What Do Academic Economists Contribute?

Daniel B. Klein

Rather than taking a stand on policy issues, contemporary academic economists have become preoccupied with model building and statistical significance.

The practice of serious medicine is the province of the doctor, just as the practice of architectural safety is the province of the engineer, and food safety the province of chemists and pharmacologists. For new and important decisions in these fields, the practitioner is the trained expert. In political economy, however, important decisions are made not by trained experts, but by government officials and ordinary voters—Everyman (which of course includes every woman). Unlike an individual making his own medical decisions, citizens and public officials decide public policy through collective processes.

Politicians must worry about meeting the approval of voters, not of economists. Because Everyman, when he votes, neither expects his vote to make a difference nor anticipates bearing any unfortunate consequences, he has little incentive to know better about public issues. He often remains in 'rational ignorance' and practices political economy rashly, ignorantly and incompetently.

Not knowing better, Everyman often shoots himself in the foot by building government housing, monopolising letter delivery, subsidising agriculture, restricting imports or pharmaceuticals, and imposing licensing requirements and price controls. Foolishness may be avoided by economic enlightenment. Well-intentioned policies usually have hard-to-see drawbacks which economists can and should illuminate.

Popular spending policies serve society poorly. They lead to operations that no one owns or takes a long-term interest in. Government investment also means the displacing of other, probably more useful investment. Imposing occupational licensing means restricting the supply of services, raising the price, and preventing poor people from entering the occupation and getting a foothold on the economic ladder. Restricting pharmaceuticals in the name of safety means denying patients drugs they need and discouraging drug development and innovation. Imposing a minimum wage law means stripping unskilled workers of their chief means of competing against higher-skilled workers and machines. Economists can lessen the not-worth-knowing-better problem if they engage Everyman in rational debate about the full consequences of populist action by pointing out such hard-to-see drawbacks.

The problem with economists

The trouble is that few academic economists fulfil this important educational role. People used to complain that ten economists got you eleven opinions (Keynes had two). Those were the good old days. Today, at our universities, ten economists might not even get you one opinion on world issues.

In academia, few economists take policy positions and engage in intellectual challenges. Few do scholarly work relevant to policy. Few even have opinions they are prepared to defend in serious debate. Academic economists belong to a careerist club, and the club has official ways of performing. Only by excelling in the ways of the club does an economist survive and prosper. But club performance doesn't contribute much to society. It is narrow, rigid and artificial. In purporting to address a policy issue, all features of the real world that cannot be incorporated successfully in a formal model or statistical investigation are ignored or assumed away. The club may

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be able to address many aspects, but each only in isolation, leaving us with a fractured series of pedantic twirls. Club performance does not—and cannot—generate overall understanding of an issue.

Club members have two official ways of performing.

The more exalted is model building. Mathematical functions are called 'consumers', 'producers', etc., in a toy economy. Like solving a puzzle the model builder solves for an 'equilibrium', which is treated as the conclusion of the story. Of the many particulars of human institutions, only one or two can be modelled at a time. Ignorance is hidden in 'dummy variables'.

The other genre of performing is finding statistical significance. If data exist or can be created, economists hunt for patterns in the data hoping to show a statistical result that is too improbable to be the result of mere chance, hence supporting an hypothesis laid out.

Model building is a craft circle in which artisans evaluate each other's work using money ultimately from sources (taxpayers, foundations, university students and donors) that know nothing and care nothing about such crafts.

Both model building and statistical significance are formalistic. Club performance tends to focus on technique rather than subject matter. Model building goes by the code word 'theory', yet many models make no reference to real world happenings. Pointless work of this kind appears in *Econometrica*, *The Journal of Economic Theory* and the *Economic Record*. 'Theory of what?', one wonders. Despite lacking connection to real issues, the official prestige of such journals is high. For the most part, model building is a craft circle in which artisans evaluate each other's work using money ultimately from sources (taxpayers, foundations, university students and donors) that know nothing and care nothing about such crafts. Outside the circle, the crafts have no value.

Though important as a basic method of studying the world, statistical significance as practiced also tends toward irrelevance. Teasing statistical results is a sort of accomplishment. But rarely are those results placed into a broader body of argument on a policy issue. If attempted, the fancy statistics are usually not the persuasive part of the argument. Very often, simpler forms of evidence and reasoning are much more believable. But the simpler forms don't qualify as club performance.

Academic selfhood

Naturally, academic economists crave academic rank and prestige, which translate into nice tenured positions, easy grant money, and influence over graduate students and the profession. As in most walks of life, material benefits intertwine with ego benefits. The academic world needs standards for ranking economists and their research. Modelling and the chase for statistical significance now dominate.

Most economists, after studying the oddities and particularities of public policy, could provide the basics and fundamentals that Everyman needs, as adapted to the policy context. But in doing so economists may not show themselves to be exceptionally smart or clever. Writing policy studies or nonacademic articles is disparaged by the club as 'advocacy', 'popularisation' and 'nonscience'. In academia, really participating in public discourse often counts against you.

Everyman is like the drunk looking for his lost keys under a lamppost because the light is better there. The academic economist, though often knowing very well where the keys are, gives no assistance. Instead, economists perform for each other. In doing so, club economists only *pretend* to engage in policy discourse, like a mime pretending to catch fish. But with the economist, the pretence is not understood for what it is. At an academic performance, if anyone had the temerity to explain all the important ways in which the model builder failed to represent reality, club officials would close ranks and expel so insolent a person.

The 'market test'

One can walk into city bookshops and find certain scholarly quarterlies. But it is ridiculous to imagine finding the academically prestigious economics journals, such as the *American Economic Review*, the *Journal of Political Economy* or the *Economic Record* in any good bookshop. When economists put themselves to 'the market test', the markets consulted should be ones in which the fundamental practitioners of political economy play some role, at least indirectly.

One might argue that the current emphasis in academic economics on abstract high-tech discourse does ultimately result in better public understanding. Economic understanding depends at its highest reaches on the top departments and the most austere journals, and by a wise and delicate process this learning filters down to policy makers and Everyman. Perhaps. But I have often wondered how economists can spend so much time studying the failures of markets, governments, and other institutions, yet place so much faith in their own institutions. And it is a *faith*: Where's the model?! Where's the data?! Or any of the other forms of argument?

For understanding, we should look instead to the 'public choice' economists, who explain politics by self-interest.

The barren tendencies of the profession have been defied and criticised by some great postwar economists: Friedrich Hayek, Ronald Coase, William H. Hutt, Thomas Schelling, Albert Hirschman, James Buchanan, Gordon Tullock, Israel Kirzner, Peter Bauer, Leland Yeager and Deirdre McCloskey. Many of them have argued that the reasoning and evidence with the greatest *oomph* are very low tech. Indeed, their writings, like Adam Smith's, can be read and understood by nonspecialists.

Missed wisdom

Not only does Everyman miss out, but by removing himself from public discourse, the academic economist fails to learn how policy and markets really work. Focusing exclusively on technical schemes, economists have blinded themselves to certain broad realities that do not fit in.

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Many of the economists who graduated from 'top' schools have never learned the really important basics of economics. Such basics might be expressed as follows:

(a) Real conditions and opportunities are highly particularistic and in ceaseless evolutionary flux.

(b) Knowledge of fleeting opportunities—in so far as the opportunities are known at all—must remain divided and disjoint among myriad participants in the economy; such knowledge cannot be meaningfully collected, summarised, modelled or mastered.

(c) It is therefore imperative to have social rules that engender wide experimentation of activities, motivate the fresh discovery of opportunity, give quick and clear feedback about the social desirability of the activity, and induce supple and speedy adaptation of activities in accordance with their effect on society.

(d) The rules that best meet these goals are rules that *fuse together the profit/loss mechanism* for social outcomes from activities *and authority* over the activities and resources involved—to wit, the rules of private property, freedom of consent and contract, and a thick-skinned tort doctrine. In other words, the free enterprise system.

As owners of our resources, including our person, we profit when we benefit others, because then others are willing to reward us for benefiting them. We suffer losses when we fail to benefit others, because then we do not receive payment to reimburse our efforts. In the free enterprise system, only by having voluntary trading partners—only by benefiting society—does one profit, and the profit motive has been fused, in ownership, with authority over the resources.

The free enterprise system does not, of course, work perfectly. But generally speaking it works far better than the alternative—government direction of economic activity. Regulators do not experience profit and loss in accordance with how well their regulations serve society. Tax-financed government enterprises do not depend on voluntary trading partners for their support. In government activities, the profit/loss feedback mechanism works, at best, poorly, and often perversely. In consequence, government activities do not adapt swiftly and appropriately to conditions and do not discover social opportunity.

This, in a nutshell, is the basic insight taught by Smith, Hayek and Coase. Yet, these basics are very poorly learned in universities because model building and statistical significance cannot deal effectively with static, particularistic conditions and disjoint knowledge. Only by assuming uniformity, stasis and common knowledge does the system of equations become tractable. Club economists have lost touch with the basics. They are in fact worse economists for having preoccupied themselves with meretricious concerns of academic rank.

Conclusion: a noble tradition

Really good economists sustain Adam Smith's role as freedom's stalwart. Many of the great postwar economists have combined a criticism of technical clubbiness with a deep appreciation of the basics and a will to illuminate for Everyman the comparative virtue of the free enterprise system. They are committed to keeping alive the great tradition of economics.

Meanwhile at the academies, economists carry on within their own closed world, giving each other jobs, grant monies, and hollow praise, pretending all the while that their model building and statistical trivia have a legitimacy that is independently grounded. ■