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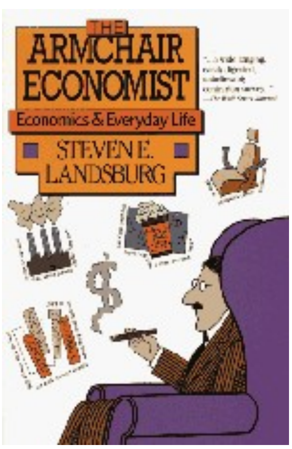
Reviews

'The armchair economist'

reviewed by Mark Wainwright



The armchair economist: economics and everyday life

Stephen E. Landsburg

"Economic theory predicts that you are not enjoying this book as much as you thought you would", remarks Steven E. Landsburg at the start of one of the most enjoyable chapters of *The Armchair Economist*. The point turns out to be this: the fact that you have chosen to read it is a sign that you have probably overvalued it in relation to all the other books you could have read instead.

Landsburg has written a very clear introduction to the thinking of a particular kind of economist: those of the so−called Chicago school of which he is himself a member. Where their thinking is confused, the book is confused; where it is clear, so is the book. Since economists of this kind are still vastly influential in public policy (though less so academically than in their heyday), this primer to understanding their thinking is useful and important. If you come to it, as I did, expecting deep insights into the world (rather than merely the mind of economists), then large tracts of it are quite absurd − so the prediction of economic theory about my enjoyment of the book held up pretty well. But I did enjoy it, and would recommend it.

In his theoretical asides, Landsburg is at pains to emphasise that economics should measure people's overall happiness, not merely their financial welfare; and that how to optimise this across many people is not a question capable of a scientific answer. Even if we could somehow measure everyone's happiness on some scale, what next? Do we maximise their sum, or their product, or the happiness of the least happy person, or something else? This can only be a matter of preference. This at least is the position Landsburg pays lip service to, but he makes it very clear he doesn't believe it.

The Chicago school relies heavily on using high−powered theorems to create mathematical models of the marketplace − theorems with, in general, very unrealistic assumptions. One says that under certain circumstances (for a more precise statement you'd better read the book), markets reach the most efficient outcome possible. "Efficiency" simply means maximising the sum of individual payoffs. So when Landsburg says (pp. 104−5):

> *we know on theoretical grounds that [under suitable conditions] market prices maximise the excess of benefits over costs. In these circumstances, we can confidently predict that a price control must be a bad thing relative to a market outcome, even without calculating any costs or benefits explicitly.*

we know that though he can't bring himself to admit it, he is taking this simple sum of payoffs as being the only possible yardstick by which to measure outcome; any other would be immoral (a "bad thing"). Here is how you measure "efficiency" of, say, a proposed policy measure in practice, by a cost−benefit analysis (p.102):

> *if we envision a change in policy ... we can imagine the following experiment. Line up all of the people who support the status quo and ask each of them, "How much would you be willing to pay to prevent this policy from being changed?" Add the responses, and you have measured the total cost of the policy change. Now line up all of the people who support the change and ask each of them, "How much would you be willing to pay to see this policy changed?" The sum of their responses is the total benefit.*

This idea is at the heart of the first two−thirds of the book, and, obviously, it is absurd for the following reason: asking people how much they would pay is less a measure of how much they want something than of how much money they have. Take the example (considered by Landsburg at length) of a proposed new factory which will enrich the owners but pollute the air of local residents. If the neighbourhood is a poor one and the residents have no money beyond what they need to feed and clothe themselves, then, no matter how unhappy the proposed factory may make them, they cannot express their preference with money so it is not counted by Landsburg's cost−benefit analysis. (Imagine choosing a government by this cost−benefit method.) It's no surprise that again and again through the book, Landsburg's prescriptions seem to favour the rich over the poor.

Nor is this the only way they do so. He notes (p.104): "Confronted with a policy that would enrich a Rockefeller by $1,000 at the cost of $900 to a struggling single parent, the cost−benefit criterion recommends acceptance" (though he admits that even economists might want to depart from strict adherence to the criterion in this specific case). The grudging admission further demonstrates how Landsburg confuses happiness with money, in spite of explicitly denying he does so, since anyone less blinkered could see that $900 is worth far *more* to a struggling single parent than $1,000 is to a Rockefeller.

Landsburg justifies the definition of "efficiency" as a sum of payoffs by saying that, even if someone loses out by one policy decision, they will probably gain in the long run if the criterion is applied consistently. This would be quite true if the costs and benefits were applied randomly, but if they have a systematic bias the story is quite different. As they are, in fact, systematically biased to favour the rich, the cost−benefit criterion turns out to be morally bankrupt. There are probably literally hundreds of examples in the book which make the same basic error, and assorted others too. It's no surprise that he affects astonishment (p. 227) that anyone could have rationally objected to the suggestion of the chief economist of the World Bank that polluting factories should be moved to developing countries.

In spite of this, there are many astute pieces of analysis in the book, so it is valuable for more than just the insight it gives into the thinking of economists. The section near the end on "How markets work", from which the quotation at the start of this review is taken, is superb, and is alone worth the cover price. The chapter in that section on "Courtship and collusion" examines what is in effect the Prisoners' Dilemma problem from an economic mindset. (A consequence of it would seem to be that people should be compelled to vote, the opposite of a conclusion reached in one of the earlier and more evangelical chapters.)

In short, this is a fascinating, infuriating book. In spite of its absurdities it should be read by anyone who wants to know how economists think about the world.

Book details:

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About the reviewer

Mark Wainwright is an ex−assistant editor of *Plus*.

Plus is part of the family of activities in the Millennium Mathematics Project, which also includes the NRICH and MOTIVATE sites.