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From Friedman to Wittman: The Transformation of Chicago Political Economy

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A COMMENT ON: DONALD WITTMAN. 1989. WHY DEMOCRACIES PRODUCE EFFICIENT RESULTS. *THE JOURNAL OF POLITICAL ECONOMY* 97(6): 1395-1424.

Abstract, Keywords, JEL Codes

WITTMAN'S AMAZING HIT[1]

Donald Wittman's "Why Democracies Produce Efficient Results" (1989) should be the envy of every heterodox economist. It has virtually no math; it has no econometrics; and it boldly tackles one of the biggest of the Big Questions—the relative merits of democracy versus the market. With these three strikes against it, it still appeared as a full-length article in the ultra-prestigious *Journal of Political Economy* in the not-so-distant year of 1989. Wittman's accomplishment is all the more impressive considering that he is not an elder statesman of economics. Top journals occasionally provide a

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Steve Miller provided excellent research assistance. The standard disclaimer applies.
[1] The thrust of this comment is critical, so let me affirm at the outset that few articles have been more worthy of *The Journal of Political Economy* than "Why Democracies Produce Efficient Results." Wittman's article is immune to most of the standard complaints—irrelevant, derivative, mere showing-off—about the contents of the top journals. Even though I reject many of his answers, the questions Wittman raises about political economy are profound.

soap box for actual and prospective Nobel prize-winners to share their wisdom in plain English, but only toward the end of a long career of conventional research. Wittman's piece was published on its merits, not as a Lifetime Achievement Award.

In the debate over markets versus democracy, there are four logically possible positions (Table 1). The first is "Markets Fail, Democracy Works," widely held by social democrats like Galbraith.[2] The second is "Markets Work, Democracy Fails," the stereotypical view of the Friedman-era Chicago economist. The third is the "Markets Fail, Democracy Fails," stance of totalitarian thinkers like Lenin. The last is "Markets Work, Democracy Works." Though this final position has had few proponents, Wittman defends it as the most consistent with the economic way of thinking.

Table 1: Markets and Democracy

		Democracy	
		Works	Fails
Markets	Work	Wittman	Friedman
	Fail	Galbraith	Lenin

A cynic might respond "It depends on the meaning of 'works' and 'fails,'" and Wittman feeds this suspicion at several points by invoking the toothless textbook standard of Pareto efficiency. A state of affairs is Pareto efficient if and only if it is impossible to make one person better off without making another person worse off. Given human heterogeneity and transactions costs, though, virtually every state of affairs meets the Pareto standard. *The Myth of Democratic Failure* (1995), Wittman's book-length case for democratic efficiency, clears up this ambiguity. His defense of democracy is substantive, not semantic.

[2] This is the one combination that Wittman does not specifically mention (1989, 1395-6) — strange given its popularity in the social sciences.

> In this book, I use the words *efficiency*, *Pareto optimality*, and *wealth maximization* interchangeably, but I always mean them in the strong sense of wealth maximization. I do not argue that voters are poorly informed and politicians shirk and that this is efficient because it would be too costly to have it otherwise; but rather I argue that voters are highly informed and there is little shirking. Nor do I argue that because any move is likely to make someone worse off, everything is efficient. (1995, 6)

How does Wittman defend his unusual position? It would be hard to answer more succinctly than he does.

> Behind every model of government failure is an assumption of extreme voter stupidity, serious lack of competition, or excessively high negotiation/transfer costs. Economists are very suspicious of similar assumptions regarding economic markets. This skepticism should be carried over to models of government behavior. (1989, 1421)

Notice that Wittman does not assert that economists who emphasize government failure *explicitly declare* that voters are extremely stupid, or politicians collude, or political transactions costs are unnaturally large. He insists only that they *need* at least one of the three to impugn the efficiency of government.

HOW TO THINK LIKE WITTMAN

Why is at least one of the three assumptions required? Given space limitations, I can only sketch Wittman's position, which he spells out in greatest detail in *The Myth of Democratic Failure* (1995).

"Extreme Voter Stupidity"

This phrase is tailored to get the following knee-jerk reaction from his intellectual opponents: "I do not assume that voters are 'stupid.' I assume that they are *ignorant*. There is a difference between stupidity and ignorance." But Wittman means what he says. "Ignorance" has a precise meaning in modern academic economics.[3] Formal models equate it with *random noise*. To capture workers' ignorance of inflation, for example, the standard technique is to assume that they observe inflation plus $\varepsilon \sim N(0,\sigma^2)$, i.e., a normally distributed error term with a mean of zero and a standard deviation of σ. If the mean error were not zero, then workers would by definition not have *rational expectations*, and would therefore be called *irrational* (or "stupid") rather than merely ignorant.[4] This is a vital distinction, because as long as the mean error is zero, the Law of Large Numbers implies that random errors tend to cancel each other out (Page and Shapiro 1992).

Critics of government routinely cite voter ignorance as the cause of wasteful spending, protectionism, and so on. Not so fast, says Wittman. This would make sense if voters *systematically underestimated* the level of waste or the harm of protectionism. But ignorance does not lead to systematic error.

> [T]o be uninformed about a policy does not imply that voters underestimate (or overestimate) its effects. For example, to be uninformed about the nature of pork barrel projects in other congressional districts does not mean that voters underestimate the effects of the pork barrel; it is quite possible that the uninformed exaggerate both the extent and the negative consequences of pork barrel projects. (1989, 1401)

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[3] Its definition in earlier, non-academic, and heterodox economic writing is admittedly less rigid. Depending on the economist and the forum, "ignorance" sometimes encompasses biased ways of thought, false interpretations, dogmatism, and so on. (Klein 1999)

[4] The rational expectations interpretation of "rationality" (Sheffrin 1996) is fairly standard in modern academic economics. Charles Rowley, one of Wittman's staunchest critics, largely agrees: "Wittman deploys thick rationality assumptions. Most, though not all, public choice scholars share this prejudice, not least because it facilitates empirical analysis." (1997, 17-8) For the sake of clarity, this paper always uses the rational expectations definitions of "ignorance" and "irrationality."

It makes no difference, Wittman adds, if voters' *sources* of information are biased. Rational actors do not take unverifiable statements by interested parties at face value. They discount, or adjust, for the trustworthiness of the source.

> I have never met anyone who believes that the Defense Department does not exaggerate the need for defense procurement. But if everyone knows that the Defense Department will exaggerate the importance of its contribution to human welfare, then, on average, voters will sufficiently discount Defense Department claims. (1989, 1401)

In other words, there is a difference between being *ignorant* and being *gullible*. If you are so ignorant that you cannot tell honest news from lies, the rational strategy is to ignore the talking heads and suspend judgment.[5]

Wittman adds that voters know a lot more than economists give them credit for. True, voters have little incentive to *gather* political information, but this in no way proves that voters *possess* little information. Other political actors—like politicians, journalists, and interest groups—have an incentive to take up the slack, to collect information for the voters and send it to them as a free gift. Moreover, the voters' problem is easier than it appears. They do not have to master the details of politics; they can rely on name brands (like partisan labels and interest group endorsements) as well as candidate reputation. Once you know that candidate X is a conservative Democrat, or a friend of the AFL-CIO, what is the "value-added" of combing through his voting record? (Popkin 1991; Lupia and McCubbins 1998)

"Serious Lack of Competition"

Most of the classic complaints about markets are wrong because they overlook the power of competition. Greed combined with monopoly means a bad deal for consumers. But if consumers have a choice, if they can transfer their patronage to another firm, greed impels you to treat them

[5] In fact, Wittman points out (1995, 107) that if voters realize that political insiders know more than they do about which policies are socially beneficial, it *reduces* the demand for government programs. Asymmetric information in politics, like asymmetric information in markets, makes equilibrium quantity go down, not up.

right. Admittedly, some economists dwell on the *number* of competing firms, but in Wittman's Chicago milieu[6] such misgivings have long been downplayed (Bork 1978). Even duopoly is often fiercely competitive.

If competition exerts such powerful discipline in markets, asks Wittman, how can it fail to do the same in politics? Whenever an economist claims that unpopular policies persist, he commits himself, perhaps unwittingly, to the view that elections are uncompetitive. Politicians are desperate to win, and those who take unpopular positions lose votes. The natural strategy for challengers, then, is to point out incumbents' unpopular policies and vow to reverse them. The natural defense for incumbents is to stick to popular policies, so rivals have little to work with when election season comes. As long as candidates play competitively, it is hard to see how unpopular policies can last.

Of course, you could concoct an elaborate story about how politicians collude to deprive the voters of real choices. Though logically possible, Wittman finds it far-fetched. "The ability to maintain such a cartel among so many people with so many possible entrants is unfathomable to a student of industrial organization." (1995, 24) Elections may look duopolistic, but only if you forget about all of the contenders who quit before the end, not to mention everyone who would have run if they thought they had a chance.

How does Wittman account for alleged symptoms of political monopoly like high reelection rates? His common-sense answer should resonate with any economist.

> Incumbents tend to be reelected for the same reason that the winner of the last footrace is likely to win the next one and the head of a corporation is likely to maintain his position tomorrow. They are the best. That is why they won in the first place and why they are likely to win again. (1995, 25)

[6] Wittman was an assistant professor of political science at University of Chicago from 1974-1976.

"Excessively High Negotiation/Transfer Costs"

Even if voters know the score and politicians vigorously compete, majority rule has built-in defects. You can get inefficient outcomes if median and mean preferences differ, if pressure groups lobby for special treatment, or if collective intransitivities lead to cycling. For Wittman, the flaw with all of these complaints is that they neglect the power of political bargaining. If one side has the votes it needs to impose an inefficient transfer, there is no need to go through with it. You can always bargain your way to something better.

Take the classic case of rent control, which transfers, say, $10,000 to tenants at the cost of $12,000 to landlords. If people vote selfishly, and tenants outnumber landlords, rent control looks like a sure winner. But there is a creative alternative. The tenants' representatives can say: "We have the votes to impose rent control, so you landlords are going to lose at least $10,000. But let's make a deal. We will drop our demand for rent control if you vote for a property tax hike of $11,000, which can in turn be redistributed back to tenants. Then both our sides are $1000 better off than under rent control."

The standard caveat for this Coasean analysis is that transactions costs stand in the way. But for Wittman, democracy is all about slashing transactions costs: "For example, majority rule instead of a unanimity rule prevents monopoly hold-outs, thereby reducing negotiation costs." (1989, 1402) Think how hard it would be to pass legislation if *all* the parties had to agree—as they must in a private contract. Wittman defends the committee system in Congress on similar grounds.

Public choice economists have often complained that governments fund thousands of inefficient programs. Individually, none is worth the transactions costs of abolition, but taken together, they are a large deadweight cost. As the quip goes, "A billion here, a billion there, pretty soon it adds up to real money."[7] The solution, according to Wittman, is an omnibus repeal bill. You can economize on transactions costs by bundling a lot of small inefficient programs together, and asking legislators to abolish the whole bundle. To his credit, Wittman emphasized this possibility years before post-Cold-War base closing legislation made it a reality.

[7] The Quotations Page attributes this quote to Senator Everett Dirksen. http://www.quotationspage.com/quote/170.html

WHERE WITTMAN GOES WRONG

Logic textbooks make a critical distinction between a *valid* argument and a *sound* argument.[8] In a valid argument, the conclusion follows from the assumptions. A sound argument is a valid argument *where all the assumptions are true*. The following argument is valid but not sound:

All men are immortal.
Socrates is a man.
Therefore, Socrates is immortal.

Most of Wittman's critics emphasize that his economic reasoning is largely *invalid*.[9] (Boudreaux 1996; Rowley 1997; Rowley and Vachris 1996) Rowley (1997, 17-18), for example, faults Wittman for ignoring the effects of rational ignorance, and goes on to argue that rationally ignorant voters are especially vulnerable to political propaganda. Rowley and Vachris (1996, 73) add that, due to asymmetric information, "political markets are biased toward policies that provide concentrated benefits to well-organized, small groups." Boudreaux's (1996, 117-8) critique of Wittman objects that even if voters are well-informed, policy bundling and infrequent elections make it very hard for politicians to figure out what voters want.

On balance, though, it is hard to fault Wittman's logic. He anticipates the arguments of Rowley (1997) and Rowley and Vachris (1996) about rational ignorance, pointing out (1995, 15-17, 107) that the *consequences* they ascribe to it do not follow. Wittman (1995, 181-2) does not specifically address Boudreaux's concerns about electoral "lumpiness." But Wittman would probably respond that Boudreaux underestimates the intelligence of the political entrepreneur. If it is hard to discern voter preferences from vote tallies, politicians can get a more nuanced reading from surveys and focus groups.[10]

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[8] See e.g. Copi and Cohen (1994: 61-6)

[9] Critics also unfortunately criticize Wittman for making assumptions he plainly rejects, such as that "all voters are fully informed" (Rowley 1997, 19) or even that people have "perfect information and an unlimited ability to understand and make use of such information." (Rowley 1997, 17)

[10] It is also worth mentioning that housing markets—and to a lesser extent all markets for durable goods—also suffer from the problems of bundling and infrequent decisions. If businesses can cope with these problems, why not politicians?

My defense of Wittman against his critics does not mean that I share his conclusion. My point, rather, is that the weakness of Wittman's position lies in his starting point, not his logic. His key arguments rest on a false assumption; though valid, they are not *sound*.[11]

Wittman convincingly demonstrates that democracy is efficient if (1) voters are rational, (2) elections are competitive, *and* (3) political transactions costs are fairly low. Furthermore, he makes a rather persuasive case, at least to my mind, for both (2) and (3). It is hard to observe a major election and conclude that the major candidates are *not* struggling to beat each other. And Wittman is clearly right that representative democracy is a much cheaper way for a quarter billion people to make group decisions than one big unanimous contract.[12]

Yet Wittman's democratic optimism has an Achilles heel: the assumption of voter rationality. Bear in mind that he uses "rationality" in the empirically falsifiable sense of rational expectations. (Wittman 1989, 1401-2) If voters make *systematic* mistakes, then they are *ipso facto* irrational. Several different empirical approaches confirm that they do. Not only are voters systematically biased, they have large biases on questions of direct policy relevance.

Comparing Average Beliefs to Known Facts

The simplest test of systematic bias is to take objective, quantifiable facts and compare them to voters' beliefs. If for example foreign aid is 1% of the federal budget, ask the public "What percentage of the federal budget

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[11] Wittman's other critics do occasionally question the soundness of his position, though only in Lott (1997) does this sort of objection predominate. Boudreaux (1996: 120-1) appeals to Brennan and Lomasky's (1993) expressive voting theory, which has important similarities to my account. Lott (1997: 7) argues that even if voters estimate the strength of relationships without bias, they may fail to consider the possibility that a relationship exists, giving public opinion a "bias towards zero." (Fremling and Lott 1996) Rowley (1997), Lott (1997), Rowley and Vachris (1996), and Boudreaux (1996) all argue that Wittman underestimates transaction costs. Rowley (1997:21-2) faults Wittman for "relying excessively on rational expectations," but makes few specific claims about what systematic biases voters have or how these biases lead to political failure.

[12] Most of Wittman's critics remark that "political property rights" are poorly defined and/or harder to exchange than ordinary property rights. But this just raises a deeper question: Why don't politicians increase their popularity by trying to solve this problem? If the answer is something like "Voters underestimate the benefits of codifying political property rights," the real problem is voter irrationality, not high transaction costs.

goes to foreign aid?" Then statistically test the hypothesis that the public's average answer equals 1%. If the average response of a representative sample is 10%, there is strong evidence that the public systematically overestimates government spending on foreign aid. Empirical work along these lines finds large systematic errors on important questions. For example, the National Survey of Public Knowledge of Welfare Reform and the Federal Budget (1995) reports that the public heavily overestimates the share of the federal budget devoted to welfare spending and especially foreign aid, and underestimates the share going to Social Security.

Comparing Average Beliefs to the Beliefs of the Most-Knowledgeable Segments of the Public

Comparing average beliefs to Known Facts is a good strategy for cut-and-dried questions, but what about questions that cannot be resolved using *The Statistical Abstract of the United States*? Political scientists such as Scott Althaus (2003) and Delli Carpini and Keeter (1996) handle this difficulty using the following technique:

1. Administer a test of objective political knowledge *combined with* a survey of policy preferences.
2. Estimate individuals' policy preferences as a function of their demographics and their objective political knowledge.
3. Simulate what policy preferences *would* look like if all members of all demographic groups had the *maximum* level of objective political knowledge.

The simulated policy preferences are often called the public's *enlightened preferences*; they are what the public would want if it knew a lot more about politics, and its other characteristics stayed the same.

If voters had rational expectations, the distribution of enlightened preferences would *match* the distribution of actual preferences. Empirically, they are not even close. Surveying a large literature, Althaus (2003, 102-33) reports that enlightened preferences are markedly more economically conservative and socially liberal—in a nutshell, more libertarian.[13] For

[13] It is less clear that enlightened preferences about foreign policy are more libertarian. As Althaus puts it, "[F]ully informed opinion on foreign policy issues is relatively more

example, the 1996 American National Election Studies has respondents choose between two positions: "One, we need a strong government to handle today's complex economic problems; or two, the free market can handle these problems without government becoming involved?" (Althaus 1996, 111) The actual break-down was 62/38 in favor of strong government, but estimated *enlightened* preferences were 15 percentage points more pro-market.

Comparing Average Beliefs to Average Expert Beliefs

We all share a (defeasible) presumption that if laymen and experts disagree, the experts are right. This suggests one last approach to systematic bias: Compare the public's beliefs to those of experts. I employ this strategy in a series of papers on economic beliefs. My tests for systematic bias compare the beliefs of the general public to those of economics Ph.D.s[14] (Caplan 2002). Once again, there is strong evidence that the public's beliefs are systematically in error. Most notably, non-economists seriously under-estimate the social benefits of the market mechanism, especially for international and labor markets.

In a footnote, Wittman throws out an interesting challenge to his intellectual opponents.

> If voter misinformation were an important reason for poor policy choices, then we should be able to observe more informed voters making better policy choices. For example, college-educated people probably have more informed opinions. (1989, 1401)

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interventionist than surveyed opinion but slightly more dovish when it comes to the use and maintenance of military power." (2003, 129-30)

[14] The main objection to this approach is that the lay-expert belief gap may reflect not the experts' greater knowledge, but their self-serving bias or ideological bias. Economists have long been attacked as apologists for the rich and conservative ideologues. Fortunately, the data set I employ—the Survey of Americans and Economists on the Economy—contains enough control variables to test—and reject—these alternative explanations.

After briefly reviewing evidence on public opinion and a few kinds of spending, he dismisses this hypothesis. But Wittman casts his net too narrowly. Caplan (2001a) strongly confirms that education does indeed make people "think like economists." The large systematic beliefs gaps between economists and the public shrink substantially as non-economists' education level rises.

Economists from Adam Smith and Frederic Bastiat to Ludwig von Mises and Paul Krugman have lamented the public's systematically biased beliefs about economics. Most teachers of undergraduate economics—including (especially?) most public choice economists—take it for granted that students arrive with systematically biased beliefs, and try to correct them. Wittman discards this accumulated wisdom of the economics discipline without a second thought, and it turns out to be a rather rash decision. Economists' widespread if covert view that non-economists' beliefs about economics are systematically biased fares extremely well when tested against hard data.

Would systematic bias lead democracies to adopt inefficient policies? Wittman freely admits it: "A model that assumes that voters or consumers are constantly fooled and there are no entrepreneurs to clear up their confusion will, not surprisingly, predict that the decision-making process will lead to inefficient results." (1989, 1402) If my empirical results on economic beliefs are correct, for example, we should expect democracies to underuse and overregulate the market, especially international and labor markets.

After reflection, though, Wittman would probably want to take back the last quote. Maybe democracy selects efficient policies *even if* the public's policy beliefs are systematically biased. Retrospective voting is the most plausible mechanism. (Fiorina 1981) If voters re-elect incumbents when times are good and challengers when times are bad, then politicians pick policies that work, even if the public fails to see their rationale. In practice, though, this answer is underwhelming. The public plainly favors candidates who share its policy views. That is why candidates follow the polls so carefully, but pay little heed to evidence about whether popular policies actually work. Retrospective voting probably dilutes the damage of voter irrationality; that is why real-world environmental policies take cost into account despite the popularity of the sentiment that "You cannot put a price on Mother Earth." But even the best results will not save the career of a politician who pursues deeply unpopular policies—like the ones economists have been urging the world to adopt for centuries.[15]

At first glance, it may appear that my critique of Wittman is mild. I seriously challenge only one of his assumptions. But rejecting the assumption of voter rationality turns Wittman on his head; the "strengths" of democracy become its weaknesses. Take his reasonable position that democracy is highly competitive. With irrational voters, this could be very dangerous. Suppose that voters are avid protectionists. If politicians have ample political slack, free traders could still win public office and undermine the misguided will of the people. But if they face intense electoral pressure, politicians must, willy-nilly, give the people the tariffs and quotas they demand. My thesis is not that Wittman slightly overrates democracy because he neglects voter irrationality. Rather, I claim that Wittman greatly overrates democracy because voter irrationality makes the well-oiled machine of democracy run in reverse.

I suspect that many economists, including Wittman, *cannot believe* that the public is persistently wrong. Surely someone will come along and show the majority the error of its ways. As Wittman sarcastically suggests in a slightly different context, "But if their model is correct and even outsiders like Bendor, Taylor, and Van Gaalen know that bureaucrats are manipulative, then surely the president and Congress should also be aware of this bureaucratic strategy (if not, someone should send them a copy of the Bendor et al. article)." (1995: 99) But this assumes that the majority will listen. And why should it bother? People can go through life successfully even if their favorite policies would devastate the world. The devout Maoists of Berkeley, California live comfortable lives even though few would survive a replay of the Great Leap Forward and the Cultural Revolution. The moral: *Sensible public opinion is a public good.* In a democratic country, if most people favor foolish policies, the whole country suffers, including proponents of better ideas. Given these incentives, we should expect people to stick with the beliefs they have. It is the path of least resistance. The real surprise would be if voters kept trying to learn more about policy even though there is little in it for the individual.

[15] It is worth mentioning, moreover, that when politicians brag about their "results," they usually list the legislation they passed, and sidestep the question of whether their policies really worked. How many politicians have bragged about passing new gun legislation, without even trying to show that gun legislation reduces crime?

THE CHICAGO CONTRADICTION—
AND HOW TO RESOLVE IT

Wittman's thesis seems original primarily because he defends it so *consistently*. Many of the leading lights of the Chicago School basically accepted the efficiency of democracy and abandoned the thesis of systematic voter bias before Wittman did.[16] George Stigler began his career with an attack on the folly of rent control (Friedman and Stigler, 1946), but eventually lost patience with free-market reformism.

> [T]he assumption that public policy has often been inefficient because it was based on mistaken views has little to commend it. To believe, year after year, decade after decade, that the protective tariffs or usury laws to be found in most lands are due to confusion rather than purposeful action is singularly obfuscatory. (Stigler 1986, 309)

Stigler (1971) actually inventories *The Wealth of Nations'* numerous "obfuscatory" explanations for inefficient policies.[17] Adam Smith should have known better than to blame perverse policies on systematically biased beliefs about economics. As Stigler puts it, "Do men calculate in money with logic and purpose, but calculate in votes with confusion and romance? To ask such a question is surely to answer it" (1971, 136).

Gary Becker confidently rejected the thesis of systematic voter error as early as 1976.[18]

> I find it difficult to believe that most voters are systematically fooled about the effects of policies like

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[16] These concessions do not however satisfy Wittman: "Thus some authors have made positive remarks about the efficacy of political markets, but such remarks are hidden in works that are overwhelmingly critical." (1989, 1395)

[17] For Dan Klein's intellectual and moral critique of Stigler, see Klein (2001).

[18] Admittedly, Becker seems to backpedal in his later writings. For example, Becker (1985, 392) writes: "I too claim to have presented a theory of rational political behavior, yet have hardly mentioned voting. This neglect is not accidental because I believe that voter preferences are frequently not a crucial *independent* force in political behavior. These 'preferences' can be manipulated and created through the information and misinformation provided by interested pressure groups, who raise their political influence partly by changing the revealed 'preferences' of enough voters and politicians."

> quotas and tariffs that have persisted for a long time. I prefer instead to assume that voters have unbiased expectations, at least of policies that have persisted. They may overestimate the dead weight loss from some policies, and underestimate it from others, but on the average they have a correct perception. (1976: 246)

But perhaps Sam Peltzman comes closest to Wittman's democratic triumphalism.

> So the broad picture that emerges here is of self-interested voters who correctly process relevant information. Indeed, one would be hard put to find nonpolitical markets that process information better than the voting market. (1990 p.63)

Future historians of thought will be puzzled by the transformation of the Chicago School. How does one get from Milton Friedman to Donald Wittman? My answer: Step by step, and myopically. More than anyone else, Friedman cemented the Chicago view that the free market is under-rated. Since many market failure arguments assume that consumers or workers are irrational, Chicago economists eagerly joined the rational expectations revolution. Initially, their new outlook made their defense of free markets more truculent; government intervention seemed even more pointless than previously believed. But this position was unstable. If people have rational expectations, how can the free market be "under-rated"? And if the free market is *not* under-rated, then what reason is there to second-guess democratically-chosen policies? This pointed question gnawed away at the intellectual conscience of Chicago economists until enough were ready to hear Wittman's unconflicted answer: There *is* no reason to second-guess democratically-chosen policies.

During this evolution, Chicago economists seemed to lose sight of a much more fundamental principle: the importance of empirical testing. Rational expectations is an empirical hypothesis. It could be true, it could be false, and it could be true for some applications and false for others. It is awfully rash to accept it as a universal truth without testing. Even if an hypothesis seems intuitively obvious, you should look for exceptions.

But at least for beliefs about economics, Chicago economists should have found rational expectations to be completely *counter*-intuitive. As teachers of economics, they must have noticed that students do not arrive as blank slates. In fact, students typically seem to believe the opposite of what you plan to teach. Yes, it is *possible* that economic educators have misread their students for centuries. But such an extraordinary claim needs compelling empirical evidence to command assent.

The Chicago School inexplicably waived this requirement. Empirical evidence that beliefs about economics are unbiased never surfaced. But the rational expectations hypothesis became de rigueur anyway. Now that a large body of empirical evidence confirms that the teachers of economics were right all along, we can justifiably say not only that Chicago economists should not have changed their minds, but that they should have known better.

You could blame this blind spot on Chicago's excessive faith in the power of economics. But the real problem is that the Chicago School did not take economic imperialism far enough. Irrationality is nothing to run away from. If we can think of children as economic goods, why not irrationality? This is the intuition behind my model of *rational irrationality*. (Caplan 2001b, 2003) Irrationality has obvious costs—your choices are tailored to the world as it is not, instead of the world as it is. But irrationality also has benefits—it lets you retain beliefs that give your life meaning (and bond with like-minded people), even if they happen to be false. In the words of Frank Knight:

> A general human proclivity for romanticism—including all interests in conflict with the quest for truth—hardly needs demonstration. Within wide limits, human nature clearly finds many forms of fiction more interesting than truth. (1960:19)

Basic micro tells us to expect people to consume more irrationality when the costs fall. Some forms of irrationality are prohibitively expensive: If you believe you can fly, you will not believe it for long. Other forms of irrationality are almost perfectly safe: You can believe that the earth is six thousand years old, and still live to be a hundred.

Where along the cost continuum do political beliefs lie? Economists have long observed that there is no incentive to vote; the same policies happen either way. A rarely-noted corollary is that voting "the wrong way" does not make a difference either. Again, the same policies happen either way. The upshot: from the standpoint of the individual voter, *political irrationality is free*. If you reject the Law of Comparative Advantage as a lie, and vote for protectionism, what happens to you? The same thing that would have happened to you if you understood the case for free trade inside and out.

Political irrationality is like air pollution. In both cases, the private benefits of self-restraint are basically zero. If you become a more rational voter, the policies you live under do not noticeably improve, just as the quality of the air you breathe does not noticeably improve when you drive less. But when enough voters or drivers make the selfishly optimal decision, the overall outcome is inefficient, and possibly disastrous. Textbook examples of externalities routinely mention environmental catastrophes. But it would be at least as appropriate to discuss voter-on-voter externalities in Hitler's 1933 electoral victory. How many of his *supporters* would have survived the next twelve years if they had coolly weighed the dangers of Nazi rule, instead of seeking solace in nationalist daydreams?

Rational irrationality provides a simple theoretical rationale for the old-school Chicago presumption: "markets work, democracy fails." Consumers, workers, and investors may not "buy" perfect rationality, but at least they have a material incentive to think clearly, to restrain themselves. Move the same actors over to the political arena, and this discipline goes away. Why bother with facts and logic when you are not financially liable for the mess?

One could respond: "If democracy really had such severe problems, we would not use it as expansively as we do." Wittman often does: "The fact that people are willing to set up majority rule with its supposed abuses of the minority instead of a two-thirds or unanimity rule suggests that the abuses of majority rule are less than the negotiation costs (and abuses) of a unanimity rule." (1989, 1402) But this is sleight of hand. Wittman jumps from individual utility maximization to group utility maximization without mentioning that the two are different, and often incompatible. For any given individual, the question is not "What is *our* best strategy?" but "What is *my* best strategy, given what everyone else is doing?" If you already live under majority rule, the path of least resistance is to accept the world as it is, even if superior alternatives exist. Indeed, to maximize your own psychological well-being, perhaps you should embrace the glory of the status quo, not just passively accept it.

Wittman's defense of majority rule ultimately suffers from a catch-22. If you cannot get a unanimous vote to relax a unanimity rule, is that convincing evidence that a unanimity rule is efficient? If no, why is it any more convincing that you cannot get a majority to restrict majority rule? If democracy makes bad decisions, one of its bad decisions could easily be to ignore its own defects. It is elephants all the way down.

CONCLUSION

"Why Democracies Produce Efficient Results" is most productively read as an impossibility theorem—or, to be more accurate, an *improbability* theorem. It is very hard to have *all* of the following: (1) rational voters, (2) competitive elections, (3) low political bargaining costs, and (4) significant democratic inefficiency.[19] If this were the only claim in Wittman's original article, I would have solely good things to say about it.

But Wittman is too quick to solve his own puzzle. He eagerly abandons (4). He gives credible arguments in favor of (2) and (3). But he embraces (1), even though there is strong empirical evidence against it. Indeed, he barely acknowledges the intellectual price: If Wittman is right about (1), the profession has been fighting windmills. Every economic educator who ever tried to root out systematically biased beliefs about economics was wrong.

A more compelling way to handle Wittman's improbability theorem is to drop (1). Never mind *voter* rationality; anyone who has taught introductory economics should rebel at the weaker thesis of *student* rationality. If you insist on formal econometric evidence, there is now a substantial literature that strongly rejects the hypothesis of voter rationality. Finally, if you believe that it takes a theory to kill a theory, my rational irrationality model is a viable alternative to the orthodox assumption of "rational expectations all the time."

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[19] Note that one could drop *more* than one of the four.

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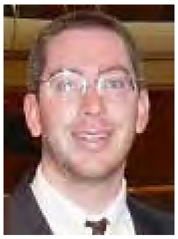

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