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Book Review: Microeconomics: A Critical Companion by Ben Fine

Sheaff, Rod

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Ben Fine. *Micro-economics. A Critical Companion*. London 2016 (Pluto).

For many years students have needed a textbook which explains what assumptions current micro-economic theory makes, what it ignores and excludes, its empirical status, and what other theories of the same phenomena are available. Ben Fine has gone a long way towards providing one.

Fine takes the reader through the fundamental components of micro-economics: consumer and demand theory; production functions; and how the two interact to produce the central theory and legitimation of perfectly competitive markets, that of Pareto-optimal general equilibrium. He gives a particularly clear account of Hicks' and Marshall's accounts of the relationships between the theory of utility and demand curves. The exposition indicates just how narrow and specific the assumptions are, upon which this core 'Technical Apparatus' of micro-economics is based, and how theoretical elegance is no substitute for realism. Many neo-classical micro-economists have been equally aware of that limitation and tried to palliate it by what Fine calls 'Bringing Back In', that is a variety of *ad hoc* supplementary applications of the Technical Apparatus to some of the empirical matters that it originally assumed away, such as consumers' imperfect knowledge of products and markets, organisational hierarchies, and information asymmetries. These efforts however then facilitated micro-economics' much-discussed intellectual 'imperialism' over other social sciences. As Fine points out, these supplements nevertheless still analyse markets and other institutions such as governments in terms of their 'imperfections' compared with perfectly-competitive markets. They still presuppose the Technical Apparatus and so leave it intact.

Next Fine explains the homologies between the micro-economic theories of consumers and of producers, this time giving a clear account of the relationships and equivalences within the different components of production-function theory. This brings the book to general equilibrium theory and Pareto-optimality, the latter (Fine argues) being an essentially normative ('welfare') criterion for evaluating economic institutions. Since the existence of an optimal general equilibrium across perfectly competitive markets requires among many other conditions the absence of externalities, the possibility of aggregation (everyone has the same indifference curves) and successively increasing then decreasing returns to scale it is, Fine points out, almost certain not to occur in real markets. There follow overviews of the range of competition theories, including the foundations of game theory, and of production-function theory (Cobb-Douglas et al.), leading to a critique of production-function theory and labour market microeconomics. These expositions take the reader to the threshold of macro-economics, subject of a companion volume. In doing all this Fine traces how neo-classical micro-economics attained its position of dominant orthodoxy and its relationship to some main alternatives: classical economics, Marxism, Keynesian and post-Keynesian macro-economics, and nowadays heterodox economics. He also contrasts the theoretical vacuity of micro-economics with the extensive body econometrics research, which has produced empirically informative studies despite, not because of, its putative foundations in micro-economics.

How might a subsequent work of this kind be developed? Fine points out that the psychological realism of utility theory has been questioned and that as a source of empirical explanations of consumer behaviour even marketing research is (despite its own uses and limitations) far superior. That point alone is fatal to the scientific claims of micro-economics as theory of consumers' - or more exactly (and as Fine says), buyers' - behaviour. Here the argument might be taken a step further. If utility theory is not a psychologically realistic theory of motivation, what kind of theory is it? Essentially, a normative theory; and not a very coherent one at that. For its foundation, as innumerable textbooks set out, is a set of inherently counterfactual assumptions stating how the *rationally* self-interested, *optimising* person *would*, and by innuendo ought to, behave in order to be a rational optimiser; and so (notice the elision from 'ought' to 'is') usually does in fact behave. Here, micro-economics honours more in the breach than the observance its boast that its 'economic fundamentals' are and should be a positive science not an *a priori* normative theory. Readers seeking an empirical alternative might also be pointed towards, say, behavioural economics at least as a (still imperfect) starting-point. Another development might be a fuller illumination of micro-economics' coyness about profits, which that theory does after all regard as what primarily motivates firms' economic decisions. Nevertheless micro-economics subjects profits to a double vanishing-trick. First, and unlike empirically-observed everyday economic transactions, it tends to reserve the term 'profit' for super-normal, above-average profits, by their nature usually transient. (Indeed they must be, by definition.) Then, its analysis decomposes normal profits into an implicit combination of pay for managerial work, rewards of innovating, premia for risk-bearing and the cost of capital, that cost standardly understood as the opportunity cost of (income foregone by) not making the most lucrative alternative investment instead. Why innovating, taking risks and not spending elsewhere should produce a money income in the context of owning a firm when they so seldom do so in other settings remains a mystery of micro-economics upon which future critics might shed unflattering light.

The knock-down critical response to neo-classical micro-economics is of course to develop more realistic, evidence-based explanations of economic behaviour, economic institutions and their effects; and as Fine implies, to analyse non-market institutions on their own terms not just assimilate them to 'imperfect' markets. It would be unreasonable to criticise Fine's book for not doing these things, but a call for recruits to these tasks would be a fitting end to this kind of book. For all that, this book makes a comprehensive, expert attempt to fill a real gap in the economics literature for those first encountering economics. I wish it had been available when I was a student.