The New Classical Economics: Theory in the Slipstream of Neoliberalism

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Abstract

This paper examines the history that binds together the early economic theory of the Walter Lippmann Colloquium and the Mont Pelerin Society of the interwar years and the New Classical Economics that developed in the 1970s. It draws the narrative between the nascent theory of neoliberalism and the rise of "scientistic" methodology in economics. The following argues that the early ideas of neoliberalism came to a head in economics through the creation of a positive economic science that separated the "political" from "economic" and that this was highly important in the restructuring of the role of the state in the neoliberal period.

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"Lucas is not a lunatic, but it was *as if* he were."[1]

1. Introduction

The methodology of economics witnessed an unequivocal change in the postwar period leading up to the neoliberal era. This change has come to set a precedent in the scientific authority of the field, one that is more and more characterized by an imperialism across the social sciences (Fine and Milonakis 2009 and Harcourt 1982). This "authority" is characterized by a claimed objectivity in economic science that aims towards a clear bifurcation between the "political" and "economic" spheres of capitalism. Emerging in the decade following WW II was a general shift in the discipline of economics away from pluralistic approaches in favor of rigorous mathematical modeling of rational agents within a general equilibrium framework.

But this change cannot be attributed to a particular moment as it is historically conditioned by an extensive and complex narrative that stretches across disciplines and back to a long-standing reaction against classical political economy. Nevertheless, the development of the New Classical Economics in the 1970's that adopted the theories of Hayek and Walras provides a point of departure in analyzing this shift as it is often viewed as the research program of modern mathematical economic science. Examining this change as an element of the greater neoliberal trajectory that began 30 years earlier with Hayek and the Mont Pelerin Society disentangles this complex history. But to understand what the rise of neoliberalism meant for economic theory, one must begin with a narrative that first explains the development of the neoliberal thought collective that simultaneously began in France, Germany, Austria, the UK, and the US in the interwar period. From such an understanding it is possible to explain how the rise of the New Classical Economics (NCE) of Robert Lucas, Thomas Sargent, Neil Wallace, Finn Kydland, and Edward Prescott, was instrumental in the revival and development of the neoliberal project.

In particular, the underlying narrative that runs between the nascent neoliberal ideology of the Mont

[1] From Arjo Klamer (2007) pp.128

Pelerin Society and the NCE is the restructuring of the role of the state (political) towards a structural intervention in the market (economy). This paper will argue that, 1) while the early neoliberals and the NCE have their methodological differences[2] the two are intimately bound by their focus on the restructuring of the role of the state as a means of achieving the free-market and 2) that the NCE cannot be taken as separate from the ideology of those neoliberal economists whose ideas they have so rigorously employed. Most importantly, the NCE's methodology of a highly deductive and mathematically technical praxeology has provided the economics profession with a larger and more pervasive role in this restructuring. Indeed, as Fine and Milonakis explain, the NCE " claims of objectivity, neutrality and irrefutable scientific rigor allowed for negotiation of a degree of government intervention in the context of Cold War McCarthyism(Fine 2009 pp.303)."

This paper is organized into three sections. The first will provide the historical and theoretical grounds for understanding the significance of the neoliberal movement that developed in the 1940s focusing on the theory of governmentality. Section two will examine the "scientism" of the NCE and the necessity of a separation between the "economic" and the "political" spheres. Section three argues that this separation was an important moment in the neoliberal narrative and an essential step in the reification of neoliberalism in the late 1970s.

2. *Identifying Neoliberalism*

Neoliberalism is often said to have emerged with the simultaneous election of Margaret Thatcher in the United Kingdom and Ronald Reagan in the United States. Characterized by a strident ideology of globalized free markets and, as a reaction to Keynesian economics, a general reduction in the state's intervention in economic affairs, neoliberalism embodies the fundamentals of the market mechanism pervasive across all aspects of society. Internationally it strives for unfettered free trade, deregulation of financial and commodity markets, weakening of labor unions labor market protections, and abandonment of full employment in favor of the natural rate. Most importantly, it preserves, at all costs, private property rights and individual freedoms, which are said to be most directly compromised by the state (Saad-Filho and Johnston 2005, Harvey 2005, Dumenil and Levy 2004, 2010, Amable 2010).

While this understanding is certainly apropos of the international political economy since the 1980s, it fails to grasp the complexity of the neoliberal narrative that began 30 years earlier. Likewise, it tends not to explore the greater implications this has had for economic theory and can easily leave unexplained the seemingly contradictory yet indispensable transformation of the role of the state in economic management. It is important to note that neoliberalism is not bounded within the sphere of economics; it has distinctive political and social aspects (See Harvey 2005 and Kelley 1997). However, the scope of this paper will primarily be contained to examining the role economic theory, and in particular the NCE, has played in the longer historical narrative of neoliberalism.

It is not easy to unambiguously define neoliberalism, yet it seems to be an indisputably distinct ideology. As this paper seeks to examine the trajectory of what began in the 1930s with the Walter Lippmann Colloquium—later the Mont Pelerin Society—and how this provides an essential backdrop to explaining the rise of the NCE in the 1970s, it will be necessary to identify clearly that which binds these two historically distinct moments. While it will become clear that the plasticity of neoliberalism makes it difficult to delineate—which is indeed what makes it so pervasive—there is indeed something that binds the ideology together throughout the postwar golden age of capitalism and into the modern neoliberal era beginning with the Reagan and Thatcher (Mirowski and Plehwe 2009).

As Philip Mirowski has explained, "neoliberalism has not existed in the past as a settled or fixed state, but is better understood as a transnational movement requiring time and substantial effort in order to attain the modicum of coherence and power it has achieved today"(Mirowski 2009 pp.426). Roger Backhouse asserts, the task of the neoliberalism of Hayek was to have "a long-term influence on the

[2] This is partly because the behavioral modeling techniques and mathematical models were simply not available to economists at the time. See Hoover 1998, Backhouse 2002, 2005.

climate of opinion, comparing its talk explicitly with that facing the earlier generation of socialist and new liberal intellectuals who had formed the Fabian Society (Backhouse 2009).” While neoliberalism certainly benefits from its lack of apodictic definition, it is nevertheless, a manifest phenomenon.

Neoliberalism is most immediately identified by the matrimony of liberal economic theory, defined by the omniscient market mechanism and preservation of individual freedoms of property rights, and a turn towards state intervention in assuring the predominance of the market and its attendant ideology over society.[3] As Michael Foucault explains, this interventionist turn is towards a biopolitical form of governmentality, that “heralds the birth of a new art of government, where the state ceases to relate to its subjects as citizen-subjects with social rights and begins to conduct its functions under the presumption that subjects will respond to economic incentives in all aspects of their lives. Neoliberalism, in short, entails the de-politicization of the social through its economisation (Madra 2010).” As Mirowski identifies it, the “primary ambition of the neoliberal project is to redefine the shape and functions of the state, not to destroy it... Considerable efforts have been developed to disguise or otherwise condone in rhetoric and practice the importance of the strong state that neoliberals endorse in theory... One should not confuse marketization of government functions with shrinking the state, however: if anything, bureaucracies become more unwieldy under neoliberal regimes. In practice, ’deregulation’ cashes out as ’re-regulation,’ only under a different set of ukases (Mirowski 2009 pp. 436).”

Understanding that in neoliberalism the way in which the state begins to relate to society is as if they behaved as economic agents within efficient markets, in fact necessitates the intervention of the state, it is possible to bridge the early neoliberal ideology of the MPS and the economic theory of the NCE. In fact, what emerges in the late 1970s is the way in which neoliberalism manifests as a state subjection of society to the economic assumption that the best mechanism for economic stability and preservation of individual freedom is the free and efficient market. This is precisely the foundation of the NCE. However, before bridging the MPS and the NCE the historical emergence of neoliberal ideology must first be delineated.

2.1 The Mont Pelerin Society and the Roots of Neoliberalism

The emergence of neoliberalism cannot be identified by a single school of thought or regional ideology. Neoliberalism, perhaps helping to explain its international reach, is rooted in a cross-continental ideological development that was a reaction to a complex confluence of social, political, and economic factors. Its economic roots emerged in the neo-Walrasian school that developed at the Cowles Com- mission; European continental schools such as the Austrian School of von Mises, von Hayek and von Böhm-Bawerk; the Ordo-liberal movement in Germany which included representatives of the Freiburg School including Walter Eucke, Wilhelm Röpke, Franz Böhm and Alfred Müller-Armack; the French neoliberals of the Colloque Walter Lippmann that included Andre Maurois, Bernard Lavergne and Jacques Rueff, and the English liberalism of the London School of Economics represented by Lionel Robbins and Edwin Cannan (Mirowski 2009 and Madra 2010).

It is important to understand what these collectives shared in common. As Mirowski argues, what brought these schools together is best exemplified in the Mont Pelerin Society, the society of intellectuals born from a “ loose group of economists, philosophers, and sociologists located in Paris [that] organized the Colloque Walter Lippmamm (Mirowski 2009 pp.12).” Founded in part by Fredrick von Hayek in 1947, the Mont Pelerin Society embodies the central tenets of the early neoliberals.[4] As

[3] To appropriate and extend a line from Karl Polanyi, “it means no less than the running of society as an adjunct to the market. Instead of the economy being embedded in social relations, social relations are embedded in the economic system.”(Polanyi 2001 p.60)

[4] Hayek states in the opening address to the MPS, “Effective endeavors to elaborate the general principles of a liberal order are practicable only among a group of people who are in agreement on fundamentals, and among whom basic conceptions are not questioned at every step (Hayek 1967 quoted from Mirowski 2009 p. 16).”

meeting ground for the representatives of the above-mentioned schools of thought the central ideology of the MPS was that,

> The market system is a spur to effcient production. Liberty itself depends on the free choice offered by market institutions and each advance of the public sector is a step along Hayek's "road to serfdom." The public sector is clumsy, ineffcient and bureaucratic. Its pricing policies lead to shortages (and restrictions of choice) which can be remedied only by pushing taxation to unacceptably high levels. As far as possible, state-provided services should be taken into the private sector on normal market principles except for those hard cases really needing direct state intervention. (David Collard 1968 quoted from Tribe, K. in Mirowski 2010 pp.90)

In essence, for the early neoliberals, "the question was no longer one of choosing between liberalism and state intervention: only the methods of interventionism remained to be determined (Mirowski 2009, pp.58)." This was a significant moment in economic history. The idea that the state was an available and necessary means, if directed correctly (i.e. away from planning and interference in economic affairs, for achieving the optimal market in its competitive and price stable form), signified an easing of previous tensions that had existed between economic theory and political and economic reality. And hence, "what distinguishes neoliberalism from classical liberalism is the inversion of this relationship between politics and economics. Arguments for liberty become economic rather than political, identifying the impersonality of market forces as the chief means for securing popular welfare and personal liberty (Tribe 2010 in Mirowski pp.75)."[5] Neoliberalism, thus attempts to be seen, as a scientific research program that employs its positive heuristic of "scientism" as the executioner operating Hume's guillotine. Severing the "political" from the "economic" was an essential canon for the neoliberals, and hence, the state was rendered inherently problematic in pursuing political objectives and needed to be re-conceptualized as an apparatus subject to the "economic." Understanding this theoretical nidus of neoliberalism we can now make the logical jump to Robert Lucas and the NCE.

3. The "Scientism" of Lucas and the Hegemony of the "Economic"

The New Classical Economics emerged in the 1970s. It was comprised of economists such as Robert Lucas, Thomas Sargent, Edward Prescott, Neil Wallace, Fynn Kyrland, Robert Borro, John Muth, and Lars Hansen. While each of these economists were pivotal in the NCE research program, Robert Lucas and "the Lucas critique" has become a particularly important representative and will, hence be the focus of this section.

To begin, the NCE is identified by a methodological superiority claim of microeconomic foundations, a revival of Walrasian general equilibrium theory,[6] rational expectations as the basic coordinates for economic analysis, and compositive subjectivism in the aggregation problems of macroeconomic theory. The NCE asserts the primacy of methodological individualism, which " takes on the extreme

[5] Also see Ellen Meiksins Wood (1995) "The Separation between the 'Economic' and the 'Political' in Capitalism" printed in Democracy Against Capitalism. Wood examines the way in which distinctively political issues become economic.

[6] General equilibrium analysis was the NCE's solution to the famous Cournot problem of overdetermination that states, "in reality the economic system is a whole of which all the parts are connected and react on each other. An increase in the income of the producersof commodity A will a ect the demand for commodities B, C, etc., and the incomes of their producers, and, by its reaction, will involve a change in the demand for commodity A. It seems, therefore, as if, for a complete and rigorous solution of the problems relative to some parts of the economic system, it were indispensable to take the entire system into consideration. But this would surpass the powers of mathematical analysis and of or practical methods of calculation, even if the values of all the constants could be assignedto them numerically."(Cournot 1927 p.127) But as Hoover (1998) argues, "In empirical practice the new classical response to the Cournot problem is simply to look the other way – treating aggregates and index numbers as if they should obey the principles of microeconomics."(Hoover 1998 p. 242) While a relatively trivial point of divergence, dealing with the Cournot problem is what separates the NCE from Friedman as he makes clear in his essay 'The Marshallian Demand Curve'(1949).

form of a representative individual with the perfect, if stochastic, foresight implied by rational expectations (Fine 2009 pp.291)." In essence, "The new classical economics is an attempt to regain the high road by applying microeconomic analysis to all economic problems." And as "Lucas casually, but self-consciously, presents new classical doctrine as the natural development of pre-Keynesian economic thinking – particularly of Hayek's theory of business cycles" (Hoover 1998 pp.231), the influence of the early neoliberals is clear. Indeed Lucas saw the " new classical theory as a movement away from Keynesian analysis and as technically superior but natural extension of the interwar views represented by Hayek."(Hoover 1998 pp.253 also See Lucas 1975)

However, what was the foundation of Lucas's "scientism" and what implications did the Lucas critique have on policy decisions and the "political" sphere from which it so desired to distance itself? Further, how was this extreme case of mathematical formalization of microeconomic foundations instrumental in the reification of the neoliberal project? This section will address the former question first, by identifying the scientific claims of Lucas and second by examining the way in which Lucas's scientifically superior method attempts to answer the nagging questions of policy relevance. A particularly illuminating way of doing this will be to use the Lucas Critique in Four-Point Framework (FPF) analysis of Spiegler and Milberg.

First, the emphasis of mathematical reasoning in the economic methodology of the NCE was nothing short of pervasive (See d'Autume and Cartelier 1997). As Lucas reflects in his memoirs, "I internalized. . . [the] view that if I couldn't formulate a problem in economic theory mathematically, I didn't know what I was doing. I came to the position that mathematical analysis is not one of many ways of doing economic theory: It is the only way. Economic theory is mathematical analysis. Everything else is just pictures and talk." This belief led Lucas, naturally to assert that "economists are in possession of a body of scientifically tested knowledge enabling them to determine, at any time, what. . . responses [to economic problems] should be (Lucas 1977)." It is clear that for Lucas, mathematics represented two vital characteristics necessary for achieving the scientific authority he so desired in economic analysis– precision and objectivity.[7]

> Lucas sets up an opposition between scientific research and research directed to answering policy questions. Scientific comes to mean removed from direct policy work, grounded in more fundamental analysis, research not directly influenced by policy and not subject to changes in public opinion, but rather full and thorough investigations undertaken by those not directly involved in policy decisions. Scientific work is separated from solving policy problems, from day-to-day economic management problems. In Lucas' view, management problems did not lead to scientific research or an increase in scientific knowledge. For Lucas, scientific work is uncontaminated by policy. (Rossetti 1990 pp.236-7)

If questions could be grinded through the process whereby they are formalized in terms of highly stylized mathematics and answered according to scientific models unencumbered by policy, they would inevitably emerge as objective, as would the answers. This process was central in Lucas's methodology; it was a scientific method and hence a superior one. It was also precisely what Lucas argued Keynes's theory contained, yet was unable to be usefully employed as it was too policy-laden and hence too politically- and value-laden. Therefore it was not scientific; it was just bad economics.[8] To get an idea of this "scientific" process let us take a closer look at the way a question becomes an economic question.

[7] As could also be added, transparency, rigor and conclusive demonstration. See Chick (1998) Backhouse (1998)

[8] Lucas attributes the emergence of this methodological process to Keynes, "The Keynesian Revolution was, in the form on which it succeeded in the United States, a revolution in method. This was not Keynes' (1936) intent, nor is it the view of all of his most eminent followers. Yet if one does not view the revolution in this way, it is impossible to account for some of its most important features: the evolution of macroeconomics into a quantitative, scientific discipline, the development of explicit statistical description of economic behavior, the increasing reliance on government officials on technical economic expertise, and the introduction of the use of mathematical control theory to manage an economy (Lucas 1978 in Rational Expectation p.296)." Obviously Lucas found some value in Keynes' theory, even if it just that part he appropriated, adulterated, and turned against Keynes.

To do this, let us employ the Spiegler/Milberg Four-Part Framework (FPF) approach that delineates the way in which answers to economic questions posed in ordinary language enter mathematical (i.e. scientific) language and reemerge as answers that constitute, in Lucas's terms, "the body of scientifically tested knowledge" that the economist possess.[9] And let us use the famous Lucas critique (1976) as a particularly illustrative and apposite example. Also, the FPF approach will be useful in not only identifying Lucas's claims of scientific merit, but also in determining the degree of seamlessness or discrepancy in the theory.

First, the delimiting phase of the Lucas Critique begins with the basic question posed in ordinary language; is economic forecasting for government policy effective with large-scale macroeconomic models? Posed in ordinary language, we must now examine how this questions gets filtered through the naming process, that is, how this ordinary question is translated into the cryptic language of a mathematically formal economic model. Regrettably, to answer this question effectively will require a terse reproduction of the models. Lucas begins with a classical difference equation that represents a dynamic economy,

$$y_{t+1} = f(y_t, x_t, \theta, \varepsilon_t) \tag{1}$$

where $f(\bullet)$ and the parameter vector θ are derived from optimal and rational decision rules of individual agents and x_t is the forcing sequence. Looking then at the "likelihood of systematic 'parametric drift' in the face of variations in the structure of shocks... it should be possible to confirm them by examination of the specific decision problems underlying the major components of aggregative models (Lucas 1981 pp.111)."

Second, Lucas constructs a theoretical agent in this economy. For this agent's consumption, Lucas adopts Friedman's formulation where permanent consumption is proportional to permanent income and all moments are true moments known by the rational agent.

$$\begin{aligned} c_{pt} &= ky_{pt} && (2)\\ \text{actual consumption } c_t &= c_{pt} + u_t && (3)\\ \text{current income } y_t &= y_{pt} + v_t && (4) \end{aligned}$$

Therefore, the short-run marginal propensity to consume is

$$k\frac{Var(y_{pt})}{Var(y_{pt}) + Var(v_t)} \tag{5}$$

As permanent income is a constant flow, y_{pt}, with subjective discount factor β, the forecasted income stream for the agent conditional on information (I) at time t is

$$y_{pt} = (1-\beta)\sum_{i=0}^{\infty}\beta^i E(y_{t-1}|I_t) \tag{6}$$

now if actual income is a sum of a, w_t, and v_t where a is a constant v_t is transitory income and w_t is a sum of independent increments, and the minimum variance estimator of y_{t+1} is $(1-\lambda)\sum_{j=0}^{\infty}\lambda^j y_{t-j}+u_t$

[9] The FPF goes as such: "1. Delimiting, in which the set of social phenomena under study is delimited and a research question is formed; 2. Naming, in which a mathematical construct meant to be analogousto the social phenomena is introduced, along with a " catalog of correspondences" which links elements of the construct with elements of the phenomena under study; 3. Solution, in which the mathematical construct is brought to a solution; 4. Interpretation, in which the mathematical solution and its implications are interpreted with respect to the research question."(Spiegler and Milberg 2008)

where λ is then the policy variable, then we can express the empirical consumption function as

$$c_t = k(1-\beta)y_t + k\beta(1-\lambda)\sum_{j=0}^{\infty} \lambda^j y_{t-j} + u_t \tag{7}$$

Now having derived an objective representation of all agents, it must follow from the above equation that if an agent is aware of a policy change "taking the form of a sequence of supplements $\{x_t\}$ to the consumer's income from time T on, the standard method of adding x_t to the forecasts of y_t for each $t > T$, then inserting this into the above equation to obtain new forecasts of c_t will give incorrect forecasts." Hence, Lucas concludes that simulations based on this rational agent will always lead to incorrect forecasts, so policy aimed at influencing consumption can overcome this problem only by 'fooling' consumers, but as Lucas laments, "it will not be at all clear how to apply (1)-(4), and hence impossible to forecast."

Therefore, Lucas proffers a superior model for macroeconomic forecasting.

$$y_t = \bar{y} + \alpha(p_t - {}_{t-1}p_t^e) + \varepsilon_t \tag{8}$$

where y_t is output $\bar{y}$ is constant natural rate of output, α is a constant, p_t is the actual price level, ${}_{t-1}p_t^e$ is the expected level of prices in time t by agents in time $t-1$ and t is a stochastic serially uncorrelated error with mean zero. Monetary policy is the choice of λ, a fixed rate of growth for the stock of money in the policy model

$$m_t = \lambda + m_{t-1} + e_t \tag{9}$$

and lastly the rational expectation model

$${}_{t-1}p_t^e = E(p_t \mid I_{t-1}) \tag{10}$$

plays an essential role where I_{t-1} is the information available to the agent at time $t-1$. Now in order to show that the policy parameter does not enter into the output equation we simply take the expected value of the ration choice model

$${}_{t-1}p_t^e = E(p_t \mid I_{t-1}) = \lambda + m_{t-1} - \bar{y} \tag{11}$$

substitute the policy model into the aggregate demand model $p_t = m_t - y_t + u_t$ where u_t is a stochastic error term for velocity shocks

$$p_t = \lambda + m_{t-1} + e_t - y_t + u_t \tag{12}$$

subtract 11 from 12

$$p_t - {}_{t-1}p_t^e = \lambda + m_{t-1} + e_t - y_t + u_t - \lambda - m_{t-1} + \bar{y} \quad (13)$$
$$= \bar{y} - y_t + e_t + u_t \quad (14)$$

which we plug back into our output formula 8 to get our solution phase of the FPF

$$y_t = \bar{y} + (1-\alpha)^{-1}[\alpha(u_t + e_t) + \varepsilon_t] \quad (15)$$

and clearly λ does not enter our final output equation.[10]

Following the solution phase of the FPF we see that according to 7 and 15, Lucas's interpretation of the solution and answer to the question of policy effectiveness is that first, "For policy, the central fact is that Keynesian policy recommendations have no sounder basis, in a scientific sense, than recommendations of non-Keynesian economists, or for that matter, noneconomists (Lucas and Sargent 1981 p.304)." And second, according to the superior rational expectation model, policy is completely ineffective in that "The only scientific quantitative policy evaluations available to us are comparisons of the consequences of alternative policy rules." By examining the Lucas critique in the FPF what it means for Lucas to do economic science becomes explicit. The system of equations behaves according to the laws of mathematics and by setting the appropriate parameters based firmly in rational expectations any attempt to alter the monetary base will necessarily be anticipated and thus futile.[11] The model, firmly resolved, unequivocally answers the question of policy effectiveness.

However, it also becomes clear that this apparently seamless method for doing economics has not necessarily come full circle. That is, it has provided a "quasi-model" that is "a hybrid articulation that expresses the structure of the model informally, using the ordinary language names of the phenomena of interest... [which] is an embodiment of the conjecture that the model's structure represents." But, it must be underscored that Lucas has not necessarily fully justified his solution in his interpretation. We are left, as we are so often with "scientific" economics, with a hybrid answer to a mathematical problem "That is a conflation of the Solution phase and the Interpretation phase." Which " amounts to reporting the Solution as a conjecture (i.e. that the solution to the mathematical model also represents a solution to the social puzzle articulated in the Delimiting phase) rather than a true (i.e. internally consistent) mathematical statement (Spiegler 2010)." Lucas's formalization is thus an implicit construction of an economic reality that obeys the model's objective laws, it is clear however, that the process of applying this "economic reality", no matter how complex the mathematics are, to the real world is anything but smooth (Benetti and Cartelier in d'Autume 1997). While the Lucas critique may seem extravagant in this framework, as Lance Taylor points out, "The idea sounds sensible, but Lucas's view of its practical implications does not fit common sense. The sensible bit is that policies based on observed past macro relationships may neglect consequent behavioral changes by economic agents, which, when added up, change the relationships themselves."(Taylor 2011 pp.231) That is, while the Lucas critique contains a hidden logic of procedural rationality, Lucas's assertion that this rationality is infinitely optimal and unencumbered by uncertainty is highly insensible.

For Lucas, mathematics is the language of science and that which constitutes good economics; for the NCE, to do economics is to mathematically model the abstract world; and to understand that math is to understand the economy. To understand the economy is the scientific specialty of the economist, hence, the ability of the economist is not unlike the ability of the engineer. To illustrate this Lucas proffers an illuminating analogy, "I believe that one who claims to understand the principles of flight can reasonably be expected to be able to make a flying machine, and that understanding business cycles means the ability to make them too, in roughly the same sense (Lucas 1981 p.8)." Examining, however, the process for understanding the principles of economic flight it becomes clear that there exists a

[10] See Hoover 1998

[11] For critiques on the laws of algebra in economic applications see Shaikh 1974.

cleavage between a mathematically consistent solution and a solution consistent with the reality it seeks to model. One major drawback for those who claim to understand the dynamics of flight is facing the reality that they may only understand the dynamic of falling. So while we may act as if we were flying, it would be seriously misleading and potentially quite dangerous to model the way we behave as falling bodies and call it flight. There is the recourse though; that those theorists will eventually all hit the ground. How many they take with them will depend on other factors.

In the protective belt of economic scientism, Lucas absolves himself from any normative responsibility. Lucas's " argument removes the need for the economist to give advice of the form, 'If you wish to achieve X, then do Y', or criticism of the forms, 'Given its goals, the policy was badly chosen.' Instead the economist stands as a spectator who simply seeks to understand in what way policies are optimal (Hoover 1998 pp.85)." As Lucas himself points out, economists " need to think of policy as the choice of stable rules of the game, well understood by economic agents (Lucas and Sargent 1981 pp.317)." But, like Popper's falsificationism in The Logic of Scientific Discovery, Lucas has " provided a set of rules for the game of science [economics] without providing an ultimate aim or purpose for playing the game (Hands 2001 pp.281)." That is, because the praxeology and extreme a priori deductive logic of Lucas's methodology simply cannot provide a basic set of coordinates on which to formulate economic questions, we are reduced instead to merely formalizing the questions.[12]

Take as a last example the question of involuntary unemployment; " New classical economics increases the (endogenous) explanatory power of neoclassical economics by defining 'unemployment' in a manner consistent with microeconomic theories of behavior. The loss of the voluntary/involuntary distinction means that agents can no longer be involuntarily consigned to a state of nonwork. The individual is optimizing subject to constraints of job offers, wages, and preferences." Hence, " We can shift decision on unemployment policy from the political sphere to the sphere of economic analysis (Rosetti 1990 pp.234-5)." It must be stressed that the questions the NCE formalizes are irreducibly normative and political questions.

This tension is ubiquitous in Lucas's work, when asked about the importance in the normative and positive distinction Lucas responds, " politics and the political role that economists play has had a very bad effect on macroeconomics. A lot of older economists seem to me [Lucas] to be solely concerned with politics, as opposed to scientific matters. People are asking the wrong questions; they are taking questions from Washington, rather than thinking about what's puzzling them or taking more scientific points of view... [but] I'll often think of hypothetical policy questions, when I'm doing some theoretical work, just to force myself to be clear on what question I'm asking and what it would mean to have an answer to it." (Klamer 1983 pp.52-3) Naturally, Lucas understands that the state is the institution that ultimately exercises the greatest influence on the economy, however, he seems truly unable to grasp the fact that this institution always operates within a historical, social and cultural context and that issues such as unemployment of labor are not a transhistorical phenomenon; it had developed pari passu with industrial capitalism. But, reducing these essentially normative questions to the scientism of the economic is a very effective process as problems such as involuntary unemployment become unintelligible. Instead they conform to a "natural" rate consistent with logic of the general equilibrium framework.

In essence, " Economics cannot address these issues, which arise from involuntary unemployment, because the concept itself is not an economically meaningful one." Truly, by inverting Descartes famous

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[12] The motivation, however, for formalizing these questions is often more consistent with expanding the logic of the model rather than expanding the domain of social inquiry. "The mathematization of general equilibrium theory, for example, was motivated not so much by the need for quantitatively more precise theoretical prediction to support empirical research, as by the need to demonstrate the logical consistency of the laissez-faire approach, as a buttress to its ideological claims... If anything, the theory is a kind of dead hand on econometric practice, requiring the embedding of simple ideas in complex models before measurement proceeds." Therefore, "Social theories can achieve their ideological and interpretive aims without fulfilling their explanatory and predictive ambitions. To teach us that market economies function to achieve an efficient allocation of existing resources, reflecting but not altering the existing distribution of wealth, general equilibrium theory does not need to identify law like regularities (Foley in D'Autume 1997 pp.223-4)." This method has led to powerful justification of a natural rate of unemployment and the distribution of wealth, which were the main concerns of Keynes and precisely what the NCE aimed to disembedded from economic theory as purely political and biased concerns. See section three below.

saying that the world is for us to discover not demonstrate, if rational agents are merely demonstrating (i.e. reveling) their preferences and objective utility functions, the only logical role for the state is reduced to facilitating the efficiency of the conditions under which these agents act.

So is unemployment bad? We simply cannot say, for the economist it merely is. In the end, what is most important for Lucas and new classical economics is a severing of the economic from the political, a critical and necessary split in decontaminating economic science from any historical or social determination of the body economic. The relation of the two in Keynesian economics was precisely from what Lucas wished to distance economics. It had provided an explicit interventionist role for the state in the economy and was incompatible with the neo-Walrasian theoretical framework. Indeed, Lucas goes so far as to say the only social injustice in the capitalist system is the government.[13]

> Lucas not only considers economics and politics as distinct, he places them in a hierarchy, with economics on top. He couches this movement in scientific, objective terms. . . Lucas implies that science (here economics) can be done objectively and so is preferable to political decisions, which are intrinsically biased. (Rossetti 1990 pp.239)

The main problem for Lucas was the explicitness of economic theory in gearing policy towards pursuing full employment and income redistribution. These Keynesian political objectives had turned scientific economic rationality on its head and it was the job the NCE to turn it back. The economic discourse in the Keynesian era had focused too much on "market failures" that related to the problems of monopoly, public goods, and externalities rather than the more inherent problems of "government failure." The NCE go so far as to see "the labor-market innovations of the New Deal as market distortions rather than corrections of market failures. As such, these innovations lacked an economic efficiency rationale, and could at best only be justified for reason of equity (Palley in Saad-Filho 2005 pp.22-3)." As equity was an essentially normative question it had no place in rigorous economic theory. "The policy implication is that macroeconomic policy makers should discard Keynesian policies of activist demand management aimed at full employment." In the end, the state really only ought to "adopt transparent policy rules that take the discretion out of policy decisions, thereby avoiding policy mistakes and letting market forces solve the problem (Palley 2005 pp.23)."

Invoking images of Humes's guillotine, the "scientism" of Lucas and the NCE had severed the "political" from the "economic". " The implication is that if the economy is to function efficiently, it needs to be protected from these [policy] effects – insulated from the political sphere (Rossetti 1990 pp. 235)." What remains to be addressed is how this separation played into the rise of neoliberalism.

4. The Neoliberalism of the New Classicals

There are many well explored investigations as to how Lucas and the NCE were heavily influenced by Hayek and the Mont Pelerin Society.[14] (See Vaughn 1994, Hoover 1998, Fine 2009 e.g.) Therefore, this section will be refined to examining the way in which the NCE adoption and "scientific sophistication" of the neoliberal ideology of Hayek and the Mont Pelerin Society was instrumental in setting the stage for the modern neoliberal revolution.

To unravel the last part of this narrative, it must be stressed that the revival of microeconomic foundations and Walrasian general equilibrium analysis (*a la* Arrow Debreu, 1954; Debreu, 1959) described above was not all that novel. What separated these theories' revival from their inception was

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[13] See Klamer 1981

[14] Lucas is in fact a current member in the Mont Pelerin Society.

more or less the strict mathematical formalization of the models within a particular historical framework. When " economists had begun to look at economic policy in new ways, seeing government failure as a problem that needed to be overcome...They pushed the new ideas developed in academia into the public arena and into policymaking circles. They also 'thought the unthinkable', very publicly, for many years, when few academic economists were doing so, preparing the ground for academic economists and policymakers, when faced with a dramatic economic shock, to consider ideas that would not previously have been taken seriously. Such an interpretation would vindicate Hayek's view of how ideas changed (Backhouse 2005)."

As is well documented by Morgan and Rutherford (1998), this was elemental in the general shift of postwar economic theory away from pluralism and towards finally fulfilling the Jevonian promise of economics becoming a hard science through its use of technical language and mathematics (See Weintraub 1998, Morgan 1998, d'Autume 1997). I argue that it was this methodological shift within the historical circumstances of the 1970's economic crisis that set the stage for the rise of modern neoliberalism. That is, with the "failure" of the Keynesian research program, Lucas and the NCE were able to take advantage of (in large part by creating) the vacuum of theory in economics. Their success was largely attributable to condemning Keynesian theory for being an ideological political program laden with normative questions of equity that inherently revolved around involuntary unemployment and income distribution. In exchange, they proffered a scientifically [mathematically] superior alternative that conveniently justified the state of the economy irrespective of income disparities and persistent unemployment. In short, for Lucas and the NCE, " redistribution, i.e. ex post change in income distribution, or social protection, i.e. an attempt to limit the rigour of competition, is considered illegitimate" (Amable 2010); intervention that's enormity was tantamount to social injustice (Klamer 1984 pp.52). Hence, Lucas calls for a wholesale rejection of state regulation across all "economic" realms.

Deregulation, however, is a crude misnomer, and the anti-interventionist rhetoric of the NCE must be considered as a particular reaction to Keynesian style intervention. Like the neoliberals of the Mont Pelerin Society that so heavily influenced Lucas and the NCE, the type of intervention the NCE sanctioned was an implicit intervention in society by a reconfigured state that exercised its power over individual agents behaving rationally within free markets. Can we then understand the methodology and meta-theory of the NCE as not just a progeny of the early neoliberals, but in a sense, a reification of neoliberalism? While it would be hard to say that Lucas and the NCE explicitly endorsed a neoliberal political agenda towards a biopolitical form of governmentality, due to the fact their entire objective was to shed any and all political affiliation, they can nevertheless be seen as instrumental in setting the meta-theoretical ground upon which modern neoliberalism could emerge. Of course, it would seem just as absurd to think Lucas, like his scientific models, was apolitical and objective; devoid of any ideological contamination. But, as Michel De Vroey, after sifting through the archives of Lucas's published and unpublished works, points out, despite whatever Lucas's personal ideological biases, his theory and methodology " did not need to act upon a political agenda because that the job of gearing theory towards a political agenda other than the Keynesian one had already been carried out by Milton Friedman. Hence they could concentrate on working, as pure technicians, on the conceptual and technical modifications that would provide firmer ground for Friedman's policy conclusions. In other words, it seems that a division of labor occurred implicitly, with Friedman doing the political job, and the next generation undertaking the theoretical developments needed to underpin the political agenda initiated by Friedman (De Vroey 2011)."

While the famous Lucas critique (1973) of the ineffectiveness of government policy bespeaks the particularly aggressive nature of the NCE towards government intervention, Lucas could not reasonably call for a wholesale abandonment of the state. As mentioned earlier, Lucas was not under any sort of extreme delusion that there was no role of the state in a capitalist economy. Instead, Lucas was calling for a transformation of the role of the government, rejecting interference in the market in favor of a facilitation of the market based on scientific logic of general equilibrium and rational expectations. It is obvious, " this transformation did not entail the disappearance of the state, but rather manifested itself in the transformation of how the state exercises its sovereignty according to the logic of 'economic incentives' (Madra 2010)."

A major part of engendering this transformation was the particular role economists had come to serve by the 1970s. By the time of the NCE main writings, as Roger Backhouse (2002 pp.288) argues, economists' role in government and international organizations had become institutionalized with distinctive policy concerns. This was a significant difference between the pre-Keynesian neoliberalism and its revival in the NCE. Government, beginning with era of New Deal state capitalism and through the age of Keynesianism, became acclimatized to the influence of economists and was, in fact, the employer of a great deal of them. It is no wonder then that the rise of neoliberal ideology with the academic vanguard of NCE in the economic discipline concluded with the election of Ronald Reagan in the United States.

Indeed, "The influence of Lucas on macroeconomics during the neoliberal period has been broad and persistent, above all, because it stresses the inherent market-clearing properties of the capitalist economy. In effect, Lucas has resurrected Say's Law, claiming that long-lasting excess supply is not possible. If there is unemployment that is the result of government policy itself, i.e. of wrong- headed attempts to force aggregate output above levels warranted by the free economic choices of those who participate in the capitalist economy(Lapavitsas in Saad-Filho 2005 pp.34)." This "wrong- headedness" of government captures precisely the idea that the governement itself, if right-headed, can exist as powerful means for benefiting capital. Policy, having thoughout the postwar period been geared towards "imprudent endeavors" such as unemployment and welfare, needed only the wholesale resurection of market rationality *a la* Say's law and the Lucas Critique to justify the overhaul of the existing policial structure in the neoliberal revolution.

5. Concluding Remarks

The history of neoliberalism is complex. What began at the Mont Pelerin Society in 1947 must not be seen to have petered out; instead it must be seen as the grounds on which we can better understand the modern neoliberal era. The ideas of Hayek and his counterparts must be taken within a broader historical context. It is important to underscore that "neoliberalism has not existed in the past as a settled or fixed state, but is better understood as a transnational movement requiring time and substantial effort in order to attain the modicum of coherence and power it has achieved today (Mirowski 2009 pp.426)." The work of the early Mont Pelerin Society "was based on the premise that disinterested social-scientific inquiry could, even if only in the long-term, contribute to better policymaking(Backhouse 2005)." This paper has argued that the NCE has been pivotal in achieving this coherence in several significant ways: the methodological shift in economics towards an authoritative "scientism," the separation of the "political" and the "economic" spheres, and the concomitant reconfiguration of the state as a subordinate to the economic sphere.

Neoliberalism was not simply the product of a political shift in England and the United States; it emerged early in the interwar period as strategy of restructuring the metabolism between the state and economy. The intellectual thought collective of the MPS set the theoretical coordinates for this restructuring by arguing for the unrestricted domain of the market and a complicit state. The NCE subsequently set the methodological coordinates by elevating the rationality of the market to the status of scientific law. As Mirowski remarks on the early neoliberal project, " It was primarily a quest for alternative intellectual resources to revive a moribund political project. It was flexible in its intellectual commitments, oriented primarily toward forging some new doctrines that might capture the imaginations of future generations (Mirowski 2009 pp. 15)." As I have argued, these ideas captured the imaginations of the New Classical Economists in many ways.

The technical methodology of the NCE laid claim to a scientific prerogative that was accepted as inherently superior to the existing (Keynesian) macroeconomic doctrine as it was apolitical, objective, and rigorous in logic. The result was a reconceptualization of the state along the purely "disembedded" economic logic consistent with the neoliberal notion of governmentality. Coupled with the cannon of hyper-rationality, the mechanism of scientific logic in the NCE has been extremely effective in instilling a "rational" justification for the neoliberalism envisaged by the MPS.[15]

[15] See Habermas 1968, Marcuse 1964, and Wood 1995

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