12. Competing Rationalities and Marginalism: Revisiting the Rational Ideal

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Abstract

Marginalism, a foundational concept in neoclassical economics, introduced the idea of 'thinking at the margin', a model of rational decision-making based on subjective value and individual utility maximisation. Developed as a critique of the Labour theory of value, marginalism marked a shift toward individualist and formal definitions of rationality. This paper aims to explore and draw connections between the various schools of economic thought–classical, Sraffian, institutionalist, and Post Keynesian, who have engaged with and reevaluated this dominant view. By tracing these developments, we aim to understand the intellectual and political underpinnings of these theories. The paper aims to explore how assumptions about rationality evolve with context and power, and how this evolution influences who economic theory is built to represent.

Keywords

- Rationality
- Marginalism
- History of Economic Thought
- Heterodox Economics
- Value Theory
- Economic Methodology

Introduction

Economic theory has long treated rationality as a foundational principle for explaining and predicting individual decision-making. It anchors the assumption that agents make choices aimed at maximising utility. Yet, the meaning of "rational" has never been fixed. Across the history of economic thought, definitions of rationality have diverged sharply, from labour- and production-based models in classical political economy to the individualistic, preference-centred frameworks of the marginalist tradition. Despite claims to universality, economic models rest on historically contingent and culturally embedded assumptions about human behaviour, agency, and value.

How do economic theories define rationality, and what kinds of agents do these definitions bring into view? This paper argues that rationality in economics is not a neutral or universal principle, but a concept loaded with theoretical and normative assumptions. Across different schools of thought, definitions of rational behaviour determine which decisions and agents are treated as legitimate within economic mod-

els. From classical political economy and marginalism to Sraffian critiques, Post-Keynesian uncertainty, and Institutionalist perspectives, conceptions of rationality evolve and with them, the image of the "rational" actor. Rather than treating rationality as a fixed benchmark, we show it reflects shifting assumptions about human behaviour, economic structure, and the meaning of value. By comparing how these traditions construct economic decision-making, this paper reveals the political and philosophical stakes embedded in what often appears to be a purely technical idea.

The historical foundations of this debate are especially visible in the work of Adam Smith, whose treatment of value anticipates many of the tensions that would later define rival conceptions of rationality. His contributions reveal the early instability of economic reasoning around utility, preference, and moral judgment, long before these terms were formalised in the language of modern theory.

The early paradoxes of defining value and the Marginal Revolution

Adam Smith's reflections on value occupy a foundational place in the intellectual history of economics, particularly in shaping early ideas about rationality and economic behaviour. Drawing on Aristotelian distinctions between use value and exchange value, Smith advanced a framework that acknowledged both the utility of goods and their market valuation. His well-known diamond-water paradox posed a lasting challenge to economic reasoning: why do goods essential to human survival, such as water, command far lower prices than luxuries like diamonds? (Staff 2025). In *The Wealth of Nations*, Smith responded with a labour theory of value, arguing that, under competitive conditions, commodities tend to exchange in proportion to the labour embodied in their production (Halton 2023). Yet this account coexists uneasily with his recognition that market prices are shaped by subjective perception and context-specific preferences. Smith's engagement with paradoxes of valuation signals a deeper philosophical commitment: that economic worth cannot be understood purely through labour input or price mechanisms alone. In acknowledging the role of perception, moral sentiment, and human need, he leaves open the possibility of a more complex, socially embedded conception of rationality, one attentive to moral judgment, historical context, and the heterogeneity of human motivation.

It was precisely this tension between objective accounts of value and the role of subjective judgement that set the stage for the marginalist redefinition of rationality in the late nineteenth century. The marginalist revolution, led by William Stanley Jevons, Carl Menger, and Léon Walras, inaugurated a fundamental reorientation in economic thought. Rather than attempting to reconcile use value with labour-based theories, these thinkers resolved the paradox of value by shifting analytical focus from total utility

to marginal utility: the additional satisfaction derived from consuming one more unit of a good (Boettke 2020). This conceptual move introduced a markedly different vision of the economic agent. Where Smith had left space for moral sentiment and embedded judgment, the marginalists posited a fully rational, optimising subject, abstracted from history, society, and ethics; whose decisions were guided exclusively by the calculus of marginal gains. Value, accordingly, was no longer anchored in production conditions or collective needs, but in individual preferences, formalised and ranked. While this framework allowed for mathematical tractability and formal elegance, it also delimited the scope of rationality, constraining it to the realm of internally consistent choice behaviour and crowding out broader philosophical questions about purpose, context, and meaning (Halton 2023).

This shift did more than reinterpret Smith's paradox; it inaugurated a new epistemology of economic behaviour, one that privileged abstraction, mathematical formalism, and atomised individual choice. Marginalist analysis redefined rationality as the capacity for calculative optimisation, rooted in subjective preferences and expressed at the margin. Yet for all its formal elegance, this framework harboured unresolved tensions. Chief among them was the ambiguity over whether utility should be treated as cardinal measurable or merely ordinal, a conceptual instability that would haunt subsequent developments in consumer theory. In recasting rationality as a strictly quantifiable and individualistic principle, marginalist thought simultaneously broadened the analytic reach of economics and narrowed its conception of human agency. What emerged was a powerful but restrictive model: one that enabled new mathematical tools while abstracting away from history, ethics, and social embeddedness.

Francis Ysidro Edgeworth, a central figure in the marginalist tradition, was instrumental in formalising economic analysis through mathematical abstraction. Grounded in utilitarian philosophy, Edgeworth conceptualised economic agents as pleasure-maximising entities, capable of making decisions via quantitative calculus. Utility, in his formulation, was not a mere heuristic but a theoretically measurable magnitude, most famously illustrated by his imagined "hedonometer," a device meant to register the intensity of individual pleasure (Sen 1977). This vision of economic rationality gave rise to analytical tools such as indifference curves, which mapped combinations of goods yielding equal satisfaction and provided a geometric representation of preference. Through these innovations, Edgeworth advanced a vision of rationality as continuous, internally consistent, and amenable to optimisation, an approach that would shape the trajectory of neoclassical economics for decades to come.

At the core of Edgeworth's model lay the principle of diminishing marginal utility, the idea that each additional unit of consumption yields progressively less satisfaction. This concept enabled a more granular and individualised conception of rationality, in which choice was rendered as marginal adjustment along a continuous, differentiable utility s-

urface. The economic agent, in this formulation, became a fully optimising calculator: self-contained, internally coherent, and stripped of historical, institutional, or ethical context. This formal abstraction of the agent would crystallise into the defining architecture of mainstream economic reasoning, privileging mathematical tractability over social complexity.

While Edgeworth's formalisation of marginal utility advanced the internal coherence of neoclassical theory, it also deepened the abstraction of the rational agent-removing economic behaviour from historical, institutional, and ethical context. This conceptual narrowing would not go unchallenged. In the mid-20th century, a series of critiques emerged that directly contested the marginalist framework, not merely on technical grounds, but on the deeper epistemological assumptions it carried about rationality and agency.

Structural critiques and the return to classical surplus

Piero Sraffa's *Production of Commodities by Means of Commodities* (1960) represents a decisive structural repudiation of marginalist economics (Economic and Political Weekly, 2022). Though not framed explicitly in terms of rational behaviour, Sraffa's rejection of marginal productivity theory and subjective utility reflects a fundamental discomfort with the neoclassical conception of the rational agent. By reviving the classical surplus approach, he redirects analytical focus from individual preference to the objective mechanics of production and distribution, implicitly dismantling the idea of rationality as a universal, context-free logic.

In contrast to the optimising individual of marginalist theory, Sraffa foregrounds systemic relations, arguing that value and economic behaviour emerge from structural conditions, not atomised decisions. This reorientation catalysed a broader heterodox response. Post-Keynesians, building on Keynes's notion of fundamental uncertainty, reject the assumption of calculable futures and stable expectations, emphasising instead the indeterminacy that economic agents must navigate (Mariani 2023). Institutionalists, in parallel, argue that rationality is never abstract or innate, it is socially constructed, historically situated, and mediated by evolving norms and institutions.

Together, these critiques advance a shared claim: rationality is not a neutral or fixed epistemic standard, but a contested and contingent category. Sraffa's intervention, while formally technical, signals a deeper rupture, destabilising the marginalist model and exposing the conceptual fragility of the rational agent it enshrines.

Social Embeddedness and Institutional Rationality

While Sraffa and other heterodox thinkers challenged the structural assumptions of neoclassical economics, another line of critique emerged that targeted the psychological and sociological premises of the rational agent itself. Where Sraffa exposed the fragility of marginalist value theory, thinkers such as Thorstein Veblen, John Commons, and later Amartya Sen interrogated the very anthropology embedded in economic models, the assumptions about what kind of person economic theory imagines and legitimises.

Veblen was among the earliest and most incisive critics of *homo economicus*. He regarded the figure not simply as unrealistic but as intellectually vacuous, deriding it as a "lightning calculator of pleasures and pains" (Veblen 1899). For Veblen, human behaviour could not be reduced to rational utility maximisation. It was shaped by a complex web of habits, social norms, institutional arrangements, and status-seeking impulses. Against the thin, hedonistic psychology of marginalism, he proposed a theory of behaviour grounded in cultural and evolutionary dynamics. Economic actors, he argued, were not atomised optimisers but socially embedded beings, animated by customs, emulation, and reputational concerns.

This critique required a methodological shift. Economics, in Veblen's view, could not remain a static, axiomatic science. It had to become historical and evolutionary, attuned to the cumulative development of institutions and the material conditions of production and technology (Veblen 1898). Rationality, for Veblen, was not a universal faculty but a contingent, historically shaped mode of reasoning. The industrial age, with its technological complexity and changing social forms, rendered the neoclassical ideal of mechanical optimisation not only implausible but conceptually obsolete.

This socially embedded conception of rationality was extended by institutional economists such as John R. Commons. Commons shifted the analytical unit of economics from the individual to the transaction, conceived not as a simple exchange, but as a complex social and legal process involving negotiation, power, and cooperation (Commons 1931). Economic behaviour, he argued, could not be disentangled from the legal norms, property rights, and institutional arrangements within which it occurred. He developed a novel theory of pricing that distinguished between relative scarcity, driven by market dynamics, and proprietary scarcity, imposed through institutional mechanisms such as patents or legal monopolies. Rationality, in this view, was inseparable from the normative and structural features of economic life (Takahashi, n.d.).

In a more formalised idiom, Oliver Williamson brought institutional theory to the centre of economic analysis. In *The Economic Institutions of Capitalism*, Williamson challenged the neoclassical assumption that coordination occurs primarily through markets and prices. Drawing on Herbert Simon's concept of bounded rationality, he argued that economic agents are not omniscient optimisers, but cognitively constrained actors navigating uncertainty (Williamson 1987). This creates transaction costs, monitoring, enforcement, and negotiation that institutions exist to mitigate. Rationality, here, is not an ideal standard but a pragmatic mode of behaviour, shaped by the architecture of rules, routines, and organizational forms (Hennart and Verbeke 2022).

Ethical expansion: Amartya Sen and the limits of Preference-Based Rationality

Amartya Sen's *Rational Fools* crystallises many of these critiques into a direct challenge to the marginalist model of decision-making. Taking aim at Edgeworth's conception of self-interest as preference consistency, Sen argued that such models place an untenable conceptual burden on human behaviour (Sen 1977). If preferences are defined purely through observed choices, and if rationality is reduced to internal consistency, the model strips away any meaningful account of motivation, normativity, or ethical deliberation.

To recover these dimensions, Sen introduced two key concepts: sympathy and commitment. Sympathy describes an emotional disposition where individuals derive satisfaction from others' well-being, motivating behaviour that deviates from self-interest without violating rational coherence. Commitment goes further, invoking ethical reasons for action that cannot be captured by personal gain. This is not irrationality; it is an expansion of what rationality can encompass.

Sen's argument demands a richer model of preference, one that incorporates moral reasoning, value commitments, and meta-rankings. Human action, he insists, cannot be reduced to utility calculus or formal consistency. His critique is not utopian but realist: people routinely act in ways that reflect duties, identities, and solidarities. To ignore this is to construct a model of agency so narrow that, as he famously remarked, "the purely economic man is indeed close to being a social moron."

Sen's intervention, while philosophical, builds on the empirical and institutional critiques of Veblen, Commons, and Williamson. Together, they dismantle the idea of rationality as a context-free, utility-maximising logic. Instead, they offer a model of economic agency that is situated, institutionally embedded, ethically aware, and historically conditioned. From the inertia of habit to the force of moral conviction, they

show that economic reasoning is plural and contested, not reducible to any singular calculus of preference or price.

What emerges from this intellectual trajectory is not merely a critique of particular models but a deeper reconsideration of what it means to be rational in economic life. Despite the analytical and mathematical elegance offered by the marginalist tradition, it obscures the moral and institutional dimensions of economic life, narrowing rationality to calculated optimisation. However, its critics are also not without their own blind spots. Sraffian and classical economists often avoid the questions of experience and motivation, treating individuals as passive bearers of economic relations rather than as decision makers with their own agency. The attempts by post-Keynesians to foreground uncertainty, social norms, and the embeddedness of choice sometimes overlook the formal clarity required to offer predictive models. Even Sen's ethical expansion of rationality, though normatively compelling, fails to resolve the middle ground in moral reasoning and economic analysis without crumbling into descriptive idealism.

Across classical, neoclassical, and heterodox traditions, the figure of the rational agent shifts from an intuitive moral actor to a mechanised optimiser, only to be reconstituted as a socially embedded, ethically responsive, and cognitively bounded subject. Rationality, in this light, is not a neutral analytical tool but a deeply political and philosophical construct, one that encodes specific assumptions about human nature, agency, and value. Placed side by side, these divergent models reveal that rationality does not evolve as a clearer picture of human behaviour but as a conceptual boundary that each tradition reshapes to stabilise its own understanding of the economy. The comparative lens therefore shows that rationality is less an empirical description than a methodological decision about what kinds of motives and contexts economics chooses to treat as meaningful. To treat it as a universal constant is to obscure the historical struggles and conceptual choices that have shaped economic thought. A more honest economics must confront this plurality, not evade it, recognising that how we define rationality is never just a technical matter, but a normative and epistemic commitment to a vision of the human.

Tracing the competing definitions of rationality across the varying traditions reveals not a linear progression toward a more accurate model of human behaviour, but a series of conceptual choices shaped by historical context, political commitments, and philosophical assumptions. Each tradition constructs a different kind of economic agent, whether an intuitive moral actor, a mechanical optimiser, a bearer of structural relations, or a socially embedded and ethically responsive subject. These differences are not merely technical: they express fundamentally different visions of what the economy is and how human beings reason within it. This diversity raises a final question: Can pluralism itself serve as a methodological stance for economics? If rationality is historically contingent and internally contested, insisting on a single, univ-

ersal model becomes less a scientific necessity and more a normative imposition. Methodological pluralism does not imply that all models are equally valid, nor that economics must abandon formal reasoning. Instead, it treats theories as tools whose usefulness depends on the phenomena under investigation. Marginalist optimisation may illuminate consumer choice under stable conditions, but institutionalist or post Keynesian frameworks may better capture behaviour under uncertainty, conflict, or evolving norms. Pluralism acknowledges that no single model can encompass the full range of economic motivations, contexts, and power relations.

Recognising rationality as a contested concept does not weaken economics; it enriches it. It opens the possibility of an economics that is empirically grounded, historically aware, ethically sensitive, and capable of speaking to the complexity of the world it aims to understand.

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