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Book Review: Debunking Economics: The Naked Emperor of the Social Sciences

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Augustana College-Sioux Falls, SD USA

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While I might disagree with Smock, her book stimulated and deepened my thinking about the value and limitations of community organizing and caused me to check out new sources and review old favorites. For me, that is the test of a good book.

Marie Kennedy
College of Public and Community Service
University of Massachusetts–Boston
E-mail: marie.kennedy@umb.edu

Debunking Economics: The Naked Emperor of the Social Sciences
Steve Keen; London: Zed Books, 2002, 335 pp. with references and index, $27.50 (paperback).
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Back in junior high school, my mother would drop me off at a football game and admonish me to "Play nice!" I did. One suspects that Professor Keen's mother never said the same to him while dropping him off at an Aussie Rules footy match. Either that or this University of Western Sydney professor has outgrown it; Steve Keen is done playing nice. Through *Debunking Economics* and its accompanying Web site, http://www.debunking-economics.com/, Keen provides a forceful head-on critique of the internal logic of mainstream textbook economics. It is some of the most forceful and persuasive work done since Piero Sraffa and John Maynard Keynes, both of whom Keen draws upon for arguments and inspiration. Marxists be warned, Keen is highly critical of the labor theory of value and those who continue to employ it. However, he continues to view a reformed Marxism as a possible alternative to neoclassical dogma.

Neoclassicals ignore Keen at the risk of their further irrelevance. Radicals should add Keen's critique of neoclassical theory to their playbook. The text serves as a provocative supplement for an intermediate or graduate-level microeconomics course. Principles-level students would find it too difficult. Even my best second- and third-year undergraduate students struggled with the level of technical difficulty. *Debunking* will be of general interest to social scientists and others seeking a critique of the internal logic and mathematics of neoclassical economic theory. Contrary to claims on the back cover, mastering Keen's arguments requires not only an open mind, but also at least a course—probably two or three—in economics.

Dr. Keen's book is divided into three sections: Foundations, Complexities, and Alternatives. Each section has four or five chapters. They follow an engaging preface and a single-chapter introduction. Even in the preface, the theory of the second best is introduced. Here Keen notes that in a world with both unions and monopolies, abolishing one may not necessarily increase social welfare. Or as Keen eloquently explains, "a single step towards the economist's Nirvana takes you not closer to Heaven but towards Hell." It only gets better from there. My review of the book overemphasizes the foundational first third of the text. It is here that Keen puts the mainstream on the defensive and his arguments are of the greatest value to fellow radicals. Three short examples provided here give the reader a sense

of the issues at stake and the way in which Keen goes about yanking up neoclassical textbook economics by its roots.

In chapter 2, Keen carefully lays out and then eviscerates the standard demand theory story. Economists derive demand curves from indifference curves and budget constraints by changing prices and plotting the resulting changes in quantity demanded. Although it is easy enough to change prices and plot out how quantity demanded changes for an individual, it is not so easy to do this for the market as a whole. The problem is that in a general equilibrium framework of neoclassical theory, a change in prices necessarily means a change in income distribution. Thus, when a social-indifference curve is considered, any change in price must change the distribution of income. In a world where individuals have preferences that differ from each other, a change in income means the underlying social-utility map will change. In fact, every distribution of income will be associated with a different social-utility mapping. In contrast to the individual case, when preferences are aggregated, the budget constraint and the preference hill are logically interdependent functions for two reasons. First, when the distribution of income changes, the weighting attached to each individual in the aggregate changes. Some are better (and others relatively less) able to now act on their preferences than they could with the previous distribution of income. Second, as income rises for some, their preferences change. For instance, as consumers become richer they are more likely to buy imported chocolate and less likely to drink generic beer. Thus, a market-demand curve cannot be derived by changing prices along a social-utility curve. Attempts to do so will yield indeterminate results. The resulting market-demand curves are unlikely to be smooth downward-sloping functions.

Keen says that neoclassicals have overcome this general equilibrium problem by making one of two assumptions. First, they assume that income is fixed. This is problematic since we then lose the neoclassical theory of income distribution based on marginal productivity. Alternatively, we could just assume that all Engels curves have the same slope and that this slope is constant. This sounds esoteric enough that by the time students hear about it in graduate school, they are willing to swallow the assumption. However, Keen points out that this assumption requires us to believe the unlikely assertion that all commodities are neither necessities nor luxuries. It also requires us to believe that as income changes the proportion of the budget spent on each good does not change. And, the kicker here, all individuals must experience this same phenomenon. This is what we are assuming when we take the shortcuts of assuming a representative agent and a representative good. Note the irony of an economic system that celebrates markets and free choice founded on an economic model that assumes we are all the same and that our preferences do not change as our income changes.

Keen's critique of supply theory in chapter 3 is equally devastating. As most economists appreciate, it is the assumption of diminishing marginal product that creates increasing marginal costs. When these marginal cost curves are summed together (above average variable costs) an upward-sloping supply curve is generated. No empirical data is necessary to reach this result. Keen asserts most real-world factories are specifically designed with excess capacity to prevent the occurrence of diminishing marginal product. As a result, the costs of production for most goods are constant or falling as output increases. (This assertion would have been even more persuasive with the addition of supportive empirical evidence.) Still believe in upward-sloping supply curves? In addition to carefully explaining

this argument and critique in words and diagrams, Keen recounts Sraffa's arguments about why supply and demand are necessarily interdependent. He also shows that when notions of chronological time are introduced to the model, profits are no longer maximized where marginal revenue equals marginal cost. By this point in the book, there is little left of the traditional supply-and-demand model.

Keen continues his assault on textbook neoclassical theory in chapter 5 by showing the collective irrationality embedded in individual firms maximizing profits. Let us engage in a thought experiment. Imagine a standard monopoly model. Above it, mentally sketch in the total revenue, total cost, and (if you wish) a profit function. Remember the total-revenue function is curved because the monopolist must lower the price on the marginal unit sold to increase the quantity demanded. It begins at the origin. The total-cost function is also curved and sloping upward. Because of fixed costs, the total-cost function intersects the vertical axis above the origin. You know the drill. Where marginal revenue (MR) equals marginal cost (MC) determines the profit-maximizing output level. One draws a line down to this point and another line up to the demand curve to determine the price for a single-price monopolist. If one continues that line all the way up to the other diagram, one sees that this corresponds with the profit-maximizing level as determined by total revenue and total cost. Usually the story ends there. But Steve Keen asks, why not consider where a perfectly competitive firm would produce?

The perfectly competitive firm produces out to the point where the marginal cost intersects the demand curve. If we find this intersection and take it up to the top diagram, we find that profit is not maximized! Since Adam Smith, we have been told that the individual pursuit of self-interest furthers the social interest. But here, we see that collective irrationality must exist to drive perfectly competitive firms to produce beyond the point where industry profits are maximized. And even if perfectly competitive individual firms do not have marginal revenue functions that differ from their demand curves, the industry as a whole surely does. It is examples like this, with their accompanying diagrams and sardonic prose that show, chapter after chapter, the logical inconsistencies within the neoclassical framework. In the latter two-thirds of the text, Keen directs his intellect and wit to the problems of time, aggregation, finance, methodology, and the role of mathematics in economics. These topics will likely be of interest to many readers of this journal.

The book has two shortcomings: it is too short and it is too long. First, the book thoroughly critiques textbook-variety neoclassical economics. However, the final chapter is woefully underdeveloped. After tearing down much of orthodoxy and taking a solid shot at Marxism along the way, students are left facing a nihilistic abyss with only brief caricatures of Austrian, post-Keynesian, Sraffian complexity theory (Keen's likely favorite), and evolutionary/institutional economics. A stronger set of alternative paradigms should be developed. This may require another chapter or two to sufficiently develop them. Alternatively, pairing Keen's book with Frank Stilwell's (2002) *Political Economy: The Contest of Economic Ideas* from Oxford University Press may be a better way of overcoming this shortcoming. Additionally, it would be useful for Keen to pen additional chapters pointing out the shortcomings of game theory and of econometrics in future editions of this text.

The book is also too long. I have successfully used this book in an intermediate micro course. However, I used less than half of the book. Dr. Keen and his publishers may want to consider creating a shorter text explicitly aimed at the intermediate micro and/or graduate

micro textbook market. This would require only the first five chapters of the text and perhaps the enhanced "alternatives" chapter or two noted above. It would also eliminate some student confusion if Keen adopted the typical textbook distinction between "quantity demand" and "demand."

In any case, Dr. Keen's logic and wit urge us to "Stop playing nice!" If radicals and other heterodox economists hope to take the ball a few more yards up the field (or advance it with a kick like they do in Aussie Rules footy), Steve Keen's book gives us a new offensive weapon. One concrete way to lead the offense is to adopt this book as a supplement to your intermediate microeconomics course. We might not be able to reeducate our mainstream economist friends. However, we can educate part of the next generation of political economic thinkers to the fundamental flaws of the theory and thereby—funeral by funeral—make progress. By adding Keen to your intermediate micro course, you may actually look forward to teaching intermediate microeconomics. Besides, denying the true believers in your department the opportunity to continue the ideological indoctrination that has substituted for education in intermediate microeconomics for far too long will likely enhance your students' understanding of how contemporary capitalism works.

Reynold F. Nesiba
Augustana College
Sioux Falls, South Dakota
Email: reynold.nesiba@augie.edu

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