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

Alan S. Blinder
Brookings and Princeton
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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.”
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
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**Criterion**
- Logic
- Language
- Calculus
- Selection principle
- Incentives
- Main concern
- Main policy ingredient
- Time horizons

**Economic**
- Aristotelian
- Logical, dry
- Arithmetical
- “IQ,” ideas
- Max social welfare
- Efficiency
- Substance (is good)
- Long

**Political**
- Political
- Spin, vivid
- Weighted by influence
- People skills
- Max election prospects
- Fairness (distribution)
- Politics, message (sounds good)
- Short
## The two civilizations

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<td>National interest</td>
<td>Narrow, special interests</td>
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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 politicos.
“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 politicos)

• 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.
  o 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?