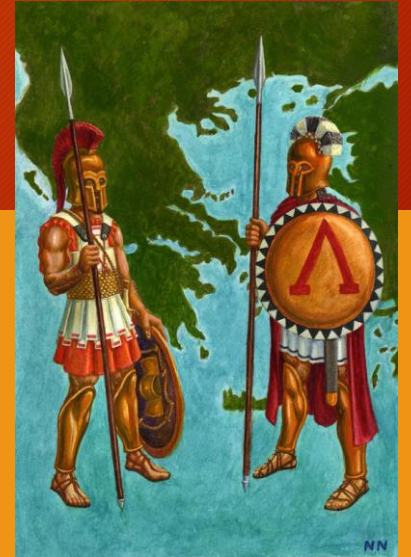


# ***The Lamppost Theory: Why Economic Policy So Often Comes Up Short***



Alan S. Blinder  
Brookings and Princeton  
June 20, 2017

# “Bibliographical” note

This talk is based on a book in progress (title tentative).

*“Politicians use economics in the same way that a drunk uses lampposts—for support rather than illumination.”*



# Outline



1. The two civilizations
2. Policy formulation: The four-ring circus
3. Impediments to sound economic policy
4. Case study: Monetary vs. fiscal policy

# The two civilizations



# The two civilizations



## Criterion

Logic

Language

Calculus

## Economic

Aristotelian

Logical, dry

Arithmetical

## Political

Political

Spin, vivid

Weighted by influence

# The two civilizations



Criterion

Logic

Language

Calculus

Selection principle

Incentives

**Economic**

Aristotelian

Logical, dry

Arithmetical

“IQ,” ideas

Max social welfare

**Political**

Political

Spin, vivid

Weighted by influence

People skills

Max election prospects

# The two civilizations



Criterion	Economic	Political
Logic	Aristotelian	Political
Language	Logical, dry	Spin, vivid
Calculus	Arithmetical	Weighted by influence
Selection principle	“IQ,” ideas	People skills
Incentives	Max social welfare	Max election prospects
Main concern	Efficiency	Fairness (distribution)
Main policy ingredient	Substance ( <i>is good</i> )	Politics, message ( <i>sounds good</i> )

# The two civilizations



Criterion	Economic	Political
Logic	Aristotelian	Political
Language	Logical, dry	Spin, vivid
Calculus	Arithmetical	Weighted by influence
Selection principle	“IQ,” ideas	People skills
Incentives	Max social welfare	Max election prospects
Main concern	Efficiency	Fairness (distribution)
Main policy ingredient	Substance ( <i>is good</i> )	Politics, message ( <i>sounds good</i> )
Time horizons	Long	Short



# The two civilizations



Criterion	Economic	Political
Logic	Aristotelian	Political
Language	Logical, dry	Spin, vivid
Calculus	Arithmetical	Weighted by influence
Selection principle	“IQ,” ideas	People skills
Incentives	Max social welfare	Max election prospects
Main concern	Efficiency	Fairness (distribution)
Main policy ingredient	Substance ( <i>is</i> good)	Politics, message ( <i>sounds</i> good)
Time horizons	Long	Short
In whose interest?	National interest	Narrow, special interests

*Theme:* If each side would learn some things from the other, we might get more illumination and better policy.



The “surprising” part, though of limited interest beyond economists, is that economists have a lot to learn from politicians.

# “Sausage making”: The four-ring circus



# The four-ring circus



- **Substance:** Economists dote on it, to the exclusion of all else.
  - **Politics:** Economists neither like nor understand it.
  - **Message:** Economists are poor at it.
  - **Process:** Economists ignore it (until they get in government).
- ↓
- **Policy:** *We have very little influence on it.*

# Politics

(\* denotes: places where academics can learn from politicians)



- Fairness (distribution) beats efficiency \*
- Unprincipled compromises beat pure solutions \*
- Narrow, parochial interest groups over the commonweal
- Sharply different time horizons
  - Equilibrium states vs. transitions \*

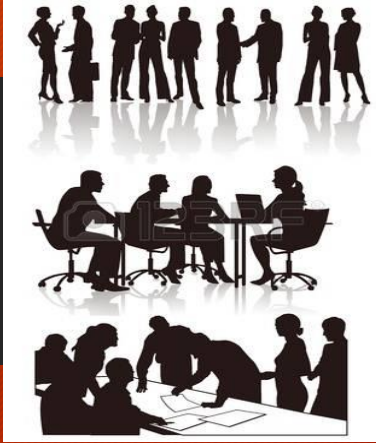
# Message

- What *sounds* good vs. what *is* good \*
- Complexity sells poorly (KISS principle) \*



# Process \*

- Academics ignore it and/or disdain it.
- But it matters.
- One reason: path dependence



Impediments to sound policy: The Three Is

“Ignorance, ideology, and interest groups”





# Ignorance



- It's rampant. Economic literacy is astonishingly low.
- There's little incentive for even smart politicians to (act like they) understand economics, if the voters don't.
- T-shirt (or baseball-cap) slogans sell better than complexity.
  - Example: "Protectionism saves jobs."
- The presidential bully pulpit can be used to *educate* or to *demagogue* and *confuse*.

# Ideology



- Dies hard
- Some examples:
  - Cutting the top marginal tax rate will speed up growth.
  - “Job-killing government spending”
  - Repealing Glass Steagall caused the financial crisis.
  - Financial markets are so efficient that government should keep hands off.
  - Carbon taxes (a) are “licenses to pollute” or (b) will kill growth.

# Interest groups vs. the common good



- Imaginary policy: +\$1,000,000 for 10 people; -\$2 for a 10 million people
  - *Note:* Trade restrictions and narrow tax breaks often have this character.
- Economic calculus: +\$10 million - \$20 million = -\$10 million
- Political calculus: The 10 million people won't pay attention; the 10 will.
- Besides, you can logroll a bunch of policies like this.
- But if you keep doing this....

Case in point: Monetary vs. fiscal policy



# Monetary policy



- The Federal Reserve's monetary policy has been pretty successful.
- That policy is made by a committee of technocrats, mostly economists.
- In practice, Congress does not interfere with monetary policy decisions.
  - In principle, it could. It could even abolish the Fed.
- But Congress sets the broad *goals*, defines (and limits) the FOMC's *powers*, and exercises *oversight*.
- Also, governors are presidential appointees, confirmed by the Senate.

# Fiscal policy



- It has had its moments, but on the whole: not very successful.
- Budgets never pass any more.
- The impact of the fiscal stance on aggregate demand is rarely even considered. (2009 was a notable exception.)
- The tax code is a disgraceful mess.
- Taxes never get reformed. (Last time was 1986!)

# A thought experiment (not more than that!)



- Imagine that rewriting the tax code was assigned to a bunch of technocratic experts—with instructions from Congress—and then brought back to Congress for an up-or-down vote.
  - Note: This is *less independence* than monetary policymakers have.
- Chances that we'd get a vastly better tax code: about 100%
- Chances that this will happen: about 0%
- Q: Does that make you think there's something wrong?