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Mid-Term Essay Two:
On "the paradoxes of individualism"

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What is meant by the phrase "the paradoxes of individualism"?

The paradox of individualism is also known in logistics as the fallacy of composition, it is, to put it in layman's terms, when the system-as-a-whole does not act according to the sum of individual intended behaviors. Samuelson defines the fallacy of composition thusly:

A fallacy in which what is true of a part is, on that account alone, alleged to be also necessarily true of the whole (Samuelson 1976:14).

Because economists in general seek to improve society[1], this 'paradox' is hotly debated within economics, and it is perhaps irresolvable. It is perhaps irresolvable for one reason. Economists are people first and they bring their value systems with them to the 'job'. Some economists believe that markets left to their own will create a common good; these economists might be known as Lockeans or Nozickians and tend to believe that government is the *cause* of retrogressive aggregate behavior and perhaps that property rights outweigh redistribution on the moral (ethical) scale. Other economists, who might be known as Hobbesians or Rawlsians, believe that government is needed to *cure* the problems of aggregated individual behavior which is counter to the common good, and believe perhaps that some redistribution outweighs property rights on the moral scale.

I propose that these two opposing world views are not resolvable within the discipline of economics. (These are of course *reductio ad absurdum* stereotypes, but many stereotypes have a grain of truth. Issues of policy are best addressed one at a time). However in this essay I will discuss the concept of the fallacy of composition, some opposing economic views, as well as the fallacy in terms of the notions of the *will- of- all* and the *general good.*

Edward Nell, on the importance of understanding the individual vs. system paradox,

> This is the hardest point, probably in all of economics. The system as a whole is not just the projection of its parts onto a larger screen; it is not the household or the firm writ-large. It is a different *kind* of system; it works according to different rules. And there is no obvious reason why this should be so. Even worse, at one time – and not so long ago – it wasn't so, and the system as a whole *did* (more or less) replicate the workings of the household. The word 'Economics' is in fact derived from the ancient Greek for household management…. (Nell 1996:4).

[1] "Businessmen are chiefly interested in profits; academics and economists tend to put the well-being of the public first" (Nell 1996:1).

F.A. Hayek (1979) stated that the purpose of social science "is to explain the unintended or undersigned results of the actions of many men" (41) in order to "grasp how the independent action of many men can produce coherent wholes, persistent structures of relationships which serve important human relationships without having been designed for that end" (141)[2]. For Hayek, society is greater than the sum of individual action.

When such diverse thinkers as Samuelson, Nell and Hayek emphasize the importance of needing to understand this difference between individual action and resultant society, we can assume that this is an important topic worth our time and effort to study and comprehend. Again, this may be *the* important topic in economics.

In *Making Sense of a Changing Economy*, Nell following Aristotle introduces the *natural intent* of a system, what that system in intended to achieve, its instrumental purpose. (For example a health care system should improve the health of people.) Nell links the philosophical concept of *natural intent* with the economic concept of the *general good* and states that, due to the fallacy of composition, market outcomes (the *will-of-all*) do not result in the *general good*. Nell gives many examples (such as the paradox of thrift and the perverse incentives of fixed-fee service provision for public goods) to illustrate the fallacy and to argue that government is needed to adjust for difference between will-of-all and the general good, "In these circumstances, the desired position will have to be achieved through actions carried out, not by individuals, but at the level of the system, i.e., by the government" (85).

Here we should note that Nell and Hayek might have different opinions on how what Nell calls the *general good* can be achieved. Like I stated in my introduction to this essay (and as is shown by the well-known joke, "if you want three opinions, ask two economists"), economics may not be able to provided definitive scientific answers on this question of 'will-of-all versus common good' because the answers may be more values-based than economics- based, and, perhaps, because these

[2] Note that Hayek emphasizes the unintended consequences of many people as creating the important structures in society. He did not think that government planners could be as successful as individuals acting freely in a decentralized manner to best distribute the resources in a society. He called this the 'knowledge problem" in the socialist calculation debate. See Burczak 2006, among others, for a discussion of the socialist calculation debate.

values find themselves into economic reasoning and therefore policy proposals. I will illustrate this below.

The following represents a list that Samuelson (1976:13-14) gives as illustrations for the fallacy of composition in economic terms. I will comment in *italics* following each item to show the economic reasoning for "the pro-government solution" and the "laissez-faire solution" (note that again, for this short essay, I will need to over-simplify concepts about which many volumes have been written).

1. If all farmers work hard and nature cooperates in producing a bumper crop, total farm income may *fall*, and probably will.

The income of the farmers might fall because the market might get flooded with supply, causing ceteris paribus*, the price to fall with constant demand. This price decrease might mean that although the farmers are selling more product, the price drop might net them in total less income. Some would say that price supports or price guarantees to the farmers could correct for this, others might say that worldwide free-trade in agriculture would allow the famers to sell their products in a therefore larger market, the relative quantity would increase and thus the overall revenue decrease would then be minimal and the farmers would net a greater income with the bumper group.*

2. *One* man may solve his own unemployment problem by great ingenuity in hunting a job or by a willingness to work for less, but *all* cannot necessarily solve their job problems this way.

Some might argue that when unemployment is larger than normal for extended periods of time the government should step in and create employment. All *cannot work for less because less wages for all would mean less income throughout the economy, decreasing demand economy-wide and creating a downward spiral of decreasing income and larger unemployment. Others might say that government employment-generation would "crowd-out" productive employment in the private sector and that the unemployment was due to structural problems created by the government in the first place (tariffs, minimum wage, regulation, taxes, inflation, unemployment benefits) that curbed productive labor, investment and growth, and that the solution would be to remove these impediments to productive growth, not crowd-out private employment and private investment and employment generation with government employment.*

3. Higher prices for *one industry* may benefit its firms; but if the prices for *everything* bought and sold increased in the same proportion, no one would be better off.

This is of course true, money prices are a means of exchange thus equal changes in all prices mean that the exchange ratios for goods (and thus original endowments and purchasing power) remain unchanged. There are no counterpointal arguments I can think of to show here. However it should be kept in mind that prices do not increase instantaneously. There are redistributive effects to money changes as these changes filter through the economic system, thus exogenous money changes themselves show the difference between the will-of-all *and the* common good. *Those that have access to the new money first gain while those lower down on the income scale (the least better-off and those not part of the chain of fiancé capital) are more harmed by the increase in money supply.*

4. It may pay the United States to reduce tariffs charged on goods imported, even if *other* countries refuse to lower their tariffs.

Some economists might disagree with this and say that lower tariffs would have a negative increase on domestic employment and that this decrease in local employment would have a downward spiral effect in addition to hurting those who have lost their jobs through increased and cheaper imports, whereas other economists might say that this decreased employment would be more than be made up for by lower prices on everything due to the tariff decreases. These lower prices would then mean more competitive local industries and thus increased local employment, income and growth. But, yes, disaggregation of macro-effects is best illustrated by this example; free trade does benefit all who are lucky enough to have it

.

5. It may pay a firm to take on some business at *much less than full costs*.

Some economists might say that this is unfair business practice and would create monopolies (and thus higher prices) in the long-run and hurt the society at-large. Others might say that this would allow firms to reach a level of lower per-unit costs due to production volume increases, and that these lower costs would benefit society at-large.

6. Attempts of individuals to save more in depression *may lessen the total* of the community's savings.

This is the paradox of thrift. Some economists believe that a large level of savings economy-wide would decrease demand, thus income, and this would then ultimately reduce savings throughout the economy because people would have to spend more of less income to get the same amount of goods as before the mass savings began. Other economists believe that an increase in savings would reduce capital costs and therefore create investment in more efficient production techniques, reducing prices throughout the economy. More goods produced with less costly techniques would mean less money would have to be spent on these goods. This would increase savings throughout the economy because goods are less expensive due to efficiency increases. Therefore there would not be a 'paradox of thrift' because saved capita would manifest itself in cheaper goods, rewarding, instead of penalizing, system-wide savings in the long- term.

7. What is prudent for an *individual* may be folly for a *nation*.

One example of this is national defense. It is prudent for an individual not to pay for national defense because they cannot get excluded from it anyway. However this is folly *for a nation because if no one paid for defense the nation would be defenseless.*

I hope the above examples show that the paradox of individualism in economics is a complex notion and one which is open to debate. The divide between the will-of-all and the common good is perhaps, as Hayek and Nell suggest, the pivotal concern in economic thought, and perhaps falls under the field of *political economy* rather than modern economics as we know it today.

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