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The Persistence of Poverty: Why the Economics of the Well-off Can't Help the Poor, Charles Karelis. Yale University Press, 2007, 208 p, $18 (Paperback). ISBN: 978-0-300-12090-5

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In this book, philosopher Charles Karelis advances an intriguing hypothesis to explain the seemingly self-destructive behavior of poor individuals who fail to take advantage of the opportunities available to them in capitalist societies. If the widely accepted theory of diminishing marginal utility of consumption is correct, the next dollar earned by those with few should be especially precious and provide a strong incentive to work, to improve one's wage prospects through education, and to smooth consumption between alternating flush and dry periods. If the theory is correct, poor people who fail to avail themselves of these opportunities behave irrationally. Why?

Karelis suggests that the diminishing marginal utility of consumption is the wrong way to understand the behavior of the poor. He argues that the marginal utility of consumption *increases* up to the level of sufficiency for basic needs and only begins diminishing after that point. If this hypothesis and the conclusions to which it leads Karelis are correct, they bolster the intuition of many basic income advocates that unconditional income grants preserve work incentives, rather than diminishing them.

Karelis begins by identifying five seemingly irrational behaviors that keep the poor in developed nations mired in poverty: not working, not finishing school, not saving, not moderating alcohol consumption, and not living within the law. He then examines the theories that attempt to explain these behaviors, including theories of dysfunction and structural theories. Dysfunction theories credit psychological defects of the poor, including apathy, a fragmented sense of self, or weakness of will, for their irrational behavior. Structural theories attribute the same behaviors to social structures that disadvantage the poor, including restricted opportunities, misguided public policies, and preferences at odds with dominant norms.

Karelis is dismissive of the explanatory power of these theories and argues that they fail the parsimony test by painting too complicated a picture of human nature, assuming essential differences between the poor and all others. He argues that the assumptions of structural theories do not conform to either the reality of contemporary conditions in the U.S. (on which his book is focused) or the self-reported explanations of the poor. Perverse incentives created by public policy might play a role, but the seemingly irrational behaviors of the poor are consistent across many periods and nations without extensive safety nets.

Karelis' swift dismissal of these theories is unlikely to sway their adherents, but the heart of the book is his rejection of the conventional wisdom that these behaviors are irrational. The development of the theory of the marginal utility of consumption since the late nineteenth century has given rise to both the laissez-faire doctrine that helping the poor reduces their motivation to help themselves and the liberal doctrine of redistribution from rich to poor – from those whose extra dollars provide diminishing marginal utility to those for whom the same dollars have a much larger effect on utility.

But Karelis believes the concerns that underlie this tension are illusory, based on the Epicurean fallacy that misery and happiness are reciprocals rather than polar opposites. On this mistaken foundation, all goods are seen as “pleasers” in Karelis’ term – goods that have the greatest utility in the first increment and diminishing marginal utility thereafter. Against this single-valued description, Karelis instead distinguishes among three kinds of goods: “pleasers,” like dessert or a glass of fine wine; “relievers,” like salve for bee stings; and “reliever/pleasers,” like food and shelter – goods that operate as relievers below sufficiency and pleasers thereafter. Critically, the marginal utility of both relievers and reliever/pleasers *increases* rather than decreases up to the level of sufficiency.

Karelis offers transportation as an example of a reliever. Suppose you have to walk six miles to work because you can’t afford bus fare. A voucher for a free one-mile ride would provide little utility when there are still five miles left to walk, but if you can get a lift with a neighbor for five out of the six miles, the one-mile voucher would have high utility. If you suddenly came into a large number of vouchers for free rides, you might enjoy a few extra trips, but the vouchers’ marginal utility would begin to decline once you satisfied your most basic transportation needs – getting to and from work.

Karelis marshals a counter-marginalist example from history to support his thesis. The Lydians who, as reported by Herodotus, faced famine over a period of many years, ate only on alternate days, rather than smoothing their meager food consumption. Marginal utility theory would view this behavior as irrational; Karelis argues that at low levels, increased consumption on alternate days provides greater utility than smoother but lower consumption every day. On the other hand, those who eat well every day derive more utility from smoothing dessert consumption than from having two desserts and no desserts on alternating days. In sum, many of the behaviors of the poor are, on this theory, rational. The poor will sacrifice higher overall consumption to consume unevenly, because doing so increases total utility.

What is intriguing about this thesis is that it provides a way of understanding the cumulative effect of the multiple burdens of the poor, but does so through the external circumstance of poverty, not through any essential nature of poor people themselves. Karelis contends that economists, philosophers, and politicians have been misled by marginal utility theory, because they failed to grasp that it is “the economics of the well-off,” reflective of the experience of individuals with enough material resources to able to pursue those occupations, but not of the poor.

The policy implications of Karelis’ theory are clear. Income transfers below sufficiency will tend to increase work effort, not decrease it. They lead to a virtuous cycle in which income smoothing and the behaviors that contribute to it become rational. Wage supplements like the Earned Income Tax Credit (EITC) in the U.S. (a negative income tax) are a “double-barreled” strategy, since they have both an income and substitution effect in favor of work – both increasing the return to hours worked and increasing the “cost” of unremunerated leisure. Unconditional transfers like basic income are a “single-barreled” approach, since they have only an income effect. But this implies the superiority of basic income as a counter-cyclic strategy, because both the income and substitution effects of the EITC reverse during periods of high unemployment or falling wages, while the basic income’s income effect would increase.

Karelis himself is agnostic as to which kind of transfer is preferable, but he suggests a greater tolerance for “gray-area” activities, since more income, even if unreported, moves poor individuals closer to sufficiency and into the virtuous cycle. This suggests that unconditional transfers may hold an advantage over conditional transfers, which come with anti-fraud regulations that discourage gray-area activities. This is in keeping with Karelis’ overall tone in the book, a tone that runs counter to the prevailing paternalistic approach to poverty and to the conservative resistance to redistribution in the U.S.