REFLECTIONS

Professor Alexander N. McLeod, Professor Emeritus at York University in Toronto, Canada, enjoyed a long and distinguished career as a bank economist in both the private sector and as an economic advisor to Latin American and African countries, with international organizations. Professor McLeod, a Canadian, received his doctorate from Harvard University in the 1940's. He has published widely, both before and after returning to the academic world in 1969, in the areas of money and banking, international economics, and stabilization policy.

A Critique of Neoclassicism and New Keynesianism

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INTRODUCTION

For the past 20 or 25 years Keynesian demand management has been pretty much in eclipse among policymakers, as has Keynesian analysis among professional economists. The fundamental reason is a practical one: demand management as presently understood has proven unable to control inflation effectively. Criticisms by neoclassicists have also played a part, but they did not win much credence until after practical considerations had pretty well emasculated the Keynesian strategy.

Various Keynesian schools of thought have attempted to meet the neoclassical criticisms, but the debate is still unresolved: neither side has yet convinced the other. One school, which professes to be Keynesian and has come to be known as New Keynesianism (Frank, 1980; Mankiw and Romer, 1991; Symposium on Keynesian Economics Today, 1993) has attempted to reconcile Keynesian and neoclassical analysis. However, they seem to have accepted so many of the assumptions on which the neoclassical position is based that I am not sure in which camp they belong. I therefore identify them as a third camp, neither neoclassical nor Keynesian.

I believe that the major neoclassical hypotheses in three crucial areas, on which their conclusions heavily depend, are open to challenge: the nature of the equilibrium relevant to the discussion of the matters at issue, the nature of the unemployment observable in the real world, and the implications of the present inflationary environment.

Finally, in academic circles one of the most telling neoclassical criticisms of Keynesian analysis has been the claim that it has not provided a convincing microeconomic foundation for believing that nominal prices and wages are sticky,


101
since neoclassicists assert that flexible prices would ensure the prompt achievement of full employment, they see this criticism as very damaging to the Keynesian case for prolonged underemployment equilibria. The importance of sticky prices and wages for the Keynesian case, however, has been disputed by some Keynesians. In any case I believe a plausible microeconomic base for belief in stickiness can be demonstrated.

EQUILIBRIUM CONCEPTS

Neoclassical analysis relies heavily on the tacit or overt assumption that something like the purely-competitive long-run static-equilibrium position is quickly and relatively painlessly attained—in the case of some rational-expectations models, apparently almost instantly (Hoover, 1984). Curiously, though monetarists and other neoclassicists usually pride themselves on the empirical verification of their propositions, they have made no such effort in this case. Until someone, monetarist or other, produces a definitive empirical study of the matter, I, therefore, we must stick with the contrary conclusions of a long list of distinguished economists of many schools. Also, with few and unimportant exceptions, neoclassical analysis ignores the traditional Marshallian concept of disparate short-run, medium-term, and long-run equilibria, each of which offers perspectives and insights not discernible in the others.

The long-run equilibrium of the model of pure competition may be identified with the situation that would obtain if the equilibrating forces could be left to operate for an indefinitely long time without new disturbances to the economy. In that situation the labor market would have two important characteristics: first, each worker would be indifferent between a little more real income and a little more leisure; second, the long-run supply curve of labor would have a positive slope throughout. This would ensure that there was no involuntary unemployment. However, since literally zero unemployment is inconceivable in the real world, it is customary to identify some minimum level of frictional unemployment with the closest practicable approach to full employment. In the 1950s and 1960s, for example, 3 or 4 percent unemployment was commonly deemed a realistic goal.

If something like the purely competitive long-run equilibrium were really the correct concept, neoclassicists and Keynesians would have little to argue about. There is nothing in any version of Keynesian theories of underemployment equilibria to deny that automatic equilibrating forces might eventually bring about a full-employment long-run equilibrium. However, there is no such meeting of minds here. Keynesian analysis is distinctly Marshallian; the relevant time frame is that in which real-world policy decisions can be designed and carried out—presumably a relatively short-run period, perhaps extending to 6 months, or a series of short-runs to medium-term periods. We needn't wait patiently for a utopian future to unfold at its own leisurely pace, because there are things we can do immediately that will speed things up enormously; or things that we could do, if only we could effectively control inflation independently of other economic goals.

In the Marshallian short run, or even the medium term, neither of the two basic conditions of long-run labor-market equilibrium need to be met. Obviously, even in the best of times the irreducible minimum number of those involuntarily unemployed would not achieve indifference between work and leisure at the margin. Also, it has long been recognized in the economic literature that the slope of the short-run labor-supply curve need not be positive throughout its length. If a major disturbance suddenly and sharply reduced employment and incomes, for example, newly unemployed workers might be willing to work more instead of less than they were before, and at a lower wage, and additional family members might join the labor force, to maintain their real incomes or just to keep bread on the table. These effects would be reinforced for homeowners and other property owners if, as would be likely, the price of real estate (and perhaps some other assets) fell sharply at the same time, reducing their wealth as well as their incomes.

Typical neoclassical and New Keynesian textbooks [Dornbusch et al., 1992; Altunbas et al., 1994; Mankiw, 1994; and Lipsey et al., 1994, for the New Keynesians, and Parkin, 1994, for the neoclassical] identify "normal" unemployment as the level that would obtain at "full employment," or as the average rate around which the economy fluctuates, and in some cases they also identify it as the non-accelerating-inflation rate of unemployment (NAIRU). However they define "normal" unemployment, they all allow both actual unemployment and actual output to fluctuate around their "full employment" levels. This raises questions about how full their "full employment" really is, and what interpretation is to be put on their "normal" unemployment. Are they identifying "full employment" with a long-run trend line of calculated potential outputs over historical time? That is quite different from the locus of the long-run equilibrium points (as defined earlier in this section) over historical time, and their "normal" unemployment is quite different from the irreducible minimum of frictional unemployment associated with real-world approximations of those equilibrium points. Long-run equilibrium implies that the resources of the economy are truly fully employed, but calculated potential output does not—especially when based on data for a period in which some calculations of the "normal" rate of unemployment (or the NAIRU) have approached or entered the double-digit range, as in much of the last 20 years.

Neoclassicists cite the real-balance or wealth effect as a fail-safe device that will rescue the economy from an underemployment equilibrium even if all else fails. Frank [1986, 8] thinks this effect is rather weak at best, and might take decades to be fully effective. He is surely right. In fact, the proportion is highly debatable in its entirety. The idea is that holders of money would become progressively better off as prices fell, with no offsetting losses to anyone else, and would eventually begin to spend. Nowadays, however, money typically consists of claims on some financial intermediary or other, no matter what definition of it is preferred, and its counterpart is in the debts of their borrowers; any advantages for the one group are pretty well offset by disadvantages for the other, so the net effect is approximately zero. Certainly, the long period of deflation this scenario envisages is not consistent with the neoclassical assumption of instant equilibrium. Instead, it suggests the possibility of serious defaults by some ultimate borrowers, which might well bankrupt the money-issuing intermediaries and destroy the supposed advantage to their creditors, so all three parties would lose.
Turning now from theoretical postulates to practical experience, economic history demonstrates not only that the equilibrating forces postulated in the purely competitive model, or whatever is their real-world equivalent, are pretty sluggish in correcting the recessional phase of the normal business cycle, but also that periods of depression and unemployment may sometimes be quite substantial and prolonged. The Great Depression of the 1930s was until now the prime example. Automatic restorative forces did show themselves to some extent; the decline bottomed out about 1933 in most countries, but they proved unable to cope with the world-wide combination of adverse circumstances that developed between 1929 (in Britain, where an overvalued pound brought years of depressed output) and 1931 (in Continental Europe, where the collapse of the Kreditanstalt set off a series of disturbances that included driving sterling off the gold standard), with the North American contribution coming in between (in 1929, when a worsening economic slowdown triggered the stock market crash and not the other way around, contrary to the conventional wisdom). It was only about two years after the start of World War II in 1939, and the massive injection of new spending this entailed in the belligerent countries and their suppliers, that full employment was achieved in most countries.

These are not mere hypotheses, but historically recorded facts, which are not open to doubt. The legal dictum *ipsa dixit* applies: the thing itself speaks. Clearly, long-run equilibrium is not quickly or easily attained in the real world.

Now, however, the even longer period from the mid-1970s to date seems to make the point still more strongly: some twenty years of macroeconomic economic strategies have failed to achieve anything approaching the measures of full employment that were regularly achieved in most major countries in the first 25 or 30 years after the war. Instead of the promised renewal of prosperity they have brought spreading poverty and despair — and they have not even achieved their first objective, which was the elimination of inflation. At least two economists (Peterson, 1994, 10 and passim; McLeod, 1995, 10ff) have identified this period as a new depression that has already lasted twice as long as The Great Depression of the 1930s and is still counting.

THE NATURE OF TODAY'S UNEMPLOYMENT

Typically, neoclassicists either assert or implicitly assume that most of today's unemployment is voluntary — if offered a job in their fields, at the going wage or slightly below it, most of the jobless would refuse. The implication is that the real-world rates of unemployment observed in the major industrialized countries nowadays — roughly double the rates regularly achieved in the 1950s and 1960s — are never far from the long-run-equilibrium rate.

The experience of the 1980s is relevant here. There is no question about the facts, merely about their explanation: the existence of substantial and prolonged involuntary unemployment and underemployment on a world-wide scale for a decade or more is incontrovertible. The labor market did not clear in the short run, because neither of the conditions that ensure a full-employment long-run equilibrium in the auction markets of the model of pure competition was satisfied in the real world of monopolistic or imperfect competition and administered prices. Nominal wages fell, slowly but persistently, yet the supply of labor increased instead of decreasing. Each increase in the labor force added to the downward pressure on wages, in a vicious circle. New hirings virtually ceased, or were far outnumbered by new layoffs. Declining wages and not layoffs further reduced consumer spending power and added to the deflationary spiral. To all intents and purposes the marginal wage (both nominal and real) for society as a whole fell to zero.

It would therefore appear that the labor market would not have cleared even if all wages had proved infinitely flexible downwards; the only way the surplus could have been quickly eliminated would have been to allow the excess workers and their dependents to starve to death. The fact that this did not happen, and that a hesitant recovery eventually began, was clearly not due to wage flexibility. On the contrary, evidently what saved the day was the persistent strength of consumer demand, albeit at a sadly deficient level, supported by (a) the stubborn resistance of wages in the face of downward pressures and (b) humanitarian aid to the destitute as the initially rudimentary emergency relief and welfare systems were gradually improved. These two phenomena sustained the economy until the growing need for some capital renewal began to inject a modest positive impetus to the spending stream.

Despite the improved social-security networks put in place in most countries in the 1990s and 1960s (which, in the way, are now under attack everywhere), there are indications that conditions in the labor market for the last decade or two differ only in degree from those of the 1930s: the bulk of today's unemployment is involuntary, and the slope of the short-run labor-supply curve is once more negative. Here again it should be possible to mount empirical studies that would settle both matters.

Some voluntary unemployment certainly does exist, at least temporarily, in the sense that anyone who finds himself or herself unemployed at any given time may use the accumulated past savings, unemployment-insurance compensation, other social security safety-net receipts, or borrowings from friends or relatives for support while taking time to systematically explore whatever employment opportunities may currently be open. However, this does not sound like the voluntary unemployment the neoclassicists describe; far from being at or just below going wage levels, these alternatives are much inferior to a steady job, and most of them are merely temporary expedients.

Many economists find it hard to accept the neoclassical assertions (Cornwall and Maclean, 1984, 18; Tobin, 1992, 396ff). Official statistics report that many people who accept part-time employment would prefer full-time jobs. Many young people accept work in the fast-food industry and in other low-paying fields, although they are clearly qualified for greater responsibilities. These people are not technically unemployed, but they are surely underemployed, and they are certainly not rejecting better jobs at the going rate.

Hasan and de Broucker (1982) find that 21 percent of the weekly of Canadian unemployment in the late 1970s was due to long-term instances (spells of over 6 months), which were concentrated in only 4.9 percent of all spells, and that about half the spells of unemployment ended in withdrawal from the labor force rather than in
finding new jobs. Additionally, there was scattered evidence that the incidence of long-term unemployment was greater than those figures suggested. Spells of unemployment contributed anything from one quarter to one third of unemployment, so long-term spells accounted for over half the total. On the basis of these findings, Cornwall and Maclean (1984, 63) conclude that Canadian labor markets in those years were characterized by hidden and highly concentrated long-term unemployment.

There is considerable recent anecdotal evidence of involuntary unemployment. Occasional newspaper accounts nowadays report new plants opening (perhaps transferred from relatively high-wage to relatively low-wage locations), and invariably the number of applications far exceed the advertised vacancies, even though the wages offered are by no means exceptional for the region. Persistent high levels of involuntary unemployment for over 20 years strongly suggest that the slope of the short-run supply curve of labor has been negative, and some observers cite the persistent shift of women (particularly married women with children) into the labor force over the last couple of decades as persuasive evidence of that phenomenon (Peterson, 1994, 87). Repeated bouts of tight money combined with downsizing in public and private employment offer clear evidence of the sort of repeated new "shocks" that could prolong a basically short-run phenomenon for decades.

THE IMPLICATIONS OF INFLATION

Keynesian demand management in the real world has been emasculated by inflation, not by the intellectual problems some academic theoreticians have found with the underlying model. Policy makers drew back from full-employment policies between the late 1960s and the mid-1970s, because of the practical problems they encountered in trying to maintain them in the face of inflationary pressures; thereafter they replaced them with repressive neoclassical anti-inflation strategies.

From the end of World War II in 1945 to the early 1970s the steadily evolving techniques of demand management gave the world as a whole, and most nations individually, the strongest and most sustained period of economic growth and prosperity ever recorded before or since. However, it turned out that, on balance, very little net stimulus in the form of deliberate deficit financing by governments was necessary in most of the major industrialized countries: Generally speaking, most of government borrowing in this period was for the perfectly orthodox purpose of financing capital expenditures on necessary economic infrastructure, including postwar reconstruction. In the early years, especially in former belligerent countries, the task was made much easier by the substantial liquid savings left over from wartime financing held by the public, consisting with pent-up demand for consumer goods that had long been very scarce or unavailable. Producers could sell goods as fast as they could turn them out, so a gentle hand on the demand-management tiller was all that was needed most of the time to reassure the public that there would be no postwar depression this time. Nevertheless, demand management's developing skills deserve full credit for maintaining sustained prosperity.

One small cloud was visible on the horizon from the very first: low levels of "creeping inflation" persisted even in those countries that had suffered no war damage and that followed what were generally considered responsible domestic economic policies. There is no denying that inflation is a serious problem, for even at relatively low rates it distorts the role of the price mechanism in directing production and consumption in a money-and-market economy (McLeod, 1981). But for a long time creeping inflation remained relatively stable and did not seem to be a serious threat to postwar prosperity.

It had always been clear that using monetary and fiscal policies too aggressively to combat unemployment would make inflation worse. However, it soon became equally clear that using them to combat inflation made unemployment worse, and in fact they proved far more effective in creating unemployment than in curing inflation. Practical policy makers therefore had to resign themselves to seeking the least painful balance between two equally intolerable evils. Unfortunately, by the late 1960s inflation was clearly accelerating everywhere, and had reached levels that the authorities in country after country found they could no longer tolerate; they increasingly eased off on the use of monetary and fiscal policies to support high levels of output and employment.

A worrying feature of the postwar period, which was at the root of the recurring crises in international financial relationships, was the fact that price trends varied materially among the major nations. The discrepancies became more serious as time passed and inflation accelerated; by 1973 policymakers brought the Bretton Woods system of normally fixed exchange rates to an end, and replaced it by a regime of fluctuating rates. Inflation soared everywhere thereafter — it soon reached 32 percent per annum in Japan, 24 percent in Britain, 11 percent in the United States and Canada, and 7 percent in prudent Germany — because balance-of-payments discipline was greatly relaxed as a consequence of the new exchange-rate regime. Lacking any better advice from professing Keynesians, or from anyone else, most national authorities soon adopted monetarist, quasi-monetarist, or neoclassical remedies. The neoclassical era had begun, as sanctioned by the 1976 G-7 summit; in most countries monetary and fiscal policies were thereafter addressed to the anti-inflation fight with increasing severity (McLeod, 1995, 146-51). However, inflation has proven stubbornly persistent everywhere; it has only recently been reduced to rates that various national authorities consider tolerable, and it threatens to accelerate again if economic growth reaches quite moderate levels. A plausible explanation of its persistence and its tendency to accelerate in good times is suggested at the end of the next section.

Neoclassicists accept continuing inflation as a fact of life for the foreseeable future and build their policy proposals around continued reliance on repressive monetary and fiscal policies to combat it. Their prescriptions, however, have signally failed to restore prosperity in 20 years of trying. A revival of Keynesian demand management seems to be the best hope for again achieving a reasonable approximation of full employment. That is impossible unless monetary and fiscal policies can be freed from inflation-control duties; like human agents, they can not serve two masters. We must find a new way of controlling inflation — one that does not make unemployment
worse and that is compatible with the free-enterprise money-and-market system —
before those techniques can again be used to support output and employment.

A number of alternatives to monetary and fiscal restraint for controlling inflation
have been proposed in the past decade or two. They include incentive-based income
policies (TIPs and MAPs), extensively examined by Colander et al. [1986]; several
other types of incomes policies; and a proposal by Cornwall [1994] explicitly designed
to revive Keynesianism and thought to be applicable in full to the United States,
Britain, and Canada and in part to the other OECD countries. Most incomes policies
apply primarily or solely to wages and salaries, which leaves returns to the owners-
ship of productive resources unfairly free of restraint, though remedies for this defi-
cency appear to be possible (McLeod, 1994, 182 and 208-10). My own short-run pro-
posals (McLeod, 1994, Ch. 12, 1998, 196) apply equivalent restraint to both types of
factor returns. The prices of goods and services would not be directly controlled, and
the profit motive would not be interfered with, but stable factor costs would be re-
flected in stable consumer prices. Longer-range remedies are also proposed for some
of the inflationary biases now to be found in the economic system.

Failing widespread agreement by the economics profession on anything better, a
new look at arbitrary price controls might be in order, despite their well-known faults.
In view of the evidence that oligopolistic firms and industries can ratchet up their
selling prices even in depressed times and in the absence of significant wage pres-
sures, presented at the end of the next section of the paper, some form of price control
should at the very least be applied to them. A carefully designed permanent or quasi-
permanent program, including continuing or periodic ad hoc corrective for the price
anomalies that would inevitably occur, would surely be less damaging than the stark
choice between uncontrolled inflation and perpetual depression that neoclassicism
offers us. The elements of such a system are suggested by Salant [1986] in his descrip-
tion of how U.S. price controls in World War II affected oligopolistic firms and indus-
tries, though Salant does not attempt to construct such a system. Its essential points
are twofold: (1) setting a price cap below the firm's ideal price (where MR = MC)
resulted in increased output at a lower selling price, and (2) when controls were lifted
in 1946 these prices did indeed rise, but not to the level they would have attained had
there been no controls. A system of permanent controls designed around these find-
ings should damp inflation sufficiently to permit substantial monetary and fiscal stimu-
lus to the spending stream.

KEYNESIAN MICROECONOMICS

It appears that the widespread belief that Keynesian underemployment equilib-
rium require sticky nominal wages and prices may be wide of the mark. Keynes [1936,
Ch. 19] argued persuasively that fully flexible wages and prices would not ensure full
employment, but he did not claim that rigid wages and prices were necessary to achieve
that goal. He merely said that he thought a stable general level of money-wages is the
most advisable policy. Some modern Keynesians have reached substantially the same
conclusions [Davidson, 1992, 453; Tobin, 1993, 46].

However that may be, a plausible explanation of sticky wages and prices can
indeed be constructed on the basis of standard textbook representations of the admin-
istered prices of firms operating under conditions of conventional imperfect- or
monopolistic-competition theory. It would appear that the error is on the neoclassicists
to show that the model of pure competition offers a better explanation of real-world
price phenomena.
The appropriate microeconomic paradigm is not an auction market, as neoclassical
theory implies, but an adaptation of the workings of organized commodity and securi-
ties exchanges, in which trading occurs in standard board lots, would-be sellers set
specific asking prices for their offerings, and would-be buyers set specific bid prices:
no trading takes place until some buyer accepts some seller's asking price, or some
seller accepts some buyer's bid price [McLeod, 1994, 101-104]. If market conditions
prove less favorable than expected, sellers may have to reduce their asking prices
sooner or later, but if market conditions prove more favorable than expected they will
feel free to raise them promptly. In general, then, wages and prices tend to be sticky
downwards but flexible upwards.

In typical labor markets an individual would be worker faces relatively few po-
tential buyers for his or her particular skills conveniently accessible with reason-
able commuting distance, and costs in time, trouble, and money in seeking out addi-
tional possibilities are significant; he or she normally has little choice but to accept
the best job offer resulting from a reasonable search. It is the buyers [especially the major
employers] who have the greatest market power and who take the initiative by posting
their bid prices. Also, the employer enjoys additional advantages from a posted-
price policy; it permits an orderly array of the wage differentials for the considerable
variety of skills a typical firm must employ, minimizes the need to bargain separately
with individual employees, and facilitates accounting control of the payroll. Posted
wages also emerge naturally from negotiations between an employer and a union or a
professional body.

In the market for goods and services — certainly for most goods and services that
the average consumer buys, and for many intermediate goods and services as well —
sellers traditionally offer their wares at posted prices, which are changed relatively
infrequently. The typical case involves a firm with relatively few close competitors
selling a specific range of products to a substantial number of individuals; the indi-
vidual consumer's bid prices will be virtually meaningless in most instances. In this
case it is therefore the sellers who have the greatest market power, and who logically
take the initiative by posting their asking prices.

A business firm will presumably set the asking prices for its wares at levels de-
signed to achieve its major corporate goal (which we may normally suppose is to
maximize its net income) under the market conditions it anticipates, over whatever
time horizon it thinks best. When market conditions prove unfavorable, however,
the firm will normally be reluctant to reduce its asking price because that would risk
spoiling its market for the future in response to what might prove to be a merely
temporary problem. Also, if the firm has one or more close competitors, market equi-
librium may be somewhat unstable and dependent on tacit or overt collusion, as in
the standard textbook case of a kinked demand curve and a dog-legged marginal revenue curve. Each firm may fear that a price war that no-one would win if it were the first to move. In the end, the firm's decision to reduce its prices is not likely to be made lightly or instantly. Rather, it may involve consideration of any changes that have occurred or might be induced in its costs, possible modification of some or all of its products and its promotional strategy, the probable responses of its competitors, and a complete reassessment of market conditions.

A typical business firm probably has some scope for raising its prices independently of its close competitors without losing appreciable market share, even when the general price level is stable, but may be reluctant to move too quickly even if its market proves unexpectedly buoyant, until it is sure the improvement in its sales is not just a temporary phenomenon. It will want to maximize its returns over the long run, rather than extract every possible immediate advantage; undue readiness to raise its prices might earn it a reputation for gouging, and lose it customer good will. The existence of one or more close competitors may also inhibit hasty action, for fear of losing market share if the others do not change their prices by about the same amount at about the same time. As before, when it does decide to make changes, setting its new price structure will probably involve a thorough re-examination of the many related considerations that will affect its ultimate profit picture.

Of course, the pricing decision is much easier in a period of persistent inflation, as has been the case ever since some imprecise time in the early postwar years when business leaders' fears of lagging back into a new 1930s-type depression finally faded. In that case it becomes merely a question of how often and how much a given firm should raise its prices. Even the most cautious oligopolist can safely inch his or her prices up persistently; at worst, moving them a bit too fast would bring a period of slow sales until competitors' prices caught up, so the general price level naturally ratchets upward. This seems to be the principal explanation of the persistent inflation of the last 20 years or so in most countries.

In the past, business leaders have often blamed increases in their selling prices on upward wage pressures, but for the last couple of decades real wages have generally been stagnant or declining in most major countries. The implication is that there must be a mechanism that permits firms to persistently raise their selling prices regardless of wage pressures, and the rationale of price setting under imperfect or monopolistic competition offered here suggests just such a mechanism. It also appears to explain why inflation tends to accelerate when the economy begins to grow more strongly: stronger growth implies greater ability of each individual firm to raise its selling prices with impunity, therefore a more rapid ratcheting upward of the general price level.

CONCLUSIONS

The first conclusion is that neoclassical economic strategies are unsound in theory, and inherently incapable in practice of delivering the renewal of the sound growth and prosperity their adherents claim for them.
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OTHER THINGS EQUAL

One Small Step for Gary

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Gary Becker has written a new book about the household, I have to review it for another journal, but I can give you the news here. Like the $500,000 diamond the orphans in Sierra Leone found under a root vegetable the other day (talk about Kirznerian "alertness"!), it's brilliant. But unlike the kids' diamond it's got a big, big flaw right through the center.

Gary takes one more step in the book towards admitting that people are people. He tries to endogenize tastes, instead of just sticking them in the category of things about which we should not dispute. He's still a little dazzled by sociology, and inclined to reach for hokey arguments from evolution. And his standard of scholar-ship in using what he takes to be the findings of anthropology or sociology is not high. Economists who view themselves as theorists, as Gary does, are usually casual about the factuality of their stylized facts. But it's enough forward. In his next book I bet he finally admits that human beings love each other, too.

What's brilliant about it is what's always been brilliant about Gary. He is, after all, something like the best economist of his generation. About 1974 to the Club at Chicago Ted Schultz, the great agricultural and development economist, a Nobel Prize winner himself from an earlier generation, asked me what I thought was the most exciting trend in modern economics. I said, "The application of economics to things conventionally outside it: Gary Becker.

Ted agreed. We all did. Gary was well known around Chicago as the best graduate student the place had produced since Friedman and Stigler (I would put Jim Buchanan in that group, but for some reason he was never popular at his alma mater). When Gary was still a student he came up to Al Harberger at a party, Coke in hand (Gary's, not Al's hand: Al's had a scotch), and said out of the blue "You know, Al, children are just like durable goods." And come to think of it, in some ways they are. What an interesting metaphor.

What's the flaw, then? The flaw is that little matter of love. You can call it "solidarity" or "social embeddedness" or whatever, tho "S" variable. Economists since Jeremy Bentham have focused on prudence or price, the "F" variable. (Actually of course both these variables are vectors, of things that sociologists like to talk about or things that economists like to talk about.) The focus by economists on "Prudence" has been very, very productive. Call it the Productive variable if you want. Economies can be thought of as the science of Prudence, planning, looking forward. Adam Smith made a lot of it, especially in The Wealth of Nations.