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Economics for the Rest of Us: Debunking the Science that Makes Life Dismal

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Economics for the Rest of Us: Debunking the Science that Makes Life Dismal

Moshe Adler
New York, The New Press, 2010, 198 pp., $24.95 hardcover
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This book is a devastating critique of textbook economics. While rigorous, it is accessible to the general reader, and it does not purport to be an entirely original, systematic or comprehensive work of scholarship. The author focuses on welfare economics and the determination of wages, showing how Jeremy Bentham and Adam Smith opened doors to progressive social policy, and how Vilfredo Pareto, John Bates Clark and their intellectual progeny closed these doors and legitimized class inequality.

The first part of the book discusses issues of inequality in the light of welfare economics. The shift from Bentham's cardinal theory of utility, which could not be quantified, to the quantifiable 'willingness to pay' (consumer surplus), advanced economics as a science but also skewed the calculus of welfare in favor of the rich. Adler shows what this means using the example of rent control, with hypothetical data for seven families bidding for apartments. Since the rich outbid the poor, they account for more consumer surplus. This neoclassical criterion reverses Bentham's, in which the poor, who have more unmet needs, gain more value from a given good than the rich. Challenging the neoclassical separation between equity and efficiency, Adler frames Benthamite utilitarianism as a paradigm of efficiency superior to Pareto's.

The latter—the kind of efficiency that obtains when no agent can be made better off without another being made worse off—is compatible with many alternative redistributions of goods, depending on who initially holds what. Nicholas Kaldor and John Hicks took Pareto efficiency one step further, making aggregate consumer surplus the criterion for public policy even if it makes the poor worse off. Kaldor required only that the poor can *potentially* be compensated for their losses, and Hicks that the beneficiaries gain so much that they cannot *potentially* be induced into foregoing the policy. Both assume that consumer surplus should be measured in absolute as opposed to proportional terms. But the free market deprives the poor of a greater percentage of their consumer surplus than the rich, so by the proportional criterion, the former gain more from rent control than the latter lose. With this kind of reasoning, Adler demonstrates the robustness and continued relevance of Benthamite utilitarianism.

There is more. The neoclassical analysis assumes that every individual has a single 'reservation price' for any given good or service. It is now known, however, that what someone is willing to pay for something they don't own is generally less than what they are willing to accept to give up the identical good if they already own it. Citing recent work in behavioral economics, Adler notes that the 'willingness to accept' price for food, health care and housing is probably at least seven times more than the 'willingness to pay' price for these same goods. Factoring this discrepancy into the analysis of redistribution policies tends to favor even greater leveling of the playing field between rich and poor.

Adler considers a number of other interesting and important issues in terms of 'utilitarian efficiency'. Even regressive taxes can be helpfully redistributive, he notes, if the rich pay more in absolute terms and the revenues are used to provide the same goods for the rich as for the poor (e.g. public education). By contrast, business improvement districts and other privatizations of public goods circumvent such redistribution. The funding of public schools with local property taxes has the same effect, and Adler shows that the consequences violate utilitarian efficiency. He demystifies the statistics on school spending and national test scores—dismantling Eric Hanushek's claim that they are uncorrelated—and reviews recent research on the efficacy of smaller class sizes.

In the second part of the book, Adler turns to the determination of wages, in which—as in the welfare economics of Part One and contrary to neoclassical wage theory—normative matters of legitimacy and relative social power enter from the start. Smith, Ricardo and Marx all viewed profit as a deduction from what labor earns, an idea that persists to our day in the accounting terminology of 'earned' versus 'unearned' income. The corresponding payment to labor is not determined entirely by market forces, but is subject to bargaining between owners and workers. It is this political process that determines, within limits, the allocation of revenue between profits and wages. (The limits are set by the survival needs of labor and some minimum profit rate of capital, below which decumulation sets in.)

Workers are, of course, chronically disadvantaged in this bargaining inasmuch as they depend on wages to meet immediate needs, and are particularly disadvantaged during periods of high unemployment. When unemployment is low, however, workers have significant bargaining power. Adam Smith noted how the workers of his time sought to organize themselves to increase their bargaining power, as did the owners. In this class struggle, the owners typically gained assistance from government, which broke strikes and enacted laws against formation of unions, but not against 'combinations' of capitalists. The role of power in the determination of wages, so prominent in the classical economists, poses a legitimation problem for the owners of capital.

Just as Pareto had provided a capitalist-friendly alternative to Bentham, John Bates Clark displaced this classical theory of wages with one purporting to show that in a market economy workers are paid exactly what they produce. Adler contrasts Clark's use of marginal analysis with Ricardo's, noting that the latter never made the counterfactual assumption that the combined contribution of labor and capital to labor's marginal product could be disaggregated.

Unlike Clark and his neoclassical successors, Ricardo did not conceive of diminishing returns as involving increasing amounts of one factor being applied to a fixed and homogeneous amount of another. Taking the case of agriculture, successive 'doses' of labor-capital yield a declining marginal product not because they are applied to a fixed amount of land, but because they are applied to successive parcels of land that are less and less fertile. This is not an analysis of productivity in the first instance, but of the economic rent that owners of a non-produced resource gain when increased production requires recourse to lower-quality grades of that resource.

Ricardo's version of marginal analysis is generally not applicable to industrial production, but only to such sectors as agriculture and mining, where the quality of one of the factors varies and the highest quality units are exploited first. By contrast, Clark's method assumes that all units of any given factor are identical and produce diminishing returns when varying amounts of one factor are applied to a fixed amount of another. This purports to be a general analysis of productivity, not merely of land rent. But Adler makes a compelling case that Clark's marginal analysis of labor and capital productivity is merely a hypothetical exercise, since actual production generally requires a constant ratio of labor to capital rigidly dictated by technical considerations.

Adler concludes with the relationship between wages and unemployment, and the issue of CEO compensation. His review of the debate between neoclassicals and Keynesians over whether the unemployment is primarily caused by high wages or insufficient aggregate demand is a good introduction for non-specialized readers, and timely in view of conservative revisionism regarding the Great Depression. Finally, Adler brings his critique of marginal analysis full circle, noting that CEOs agree with this critique when rationalizing poor corporate performance. How is it possible, they ask, to disaggregate their individual contribution from that of the rest of their team? Indeed. But in that case, why are they paid so much?

My overall evaluation of *Economics for the Rest of Us* is positive. Adler succeeds brilliantly in providing the general reader with an engaging yet intellectually serious treatment of important economic topics. He relentlessly unmasks the role of economic theory in legitimizing unequal wealth, a salutary corrective to the dominant picture of economics as disinterested science. Having said that, I must also note the downside of Adler's single-minded focus: his tendency to reduce economics to ideology. A dialectical understanding of economics as *both* ideology *and* science would have been more productive. Lacking such an understanding, Adler fails to provide a reliable framework for the history of ideas.

The most notable example of this is Adler's account of why cardinal theories of utility were replaced by theories of consumer surplus. The former legitimized equalization of wealth, he notes, and fell prey to the latter because the concept of consumer surplus better served the interests of the rich. While this may be true as far as it goes, it is necessary to go further. A scientifically adequate theory of demand (capable of empirically distinguishing between substitution and income effects of price changes) could never have been built on cardinal utility. That alone was sufficient to doom the concept, whatever the political circumstances of its demise.

Nor can we understand the concept of consumer surplus merely as a capitalist-friendly alternative to cardinal utility. In fact, Jules Dupuit first developed consumer surplus as a tool for analyzing the benefits of public works (Ekelund & Hebert, 1985), and Abram Bergson (1980) showed how to marry it to a social welfare function that can support egalitarian policies. While Hicks's version of consumer surplus did have politically conservative implications, it also advanced the scientific understanding of demand and was indispensible to the work of Bergson and other economists concerned with issues of equity. Ironically, by ignoring imperatives immanent in the development of scientific ideas, Adler ends up abandoning fundamental concepts (such as consumer surplus) to his ideological opponents. In reality, such concepts are simultaneously the focus of ideological struggle and scientific debate. That is the dual nature of economic thought, which can only be grasped by a dialectical approach.

Adler's one-sided understanding of economics as mere legitimation is a serious limitation of this book, but it is not fatal. *Economics for the Rest of Us*, after all, does not purport to be a theoretical treatise. Although containing material of interest to the academic reader, it is primarily written for a wider audience that deserves instruction on the many, and typically veiled, ways in which economics can be made to serve the status quo. With that proviso, I have no hesitation recommending a book that packs so much critical insight and valuable information so clearly into so few pages.

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