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Two Ideological Ships Passing in the Night

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Link to Abstract

When I was an undergraduate economics student at San Francisco State College from 1963 to 1965, several of my professors were people who had earned their Ph.D. degrees at UC Berkeley. During their lectures, they would sometimes make passing references to Milton Friedman. Although I did not understand why they broke into laughter after making such references, I surmised that this Friedman fellow must be some kind of economic quack or charlatan and that any reference to him or his ideas was intended to provide comic relief during a serious classroom presentation. None of my professors ever assigned any of Friedman's writings for students to read, and it never occurred to me to seek out such writings.

Later, when I was a graduate student at Johns Hopkins from 1966 to 1968, I found that Friedman's writings were treated with respect. Friedman's price theory text was one of the assigned books in the first micro course, along with James Henderson and Richard Quandt's text and other readings, and Friedman's articles on the demand for money and other topics were assigned in the macro courses. As I read these sources, I thought back to my undergraduate experience and wondered why my teachers at San Francisco State had treated Friedman as such a joke.

Later still, after I joined the economics faculty at the University of Washington in 1968, I encountered this professional split from the other side. At that time the dominant faction in the department at Washington consisted of Chicago Ph.D.s and others sympathetic to the Chicago School. These people viewed the superstars of the MIT–Harvard–Berkeley group at least as contemptuously as my undergraduate professors had viewed Friedman and his associates and disciples.

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By this time, I was beginning to gain an understanding of the social structure of the U.S. economics profession. For a while I gravitated toward membership in the Chicago–UCLA crowd, although I never became quite as dismissive as they were of the professionally dominant group led in those days by Paul Samuelson, Robert Solow, and other likeminded luminaries.

Having discovered F. A. Hayek's writings in the late 1960s, which led me in due course to the writings of Ludwig von Mises, Israel Kirzner, Murray Rothbard, and other members of the Austrian School, I gradually parted company with my Chicago-oriented views, at least in regard to the fundamental epistemological and methodological underpinnings of economics. From my new, more professionally estranged vantage point, I could see even more clearly what was going on in connection with the various frictions and disagreements between the two main competing factions in the mainstream economics profession.

So, at least forty years ago, perhaps under the influence of my Chicago School colleagues at Washington, I began to divide the mainstream profession crudely into a group whose members believe that "markets work" and an oft-opposing group whose members believe that "markets fail." From these broad default positions, many consequences arise in regard to how economists go about their work, interpret their findings, view the economy, and determine what government policies, if any, they should recommend to improve the economy's operation.

Of course, many, perhaps most, mainstream economists stand somewhere between these two groups, inclining sometimes toward the one and sometimes toward the other, depending on the particular issue at hand. In my comments here, I confine my attention to the two groups I've identified, in part because of space constraints and in part because these two groups have had, and continue to have, highly disproportionate influence in the profession.

Markets-fail economists have been trained for the most part in graduate programs that place heavy emphasis on the construction of formal mathematical models. In such models, the conditions for equilibrium and stability are precise and well defined. So, if the economist constructs a model subject to stipulated assumptions and the model's solution displays inefficiency or other suboptimality, he has thereby shown that such theoretical "market failure" is *possible* in the real world to the extent that the model adequately represents actual conditions. Now, the map is never identical to the territory, and therefore a skeptic might be inclined to dismiss such a showing of possible market failure on the grounds that the model does not in fact capture all relevant aspects of how real-world markets operate or take into account all the factors that enter into their operation. But markets-fail economists, perhaps because they invest so much of their time, intelligence, and identity in model building itself, are more inclined than others to take seriously the idea that the model does adequately capture the workings of real markets and hence that if one can build a model in which market failure arises, one has *ipso facto* shown that such failures occur in reality. It's as if the working mantra were: whatever *can* go wrong (in the model) *does* go wrong (in the real world).

Markets-work economists have been trained for the most part in graduate programs that place less emphasis on the construction of formal mathematical models. Hence they generally regard such formal showings of market failure as suggestive at best and wholly worthless and misleading at worst. Members of this group make less precise demands on the real world. They believe that because formal models cannot capture every aspect of how real markets work or take into account everything that enters into their operation, it is inevitable that real-world conditions will always diverge from strict satisfaction of formal-model conditions for optimality; that is, given the nature of the formal models, "market failure" in the real world is effectively preordained. However, in their view, such divergences condemn the actual markets less than they condemn the models—or at least the insistence that policy makers should try to force real markets into conformity with the conditions required for optimality in a formal model. For this group of economists, models are worthwhile for the insights they allow economists to gain into aspects of how real markets operate, but such models, by themselves, can never justify policies by which the government purports to intervene in real markets in order to bring about an actual correspondence between a model's efficiency requirements (e.g., price equals social marginal cost [whatever that might mean], general equilibrium throughout the entire economy, no uncompensated external effects, etc.) and the conditions prevailing in the real world.

Thus, markets-fail economists put more stock in blackboard models as such than do markets-work economists. Indeed, notwithstanding their avowed commitment to Friedmanesque standards of empirical testing, markets-work economists, when they encounter a finding of market failure in an empirical test, are inclined to think that something must be wrong with the data or that something must have been faulty in the test setup or its implementation. Whereas markets-fail economists jump readily from the blackboard to proposals for actions by the administration, Congress, or a regulatory agency, markets-work economists are far more hesitant to make this leap, and they give serious thought to the possibility that even if the theoretical market-failure is manifest in the real world, the government's intrusion into the market process may still do more harm than good. Although markets-fail economists have gradually been compelled to recognize at least the possibility of "government failure," they tend to place little weight on it and often ignore it entirely.

Differences between these two groups of economists, however, are not entirely the product of differing degrees of devotion to formal model building. Their differences also spring from differences in the default conception they bring with them when they undertake their work. They differ in what Joseph Schumpeter called "preanalytic cognitive acts" or "vision." Moreover, as Schumpeter observed, ideology "enters on the very ground floor, into the preanalytic cognitive act… the way in which we see things can hardly be distinguished from the way in which we wish to see them" (Schumpeter 1954, 42). One expects, therefore, that an over-arching ideological coherence will apply within each of the groups. Markets-fail economists tend to be more aligned with socialist or social-democratic political programs; more inclined to trust government officials and regulators to act in the general public interest; more skeptical that private actors in general and business people in particular can or will bring about socially desirable outcomes; and more inclined to see private actors as ignorant, irrational, and incapable to acting in socially responsible ways. Markets-work economists, in contrast, tend to be more aligned with conservative political programs; less inclined to trust government officials to do anything well, aside from lining their own pockets and those of their key supporters; and more inclined to view private actors in general as sufficiently rational and informed to serve their own interests better than anyone else—not to mention that private actors are often highly inventive and innovative when left to themselves, even in devising ways to remedy problems that markets-fail economists attribute to imperfections in the market order. Markets-work economists have been much more inclined to take Public Choice analysis seriously and to contribute to this field of study. In contrast, markets-fail economists tend to contribute disproportionately to Social Choice Theory and to Public Economics, where a presumption that government intervention is (or at least might be) desirable holds greater sway.

One sees, therefore, that methodological and ideological differences merge naturally into differences in personal-cum-professional identities. (On the critical connection between ideology and identity, see Higgs 1987, 42-43.) Such differences impede an analytical meeting of the minds between members of the two groups because on each side the practitioners look with some suspicion on members of the opposing group, viewing them as "not my kind of folks." Institutional affiliations reinforce and perpetuate such distinctions in the profession, as friends, colleagues, and fellow travelers tend to promote the professional activities and achievements of like-minded others. It is not a coincidence that the same names keep appearing year after year on the program for the AEA meetings; indeed, the same person's name often appears there more than once in a given year. Although these individuals may be well qualified to present their work at such a prominent conference, it is difficult to dismiss entirely the hypothesis that an element of "who you know" also plays a role. Similar factors affect the submission of grant proposals to the National Science Foundation and other research support institutions, as well as the likelihood that one's proposal will be favorably reviewed and selected to receive support.

If one believes that markets tend to fail, one is more likely to support not only regulation of the particular markets perceived as failing, but also interventions aimed at altering the personal distributions of income and wealth, which are seen as the ultimate outcomes of the entire aggregate of "imperfect" markets. So the associations documented by Daniel Klein (2015) and others are exactly what we would expect to find—indeed, what many of us have found already, albeit by less systematic observations and by personal experience.

The irony is that the income and wealth distributions viewed as justifying welfare-state intervention are in many cases the end products not simply of an aggregation of imperfect markets, but also of countless government interventions (e.g., minimum-wage laws, occupational licensing requirements, crony-capitalist subsidies and bailouts, and product bans, taxes, and business restrictions that inhibit the formation and success of small firms). Whereas economists in the markets-fail group see an obvious need for welfare-state measures to "correct" the distributions of income and wealth that markets have produced, those in the markets-work group see an equally obvious need to remove the government intrusions that have done much to generate a perceived need for the welfare state in the first place. Here, once again, the differences between the groups have a great deal to do with how their members conceive in general of the government vis-à-vis private-sector actors. Which is to say, once again we see reflections of ideological differences that play themselves out in a variety of ways within the mainstream economics profession.

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