HOW ECONOMICS UNDERMINE OUR RELATIONS WITH EACH OTHER AND WITH THE PLANET[1]

What is economics? There is no high priest, no final arbiter of what constitutes economics. My characterization necessarily involves a subjective element; it is my reading of the center of gravity of an evolving discipline with a gamut of practitioners and practices. Notwithstanding the variety, there is a mainstream so dominant that the other streams have become mere trickles. If we focus on what is taught in the typical principles course, or on the entire undergraduate curriculum, or even on the content of graduate theory courses, there is consensus, and it is this consensus to which the term *economics* refers in this essay.

A good starting point is that economics is the study of the allocation of scarce means to unlimited ends, the standard definition of economics since Lionel Robbins's *Essay on the Nature and Significance of Economic Science*, first published in 1932. This definition leads to an economics which emphasizes opportunity costs, trade-offs, the idea that there is no gain without pain, that something must be given up to get something else. In short, an economics geared to efficiency, to identifying and eliminating waste. All good and useful things to know—within limits. My purpose here, as in *The Dismal Science*, from which much of the argument is taken, is to explore some of those limits.

A crowning achievement of mainstream economics has been to identify the conditions under which a market system accomplishes the goal of minimizing waste. Enshrined in the concept of Pareto optimality, the claim is that a system of competitive markets will allocate society's resources so that it is impossible to improve on the allocation for everybody: any gain for any one individual must come at the expense of somebody else. Limited as the concept of Pareto optimality is—I shall explore some of its limitations momentarily—it is nonetheless a formidable intellectual achievement to discover a coherence in a market system, even an idealized one that abstracts from many of the features of a real-world market system. We might expect a market system to produce nothing but chaos; that it can, even under idealized conditions, produce an equilibrium is itself surprising; that this equilibrium provides an

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"optimal" allocation of resources, even in the very limited sense of Pareto, is nothing short of remarkable.

Yet there may appear to be a contradiction in the claim of mainstream economics to be a machine for identifying and eliminating waste and the claim that markets achieve this goal. If a market system guarantees that there is no free lunch, that there will never be any $500 bills lying around, what inefficiencies are left for economists to discover? For the mainstream economist the answer is simple: real-world markets suffer from inefficiencies due to a lack of competition—monopoly, oligopoly, monopolistic competition—as well as from the presence of externalities, public goods, and asymmetric information. The cure is equally simple: more and better markets. Does the market for electric energy fail to maximize total well-being because the local utility has monopoly power over prices? Replace the monopoly with competition. Does the energy market fail because of the pollution that accompanies the generation of power, pollution that harms people who are not party to the transaction of buying and selling energy? Create markets in pollution permits.

But there remains a disjuncture between economics as description and economics as prescription. In fact, mainstream economics has long maintained a distinction between positive and normative economics. Positive economics consists of statements like "The bottom 10 percent of the income distribution have to make do with 2 percent of national income." Or "Raising the minimum wage by 10% will double youth unemployment." Normative economics evaluates: "The bottom 10 percent ought to have more than 2 percent of the national income." Or "The increase in income that can be had through raising the minimum wage is outweighed by the loss of jobs." In short, positive economics simply describes the world, tells it like it is. By contrast, normative economics makes ethical judgments about the world. Thus, when working the positive side of the street, economists can lay claim to science, an imperfect science but science nonetheless. When working the normative side, economics veers off into philosophy.

The problem with this division is that it fails to give a good account of the apparatus of mainstream economics. Why do we begin the study of markets with perfect competition, adding "imperfections" such as monopoly, oligopoly, and monopolistic competition as departures from the norm? Why don't we start from oligopoly and treat perfect competition as the special case that it is? (When students ask for examples of perfect competition they are told about commodity markets, such as the market for Number 2 red winter wheat, and stock markets, such as the market for IBM shares. Teachers hope against hope that their students will not ask for a third example that looks beyond agricultural and securities markets.) Why, when we teach the theory of consumer choice, do we assume that preferences are constant over time? It is not, after all, hard to model changing preferences and there have been a number of interesting models presented over the years. For that matter, why do we study the theory of consumer choice at all? Why not simply start with demand curves? What's wrong with monopoly, and indeed why is a perfectly discriminating monopolist not a problem?

There is a straightforward answer to these questions: the apparatus of economics exists to further a normative agenda, not because of its usefulness in describing the world. If one were interested in describing the world, perfect competition would be treated as a *curiosum*, a limiting case, but hardly the norm from which to judge real markets. We assume constant tastes not because we need this assumption to describe the world, but because judgments about how well markets perform are made in terms of preference satisfaction. If preferences are changing over time, we can't do even hypothetical comparisons of alternative consumption patterns. A perfectly discriminating monopolist is *not* a problem if we accept that the injuries visited on consumers are balanced by the gains to the monopolist.

What is the normative agenda? In a word, to convince us that markets are good for people. There are several steps in the argument. First, define "good for people" in a very limited way, namely in terms of efficiency: markets are good for people because markets eliminate waste. The second step is to assume away a whole list of market failures—from monopoly, oligopoly, and monopolistic competition to externalities, public goods, and asymmetric information. The so-called First Welfare Theorem guarantees that, absent such failures, a market equilibrium will eliminate waste: starting from a market equilibrium, the only way to make somebody better off is at the expense of somebody else, which makes the starting point Pareto optimal.

To be fair, mainstream economists recognize that market failures are endemic to the real world, but we are required nevertheless to suspend disbelief for the sake of the normative agenda, treating market failures as relatively minor exceptions to a grand scheme of competitive markets, as nuisances rather than as debilitating diseases. In any case, as I have observed, the cure for market failure is more and better markets: more competition is the cure for monopoly, commodification is the remedy of choice for mitigating the impact of negative externalities (as in cap-and-trade as a way of dealing with atmospheric pollution), and so forth. So even when markets are seen to be problematic, markets are the solution.

But we're not done with the problems. Once we step out of the straitjacket of efficiency, we have to consider issues of distribution of wealth and income—equality and fairness. Economists do not deny that market outcomes may be highly unequal and unfair. Instead, they deny that in order to remedy distributional shortcomings it may be necessary to intervene in the market.

Mainstream economists rely on the Second Welfare Theorem to carve out a sphere for the market independent of equity considerations. The Second Welfare Theorem states that every possible efficient outcome, every Pareto optimal configuration, can be achieved by a competitive market equilibrium, provided that there are no market failures and provided as well that the starting point in terms of agents' endowments of productive resources can be modified at will. In other words, if you don't like the distribution associated with any particular market outcome, change the endowments and the markets will settle at a different equilibrium with a different distribution of income and wealth. And, market failures apart, every one of these equilibria will be efficient. The consequence is supposedly that we can separate the hard, objective desideratum of efficiency from the soft, subjective desideratum of equity. The first is for economists to worry about, the second for philosophers.

The problem lies in the seemingly anodyne phrase "modified at will." *Whose* will? If we are speaking of the will of people acting in historical time, then distribution becomes subject to all kinds of political constraints, not to mention the so-called deadweight losses associated with any systematic transfer of income or wealth from one individual to another. Income and wealth can't be *re*distributed without some loss of efficiency, and there are real limits as to how much redistribution is politically feasible. Under these circumstances, to salvage the theoretical possibility of achieving both efficiency and equity envisioned in the Second Welfare Theorem we would have to be able to rewind the movie of history to start at a different place in terms of the original configuration of resource endowments, a place which then evolves on its own to the desired present distribution of endowments. The Second Welfare Theorem may prove that all efficient outcomes are compatible with one competitive equilibrium or another, but the range of equilbria exist only in the mind of a God who can run the movie of history any which way.

The reality is that, however we look at it, the distribution of income and wealth is a cause for concern. Worldwide, the gap between the rich countries and the poor countries remains wide and in some cases, Sub-Saharan Africa in particular, the gap is growing. These wide disparities have been politically tolerable, and for some observers ethically tolerable, as long as incomes can grow everywhere and especially where income growth is mutually stimulating, so that both rich and poor countries benefit. But in the coming decades, if and when ecological limits kick in, the symbiotic element in North-South growth can be expected to give way to competition for environmental sinks and for ecologically constrained resources.

Within the rich countries themselves distribution is also problematic. In most of Western Europe and North America, the distribution has become considerably less equal in the last 30 years. In the US in particular, the contrast with the so-called Golden Age (the 30 years after the end of World War II) is striking. Whether measured by the ratio of CEO pay to average worker pay, by Gini coefficients, or by the ratio of the share of top income recipients and wealth holders to the bottom or middle of the distribution, the increase in inequality has deprived a good part of the population, perhaps the majority, from enjoying the fruits of growth—unless a second wage earner (invariably a wife and mother) enters the paid labor force.

We are still not done. Even if we could finesse the problem of distribution along the lines of the Second Welfare Theorem, there remain consequences of the market left out of the standard efficiency calculus. The most important are the ecological consequences of the market, and the impact of the market on human relationships, relationships that run the gamut from the family to the community to our relationship with the cosmos.

Here too mainstream economics has a defense in a particular model of *homo economicus* and economic society. *The very assumptions that constitute the metaphysical basis of economics rule out the possibility of adverse consequences for both our relationships with the planet and our relationships with each other.*

What are these assumptions? In a word, agents are assumed by their very nature as human beings to be motivated solely by self interest; to be rationally calculating and comparing alternative courses of action at every moment of time; to have unlimited wants, always in pursuit of more, more, and still more. Society is assumed to be a collection of such individuals, whose only community is the national community. Taken together, these assumptions provide a defense against the charge that a market system damage our relationship with the planet or with each other. Here I have to be careful, first to emphasize that what is at issue is not markets as they have existed since time immemorial, embedded in an institutional system which shapes and constrains markets to serve non-market ends, but a market *system* in the sense of Karl Polanyi, a self-regulating nexus of markets which collectively allocate resources, set prices, determine the distribution of income—in short, a system in which markets provide for our needs and wants and from which we derive our sustenance. And something more: a system that not only regulates itself but also regulates ourselves, a process that shapes and forms people whose relationships with one another are circumscribed and reduced by the market. A second qualification is that what I call the metaphysics of economics are the foundations not of the actual markets we encounter in the real world, but of markets from which the warts of monopoly, externalities, and the like have been removed.

On these assumptions, there is no community to be damaged, and no way of improving upon the market with regard to ecology. By the same token, economics as a discipline is absolved from complicity in the undermining of ecology or community. If the foundational assumptions about people and society derive from human nature, thinking like an economist becomes thinking like a human being, perhaps more clearly and acutely, but not different in kind from the way people are hardwired to think. Nothing much is left of my book, *The Dismal Science*, as reflected in the subtitle, *How Thinking Like an Economist Undermines Community.*

Of course I don't believe this, or I wouldn't have written the book in the first place. My counter-argument is that economics is not grounded in human nature but on assumptions derived instead from the culture of modernity forged in the crucible of the history of Europe and North America in the last 400 years and subsequently globalised, at least to "Westernized" elites. And an economics based on that metaphysics, the mainstream economics that is distilled today in secondary schools , in college introductory courses, even in graduate theory courses, is indeed an accessory to the undermining of community, both in legitimizing the market (via the First and Second Welfare Theorems) and, more insidiously, in fostering the construction of a market system in the image of mainstream economic theory.

Evidently I cannot go into much detail here. I should make it clear however that I do not condemn either the market or economics out of hand. Both have brought real benefits in the form of the material gains from four centuries of economic growth in the West. We live longer, in better health and physical comfort, than our ancestors a century ago, not to mention our more distant pre-modern forbears. No little part of these gains is due to the market and to the economics which has defended and promoted the market. (Though I argue in *The Dismal Science* that the reasons for the success of the market are very different from the mainstream argument based on efficiency.)

The problem is that, at least in the rich countries of the West, growth has long since got beyond the point that the economy provides the basis for a life of human dignity; we are well into what economics would term the region of decreasing returns. Moreover, there are serious questions about the sustainability of growth in light of the limits of the ecosystem to absorb the detritus of growth and to provide the raw materials necessary for further expansion of the economy (or for that matter even to maintain current levels of output).

At the same time, economists have difficulty even recognizing that there are costs to growth. Only grudgingly and belatedly has the ecological crisis entered into economists' thinking, and even when it does, there is a general failure to recognize that mainstream economics is part of the problem rather than the solution. Case in point: in 2006 Lord Nicholas Stern, former chief economic adviser to the British Government, completed a review and synthesis of the literature on climate change which led him and his team to a recognition of the potential severity of the problem and the corresponding need for immediate action to counter global warming.

The eponymous *Stern Review* was a pathbreaking document in many ways, not least in its clear and forceful call to action. But it is a disappointment in its attempt to win over the economics profession by adopting the framework of mainstream economics lock, stock, and barrel and attempting to justify its non-mainstream conclusions in mainstream terms. Predictably the decision to adopt the framework of mainstream economics has led to endless squabbling about secondary matters like the rate of time discount and to the sidelining of more important issues like the distributional consequences of inaction and the uncertainty that surrounds estimates of future ecosystem damage.

With respect to community the situation is even worse. Thomas Leonard, who reviewed *The Dismal Science* in the *Journal of Economic Literature*—and who, presumably not by pure coincidence, is the discussant of this paper—chided me for not answering this question: "Is it not possible that markets, like all human creations, are imperfect and fallible, but, on average and all things considered, better for human welfare than all known alternatives for organizing economic life?" I can only conclude that I had not made the point of the book sufficiently clear, my argument being precisely that the foundational assumptions of economics make the discipline blind to community. The writer, poet, and tobacco farmer, Wendell Berry, once wrote an essay with the provocative (in the best sense of the word) title, "Does Community Have a Value?" This essay repays a close reading in multiple currencies, but the important point for present purposes is that Berry's question cannot be posed, much less answered, in terms of the framework of mainstream economics. There is no vocabulary, no language, for discussing the impact of the market on community. It follows that this language provides no way of comparing what has been, *and is being*, lost in terms of community with the gains from continuing the expansion of the cornucopia available to the average consumer in the rich countries today. Perhaps I overstate the case: there may be a language, but it is the language that a tropical or subtropical country might use to discuss snow, not the nuanced language of Finns, Swedes, or Norwegians that is necessary to get beyond the idea that snow is white and cold.

In this respect the fundamental flaw in the metaphysical foundations of mainstream economics is its embrace of an extreme characterization of individuals and their social interactions. Yes, individuals are self-interested, but people are not only self interested. Yes, individuals deploy rational calculation based on a certain kind of knowledge that I call "algorithmic," but the same individuals deploy knowledge based on intuition, convention, authority—"experiential" knowledge in short—as well. Yes, individuals derive satisfaction and meaning from the goods and services they consume, but they derive satisfaction and meaning from spiritual pursuits also. Yes, the national community has become increasingly present and important in our lives over the last 400 years, but other communities are important for connection and identity.

In short, the question is one of balance. As Rabbi Hillel, the great sage of 2000 years ago put it, "If I am not for me, who will be? And if I am only for me, what am I?" Mainstream economics highlights one part of the complex psychology and sociology of living in the 21st century and argues as if this were the whole of being. My complaint is not that the assumptions of economics are entirely false, but that these assumptions, in confusing the part for the whole, are bound to mislead.

A broader economics would take account of the other side of human nature, the human nature that *homo economicus* obscures: the importance of human connection, of non-rational knowledge, of measures of human worth that allow us to escape the endless quest for evermore consumption. A broader economics would highlight an awareness of what is being sacrificed on the altar of endless growth: the environment, community, the possibility of a spiritual life.

It is more than possible that the present crisis will stimulate bold thinking about new directions for economics. Whether the seeds of intellectual change will find a favorable soil in which to germinate and grow into healthy plants, however, will depend in large measure on whether the questioning of economics can ally itself to a movement to broaden the political discourse to include discussion of the purposes of growth and the virtues of restraining our appetites, of a revival of social solidarity, so that we can fashion a new relationship between individual and community, between government and market.

One does not wish for more misery even for so noble a purpose as renewing economics, but it must be recognized that it will take a deeper and longer crisis to engender a new political movement. In this country the 2008 Obama campaign promised a revival of a broader politics. Those hopes have long since been disappointed. Some now look to the Occupy movement for this new direction in politics. Chou En-Lai, when asked whether the French Revolution had been good for humankind, replied—or so the story goes—"It's too early to tell." He would presumably give a similar judgment on the Occupy movement.

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