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The Political Limits of Economics

Question

- Doctors follow their patients' wishes, no matter the consequences
- Why economists do not do the same when it comes to policy?
- Why do we ten to insert our preferences in policy work, when our discipline says that consumers/voters know what is best for them?

Political Failures

1. Gruber model:
   - Voters are stupid. We need to deceive them for their own good
2. Blinder (1997) model:
   - Politicians are myopic
   - We have left "too many policy decisions in the realm of politics and too few in the realm of technocracy."
3. Time inconsistency model:
   - Voters cannot be relied to punish inconsistent politicians
   - We need a commitment mechanism
   - Let's make them as hidden as possible for the benefit of the voters
   - Prodi: "I am sure the euro will oblige us to introduce a new set of economic policy instruments. It is politically impossible to propose that now. But some day there will be a crisis and new instruments will be created."

4. Economic Inconsistency:

- Robinson-Patman Act introduced in 1936 and never abolished
- In the first two decades, the FTC brought 429 Robinson-Patman cases and issued 311 cease-and-desist orders. In the last two decades, it filed only one such case (Blair and DePasquale, 2014).
- Why?
    - Inconsistent with goal of Antitrust Law
    - Set by Congress?
    - No, decided by the economists

Nirvana Fallacy

- Some (if not all) the political failures described above can be real
- But is the cure better than the remedy?
- Not necessarily. We need to assess

1. Divergence of economist's preferences from those of voters
2. Inefficiency due to expert failures

1. Divergence of economist's preferences

- There appears to be both selection and treatment
  - Economists less pro-social
  - Focused only on efficiency and not on distribution
  - Economists agree among themselves most in the topics most covered in the economic literature. Yet, these are the topics on which their opinions differ most from those of average Americans.
  - For example, 95% of economists believe that "on average, citizens of the U.S. have been better off with the North American Free Trade Agreement" vs. only 46% of Americans.
  - Similarly, only 12% of economists think that "Buy American" may have a positive impact on manufacturing employment vs 76% of average Americans (Sapienza and Zingales (2013)).

Not Due To Information

- "A tax on gasoline would be a less expensive way to reduce CO2 emissions than mandatory standards for cars"
  - Economic experts 93% in favors Americans 23%
  - If you provide to average Americans the expert opinion, the answer does not change
  - "the government promises that the additional burden imposed on you by a gasoline tax would be compensated by a reduction in other taxes you pay."
  - Only 17% changed their minds.
  - Asked to explain why not, 51% says that they do not trust the government to actually rebate the extra tax revenues and 14% that they do not trust experts

2. Economic Experts' Failures

- From eugenics to the Bay of Pigs, from Chernobyl to economic development policy, history is littered with disastrous failures produced by the most famous experts (Koppl, 2018).
- Two main causes:

i) Economists' Capture:

  - Economists can be captured exactly as regulators (Zingales, 2014)

- Conscious capture: as regulators who tilt their decisions to favor their future employers
- Subconscious: when only economists holding certain beliefs are chosen for certain jobs.

2. Economists' Groupthink

- Janis (1972): a psychological phenomenon that occurs within a group where the desire for conformity results in a dysfunctional decision-making outcome (Bay of Pigs)
- Sense of superiority fosters groupthink, especially when a group feels threatened from the outside.
- Entertaining a critical hypothesis is seen as betrayal of the group and punished with ostracism.
- The result is excessive conformism, especially on those ideas that are very far away from those of the rest of the population.
- Consistent with what Sapienza and Zingales (2013) find

Potential Remedies

1. How to delegate decision authority power to economic experts so as to minimize these problems

- Tucker (2018): five delegation principles for expert agencies:
  - i) a clear purpose;
  - ii) clear procedures;
  - iii) clear operating principles;
  - iv) sufficient transparency/accountability;
  - v) a clear mechanism to limit experts' power in emergency situations

2. What we economists can do, inside our profession, to reduce the risk of preference distortions and groupthink:

I. Re-embed economics into social sciences

I. Political-Economy Welfare Analysis

I. Re-embed economics into social sciences

i) Historicize economics

- Antitrust example

ii) Sociologize economics

- Euro example

III) Politicize economics

- Academic lobbying example

II. Political Economy Welfare Analysis

- Political Economy has mainly focused on positive, not normative, analysis.
- A similar effort should be made to incorporate political science into our economic welfare analysis.
- Rather than using political failures to justify arbitrary economic interventions, we should incorporate the very frictions present in the political process to conduct a feasible welfare analysis.
- The idea can be best illustrated with an example.

- Assume that
  - each person's marginal utility of income is very high up to a minimum income level and then constant
  - the social welfare function assigns equal weight to all individuals.
- Absent any friction in the political process, this welfare function is maximized by

1. Maximizing GDP
2. Reallocating income in favor of those who earn below the minimum income level.

Let us now introduce a realistic friction in the redistribution process

- If there are a few billionaires and a large mass of unemployed people, the cost of redistribution would be very concentrated, while the benefit diffuse (Olson, 1965), making the redistribution more difficult (let us say for simplicity, impossible).
- Then, the separation between production efficiency and distribution falls apart; so will many of the standard economic predictions.
- In this context, a law like the Robinson-Patman Act can be an effective way to ensure a minimum income, without needing a massive fiscal redistribution.

Conclusions

- Marshall transformed political economy into economics
- Large set of useful results, but lost interest for distributional aspects which are very crucial in a democracy
- By keep ignoring the distributional aspects we run the risk of becoming
    1. at best useful idiots
    2. at worst the mouth piece of vested interest
- We need to
    1. become aware of this risk
    2. bring distributional issues full front in our discipline