TEACHING PRINCIPLES OF ECONOMICS FROM A SOCIAL ECONOMICS PERSPECTIVE

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ABSTRACT

Mainstream economics thinks about economic affairs in a way that underscores things: prices, resources, goods, services, wealth, assets, liabilities, and the like. This approach allows the instructor to side-step ethical issues because things cannot act ethically. Social economics, or what we prefer to call personalist economics, proceeds by centering attention on persons acting as economic agents and evaluating human action in economic affairs in terms of its ethical content.

Mainstream economics argues that economics relates to the means that achieve given ends most efficiently but is silent about those ends. Personalist economics states that the end of all economic systems is to provision human material need. In an effort to make mainstream economics value-free its advocates reject the value-laden concept of need whereas for personalist economics need is central to understanding economic affairs.

In contrast to mainstream economics that makes the individual the basic unit of economic analysis, personalist economics centers analysis on the person – a fusion of individuality and sociality. Individuality in economic affairs is addressed through microeconomics while sociality is undertaken in macroeconomics. Three other premises are important in personalist economics: institutions, uncertainty, and sacred dignity. The other premises of mainstream economics are the law of nature, certainty, and instrumental value.

Keywords: teaching economics, personalist economics, mainstream economics, person, individual


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1. INTRODUCTION

Over the past 25 years I have taught principles of economics to more than 7,000 students and recently distilled that experience into an e-text titled -- *A Critical Examination of Human Beings as Buyers and Sellers, Producers and Resourceholders, Employers and Employees, Entrepreneurs and Bankers* that is accessible via the internet. \(^2\) This text follows my own understanding of economic affairs as directed by personal instincts, convictions, values, insights and a philosophy that perceives human beings and, therefore, all economic agents as persons as opposed to individuals.

The text is offered to all students in my ten-week, one-term principles class without charge. Other benefits include the elimination of (1) the lag between the time the text in revised form is ready for publication and becomes available for use in the classroom, (2) the work in preparing an index since the e-text is available as a PDF file that has a built-in search function, and (3) the inevitable hassle with a publisher as to what material must be removed and what has to be revised.

My teaching has evolved significantly since I first took to the classroom and since I first began questioning the validity and the efficacy of the tools that are routinely employed by teachers of mainstream economics and by those who write principles textbooks. Does the invisible hand, for example, faithfully represent what happens in markets or is it just a manner of speaking, is it real or rhetoric? Why is the course called the principles course, the mainstream textbook referred to as the principles text, but the teacher expected to teach laws, as in the law of supply, the law of demand, the law of profit maximization? Is there a better way to teach the law of diminishing marginal utility that taps into the typical student’s own experience and that connects that law to the law of demand?

As my thinking about economic affairs developed by wrestling with those questions, I found myself questioning other aspects of the principles course and standard text. In teaching how prices are determined, is it more accurate to ask the question ‘Who determines price?’ than ‘What determines price?’ If it is ‘Who determines price?’ does it make sense to continue to explain the market as tending toward equilibrium? And if one takes account of the entrepreneur, is it more telling to characterize the market as tending toward equilibrium or disequilibrium?

Through this Socratic method turned inward on myself rather than outward on my students, I began to see that much of how one approaches the teaching of the principles course depends on the premises that one begins with, and that the single most important premise in mainstream

\(^2\) Go to www.pageout.net/user/www/e/o/eoboyle/Notes215.pdf.
textbooks is that the basic unit of economic analysis is the individual. Little by little I began to appreciate that my understanding of human nature was not fixed in the concrete of individualism, the dominant Western philosophy originating in the 17-18th century Enlightenment that gave birth to the classical economics of Adam Smith, and that there is more to human nature than individuality. A human is a social being no less than an individual being, a fusion of body and spirit, of intellect and free will, reason and emotion that is better characterized as person and is better represented by the 20th century philosophy of personalism. That discovery changed my way of approaching economic affairs from gut instinct that there is something inadequate about mainstream economics and that I referred to at first as social economics to reasoned argument that I now call personalist economics.

In the last several years, this new approach of mine has been strengthened by the insight that the development of electronic means of human communication beginning with the introduction of the telegraph has changed our awareness of ourselves no less than of others. Thus, as economic agents, we no longer are the one-dimensional individual of mainstream economics, a premise suitable perhaps for economic affairs conducted in the script stage of human communication and directly reflected in classical economics, but the two-dimensional person, a premise of much greater validity for economic affairs conducted in the electronic stage.

This difference between what the student learns through my e-text and the standard textbook is driven home in virtually every topic addressed in the course. Four examples follow. First, I ground the principal pedagogical tool in teaching microeconomics (Marshall’s scissors diagram) and the main tool in macroeconomics (circular flow diagram) not in things such as equilibrium/disequilibrium but in the more human language of agreement/disagreement, accord/discord. Second, in presenting economic affairs in terms of human beings acting as economic agents, I find it necessary to address the problem of the conditions under which economic agents act ethically or unethically. Third, defining and measuring poverty is two-dimensional reflecting both the individuality and the sociality of human nature as confirmed by personalism. Fourth, both the principle of diminishing marginal utility and the principle of diminishing returns are presented as originating in the materiality of human nature.

The concept of the limit plays an important role in the way I understand economic affairs and therefore how I teach principles. Limit, for example, is descriptive of a price ceiling and price floor in teaching price theory and of the much more abstract concept of carrying capacity in teaching the constraining role of environmental pollution in
macroeconomic affairs. Justice limits the gains that are reasonable in any interaction between economic agents. Poverty thresholds - whether they originate in a relative standard or absolute standard - are limits below which persons/families are identified and counted as poor. Because both the principle of diminishing returns and the principle of diminishing marginal utility are grounded in human materiality, work and consumption are effectively limited by the human body. The concept of the limit applies more widely than suggested in the foregoing, but limits on the length of this essay do not permit us to mention the others.

1.1 Price Determination and Resource Allocation

The question 'How do markets work?' raises two other questions: 'Who/what determines prices?' and 'How do markets allocate resources?' Stating the first of these latter questions in terms of “what” leads the student to think of markets in terms of things that are exchanged such as goods and services and natural resources, or more simply supply and demand. Formulating the question in terms of “who” directs the student’s attention to the human beings who are interacting in the marketplace and the workplace: buyers and sellers, employers and employees, producers and resource holders. Our approach presents the market system in terms of the human beings who are engaged in their everyday economic activities.

Mainstream economists like to refer to the intersection of the supply curve and the demand curve as the point of equilibrium, and the market price as the equilibrium price. Personalist economists prefer to call that intersection the point of agreement and the market price the agreed price because agreement underscores that markets are places for sorting out differences between humans whereas equilibrium suggests that markets are places for striking a balance between things.

As to the second question, "How do markets allocate resources?", we argue that two forces are at work: the “pulling force” of prices and the “pushing force” of unmet need. An example helps flesh out our meaning. Producer A faces a shortage in the product market, while Producer B faces a surplus.
ALLOCATING RESOURCES: 
THE PULLING FORCE OF PRICES, THE PUSHING FORCE OF 
UNMET NEED

Producer A faces shortage of his/her product

Producer B faces surplus of his/her product

⇓

Producer A raises price and increases output

⇓

Producer B lowers price and decreases output

⇓

Producer A hires more resources and is able to pay more because the price of the product is rising

⇓

Producer B discharges resources and is not able to pay more because the price of the product is falling

The resources discharged by Producer B who is experiencing a surplus in the product market are attracted to Producer A who due to a shortage in the market is hiring and is paying more for the resources he/she requires. This is the way in which mainstream economics explains the allocation of resources in a market economy: the pulling force of prices draws resources away from producers where they are in excess supply and toward producers where they are in short supply, thereby simultaneously remedying Producer B’s surplus-market condition, and Producer A’s shortage-market condition.

Personalist economics adds the pushing force of unmet need. That is, redundant workers and other idle resources are pushed away from producers where they are in excess supply and toward producers where they are in short supply by the hardship and unmet need brought on by their idleness. For more, see Topic 7 in the e-text.

1.2 Macroeconomics Circular Flow

Several features of the circular flow diagram on the following page should be noted because they represent a departure from the diagram used in mainstream principles texts. First, reference is made only to the U.S. domestic economy. Second, the diagram has been revised to replace the workplace, household, and government sectors with human beings -- the producer/entrepreneur, the consumer/worker, the public official, and the creditor/banker -- thereby personalizing the way one thinks about macroeconomic affairs. Third, Flow 14 represents wasted natural resources, allowing the student to visualize environmental degradation in the context
of the circular flow. Similarly, Flow 15 represents wasted human resources, so that one can visualize job loss, unemployment, and reemployment from a macroeconomic perspective.

Flow 14 and Flow 15 are sufficient for our purposes because there are only two principal resources used in the production process. Discarded natural resources, Flow 14, can be either recycled or reprocessed and used again in the production of goods and services. A reprocessed item is one that undergoes some change before it is used again. A recycled item is one that is returned to the production process without being reprocessed. Both are shown as being returned to the process of production through Flow 3d.

Carrying capacity is a concept that has emerged as a result of heightened awareness of the importance of the environment to the well-being of all earthly creatures, especially human beings. Carrying capacity refers to the limit on the capability of our planetary home to absorb contamination of the air, soil, and water. There is in other words a limit to the amount of Flow 14 that can be tolerated without impairing the well-being of every earthly inhabitant. Where that limit lies is precisely the question at the heart of the public discourse on greenhouse gases, for example.

Though we know of persons who have been jobless for long periods of time, and we recall that during the Great Depression of the 1930s the United States was beset by massive and persistent unemployment, the average unemployed person remains jobless for one to two months. Indeed, during an economic boom when there are labor shortages, a spell of unemployment may run for just one or two weeks. Large proportions of the unemployed are on temporary layoff and subsequently are recalled by their employers. Others find new jobs. We represent both types through Flow 3c. From experience it appears that the lower limit on wasted labor resources is indicated by an unemployment rate of 2-3 percent and the upper limit by a rate equal to or greater than 10 percent.

In the circular flow diagram, new labor resources are differentiated from new natural resources. Flow 3a represents new labor resources as originating in the household sector. Flow 3b portrays new natural resources as the endowments of nature. We have included Flows 3a, 3b, 3c, and 3d in our macroeconomic representation of the resource market at the bottom of the diagram where we also take note of the flows specific to the product market and the financial market. For more, see Topic 12 in the e-text.
MACROECONOMIC CIRCULAR FLOW: PERSONALIST ECONOMICS CONTEXT

United States Domestic Economy

6. Payment for Goods and Services
5. Supply of Goods and Services

Combined Demand for Goods and Services
1. Consumer
10. Public

9. Capital Goods and Services: Demand/Supply/Payment

7. Demand for Financial Resources

12. Demand for Borrowed Funds

8b. Savings

2. Demand for Resources
3a. Labour Resources
4. Payment for Resources: Labour/Natural/Financial
3b. Natural

8a. Private Creation of Credit

8. Supply of Financial Resources

Combined Supply of Resources
3c. Reemployed
3d. Recycled/Reprocessed

14. Waste

15. unemployed

Product Market flows: 1-5-6-9-10
Resource Market flows: 2-3a-3b-3c-3d-4
Financial Market flows: 7-8a-8b-12-13
2. ECONOMIC GAIN AND JUSTICE

Are decisions regarding ethical issues in economic affairs entirely arbitrary, depending completely on the whims, fancies, feelings, opinions, attitudes, and values of the persons making those decisions? Or, are there objective standards that apply in economic affairs rendering ethical decision-making reasoned, defensible, and alike from one person to the next except in instances of specific extenuating circumstances? Overwhelmingly mainstream economics argues that ethical standards are essentially relative, that they differ from one person to the next, and therefore are entirely outside the limits of legitimate inquiry for economic science.\(^3\)

Our view is that there are certain objective ethical standards that ultimately originate in the human experience. Thus, shoplifting is destructive of retail trade because clearly it is unreasonable to expect a shopkeeper to operate his/her store when customers are free to take whatever they want without paying. Indeed, not punishing shoplifting assures that no one would be so foolish as to become a merchant and expect to earn a living. To teach and reinforce the ban on shoplifting, it is necessary to have laws and enforcement officers to assure that shoplifting is punished.

There are three principles of economic justice because there are only three modes of human interaction in economic affairs: person to person, superior to subordinate, and member to group. The principle of equivalence sets forth the duty of buyer to seller in the marketplace and worker and employer in the workplace. The principle of distributive justice defines the duties of the superior to his/her subordinates whether that interaction takes place in the marketplace or the workplace. Finally, the principle of contributive justice sets down the duties of the member to the group in interactions occurring in the workplace or the marketplace.

2.1 Economic Gain: Profits, Consumer Surplus, and Economic Rent

Before moving on to the principle of equivalence, it is instructive to address first what happens in a market exchange. Every exchange involving economic agents who are well-informed and free to act entails gain for the parties involved: what is gotten in the exchange is more highly valued than what is given up.

In the workplace, for example, when the baker hires a sales clerk to tend to his/her customers, there is gain for both parties. The baker gets the

\(^3\) Samuelson’s first edition *ECONOMICS* (p. 14) employs the relativist argument that ultimately there is no disputing ethics.
clerk’s labor services that are more useful to him/her than the wages that must be paid, thereby adding to the baker’s profits. Without that gain, the baker could not afford to hire the sales clerk. At the same time, the clerk contributes his/her labor services because the wages paid are more than the clerk otherwise would have accepted, and the clerk can save that gain (economic rent) or apply it to buying other things that he/she needs or wants.

The gain to the worker or the owner of natural resources that are used in the production process may be enhanced further by the generous employer/producer who pays more than is absolutely required perhaps in the expectation that his/her generosity will be repaid by more diligent workers and more careful suppliers, thereby adding to the employer’s profits. The model employee or supplier is one who contributes more to profits than is normally expected.

In the marketplace, the baker produces more loaves of bread than can be used for his/her own personal consumption, and sells them provided the money gotten is greater than the cost to produce the loaves, thereby adding to the baker’s profits. Without that gain, there is no incentive for the baker to produce and sell bread. At the same time, the baker’s customer who does not bake bread, or does not make it as well or as inexpensively, buys from the baker because the bread that is gotten is more useful than the money given up. The gain achieved by the consumer (consumer surplus) can be saved or applied to buying other things that the customer wants or needs. A 'bargain' is an exchange in which the consumer’s gain is greater than initially expected.

Thus, profits flow from two sources because the producer engages in exchange in two markets each yielding its own gain. There is the gain that comes from the producer’s buying inputs in the resource market for use in the production process, and the gain that derives from selling the finished goods in the product market. Thus the producer’s profits are enhanced in two fundamental ways: by reducing the cost of production and by selling finished products at a higher price.

However, in the case of economic rent and consumer surplus alike, the gain originates in exchange that takes place in a single market. For the worker and the owner of natural resources, economic rent originates in exchange only in the resource market. For the consumer, it is exchange only in the product market that gives rise to consumer surplus. Though the language used in mainstream economics to designate these gains -- profits, economic rent, and consumer surplus -- suggests that they are incidental to the exchange process, the hard reality is that all three gains are essential to that process. In their absence, exchange tends to break down. See the schematic below for a summary.
There must be limits to profits, consumer surplus, and economic rent in order to prevent one party from taking advantage of another and to assure that market exchange serves all economic agents fairly and effectively and not just those with the power and will to turn gain into excess. Those limits are grounded in the duties that economic agents owe one another under the principle of equivalence, the principle of distributive justice, and the principle of contributive justice.

2.2 Equivalence

The principle of equivalence states that buyer and seller in the marketplace and worker and employer in the workplace have two duties that are binding on both parties: exchange things of equal value and impose equal burdens on one another. In many such transactions, personal experience informs us as to what equal value means.

**ECONOMIC GAIN**

WHAT IS GOTTEN THROUGH EXCHANGE IS MORE HIGHLY VALUED THAN WHAT IS GIVEN UP

- **BUYER**
  - finished product or service (d)
  - buyer’s gain (consumer surplus): (d) is more highly valued than (c)
  - and
  - sellers gain (profit): (c) is more highly valued than (d)

- **SELLER**
  - payment $ (c)

- **PRODUCER**
  - payment $ (a)
  - labour, financial, and other resource inputs (b)

- **WORKER & RESOURCE SUPPLIER**

  - in the resource market exchange depends on …
    - Producer’s gain (profit): (B) is more highly valued than (a)
    - and
    - Worker/resource supplier’s gain (economic rent): (a) is more highly valued than (b)
By equal burden we mean that the burden of the seller is to give up possession of the good or service in question. For the buyer, the burden is to give up possession of the money necessary to take possession of that good or service. For the worker, the burden is performing the work required by the employer. For the employer, the burden is paying the worker the wage they agreed to.

At times, the things exchanged are not of equal value, such as when a house is sold and the buyer makes only partial payment in cash but takes possession of the entire house at the time of closing. To simplify this example, we assume that the seller offers to lend the buyer the unpaid balance by allowing the buyer to make regular payments over time until the balance is paid in full. Notice at closing, the buyer’s immediate burden is to make partial payment in cash to the seller. The seller’s burden is to surrender the whole house, and accept the buyer’s written promise to pay the balance in the future. Under those circumstances, the seller faces the risk that the buyer may not be faithful to his/her promise to make payments in the future until the balance is paid in full. And the seller must wait until payments are made and at closing forgoes the use of that money had he/she insisted instead on payment in full at closing. Consequently, the seller/lender is justified in requiring the buyer/borrower to repay more than the amount of money that was borrowed. Indeed, the seller/lender is justified in charging interest in order to equalize the burdens involved. The precise amount of interest that equalizes the burden is problematical and varies with market conditions. To illustrate, in 1981 banks across the United States were charging their most credit worthy customers an average of 21 percent on loans and as much as 35 percent for other higher-risk borrowers. Today, bank rates are much lower though credit card companies commonly charge 18 percent annual interest.

One common expression for the principle of equivalence in the marketplace is the money-back guarantee wherein the seller recognizes that at times an honest mistake is made in routine transactions, whether the fault lies with the buyer or the seller, and that the things exchanged are not of equal value. Merchants who depend on repeat business understand that the money-back guarantee is good for business even though they might not understand consciously that they are being faithful to the demands of the principle of equivalence. In the workplace, the common expression “full day’s work for a full day’s pay” is a reminder of the worker’s obligation under the principle of equivalence. Reversing the language to “full day’s pay for a full day’s work” underscores the employer’s duty.
There are several specific ways in which the principle of equivalence may be violated in the marketplace. We mention only one. Bait and switch is the practice of a merchant attracting customers into his/her store by offering an item at a very attractive price, telling customers as they enter the store that the item is sold out, and switching and high-pressuring them into buying a more expensive item. In the workplace there are several ways in which the principle of equivalence may be violated. Here as well we concentrate on just one. A sweatshop refers to an employer who cheats his/her workers in terms of wages, hours, or working conditions. Paying less than the minimum wage or the wage agreed to, forcing employees to work very long hours without rest or compensation, operating a workplace that is unsafe are ways in which an employer “sweats” his employees in order to reduce labor costs and add to profits.

2.3 Distributive Justice

The second principle of justice -- distributive justice -- requires the superior to distribute the benefits and burdens of the group under his/her supervision among its members in some equal fashion. This does not mean strictly equal because there likely are significant differences among subordinates and it is entirely appropriate to take those differences into account. For example, handicapped employees appropriately may require different restroom accommodations than able-bodied employees. Distributive justice demands that the superior differentiate among subordinates only when the differences among them are real and substantial and require different arrangements. A superior may allow a single parent to rush home to tend to a sick child when the same permission might not be given to a married worker with a spouse who routinely stays at home to look after the children.

Discrimination occurs when the superior differentiates among subordinates for reasons that are insubstantial, and false stereotyping may be the device used to rationalize the practice. For example, older workers may be treated differently because they simply have “less upside potential” than younger workers. Immigrant workers may be treated differently because they dress differently or speak with heavy accents. Favoritism is simply the other side of the coin of discrimination: treating some better than others for reasons that are superficial or based on the false stereotyping of others. False stereotyping is especially insidious because until it is exposed false stereotyping blames the victim rather than the perpetrator for the discrimination, rationalizing the discrimination on the basis of an alleged defect in the character of the victim.
Discrimination and the government intervention required to address it are evidence that the law of nature -- that each individual economic agent in the pursuit of his/her own self interest also serves the common good through the invisible hand -- is not always sufficient to resolve important conflicts in economic affairs.

“Equal pay for equal work” is a requirement under distributive justice. It means that persons doing the same work, with the same on-the-job-performance of their assigned duties, are to be paid the same wages. “Equal opportunity” too is a requirement under distributive justice. It means that persons of equal experience and qualifications are to be afforded the same chance to be hired and promoted. “Affirmative action” is controversial because some argue that it is necessary and others assert that it is reverse discrimination. The principle of the double effect, which we borrow from ethics, is instructive regarding affirmative action because affirmative action -- the hiring and promoting of persons in protected classes over others -- has two effects, one positive and one negative. The positive effect is the good that is done for the person(s) hired or promoted. The negative effect is the bad that is experienced by those who are passed over in the hiring or promotion process. The principle of the double effect says that: (1) the good effect must be greater than the bad effect, otherwise the superior/decision-maker is doing more harm than good; (2) the bad effect must not be intended. That is, the superior/decision-maker must not intend to bring harm to the person(s) being passed over, but recognizes that there is no way to hire or promote one or two from an applicant pool without passing over everyone else.

The principle of distributive justice has application in the marketplace too, but here the issues are not nearly as serious as in the workplace. In the marketplace, it is the merchant or shopkeeper who is the superior because he/she is the one who must treat his/her customers with fairness. Although there are several ways in which this is done, we refer to only one. A merchant who makes rain checks available to his/her customers is saying in effect that when an item is put on sale at a very favorable price, he/she will treat all customers alike even those who come to the store after the supply of that item has been exhausted. Under those circumstances, the merchant re-orders the item in such quantities to satisfy all customers who have been issued a rain check.
2.4 Contributive Justice

The third and last principle of economic justice is contributive justice that lays down the obligation of the member to the group to which that person belongs. Insofar as a person receives benefits from the group, that person has a duty to maintain and support the group. A common practice reinforcing this principle is the requirement that members of formal organizations have an obligation to pay dues. Failure in this regard typically reduces a person to inactive membership status enjoying fewer benefits of membership than those in good standing.

There are several powerful examples demonstrating how contributive justice is violated in the marketplace and the workplace. In the workplace, for example, industrial spying and sabotage violate contributive justice because the person who appears to be a loyal and productive member of one business establishment actually is faithful to a rival organization and seeks to undermine the effectiveness of that establishment by stealing secrets and disrupting the work of that establishment. Is it a violation to hire a person from a rival establishment and then pick his/her brain for whatever information he/she might be able to share with the new employer? It is, if that person surrenders proprietary information.

In the marketplace, insurance fraud violates contributive justice because if a fraudulent claim is not detected by the insurance company, payment is made to the insured party that drives up the costs of the insurer who then may pass those additional costs on to all policy holders in the form of higher premiums. The Coalition Against Insurance Fraud estimates that insurance fraud costs Americans about $80 billion every year or $950 per family (see www.insurancefraud.org).

Also in the marketplace, insider trading is the practice of persons within a corporate organization whose shares of stock are publicly traded on a stock exchange using information that is confidential and not available to the trading public to buy or sell shares in that corporation for personal gain. Insider trading is morally the same as playing cards with a marked deck. The gains achieved by the insiders come at the expense of other traders who do not have access to that confidential information and therefore are buying shares that soon afterward will fall in value or are selling shares that later will rise in value. The federal Securities and Exchange Commission is charged with the responsibility of monitoring trades made by senior corporate executives involving shares of stock in their own corporation in order to detect and punish insider trading. Unrestrained insider trading undermines the effectiveness of a stock exchange because in effect the big fish are eating the little fish. For more, see Topic 2 in the e-text.
3. POVERTY

Poverty has been defined and measured in the United States since the early 1960s. From the very beginning the choice of an absolute standard has been at the heart of a long-standing controversy. An absolute standard defines poverty by asking this question: 'How much income does an individual/family need to purchase the goods and services required to maintain a minimal standard of living?' The alternative relative standard asks this question: 'How much income does this individual/family have relative to the income of others?' The absolute standard, or what I prefer to call the minimal-living standard, defines poverty in terms of human individuality. The relative standard, or what I prefer to call the income-distribution standard, defines poverty in terms of human sociality.

In the United States, the absolute or minimal-living standard is operationalized in terms of the cost of the food needed to provide a nutritionally adequate diet. Years ago, the U.S. Department of Agriculture estimated those food requirements and called the diet the Economy Food Plan (EFP). Every year the cost of purchasing the food items enumerated in the EFP is estimated, and this estimate is multiplied by three. That overall figure becomes the poverty threshold. A person whose annual income is below that threshold is counted as poor. A person whose annual income is above that threshold is counted as not poor. Multiplying the annual cost of the EFP by three is rationalized on grounds that years ago, individuals/families spent one-third of their income on food. Thus, if one estimates the cost of the food minimally required to provide an adequate diet and multiplies that estimate by three, it follows that the result is an estimate of the income required to purchase all the goods and services needed to maintain a minimal-living standard. From the very beginning this is the procedure that has been used to estimate the poverty threshold that changes every year depending on year-to-year changes in food prices. And the thresholds are adjusted by size of family since larger families have greater needs. For a family of four, the official poverty threshold in 2003 was $18,979. Critics have argued that the threshold figure is crude at best and should be developed through separate estimates for each of the essentials of living such as shelter, clothing, and medical care.

The relative or income-distribution standard is defined and measured in several ways. The most commonly used definition is that anyone with

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income below one-half of the median income of all persons is counted as poor. If median income for all persons in the United States is, say, $39,000, the poverty threshold is set at $19,500. Others define and measure poverty in terms of one-third of the median, or in terms of the poorest 10 percent of the population, or the poorest 20 percent. Where the threshold is drawn depends largely on the person who is making the estimates of poverty, that is it depends importantly on the values of the person making those estimates. Ultimately, though, what should emerge is a consensus among those who specialize in studying poverty based on the evidence that they collect on poverty and what that evidence reveals about the poor.

To borrow from Alfred Marshall, asking which standard -- the minimal-living standard or the income-distribution standard -- is the correct one is like asking which edge of the scissors does the cutting. Both have a place in a proper definition because the minimal-living standard incorporates human individuality into the definition, and the income-distribution builds human sociality into the definition. We recommend such a definition because it conforms more closely to human nature than either one does alone. Further, including both in a single definition allows us to address a problem that plagues both standards. Since both use a sharply defined income threshold, both differentiate between those persons/families just above the poverty threshold who are counted as not poor, and those just below the threshold who are counted as poor. And more to the point, neither one differentiates between those who are just below the threshold and those who are well below the threshold, all of whom are counted as poor. This failure to differentiate appropriately among the poor is called the depth of poverty problem.

We argue that there is a common-sense way to differentiate appropriately and to include human sociality and human individuality in the poverty definition, using the information referenced in the foregoing. A person/family is poor when personal/family income is below both thresholds, and is not poor when income is above both thresholds. A person/family is marginally poor when income is above the lower of the two thresholds but below the higher of the two. For more, see Topic 13 in the e-text.
DEFINING AND MEASURING POVERTY TWO DIMENSIONALLY

<table>
<thead>
<tr>
<th>Minimal-Living Standard</th>
<th>Income-Distribution Standard</th>
</tr>
</thead>
<tbody>
<tr>
<td>family of four</td>
<td>family of four</td>
</tr>
<tr>
<td>threshold = $18,979</td>
<td>threshold = $19,500</td>
</tr>
</tbody>
</table>

Poor .............................................. income below $18,979
Marginally poor ......................... income between $18,979 and $19,500
Not poor ................................. income above $19,500

4. DIMINISHING MARGINAL UTILITY AND DIMINISHING RETURNS

All consumer behavior involves two limits that originate in the human body. Limit I refers to the one unit consumed that produces the largest increase in utility or satisfaction. We reference Limit I as maximum marginal utility. Limit II refers to the last unit consumed that offers some increase in utility but beyond which disutility sets in. We refer to Limit II as the point of maximum total utility. Strictly speaking going beyond Limit II is irrational.

Why do consumers at times freely exceed Limit II? Peer pressure is one reason. The availability of the product free of charge is another. To illustrate, a friend says “drinks are on me” or “let’s have one more for the road.” Another reason is that the consumer is willing to challenge his/her own limit, thinking that perhaps that limit is higher than it actually turns out to be. The disutility of exceeding Limit II in the consumption of alcohol presents itself in terms of a fight with a close friend, an accident while driving under the influence, a hangover the next day. In like manner, “pigging out” can lead to unwanted weight gain or some physical problem such as a blemished complexion.

When a person begins consuming a good or service, he/she experiences a large increase in total utility with every additional unit consumed. After a certain point (Limit I), he/she notices that the increase in total utility begins to diminish with every additional unit consumed. Consumption continues until the additional utility from one more unit consumed approaches zero. At that point (Limit II), he/she experiences maximum utility.
Every human being as a consumer faces these two limits because every human being is embodied. Dispose of the body, and the limits disappear. Even so, the limits are not the same for every consumer because each one of us has his/her own body with its own metabolism and tolerances. And as we age, our limits tend to change as well. The hyperactive body of the teenager or athlete requires more calories than the sedentary body of the same person much later in life.

The reason consumers buy more when the price is lower is that as they consume more they eventually reach Limit I beyond which each additional unit consumed offers a smaller increase in utility than the preceding unit and they are willing to purchase those smaller increments beyond Limit I only when the price is lower. When it comes to consumer behavior, the principle of diminishing marginal utility probably best represents what conventional economics means by *homo economicus*.

Understanding producer behavior begins with the principle of supply. However, this principle as in the case of the principle of demand is strictly descriptive. It does not probe deeply into the behavior of the producer. It merely describes it in terms of price. And as with the principle of demand another principle is required to help explain producer behavior. That principle is the principle of diminishing returns. And as with the role of principle of diminishing marginal utility in explaining consumer behavior, the principle of diminishing returns explains producer behavior in terms of two limits: Limit III or maximum returns and Limit IV or capacity. The limits applying to producer behavior originate in the human body just as we observed regarding the limits applying to consumer behavior.

To explain how those limits help improve our understanding of producer behavior we begin with a very simple case – the man who makes handrolled cigars. If, for example, a cigarmaker works one hour, he is able to make six cigars. If he works six hours, he is capable of rolling 52 cigars. With nine hours of work, his production is 61 cigars, but beyond nine hours his total output drops to 58 cigars. His capacity, Limit IV, is reached in the ninth hour, and if he works beyond that limit, his output drops due to physical exhaustion. At that point he makes mistakes, perhaps spilling some coffee on the day’s production of cigars and ruining some of them. We see this kind of behavior very dramatically on the highway where from time to time exhausted truck drivers fall asleep, wreck their trucks, destroy some of the goods they are carrying, or worse yet injure or kill someone. Limit IV or capacity applies to everyone who works because every worker is embodied and the human body requires rest on a daily basis.

But there is a second limit operating on everyone who works, and that limit too originates in the human body. The cigarmaker’s hourly production varies in ways that are predictable. In the first three hours of work, his hourly production rises from six to eight to 12 cigars where it reaches a
peak. After the third hour of work his output per hour begins to fall until in the ninth hour he produces only one more cigar. Limit III refers to the single hour of work in which he produces more cigars than any other and is called maximum returns. Notice that after Limit III is reached, returns are falling or diminishing. Notice that before Limit III is reached, returns are rising or increasing. After Limit IV is reached, returns are negative. Limit III or the point of maximum returns pinpoints the single hour of work in which our worker is most productive. Diminishing returns reflects our own experience with work. Exhaustion does not suddenly overtake us. Rather, we tire little by little as the workday unfolds, with hourly output declining as the work itself saps our strength, until full exhaustion sets in. For more, see Topics 8 and 9 in the e-text.

5.0 CLOSING REMARKS

Mainstream economics introduces students to a way of thinking about economic affairs that underscores things: prices, resources, goods, services, wealth, assets, liabilities, among others. This approach allows the instructor to prescind from ethical issues because things cannot act ethically. Personalist economics, on the other hand, proceeds by centering attention on persons acting as economic agents and necessarily requires the student to evaluate that human action in terms of its ethical content.

Mainstream economics argues that the study of economics relates entirely to the means that achieve given ends in the most efficient manner possible but is silent about those ends. Personalist economics states emphatically that the end of all economic systems is to provision human material need. Thus in an effort to make mainstream economics value-free its advocates reject the value-laden concept of generic human need in economic affairs whereas for personalist economics need is central to an understanding of the economic order. Notice how excluding need as a concept, proves to be especially awkward when it comes to addressing the problem of poverty that obviously must be defined and measured in terms of human need.

As stated in the foregoing, the central unit of analysis in personalist economics is the person. Human individuality in economic affairs is addressed through microeconomics while human sociality is undertaken in macroeconomics. Due to the fusion of individuality and sociality in the human person, someday all economic theory will be unified. Three other

5 Need, or its equivalent necessities, is mentioned several times in the 1948 edition of Samuelson’s ECONOMICS in ways that indicate that the concept has a legitimate place in analyzing and understanding everyday economic affairs. See for example pages 16, 31, 67, 72, 83, 118, 256, and 581.
premises are of paramount importance to personalist economics: institutions, uncertainty, and sacred dignity.

Markets at times dysfunction, and institutions are needed to intervene in order to address that dysfunction. For example, some employers left to their own devices would contaminate the air, soil, or water with their waste discharge. Therefore it is necessary to limit the amount of waste that they are allowed to discharge legally and to fine them and shut them down whenever they exceed that limit. The limit is determined by science, that is by an investigation that addresses the question 'How much of a specific waste such as mercury can be discharged into the environment without inflicting harm especially on human beings?' Another limit is the legal minimum wage that forces employers to pay the legal minimum when otherwise they might take advantage of their workers and pay them less.

Personalist economics is somewhat skeptical about economists’ abilities to understand economic affairs with certainty. All questions, issues, and problems in personalist economics are answered with some uncertainty. Since economic affairs involve humans acting as economic agents, and humans are not fully understood and fully predictable, we cannot always know what is necessary to do economic analysis with certainty. The typical human being is at least in part still a mystery, not fully understood by others and even at times by himself/herself.

Personalist economics insists that most fundamentally a person’s worth is not determined by any contract, by instrumental value. Rather every person has the same worth because everyone has a sacred dignity that must be respected.

Beyond the question as to which premises to use in addressing economic affairs, there are other differences between personalist economics and mainstream economics. Personalist economics, for example, sees culture as playing an important role in economic affairs. Conventional economics asserts that there is no such role for culture in economic affairs.

Culture relates to the specific ways in which the needs and wants of the human body and human spirit are addressed. To illustrate, in the United States work itself is so highly valued that many Americans are workaholics, and related to that addiction many Americans experience a sleep deficit, and at times fall asleep on the job.

In teaching introductory students, I have found it instructive to compare the economy to a twin-engine aircraft that is fueled by the credit created by private commercial banks, and is piloted by the entrepreneur who controls the aircraft in flight. Culture relates to the economy the same way weather influences the aircraft. A culture of life and hope, that is affirmed most fundamentally when human beings are not totally self-absorbed and at least from time to time care about one another in economic affairs, enhances the performance of the economy just as the aircraft
performs better in good weather. In contrast, a culture of death and despair, that in the extreme is reinforced by a pervasive attitude that death is the answer to social problems, slows down the performance of the economy just as the aircraft performs less effectively in bad weather.

The origins of personalist economics, as well as other kinds of heterodox economics, lie most fundamentally in the four premises used to begin thinking about economic affairs. My students are taught that the most important of all is the premise that the basic unit of economic analysis is the human person.