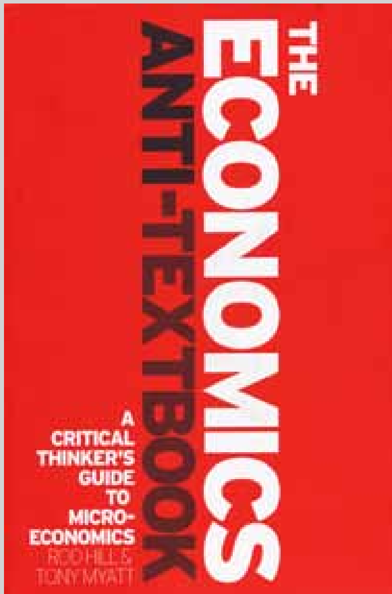

THE ECONOMICS ANTI-TEXTBOOK

Rod Hill & Tony Myatt

Western capitalism has exploited the power of greed to win the fight against mass poverty. With entrepreneurial ingenuity, it has removed the irritation of domestic industrial disputes through 'delocalizing' the working class farther away. This militaristic occupation of the ideological ground, compounded by the collapse of economic systems based on antagonistic theories, has bought some time for the establishment, as well as for the embedded mainstream economists.

Nevertheless, the latest crisis has cast some doubts on the soundness of the laissez-faire economic philosophy whose reputation has been essentially built on the failure of an even worse system: the state-run economy of Soviet fame. But, as we all know, history is written by the winners. Consequently, today, most economic textbooks reflect the particular vision of Wall Street and market fundamentalism.

The authors of Anti-Economics, one a self proclaimed 'post-Keynesian' and the other a 'European-style social democrat', don't present an alternative paradigm. With this book, they rather analyze the language of the winners to uncover the hidden biases and the perspective gaps as revealed by their omissions and by their implicit value judgements.

Reading this anti-textbook will not help the academic performance of economics students, but it will certainly stimulate the best of them in approaching the discipline with the sceptical eye that such a complex subject deserves. Possibly, it may encourage those inclined towards speculative research to study the socioeconomic reality of our times with fairness untainted by financial complicity. And, maybe, one day to contrive a new economic paradigm, rather than tweak theories conceived over a hundred years ago. The past century has been short of giants of the stature of Adam Smith and Karl Marx. Perhaps, this book is the harbinger of a timely maturity for new economic visions.

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This book is not anti economics, or even anti mainstream economics. It is anti mainstream textbook economics. This is a much easier target to attack. The evidence is palpable. The books exist. You can see them, touch them and read them yourself. And should you do so, you would find that the mainstream textbooks are remarkably uniform and reflect a narrow range of world-views — indeed, a much narrower range of world-views than those held even by mainstream economists.

Textbooks are necessarily selective. They must include and emphasize some things and exclude or downplay others. They ask certain questions and not others. They place some topics and questions in the forefront, and put others in the background or leave them out entirely. Those decisions usually reflect implicit, not explicit, value judgements about what is interesting and important. No 'objective' account is possible. For most people - including many economists - this is not a controversial claim. Yet the textbooks cloak themselves in an aura of objectivity. They portray economics as a science dealing with facts and theories that make predictions. Economists are the technicians wearing white lab coats objectively comparing one theory with another, coming up with policy prescriptions supported by a consensus of professional opinion.

The Anti-Textbook argues that this is a myth - one which is not only dangerously misleading but also bland and boring. Value judgements arise on the first page, where the textbook writers ask 'what is economics?' and attempt to define the subject and the main problems that it addresses. A variety of possible definitions exists, and each one would give rise to different lines of enquiry. One definition might stress the importance of using society's scarce resources to make total income and production as large as possible; another might stress the importance of eliminating poverty and deprivation so that everyone's basic needs are met. When an author gives one view and ignores alternative possibilities, a value judgement has been made.
Moreover, the hope that economics would one day become a positive science relying on the evidence to confirm or to refute theories has, up to this point, been in vain. There are long-standing disputes about the effects of relatively simple policy changes. For example, does an increase in the minimum wage increase unemployment? What could be simpler than that? Many texts claim that economists have a consensus answer to this question supported by a clear body of empirical evidence. But nothing could be farther from the truth. Contradictory evidence abounds. Furthermore, the notion that an appeal to evidence could resolve all theoretical disputes is - to put it mildly - methodologically naive. As Einstein (1926) said: 'Whether you can observe a thing or not depends on the theory which you use. It is the theory which decides what can be observed.'

Economics is inevitably a battleground between opposing ideologies. This isn't necessarily a bad thing. Recognizing this reality puts the controversy and excitement back into economics, and reveals a fascinating and vibrant field of study — one which is more an 'art of persuasion' than it is a science. One of the major aims of our book is to point out where ideological issues arise, and where the textbooks make implicit value judgements that you may not share. One major area where such value judgements crop up is the decision as to what to leave out of the text. Alternative perspectives may not be discussed, inconvenient questions may not be asked and contrary empirical evidence may be omitted.
We offer the readers of The Economics Anti-Textbook examples of such omissions in the hope that they will get into the habit of thinking about what is not in the text as well as what is.

THE WORLD-VIEW OF MAINSTREAM TEXTBOOKS

So what is the world-view of the introductory texts? Harvard professor Dani Rodrik (2009) put it well in a recent commentary:
Non-economists tend to think of economics as a discipline that idolizes markets and a narrow concept of (allocative) efficiency. If the only economics course you take is the typical introductory survey ... that is indeed what you will encounter. But take a few more economics courses, or spend some time in advanced seminar rooms, and you will get a different picture.

We agree that the typical text offers a view that 'idolizes markets' — usually not in a crude way, but in a subtle way through its choice of themes, and through its emphasis on demand and supply (also called the model of perfect competition) as the central theoretical structure. Most of the standard textbook is spent developing and applying that structure. It describes a world of perfect markets in which given resources are allocated as if by an invisible hand in a way that maximizes the value of total production. The belief that this model approximates how markets operate in the real world is often referred to as 'market fundamentalism'.
It's quite true that many qualifications to market fundamentalism can be found in the mainstream texts, but they are made in such a way that they appear of secondary, rather than primary, importance. The theory of perfect markets is all too often applied reflexively to policy questions, without any discussion of whether it is relevant or appropriate.

WHAT'S WRONG WITH THIS WORLD-VIEW?

Market fundamentalism — the analysis that dominates the mainstream textbooks — assumes perfect and costless information. Much research in recent decades has explored the implications of relaxing this extreme assumption and considering what happens in a setting of imperfect information, where some people know more than others (termed 'asymmetric' information). The Anti-Textbook highlights the many places where this more realistic approach is relevant. With pervasive informational problems, the market economy systematically fails to produce the efficient allocation of resources that is the centrepiece of the textbook story.
Furthermore, the perfect markets of the texts are populated by large numbers of small firms, producing identical products, with no power to set their own product price. Does it matter that very few actual markets resemble this? Many economists think it does. in recent decades, a great deal of research has been devoted to markets in which there are a few large firms, or in which firms produce different products. Theories of international trade are now dominated by such approaches. The efficient allocation of resources that occurs in the perfect markets story does not happen in these more realistic approaches. The focus on 'efficiency' that runs through the texts comes at the cost of neglecting issues of the distribution of income and wealth and economic justice, which get short shrift in virtually all texts.

Another neglected topic is the problem of externalities. Even when people make their decisions with perfect information, they can still choose not to take into account the effects of their actions on others. Every kind of pollution, from the local to the global, is an example of this.
Questions of power are absent from the texts. Yet in reality sellers try to shape and to influence the preferences of consumers, while consumers may try to exert their power to get producers to produce products in more ethical or environmentally sustainable ways. Corporations, labour unions, citizens' groups and non-governmental organizations may struggle to influence the 'rules of the economic game' — tax law, regulation, government programmes and so on. A similar struggle takes place at the

international level. Economics textbooks often present hypotheses and policy prescriptions with surprisingly little or no supporting evidence, or (worse) they ignore inconvenient contrary evidence.

Another goal of this book is, where relevant, to ask for the evidence and to show the student the way to the evidence that the texts omit. It is remarkable, for example, that the texts present no evidence at all about what determines individuals' well-being. Lurking between the lines is the materialist assumption that people are better off if they have more stuff. Yet the evidence offers little or no support for the materialist position.
Finally, the whole textbook structure is built on a view of human beings as rational calculators — a view that is increasingly being challenged. It is being replaced with a view of human beings as having limited rationality, and capable of irrational exuberance and exaggerated herd-like reactions to economic events.

Many of these neglected topics are needed to understand the recent global financial meltdown. Despite the existence of competition in credit markets and despite the existence of theories telling us that stock markets are efficient, we have seen a huge financial and real estate bubble burst and threaten to plunge the world economy into another Great Depression. This would be hard to explain using the textbook model of rational economic actors operating in perfectly competitive markets where there is perfect information. Indeed, a full explanation involves precisely all those aspects of reality that mainstream textbooks downplay — imperfect and asymmetric information, a externalities, power and limited rationality.

THE TEXTBOOKS AND THE ANTI-TEXTBOOK

The Economics Anti-Textbook presents a different picture of economics and a different vision of the economy — it's one that many economists see, but it has been filtered out of the mainstream introductory textbooks. It is not based on the ideas of an obscure fringe of the economics profession. We draw on the writings of many prominent economists — many winners of the Nobel Prize in economics, including even the authors of prominent introductory textbooks.

ECONOMICS IS THE SCIENCE OF CHOICE

It seems obvious that economics is about the economy; so a commonsense definition of economics might be that it concerns itself with money, markets, business and how people make a living. But this definition is too narrow. Economics is not just the study of money and markets. The fact that economics can examine subjects traditionally studied by other social sciences suggests that content does not define the discipline. As long as a topic has a social dimension, we can look at it from the perspective of any social science.
Most textbooks define economics as the science of choice. It's about how individuals and society make choices, and how those choices are affected by incentives. Its drawback is that it doesn't help to differentiate economics from the other social sciences, since they too look at how we make choices.
What distinguishes economics from other social sciences is its commitment to rational choice theory. This assumes that individuals are rational, self- interested, have a stable set of internally consistent preferences, and wish to maximize their own happiness (or 'utility'), given their constraints — such as the amount of time or money that they have. Social situations and collective behaviours are analysed as resulting from freely chosen individual actions. Just as science attempts to understand the properties of metals by understanding the atoms that comprise them, so economics attempts to understand society by analysing the behaviour of the individuals who comprise it.

PEOPLE AS CONSUMERS IN THE STANDARD TEXT

A consumer's demand for goods summarizes the quantities that would be purchased at various possible prices. In principle, we can ask the consumer the maximum amount he would be willing to pay for various amounts of the good and construct a demand curve from that.

PEOPLE AS CONSUMERS IN THE ANTI-TEXT

The previous account of consumer choice offers a reasonable way of thinking about the demand for pizza and how that might change if income changes, the sort of uninteresting question that the textbooks consider at length. But the approach has serious shortcomings that should be a source of concern if we use it as the central or 'default' model to assess the outcomes of consumer decisions in particular markets and in the economy as a whole. First, this account says nothing about where our consumer's preferences come from.

PREFERENCES ARE SIMPLY 'GIVEN'

As Milton Friedman put it in his graduate text: 'The economist has little to say about the formation of wants; this is the province of the psychologist. The economist's task is to trace the consequences of any given set of wants'. This narrow view unduly limits the questions that economics can address. Do some producers and retailers have real influence through advertising and marketing over people's preferences? Why does it matter?
Second, it is assumed that buyers have perfect information about what they're buying. In reality, however, imperfect information is the rule, not the exception. As well, information is asymmetric - in this case the producers of goods have more and better information than their potential customers. Does imperfect and asymmetric information result in important systematic errors when buyers make spending decisions?
Third, the benefit a person gets from consumption in the textbook story has no social context. It is entirely unrelated to what other people in the surrounding society have. What happens if social context matters?
We'll consider each of these points in turn. The ideas and their implications are not difficult to understand, so their absence from the textbooks can't be blamed on that. However, they spoil the rosy picture of the operation of the unregulated market economy that an innocent reader can easily take away from the textbook account.

WHAT IF PREFERENCES ARE NOT 'GIVEN'?

The textbook account implicitly assumes that people's wants originate within themselves. For example, a buyer's preferences about pizza and willingness to pay for it reflect how good it tastes compared with other things. If that's true, we don't really have to consider where our taste for pizza comes from; it's just a part of our nature, shaped by evolution to induce us to satisfy our needs for nutrients. This way of thinking clearly does not apply to all goods and services. But the economists who developed the theory of demand were not trying to develop la real theory of people's "wants". They sought only a simple account to explain the demand curve, a building block in the supply and demand model that in turn produces a theory of prices, their real goal.
Why shouldn't we acknowledge that wants are, in part, determined by people's previous consumption experiences, the social environment in

which they live, 2 1 and attempts by firms to influence individuals' wants? Textbook economics has long been criticized for ignoring this; if preferences are influenced in important ways within the economic system itself, it's hardly convincing for Friedman to claim that it's not economists' business.

ADVERTISING

'Advertising may be described as the science of arresting the human intelligence long enough to get money from it.' Stephen Leacock (1924: 123)
Advertising is the most obvious attempt to influence people's preferences. In textbook economics, people are perfectly informed, so advertising must just provide consumers with accurate information about product characteristics, sellers' locations and prices. This assumes away persuasive advertising that tries to change people's wants and stimulate new wants; and it assumes that advertising never provides biased or misleading information. The supply and demand model at the heart of textbooks doesn't permit such questions about advertising to arise. Advertising is acknowledged only later in the textbook when discussing industries dominated by one or a small number of firms, but this has no impact on the theory of consumer behaviour.
The advertising industry is large. in the United States, probably the world's most advertising-saturate country, it constituted about 2.1 per cent of US gross domestic product in 2008, or about $970 per person. In The Affluent Society, John Kenneth Galbraith wrote that advertising expenditures 'must be integrated with the theory of consumer demand. They are too big to be ignored'. Yet textbook economics relegates them to the sidelines.

THE PROBLEM OF CHANGING PREFERENCES

Some economists have given the formation and change of preferences serious thought and reached conclusions that undermine the textbook account. A straightforward example illustrates the central idea.
Suppose that new cell phones receive television signals. You have no interest in watching television and your willingness to pay extra for this feature is zero. The heavily advertised new cell phones are all the rage, however, and your friends look at you with pity and puzzlement. Finally, you trade in your old cell phone for the new model. Evidently, your preferences changed.
How would we evaluate this situation? if we use your initial preferences, when you placed no value on the TV feature, we must conclude that you are worse off: you've paid good money for something you think is worthless. if we use your new preferences, we must conclude that you got some consumer surplus from the deal and are better off after the purchase.
The fundamental problem is that it's not always obvious whether the preferences before or after the change are the ones to use in judging your situation. You have the freedom to change your preferences, after all. on what grounds can we say which preferences are the most valid? Does it depend on why you changed your preferences? The problem is even more complex if people's preferences continually change because of their experience and their changing social environment.

INCOMPLETE AND ASYMMETRIC INFORMATION

The textbook economics story of consumer choice with its assumptions of informative advertising and perfect information leading to optimal choices is particularly misleading in situations where incomplete and asymmetric information is a central feature. This provides an opportunity for manipulative marketing by producers. Let's consider a couple of examples.
Example: marketing prescription drugs No one should have been too surprised when a recent study finally revealed that Prozac, the popular antidepressant taken by 40 million people, and three other drugs in its class are no more effective for most people than a placebo (a sugar pill that the patient believes is a drug).
Unfortunately, the Prozac story is no aberration. Pharmaceutical drugs are complex products that their ultimate users are in no position to understand or assess. Consumers rely on drug companies and supposedly independent researchers, medical journals, healthcare providers and government regulators to make safe products available and to prescribe them properly. This system has been deeply compromised according to recent exposes (e.g. Angell 2004; Moynihan and Cassels 2005).
Drug companies have discovered that they can expand their markets by having drugs prescribed to healthy people: just reclassify them so they become candidates for a prescription drug. Recent decades witnessed highly profitable increases in the number of 'depressed' people, children with attention deficit hyperactivity disorder', people with 'high' cholesterol, and on and on.

Example: food The food industry is crucial in satisfying one of our most fundamental needs. We can see, smell and taste what we eat and drink, but to find out what it contains at the molecular level is no easy matter. It should not be surprising, then, that much food and drink contains additives to enhance the appearance, texture, flavour or shelf-life of the products - additives that, on closer examination, have serious adverse consequences, such as allergic reactions, behavioural problems in children, such as hyperactivity, and cancers (Hickman 2007).
If demand for a product (such as adulterated factory-produced chicken meat) in the presence of imperfect information is greater than it would be in the presence of perfect information, then consumers really do not use their budgets efficiently to maximize their well-being. The misallocation of resources parallels what we saw in the earlier example, where preferences were altered by advertising.

The real default case: incomplete and asymmetric information Despite the pervasiveness of informational problems and the inefficiencies they give rise to, textbook economics focuses on the improbable assumptions of given tastes and perfect information that helps make Adam Smith's good-news story of the invisible hand work for consumers. But incomplete and asymmetric information - that is, buyers and sellers knowing different things - is a better description of reality for almost all goods. As the examples we give suggest, ignorance about what we buy and use is commonplace and in many situations buyers' ignorance has important consequences.
What about the news media? Don't investigative reporters uncover problems and inform the public? Don't governments monitor the market and act on the public's behalf, regulating or providing information? We explain the economic basis for corporate power in the next chapter, but for now let's just note that the media corporations that provide most people with their news are primarily interested in profits; systematically upsetting other corporations (which may be major advertisers) is not profitable.

How governments behave depends on the strength of the country's democracy. Where democracy is weak and the power of big business is strong, governments can be expected often to act against the interests of the vast majority of the population.

PREFERENCES AND RELATIVE POSITION

Advertising and other actions by producers are not the only way in which people's tastes are shaped within the economic system itself. We are, after all, social animals: we see what others have and that influences our own wants and the utility we get from the things we have.

According to evolutionary psychology, the way we think about our place in society has been shaped, like all the other processes of our minds, by evolutionary forces (Pinker 2002). A concern for status and security is central to the individual's ability to survive, to find mates and to reproduce. We have an innate concern about our relative position in our 'reference group', those people with whom we compare ourselves. As Juliet Schor reminds us, 'While most critics of consumer society focus on ads and the media, it's important to remember that the more powerful stimulator of desire is what friends and family have.'

The implicit assumption in textbook economics is that the utility people get from things is entirely independent of what others have. But what is the evidence about how other people's consumption affects our utility? The textbook account presents none. How does considering utility in a more realistic way change our judgements about how well the economy is functioning?

John Kenneth Galbraith expressed a central aspect of the problem in The Affluent Society:

> If the individual's wants are to be urgent they must originate with himself. They cannot be urgent if they must be contrived for him. And above all they must not be contrived by the process of production by which they are satisfied. For this means that the whole case for the urgency of production, based on the urgency of wants, falls to the ground. One cannot defend production as satisfying wants if that production creates the wants.

Production creates wants through people's desire to emulate others. 'One man's consumption becomes his neighbour's wish ... The more wants are satisfied the more new ones are born,' as Galbraith wrote. If this is true, we keep working to produce more and more, yet we remain in the same place in terms of the utility we get from those things. Is there evidence to support this view?

The 'Easterlin Paradox' The evidence we have reviewed has paradoxical features. At any time within a country, higher-income persons have a higher level of well-being on average. Yet there seems to be no significant positive relationship between income and average well-being over long periods of time, even when incomes have grown substantially. This puzzle has been dubbed the 'Easterlin Paradox'.

Easterlin's own explanation of the Easterlin Paradox is straightforward: people evaluate their well-being using a standard or norm based on the social conditions they experience. If material conditions improve, the social norm changes with it. As a result, on average, people feel no improvement in their well-being. Norms and aspirations rise to cancel out the effects of higher real incomes and consumption. This is perfectly consistent with higher-income individuals reporting themselves happier or more satisfied than lower-income individuals at any particular time. That's what makes it sensible for individuals to try to improve their relative position. People don't seem to realize that a gradual rise in norms will take place and they seem to believe that they'll be happier in the future with higher incomes than they really turn out to be.

Easterlin suggests a simple thought experiment: 'Imagine that your income increases substantially while everyone else's stays the same. Would you feel better off?' of course you would. 'Now, suppose that your income stays the same while everyone else's increases substantially. How would you feel?' He asserts that most people would feel less well off than they did before.

POSTSCRIPT: A CASE STUDY ON THE GLOBAL FINANCIAL MELTDOWN

In this postscript we want to connect our main themes with the global financial meltdown that exploded into headline news in March 2008 with the collapse of Bear-Sterns, one of the world's largest investment banks.

This financial debacle illustrates the importance of many of the issues highlighted throughout this Anti-Textbook –issues that are downplayed and underemphasized by the mainstream texts. It illustrates the importance of imperfect and asymmetric information, externalities, limited rationality and inappropriate incentives. In particular, it illustrates the necessity of appropriate government regulation, and the ability of powerful business interests to change the rules of the game through lobbying – especially in the USA (which was the epicentre of the global collapse).

WHY DID THIS HAPPEN?

Why did successive US administrations opt for deregulation? Akerlof and Shiller attribute it to public antipathy towards regulation. The United States was deep into a new view of capitalism the no-holds-barred interpretation of the game. They argue: 'We had forgotten the hard-earned lesson of the 1930s: that capitalism can give us the best of all possible worlds, but it does so only on a playing field where the government sets the rules and acts as a referee.' The US administration was trapped into the mantra of deregulation. Some commentators, such as Rodrik, specifically blame economists.

He says:

> [E]conomists (and those who listen to them) became over-confident in their preferred models of the moment: markets are efficient, financial innovation transfers risk to those best able to bear it, self-regulation works best, and government intervention is ineffective and harmful. They forgot that there were many other models that led in radically different directions. Hubris creates blind spots. If anything needs fixing, it is the sociology of the profession. The textbooks at least those used in advanced courses - are fine.

Finally, we mustn't forget Stiglitz's point that deregulation made a lot of people very rich. Those who saw this potential were willing to invest to get it – spending large amounts on campaign contributions and lobbyists to secure the necessary legislative changes and financing 'think-tank' propaganda to influence public opinion.