

THE PERSISTENCE OF POVERTY

Maria McKee interviews Charles Karelis

“Following a century-old orthodoxy of economics, which has crept from textbooks into common sense, the main accounts of poverty start by misidentifying the kinds of allocations that draw the most benefit from truly scarce resources. So the conventional poverty debate gets off on the wrong foot. It can hardly matter whether the poverty-causing behaviors truly fail the textbook test of economic rationality – which is the starting point of dysfunctionality – or only seem to fail it – as the conventional rationalizers contend – if the textbook test of rationality is not the true test.” (Excerpt from “The Persistence of Poverty,” pp. xi–xii)

In his new book, *The Persistence of Poverty: Why the Economics of the Well-off Can't Help the Poor*, Dr. Charles Karelis, professor of philosophy at George Washington University, seeks to answer the question of poverty by challenging one of the primary assumptions of microeconomic theory: the law of diminishing marginal utility. Diminishing marginal utility posits that as consumption increases, additions to the consumer's utility produced by these increases get smaller and smaller. Dr. Karelis argues that the dominant theories of poverty, which are based on this law, “start by misidentifying the kinds of allocations that draw the most benefit from truly scarce resources” (p. xi). If, as Dr. Karelis hypothesizes, marginal utility is increasing amid scarcity, then the behavior of the poor is entirely rational and policy responses to poverty have often been severely misguided.

MM: The idea of diminishing marginal utility is one of the most basic and commonly known principles of economics. You argue that the assumptions of this idea are fatally flawed, particularly in how it relates to the poor. Why do you believe this?

CK: The beginning of wisdom on the utility function is to distinguish three types of goods: relievers, pleasers, and reliever/pleasers. These ideas are best explained using excerpts from my book:

“Relievers, such as salves, are goods that reduce pain, unhappiness, or misery. Contrary to the law of diminishing marginal utility, which purports to hold for goods generally, relievers are a major type of good that exhibits increasing (not diminishing) marginal benefit” (p. 67).

Pleasers “are goods that cause a positive experience, as distinct from removing a negative experience [...] Unlike relievers, pleasers do generally conform to the law of diminishing marginal utility” (p. 73).

Reliever/pleasers “are relievers at low levels of consumption and pleasers at high levels of consumption [...] Characteristic of these goods, besides being generally valued, is that they can be used or consumed at three levels: insufficient levels, where shortfalls make for misery and more consumption makes for relief; sufficient levels which cause neither misery nor positive pleasure; and above-sufficient levels, where the consumer takes a positive enjoyment or satisfaction from consuming them” (p. 74).

My hypothesis is that relievers, and reliever/pleasers at their reliever level, exhibit increasing marginal utility. This is the same argument used in every Econ 101 text, except upside down. Most economics text books remind students that the second hot dog isn't as good as the first, with no other explanation. These texts appeal to a universal experience of consumption. But I want to look at other goods: goods that relieve misery. Let's use the same introspective experience and look at goods that are relievers and reliever/pleasers.

Take the example of the worker walking to work. If the worker doesn't have transportation and has to walk a long way, then there are various troubles that beset the worker: blisters, pots that go unwashed because there is not enough time, reprimands from the boss for fatigue-related mistakes at work.

These negative phenomena obey the same psychological law as positive experiences: the tenth blister doesn't add as much misery as the first; the tenth unwashed dish isn't as bad because of the other nine; the tenth reprimand is drowned out by the others. So, when you relieve these miseries, the impact of relieving the first is small, but as you relieve additional miseries, the impact grows larger. Relieving one of the ten blisters is like quieting one shout in a riot; it doesn't make much difference. However, if you have already relieved the misery of nine of the blisters, then addressing the tenth blister is like quieting a single shout in an otherwise quiet street. Relieving the tenth blister is worth much more than relieving the first. So relievers exhibit increasing marginal utility.

People living in poverty characteristically consume basic goods like transportation, living space, and leisure at insufficient levels, where they function as relievers, not pleasers. For them, marginal increases in consumption of these goods bring *increasing*, not decreasing benefit.

MM: This sounds very commonsensical. Why isn't this idea included in microeconomic theory?

CK: I don't want to sound presumptuous, but in explaining my hypothesis, no one has ever disagreed with me. Most people respond, "Yeah that's right. Don't we already know that?"

The answer is: we know it when we ask the right questions, but we never do because we tend to conflate pleasers and relievers. The reason we do so is the Epicurean Fallacy.

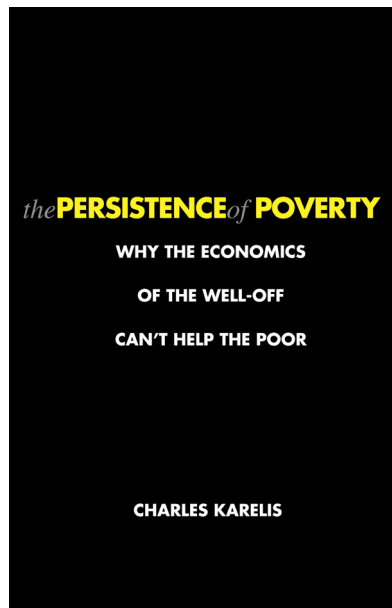
"Epicurus regarded happiness as the reciprocal of misery, in the sense that fullness is the reciprocal of emptiness, and tallness is the reciprocal of shortness: increases in the one can just as well be seen as decreases in the other [...] This plainly entails that to

relieve unhappiness and to cause happiness are simply alternative names for the same process. But this means in turn that goods that serve as relievers of unhappiness and goods that serve as bringers of happiness must be the same things by different names. Relievers are pleasers, and pleasers are relievers [...] But [...] the Epicurean Fallacy is a fallacy, and therein lies the problem with generalizing from the marginal utility of pleasers. Happiness and unhappiness are not reciprocals. More of one does not mean less of another" (pp. 103-105).

There should be a consumer product recall of Econ 101 textbooks. There is such an important gap in the thinking regarding utility. I have said

to some economists that this is a real problem; they say, "these are special cases." I am arguing that most economists are addressing special cases; the economics of happiness is the special case. Most people in the world are poor. I am addressing the economics of the more common experience.

"The marginalists, like theorists in every age, were drawn from the financially comfortable classes. They were used to consumption of basic goods at pleasing levels. Not surprisingly, then, they started with the introspectible datum that pleasers have diminishing marginal benefit and saw no need to look further [...] Marginalist economics was an economics of more-than-enough that mistook itself for general theory, applicable to both surplus and deficit. It was an



economics of happiness that saw itself as an economics of both happiness and misery” (p. 105).

MM: Can you explain some of the competing explanations for poverty? For instance, the perverse incentives theory, the idea that public policy creates perverse incentives that encourage the poor not to work, and therefore to remain poor, has come to dominate the poverty debate. What is the primary shortcoming of this approach to poverty?

CK: The perverse incentives theory doesn't seem to work internationally. The same behaviors, the culture of poverty observed by Oscar Lewis, exist in places that don't have a robust system of public assistance. I am just starting to think about extreme poverty on the international level. In developing countries, no one can accuse government bail-outs of distorting the behavior of the poor because such welfare programs do not exist, but you still see low savings rates, low employment, low school attainment.

You could say perverse incentives explain the behavior of the poor in the context of the US, while opportunity constraints explain behavior in developing countries. But, in my view, parsimony is valuable. If you can find a global explanation for a global phenomenon, that's where you start. You pursue local explanations for global phenomena only when you have failed to find a simpler explanation.

MM: In relation to dysfunction theories that assert that poverty is the result of apathy, psychological fragmentation, and weakness of will, you offer the idea of satisfaction efficiency. What is this concept?

CK: Satisfaction efficiency is another way of talking about utility maximization. These terms are probably interchangeable. Utility is a tricky word; it carries Epicurean baggage. I wanted to be quite specific about what “dysfunction” means, because for a lot of people, especially those right of center, individuals allowing themselves to be poor is normatively dysfunctional. The poor have “bad values.” By satisfaction inefficient, I mean the failure of people to maximize their own satisfaction regardless of their values. I wanted to use a non-normative term.

I am not really saying that there aren't any dysfunctional poor people. I am saying that bona fide examples of dysfunction have been over-generalized because of the absence of alternatives and because of the assumption that I seek to discredit: that poor people should have a greater incentive to work and save. Explaining the failure of the poor to do what is apparently in their best interest in terms of dysfunction appeals to the Right because they don't want to explain poverty through a lack of opportunity. Thus, the Right is sort of driven to the dysfunction theory—it has become a very appealing way to explain poverty.

If you look at Obama's and Edwards' campaigns, they are trying to muster support for a big push against poverty by combining liberal and conservative approaches: the need for opportunity and the need to address self-discipline. They will get voters through this combination of theories from the Right and Left.

According to my theory, it's not “both/and,” it's “neither/nor.” Taking two bad theories and adding them together is not a good theory. Neither theory is strong individually—though there is a grain of truth in both—and the combination is certainly no better.

MM: Using your theory, how would you assess the 1996 welfare reforms?

CK: The 1996 reforms can't be considered outside of the context of other changes since 1996, in particular, the enormous growth of the earned income tax credit (EITC). The old welfare system has been effectively replaced by the EITC. In my view, this represents the replacement of something okay with something better.

While AFDC [Aid to Families with Dependent Children] was not the best possible transfer program, I think it got a bad rap. It was assumed that the income effect of handouts on workforce participation was negative, and that there was no substitution effect because handouts had no effect on salary. In other words, handouts did not make leisure more expensive, so the substitution effect was neutral and the income effect was negative. The net effect was assumed to be a disincentive for work. I counter that while the substitution effect was indeed neutral, such transfers had a positive income effect for the very poor and so may have encouraged work.

According to my theory, the EITC has a positive income effect *and* a positive substitution effect. In that sense, it is probably better than AFDC, but that doesn't mean that old style welfare should be laid to rest. It may be dead politically, and I don't support lost causes, but I can imagine scenarios in which cash transfers that aren't work-contingent could be relevant. For example, if the EITC isn't encouraging some people into the work force, it could be that those people would be more attracted to work if they started with greater income. In other words, if the government offers a cash transfer to the very poor, work may become more attractive and the EITC could then reinforce the attraction of working.

MM: It appears, to some extent, that the American public has turned its back on poverty, focusing far greater attention to economic issues faced by the middle class. Do you think there should be a policy or culture shift towards poverty reduction?

CK: There is a kind of pessimism about the capacity of public policy to do anything about the issue of poverty; 40 years of the same poverty rate is discouraging. However, the NPR/Kaiser/Kennedy School poll on poverty in America indicates that 85% of Americans consider poverty a problem.¹ Recently, Barack Obama and John Edwards have brought this long-dormant issue out of the closet.

MM: Why poverty? What drew you to the issue of poverty?

CK: I got to poverty a little indirectly. I was initially skeptical about the assumption of microeconomic theory that the utility functions of the poor are the same as those with higher consumption levels. I think I had the average citizen's concern with poverty. I simply found that my interest in this particular aspect of microeconomic theory dovetailed with that concern.

Endnotes

¹ See <<http://www.icrsurvey.com/Study.aspx?f=PovertyAmer.html>>