

(SHREDECON EDITION)

TIBOR SCITOVSKY

*Peter E. Earl (1992)**

1 INTRODUCTION

Tibor Scitovsky was born in Budapest in 1910, the son of a senior Hungarian official who became the country's Foreign Minister. The kind of economist that he became and, indeed, the fact that he became an economist at all both owe much to his lifestyle in childhood and adolescence. In his (1992) paper on his life philosophy he explains how his parents used his father's high income to provide a private tutor for him in a house that was replete with antiques and often the location for great parties. They also took him on their travels to countless museums, exhibitions and artistic performances in many countries. But he also became aware of the plight of those who were less fortunate, for he often travelled through the slums of Budapest and had many occasions to see his mother serve as a fairy godmother to anyone she knew who was in difficulties. This gulf between rich and poor, and his awareness of the ways in which career paths in Hungary were dominated by social connections, eventually led him to revolt against his mother's desire that he should become a banker. Wanting to stand on his own feet, and interested by the economic problems of the day, he left Hungary in 1935 to enrol at the London School of Economics. Thus began an academic career in which the sources of economic power and the nature of human satisfaction have often provided a focus for his attention. Though he retired in 1976, the year his best-known book *The Joyless Economy* was published, he continued to write and enjoy an active life almost up to his death in 2002 at the age of 91 [for an useful obituary article, see Bianchi (2003)].

It is no easy task to organize a chapter on this remarkable economist's work, for his half-century of books and articles contain many interlocking ideas and he kept coming back to some topics after long periods occupied in

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other areas. The structure that I have chosen involves some sudden changes of direction between sections but wherever possible tries to make the most of theoretical linkages between his contributions. We begin with his work on the welfare and the competitive process, which provide the micro-foundations for many of his macroeconomics contributions. There is then something of a jump to his famous attempts to infuse psychology into economics and his controversial critique of the American way of life. These discussions lead us back, finally, to macroeconomic issues.

2. WEALTH AND WELFARE

The distributional implications of changes in policy for the underlying structure of the economic system are one of the most frequent points of focus in Scitovsky's works. He caused controversy very early in his career by uncovering problems with Kaldor's (1939) confident claim that economists assessing the desirability of particular projects could avoid interpersonal welfare comparisons by seeing whether or not gainers could potentially compensate losers. Scitovsky (1941b/1964, pp. 136–7) took note of earlier debates in relation to the use of the rival formulae of Paasche and Laspeyres for estimating cost-of-living index numbers and pointed out that Kaldor's criterion for an increase in social income was merely one way of viewing things: an alternative test would be to see whether or not potential losers would be willing to offer potential gainers a bribe big enough to deter them from supporting the contemplated change. If they were not that willing to pay to preserve the status quo then it could be said that the change represented an increase in social income.

The 'losers bribing gainers' criterion that Scitovsky suggested is obviously open to the criticism that the willingness of losers to pay others not to disturb their positions is constrained by their wealth. As an extreme case, consider the position of primitive tribespeople in confrontation with logging companies who wish to cut down the rainforests in which they live. No matter how highly the tribespeople value their existing lifestyles they are unlikely to be in a position to compensate the latter for the profits that will fail to materialize if the rainforests are not logged. But the point of raising this criterion may really have been just to show that matters were not quite as straightforward as Kaldor had asserted, for Scitovsky had two further objections to Kaldor's criterion. First, it is unlikely that compensation will *actually* be paid in free enterprise economies to those who are disadvantaged by change (1951a/1964, p. 182); hence recommendations made on the basis of potential Pareto improvements involve a value judgment in favour of those who stand to gain. Secondly, even if they expect compensation to be paid, economists should recognize that their efficiency-oriented

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recommendations ‘are not independent of value judgements between alternative income distributions either. For, going out of their way to preserve the existing distribution of income, they imply a preference for the *status quo*’ (1941b/1964, p. 126).

Not surprisingly, Scitovsky’s views provoked a heated debate, a detailed discussion of which is provided by Dobb (1969, chapters 5 and 6). Attention should also have been given to some of his insights on how the competitive process might affect income distribution. For example, in another of his early papers he (1945/1964, p. 200–1) pointed out that if firms practice price discrimination against the wealthy this will tend to reduce differences between rich and poor in terms of the physical consumption of commodities. But he also noted that this effect will be somewhat reduced insofar as the dividend incomes of the rich are inflated by higher profits resulting from price discrimination. Moreover, although the rich may end up paying at a higher rate for the characteristics they consume, any negative attitudes of the rest of society towards their conspicuous consumption are nonetheless likely to be a function of the nominal expenditure involved, for this serves as a proxy for the money incomes that the rest of society might have enjoyed. Preferences of better-off consumers for differentiated products can also be seen as a matter for concern if they result in goods being made to order rather than for stock, causing economies of large-scale production to be lost and prices to be higher (1958, pp. 28–30).

Doubts about the use of price as a rationing mechanism arise once we recognize that costs and benefits reflect the existing distribution of income. Suppose that it is thought necessary to limit entry to a national park in order to avoid undue strain on fauna and flora. The conventional policy is to set an entry fee at a level high enough to keep numbers down to the tolerable level. But this approach is a recipe for turning a visit to the park into what Hirsch (1976) labels as a ‘positional’ good. Scitovsky (1964, p. 261) therefore canvasses a policy of making access difficult by providing very poor quality access roads. In this case, rich and poor alike will have to decide whether they value access to nature highly enough to tolerate a long, rough drive in order to get to the park. (It is probably no coincidence that this suggestion appears to anticipate Hirsch’s thinking. The two economists were friends and it was Scitovsky who actually encouraged Hirsch to write about the social problems of economic growth [see Scitovsky (1992)].

In trying to decide how economists might best make policy recommendations Scitovsky (1964, chapter 16) assigns a central role to the ways in which the public at large view the concept of equity. His interpretation of how people decide whether something is fair implies a lexicographic criterion in keeping with more recent discussions about ‘basic needs’ and the use that Lutz and Lux (1979) have made of the ‘idea of a

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hierarchy of needs' proposed by the psychologist Maslow (1954) [Scitovsky himself makes no reference to Maslow's well-known contribution]. He suggests (1964, p. 254) that:

The first dictate of people's consciences is that the prime necessities of life should be generally available and distributed in an egalitarian way. Even great inequalities of income and wealth will not be considered oppressive as long as necessities are cheap and plentiful enough to be generally available; whereas slight inequalities of income may be considered unjust if one or more necessities are short — that is, scarce and expensive enough to become the privilege of the well-to-do.' In other words, 'most people consider equitable an economic system or economic organization that leads to an egalitarian or near-egalitarian distribution of the necessities of life.

The use of local reference standards is also implied in his analysis of how people judge what is fair: he portrays people as judging their lists of necessities very much with a view to the state of development of the economy of which they are members (1976, pp. 115–20). In affluent societies the list of necessities includes the assurance that retirement will not see a plunge in a person's living standards (1964, p. 258) and that 'one will be able to continue to enjoy one's accustomed level of comfort in the future' (1978a, p. 229). These views of equity figure in his analysis of inflation. So, too, do his writings on market processes, to which I will now turn.

3. INFORMATION AND ECONOMIC EFFICIENCY

One of the unusual things about Scitovsky's work on the efficiency of capitalist economies is his recognition of the role of expectations in determining whether or not an economic system will deliver the goods that consumers would most prefer and whether it will achieve equilibrium following a disturbance without undergoing major adjustment costs. This role is crucial, since the real world, unlike the world of much general equilibrium theorizing, is a place that has neither complete futures markets nor consumers who are born with well-defined preferences.

If tastes are acquired rather than innate, preferences will depend upon experiences of consumption, either at first hand or via the observation of others. Mindful of this, and despite his concern with the effects of product differentiation on average costs and hence on income distribution, Scitovsky (1960/1964 p. 237; 1962/1964, p. 245) argues that the supply of a wide

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variety of products is essential for social well-being. He points out that if poorly-informed consumers comprise the majority, they may fail to discover better ways of spending their money unless the minority of better informed consumers with ‘good tastes’ can set an example. This requires that the minority have access to the sorts of products they wish to buy. However, problems of access are likely to arise if costs can be reduced by large-scale production and if domestic producers are sheltered from competition from overseas producers whose home markets have different tastes. If the biggest domestic producers do not face such competition and only supply products that are consistent with what their market research tells them about the existing tastes of the majority, there is no mechanism by which they can discover whether they could be meeting underlying needs better by being more imaginative with their offerings. They could end up pandering to a mythical majority—just as Hollywood and Detroit did before the importation of foreign films and cars showed them just how wrong were their interpretations of market preferences (Scitovsky, 1962/1964, p. 247). [With hindsight it appears Scitovsky was a bit premature in assuming that American car producers had actually learnt from the success of smaller, less powerful imported cars: witness the ascendancy of Japanese products in the 1980s, and note also the drift of US producers and consumers towards pick-up trucks and SUVs prior to the Global Financial Crisis.]

Scitovsky’s thinking on the attainment of equilibrium has much in common with Richardson (1960), who discussed this problem at greater length and whose contribution is only lately being given the attention it deserves [Scitovsky (1990, p. 142) himself eventually noted Richardson’s contribution without mentioning its similarities with some of his own work]. The essence of the problem is that payoffs to competitive and/or complementary investments depend on future market conditions but in the absence of futures markets the market only transmits information about the current state of affairs (Scitovsky, 1951b, p. 243, 1971, pp. 238, 284).

Introductory texts sometimes use the ‘cobweb diagram’ to illustrate what may happen if a state of excess demand arises in a market: widespread optimism can result in excessive capacity creation and losses for all concerned, whereas payoffs to competitive investments can be handsome if caution leads to relatively small expansions in capacity. However, such texts rarely seek to explain how or when chaos is likely to be avoided. In his discussion of the problem in the context of a wartime economy Scitovsky suggests that it is likely to be most acute following a sudden, major price change, and when the authorities encourage prompt adjustment of production plans to the new conditions (Scitovsky, Shaw and Tashis, 1951, pp. 272–4). He also anticipates Richardson by noting the coordinating role of non-market sources of information about production plans, such as might exist in government publications and trade journals. Elsewhere, he

raises the possibility that a history of past coordination disappointments might eventually produce sufficient hesitancy on the part of some producers as to facilitate an orderly, sequential expansion of capacity (1951b, p. 238, 1971, p. 234). Later, however, he (1990, p. 142) supported Richardson's view that barriers to entry associated with market power may serve a socially beneficial role by limiting the number of possible players in a market and allowing incumbent pricemakers to respond to quantity signals such as their own waiting lists.

Scitovsky discusses complementary investments in his work on balanced growth (1959), European economic integration (1958, p. 19) and external economies (1954/1964, pp. 78–83). Here, one sees him rather moving away from the idea of a system tending toward equilibrium. Like Myrdal (1957), he recognizes that if one firm's investment expenditure improves the profitability of its customers' activities (for example, by reducing the cost of their inputs), then the latter may undertake investments which have beneficial repercussions for others, and so on, in a virtuous circle. However, each firm will normally be thinking only of its own profits when it decides how much to invest. It is easy to see how inflationary bottlenecks could arise in multistage production and distribution processes if producers at one stage in the chain only make tentative, incremental expansions of their operations because they are not sure of the price elasticity of demand for their output or because they are afraid of excessive capacity creation. The only benefits likely to come of such bottlenecks are innovations designed to reduce the need for the inputs that are in short supply (1959/1964, p. 108). These considerations made Scitovsky pessimistic about the results of investment decision-making in systems involving large numbers of specialist producers, leading him to see potential benefits in moves towards indicative planning and the integration of decision-making units in order to 'internalize' external economies.

The notion of internalization is now commonplace in industrial economics, where mergers and moves toward vertical integration are seen as the responses to difficulties in using the market to handle externalities. But such perspectives owe little to Scitovsky: despite his pioneering use of the term, he did not attempt to follow the lead of Coase (1937) and portray the firm as an institution that uses an internal managerial command system for dealing with coordination problems. It is a pity that when he was preparing the revision of *Welfare and Competition* (1971) he did not take heed of Graaf's (1965) comments about the narrowness of his earlier work on externalities.

At an early stage Scitovsky (1950/1964) took the view that ignorance is a source of oligopoly power and he returned to this in some of his later work (1990). His early discussions focus on the relationship between firms and the buyers of their products, noting how incumbent producers often try to deter customers from switching to new, unknown suppliers by pursuing

advertising policies which highlight the complexity of the product and its production process, along with the resources needed to design it and provide after-sales back-up. Potential competitors may thus be deterred by the marketing costs that they will need to incur if they are to build up customer goodwill (1950/1964, p. 207). Forty years later, we find him arguing that ‘today, superior knowledge and earlier knowledge are the main sources of monopoly power’ (1990, p. 138). However, we do not find him attacking monopoly power in general, even though, by extending his early observations about the growing importance of highly complex, differentiated goods (1941c, pp. 679–80) and the tendency of buyers to judge quality by price (1945), we might nowadays expect that it may take more than just a competitive price to enter someone else’s market. Rather, he offers a more intricate, evolutionary view of the competitive processes.

Modern-day consumers may find it difficult to make choices between complex products but, as workers, they often enjoy information advantages that go with experience in a specialized job. They have countervailing power insofar as they know more about their jobs than do their employers or would-be occupants of their job-slots. Scitovsky does not note similarities between his views about the consequences of specialization and those of Williamson (1975). Nor does he recognize the possibility that workers may be able to enjoy total benefits in excess of their transfer fees if they can conceal the fact that they are working below their potential. It is indeed surprising to find no discussion of Leibenstein’s famous (1966) work on ‘X-inefficiency’ in either the 1971 edition of *Welfare and Competition* or his later works on the performance of economic systems. [The closest he comes to an implicit discussion of X-inefficiency is a recognition (1971, pp. 463-4) that *managers* may need to be motivated by the pressure of competition if their firms are to achieve technological efficiency]. However, his later work does look more penetratingly at dynamic efficiency in a somewhat Schumpeterian way. He emphasizes that, although the complexity of modern products and production processes may give firms information advantages over their customers and potential competitors, these advantages are often the result of innovations that, in time, others may copy. In the absence of a prospect of temporary monopoly profits, firms might not develop the products for which customers may initially be asked to pay a premium price. But firms may also be unlikely to be very innovative if they can hold on to their information advantages indefinitely. From this standpoint it appears that patent rights are necessary (1985/1986, p. 98), along with antitrust legislation to promote non-price competition and regulations concerning truth in advertising (1990, p. 146).

4. PRICEMAKERS AND PRICETAKERS

Scitovsky's first book *Welfare and Competition* (1951b; revised edition, 1971) introduced the terms 'pricemaker' and 'pricetaker' in economics. The analysis of price determination in his book is an extension of his earlier articles (1945/1964, 1950/1964) on the effects of incomplete information on market processes, and this analysis was itself extended in more recent articles (1978a, 1985/1986, 1990). But it is useful to begin a discussion of his views in this area much as he does in his book, by recognizing that since each buyer must trade with a seller, four types of trading relationships are possible.

One is the case assumed in theories of perfect competition, where both sides of the market treat the price as parametric; it leaves unanswered the question of who actually sets the price. Though he accepts the idea that perfectly competitive markets are valuable as a reference point for discussions of efficiency, Scitovsky emphasizes that there are few real-world examples of markets in which both buyers and sellers are pricetakers; these are confined largely to commodity exchanges in which large numbers of expert buyers and sellers confront each other in a centralized trading arena. A second case is that of bargaining, where buyers and sellers both try to act as pricemakers, putting forward take-it-or-leave-it suggestions as to the terms on which trade should be conducted. The practical importance of bargaining is limited by the negotiation costs it involves in terms of both time and investment in the skills required to know which concessions it would be wise to make. A third possibility, nowadays most familiar in the context of corporate takeovers, involves a buyer stating a price for a specified commodity and offering to buy as much or as little as sellers are prepared to make available. Finally, and most importantly for practical purposes, there are exchanges in which the seller makes a take-it-or-leave-it offer and the buyer decides how many, if any, units to purchase.

Scitovsky sees the question of who takes the initiative in setting the price as one to be answered with reference to information problems. In real-world instances of perfectly competitive markets both buyers and sellers are professionals and the commodities in terms of which they are dealing are standardized. There is thus no confusion as to whether or not changes in price reflect changes in quality rather than altered market conditions. The geographically centralized nature of trading means it is practically impossible for an individual seller to get away with an attempt to charge a market price higher than the going rate: it is easy for buyers to check price offers. Bargaining, likewise, will normally involve experts on both sides of the market: there is little point in trying to engage in bargaining if one has no basis for deciding whether to accept an offer as the best that one is likely to get, or to continue to try to beat one's opponent down. Costs of acquiring

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information will be relatively small where buyers and sellers operate in close proximity to each other and frequently have occasion to deal with each other. But they will tend to become prohibitive if (a) an individual only wishes infrequently to trade a particular commodity, especially if its quality is difficult to judge; and (b) there are many transactors with whom potential deals could be negotiated before it becomes clear where the best deal is to be obtained. Hence Scitovsky predicts one-sided pricemaking behaviour in markets for non-standardized commodities in which both the number of buyers and sellers and their expertise are not evenly matched [if both sides of a market lack expertise, Scitovsky predicts the emergence of intermediaries]. The pricetakers will be those whose numbers are largest, for the economies of gathering expertise are on the side with the smaller number of traders. The specialists forego potential costs and benefits associated with striking individual bargains and instead use their expertise as a basis for selecting sufficiently profitable price/product packages to offer to the non-specialist market as a whole.

If non-specialists become passive quantity adjusters rather than incurring the costs of becoming expert traders and haggling over prices, they still need a basis for deciding to whom they should give their custom when they are unsure of the relative qualities of the goods that are on offer or the prices at which goods of a given quality normally change hands. The relative ignorance and reluctance of pricemakers to risk disappointments limits the range of situations in which they will opt to compete on the basis of price. Yet it also means that competition on the basis of product quality is by no means assured of success. For example, a reduction in price unambiguously signals a better deal only to buyers who are regularly incurring the costs of checking on conditions in the market and who therefore know what the previous price was; if infrequent buyers use current prices as indicators of quality, the price reduction can lead to reduced sales. Similarly, if 'the proof of the pudding is in the eating' it may be very difficult to signal in a credible manner that better value for money is being offered via a quality upgrade. The situation is very different if new models are introduced at the same price as those they supersede and can *easily* be seen to offer more \tilde{N} particularly if the old ones continue to be offered but at a lower price than before (1945/1964, pp. 195-7).

If we compare *Welfare and Competition* with Scitovsky's more recent (1985/1986, 1990) work it is evident that he only laterly recognized a key element in the answer to this question of how pricemakers might rationally compete if uncertainty makes value-for-money judgments difficult for consumers to make. His later work highlights the relatively limited success of discount warehouses that offer little by way of customer services and focuses on those aspects of non-price competition which involve the pricemakers in *providing their customers with the information* they will need to

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make risk-free judgments and with services that it would be more expensive for the pricetakers to procure for themselves. Relevant elements here are warranties and professional accreditations of suppliers; the variety of goods in stock and the displays, comfort and opening hours of the shopping environment; well-informed staff who readily make refunds and do not try to pressurise people into buying; and the availability of credit and insurance. This view of how frictions between buyers and sellers can be lessened is close to that found in the marketing literature. But Scitovsky (1985/1986, p. 104, my italics) surely goes too far when he asserts that these aspects of non-price competition make shopping a ‘*completely* frictionless and even enjoyable task.’

5. INFLATION: ITS CONSEQUENCES, CAUSES AND POSSIBLE CURES

A good deal of Scitovsky’s initial post-retirement output applied his views about the competitive process to the economics of rising prices (1978a, 1978b, 1982, 1983). This research is concerned primarily with the causes of inflation, rather than its effects, which are considered in his earlier work (1941a/1964, and Scitovsky and Scitovsky, 1964). One is left with a rather mixed picture of the effects of inflation, but this is to be preferred to the typical economist’s stance of assuming it is a problem without bothering to stop to consider why. On the one hand, we are told that ‘relative prices are a very poor index of the relative urgency of wants when the price-level as a whole is galloping up or down’ (1941a/1964, p. 46), and that, since inflation is unlikely to involve simultaneous equiproportional movements in all prices, it is likely to lead to managers and consumers having to spend more time studying market conditions and to feel a greater need to use intermediaries (Scitovsky and Scitovsky, 1964, pp. 460–1). On the other hand, Scitovsky and Scitovsky (1964, pp. 460, 463) note how wage lags in times of inflation may aid economic growth by increasing the profits share, with inflation facilitating relative price adjustments in a world in which wages are downwardly sticky. They also (p. 459) highlight the difficulties of finding instances in which moderate inflation has caused resource misallocation and suggest that such costs were not spectacular even during Germany’s hyperinflation. Here, they may be paying insufficient attention to the possibility that difficulties involved in sizing up future relative prices in an environment of uneven inflation may lead entrepreneurs to avoid investing in the wrong line of activity by not investing at all, or to focus their attention on the gains to be had from financial speculation rather than from the creation of new physical capacity [*cf.* Leijonhufvud (1977)].

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In analysing the causes of inflation, Scitovsky focuses on incompatibilities within the economic system. He sees excess demand inflation in a pretty conventional way, except that he does stress its tendency to arise due to disruptive events on the supply side (such the diversion of workers to fight in a war, or bottlenecks in the supply of capital goods) rather than an increase in monetary demand (1982, pp. 1–3). What most of us call ‘cost-push inflation’ Scitovsky thinks of as ‘excess claims inflation’, which is due to an incompatibility between prices of factors and products and which can occur regardless of the level of aggregate demand. His thinking about the latter appears originally to have been inspired by work of scholars such as Schultze (1959) and Eatwell *et al.* (1974) which centred on the role of differences in productivity or demand growth among sectors of an economy, and on the desire of workers to maintain their wage relativities.

Firms that are doing particularly well may be able to pay more to their workers without increasing their prices. However, other workers may then insist on similar increases to maintain parity even if their living standards have not been threatened. The latter’s employers may only be able to maintain their real mark-ups if they can pass their higher costs on into higher prices. This, in turn, restores the abilities of the leaders to concede higher wages and so the process continues. As Scitovsky (1983, p. 224) points out, this hardly fits in with general equilibrium analysis. The general equilibrium framework would not lead one to expect chronic inflation, but instead the dissipation of any price-rising disturbance as lateral processes of substitution led it to affect more and more markets. Rather, ‘Everything we know about inflation suggests that ... a multiplier-type vertical transmission process must be at work, which generalizes an isolated price increase into a general price increase and gathers enough momentum to keep the process going.’ The key to explaining why a process of inflation keeps up its momentum lies in the presence of asymmetric market power between buyers and sellers and the fact that buyers in one market are often sellers in other markets (1982, p. 6; 1983, pp. 229–32).

Scitovsky’s insight here involves an application of his pricemaker/pricetaker analysis. For example, suppose producers are pricemakers in their product markets and opt to increase their prices. If they are also pricemakers in their labour markets they can prevent workers from attempting to obtain higher wages to restore their living standards. A change in income distribution is effected via a one-off hike in the price level, not ongoing inflation. Similarly, inflation would not be expected in an economy in which producers were pricetakers in both their product and factor markets: faced with tougher terms on which labour or other inputs could be obtained, firms would simply have to suffer reduced profit margins and/or cut back their rates of output to viable levels. However, all too often producers are pricemakers only in their product markets, and workers (or

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other factor suppliers)—the producers’ victims in the product markets—can retaliate because they call the tune in factor markets.

A pricemaking producer that is presently setting its price by equating its marginal cost and marginal revenue will find it costly to concede workers’ demands for higher pay: at the present price the price elasticity of demand must be greater than one, so a raising of that price in an attempt to recoup higher marginal costs will be only partially successful (1982, p. 5). Ideally, therefore, the producer should stand firm, but it is unlikely to be operating in a first-best environment in which it can coolly make a wage offer on a take-it-or-leave-it basis. Even if it judges that its workers would eventually give in and accept its original terms, it must take account of the costs of disruption that they could impose in the interim.

Rather than discussing the ways in which protagonists bargaining over factor prices can impose costs on each other [for such a discussion, see Tylecote (1981)], Scitovsky simply argues that if such a producer opts to concede demands for higher pay it may be indicative of a second-best solution which the firm has adopted because its market power is greater in its product market than in its factor market. He might have been wise to add some discussion of the likelihood of the firm expecting its demand curve to shift to the right. This could happen due to (a) its rivals making similar concessions and/or (b) the demand for its product being affected by increases in nominal purchasing power as a result of wage inflation in the economy as a whole. Both of these factors could reduce or altogether eliminate the loss of real profits resulting from payment of higher factor prices.

An implication of Scitovsky’s analysis is that it may be fruitful to explore factors affecting countervailing power to understand why inflationary tendencies differ on a cross-sectional or time-series basis [here, too, it may usefully be read in conjunction with the excellent book by Tylecote (1981), which not only has many parallels in theoretical terms with Scitovsky’s bargaining-oriented approach but also includes a wealth of comparative institutional case studies]. For example, we may consider explaining the increasing pushiness of workers in the late 1960s and 1970s in terms of ‘increasing affluence and social security having led to conflicting power relations in different markets’ (1978b, p. 228): compared with their forebears who were living financially on the margin, modern-day affluent workers will be more willing to embark on industrial action that may involve the risk of a lengthy strike. The willingness of an individual firm to give in to its workers’ demands will change as its market situation changes: the more discretion it has over the prices that it charges, and the more market goodwill it stands to lose if it suffers supply disruptions, the more willingly it may be expected to give ground to its workers.

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Changes in the technology of production may also affect the willingness of management to keep on the side of their workers by granting pay increases—even if they see themselves as wagemakers because their workers are not tending to engage in collective bargaining. Here, Scitovsky (1982, p. 6; 1983, pp. 236–7) contrasts old-style, repetition-based factory work and work in modern, mechanised environments where workers enjoy positions of responsibility and have to be attentive, always on the lookout for unexpected breakdowns or lapses of quality. The latter situation is one in which the worker's task cannot be fully pre-specified in a hiring contract and where it may be rather difficult to find a replacement if the worker quits. It is thus particularly important that management maintain the morale of workers in such positions. Firms in leading sectors may be able to do this by offering better remuneration packages without reducing their profits to sub-normal levels; less prosperous firms will then find themselves having to follow if they are to maintain the morale of their workers and hence their productivity levels. All this may happen without such workers needing to belong to a trade union or threatening strike action.

To the extent that inflation arises from excess claims on an economy, measures aimed at reducing it will only succeed if they can, directly or indirectly, reduce the sum of claims to realizable levels. Scitovsky (1978b, p. 229; 1982, p. 8) argues that if restrictive monetary policies are not merely to lead to higher levels of unemployment their beneficial effects on inflation are likely to arise as a result of their making people more cautious and choosy—not merely because this will mean less aggressive bargaining by workers but also because fussy buyers put firms under greater pressure to engage in research, development and innovation. Though this might appear to suggest that, in the long run, monetarist policies may achieve their desired results by their effects on incentives, we do not find Scitovsky concluding that a Thatcher-/Reagan-style of policy towards inflation is inherently the most desirable. He recognizes that an environment of tight money is likely to deter investments aimed at encroaching on the territory of other market participants and that there are other ways of stepping up competitive pressures in an economic system that may not involve the creation of 'short-run' unemployment. These include more aggressive anti-trust policies, and assistance to would-be market entrants who might otherwise find their access to know-how rather restricted. However, in the light of his (1990) work, we must note that policies aimed at reducing excess claims inflation by reducing pricemakers' market power need to be used with caution: innovation may suffer if the ease of entry makes would-be innovators pessimistic about the chances of getting an adequate return on their investments.

6. INTERNATIONAL ECONOMICS

Scitovsky made a wide variety of contributions to international economics: on the theory of tariffs (1942/1964, 1987b); on the effects of import substitution policies (Little, Scitovsky and Scott, 1970); on economic integration (1958, 1964, Ch. 6); and on the more general operations of the international monetary system (1964, Ch. 17, 1965, 1966, 1969). The usefulness of this work to economists nowadays varies considerably. Certainly, the rise of the World Trade Organization and associated moves to free trade and globalization to some extent may be traced back to the impact of the Little, Scitovsky and Scott critique of import substitution policies. Those who might hope to find his 1950s thoughts on European economic integration to be of great assistance in analysing the effects of the creation of the unified market within the European Community in 1992 are likely to find his thinking rather dated: for example, a modern-day investigation would pay much attention to the effects of multinational firms and to the ways in which licensing, subcontracting and joint venture arrangements may be used to achieve a reasonably even spread of growth around a set of small economies each of which is below the minimum efficient scale required for balanced growth. Given Scitovsky's great insights into the ways in which information problems affect competitive processes, it is rather surprising that his writings on trade are not themselves integrated with the dynamic, knowledge-based theories of trade produced by economists such as Posner (1961) and Vernon (1966). With the rise of China and in the aftermath of the Global Financial Crisis, there remains much to be learnt from his writings in the general area of the management of payments disequilibria. In particular, his delightfully titled satire 'International Payments in Laputia' (1964, chapter 17) is a remarkably clear analysis of the deflationary bias of the world economy, similar in vision to subsequent contributions by Robinson (1966) and Stewart (1983). It retains its freshness and relevance despite being written during the Bretton Woods era when exchange rates were difficult to revise.

The central problem with today's international economy, as with the Bretton Woods system, is that the financial community has been unwilling to recognize that it could be far more efficient to remove payments imbalances by forcing action on the part of nations with financial surpluses, rather than by those that suffer from deficits. The latter have typically lacked bargaining power in international negotiations, since bankers regard deficits as signs of faulty economic policies or economic weakness. Bankers fail to see that a payments surplus involves 'a squandering and unproductive hoarding of national resources' (1964, p. 269). Moreover, in addition to attributing blame in a one-sided manner, money managers tend to be more concerned with price stability than with full employment; yet they fail to see

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the role of a balance of payments deficit as an anti-inflation device in a fully employed economy. Hence their inclination towards insisting that countries in deficit eliminate the imbalance by cutting domestic activity levels, rather than suggesting that countries in surplus should take steps to increase their activity levels and hence their imports. If countries with surpluses expanded their economies, the deficit nations would only need to reduce their domestic demand levels if they were already at full employment or if the additional export demand would make them hit the full employment output ceiling.

In addition to arguing that pressure should be placed on surplus countries to dispose of their surplus reserves, Scitovsky proposed an ingenious new role for the International Monetary Fund as a benevolent issuer of an international reserve currency. He saw a larger supply of international liquidity as necessary so that deficit countries can weather their difficulties until the surplus nations wake up to the consequences of their surpluses in terms of higher inflation or the underemployment of their resources. Some might argue that, since the time he was writing, the development of the international currency market has removed the need for such a reserve currency, for it is now far easier for nations to continue to run deficits—too easy, in fact, given the international debt crises that have emerged. However, an IMF reconstituted in the manner that Scitovsky proposed would be well placed for helping sort out that mess that has emerged in the interim. His new version of the IMF would put its international reserve currency into circulation in ways which would benefit poor nations: some of it would enter in the form of aid to these nations, some would be used to buy on the open market securities representing debts of the poor countries. The IMF could put upward pressure on the currencies of surplus countries by choosing to do its open-market buying of bonds in their money markets.

Such measures for the correction international payments disequilibria are based on the premise that the disequilibria are ‘the joint responsibility of all countries affected’ (Scitovsky, 1969, pp. 183-4). As such, they are open to abuse by countries that opportunistically choose to ‘live beyond their means’ in the expectation that their deficits will ultimately be absorbed by the IMF. However, flagrant behaviour of this sort could be responded to by the IMF in its choice of markets in which to inject the international reserve currency.

7. TOWARDS THE INTEGRATION OF PSYCHOLOGY AND ECONOMICS

At the age at which most academics are thinking of retiring, Scitovsky chose to challenge established economic doctrine by writing *The Joyless Economy*

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(1976), a book that calls for the integration of economics and psychology. Readers of the preface to that book could be forgiven for thinking his belief that economists would be unwise to continue to try to get along without psychology was something which had emerged only in the early 1970s. However, since he actually raised psychological issues on a number of occasions in his earlier work, we might be wiser to see his controversial book as representing the culmination of a process of mental adjustment that had been going on for many years. To judge from the preface to his (1986) collection of papers and from his (1992) essay on his life philosophy, his fascination with the psychology of human satisfaction probably originated in his decidedly non-puritanical upbringing in Hungary, which contrasted strongly with the lifestyle he was later to observe in the United States. The idea that many Americans are best seen as puritan income maximizers, not utility maximizers, certainly crops up frequently in his writings on motivation and welfare. However, it was the issue of price expectations that provided the first sign of his recognition that economists may need to take account of psychology.

In one of his earliest papers, on unemployment and inflation, we find Scitovsky (1941a/1964) considering the possibility of what we would now call a 'real balance effect' or 'Pigou effect' [after Pigou (1941)] and stressing the role of the community's psychology in the determination of the general price level and orderly functioning of the economic system. Scitovsky pointed out that a changing price level would fail to exert a stabilising effect on the level of real aggregate demand if its initial impact on the value of money balances led to expectations of a further change in the same direction. But this would not always occur, since the 'limit to the degree of price-flexibility, beyond which it would destroy the belief in a normal price-level seems to be analogous to the "threshold of consciousness" which must be surpassed by a sensation to become perceptible to our senses' (1941a/1964, p. 50). In other words, people would only become aware of the changing value of money if price movements become 'very general or very drastic' (p. 52); otherwise, price changes will be seen merely as temporary fluctuations. So long as the threshold is not crossed, a belief in normal prices would tend to be self-sustaining, the more so in the presence of technical and organizational factors that make prices difficult to change.

A couple of years later, Scitovsky was questioning economists' assumptions about the motivation of entrepreneurs. The idea of a profit maximizing entrepreneur involves a lexicographic kind of psychology: a single minded concern with making money, with no willingness to hold back from the pursuit of profit in order to find time to consume the fruits of one's business success (1943/1964, pp. 170–2). It might be in order to assume such a way of thinking in cases where puritanical backgrounds led entrepreneurs to desire money as an index of their success in life rather than

as something to be spent. But until empirical investigations were undertaken one would have to recognize that the population of entrepreneurs might include many, even a majority, who, with rising success, would tend to relax their efforts, either because their wants were satiable or because they wanted time for leisure.

That this critique of the notion of profit maximization needed further development was evidenced in his (1958, p. 23) work on European integration, which saw him pondering the effects of freeing up trade between nations with very different work ethics: if other European Community members might *have* to adopt German work ethics, at the cost of lost leisure, in order not to be swamped by German competition, then one might equally well argue that a puritanical entrepreneur within an individual economy would tend to force rivals to adopt a similar life philosophy or go out of business. In the European case, Scitovsky failed to note the slack permitted to leisure-oriented nations by exchange rate adjustments. This is something that the advent of the Euro-zone has removed. However, by the second edition of *Welfare and Competition*, he was more careful to point out that entrepreneurs would need some protection of their market positions if they wished to take a more relaxed approach to business (1971, p. 153; contrast with 1951b, p. 147). Given his insights about the origins of market slack, it is strange that he did not make more use of behavioural or managerial theories of the firm (such as Cyert and March, 1963, Williamson, 1964) in his subsequent discussions of welfare: a less taut competitive environment may do wonders for entrepreneurial well-being at the expense of that of consumers and yet neither *Welfare and Competition* nor *The Joyless Economy* includes an index entry on stress, executive or otherwise.

Despite Scitovsky's willingness to embrace psychology, he has made little use of the literature associated with the work of Herbert Simon which abandons maximization altogether on the grounds of its logical impossibility and cognitive complexity. This is surprising, given his interest in the role of information in the competitive process. It is particularly puzzling since he came close to a satisficing perspective at a very early stage in his career: in his (1945) analysis of how people decide what to purchase in economies whose growing complexity is making them increasingly bewildered, he suggested that buyers rely on reputation and assume that quality is a function of price or of the size, age or financial success of the manufacturer; and that the more affluent consumers are, the more casual they are likely to be in their shopping activities.

His neglect of the literature on bounded rationality should not be taken to imply that he was oblivious of links between psychology, complexity and human welfare. On the contrary, when he later returned to the question of the implications of the increasing complexity of modern economies, he

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actually (1964, pp. 227-9) drew on the work of Erich Fromm and other members of the American neo-Freudian school of psychologists to paint a picture of parents who are at a loss to answer their children's questions about the nature of every day objects, and who, as a result of increasing specialization in the workplace, feel dependent on distant officials and gigantic, mysterious organizations. But he did not address a question that mainstream economists might want to ask in order to avoid facing up to the need to include psychology in welfare analysis: if people do feel alienated by modern society and technology, should we not expect media entrepreneurs to come to their rescue by offering information-oriented television programmes rather than soap operas and game-shows?

The links between macroeconomics, psychology and welfare were highlighted in his joint paper with his (then) wife Anne Scitovsky (1964) for the Commission on Money and Credit. They note the capacity of inflation to provoke anxiety, particularly for the middle classes who find their savings being eroded as speculators make quick bucks (p. 468). The importance of upbringing in shaping how well people cope with unemployment is canvassed via the suggestion that those with a puritan ethic will find unemployment a particularly distressing experience because they lack skills for coping with enforced idleness (pp. 433–5, 469). Even those who do not lose their jobs may suffer reduced welfare in times of unemployment insofar as they fear that they, too, could join the ranks of the unemployed and suffer social humiliation. Feelings of being unwanted and of resentment towards the economy will be most acute if unemployment is concentrated on an ethnic basis. Worse still, if unemployment reduces feelings of independence, self-assurance and self-reliance, or if policymakers do not try to reduce the distress caused by unemployment associated with economic transitions, then rates of innovation and growth may suffer.

8. GROWTH AND WELFARE

It is the question of the *effects* of growth on welfare that provides the focus for Scitovsky's (1976, 1986) most extensive use of psychology. However, I must stress that by 'extensive' I mean the range over which he has sought to apply psychology, not the range of inputs from psychology that he uses. As in his early discussions of complexity and economic development, he makes no use of the extensive literature on decision heuristics and biases; and he is seemingly unaware of branches of cognitive and social psychology that complement his perspectives on how people go about their lives [*cf.* my review of the broader literature in Earl, 1990]. This has made his contributions easier for orthodox economists to digest and less of a

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challenge to their work but, despite this, his ideas are yet to filter into the core of modern welfare economics.

Scitovsky's particular focus is on economic implications of Daniel Berlyne's (1960, 1971) optimal arousal model of behaviour, a stance that he seeks to justify with reference to the empirical work that has demonstrated the model's robustness in a variety of contexts. The essence of the model is neatly summarised by Middleton (1986, p. 397), who notes that the optimal arousal model 'hypothesizes that a certain general type of utility is a function of the degree to which the distribution of events in an experiential "frame" is "new" in the subject's experience. Utility increases with "subjective novelty" up to a point, then decreases, and then is replaced by disutility and anxiety. Subjects prefer intermediate degrees of novelty.'

Scitovsky illustrated this hypothesis with reference to a diverse range of examples such as tolerance of types of music and other art forms (originally discussed in his 1972/1986 paper), theme parks, gambling, fashionable clothing, and even economics texts such as his own which would be ignored if either saying nothing new or too different from the mainstream. Middleton (1986, p. 409) has gone further, suggesting that changes in the amount of new information flowing in financial markets may affect the mood of investors: 'It may be very pleasurable to trade in a market with a certain amount of dynamic surprise, while highly surprising markets are known to cause investors anxiety.'

Awareness of the extent of novelty in a situation that one is confronting affects one's level of physiological arousal and the sensation of excitement that one feels. In his (1981/1986) paper, Scitovsky portrays the effects of novelty on arousal as arising insofar as a stimulus is strong enough to threaten or challenge one's position and demand that one acts. He sees uncertainty about one's physical or intellectual capacity for dealing with the new situation as a major precondition for any situation to represent a challenge, whether to one's life, limb, health, economic well-being, prestige, status or self respect. All this fits in very well with the psychology literature on stress [such as Hanson (1987) and Hurrell *et al.* (eds) (1988)]. Our bodies have limited capacities for dealing with high levels of arousal. Sustained challenges over long periods lead to 'burnout'. On the other hand, people will 'rustout' if they do not choose to place themselves in a sufficiently challenging environment. For people to function most efficiently in physical and mental terms they need to position themselves somewhere between these two extremes. So long as they are not fully constrained by their environments, people can choose how much excitement/arousal/stress to confront.

Scitovsky argues that people in relatively primitive societies did not need to seek out excitement: it was often thrust upon them by difficulties in meeting their basic needs. However, the major uncertainties of life were

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made bearable by its normally sedate pace and the availability of time to spend engaging in folk art and cultural rituals. In advanced economies, by contrast, people may find it necessary to set out to find excitement insofar as their jobs become boringly repetitive whilst providing them with economic security. They can seek to meet this need for excitement by trying new forms of entertainment; in do-it-yourself or travel; by switching, as many are, from being mere spectators to become sports participants or political activists; or by indulging in gambling, violence (whether as participants or by watching it on screen) and drugs.

Many of these activities display similarities with work, in that they are both rewarding and onerous. But they vary considerably in their social implications, depending on the kinds of externalities they involve: the differences between participation in adult education classes and other cultural and sporting activities, as opposed to vandalism, violence and coping with addictive forms of stimulation, are so obvious as not to need elaboration. These externalities point to a need for policies aimed at crowding out antisocial activities with substitutes that provide risk, danger and excitement and at the same time have positive spill-over effects on the rest of society. Scitovsky (1981/1986, p. 134) places a lot of faith in changes in relative prices as a means to produce such substitutions, claiming that 'There is no reason to believe that the poor practice violence rather than dangerous sports because they prefer it and not because it is cheaper.' I suspect that major propaganda expenditure is also necessary to realign attitudes and reduce the extent to which people conform to antisocial pressures from their peers.

In addition to varying between societies at different stages of development, preferences in respect of excitement may vary through time for an individual (even an elderly person who normally leads a sedate life may be attracted by a challenge involving a burst of great uncertainty so long as its duration is certain to be short) and between individuals at similar lifecycle stages. The latter possibility arises because the way people feel about a given situation will depend on whether they believe they possess the skills required to cope with it. For example, someone who has grown up in a Swiss mountain village might not be greatly aroused by the prospect of skiing, whereas, to someone who has never tried to ski before, the very idea of a skiing holiday could seem far from ideal as a way of winding down. Choice is thus path-dependent, affected both by past experiences resulting from choices based on the exercise of personal imagination and by the social and informational environment in which the individual comes under pressure to try particular activities and picks up ideas about what may be exciting.

The choice of how much arousal to aim for is, in Scitovsky's view, a choice about how *comfortable* one's life is to be. How *pleasurable* it will be is an

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altogether different matter, for experimental work by neurophysiologists suggests that feelings of pleasure arise as a result of *changes* in one's *level* of arousal, particularly changes which move the level of arousal toward its optimum. The distinction is a major one for normative purposes: to experience pleasure, one must first have sacrificed comfort (by choice or force of circumstances) and moved away from one's position of optimal arousal.

This conflict was already much on his mind during the preparation of the second edition of *Welfare and Competition*: there (1971, p. 244), he notes that 'Instinctive behaviour is not always the one that yields most pleasure; and when it is not, self discipline and the sophistication of going against one's instinct are required to obtain the best satisfaction'. Consumers may thus feel that, despite their increasing affluence, their lives are not particularly pleasurable—are joyless—without realising that this is the result of their having chosen to spend their extra money and time in ways which only involve them in facing as much novelty as is necessary to keep themselves at an optimal level of arousal. The consumers who find that increasing affluence makes their lives more satisfying may be either the ones for whom it provides the means to increase the amount of novelty in their lives and bring them nearer to their optimal level, or those who use greater affluence as a means of obtaining periods of stimulation in which they depart temporarily from their positions of greatest comfort.

9. THE AMERICAN WAY OF LIFE

Scitovsky could simply have suggested that economists should try to use physiological psychology to make better sense of differences in the behaviour of individuals and as a basis for discussions concerning matters of public policy such as merit goods. *The Joyless Economy* would then have raised controversy merely because of its challenge to mainstream methods of theorizing. However, he also raised the hackles of his peers by choosing to use the psychological material, along with a mass of comparative statistics and his long-held view of the United States as an overwhelmingly puritanical society, as a basis for contrasting the lifestyles and feelings of satisfaction of Americans and their more Bohemian European counterparts. Criticisms of how he did this may have served a useful smokescreen role for those who were unsettled by his message that economics could do with an infusion of psychology.

Economists should have been well prepared for his lengthy critique of American lifestyles since, a few years before, he had already set out his views in three articles (1972/1986, 1973a/1986, 1973b/1986)—albeit with the first two being based more on the implications of puritanism rather than on an

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extensive psychological discussion. He was concerned that there was a tendency for American consumers to hand over passively to producers or intermediaries the key decisions concerning the quality of goods and the basis for choosing them. The result of this was a diminution in the range of goods on offer as producers sought to mould tastes in favour of products that would enable them to obtain economies of scale. A puritan education focused on the development of workplace skills left little room for education in matters of taste in respect of leisure pursuits. The result was the stereotypical 'nouveau-riche' lifestyle of affluent Americans in which consumption became a defensive activity, aimed at avoiding 'pain, effort, discomfort, boredom, the unknown and the uncertain' (1972/1986, p. 41).

In a review of *The Joyless Economy*, Alan Peacock (1976, pp. 1278–9) brilliantly summed up how Scitovsky had portrayed American lifestyles:

Look around you Yankees and see what a miserable lot you are, wholly inexpert in the art of living, laughing and loving. The normal ambiance for a meal resembles the atmosphere of a filling station—it frequently is a filling station—rather than a pleasant communication of connoisseurs. Speech is for rapidity of communication and not leisurely mind-stretching converse. You have no music in your soul. All that leisure time you have created by labor saving devices is used up in being glued to the TV, and when social pressures demand the allocation of some of it to the European Grand Tour, your cultural background is so exposed in its inadequacy that you seek protection in the encapsulated package deal, only too glad at the end to return to the homelier pleasures of coffee and apple pie. Travel broadens your feet but not your mind. Your lack of faith in the quality of your domestic decision-making drives you into the arms of an array of predators, such as home decorators and psychiatrists. In short, the Puritan Ethic haunts you.

Non-Yankees may find it difficult not to have some sympathy with Scitovsky's imagery and yet agree with Peacock's criticism that it is misleading since it seems to treat the whole of the United States as a single unit. Mainstream economists would also be expected to find comfort in Peacock's observation that, contrary to the impression Scitovsky gives in his theoretical analysis, there do exist sophisticated neoclassical models which recognize sources of (dis)satisfaction derived from intangibles such as social interaction and the nature of work environments (p. 1279).

Aufhauser's (1976, p. 913) criticism that Scitovsky's analysis ignores alternative historical and institutional explanations is potentially more

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powerful in methodological terms. Aufhauser uses the fact that Americans eat less fresh fruit and vegetables than the French to make this point:

The book would have us think that this results from our Yankee avoidance of gustatory pleasures. But if the author had thought for a moment in historical or institutional terms, it would not have been difficult to find that Americans' consumption of fresh produce has been declining ever since the big agribusiness companies began taking over that sector of the economy (U.S. Department of Commerce, *Historical Statistics of the U.S.*, Washington, 1961, p. 186). According to Scitovsky's line of reasoning, however, the decline would have to be attributed, absurdly, to a revival of puritan anti-sensualism during the period.

Given that the author of *The Joyless Economy* had not long since revised *Welfare and Competition* it is most surprising that, in looking at the state of consumer dissatisfaction, aspects of industrial organization were not raised in conjunction with the socio-psychological material. However, it may also be said that Aufhauser leaves open the question of why the agribusiness giants could get away with their policies. If the typical American consumer were less passive and more inclined to connoisseurship, food consumption patterns might well have been very different.

10. UNEMPLOYMENT IN AFFLUENT SOCIETIES

Since Scitovsky's formative years as an economist coincided with the unemployment of the Great Depression and the emergence of Keynes's theoretical analysis of its causes, it is not surprising that he maintained a concern with the origins and of unemployment and a broadly Keynesian perspective on what might be done about it. He was always careful to point out that standard approaches to the notion of efficiency are essentially the 'The Economics of a Fully Employed Economy' (this was the subtitle to the first edition of *Welfare and Competition*, and its absence from the second edition is actually the result of a typesetting omission that he failed to spot at the proof stage; the message is still very clear from its opening chapter). Rather than seeing stagflation as implying the need for a return to the sort of equilibrium analysis advocated by many economists of the Right, he looked for features of modern economies that cause aggregate demand and supply problems which Keynes did not anticipate. His distinctive perspective only appears to bolster mainstream views through its suggestion that status-conscious people are reluctant to accept jobs that they see as beneath their stations in life (1986, p. 121 and chapter 11). In conjunction

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with subsidies for high-level training and the availability of unemployment benefits, this ‘excess demand for job importance’ may help account for coexistence of unemployment amongst professionals and unfilled vacancies for more lowly positions.

The issue of status was also on Scitovsky’s mind when he chose the occasion of his Fred Hirsch Memorial Lecture to make one of his most thought-provoking contributions on unemployment, reframing some of Keynes’s concerns in a modern context. He began by airing the possibility that the satiation of wants in affluent societies might pose a threat to the continuation of economic growth. Certainly, basic needs are already more than satisfied for many affluent consumers, who demonstrate this by dieting and jogging. But consumption demand might nonetheless remain buoyant due to spending on needs associated with the attainment of social standing and personal fulfilment. In his (1987a) Hirsch lecture, naturally enough, he concentrated only on the means by which people seek to meet their social needs but, as far as the latter is concerned, we should note his discussions elsewhere (1976, pp. 78–82; 1981/1986, pp. 130–1) of the increasing extent to which people are engaging in do-it-yourself activities—i.e., internalizing the production of goods and services they could have purchased in the market—in order to obtain excitement and stimulation. Do-it-yourself activities may contribute towards a stagnationist tendency insofar as people who undertake them save money and do not spend more elsewhere.

According to Scitovsky, macroeconomic problems do not arise from social needs due to modern consumers striving to attain status by purchasing more goods of a particular kind [the typical person is, after all, disgusted by the Imelda Marcos’s extravagance in owning 3000 pairs of shoes (1987a, p. 3)]. Rather, the problem is that they seek to increase their income regardless of whether they can get around to spending it all, and by concentrating their spending on exceptional items—i.e., goods that are prestigious because they are in short supply and thus command high prices. In the extreme case, as with homes in prime locations, antiques and old masters, the act of spending on such items involves no direct demand for new production aside from that for the services of auctioneers and other dealers in such commodities, and for maintenance and restoration services. It is a form of spending that is akin to hoarding one’s flow of income as cash or leaving it as a bank deposit rather than placing it where it might increase the supply of funds that others would like to borrow. However, unlike an excessive preference for liquidity, the preference for hard-to-reproduce positional goods exerts an inflationary impact on the price level as well as a deflationary effect on the demand for labour (1987a, pp. 10–11), all the more so since the predictable rise in prices of such goods makes them attractive as hedges against inflation and diverts funds away from investment in new business activities.

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This was a most timely analysis, coming as it did during the mid-1980s boom in conspicuous consumption and real estate prices; yet one can see it very much as an extension of ideas rehearsed in his (1940/1964) study of interest and capital. However, Scitovsky did not consider the underlying process as carefully as in the earlier paper. He neglected to note that, for each buyer of a positional good, there must be a seller. If a seller uses the proceeds towards buying an alternative higher-status good, he or she must find another seller. If funds are to move into supply-inelastic positional goods markets at the expense of sales in markets for reproducible commodities, we must have a situation in which sellers of the former are choosing to keep liquid rather than spending their capital gains on reproducible goods or on newly issued financial assets. (If someone sells a piece of prime real estate and uses the proceeds to purchase existing financial assets, the buck is merely passed to the seller of these securities.) So unless this argument is to hinge upon time-lags in the buying and selling of assets causing a rise in the transactions demand for money, we need a more detailed flow of funds analysis to see whether the end result is as Scitovsky proposed. His story works fine, for example, if a yuppie withdraws a bank deposit that he otherwise have used to purchase some current output and buys instead into the market for positional goods *and* if the seller in this market banks the proceeds as a means of financing a less ostentatious lifestyle, such as early retirement (though here we also have a reduction in labour supplied!). The analysis would also hold if the rise in prices of non-reproducible assets led to a rise in the propensity to save of people who desired to accumulate enough—for example, a house deposit—to get on to the first rung of the positional ladder or who, at the expense of would-be purchasers of reproducible goods, took out bigger loans to do so and then had less left over each month to spend on newly produced goods and services.

Scitovsky's view of the origins of at least part of observed unemployment makes the macroeconomic policies of both Reagan and Thatcher seem particularly unhelpful. Policies aimed at promoting greater equality would have been much better than tax cuts for the rich, for the demand for positional goods would thereby have been reduced and the structure of aggregate demand would have been shifted more in the direction of unsatiated needs for personal comfort. Furthermore, if the supply of positional goods is inherently difficult to expand, the Reagan/Thatcher 'justification' for cuts in marginal rates of income tax—namely, that they would lead to an increase in the supply of labour and thus to the expansion of output and reduction of inflation—is wrong-headed: it would have been better to reduce the demand for employment and to spread employment around more equitably by encouraging part-time working and job sharing. So long as policy-makers are dealing with fairly small changes in

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the average number of hours worked per week, Scitovsky did not feel policymakers should worry about causing the kinds of psychological problems that can arise when people are not skilled in filling their leisure time in an active manner.

Today, as environmental problems are beginning to be taken seriously, environmentally responsible governments ought to be considering encouraging affluent consumers to work less and consume less. This will require giving attention to the practical issue of how one ensures an equitable distribution of part-time/shared work and sets about ensuring that people receive education in making the most of their extra leisure. Most politicians are yet to abandon the goal of full-time full employment, and have not set about trying to produce a similar paradigm shift in the minds of voters. It is here that Scitovsky's integration of psychology and economics is potentially most significant: his (1979/1986) message for the American public is that if they acquire skills for enjoying a non-puritan lifestyle they will be able to reduce their expenditure on consumption (and hence their need to work) and at the same time find greater fulfilment in their lives.

11. CONCLUSION

If we take a broad view of Scitovsky's contribution to economics it is difficult to avoid the conclusion that, despite a very extensive record of being cited, his work has not had the kind of impact it deserves. His works are well known and yet do not seem to have affected fundamentally the way in which most economists nowadays teach or research the subject. Most modern-day economists probably now see *Welfare and Competition* as nothing more than an intermediate-level textbook on microeconomic theory and welfare economics, not as something presenting a much more complex view of the functioning of economic systems than is found in many more recent and more technically demanding texts. To the extent that economists have started to recognize that market power has informational foundations they appear to have been reinventing Scitovsky's wheel rather than recognising this persistent theme in his writing. *The Joyless Economy* has been cited mainly by non-mainstream economists or by scholars in other fields and has made little impact on welfare economics. As Scitovsky (1988, p. vii) himself pointed out, his work tended to foster the creation of a distinct psychological branch of economics rather than 'infuse some psychology into the general framework of the discipline.'

Part of the answer to the question why his work has not had the impact it deserves is probably to be found in its very novelty, which presents too much of challenge to established research practices. It is not just that he made economists uncomfortable by asking them to take on board the

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unfamiliar and diverse the literature of psychology. On top of this, there was the issue of the kinds of models towards which it points. Differences in knowledge are inherently difficult to capture in mathematical models, while deterministic conclusions about matters such as consumer sovereignty become difficult to achieve if tastes are seen not as genetically given but as affected by external factors including tradition and education as well as advertising. Scitovsky (1992) himself thought that part of the explanation of resistance to his analysis of the deficiencies of modern economies lay in a mistaken view that he was an elitist: actually, he stresses that one can achieve sensory stimulation outside the workplace by many means other than intellectual activity.

No less important as a factor hindering the impact of Scitovsky's work may be the way it has been packaged and served up to the economics profession. It needed to be better linked to other works that seek to challenge the mainstream and its various components themselves needed to be more thoroughly integrated. In this chapter one of my aims has been to give pointers as to how these things might have been done. But what we really need is a third edition of *Welfare and Competition* which pays careful attention to recent contributions by others on the effects of information on the operation of economic systems (such as the transactions cost literature) and which explores the welfare implications of his socio-psychological view of consumer behaviour.

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