The Review of Austrian Economics, 16:4, 381–384, 2003.

Review

Steve Keen (2001) *Debunking Economics*, Annandale, NSW, Australia: Pluto Press, 335 + ix pp., $27.50

Debunking Economics is a bold attempt to shake the foundations of the neoclassical economic mainstream. Embarking on this review, we had suspected we might find large areas of agreement with a fellow apostate. However, Keen's work suffers from many of the very faults of which he accuses the mainstream. The most troublesome is that Keen's work is quite frequently ideologically motivated, even while criticizing neoclassical practitioners for ideological economics. In the end we find it a brave but flawed effort to dethrone the current economic orthodoxy.

Methodological Holism Versus Methodological Individualism

Keen demonstrates that many attempts to aggregate quantities applying to individuals, so as to come up with a measure for "society's utility" or "society's indifference curves," lack coherence. Fair enough. But the conclusion he draws from that fact is an ideological one. After pointing out the flaws in certain aggregate measures, Keen says, "society must exist as an entity in its own right" (p. 40). But that doesn't follow from his argument; indeed, we would say Keen hasn't taken the argument far enough. "Social utility" is a meaningless concept, period, and so it is not surprising that (as Keen shows) it cannot be calculated from individual utilities.

"Society" is one of many useful concepts with which individuals comprehend their world. It is true that there are many aspects of individual experience from which we can usefully abstract a social aspect. But it is purely metaphysical speculation to imagine that an abstraction from individual experience exists apart from the individual experience itself. (Ironically, Keen immediately follows the quote above with a criticism of the mainstream for its "unscientific nature.") As we see it, society is a network of practices, practices whose existence is entirely dependent upon their being subscribed to by individuals.

Keen goes on to say, "society is something more than the sum of its individual members" (p. 47). Keen believes that his truism explodes the economist's traditional "atomistic" method of focusing on the individual (e.g. p. 261 and p. 306). But this doesn't follow at all: All "social" outcomes are the composite of individual actions, even if such actions are influenced by the existence of others. One does not show the limitations of physics by pointing out the influence of *The Communist Manifesto*.

The idea of society as an independent being above and beyond its members is, of course, a key element in many collectivist ideologies. Keen, in reaching conclusions that do not follow from the arguments he presents, is letting his ideological slip show.

Mathematical Economics

Keen's critique of mathematical economics is emblematic of the book as a whole: he takes many shots at the mainstream, and some of them hit the target. For instance, we think his suggestion that mathematical economics pursue research in dynamic systems and simulations is sound.

We especially liked the discussion (pp. 178–183) of dynamic versus static models, and the example of a dynamic system with multiple, unstable equilibria that nonetheless oscillates in the neighborhood of those equilibria. We feel this is a good metaphor for the real economy, which possesses what may be called equilibrating forces—forces that keep the economy from going too far "awry"—but never actually *achieves* equilibrium. As Keen puts it, "rather than equilibrium being where the action is, equilibrium tells you where the model will *never* be" (p. 183).

In addition, Keen does a good job in highlighting some of the contradictions at the heart of the theory of perfect competition. The elementary problem with the theory is that rather than employing the limit analysis implicit in its equations to examine conditions as perfect competition is approached, analysis proceeds as if the system were *at* its limit, leading to various conundrums.[1]

Keen offers a clever analogy to explain the problem: one can "prove" that the Earth is flat if one is allowed to treat the tiny local deviations from flatness as non-existent (p. 86). All of these contiguous, flat segments of the Earth must yield a flat Earth as well.

In fairness to Keen, we note that he is willing to follow his theorizing even when it leads him onto ideologically foreign territory. Keen, who clearly sees himself as more interventionist than his neoclassical colleagues, here attacks an argument for anti-trust laws. And Keen admits that the neoclassical mainstream follows their own logic to argue *for* intervention to control monopolies.

However, in his zeal to attack mainstream economics, Keen often overshoots. After "debunking" the notion that the production of a firm is constrained by rising marginal costs, Keen asks what *does* constrain a firm's production? Quite oddly, his answer is "rising marketing and financing costs" (p. 73). But those are rising marginal costs themselves! Keen has fallen prey to the fallacy, exposed by Mises ([1949] 1998:319), that there is any important economic difference between "production costs" and "sales costs."

The Uniqueness of Labor

His ideological bias is epitomized in Keen's analysis of labor. He repeats the cliché that labor is a unique commodity, and is therefore exempt from the traditional laws of supply and demand (pp. 111–112).

But there is nothing to distinguish the supplier of labor (who *ceteris paribus* prefers leisure) from a supplier of wood pulp (who *ceteris paribus* prefers the beauty of his virgin forest). The fact that the laborer depends on his wages for sustenance is irrelevant, since *all* sellers of commodities use their income to obtain life's necessities. (After all, couldn't the proverbial "bond coupon clipper" claim that she is "forced" to accept whatever interest rate prevails on the market, since she relies on her coupons to eat, and is therefore also subject to "exploitation"?)

Keen (2002a) argues that there truly is a difference, since the supply of labor is fixed at 24 hours per day, while the sellers of other commodities can increase their output. But this rejoinder relies on the very same assumptions of convenience that Keen ostensibly abhors. The short-run supply of trees is just as fixed as the short-run supply of labor hours; the owner of a forest can't cut down more trees *today* than are standing on his property. Furthermore, Keen's model of labor is every bit as unrealistic as the neoclassical model of firm production (which Keen ridicules). In truth, a person's body is a machine that produces a variable amount of "service," just as a plot of land can be cultivated intensively to squeeze more trees out (at future cost). A worker certainly cannot supply 24 hours of labor per day for any extended period.

We thus see that Keen's attack on the mainstream, "apologist" belief in wages equaling marginal productivity, is unfounded. Like his orthodox opponents, Keen has used a simplified model that yields the conclusion (labor is exploited by capitalism) that he wants.

Heterodox Schools

Keen includes interesting sections on various heterodox schools, including Marxism, evolutionary economics, complexity theory, Post-Keynesian economics, Austrian economics, and Sraffian economics. He seems to come down on the side of evolutionary economics as having the most promising future (p. 311).

Keen has an excellent discussion of Marx's labor theory of value (pp. 278–295), in which he demonstrates that it is not even internally consistent. However, Keen instead posits a real-cost theory of value, ignoring the Austrian insight that costs themselves are subjective. He never addresses the theory of subjective value, but instead baldly states the somewhat stunning proposition that "the subjective utility of the buyer and seller are irrelevant to the price" (p. 273). What in the world could Keen mean? If one just drives one's cost in making mud pies high enough, one can charge an arbitrarily high price for them?

Keen is not unsympathetic to the Austrian School, but it does not seem to us that he fully understands it. For instance, Keen gets the posited effect of interest rates on the "roundaboutness" of production backwards. (Keen has later acknowledged that the section is in error [2002b].) He is also wrong in implying that the Austrians depend on an equilibrium analysis of returns to factors of production to defend distribution in the market economy. (In fact, the Austrian analysis of the return to entrepreneurs relies entirely on disequilibrium conditions.)

Furthermore, Keen's debunking of the "equilibrium always" view of Say's Law does not refute Say's Law (pp. 189–199), but only an equilibrium-always treatment of it. The work of Mill et al. (see Hazlitt, [1960] 1995) show that Say's Law is perfectly sound if seen as expressing a prevailing tendency in the market economy, rather than as an equilibrium relationship that always holds true.

Keen concludes that the Austrian school is "too close to its neoclassical cousin to make a major contribution to reformed economics." But, in at least one fundamental critique, that of the limitations of *all* formal modeling of economic activity, the Austrians are further from the neoclassicals than any of the other schools Keen discusses.

Despite our criticisms, we are glad Keen wrote the book, and glad that we had the chance to read and review it. Keen is raising important questions, even if we cannot go along with him on all of his answers.

Note

1. By way of illustration: The limit of $1/n$ as n approaches infinity is zero. But we cannot assume that $1/n$ *is* zero, because then we get nonsense like $n * 1/n = 0$!

References

Hazlitt, H. (Ed.) ([1960] 1995) *The Critics of Keynesian Economics*. Irvington-on-Hudson, NY: The Foundation for Economic Education.

Keen, S. and Murphy, R. (2002a) E-mail discussion of March 23 archived at: http://maelstrom.stjohns.edu/CGI/wa.exe?A2=ind0203&L=hayek-l&P=R21116.

Keen, S. (2002b) E-mail discussion of March 18 archived at: http://maelstrom.stjohns.edu/CGI/wa.exe?A2=ind0203&L=hayek-l&P=R13866&D=0&H=0&O=T&T=1.

Mises von, L. ([1949] 1998) *Human Action*. Auburn, AL: Ludwig von Mises Institute.

Robert P. Murphy
New York University

Gene Callahan
Ludwig von Mises Institute