

*The scope and limits of
economic-science*

*Is the name of economic science
invoked in vein?*

Flora Gill

The University of Sydney

e-mail: flora_gill@yahoo.com.au

Answers

- Scope?

- It is quite limited.

- But please don't throw the baby out with the bath water

- Invoked in vein?

- Yes, too often.

Things worth noting - 1 -

- ❑ There is **no** such thing as
 - ❑ “economic theory says that”
 - ❑ social insurance should be privatised”, or that
 - ❑ “health services should be privatised,” or that
 - ❑ “the user pay principle would create more efficient economic outcomes, than would public provision of health services.”

Things worth noting - 2 -

- There are three, not just one, players in any (economic) professional attempt to address a social policy issue:
 - Economic theory
 - The profession's habits of thought
 - The individual economist's world view, and his/her social belief system

An example: economic theory on how do we explain the poverty trap

❑ **Theory:** The root-cause might be one or all of the following

❑ wrong skills

structural factors

❑ preference for leisure

'taste'

❑ geographical change or retraining requires \$

❑ lack of financial means to facilitate geographical move or skill acquisition

non-pecuniary, utility, cost

❑ value placed on community ties

non-pecuniary, utility, cost

❑ aversion to risk-taking

non-pecuniary, utility, cost

pecuniary Adjustment cost

budget constraint

The upshot

- ❑ Theory does not speak alone – human mediation is required
 - ❑ A choice has to be made
 - ❑ Is there a primary root cause, or are all of the listed causes significant?
 - ❑ An answer to this question must be given before we begin sketching a remedial policy.

The economist's choice – how is it made?

- ❑ It all depends on
 - ❑ the professional community,
 - ❑ the individual economist, and on
 - ❑ the prevailing political climate

The professional community

- ❑ *Tilted towards*

- ❑ 'blaming' subjective tastes ("preferences")

- ❑ *Underplays or completely overlooks*

- ❑ constraints such as
 - ❑ lack of access to finance, or
 - ❑ outright prohibitive costs of finance and uncertainty

Individual economists

- Type A -
 - produce research that among other things underplays limited access to finance, prohibitive pecuniary costs of retraining, constraints, high burden of uncertainty (non-pecuniary cost), and the importance of community ties for an individual's well-being
- Type B – (*alas only a minority*)
 - Their research output tends to recognise the above.

Type A – Who are they?

- A whole array of them
 - True blue dry, on the right of the political spectrum
 - Followers of the professional crowd
 - Otherwise progressive in social outlook
 - Affected by the media and general political climate. These include:
 - Otherwise progressive in social outlook
 - Those who by their very personal make up fail to comprehend the predicament of the disadvantaged.
 - Personal profile:
 - *self-confident, good at projecting image, thrive on competition and derive most pleasure from things that money can buy.*

Type B

- Those whose social outlook that predisposes them to
 - identifying structural factors among to root causes of economic misfortune
 - respect difference even regarding personal attitudes to competitive conduct
 - Those who temperamentally can stand step out of the trodden path
 - Personal profile:
 - *May, or may not, be self-confident, good at projecting image, thriving on competition, or deriving most pleasure from things that money can buy. But they possess empathy with the less fortunate.*

In summary:

Further things to note

- Proponents of conservative policy wrongly claim, or perhaps merely successfully create a misleading impression, that the whole armoury of economic theory stands right behind them.
- Similarly, just because an ‘economist’ says something, it does not follow that all economists are right behind her/him.
 - *Examples:*
 - *Kenneth Arrow, Joseph Stiglitz, David Card, Alan Krueger, Ariel Rubenstein, Peter Gottschalk, and John Quiggin, .*

Some armoury for social advocacy

- Concepts!!!!!!
- Terminology!!!!!!

What is this things called “efficiency”?

- Economic theory:
 - Efficiency is achieved when the cost of achieving a certain goal is minimised.

Alternatively (but equivalently),

- Efficiency is achieved when your goal reaches its highest value, given the resources you have at your disposal.

Why equivalent?

What is this thing called “Pareto-efficient state”

- Vilfredo Pareto (Italy, 1930s) proposed the following definition:
 - If a society can improve the lot of some individuals without worsening the lot of other, then the existing allocation of resources is suboptimal (inefficient).
 - Efficient allocation of resources is achieved, when you cannot make one person better off without making someone else worse off.

What do you think?

First attempt to break the Paretian grip on the status-quo

- A twist on the Pareto's view of *efficiency*
 - N. Kaldor, J. Hicks & T. Scitovsky (UK & US 1930s)
 - If we can enhance the well-being of the society in aggregate, then we should go ahead, but we should compensate the losers.

What do you think?

The catch: you must compensate regardless of whether the losers are the very rich or the very poor

Breaking the Paretian grip on the status quo

- Tony Atkinson (UK 1972):
 - Why should we compensate regardless of wealth position?
 - If we care about the distribution of income and comparative well-being in general, and we wish to keep inequality within bounds, then this has direct implications for the manner in which our resources should be allocated.

Atkinson's proposition (*con'd.*)

- Allocation of resources that yields maximum level of GNP per capita would be 'efficient' only in a community that is absolutely indifferent to all degrees of economic inequality.
- Societies that prefer to keep inequality within bounds, should accept a cut in (or a slower rate of growth of) GNP per capita. Otherwise, they would fail the efficiency test.

This is a trade-off proposition. It is a trade-off not between efficiency and social justice, but between average standard of living and a modicum of social justice.

In summary,

- Atkinson reminds us the **theoretical** definition of 'efficiency'. He then observes that

- It is the efficiency itself that require us to take into account our social concern for the disadvantaged (or the environment) .
- Social justice (or environmental quality), therefore, **does not** entail a sacrifice of efficiency.
- Efficiency would be compromised if we focus only on maximising income per capita, because we are disregarding our concern for inequality, the environment, etc'

Efficiency & privatisation: the concept of 'market-failure'

- 'Market failure' means that the market fails to allocate resources efficiently.
 - This occurs the following have significant presence:
 - 'Public' goods
 - 'Externalities' and
 - 'Co-ordination failure
 - When either of these exist, the allocation fails even the conservative Paretian test. Privatisation creates inefficiency even in term of its minimalist definition.

Behind Atkinson's argument: The two measures of well-being

- The first measures well-being in money terms.
- The second measures well-being in 'utility' terms.
 - This bizarre term, 'utility', can be a very objectionable, to me too. But it can also be quite attractive and useful in certain context (eg, as in Atkinson's argument).
 - Utility, is the theoretically sound measure.
 - Money is only a medium used to attain 'utility'
 - Utility can also be attained from things that money cannot buy.

Concepts/terminology

Taking stock

- We have already encountered the following:
 - Efficiency
 - Utility (tastes, preferences)
 - Budget constraints (comment: individuals vs. governments)
 - Pecuniary vs. non pecuniary costs/benefits
 - Society's goal
(the professional terminology is *The social welfare function*)
 - Adjustment costs
 - Market-failure
 - Public goods
 - Externalities
 - Co-ordination failure

Simplification – legitimate vs. illegitimate

- A little fictional story
- The moral of this story?
 - At times simplification is warranted
 - At others it isn't