distribution of the income of society is controlled by a natural law, and this law, if it is worked without friction, would give to every agent of production, the amount of wealth which that agent creates. However wages may be adjusted by bargains freely made between individual men, the rates of pay that result from such transactions tend … to equal that part of their product of industry which is traceable to the labor itself."

Readers of the GEM Blog know that Clark, once choosing to investigate factor-income distribution, had to confront the "adding-up problem". (See the November 2, 2015 post, "A Modern Income-Distribution Model".) Based on some, even for the time, pretty shallow analysis, the distinguished economist concluded that, in a competitive-market economy, a firm's aggregated marginal productivities must equal the aggregate value of the goods and services produced. Modern students feel cheated when they find out that familiar result is a special case to be used with care. Knut Wicksell, a more rigorous European contemporary of Clark, showed that the strong marginal-productivity assertion requires constant returns to scale. (Besides being very good, Wicksell was one of the most interesting of the turn-of-the-century economists, once serving two months in jail for a speech making mock of the Immaculate Conception.)

Given we know that a principal driving force of the Second Industrial Revolution is increasing returns to scale, things now get more entertaining. Despite the inattention market-centric economists, increasing returns are really important. They are, for example, most responsible for eventually breaking the global economy out of the Malthusian trap that kept the wages of most workers near subsistence levels. It is a vital concept in understanding economic progress. But the labor theoretician in Clark was innocent or disinterested in the fundamental change that was occurring around him. That disinterest was broadly shared, then and now, in the academy. It is illustrative of deep problems that plagues the adding-up issue, leaving its incorrect marginalist analysis largely unchanged since the turn of the 20th century.

And that's what about Clark that most fascinates me. He appears to be an unhappy godfather of the ostrich-like failure of modern macro theorists to appreciate the analytic necessity of modeling rational exchange in large, complex workplaces. It appears that the primacy of market-centric economic theory in highly specialized economies has always been defended, even at the cost of inadequately explaining the most crucial evidence. Isn't it shameful that NK textbooks continue to assume away increasing returns to scale in their analyses of factor income distribution? It may or may not mitigate the shame that increasing returns are assumed away in almost all modern modeling, suppressed by assuming the crudest of crude production sectors. Did the longstanding Ptolemaic triumph of theory over evidence began with John Bates Clark?

In Clark's lifetime, large bureaucratic firms became ubiquitous but their managers were still trying to figure out how best to do their jobs. They were still some time away from replacing foreman-centric labor management with modern human-relations systems. It is probably appropriate to give Clark a partial pass on failing to incorporate into his analysis the fundamental large-scale shift in labor-pricing away from the marketplace to information-challenged workplaces produced by the Second Industrial Revolution. But the pass should be only partial, because of Frederick "Speedy" Taylor (1856-1915). Taylor is familiar to faithful readers of the GEM Blog as the founder of scientific management. (Recall the post "Job Loss in Modern Mainstream Modeling" on July 20, 2018.) He chronicled the partial shift in economic decision-making, including wages, from the marketplace to highly specialized establishments that began in the late 19th century. (While Taylor did not specifically identify the motivating force to be costly asymmetric workplace employer-employee information, that conclusion is easily gleaned from his analysis.) Taylor became extraordinarily well known in his lifetime, certainly much more of a public figure than Clark. His work was the subject of Congressional investigations and was at the epicenter of a national debate on the altered industrial landscape. Speedy Taylor may not have heard of John Bates Clark, but Clark surely knew of Taylor.

And Clark did not care, at least enough to think through what firm-centric wage decision-making implies for his market-centric theory. Clark did not simply ignore the corporate behemoths, so adept at exploiting increasing returns to scale, that were springing up all around him? In a number of articles later in his career, he defended big business. The champion of competitive markets was little bothered by monopoly and oligopoly. Potential competition would prevent excess profits and assure that income distribution was fair. Clark was misled in all this by his own analysis and is indicative of his capacity to preview the failures of modern New Keynesian theorists.

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