NEOLIBERAL UTILITY AND THE PARADOX OF TAXATION

I've written about definitions and uses of "market" in several posts. The term "utility" is equally important in the development of mainstream economics. Here's what Samuelson and Nordhaus say in *Economics*, 2005 ed.:

> In a word, *utility* denotes satisfaction. More precisely, it refers to how consumers rank different goods and services. If basket A has higher utility than basket B for Smith, this ranking indicates that Smith prefers A over B. Often, it is convenient to think of utility as the subjective pleasure or usefulness that a person derives from consuming a good or service. But you should definitely resist the idea that utility is a psychological function or feeling that can be observed. *Rather, utility is a scientific construct that economists use to understand how rational consumers divide their limited resources among the commodities that provide them with satisfaction*. Emphasis in original.

The idea of a "scientific construct" seems at first glance to be far from the early neoclassical economists; in fact it seems downright bizarre. Recall from this post that the neoclassical economist William Stanley Jevons defined utility this way, quoting Bentham:

> "By utility is meant that property in any object, whereby it tends to produce benefit, advantage, pleasure, good, or happiness (all this, in the present case, comes to the same thing), or (what comes again to the same thing) to

> prevent the happening of mischief, pain, evil, or unhappiness to the party whose interest is considered.”
>
> This perfectly expresses the meaning of the word in Economics, provided that the will or inclination of the person immediately concerned is taken as the sole criterion, for the time, of what is or is not useful.

Jevons recognizes something Samuelson and Nordhaus seem to think, but do not make explicit: utility is solely related to each individual in the role of consumer of goods and services at a specific point in time. Jevons says that we get the total utility of all consumers by adding up the utility of each consumer, and argues that for perfectly competitive markets, this is the highest possible total of utility given a specific group of resources.

But it’s easy to show that even with the highly unlikely circumstances of rational consumers and competitive markets, there are plenty of outcomes that are far less than optimal. One obvious example is the paradox of thrift, first identified by John Maynard Keynes, and popularized by Paul Krugman; here’s an example from his blog, complete with charts and graphs. Here’s another example:

> … [S]ometimes the economy is not like a household, [and] our individual choices sometimes lead to outcomes that are in nobody’s interest.
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> In particular, when you have economy-wide deleveraging — when everyone is trying to spend less than his or her income, so as to pay down debt — you have a fundamental adding-up problem. My spending is your income, and your spending is my income, so if both of us try to spend less at the same time, what we end up achieving is mutual

> impoverishment.

Those who reject the paradox of thrift, including the Austrians, suggested that something else would happen in the current economic circumstances. They have been proven utterly wrong. For the individual consumer, it is easy to see why the choice of paying down debt is better than the choice to consume more, but the result is an interminable recession.

Here’s another example. No body wants to pay taxes. For each of us, it would be much better not to. But there’s a disaster waiting to happen if everyone ducks taxes, as the examples of Greece and Italy show. The problem is also present in the US, though so far only the rich and their corporations and trusts have managed to escape taxation in a big way; most of us just got miserly tax cuts, and cheating by the 99% is still low. But the results are just as horrible. As Elizabeth Warren and Elijah Cummings pointed out in this op-ed in USA Today, the US middle class is collapsing. They explain the problem this way:

> Beginning in the late 1970s, corporate executives and stockholders began taking greater shares of the gains. Productivity kept going up, but workers were left behind as wages stagnated.
>
> Families might have survived as their incomes flattened, except for one hard fact: the costs of basic needs like housing, education and child care exploded. Millions took on mountains of debt and young people began struggling to cling to the same economic rung as their parents.

The response of both political parties at the state and federal level to this slowly growing disaster was the standard neoliberal prescription: tax cuts and reduced regulation. There were some small tax cuts for the working classes, and massive tax cuts for the very rich and their corporations. At the state level, the damage was especially great as governments also doled out huge tax cuts to keep businesses or lure them from other states. See, e.g., Kansas.

Those tax cuts starved state and local governments, and led to cuts in federal spending on all discretionary programs except military and spying. The result was that the cost of education rose dramatically, and that meant a staggering increase in student debt. The cost of housing rose for reasons related to the stunning increase in money in the hands of the wealthy with no investment prospects in new productive enterprises. Child care rose as two worker families and single mothers worked longer and harder to pay for necessities.

Meanwhile, cuts to education were inadequate, so governments stopped maintaining infrastructure. Driving around Chicago is a nightmare of "Rahmholes" and invisible lane dividers. Bridges collapse, inadequate transit systems collapse under winter weather, schools rot, and generally life is more unpleasant.

This list could be extended indefinitely, but I'll stop. It should be clear that for most of us, the extra costs imposed by the inadequate provision of public goods far outweigh the minimal savings from the tiny tax cuts available to the bottom 90% of income earners.

Here are three lessons I draw from the paradox of taxation:

1. Tax policy focused on the middle class won't help. That's the Third Way Democrat policy, and it's the policy of the remaining sane Republicans. Warren and Cummings suggest getting rid of tax loopholes for the rich and their corporations. That's a start. Heavy top end income taxes, heavy capital income taxes, heavy estate taxes, greater taxation of corporations, and a heavy wealth tax are a better goal. The key to higher incomes is reducing the ability of the rich to buy up politicians, reporters and

compliant academics.

2. Neoclassical economics turns on a simple form of total utility in an economy. They teach that we just add up the utility of all consumers, and claim that we are maximizing utility. That is inadequate for accurate analysis of a complex economy. In fact, it is guaranteed to produce an inadequate supply of public goods, and thus a rotten distribution of scarce resources. It doesn’t deal with the future in any intelligent way. It doesn’t handle scale problems like poisoning of the atmosphere, or filling up the oceans with plastic.

3. The rich take advantage of the inadequate supply of public goods by privatization.The problem the rich have is what to do with all the money they’ve gouged out of the economic system. One solution is to buy roads and rent them to you, to buy street parking and rent it to you, to establish training schools to sell you an education and keep you in debt and hungry for income so you’ll take any rotten job. They want to profit from goods and services we can buy cheaper through government.

The plain fact is that neoliberal economic theory is solely about keeping the rich happy. It has nothing to offer average people who only have labor to sell for the money they need to live.