Orthodox Economics and the Economics of Harm

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Comments by James Bass were very helpful in shaping this paper.

This is an Accepted Manuscript of an article published by Taylor & Francis in the Journal of Economic Issues on October 15, 2021, available online:

https://www.tandfonline.com/doi/full/10.1080/00213624.2021.1948280

Abstract:

Orthodox economics understands productive activity, which obtains income by benefitting others, but does not have an adequate conception of activity which obtains income by harming others. There is a broad and important range of activities which obtain income by harming others. This paper considers the analysis of some of these including conflict theory, rent-seeking, corruption, harm of workers, consumers, and nature, economic historians' consideration of extractive political and economic institutions, and the varieties of discrimination. The omission of harm is evident in undergraduate textbooks in microeconomics and public economics. The fundamental political economic system of past and present, a productive plus harmful one, is not being taught to economics students.

Keywords: Harm, Conflict, Rent-seeking, Social and Economic Stratification

JEL Codes:

Distribution (D30)

Analysis of Collective Decision-Making: Political Processes: Rent-Seeking, Lobbying, Elections, Legislatures, and Voting Behavior (D72)

Analysis of Collective Decision-Making: Conflict • Conflict Resolution • Alliances • Revolutions (D74)

Political Economy (P48)

Comparative Analysis of Economic Systems (P51)

Unlike Marxist economics, orthodox economics does not have an adequate conception of harm incorporated into its analysis.

Throughout recorded history groups have oppressed others as a way of gaining control and income. There were empires and kingdoms throughout the world in the pre-Christian and Christian eras. And, over the last centuries, as these declined, minority rule and control of resources and income remained, though this was now established with state titles like "republic," whose dictionary definition is "a state in which supreme power is held by the people and their elected representatives."

What needs to be studied is not only productive activities, but also harmful ones; not only a productive economic system but a productive + harmful social system including political, economic and social components, where the interaction is much different than that put forward in orthodox economics. Harm is not a term in much use in economics; I am using it to enable us to see the commonality in a variety of terms in standard and heterodox economics. Marxist economics would refer to it as exploitation and oppression, and productive + harmful systems (over the last several centuries) as capitalism. I am taking as my reference for my summary of "what orthodox economics says," what appears in orthodox economic textbooks. We must look at what is being transmitted to new generations of students, and this should be the basis of criticism. Understanding productive + harmful systems requires a significant expansion and change of orthodox economics, one where heterodox economists have an important role to play.

Both orthodox and heterodox economists have examined specific types of harm and ways to understand political economic systems that include harm. Social movements and governmental and nongovernmental organizations have also brought specific types of harm to wider attention and political action. This paper highlights specific examples showing their broad range. What is needed is a major new segment of economics equal to macro- or micro- economics that considers the economics of harm and of productive + harmful systems. The fundamental political economic system of past and present: a productive plus harmful one, is not being taught to economics students.

Harm

The idea of harm presented here is that of James R. Taylor: *one group uses resources to restructure the alternatives of a second group in such a way that the first group benefits* (Taylor 1977). This restructuring reduces the value of the opportunities available to the second group. The set of opportunities facing some individuals in a system with harm is different, providing less opportunity, than in a system completely composed of productive activities. Slavery provides an undesirable life of compulsion and confinement to induce slaves to produce value greater than what they receive. Monopolists use market power to increase prices and profits. Such structures are established and maintained by those who benefit. These structures can be principally in economic, political, or social spheres. Very frequently actions in each sphere are coordinated and strengthen each other. Political and economic structures for slavery were accompanied by social denigration of those who were or could be slaves.

Important areas of harm have been described by orthodox and heterodox economists. *Monopoly/market power.* Certainly, the type of harm best understood by standard economics is market power. Monopolists can use market power to raise prices, providing monopoly income without providing a service, in fact by reducing production. Other types of market power such as oligopoly and monopsony obtain income by reducing the benefit to others. Thomas Philippon, drawing on the work of others, estimates that the decline in competitiveness has reduced U.S. GDP by 5 percent and employee compensation by 13.6 percent (2019, 293).

Use of cost-benefit analysis to measure conditions of work and other sources of harm. Situations where harm was being done, such as worker safety and health, workers' bargaining rights, environmental harm, and product safety, have been raised to the level of political action against them by social movements. These harms are now addressed in orthodox economics using cost-benefit analysis. See, for example, Boardman et al 2011. In a heterodox analysis, K. William Kapp (1950) refers to such harmful situations as social costs and shows the tendency of private enterprise to transfer these costs to workers and the public.

Game theory. Game theory can address situations where differential power can extract a reward for the stronger. Conflict theory, a subfield, addresses this in a way very specific to orthodox economics.

Jack Hirshleifer (1991) recognized that there are two main approaches to obtaining income: production and conflict—using resources to take away from another party. It provides an introductory analysis of some key issues when conflict was possible. When two parties produce, the production is additive. Conflict, however, has a winner. The article introduces the idea of the contest/conflict success function, which describes the probability of success for each participant measured in the distribution of the good of the model, given contestants' efforts, and the technology of conflict. Stergios Skaperdas (2003) points out that orthodox economics' *homo* *economicus* will haggle over price but will not take what he wants by force, which is only an assumption on the part of orthodox economics. In the real world, power can be more highly rewarded than productivity. Governments may act to constrain harmful activity or be an essential participant.

Orthodox economics does not treat conflict as an integral part of economics. Conflict expenditures are viewed as national defense and consequently productive expenditure, and defense expenditures are discussed as examples of public goods, which, while true, sidesteps the necessary discussion of conflict, which is in fact used to shape outcomes in the real world and which involves substantial amounts of harm.

Conflict, even narrowly defined, is an important activity. The Stockholm International Peace Research Institute estimates world military expenditure at $1.9 trillion in 2019, or 2.2 percent of global gross domestic product (Tian et al 2020). In 2019, there were 54 state-based armed conflicts and 67 non-state armed conflicts (Pettersson and Öberg 2020). The drastic worsening of peoples' lives is a major source of harm from conflict. For example, at the end of 2019, 79.5 million people were forcibly displaced worldwide as a result of persecution, conflict, violence, or human rights violations (UNHCR 2020). Approximately one of every 100 people worldwide have moved from normal lives to the bleakness and desperation of a refugee situation.

Rent seeking. Rent seeking is another strand of orthodox economic theory analyzing unproductive activities that obtain income, focusing mainly on the sphere of government action. Rent seeking first emerged as a term in a discussion of what were the real losses from such things as tariffs, monopoly, theft, and quantitative import restrictions and monopsony (Tullock 1967; Krueger 1974). As in conflict theory, there is unproductive activity which does receive income and there is a cost in carrying it out. See Congleton and Hillman's (2015) excellent relatively recent overview of the literature. Rent seeking has increasingly come to be understood as a group obtaining income in an unproductive fashion by manipulating public policy or economic conditions.

Transparency International's analysis of corruption is related. TI defines corruption as the abuse of entrusted power for private gain. Though this definition encompasses corrupt practices in both the public and private sectors, the Corruption Perceptions Index (CPI) ranks 180 countries according to the perception of corruption in the public sector only (2020). With a scale of zero (highly corrupt) to 100 (very clean), more than two-thirds of countries score below 50, with an average score of only 43. It is fair to say that corruption is significant in most countries of the world.

Economic history. Some economists writing on history from an orthodox economic perspective have also considered societies which have central and essential elements of harm. These writers include Daron Acemoglu and James A. Robinson (2012), and Douglass North, John Joseph Wallis, and Barry R. Weingast (2009).

North, Wallace and Weingast use limited access order or natural state.

> A natural state… form[s] a dominant coalition that limits access to valuable resources—land, labor, capital—or access to and control of valuable activities—such as trade, worship, and education—to elite groups. The creation of rents through limiting access provides the glue that holds the coalition together, enabling elite groups to make credible commitments to one another to support the regime, perform their functions, and refrain from violence (2009, 30).

They estimate that limited access orders have about 85 percent of the world's population.

Acemoglu and Robinson refer to extractive economic institutions that extract wealth from one subset of society to benefit a different subset and extractive political institutions which

> concentrate power in the hands of a narrow elite and place few constraints on the exercise of this power. Economic institutions are then often structured by this elite to extract resources from the rest of society. Extractive economic institutions thus naturally accompany extractive political institutions. In fact, they must inherently depend on extractive political institutions for their survival (2012, 81).

Both sets of authors distinguish a second group of countries that has emerged—an open access order for North, Wallace and Weingast and inclusive for Acemoglu and Robinson, with about 15 percent of the world's population—those that live in developed countries.

Freedom in the World (2020), Freedom House's annual global report on political rights and civil liberties covering 195 countries, addresses the same topic. Separate scores are awarded for political rights and for civil rights which, weighted equally, are used to determine the status of Free, Partly Free, and Not Free. Forty-three percent of the countries of the world are evaluated as free, while 57 percent are classified as either Not Free (25 percent) or Partly Free (32 percent).

Discrimination and group inequality. Black and feminist economists have written on group inequality. William Darrity, Jr. (2001, 2005) and others have developed "stratification economics" to understand racial and other inequality, and Elissa Braunstein (2008) has developed "patriarchal rent-seeking" to understand gender inequality.

Stratification economics considers that societies are hierarchical. There is a dominant group and a subordinate group in society; the dominant group can restrict access to jobs, education, housing, social circles, and other advantages, resulting in significant harm to the subordinate group. Orthodox discrimination theory, focusing on human capital explanations and, to a lesser extent, the "taste for discrimination," does not capture the importance of such stratification.

Braunstein says "Patriarchal rent-seeking affords better insight into the puzzle of why gender hierarchies persist. While the exercise of power, and maintenance of the social institutions that support that power may be costly from a social perspective, to the extent that patriarchy benefits a hegemonic group, institutional change will be slow in coming" (2008, 972).

According to U.S. Census Bureau authors Semega and others (2019, 5), the real median household income of Blacks (US$41,361) was only 58.6 percent of non-Hispanic Whites (US$70,642) in 2018. The UNDP Gender Development Index measures gender gaps in human development by accounting for disparities between women and men in three basic dimensions of human development—health, knowledge and living standards. According to the GDI measure, world-wide, women are about 6 percent worse off than men, while South Asia has the worst disparity between women and men at 19 percent (Conceição 2019, 312-315).

Heterodox contributions. Heterodox economists are making important contributions to understanding harm, including the following.

Dean Baker (2016) considers that the growth in rents has played a key role in the growth of inequality in the U.S. economy. The main areas cited are increased patent and copyright rents, growth of the financial sector, the increase in CEO pay permitted by failure of corporate governance, and the increase in pay of highly paid professionals due to protectionist barriers.

Eileen Appelbaum (2017) says that firms have had an increasing ability to extract economic rents due to various factors, including market concentration and adoption of the financial model of the firm. The increase in earnings inequality has come because these firms have reorganized production from "everything under one roof" to production networks, and have used their market power to squeeze the income of the other firms and workers in the production network.

Dirk Bezemer and Michael Hudson (2016) make the distinction between real capital (productive) and financial capital (unproductive). They argue that though credit is viewed as being used to finance real investment, a very large fraction of credit use today is to finance the ownership of assets, increasing asset values and the (unproductive) income of financial firms.

William Lazonick and Jang-Sup Shin (2020) set out predatory value extraction, the process by which powerful financial interests extract value from business corporations that is greatly in excess of their contributions to the value creating process, including corporate executives as value-extracting insiders, institutional investors as value-extracting enablers, and hedge-fund activists as value-extracting outsiders.

Harm in orthodox economics texts

To what extent do orthodox economics texts consider harm? Price theory and public economics texts would be the key places to look. The two types of harm described here well covered in price theory texts are market power in both product and factor markets and game theory. (There are also very brief discussions of rent seeking.) Though game theory can be used to show harm, the textbook treatments of game theory do not do this. See, for example, Perloff (2012 Ch. 14) or Varian (2006 Ch. 28-29). Unproductive economic activity that obtains income is not discussed as a general category in price theory, nor its implications for a "market" economy. See, for example Frank (2008), Perloff (2012), or Varian (2006).

Structures of harm are present in the political and social spheres as well. Orthodox economics texts consider the political sphere, in public economics texts, but not the social. In orthodox public economic texts, the government is treated as democratic. Major expenditure and policy decisions are carried out by voting. The major obstacle to carrying out the wishes of the people is the paradox of voting. See, for example, Gruber (2013), Hindriks and Myles (2006), and Stiglitz (2000). Yet, as we have seen above, only a small minority of governments can be considered as free. What is going on here? If orthodox economic texts are focusing on the United States and other developed countries because that is where their audience lives, that is a profound mistake. Science describes what is happening, not a comfortable subset of reality.

Throughout history, including the present, a principal government activity is controlling people. Whether this is benign or not is not discussed in public economics texts. Is this control to ensure people's freedoms, or maintain oligarchic/elite control of government and society? Nor are the ways and extent to which elite priorities can be maintained in a system which is both nominally and significantly democratic.

Conflict is not really discussed at all. "National defense" is discussed as a government good, a response to potential harm, but conflict as harm to gain benefits is not discussed. Since discrimination is not viewed as a central economic issue, discrimination is not discussed, nor government's role in maintaining discrimination, reducing discrimination, or both simultaneously, according to the particular government considered. Nor is occupational health and safety, environmental protections, or worker bargaining rights. A substantial portion of government activities in societies where democracy has gained some ascendency over oligarchy is protection against harm. This should be brought out in a government economics text and is not.

It is essential to see the different types of harm as part of a broader category. I have called it harm in this paper, but others have referred to it variously as conflict, rent-seeking, exploitation, oppression, extractive political and economic institutions, or predatory value extraction. While these terms have tended to focus attention on specific types of harm, they can be used to describe harm more generally. Once we have a more general term, we can see the important commonalities, such as obtaining income, though not productive. I chose harm as being a general term, one that describes what happens, and which fits in with the conceptual framework of orthodox economics, but another general term might be considered better.

Marxist economists might question the need for including harm in orthodox economics, since exploitation and oppression have been included in Marxist economics from the beginning. There is something to be said for this position; it is true that very little progress has been made in incorporating harm into orthodox economics. Nonetheless, orthodox economics has a framework that can consider harm. It is just not doing so.

Harm is a fundamental part of how income is obtained; you cannot have economics without considering it adequately. Students are injured by learning a subject which does not properly describe reality. I believe that including harm into standard economic analysis will lead to insights that will help everyone understand harm better. For example, exploitation/harm does not depend on the labor theory of value. It is a “natural” way of obtaining income which has been important for millennia. Reducing harm has been a central part of the struggle for freedom over the centuries until today.

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