



The Discourse on Social Costs

Heterodox vs. Neoliberal Arguments

Theses

- A variety of theories of social costs form the discourse on social costs
- These can be grouped into two categories: heterodox and neoliberal
- The purpose of this classification is to show that the heterodox theory of social costs provides a fuller understanding as well as more viable and socially just policy proposals

Heterodox Theory of Social Costs – Its Precursors and Conceptual History

- Classical Political Economy: Smith, Ricardo
- Socialists
- K. Marx
- Historicists
- J. M. Clark
- T. B. Veblen
- J. M. Keynes
- J.K. Galbraith

Karl Marx

- Labor theory of value: idea of exploitation (wages < the laborer's contribution to total product)
- Profits = losses to society (no net gain; opposite of invisible hand):
 - *“No matter how economical capitalist production may be in other respects, it is utterly prodigal to human life [...] Capitalism loses on one side for society what it gains on another for the individual capitalist”* (Marx, Capital, vol. III, 1909, p. 104 in Kapp 1970: 844)
- E.g. ecological degradation:
 - *„all progress in capitalist agriculture is a progress in the art, not only of robbing the laborer but of robbing the soil; all progress in increasing the fertility of the soil for a given time is a progress towards ruining the lasting sources of that fertility ... Capitalist production .. [saps] the original sources of all wealth, the soil and the laborer.“* (Marx, Capital, vol 1, p. 555-6)

Thorstein Veblen

- Social waste results from “pecuniary principles”
- Industrial sabotage, planned obsolescence, degradation of existing product values
- Depletion of natural resources:
 - *“Business enterprise has run through that range of natural resources [the fur-bearing animals] with exemplary thoroughness and expedition and has left the place of it bare...It is a concluded chapter of American enterprise... This American plan or policy is very simply a settled practice of converting all public wealth to private gain on a plain of legalized seizure.” (Veblen, Absentee Ownership 1923, p 168)*



The Heterodox Theory of Social Costs

Heterodox Theory of Social Costs

- Kapp's *Social Costs of Private Enterprise* (1950) integrates these insights into a coherent theory of social costs
- Social costs are „those harmful consequences and damages which other persons or the community sustain as a result of productive processes, and for which private entrepreneurs are not held accountable“
 - (1) it must be possible to avoid them
 - (2) result of economic activity (man-made)

Heterodox Theory of Social Costs

The key ideas :

- Cost shifting: Socialization of Costs and Privatization of Profits
- Impossibility thesis: “in a pure market economy social costs are not accounted for in exchanges between isolated individuals; hence prices do not reflect total costs and allocation cannot be rational”
- What is rational and good for the individual businessman (cost minimization) is often irrational or bad for society
- The classical, neoclassical and neoliberal theory of the invisible hand is disproven

Social Costs of Government?

- Kapp also explores the social costs of ineffective government when social use values such as environmental or social justice are neglected
- Thus, based on the heterodox theory of social costs government can also be responsible for social costs
- This has recently been elaborated by Galbraith's "*Predator State*" and Klein's "*Shock Doctrine*"
- *The cause of the social costs of government is, however, that it has been seized by private enterprise. This is not an argument against but for truly democratic forms of governance*

Social Costs of Economics!

- Many modern heterodox economists view the current financial, economic, ecological and social crises as a direct social cost of the breakthrough of neoliberal economics since the late 1970s: e.g. Yves Smith's "*Econned*"
- Research into the neoliberal thought collective suggests that several leading protagonists were mouthpieces for their wealthy corporate donors (e.g. *The Road from Mont Pelerin, Building Chicago Economics, The Inside Job*)
- Evidence suggests that economists are business men trying to profit by promoting pro-corporate ideas

Policy Principles of the Heterodox Theory of Social Costs

- Ex ante precaution instead of ex post remedies: Social controls of allocation, investment and location decisions before damage can occur
- Safety standards: break with the utilitarian principle, i.e. what is morally good, desirable, useful is no longer left to the individual alone but embedded within safe limits (this is accepted partly by some neoliberals)
- Reversal of principle of proof: producers have to prove the harmlessness of their activity beforehand (e.g. toxicity)
- Institutional change: education; prohibitions; regulation; democratic governance of science and technology

Heterodox Theory of Social Costs

“Social costs are damages which under different institutional conditions could be avoided. For, obviously, if these costs were inevitable under any kind of institutional arrangement they would not really present a special theoretical problem. To reveal their origin the study of social costs must always be an institutional analysis. Such an analysis raises inevitably the question of institutional reform and economic policy which may eliminate or minimize the social diseconomies under discussion.” (Kapp 1963)

Heterodox Theory of Social Costs

- Emerges in a discourse on “free-market” vs. “interventionism”
- Reply to Hayek’s and Mises’ neoliberalism and Pigou’s neoclassical economics
- Initial success: e.g. the 1972 UN environmental conference
- 1970s: neoliberal ideological counter-revolution breaks through



What are the neoclassical and neoliberal arguments?

Classification

	Neoclassical	Neoliberal	Institutional
View	Micro level, individualist		Macro level, social structure
Cause	Accidental, or no analysis		Systemic and Institutional
Value Theory	Market Value		Pragmatist/Humanist values
Nature of Remedies	Ad hoc, ex post		Systematic, ex ante
Main Solution	Taxes	Bargaining, Growth, Law Suites	Social Controls, Safety Standards, Precautionary Principle

Classification

	Neoclassical	Neoliberal	Institutional
Political Economy of Remedies	Conservative or classical liberal: slightly interventionist but mechanism of allocation not affected	Revolutionary or (Neo-) liberalism: strongly anti-interventionist, power is with the richest market actors (“the poor sell cheap”) or large property owners	Social-democratic: strongly affecting mechanism of allocation (planning, prohibitions, controls) and eco-social safety limits: power is taken back by the disadvantaged masses

Neoclassical Arguments

- A. C. Pigou (Economics of Welfare, 1920) reconciled unaccounted damages with neoclassical economics
- Based on A. Marshall's concept of external economies, Pigou uses the term "external costs"
- "Externalities" are portrayed as exceptional occurrences outside an otherwise harmonious system
- Accidental divergence of social and private costs

Neoclassical Arguments

- Damages are valued monetarily (although Pigou also states “not all social losses can be readily brought into relation with the measuring rod of money“)
- Taxes are viewed as the solution(although Pigou also mentions prohibitions and social legislation)
- Pigou later became more radical and spoke of general disharmonies, wastes arising in production, distribution and industrial fluctuations:
 - “we may be confronted with evidences of the bankruptcy of capitalism and a case for extending the range of public ownership and public operation to industries in which they have not yet been involved“

Neoliberal Arguments

- Since 1960s: transformation of the discourse on social costs
- Neoliberal thought collective since 1947 (Mont Pelerin, post WWII Chicago School)
- Strongly anti-interventionist
- Dissatisfaction with interventionism of Kapp and even Pigou
- Heterodox arguments are deemed too costly, ineffective, anti-growth, or anti-freedom

Neoliberal Arguments

Knight (1951): “socialist propaganda” “does not mention freedom”, “costs of eliminating costs”, “waste” is problematic because waste can only be defined in reference to costs of conservation

Neoliberal Arguments

- Coase and Stigler:
 - damages are justified when smaller than benefits in terms of money
 - do nothing about social costs, or
 - allow bargaining between individuals about damages
- “Reciprocal nature of the problem“: after property rights are defined damages can be handled by individual bargaining
- Redefining social costs as a problem of specifying property rights and minimizing transaction costs
- No analysis of institutional causes of damages
- Ex post compensation rather than ex ante precautionary principle

Neoliberal Arguments

- James M. Buchanan:
 - *“[...]its failure to include analyses of similar imperfections in realistic and attainable alternative solutions causes the analysis itself to take on implications for institutional change that are, at best, highly mis-leading. [...] any attempt to replace or to modify an existing market situation, admitted to be characterised by serious externalities, will produce solutions that embody externalities which are different but precisely analogous, to those previously existing. “(1962)*

Neoliberal Arguments

- Calabresi acknowledged that Kapp was probably correct in projecting a vast web of unpaid social costs, but took the position that it would be ‘too costly’ for our society to determine those social costs and even more ‘costly’ to attempt a redistributive remedy
- Mises: Do nothing about social costs
- Hayek: mildly interventionist in RTS 1944; later: “do nothing about social costs, economic growth will make up for them” (since 1970s)
- Cardato (Austrian): social costs do not exist either in reality or as a concept because market failure does not exist; only violation of property rights is real



Heterodox critique of neoliberal and neoclassical ideas

Heterodox critique

Pre-analytical value premises:

- a priori notion of the beneficial and rational character of business enterprises and evils of government regulation
- Treating damages as exceptional disturbances that are remediable ex post via ad hoc measures (mostly monetary compensation)
- Downplaying empirical evidence of the inherent irrationalities and destructiveness of the system of business enterprise

Heterodox critique cont'd

Value problems obscured:

- Kant's *Metaphysics of Ethics*: that which cannot be exchanged has no exchange value (human health) and humans must never be turned into a means for some opportune end (maximum output, profits, growth, etc.)
- Transforming original human needs for clean air and water into a desire for money falsifies original needs
- Human needs (health/life) lie outside the market
- Environmental problems cannot be adequately solved with policies relying on market principles, prices, values

Heterodox critique cont'd

Complexity and Irreversibility of Damages Obscured:

- Damages arise from synergetic and cumulative effects of pollutants
- Damages are often hidden with timelags; not transparent to the individuals involved
- Difficulty in proving causality to a specific corporation
- Heterogeneous magnitudes/qualities have no common denominator
- Individual willingness to pay cannot be established if no precise knowledge about the problem situation
- Many damages are irreversible and cannot be remedied ex post at all; money payments do not reverse real effects

Heterodox critique cont'd

Power Structure Obscured:

- Social costs are a forced one-sided relation which the individual usually cannot escape (happens behind the back)
- Corporations pass on Pigouvian taxes in the form of higher prices to low income households who are often the victims of social costs
- Corporations may not participate in fair Coasian bargaining
- Taxes and bargaining do not guarantee that firms will avoid damaging activities

Heterodox critique cont'd

Neoliberal Double Truth

- Neoliberals argued that heterodox proposals for intervention are too expensive while completely obscuring the costs of defining and enforcing property rights
- Neoliberals argued that calls for social-democratic controls of the economy are anti-freedom but do not discuss the dangers for human freedom of the doctrine of “the poor sell cheap”



This is it
thank you!