A Radical Critique of Welfare Economics

Welfare economics is the heart of neoclassical economics. Together with the descriptive theory of self-adjusting markets, it provides the ideological foundation upon which the entire edifice of elaborate neoclassical apologetics for capitalism is constructed. Conventional economics has been criticized persistently for over a century for its grotesquely unrealistic assumptions about homogeneous, maximizing, *economic man* and the socially beneficial constraints imposed upon him by atomistic competition. Yet these assumptions have remained at the core of orthodox theorizing. They are the indispensable axioms of neoclassical welfare economics, and, as yet, no alternative ideology of capitalism has been able to provide an equally rigorous and elegant justification of the status quo.

The hedonistic foundations of welfare economics

Welfare economics rests squarely on hedonistic preconceptions. It contains both a psychological hedonism and an ethical hedonism. The psychological hedonism was, in the late nineteenth century, a rather crude theory of human behavior. *Utility* was conceived as a cardinally quantifiable relationship between a man and external consumable objects. This relationship was treated as though it were metaphysically given and fixed, and not a proper subject for further investigation. All human behavior was then reduced to attempts to maximize utility through the use or exchange of the commodities and productive resources with which the individual had been endowed (the source and propriety of the endowment, like the utility relationship was beyond the purview of analysis).

Psychological hedonism, however, had been thoroughly discredited by the late nineteenth century. The development and refinement of the behavioral assumptions of welfare economics over the last half-century represent attempts to obviate the objections against psychological hedonism while continuing to draw conclusions identical to those derivable from the discredited theory. *Indifference curves* permitted the substitution of ordinal quantification of utility for cardinal quantification. Further, the word utility was frequently dropped in favor of the word preference. Preferences were something, the bourgeois economist argued, that could be empirically observed, provided only that we assume that individual choices are *consistent*. The consistency, however, was merely the assumption that choices reflected a preexisting, metaphysically given preference ordering (empirical observation, of course, has continuously shown what common sense should have told these economists, that choices do not have this type of consistency). Cardinally quantifiable utility or ordinally quantifiable preferences have identical psychological and ethical import, and welfare economics remains a hedonistic theory of maximizing economic man behaving in a manner totally predetermined or programmed by two metaphysically given and, by implication, immutable entities: his preference ordering and his initial endowment of assets.

The ethical hedonism of welfare economics has been called “the pig principle” by Professor S. S. Alexander. The pig principle is simply “that if you like something, more is better” (Alexander, 1967, p. 107). Thus, the ultimate normative principle of welfare economics can be stated several ways: more pleasure is ethically better than less (Benthemite version); more utility is ethically better than less utility (late nineteenth-century neoclassical version); and a preferred position on one’s preference ordering is ethically better than a less preferred position (contemporary neoclassical version). In each case, the isolated, atomistic individual is the sole judge qualified to assess the pleasure, utility or preferability of an object because these welfare magnitudes are presumed to depend only upon the relationship between the individual and the object of consumption. Individual desires, weighted by market purchasing power, are the ultimate criteria of social values. Externalities caused by interdependencies of preference orderings (that is, consumption considered as a social activity) can only be handled by treating them as isolated exceptions (of which more will be discussed later). Welfare economics ignores the fact that individual desires are themselves the products of a particular social process and the individual's place within that process. If they did not ignore this they would have to acknowledge the fact that normative evaluations can be made of totally different social and economic systems and their resultant patterns of individual desires. Welfare economics is the direct lineal descendent of the doctrines Marx labeled as "vulgar economy." A point of view which — confines itself to systematizing in a pedantic way, and proclaiming for everlasting truths, the trite ideas held by the self-complacent bourgeoisie with regard to their own world, to them the best of all possible worlds. (Marx, 1961, p. 81, footnote)

Pareto optimality

Upon this foundation of psychological and ethical hedonism is constructed the norm of Pareto optimality — the core concept of welfare economics. The usual exposition of this norm begins with a sharp dichotomy — the theory of the consumer and the theory of the firm. Each isolated, maximizing consumer is constrained by a fixed budget. Constrained utility maximization results in commodities being chosen in such proportions that the individual's marginal rate of psychological substitution between any pair will be equal to the ratio of their prices. This means that relative prices accurately reflect the psychic or utility evaluations (at the margin) for every commodity for every consumer — because in a competitive economy every consumer is faced with the same prices. And because prices reflect the relative evaluations of every consumer considered individually, they must, in a capitalist economy where the consumer is sovereign, perfectly reflect the relative *social values* of commodities.

Next, an individual business firm with a "continuous twice differentiable" production function is confronted by given prices in a competitive market. A mathematical or geometrical analysis of constrained profit maximization shows each firm choosing a point on its production function where (1) the price of any factor (including labor) is equal to the value of its marginal product, (2) the marginal rate of substitution between any pair of factors is equal to the ratio of their prices, and (3) the marginal rate of transformation between any two outputs is equal to the ratio of their respective prices.

The first of these conditions of profit maximization is equivalent to the neoclassical marginal productivity theory of distribution. It assures us that each factor of production (and, by implication, each human being) receives an income exactly equal to that which it contributes, an ideal which has long served as a bourgeois ideal of distributive justice. The third of these conditions of profit maximization assures us that the prices of commodities accurately reflect the marginal opportunity costs of society foregoing some of any commodity in order to get more of another commodity.

In the competitive world of the neoclassical apologist, every consumer and every firm faces the same set of prices as every other. This means that in equilibrium the mental evaluation of any pair of commodities by any consumer is a perfect reflection of the technologically determined opportunity cost of producing those commodities. No reallocation of resources through changes in consumption, exchange or production could *unambiguously* augment the value of the commodities being produced and exchanged. This is Pareto optimality — the fundamental norm of bourgeois economics.

The fundamental rule of Pareto optimality states that the economic situation is optimal when no change can improve the position of one individual (as judged by himself) without harming or worsening the position of another individual (again, as judged by himself). A Pareto improvement is a change that moves society from a nonoptimal position closer to an optimal position: “Any change which harms no one and which makes some people better off (in their own estimation) must be considered to be an improvement” (Baumol, 1965, p. 376).

Two points are significant in the Pareto rule: First, in the hands of many nineteenth-century reformers the notion of diminishing marginal utility had radical equalitarian implications. If all individuals have similar capacities for enjoyment, and if the marginal utility of income declines as one’s income increases, then it follows that an equal distribution of income maximizes the total utility for all of society. Contemporary ideologists avoid this conclusion by insisting that interpersonal utility comparisons are impossible and that statements about the effects on the total social welfare of redistributions of wealth and income are thereby impossible. The insistence that an individual’s welfare can only be judged by himself is the means by which these interpersonal utility comparisons are avoided. The second significant point to note in the Pareto rule is its conservative consensual character. Defined away are all situations of conflict. In a world of class conflicts, imperialism, exploitation, alienation, racism, sexism, and scores of other human conflicts, where are the changes that might make some better off without making others worse off? *improve the plight of the oppressed and you worsen the situation of the oppressor* (as perceived by himself, of course)! If there are any important social, political and economic situations where improving the lot of one person, group or class is not opposed by persons, groups or classes, who, by virtue of their roles in the economic, political and social spheres, are their natural antagonists, then such situations are indeed rare. The domain of this theory would, indeed, seem to be so restrictive that it would hardly warrant a serious social scientist’s time to investigate it were it not for the fact that the theory is thought to be important not only by the overwhelming majority of bourgeois economists, hut by many unwary Marxist economists as well (Hunt, 1975).

The neoclassical notion of market efficiency encountered in every branch of applied economics, as well as the bourgeois notion of rational prices encountered in so many discussions of the role of the market in a socialist society, have absolutely no meaning whatsoever other than the belief that a free competitive market will tend toward a Pareto optimal situation in which, *by definition,* resources are said to be efficiently allocated and prices are said to be rational. There is no further criterion or justification for using the words efficient and rational than the assertion that the particular resource allocation and price structure obtaining in a free competitive market will have some connection with that envisioned in the analysis of Pareto optimality.

The social values underlying welfare economics

Acceptance of the efficiency or rationality of the free market solution to the problem of the allocation of resources demands that one accept the social values underlying the analysis. Moreover, one must accept the general framework of empirical and behavioral assumptions as being tolerably good reflections of reality. The above discussion of hedonism alludes to some social values which form the basis of the analysis. Those values should be made explicit.

The only values which count in Pareto analysis are the preferences of each isolated individual weighted by the purchasing power of that individual. Both the individualism and the distributional assumption must be separately considered.

The axiom of individual preferences is extraordinarily constraining. Because in the neoclassical analysis we have no way of evaluating the relative merits of different persons’ preferences, we likewise have no criterion for evaluating changes in a given individual’s preferences. To be able to do the latter would be to be able ipso facto to do the former. At the level of abstraction on which this theory is constructed the only differences among individuals are different preference orderings. There is absolutely no difference in the theory between the change in a given individual’s preference ordering and the complete withdrawal from society of one individual and his replacement by a new individual. For this reason the theory can consider neither the historical evolution of social and individual values nor their day to day fluctuations. To do so would be to admit the normative incomparability of any two events or situations which are temporally separated, i.e. to exclude all real life phenomena from the domain to which the theory is applicable. On the other hand, to permit such normative comparisons would be to return to the egalitarian conclusions of the philosophical radicalism of the early utilitarians and seriously weaken neoclassical economics as an intellectual support of the status quo.

It is therefore obvious that this theory is applicable only where individual preferences or tastes do not change over time. It is equally obvious that every person, including fanatics, lunatics, sadists, masochists, mentally incompetent persons, children, and even newborn babies must always be the best judge of their own welfare. (It might also be added that all decisions must be made individually and never simply by heads of families or other social groupings.) They must have perfect knowledge of all presently available alternatives and there must be no uncertainty about the future. Unless these conditions are realized then people will find that the utility they expect before an act will have no necessary relation to the utility realized after the act. and individual choices or preferences will have no demonstrable connection to an individual's welfare. This extreme individualism also breaks down when we admit the presence of envy and sympathy which make one individual's perception of his own welfare depend upon his perception of the welfare of others (this is, of course, a special case of the general problem of externalities, of which more will be discussed later).

The fact that any Pareto optimum can be defended as optimal only in relation to a specific distribution of wealth and income is, perhaps, the most decisive normative weakness of the theory. Although orthodox economists usually admit the incredibly restrictive relativity of any Pareto optimum, they tend to slur over it in passing and hurry on to safer topics before facing the embarrassing consequences of this condition. On the normative assumptions of Paretian analysis itself it can be shown that unless the existing distributions of wealth and income are socially optimal, then a situation which is Pareto optimal may be socially inferior to a large number of situations which are *not* Pareto optimal but which have distributions of wealth and income that are preferable to the one in question. Orthodox economists skirt this issue by inserting one standard sentence: "assume that the existing distributions of wealth and income are ideal *or that the government uses a system of taxes and subsidies to make them so.*

After stating this standard caveat the bourgeois economist proceeds to his policy analysis using cost—benefit techniques which are based upon the assumption of the normative and empirical adequacy of standard Paretian analysis. Never is there hint of the fact that the government has *never* used its taxing and spending powers to attempt to obtain a just distribution of wealth and power.

The lack of such an admission is not surprising because it would force orthodox economists to come to grips with the nature of social, economic and political power—an analysis of vested economic interests and their relation to political power has always been taboo for orthodox economists (and political scientists as well). The reason that no serious effort has ever been made to achieve a more just distribution of wealth and income — and the reason seems painfully obvious — is that the ordinary social, legal and political means of making such a redistribution are themselves an integral part of the initial distribution of wealth. To possess wealth is to possess political power in a capitalist system. The orthodox economist's hope that political power will be used to redress economic inequities is perhaps his most glaring blind spot (Samuels, 1972).

In practice, economists merely accept the existing distribution of wealth without question. But only rarely do they have the candor to admit that accepting the existing distribution of wealth implies accepting the existing system of legal and moral rules (including the laws of private property). More generally, it implies the acceptance of the entire system of social power, all roles of superordination and subordination as well as the institutions and instruments of coercion through which power is assured and perpetuated. Thus most of the important issues with which radical economists are concerned are eliminated from the orthodox economists' analyses with the initial assumption of the Paretian approach.

The empirical and analytical assumptions

In addition to these assumptions of individualism and distributional justice, the theory requires many further empirical and analytical assumptions. These make up the familiar textbook recitation of the conditions necessary for equilibrium under pure competition (and no orthodox economist has ever argued for any alternative means of achieving Pareto optimality in a capitalist economy). These include the assumptions: (a) a large number of buyers and sellers, none powerful enough to appreciably affect the market; (b) ease of exit and entry; (c) homogeneous inputs and outputs each divisible into units of any desired size; (d) no uncertainty about the future; (e) perfect knowledge of all present alternatives in production and consumption; (f) production functions having the appropriate second-order optimality conditions (i.e., being of smooth curvature, not having increasing returns to scale, and having diminishing marginal rates of substitution along any isoquant curve); (g) similarly appropriate utility functions which are stable over time; (h) productivity being unaffected by the distribution of wealth income and power; (i) all external economies or diseconomies being correctable or nullified with taxes, subsidies, and/or the creation of new property rights; and (j) all markets being always and continuously in equilibrium, with all change represented as instantaneous, static shifts from one equilibrium vector to another.

These assumptions do more than merely limiting the domain of applicability of the neoclassical analyses of competitive equilibrium. They totally overwhelm the whole analysis. Assumptions (a) and (b) of large numbers and ease of entry are the foundations of the orthodox concept of competition. But in the real, concrete historical development of capitalism they are the first casualities of competition. Real capitalist competition, unlike the neoclassical textbook variety, is warfare — a deadly struggle to eliminate rivals and achieve a monopoly. Competitive neoclassical equilibrium is often called long-run equilibrium. Real capitalist development, however, moves inexorably in the opposite direction.

Assumption (j), concerning the static nature of the theory, is indicative of the general inability of neoclassical economics to deal with economic phenomena in their historical development. Despite a veritable mountain of articles and books on economic growth, the neoclassical economists are unable to consistently integrate welfare and growth analyses. Once economic growth is admitted the neoclassical analysis itself shows that instability is the inevitable result (Hahn and Mathews, 1966, pp. 1-124). When instability and unemployment are admitted the Pareto criterion seems unimportant even to most neoclassical economists. Moreover, not only is there nothing in the system to insure golden rule growth, the essential question of *what* maximizes welfare in a growing economy is not clear. Is it maximizing the rate of growth, maximizing profit, maximizing consumption, maximizing consumption per head? And with each of these questions comes the issue of the nature and significance of a social rate of time discount to appropriately weight the welfare of unborn generations which is being decisively affected by current consumption and investment decisions. The various criteria of welfare in a growing economy have no necessary consistency (Hahn and Mathews, 1966, pp. 99-1131. The neoclassical Paretian criterion simply cannot handle such problems. It is, by its very nature, a static theory which cannot be extended to describe a growing or changing economy.

The remaining assumptions (c through i) all involve similar difficulties. Assumptions (d) and (e) about certainty and perfect knowledge abstract from two inevitable consequences of free-market capitalism which are of singular significance in understanding the human costs of the system's instability and misallocation of resources. Assumption (c) on homogeneity of inputs (particularly capital) and tf) about properly behaved production functions, have both been definitively shown to be untenable by the recent Cambridge capital controversy (see the contribution of Donald Harris in this volume). And finally assumption (i) about externalities is perhaps the most indefensible part of the entire analysis. We will examine it in greater detail later.

Welfare economics as a guide to policy making

Few neoclassical economists would argue that the assumptions underlying the theory of competitive equilibrium are realistic, but nearly all accept the social, moral and philosophical foundations of the Paretian welfare criterion. The lack of realism of the assumptions, however, does not prevent them from advocating the theoretical model as a basis upon which policy making by government officials should be based. The analysis should not, they argue be considered as descriptive of reality, but as a normative model that can be used to guide government interventions into the market place whenever various of the above assumptions necessary for competitive equilibrium are not met (Hunt, 1968). Two comments should he made regarding this view of government interventionism in a capitalist economy.

First, this bourgeois view gives government a shadowy existence. As long as Pareto optimality exists it is nowhere. When an imperfection occurs (it is generally regarded as an isolated occurrence in an otherwise perfect world) the government becomes a *deus ex machina* which restores the system to a state of bliss. It is an aloof, neutral, impartial arbitrator that descends on the scene, enacts an excise tax or gives a subsidy, the only purpose of which is to restore Pareto optimality. If the neoclassical economist is asked about vested interests, about corruption (which is, after all, simply another aspect of the functioning of the market), about economic and political power, or about class control of government processes, he replies with disdain that these are the concern of sociologists and political scientists (although one searches in vain for such concerns in orthodox social science).

The second criticism of Pareto optimality as a norm for government policy is even more damaging. Perusing the several necessary assumptions and contemplating the hundreds of thousands of interdependent markets in the contemporary capitalist economy, one is impressed by the certainty that at any moment there are, in fact, innumerable departures from any potential state of Paretian optimality. But according to the theory of the second best, policies designed to remedy only some and not all of the defects (since simultaneously remedying all would obviously be impossible) will often result in effects diametrically opposed to those envisioned by the authors of these policies. In the words of William J. Baumol:

> In brief, this theory [of the second best] states, on the basis of a mathematical argument, that in a concrete situation characterized by *any* deviation from perfect optimality, partial policy measures which eliminate only some of the departures from the optimal arrangement may well result in a net decrease in social welfare. (Baumol, 1965; Lipsey and Lancaster, 1956-57)

Where then does this leave the normative theory of Pareto optimality upon which the neoclassical notions of market efficiency and rational prices (not to mention the whole classical liberal argument for laissez faire capitalism) are based? The answer is obvious: It is riddled by even more acute contradictions than the economic reality from which it springs and for which it attempts to provide an ideological defense.

Welfare economics and externalities

The Achilles heel of welfare economics is its treatment of externalities (if a theory so utterly indefensible in so many of its facets can be said to have an Achilles heel!) In the usual neoclassical approach, the processes of production and consumption are assumed to have direct effects on only one or a few persons who are doing the producing or consuming (Mishan, 1971). Externalities occur when the utility function of one consumer is affected by the consumption of another consumer, or the production function of one firm is affected by the production of another firm, or, most importantly, the utility of an individual is affected by a production process with which he has no direct connection. The traditional neoclassical approach is to assume that, except for a single externality, Pareto optimality exists everywhere. With all prices other than those in the market in question reflecting perfect market rationality, then through a supposed process of extrapolation and/or interpolation (commonly referred to as cost-benefit analysis) the welfare economists claim to be able to simulate what would be the correct, rational market price in the absence of this lone externality.

The cost-benefit analysis by means of which externalities are to be corrected is itself a mere extension of the Paretian theory of allocative efficiency. As E. J. Mishan has stated:

> A person who agrees to apply the principles of allocative efficiency needs no new assumption to extend his agreement to the application of existing cost-benefit analysis. In sum both the principles of economic efficiency and those of cost-benefit analysis derive their inspiration from the ... Pareto criterion, and a person cannot with consistency accept the one and deny the other. (Mishan, 1973, p. 17)

The externality being analyzed is not really imagined to be the only actual deviation from Pareto optimality. Rather, it is asserted that this is only a tolerably close approximation to reality. Mishan, for example, asserts that although it is not expected that the economy at any moment in time, attains an optimum position, in its continuous adjustment to changes in the conditions of demand and supply, it may not be too far from an overall optimal position for any prolonged period. (Mishan, 1973, p. 80)

So when, in this set of circumstances, we find an externality, the beneficent, impartial *deus ex machina* is again called upon; this time to tax or subsidize in such quantities as to exactly nullify or neutralize the lone externality. Pareto optimality is restored. But the cost-benefit analysis that forms the foundation of the tax-subsidy approach to externalities is as unrealistic as a simple statement that there are no externalities at all, because it rests on the assumption of Pareto optimum prices in all markets except the one in question (Mishan, 1973, pp. 79-83).

Even more devastating criticism (if such is, indeed, needed) results when we realize that externalities are totally pervasive (d'Arge and Hunt, 1971). When reference is made to externalities, one usually takes as a typical example an upwind factory that emits large quantities of sulfur oxides and particulate matter inducing rising probabilities of emphysema, lung cancer, and other respiratory diseases to residents downwind, or a strip-mining operation that leaves an irreparable aesthetic scar on the countryside. The fact is, however, that most of the millions of acts of production and consumption in which we daily engage involve externalities. In a market economy any action of one individual or enterprise which induces pleasure or pain to any other individual or enterprise and is unpriced by a market constitutes an externality. Since the vast majority of productive and consumptive acts are social, i.e., to some degree they involve more than one person, it follows that they will involve externalities. Our table manners in a restaurant, the general appearance of our house, our yard or our person, our personal hygiene, the route we pick for a joy ride, the time of day we mow our lawn, or nearly any one of the thousands of ordinary daily acts, all affect, to some degree, the pleasures or happiness of others. Only the most extreme bourgeois individualism could have resulted in an economic theory that proceeded on the assumption of the existence of only a single externality.

With the recognition of the fact of pervasive externalities the tax-subsidy solution is seen clearly as the fantasy it is. This solution would require literally hundreds of millions of taxes and subsidies (in the United States alone)! Moreover, the imposition of any single tax or subsidy would undoubtedly create totally new externalities because a system of taxes and subsidies, as personalized as this system would have to be, would certainly create new patterns of envy and sympathy with each new tax or subsidy. This envy and sympathy would constitute new externalities for which there would have to be new taxes and subsidies. So the process would go on forever, with an infinitude of taxes and subsidies never getting us any closer to that most elusive of all bourgeois chimeras — Pareto optimality.

But the more reactionary element of orthodox theorists — the Austrian *cum* Chicago school —has never accepted the principle of discretionary government intervention into the market processes. Therefore, for many years they simply ignored externalities. In the late 1950s and early 1960s, however, Coase and his followers devised new formulations of their doctrines that permitted them to enter the debates on externalities that came into vogue in the late 1960s when even orthodox theorists could no longer ignore the environmental degradation of American capitalism.

The policy of the new reactionaries was to create new property rights to pollute the environment and then to create new markets in which these rights to pollute could be freely bought and sold (Crocker and Rogers, 1971). Presumably such trade would continue to the point where the marginal utility to the polluter of another dollar's added pollution would just equal the marginal disutility to the sufferers of pollution of another dollar's added pollution. At this point it would be impossible to effect a Pareto improvement by either increasing or decreasing pollution, and a new, laissez faire, competitive, Pareto optimum with pollution is attained (one should never underestimate the ingenuity of apologists)!

One might ask the new reactionaries: to whom would the neutral, impartial government assign these rights to pollute? To the poor residents in the polluted slums? To people chosen randomly? Or to the giant monopolies and oligopolies who do the polluting? The answer to this question might have been anticipated from a knowledge of the Austrian *cum* Chicago school's answer to every policy question of the past one hundred years: *if* we assume perfect competition, and *if* we assume perfect knowledge on the part of all producers and all consumers, and *if* we assume there are *no transactions costs* (that is, *if* we assume, for example, that all of the isolated, powerless, low income sufferers who are the victims of a giant, monopolistic, corporate polluter, can *costlessly* organize themselves so they can bargain as one with the polluter), then, these apologists argue, it can be demonstrated that "the initial allocation of property rights has no effect on allocative efficiency." With these assumptions the inevitable conclusion is that within a laissez-faire capitalist market the "failure to reach mutual agreement . . . can be regarded as *prima facie* evidence that . . . a *net* potential Pareto improvement is not possible" (Mishan, 1973, p. 17). This is, however, too obviously apologetic for the more candid neoclassical economists. E. J. Mishan, for example, writes: "Rationalizing the *status quo* in this way brings the economist perilously close to defending it" (Mishan, 1973, p. 17). Perilously close indeed!

Reflecting the extremely individualistic orientation of the new reactionaries is their view of the nature of externalities. They simply take the externalities, for which property rights and markets are to be established, as somehow metaphysically given and fixed. In ignoring the relational aspects of social life their theory ignores the fact that individuals can create externalities almost at will. If we assume the maximizing economic man of bourgeois economics, and if we assume the government establishes property rights and markets for these rights whenever an external diseconomy is discovered, then each man will soon discover that through contrivance he can impose external diseconomies on other men, knowing that the bargaining within the new market that will be established will surely make him better off. The more significant the social cost imposed upon his neighbor, the greater will be his reward in the bargaining process. It follows from the orthodox assumption of maximizing man that each man will create a maximum of social costs which he can impose on others. In another paper I (and a co-author) labeled this process "the invisible foot" of the laissez-faire capitalist marketplace (Hunt and d'Arge, 1973). The "invisible foot" ensures us that in a free-market, capitalist economy each person pursuing only his own good will automatically, and most efficiently, do his part in maximizing the general public misery.

To see why this principle has some validity, note that a self-oriented individual will maximize the value, to him, of participating in organized markets and creating nonmarket transactions. Taking this production possibility set for creating external diseconomies, he will select only those with a higher return than he could earn by engaging in market transactions. But by so doing, he will maximize the cost to others in that his gain is someone else's loss. All individuals acting independently to maximize the cost imposed on others will yield a maximum of these costs or payments to society, that is, by selecting only highly productive external effects. The recipient of contrived or inadvertent external diseconomies will undertake defensive expenditures or pay bribes until the usual marginal conditions of efficiency are fulfilled. Thus, the recipient's cost will be minimized for each external diseconomy, and an efficient pattern of external diseconomies will emerge (Hunt and d'Arge, 1973, pp. 348-49).

But if external diseconomies, in terms of value to the generator, are maximized in the society and if they are efficiently contended with by recipients, then we have a mirror image of consumption theory and Pareto efficiency. That is, instead of allocation of a good to its highest value use with its production costs minimized, we have allocation of a bad (external diseconomy) to its most costly impact, with the impact being minimized in terms of recipient cost as well as production costs. The economy, of course, is efficient but efficient only in providing misery. To paraphrase a well-known precursor of this theory: *Every individual necessarily labors to render the annual external costs of the society as great as he can. He generally, indeed, neither intends to promote the public misery nor knows how much he is promoting it. He intends only his own gain, and he is in this, as in many other cases, led by an invisible foot to promote an end which was no part of his intention. Nor is it any better for society that it was no part of it. By pursuing his own interest he frequently promotes social misery more effectually than when he really intends to promote it.*

External economies also offer incentives for individual gain, but the incentive structure here is basically different than for external diseconomies. Without liability or nuisance rules that establish social responsibility, it is in the interest of both generator and recipient to negotiate on external diseconomies. However, with external economies the recipient gains more by attempting to be a free rider except, perhaps, at the margin. In consequence, the incentive for creating or producing external economies is less than that for external diseconomies, except perhaps for altruists. The policy prescriptions for resolving external diseconomies by assigning property rights or using governmental taxing and subsidy powers are doomed to failure because neoclassical economists fail to analyze the social forces underlying the incentive structure in the competitive system. It appears to be an impossible task to develop legal rights on every type of physical, biological, and social interdependence, or a rational taxation system that will eliminate external diseconomies. Rather, to move toward a better efficiency of the economic system the incentive system itself needs alteration. Needless to say, however, this is a task that goes far beyond the purview of orthodox neoclassical economics.

The theory's absolute inability to handle pervasive externalities should more than suffice to convince any reasonable person of its utter irrelevance, particularly in the light of the conclusion of the theory of the second best, viz., that attempts to partially achieve Pareto optimality may well have effects diametrically opposed to the intentions of the initiators of the attempts. But the theory is much worse than irrelevant. The more candid and honest orthodox economists are, themselves, admitting this. One of the most eminent recently wrote:

> The achievements of economic theory in the last two decades are both impressive and in many ways beautiful. But it cannot be denied that there is something scandalous in the spectacle of so many people refining the analysis of economic states which they give no reason to suppose will ever, or have ever, come about. It probably is also dangerous. Equilibrium economics, because of its well known welfare economics implication, is easily convertible into an apologia for existing economic arrangements and it is frequently so converted. On the other end of the scale, the recent, fairly elaborate analysis of the optimum plans for an economy which is always in equilibrium has, one suspects, misled people to believe that we actually know how an economy is to be controlled . . . It is an unsatisfactory and . . . dishonest state of affairs. (Hahn, 1970)

The normative critique of Paretian analysis

Many economists regret this state of affairs. “Too bad,” they say, “that the theory is so irrelevant. It is so elegant and analytically sophisticated, and seems to have such universal normative appeal.” This lament, it seems to me, is misplaced. The normative objections to the theory are more damaging than all of the practical, empirical and analytical objections raised to this point. Orthodox welfare economics accepts as the ultimate ethical criteria of social value the *existing* desires, generated by the institutions, values, and social processes of *existing* society, and weighted by the *existing* distributions of income, wealth and power. Accepting them as such the theory becomes by its very nature incapable of asking questions about the nature of an ethically good society and the ethically good man that would be the product of such a society. The plausibility of the normative criteria of the theory derives from the widely felt moral repugnance toward the notion of an omnipotent central government arbitrarily and capriciously dictating the choices and behavioral patterns of individuals. Moral rejection of this Orwellian spectre should not, however, be confused with the imagination that existing society reflects that spectre’s antithesis. Orwell’s *1984* was, after all, merely the extension of tendencies which he saw in the capitalist economies of his day. We are closer to *1984* than was Orwell.

Commenting on a lifetime of psychoanalyzing people afflicted by the system of desires generated by capitalist society, Erich Fromm has written:

> Man today is fascinated by the possibility of buying more, better and especially new things. He is consumption-hungry. The act of buying and consuming has become a compulsive, irrational aim, because it is an end in itself, with little relation to the use of or pleasure in the things bought and consumed. To buy the latest gadget, the latest model of anything that is on the market, is the dream of everybody in comparison to which the real pleasure in use is quite secondary. Modern man, if he dared to be articulate about his concept of heaven, would describe a vision which would look like the biggest department store in the world, showing new things and gadgets, and himself having plenty of money with which to buy them. He would wander around open-mouthed in his heaven of gadgets and commodities, provided only that there were ever more and newer things to buy, and perhaps that his neighbors were just a little less privileged than he. (Fromm, 1965. p. 123)

Human nature does not automatically produce the consumption-hungry capitalist man, so necessary for the smooth, profitable operation of our economic system. Capitalist man is created through an elaborate system of social control, manipulation, deception and general verbal pollution.

Deception is learned early through television advertising, magazine ads, sales pitches in department stores, pervasive cheating on income taxes, etc., etc. It soon becomes apparent that the entire system *runs* on corruption. In the late Professor Edwin H. Sutherland's survey of white collar crime in the nation's 70 largest nonfinancial corporations (Sutherland, 1961), he found 980 court decisions against these corporations (in a system in which law enforcement and the judiciary are certainly not noted for their vigorous enforcement of the laws typically broken by executives of giant corporations). One corporation had 50 decisions against it, and the average per corporation was 14. Sixty of the corporations had been found guilty of restraining trade; 53, of infringements; 44, of unfair labor practices; 28, of misrepresentation in advertising; 26, of giving illegal rebates; and 43, of a variety of other offenses. There were a total of 307 individual cases of illegal restraint of trade, 97 of illegal misrepresentation, 222 of infringe- merit, 158 of unfair labor practices, 66 of illegal rebates, and 130 of other offenses (Lundberg, 1968, pp. 131-32). Not all those cases were explicit criminal cases. But 60 percent of the corporations had been found guilty of criminal offenses an average of four times each.

From May 10, 1950, to May 1, 1951, a United States Senate Special Committee to Investigate Crime in Interstate Commerce, under the chairmanship of Senator Estes Kefauver, probed the connections of business and organized crime. Senator Kefauver, Democratic vice-presidential candidate in 1956, later wrote a book based on those hearings. Although he emphasized the fact that there was no evidence to link most big corporations with organized crime, he was nevertheless greatly alarmed at the extent of such connections:

> I cannot overemphasize the danger than can lie in the muscling into legitimate fields by hoodlums . . . there was too much evidence before us of unreformed hoodlums gaining control of a legitimate business; then utilizing all his old mob tricks — strong-arm methods, bombs, even murder — to secure advantages over legitimate competition. All too often such competition either ruins legitimate businessmen or drives them into emulating or merging with the gangsters. The hoodlums are also clever at concealing ownership of their investments in legitimate fields — sometimes . . . through "trustees" and sometimes by bamboozling respectable businessmen into "fronting" for them, (Kefauver, 1951, pp. 139-40)

In 1960, Robert Kennedy, who later became Attorney General of the United States, published *The Enemy Within.* He gathered the material for this book while serving as chief counsel of the United States Senate Select Committee on Improper Activities in the Labor or Management Field. Kennedy, like Kefauver, stressed the fact that he was not condemning all, or even most, businessmen. He wrote that:

> we found that with the present-day emphasis on money and material goods many business-men were willing to make corrupt "deals" with dishonest union officials in order to gain competitive advantage or to make a few extra dollars . . We came across more than fifty companies and corporations that had acted improperly — and in many cases illegally — in dealings with labor unions . . . in the companies and corporations to which I am referring the improprieties and illegalities Were occasioned solely by a desire for monetary gain. Furthermore we found that we could expect very little assistance from management groups. Disturbing as it may sound, more often the business people with whom we came in contact — and this includes some representatives of our largest corporations — were uncooperative. (Kennedy, 1960, p. 216)

Kennedy's list of the names of offending companies included many of the largest and most powerful corporations in the United States.

Ferdinand Lundberg has described the extent to which corporate leaders and management receive either very light punishment or no punishment at all when they become involved in improprieties or illegalities. Among the many cases he cites is

> the case of the bribe of $750,000 by four insurance companies that sent Boss Pendergast of Missouri to jail, later to be pardoned by President Truman . . . It was almost ten years before the insurance companies were convicted. Then they were only fined; no insurance executives went to jail. There was, too, the case of Federal Judge Martin Manton who was convicted of accepting a bribe of $250,000 from agents of the defendant when he presided over a case charging exorbitant salaries were improperly paid to officers of the American Tobacco Company. While the attorney for the company was disbarred from federal courts, the assistant to the company president (who made the arrangements) was soon thereafter promoted to vice president: a good boy. (Lundberg, 1968, p. 139)

In more recent times the escapades of I.T.&T. come to mind. Undercover, clandestine "deals" to "buy off" the antitrust division of the U.S. Department of Justice are matched in audacity only by an offer to the United States Government of one million dollars to help to subvert the duly elected government of Chile.

At the level of government the deception gets worse. The revelations of 3,500 secret bombing raids over Cambodia in the period preceding the President's speech in which he stated that the United States had not violated Cambodia's territorial sovereignty; the revelations of deliberate bombings of hospitals; the Watergate scandal in which it was learned that powerful Democrats and Republicans were fair game for the illegal spying and intimidations that the government had supposedly used only against socialists and radicals; all of these came on the heels of the publication of the *Pentagon Papers* which showed the pervasive long-term public deceptions aimed at hiding the motives and facts of American foreign policy from the voting public.

In this economic and political system based on corruption and deception, each lonely, isolated individual is pitted against all other individuals in merciless competition. Is it any wonder that the result is nearly universal disorientation, apathy, and despair? A pervasive sense of the emptiness and futility of life is the basic foundation upon which corporate advertising executives create the capitalist man. Such a man watches commercials in which bright, happy, vivacious people are buying new cars, houses, stereos. He then strives to overcome his own unhappiness and anxieties by purchasing. Purchase, purchase, purchase becomes his Moses and his prophets. But he gets no relief so he sets his sights on a bigger car, a more expensive house, etc., and he is aboard the Alice-in-Wonderland treadmill of consumerism.

Such are the desires of the isolated, egoistic, alienated, manipulated economic man created by the capitalist social system. These form the moral foundation upon which neoclassical welfare economics is constructed. Many bourgeois economists, when confronted with the arguments of this article (as well as many other criticisms which could be made) will admit that welfare economics cannot be defended on normative, empirical, or analytical grounds. Nevertheless, they continue to use concepts, which are only defensible on the assumption that the Paretian analysis is accepted, in most lines of applied economics. Paretian efficiency notions underlie the theory of comparative advantage in international trade theory, they underly most normative conclusions in the neoclassical theory of public finance, most cost-benefit analyses, and nearly every other area in which neoclassical economics culminates in policy recommendations. Even worse are the rarely defended, sanctimoniously stated cliches and shihboleths about rational prices and market efficiency in that most ideologically tainted of all neoclassical academic specializations, comparative economic systems or the analysis of socialist economies.

The pervasive use of subtle variations of the elements of Paretian analysis in most areas of applied economics is inherently conservative. Even when the economist using this analysis has the most progressive and humane intentions, the very foundational presuppositions of welfare economics have a significant tendency to thwart such intentions. Consider the presuppositions; a view of people as one dimensional, calculating maximizers, a basic moral postulate that exalts infinite greed, and an ahistorical view of isolated, alienated competitors that totally ignores their history, institutions, and power relationships, an acceptance of the existing distribution of wealth and income, the system of moral and legal rules, property rights, social power, all of which then enter into an assumed harmonious general equilibrium. Such an analysis can hardly be a useful vehicle for the study of class conflict, economic crises, alienation, racism, sexism, imperialism, militarism, and all of the other problems of contemporary capitalism. And if critical overkill is necessary, the theory can be shown to be riddled with empirical as well as logical shortcomings. For these reasons I believe the greatest barrier to constructive radical economic analysis for an individual trained in a bourgeois economics department to be the necessity of intellectually transcending the habits of thought inculcated through years of intensive study of neoclassical welfare economics in both its pure and applied forms.

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