Viewpoint

George J. Stigler

Economists and Public Policy

IN THIS ESSAY I attack a highly vulnerable target and do so with well-placed confidence, because the target is myself. More precisely, my target is a paper I once wrote ("The Economist and the State") in which I proposed two main theses. The first was that economists have a deplorable habit of giving emphatic advice on public policy without bothering—even if they live long after—to see whether their predictions of the effects of the policy were correct. In the mid-nineteenth century, Nassau Senior and Robert Torrens predicted dire consequences for the textile industry if Britain's Parliament passed the ten-hour day bill. In a characteristically terse eighty-page letter to Lord Ashley, the bill's sponsor, Torrens stated:

> I have not hesitated to address your Lordship . . . a free and unmitigated expression of my opinions in regard to a measure [whose] necessary tendency would [be] to effect a reduction of wages proportionate to the diminution in quantity of work performed within a given time; and ultimately to create a bitter spirit of disappointment and despair, endangering the security of life and property, and terminating, it might be possible, in the horrors of a servile war.

From Senior's letter I quote only his conclusion, of which he said he had no doubt, that a ten-hour bill would be "utterly ruinous." Each of these famous economists lived for seventeen years after that bill was passed, but neither of them found the time to examine its actual effects.

George J. Stigler is Charles R. Walgreen distinguished service professor of American institutions at the University of Chicago. This essay is adapted from his G. Warren Nutter Memorial Lecture, sponsored by the Thomas Jefferson Center Foundation and delivered on April 23, 1982, at the American Enterprise Institute. AEI will publish the full text of the lecture in the fall.

Near the end of the nineteenth century, again, there was substantial hostility or indifference among economists toward the passage of the Sherman Antitrust Act. Yet not one of them made a study to confirm or deny the popular prediction that a mere statute could not retard the gigantic forces making for large business enterprises. My first thesis has surely been completely valid for most of our history as a science, and remains entirely too valid today.

The second thesis is the one I now wish partially to recant. It asserted that once the practice of testing our predictions by examining the evidence became general practice, economists' advice—that is, the advice that survived the empirical tests—would be heeded by the society. For truth, even temporary truth, is a God that the rational society must worship. And of course our society is rational, being constituted as it is of some 230,000,000 utility-maximizing individuals.

My argument rested on the proposition that a society will not long challenge established truths about the real world, because that is unwise behavior no matter what one is seeking to do. To disregard the real world is to act inefficiently. For example, suppose that economists confirm Walter J. Wessels's proposition that a legislated minimum wage is largely vitiated by the ability of employers to reduce fringe benefits and costly working conditions (*Economic Inquiry*, April 1980). Then the labor unions which support such laws would surely address this means of frustrating their desired increase in the cost of employing workers who receive low wage rates. But I erred, I believe, in confusing truth with virtue. Let me go back to the beginning.

The Place for Hard Science

There are things that economists know with great confidence about the working of an economic system. The price of a commodity will rise when its supply falls, even if the state passes a law against a price rise: the rise will then simply take the form of legal or illegal costs in getting the rationed commodity—waiting in line or buying in a black market. A large and rapid rise in the supply of money will lead to a rise in prices (again, possibly concealed but not avoided by public controls). A competitive industry will refuse in the long run to supply its product at less than a cost-remunerative price, and will be unable to get much more. Such elementary and even platitudinous findings are deducible from first principles and illustrated by many thousands of documentable instances.

These were the sorts of findings which, I argued, were inescapable and therefore irresistible to an intelligent society. I was saying, as Edwin Cannan once put it, "However lucky Error may be for a time, Truth keeps the bank, and wins in the long run."

I am still prepared to assert that such established economic principles are accepted by the society, whether they are liked or not, just as birds and stones accept gravity. When the society imposes a price ceiling that prevents a market from clearing, for example, that is not an act of defiance against the law of demand. Rather, it is a decision based upon a preference for another system of assigning goods and distributing income. The rent ceiling in effect assigns each property to the tenant already residing in it, forcing later comers to take the leavings. The ceiling redistributes income from landlords to tenants, and is a feasible policy because even neglected dwellings are fairly durable. These are known consequences. While someone may assert that the consequences were unknown when rent control was first adopted in some Dark Age of long ago, will that person have the effrontery to say that they are still unknown today? No, it will not do to say that rent control and its many brothers and cousins are adopted out of ignorance of their effects.

Indeed, if such policies were adopted in ignorance of their effects, we would be hard put to explain their form as well as their duration. If rent ceiling laws were not anticipated to have the effects they do have, many of their aspects would be mysterious. If it were not expected that landlords would seek to escape the controls—that is, if the elasticity of supply of rental housing were really thought to be insignificant—then the laws would not include controls over conversions and demolitions. If the chilling effect of rent controls on new construction had not been anticipated, the promise —however badly kept—to leave uncontrolled the rents of premises built thereafter would not have been made. If queuing had not been expected, rent control laws would have paid little attention to the rights of tenants to sublease controlled properties.

I believe that if we look at any important economic policy of the state, we shall find that it takes account of whatever established knowledge economists possess, and perhaps of some that we do not yet possess. The theory of price discrimination, for example, emphasizes the possibility of profiting from differences among buyers in the "intensity" of their demand for a product when they can be prevented from reselling to one another. This theory is fully recognized in the regulation of the structure of public utility prices. Indeed, we may turn the situation around and assert that legislation we economists usually dislike is capable of teaching us economics. I conjecture, for example, that the early applications of a minimum wage policy are to classes of workers most substitutable for the workers whose unions achieve such laws, and only gradually is the law extended to workers with lesser substitution capabilities, or to closely substitutable workers with less political influence.

On this interpretation, economists have no great difficulty in getting their solid new findings adopted. That part of the thesis I am recanting need not be withdrawn or qualified.

The Presence of Other Values

And now I come to the error of my ways, and indeed of economists' ways generally. We expect the society eventually to believe our case for free trade and our case against minimum wages and our case for free energy prices and our case against rent controls. Every one of these recommendations is based on a tolerably accurate analysis of the effects of the policies on aggregate social income. Yet the community often pursues very different economic policies. How can I still say that society accepts all the truly reliable findings of economics?

If "the society" (that is, the government) wishes to give more income to a class—say, tenants or farmers or steel producers or teamsters—than the free market will afford, it seeks to contrive a policy that will accommodate that goal. There are numerous other goals of the state, such as the moral improvement of the society's members, and they are implemented with instruments such as tax exemption for certain activities and legal prohibition for others. These supplementary goals are unimportant in our society compared with income redistribution, however, and I put them aside here.

Goals of income redistribution, it should be pointed out, are not simply derived from some widely accepted ethic such as the moral value of redistributing income more equally, although there may be some of that in fact and certainly a great deal in rhetoric. The beneficiaries of income redistributions in a modern state include an unbelievably varied assortment of groups: oil millionaires, large banks, the elderly, families without male heads, airline pilots, Harvard professors, government employees, city land owners, and beekeepers. The losers include automobile drivers, small bank depositors, young workers, owners of television sets, landlords, non-minority students and employers, Grumman stockholders, and owners of some California coastal lands. Whether any specific person gains or loses on balance by the sum total of all the redistributive measures that affect him is a question whose accurate answer would require perhaps several billion dollars of economic research. (In a time of less overwhelming concern with deficits I would of course propose such a research program.) Clearly on average we lose since there is no redistributive policy that simply transfers income: each imposes deadweight losses—costs without any corresponding benefits—because of the need to collect and disburse money and even more because of the efforts of buyers and sellers of goods to get around the policy.

Quite evidently this immense smorgasbord of redistributive policies bears hardly any relationship to simple compassion for the poor or envy of the rich, since there are dozens upon dozens of policies that injure the poor and just as many that help the well-to-do. The political system responds to groups who can organize and raise funds to influence the politicians by votes and campaign contributions. We need not go into the precise factors that determine whether any particular group will have much, little, or no political clout, which is a good thing for me since we still know very little of the answer. The facts that there are literally hundreds of political groups at various levels of government, that they vary greatly in political strength, and that this strength is not at all closely related to one's place on the income ladder—these facts are enough to show that political life displays a set of preferences for income distribution that fits no simple ethical or political theory.

Any thinking person surely disapproves of many of the redistributions engaged in by even the most democratic of societies, and economists are singularly united in their disapproval of many of them. (One is entitled to suspect that a person's disapproval is related to his circumstances: economists believe that federal support of their research is more desirable than federal support of industrial research.) The disapproval of the economists, however, is uninformed.

It is uninformed with respect to the reason that the disapproved policies are adopted—uninformed with respect to what the operative political desires of the community are. Clever economists have displayed an obtuseness in this matter that is difficult to believe. They will say, not year after year but generation after generation: "Parliament, do you not realize that free trade would increase the national income?" As if the Parliament did not know this! At their most sophisticated, these economists have added: "If you must aid farmers or whomever, tax a portion of the larger income obtained with free trade and give the revenue directly to the people the tariff was intended to help." As if they had studied the comparative efficiency of subsidizing a given group by tariffs as compared with general taxes and selective subsidies.

The true account, then, is that the economists refused to listen to the society, not that the society refused to listen to the economists. What the economists had to say that was relevant was heard and acted upon, but the society insisted also on taking into account the realities of a political process which the economists persisted in viewing as an all-powerful God who shared their preoccupation with efficiency. Nature was not stupid because it required so long for some of its methods to be disclosed to physicists, and society is not stupid because social scientists have been slow learners.

I explain the disregard of economists' policy advice by the fact that society pursues other values, income redistribution in particular. And I find the traditional explanation given by economists—that society does not comprehend the theories on which our evidence is based—to be unsatisfactory because it fails to account for the efforts that are made to achieve precisely the effects we deplore. No one could support the thesis that societies make no mistakes, especially in a magazine published in Washington, D.C., the center of the mistake industry. But to explain something by saying that it is a mistake is on the same level as explaining it by pointing to invisible spirits.

Reflections on a Chicago Credo

The Chicago economists have nourished as far back as I can remember a credo: people act efficiently in their own interests. The people who make automobiles on average know better what to make and how to make it than the best industrial economists. The worker who chooses an education and a craft on average knows better how to choose than the best labor economist. The householder who buys a consumer good on average knows better what and where to buy than the best home economist.

This is not to say that the economic world is perfect—although it really is pretty impressive—or that its imperfections can never be discovered by an economist—although I am hard put to find an example. The credo does assert, however, that economic agents learn all the presently knowable things it pays them to know—always on average—and act with due regard for this knowledge. The credo asserts that nothing is easier than for an economist to be wiser in 1982 than the American automobile industry was in 1972, but no economist in 1982 is so wise as the automobile industry in 1982 or even in 1981.

Not only is this credo not owned by Chicago economists, but it was not even invented by them. Indeed it is the cornerstone of Smith's *Wealth of Nations.* Recall Smith's observation:

> The statesman, who should attempt to direct private people in what manner they ought to employ their capitals, would not only load himself with a most unnecessary attention, but assume an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it.

He would have been no kinder to presumptuous professors. The credo was given an elegant and powerful formulation in Friedrich von Hayek's famous essay, "The Use of Knowledge in Society." The basis of the credo is simply the fact than an economic actor on average knows better the environment in which he is acting and the probable consequences of his actions than an outsider, no matter how clever the outsider may be. I attribute the credo to Chicago only because that is where I learned it.

Whatever its proper name, the credo is often ignored by others. That professional reformer, Galbraith, has found time in his active life to instruct Detroit in the design of automobiles and Peoria in the correct amount of municipal services. An equally busy man, Irving Kristol, has been seeking to mend the public manners of corporations for years. At one point in the Nixon regime the leading economists of the administration were advising the public to fight inflation by eating cheese instead of meat, perhaps the most exotic monetary policy of recent times.

Even our acceptance of the credo in Chicago has been selective. We have ridiculed the advice an economist gives to a businessman about running his business but have been quick to tell this same businessman how he should deal with public policies. The businessman is the best arbiter of whether to build a new plant to produce a new product, but—lacking as he does a Ph.D. in economics—he is less qualified to determine the effects of tariffs or the efficient methods of reducing environmental damage.

The inconsistency is evident. If the businessman will spend a dollar to get a dollar or more worth of information about affairs as complex as labor strife and new and untested technologies, why does he not do the same with respect to public policies which strongly affect him? A similar question can be asked of the worker or the investor or the consumer. A good many public policies will have consequences for the economic actor easier to estimate than the consequences of more narrowly economic decisions. It is easier to estimate the major effects of a rent control program, I suspect, than the consequences of an investment in a foreign country.

There is of course a conventional response: knowledge of particular public policy proposals cannot sensibly be collected by any one person or company, because the costs are usually too large relative to any one person's benefits. Hence there is underinvestment in knowledge of this sort. The argument does operate strongly to weaken the role of individual consumers in policy formation, although there are some defenses against ignorance, even for consumers (including professors of economics).

one sided rent seeking

The argument does not fit businesses very well, for they have formed thousands of associations precisely to deal with this problem. It is interesting that no one has yet produced an inventory of cases in which businesses neglected proposed legislation or administrative decrees of large potential influence on their affairs.

So I plead for consistency—and that means generality—in the application of the credo. Consistency demands, or at least requests, that we should not ascribe incompetence in acquiring information on policy positions, or in acting upon it, blithely and almost routinely to the various economic agents. That attribution of amateurism in public policy is an obstacle to understanding how people behave.

Conclusion

The Chicago credo—the extension of the theory of rational behavior to all areas of man's behavior—has one immense and decisive attraction. It arms the student of life with a powerful and versatile theory which can produce suggestive hypotheses to tackle new problems, and it provides also the methods for studying these hypotheses. The ad hockery of special explanations and the easy recourse to exceptions that prove no rule are replaced by a tough logic.

The extension of this logic to political processes on a systematic and persistent basis is now only about twenty-five years old. This is of course the way in which I introduce the fact that the achievements of this approach are still meager, and the known unfilled tasks are manifold. I do not feel apologetic for the modest achievements, for we have still been a good deal more successful in dealing with political events than the previous centuries of study by economists.

The credo has one substantial, but not wholly offsetting, disadvantage. Curiosity about a vice in the world and self-examination of the motives for mounting an attack against it are no sources of strength to a reformer. Worse yet, the message of a reformer who adopts the Chicago credo loses a good deal of its appeal. He can no longer say:

> We know beyond reasonable doubt that free trade is good for the nation: let me explain the fallacies of protectionism and then I shall estimate for you the rise in our nation's income if we move to free trade.

Instead he must say:

> Will you supporters of protective tariffs and quotas please stop pursuing your own welfare, as you have been doing with insight and success? Become altruistic and abandon your trade barriers, and if we can also persuade the many other groups who have been feathering their nests to abandon those nests, it is probable that you will actually benefit from your altruism, and surely recoup at least a part of your losses.

Constitution to cont[illegible] rent se[illegible] (budget (rules)

It is indeed possible to advise people to stop being sensible, but it takes unusual skills to do it well.

Let me close on a truly old-fashioned note. I have raised doubts about the nature and role of economic reformers. They are not serious doubts, because I must assume that these reformers are employed by sensible, informed people, and they must be providing useful services. In any event, I have no doubts about the importance of increases in our understanding of the economic system. Ancient faith joins the Chicago credo in saying that everyone will respect and use genuine scientific knowledge, and the society will be the better for every truth conquered or error vanquished. ■