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Need For A Need-Based Economics: A Critical Look At The Conventional Demand-Supply Curve

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Abstract:
Conventional economics is guided by the fundamental force of self-interest as envisaged by Adam Smith. Later on the concepts of rational man, marginal utility, Pareto optimality etc. developed. These assumptions were made by early economists to simplify the things so that mathematical calculations could be easy. A critical look at the conventional demand-supply curve reveals that it is related to wants and desires only. A need-based demand-supply curve will have a different appearance. Recent insights into psychology and social behaviors have challenged the very basic assumptions of economics. Yet these assumptions continue to play a decisive role in government policies and programs. As a result there is great disparity in society and a very inequitable distribution of wealth and resources. There is no differentiation between needs and wants. Consequently, very rich people and corporate houses have cropped up. Such entities prefer luxurious items and the production of non-essential goods and services. The governments find it difficult to take straight forward decisions regarding social welfare. It is time that Economics is demystified so that it is comprehensible even to a common person. If real social welfare is to be achieved, governments need to take bold need based decisions so that there is a more equitable distribution of wealth and resources.

Key words:**Affordability, Demand-supply curve, Economics, Indifference curve, Marginal utility, Needs, Pareto optimality, Rational man, Self-interest, Social welfare

Introduction:

The word Economics is derived from Economy which means saving of money, time, energy etc. Economics is considered as the system of trade and industry by which the wealth of a country is made and used. It is also stated that Economics is the study of how society decides what, how and for whom to produce (Begg et al, 1998).

By definition, Economics appears to be a nice tool to manage the resources of a country or region for the welfare of the people. But gradually Economics has been transformed into a very complex discipline. Its assumptions and theories are generally not comprehensible to a common person. It has now overarched all other sciences and disciplines. Its assumptions are taken to be sacrosanct in spite of clear evidences that they are grossly wrong or mistaken. Even the ecosystems and natural environment are considered to be subsets of economy and here also the economic assumptions are applied resulting in degradation of natural ecosystems and depletion of natural resources. All this is resulting into an inequitable distribution of wealth and resources. In the garb of economics, big corporations and business houses have cropped up to compete with each other for the control of earth's resources. While one out of every eight people goes hungry every day, the corporate are busy manipulating the global agriculture. Large farms are gradually forcing out the smaller ones and thereby contributing to worsening of poverty, political stability, inequality and loss of social cohesion (Ghosh, Bishwajit, 2014).

It appears that Economics has been consciously mystified and demonized so that even very logical inquisitiveness is dubbed as economically incompatible. A discipline which was supposed to solve the problem of the basic needs of humanity has been converted into a tool for creating big corporations and unfettered ventures in the name of economic growth. It is gradually becoming very apparent that the market is not perfectly self-regulatory either in principle or in practice, and left to itself will lead to social inequality and not adequately meet human needs. There is an inherent imbalance in market transactions where some traders are trading for necessities and others for luxuries, which is very often the case. When people with significantly different income levels are in the market, the poor person is at a disadvantage. The necessities are overpriced and the luxuries are underpriced. The market thus has a built in tendency to undersupply the needs of a population, while at the same time over supply the desires (Lutz and Lux: 1988). The basic function of Economy should have been to better serve the good of the whole society. But now-a-days public governance is being neglected in favour of so-called market self-regulation (Kayanov, Pavel: 2008)

The Flawed Assumptions:

The basic problem with current economics lies with the faulty assumptions about human nature. Human psychology is a complex subject and still much more is to be learnt and investigated. Without sufficient insight into human nature the early economists made very simplistic assumptions and applied it uniformly in all economic approaches. This facilitated the arithmetical calculations and development of certain laws and rules. These rules and laws came to be applied as if they were natural universal laws equivalent to the laws of physics and mathematics. Government and policy decisions were made based on these assumptions and laws. But since the basic premise itself has been faulty, the application of the principles of economic growth has only resulted in a number of socio-economic problems all around the world and no easy solution appears to be in the offing. To deal with these problems, the governments have no option available but to revert back again to the same economic philosophy.

Economic principle is guided by the fundamental force of self-interest. It is assumed that by pursuing his own interest, a person supports the interest of the society more effectively than when he really intends to promote it (Smith, Adam: 2003). This assumption of Adam smith may be true to some extent if the self-interest is interpreted as sincerity in market transactions. But one can only imagine the consequences if this principle is literally adopted by everybody in all walks of life. Yet this principle lies unchallenged even after more than two centuries. Another assumption of economics is the concept of economic man. It is assumed that in a market every individual behaves in a rational manner. Economic man is an idealized concept of a person who is purely rational, and whose only motivating forces are economic (Samuelson and Nordhaus: 1983). This assumption has also been refuted by recent insights into human psychology and social behavior. Yet it remains the foundation of all conventional economic thought.

While the basic assumptions of economics remain flawed, it is on these very assumptions that the economic modeling is done and the economic theory is applied to real world problems. Conventional economic assumes that rational economic individuals allocate their resources in order to maximize their overall utility. This is the basis of individual economic behavior (Edward-Jones, Gareth et al: 2000). Based on this assumption the law of diminishing marginal utility has been derived which says that the more of a commodity that an individual has already consumed to satisfy a want, the less is the extra gain in utility generated from consuming one more unit (the ‘marginal’ unit). In short, the level of utility increases decreasingly with additional units of the same good. This law has been extended to explain the indifference theory of consumer choice and drawing of indifference curves. It is evident that the indifference curve is related to wants and not the needs of a society. The wants of a society or individual are interchangeable, and hence an individual may get same satisfaction or pleasure from different or same quantities of two different commodities. But the needs are limited and not interchangeable. Hence, the assumptions of marginal utility or indifference theory have little value in a situation where meeting the needs of a society is the primary concern.

Another important concept in conventional economics is the Pareto optimality. It states that there is no opportunity for increasing the overall supply of goods to promote universal enrichment; welfare gains could only come about by taking away from some people and redistributing them to others. Pareto optimality concept discourages governments from taking steps for the welfare of marginalized groups, because it would amount to disenrichment of some rich people. Pareto optimality ignores the possibility that it might be due to previous faulty policies that there is gross inequality in societies. People having a large share of the resources of a country cannot be considered to be on the same footing as the poor and marginalized sections. What the poor and marginalized require is the fulfillment of their basic needs. What the rich have to lose is only a fraction of the surplus resources which has anyhow accumulated with them. Moreover, once the basic needs of an individual have been met, more money or resources do not necessarily increase the satisfaction, utility or pleasure of the individual. Most psychological data show that the main determinants of happiness in life are not related to consumption at all. Prominent among them are satisfaction with family life, especially marriage, followed by satisfaction with work, leisure and friendships (Durning, Allan: 1991). In fact there is very little difference in the levels of reported happiness found in rich and very poor countries (Argyle, Michael: 1987).

With recent insights into psychology and human behavior, it is time that the centuries old assumptions of conventional economics are examined critically. It would be detrimental to human society if we keep our eyes closed and are not ready to see the reality as it is. We require an economics

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which encourages sustainable ecosystems along with sustainable societies (Ahmad, Shahbaz: 2013).

The conventional economics does not differentiate between needs and wants and this is the main cause of most of the socio-economic problems. Need has a natural capacity. When this capacity is not fulfilled, it leads to serious deterioration of the health of the individual. Different needs cannot be added together while wants or demands are commensurable. According to humanistic psychology, a person consists of a dual self. The lower aspect seeks one's own advantage. This is the self that finds its rational in free trade. In contrast the higher self identifies with a common humanity and finds its rationality in objectivity, fairness and truth (Maslow, A. H.: 1968). This finding in psychology is a shattering blow to the concept of the economic or rational man in conventional economics. A descriptive analysis of human choice and decision making by cognitive psychologists show that the assumptions of economic theory are usually wrong. People make many decisions under considerations of uncertainty, do not use probability information as statisticians would, and are subject to cognitive biases that expose the fallacy of the rational decision-making model (Zimbardo, Philip G.: 1999).

The assumptions of conventional economics are so much deep entrenched into the society that even if governments sincerely want to take straight forward welfare steps they find themselves in dilemma. For socio-economic problems there are conventional remedies suggested by economists which have to be prescribed. But the real problem of the people is not attended to directly. A poor person is unable to understand why inflation is good for the economy. He is perplexed to know that the food subsidy for the poor is not good for the economy of the country, yet huge subsidies to big farmers for keeping their land fallow is justified. A common person is unable to understand the helplessness of governments in controlling rising prices of essential commodities. In fact these problems require direct humanistic interventions by governments which conventional economics discourages.

A Critical look at the conventional Demand-supply Curve:

Here it would be pertinent to have a look at the demand-supply curve of the conventional economics for a product A (Fig. 1.1). It is claimed that it is the interaction of demand and supply which determines price. An economic equilibrium is attained when all the agents are choosing the best possible actions for themselves, given their preferences and available opportunities, and where each agents behavior is consistent with that of the other. The point E in Fig. 1.1 is the equilibrium point, implying that Q_e is the equilibrium quantity and P_e is the equilibrium price.

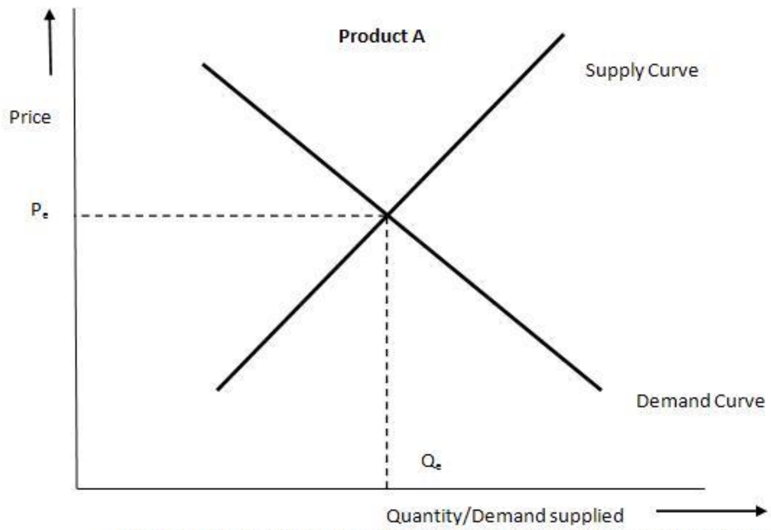

Fig. 1.1: The interaction of market demand and supply curves of a product A (not a basic need)

Further analysis of Fig. 1.1 reveals many more things. It assumes that the players in the market are individuals who are not concerned with basic needs. The buyers are those individuals whose basic needs have already been met and they are venturing in the market in search of more pleasures and utilities. The suppliers in the market are those firms who are trying to cater to the desires of such individuals. Such supplier firms may also try to attract more and more of such buyers through advertisements and other campaigns. They may even create demands/desires which might not have been there earlier. The cumulative effect of the efforts of the supplier firms and the desires of the buyers results in an

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equilibrium when for Quantity Q_e the price of the product is P_e. Now it is for the supplier firms to decide whether to maintain the price at P_e or increase/decrease it. The gainers in such a market place are the supplier firms who are able to sell their products in a quantity which results in a net profit. The buyers in such a situation are also not the losers. Even if they don't buy anything they have already satisfied their basic needs. If they buy some products, they may have the satisfaction of having some more products though they may not be necessary at all. Individually some buyers may like to pay more or less than the equilibrium price P_e. But collectively they have contributed in making the equilibrium Price P_e. The overall effect of such transactions is that there is flow of money from some well to do buyers to some supplier firms. Hence, the circulation of money in such a case remains largely within the well-off people. It means that market transactions of luxury and non-essential goods and services make the rich richer and the poor poorer.

Now, let us examine the demand-supply curve of a product B which is a pure basic need to be consumed e.g. an essential commodity. Since it is a need it will be required in an estimated quantity according to the population of the region. Here the demand is not dependent on any other extraneous factors. In such a case the Demand(Requirement) curve will be a vertical line at quantity R(Fig. 1.2). Supply curve will remain sloping as before. P_e is the equilibrium price at which the supplier firms will be making the maximum gross profit. If the total quantity is R and the supply is also R then there is no glut in the market. If the supply is increased to R_2, the increased supply will have no demand and so the price again will have to be decreased. Now let us examine the basic question of affording a basic need.

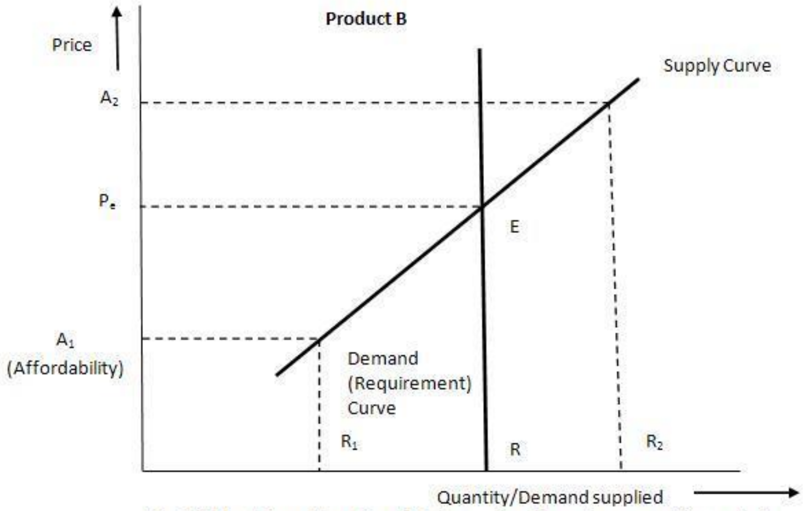

Fig. 1.2: The interaction of market demand and supply curves of a product B (a basic need)

Even if every individual is capable of paying a price A_2(Affordability), then also they will purchase their requirement at price P_e only because that is the equilibrium price which is determined by the market. No individual will purchase the commodity in a quantity which is more than his or her requirement. But suppose there are certain individuals who are able to afford a price of just A_1. In that case they would be able to purchase a quantity R_1 only. They will not be able to purchase their full requirement and they will get impoverished by a quantity R--R_1. But since it is a basic need, it becomes the duty of the government to intervene either in the form of subsidy or otherwise so that the difference of price P_e—A_1 or quantity R--R_1 is made up. In fact the economic policies have to be such that for basic needs, all individuals and households should have affordability $A \geq P_e$. This is the essence of humanistic intervention. Conventional economics focuses on wants and demands. This approach neglects the basic needs and the marginalized people. The result is that the rich get richer and the poor poorer. The circulation of wealth and resources is such that there is an aggregation with a few affluent people and corporate at the cost of others. The flow of wealth created is more towards the rich and the corporate than otherwise. In fact the welfare interventions by the governments should have been need based. With this approach the flow of wealth created would be more towards the general masses, because the focus of economic activity is essential goods and services which is a concern of all especially the poor and the marginalized. This will tend towards an equitable circulation of wealth and resources.

Conclusion:

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The centuries old assumptions of economic theory still continue to rule the policies and programs of governments. Economics has been so much mystified that it is incomprehensible to the common person. The governments also do not feel confident to take straightforward humanistic welfare decisions. It is time that the assumptions of conventional economics are critically examined so that realistic and need based approaches are adopted for the welfare of the people and societies at large.

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