

**Ideologies, beliefs, and economic advice –
A cognitive–evolutionary view on
economic policy-making**

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6. Ideologies, beliefs, and economic advice – a cognitive–evolutionary view on economic policy-making

Tilman Slembeck¹

People act in part upon the basis of myths, dogmas, ideologies and ‘half-baked’ theories. (A.T. Denzau and D.C. North, 1994, 3)

1. INTRODUCTION

This chapter discusses several aspects of the politico-administrative process from an evolutionary and cognitive perspective with focus on the roles of beliefs and ideologies. While ‘ideological beliefs’ are often blamed by economists for causing irrational policy decisions, I argue that beliefs and ideologies are at the center of economic policy-making, and can, therefore, not be overcome by simply proposing ‘efficient solutions’ to policy problems, nor by fostering ‘solid analytical knowledge’ alone. Such a view would naïvely overlook the very essence of politics. That is, the aim of ‘decreasing the influence of ideologies’ cannot be achieved solely by putting forward ‘rational policies’ without taking into account the nature of the game called politics.

Therefore, it seems crucial for economists to understand the roles of beliefs and ideologies in policy-making, and to take them seriously – especially when giving economic policy advice. In this view, economic advisers are themselves part of the game. They are only actors among other actors – many of whom are much more influential in, and knowledgeable about, the political process. Within the rules of the political game, economists are often not equipped with superior knowledge or wisdom. Their views on the economy and the way it functions are not unrivaled. This has, for instance, led to the following complaint by William H. Hutt in 1936:

Although an expert, no authority attaches to the economist’s opinion ... whilst there are few intelligent members of the public who would dare to argue with a professor of mathematics about *his* subject, there are few who would *not* be prepared to question the validity of an economist’s teachings. (Hutt, 1936, 36; original emphasis)

Promoting rationality in politics requires understanding the game and knowing how to play it. Otherwise, politicians and economists may well end up blaming each other for being 'ideological'. Note, for instance, that terms such as 'economization of society' or 'economic imperialism' have a negative connotation, and are used to fight the 'ideology of the market'.

But, then, what should economists do? How can they put forward rational policy solutions? The first step is to systematically analyse and understand economic policy-making as an evolutionary process that involves important psychological aspects of perception and interpretation on one hand, and aspects of power and interests on the other hand (Sections 2 and 3).

A second step is to look at the effects and compatibility of economic policy proposals within the system. In Section 4 I will discuss why many seemingly efficient improvements or reforms are not attractive for politicians and are, thus, difficult to implement.

Both steps are outlined in this chapter. In following them economists may be able to judge their own possibilities and limitations more realistically. They may avoid falling prey to fruitless ideological confrontations and be more effective in giving policy advice.

While the public choice school has emphasized the importance of individual and group interests, and has analysed the (maximizing) behavior of politicians and bureaucrats under various restrictions (such as budgets and re-elections), I will focus on the cognitive and evolutionary aspects of policy-making, and those of giving policy advice. This is not to deny the importance of the public choice view. It is to enlarge the analysis in crucial respects, and, hopefully, to make economic advice more successful.

2. IDEOLOGIES AND BELIEFS IN DEMOCRACIES

There seems to be a strong tendency for economists to fight ideologies. At least two battle grounds exist. One is *within* the field of economics where economists aim to keep their science ideology-free, since 'given the economists' desire for status as "scientists" the very notion of ideology is threatening' (Samuels, 1977, 469). I will not enter the discussions on the roles of ideology within economics, but instead focus on the second area where economists fight ideologies from *outside* their field, namely with regard to economic systems and policies.

Until the 1989–91 soft revolutions in Eastern Europe the main ideological enemy was socialism. After the 'factual victory' of capitalism in most countries and in the light of the spreading of democracy throughout the world, however, there still exist 'ideological debates' over economic goals and policies within capitalism. The term ideology, as used by economists in such debates, is in a sense the opposite of rationality.² Ideologies are thought to conceal rational

argument, and to prevent us from using solid analytical knowledge. Hence the economists' call for 'decreasing the influence of ideologies' in favor of rational solutions that are argued to be non-ideological, but efficient in the sense that goals are achieved at minimal cost or that given resources are put to their maximal use.

I will refrain from discussing to what extent the economists' views involve ideology. It may suffice to say that most of what economists do – like the selection of topics, the definition of problems, the formulation of concepts and theories, the ascription of meaning to phenomena, data and variables, the differentiation between means and ends and so on – is not value-free, and that presenting 'optimality proofs and implications for desirable government policy [is] an inevitably ideology-laden exercise' (Samuels, 1977, 479). Instead, I will try to shed some light on the roles of ideology and beliefs in policy-making. While economists see them as obstacles to rationality, I argue that ideologies serve certain purposes in politics, and that differences in beliefs between political actors are inevitable. Understanding these purposes and learning to deal with these differences may not only make the life of economists easier, but enable them to be more effective in giving policy advice (see Section 4).

2.1 Ideologies vs. Beliefs

Let us start with a tentative and incomplete definition of the term ideology. Broadly speaking an ideology is a 'coordinated and integrated set of ideas, beliefs, and conceptions, which presents a more or less coherent view of the nature and structure of the socio-economic system' (Samuels, 1977, 470; see Denzau and North, 1994, 4, for a similar definition that refers to ideologies as *shared mental models*). By this definition, ideologies are conglomerates of beliefs that are organized in a systematic, possibly coherent manner. This is to define ideology as a social phenomenon that does not *a priori* include the negative connotation it has in public debates. Similarly, Tuchtfield (1983) uses the more neutral notion 'systems of ideas' (Ideensysteme) for describing and distinguishing the concepts of liberalism or socialism.

Beliefs, as basic elements of ideologies, involve two main aspects (Slembeck, 1997a, 230). *Normative beliefs* define what *ought* to be at a normative level. They include preferences over how the world should work and what outcomes are desirable. In addition to the traditional connotation in economics, preferences in the political context also refer to processes, institutions and outcomes in politics, in the economy, and in other domains of society. In this view, normative beliefs are the individual-based, normative building blocks of ideologies.

The second aspect is *positive beliefs* about what *is* and how the socio-economic world does work. At a positive, though not objective, level positive beliefs identify real-life causalities, dependencies, and restrictions. They define

how one perceives the world 'as it is' as an outside observer. The distinction between normative and positive beliefs may seem somewhat artificial, since both types of beliefs tend to influence each other, but it may help to understand the nature and roles of beliefs more clearly. This point will become more lucid when I focus on the content of positive beliefs in Section 2.3.

Taken together normative and positive beliefs have been labeled 'regulative beliefs' in Slembeck (1997a) while the German word '*Ordnungsvorstellungen*' was used in the textbook by Meier and Slembeck (1998). Before discussing their meaning and roles within the *process* of economic policy-making in Section 3, I will now turn to the basic roles of ideologies and beliefs in a more *static* view.

2.2 The Roles of Ideologies

It is typical for established ideologies that they are held not only by individuals, but are shared, formed, promulgated, and actively developed by groups such as political parties. In providing a more or less coherent view of the world, ideology serves several functions for the group or party (see Samuels, 1977, 471). First, ideology provides meaning and attaches value to socio-economic reality. Hence, a fundamental role of ideology is to explain and to rationalize. Second, by providing a definition of system reality, ideology focuses perception, directs analysis, and biases interpretation. Third, by providing a framework of thought *and* behavior ideology serves to promote social cohesion and group identity. Fourth, 'ideology serves as an instrument of social control and rule: an instrument for standardizing and routinizing attitudinal and behavioral responses, a mode of conflict generation and resolution, and a weapon in the struggle for power' (op. cit., 471). Thereby, ideology helps in legitimizing a system and structure of power, status, and privilege.

With regard to policy-making in democracies ideology not only serves as a device for putting forward a group's views and interests, but has properties that may be desirable from a system view.

One property is that ideologies allow the formation of groups of actors that share interests and beliefs. Without the possibility to commit to some ideology it would be difficult for isolated political actors to bring together their resources and find political support. This bundling and coordination of interests and views may be desirable (at least to some degree), because it allows the formation of platforms that are needed for finding the consensus necessary for collective action in a democracy.

A related aspect is that ideology makes political actors and groups identifiable. In a democracy, ideology provides orientation in the political market of ideas, views, and interests. It allows voters to gather information more efficiently, and therefore to take better informed decisions. This has been

emphasized, for example, by Downs (1957). Democratic competition between ideologies is to prevent an ideology of the type found in socialist systems from dominating and may bring forward new ideas and solutions to collective problems. The extent of such competition, however, depends on the number of groups or parties that are able to compete for government, and the degree of 'ideological overlap' induced by this number (see below for a short comparison of Switzerland, Germany and the United States).

The predominant aspect of ideology in a democracy is perhaps that it provides an 'anchor' for making commitments that may otherwise not be credible. The advantages of rule-based over discretionary policy-making have widely been acknowledged in the literature (see, for example, Barro 1985). Following rules has the advantage that it makes behavior more predictable and thus reduces the costs associated with uncertainty.³ Therefore, it can be rational for policy-makers to confine themselves to certain rules and behaviors, rather than have discretion. In their seminal paper Kydland and Prescott (1977, 487) conclude: 'The reason that they should not have discretion is not that they are stupid, or evil, but that discretion implies selecting the decision that is best, given the current situation. Such behavior either results in consistent but suboptimal planning or in economic instability.'

The problem of *time-inconsistency* that emerges here is that a policy that seems to be optimal at a given point in time may no longer appear to be optimal at a later time. Without a binding commitment to the original plan, policy-makers may switch to a new, seemingly better policy. But if economic actors or markets form rational expectations, they will anticipate such policy change and will behave in ways that make the original plan ineffective. Kydland and Prescott (op. cit.) recommend that 'economic theory be used to evaluate alternative policy rules and that one with good operating characteristics be selected. In a democratic society, it is probably preferable that selected rules be simple and easily understood, so it is obvious when a policymaker deviates from the policy.'

The problem of much policy-making, however, is that self-binding to overcome time-inconsistency is not easy to implement. In a dynamic context where policy decisions are taken sequentially over time new coalitions may be formed in parliament or the incumbent government may be replaced by elections. One possibility is to delegate policy-making to institutions that are not directly accountable to voters, and do not depend on majority-voting. This option is used in *monetary policy* by establishing independent central banks. Another way of self-commitment is to anchor policy rules at the constitutional level which makes it more difficult and costly to change the rules at later stages of the political process.

An additional aspect is that policy-makers or governments often lack credibility in their policy-making. This can be overcome only in the long run by forming a *reputation* for sticking to their own rules and policies. The problem

of lack of government credibility in macroeconomic policy has been emphasized in the literature especially with regard to monetary and fiscal policy (see Persson and Tabellini, 1997, for an overview of the literature).

In view of these problems there is an important role for ideology in policy-making. Ideologies limit the set of behaviors that are compatible with a given ideology. Hence, for a policy-maker that is known to stand for some ideology it is difficult to change behavior radically or to implement a policy that is not compatible with this ideology without losing credibility and jeopardizing re-election. Therefore, the occurrence of ideologies tends to make behavior of policy-makers more predictable. Ideologies support rule-based behavior and tend to limit discretion. They serve as anchors for implicit rules that cannot easily be violated and make deviations from such rules more easy to detect. Ideologies can also help policy-makers in gaining reputation and implementing policies that are credible not only in the short run.

In this view, ideologies serve as a self-binding device that allow policy-makers to credibly commit to some rules or programs. As noted in the literature mentioned above, rule-based behavior, credibility, predictability, and detectability of deviations from rules are all features that are supposed to be desirable in economic policy-making. Ideologies tend to foster these features. They help policy-makers to overcome the time-inconsistency problem, and can, thus, be understood as a rational device of commitment. This aspect, however, has been ignored by those economists who label ideology as being irrational.

It should be stressed that the favorable features of ideologies are most pronounced in an open democracy where there is competition between political parties and ideologies. For instance in Switzerland there are four leading parties that share responsibility in federal government. In Germany there are two leading parties competing for federal government, each of which forms coalitions with one of two smaller parties. In the United States there appear to be only two parties able to compete for federal government.

Figure 6.1 visualizes the relative positions of the political parties of these three countries according to the common left–right scheme (horizontal axis). The circles depict the size and outreach of the respective ideologies. It is shown that there exists an overlap in ideology between neighboring parties in all countries. What is important to note, however, is that the ideological overlap of the center parties increases with a decrease in the number of parties able to compete for government. In the United States, for instance, there appears to be a large overlap in ideology between Democrats and Republicans.

Hence, it is difficult to distinguish between these two parties or their proponents in terms of ideology or political program, and both design their programs in aim of the median voter. In Switzerland four leading parties are involved in federal government according to a ‘magic formula’ that assigns a fixed number of seats in the cabinet to each party since 1959 (so-called *Zauber-*

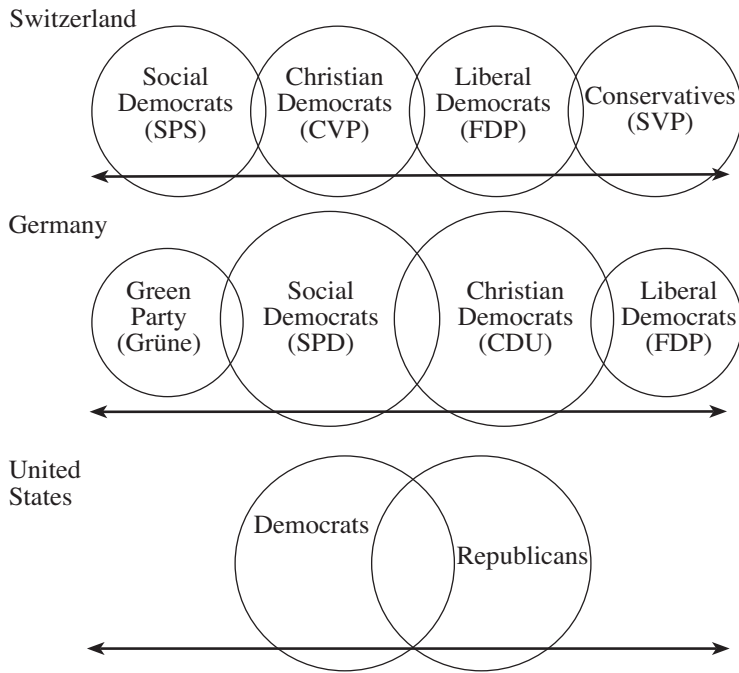


Figure 6.1 A comparison of countries

formel). This allows larger differentiations in ideology (see top of Figure 6.1), since the ‘opposition’ is always included in government (system of *concordance government*). Such differentiations may also be fostered by the public’s need for information induced by the Swiss direct democratic system where citizens are routinely asked to vote over policy proposals. In such a system, different ideologies may be useful or even needed to produce additional information.⁴

In effect, in political systems with only two dominant parties (for example, induced by the single-member constituency currently used in most English-speaking countries) there are fewer ‘ideological anchors’ available. This makes it less predictable what policy a government will adopt in a specific case or policy field over time. It increases the probability of policy changes within the incumbent government. For instance, some have argued that policy under the Clinton administration over time tended to become more conservative than previously expected. Similar tendencies have been observed in the Blair administration in Great Britain whose economic policy has been found to be more conservative than that of the Tories by commentators. Also, George W. Bush has adopted policies (such as subsidies in farming and protection in the steel industry) that are not strictly in line with ‘market ideology’, indicating that his

ideological anchors are not overly strong. However, since the leading parties do ideologically overlap in the center of the political spectrum, no extremist policies or drastic changes of policies are to be expected.

2.3 The Roles of Beliefs

As mentioned in the previous sections, beliefs fall into two broad categories. Normative beliefs define what *ought to be* while positive beliefs involve concepts about *what is*. The former are the normative building blocks of ideologies, and their social power has long been acknowledged in economics, for example, by John Stuart Mill who finds that ‘One person with a belief is a social power equal to ninety-nine who have only interests’ (quoted in Hutt, 1936, 63). Similarly, John Maynard Keynes (1936) in one of the most famous quotes in economics finds that ideas are more powerful than interests:

Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. ... I am sure that the power of vested interests is vastly exaggerated compared to the encroachment of ideas. ... sooner or later, it is ideas, not vested interests, which are dangerous for good or evil.

Given the power of normative beliefs, it seems somewhat surprising how little attention economics has paid to them. Instead, the discipline has focused on *preferences* in the economic realm and on *interests* in the political realm. However, when it comes to economic policy-making there appear to be good reasons to take the normative aspect of beliefs, ideas or views seriously, especially when they emerge in the form of organized ideology. Since I have tried to discuss these normative aspects above, I will now take a closer look at positive beliefs.

Positive beliefs involve mental constructions of real-life causalities and restrictions.⁵ They are individual or shared theories about how the world works. Such beliefs are inevitable since they allow us to interpret our environment, understand economic and social relations, and make plans. They are cognitive (though not necessarily conscious) constructions of the world and allow us to communicate with others. As will be discussed in more detail below (Section 3), processes of collective construction and interpretation of the socio-economic world or system play a crucial role in actual policy-making. The point I want to make for now is that the positive beliefs of economists differ from those of politicians and the public in many important respects.

The economists’ complaints about how little the public as well as professional politicians understand about the economy and its functioning has some tradition, especially among those who give economic policy advice (see

Schultze, 1996; Stiglitz, 1998). Surveys on economic literacy routinely find that the general public is badly informed about economic processes and institutions.⁶

A somewhat natural reaction of economists is to identify and brandmark so-called 'economic fallacies'. For instance, Wood (1997) has compiled a list of such fallacies in order to demonstrate the many areas in which the public 'misunderstands' basic economic principles. The list presented at the end of this section (Table 6.1) draws on Wood's observations and merges them with cases where the beliefs of policy-makers are at odds with economic wisdom. The latter are in the focus of what Henderson (1986, 3) calls 'do-it-yourself economics': 'Over wide areas of policy the judgements of politicians and their officials, as also of public opinion in general, have been and still are guided to a large extent by beliefs and perceptions about the working of the economic system ... which owe little or nothing to the economics profession.'

Similarly, Buchanan (1993, 10) observes that

the operation of markets is within the working knowledge of everyone. 'Every man his own economist' or 'do it yourself economics' has been a characteristic feature of policy discourse since the professionalization of the science. ... Even in those national economies that are not, and have never been, organized on socialist principles, there is no general public understanding of the 'principles of economics'.

The fact that economists talk about 'economic fallacies' or complain about the lack of understanding of economic principles implies that economists perceive themselves in the possession of superior knowledge about the economy and the way it works. This observation clearly reveals the normative nature of much economic theorizing.⁷ For the purpose of the present chapter, however, it seems unimportant whether one agrees on the existence of fallacies, since the focus is on observing the existence of differences in economic beliefs between economists and non-economists, and on deducing implications for policy-making and policy advice.

2.4 Towards a New Research Agenda

Despite their apparent significance in economic policy-making, the roles of positive beliefs have rarely been studied by economists. While in psychology there exist some attempts to investigate what mental models people have about the economy (for example, Williamson and Wearing, 1996) and how they may affect behavior (for example, Shimp and Sharma, 1987), little work has been done in economics. There exist only few studies that try to explore and assess the positive beliefs (for example, Caplan, 2002) or mental economic models of the general public – though not of policy-makers. Shiller (1996) asks why people do not like inflation. Economists have a long list of reasons why inflation

may harm the economy. Lay-people also dislike inflation just as economists, however, for quite different reasons. Shiller (1996, 44) reports that low inflation is an important element of national pride, and concludes from his study that people appear to believe in a 'bad-actor-sticky-wage model'. That is, inflation is seen to be caused by some badly-behaving or greedy people. Inflation hurts the general public's standard of living. Increases in prices, however, are not met with increases in wages. Such a finding may have implications for the making of monetary policy:

Those who implement national policy towards inflation have to sort out which concerns they share with the public, and which they do not. ... The public's models of the economy are fundamentally different from those of economists. (op. cit. 46)⁸

In the light of such (still preliminary and incomplete) evidence three basic and broad questions arise: (i) What beliefs do citizens and policy-makers actually hold and how do they contrast with economists' beliefs? (ii) To what extent do economic beliefs guide economic behavior and what happens when economic and political actors behave according to their 'deviating' beliefs? And perhaps more fundamentally: (iii) How do people acquire beliefs, mental models or theories, and how do they evolve?

The simple background to the last question is that people do not seem to be equipped with beliefs at birth (that is, a *near tabula rasa situation*, Denzau and North, 1994, 15), and that they live in a world of true (or Knightian) uncertainty that requires them to form mental models in order to act purposefully. This leads to the even more basic question of how people learn about and cope with the world around them. Hence, a solid foundation to answer the third question requires a *theory of human learning under uncertainty*.

While most economists' efforts to develop an economic theory of learning have focused on learning under certainty (and sometimes risk),⁹ and have tended to ignore the roles of positive beliefs or mental models, there exist attempts to develop behavioral (not behaviorist) foundations of economic learning (Slembeck, 1998), or to explicitly account for the roles and evolution of 'shared mental models' (Denzau and North, 1994, who refer to Holland et al., 1986, and Arthur, 1992). Somewhat surprisingly, psychologists seem to have only started to study economic socialization (Leiser et al., 1990; Lewis et al., 1995; Lunt and Furnham, 1996), however, without referring to the economic literature or making use of economic thinking (Frey, 1998).

The answer to the second question seems to be taken for granted by most economists. Even Denzau and North (1996) who carefully discuss several aspects of the roles and evolution of mental models (that is of positive beliefs in the terminology of the present chapter) do not address the problem of how these models translate into actual (economic) behavior.¹⁰ Their implicit

assumption, like in most standard economics, appears to be that people act according to their mental models or beliefs. However, the basis for such an assumption has been in the center of much debate in social psychology (see for example, Triandis, 1971; Ajzen and Fishbein, 1980; Upmeyer, 1989), and the connections between attitudes, beliefs, and behavior continues to involve many unsolved questions (for example, with regard to ecological behavior, see Kaiser and Fuhrer, in press).

In economics, a potential problem arises from the fact that *homo oeconomicus* is implicitly assumed to hold the same beliefs as his creators. But what if real people hold beliefs different from the model-builders (alias *homo oeconomicus*) and behave according to these beliefs? Does economic theory need to be revised if economic actors do not stand up to the normative implications of this theory? Or should we teach people how to behave rationally until their behavior fits the theory? What if political actors behave according to their economic beliefs (for which there exists much evidence in real-life policy-making)? Is it enough to give them 'rational' economic advice? Should we revise our models, or simply teach laymen until they 'get it right' (Barro, 1996)?

I cannot offer any definite answers to these broad and deep questions. However, I suggest two things: first, we need to revise and enrich our models of economic policy-making to better account for the roles of ideologies and beliefs, and to understand actual policy-making as an evolutionary process. An attempt in this direction has been made in the *cognitive–evolutionary approach* (Slembeck, 1997a; Meier and Slembeck, 1998) as briefly discussed in Section 3. Second, I suggest that studying systematically and empirically the actual beliefs of the general public, policy-makers, journalists and business leaders (as compared to economists) would be a good starting point. Such studies seem largely missing today (with the exception of Caplan, 2002). The odds are strongly in favor of finding significant and systematic differences not only in normative, but also in positive, beliefs between economists and non-economists in many important areas of economic policy-making.¹¹ Having established such differences empirically, the next step will be to investigate their relevance for economic and political behavior.

That is, if beliefs induce or guide behavior – as implicitly assumed in most economic theory – actors that hold beliefs different from those of economists may behave differently from what is predicted by economic theory. At the level of individual behavior, for instance, people that hold mercantilistic beliefs may prefer domestic over foreign goods. At the political level people may vote in favor of (protectionist) policies that are compatible with their own positive beliefs, but that may appear 'irrational' or inefficient in economic terms. Thus, establishing the link between positive beliefs on one hand, and economic and political behavior on the other hand, may help us to understand why people buy, save or vote the way they do. This may not only improve theory prediction,

Table 6.1 Economic 'fallacies' and possible implications

Economic 'fallacy'	Economic/behavioral level	Possible implications	Economic policy level
Economic activity is always a zero-sum-game.	Potential gains from trade or exchange are not recognized.		Support of policies that redistribute income and/or wealth.
Small firms cannot survive in the free market.	Behavior is more competitive/less cooperative.		Support of strong antitrust laws and subsidies or tax cuts for small firms.
Markets are created and maintained by the government.	Discouragement of entrepreneurship.		Support of a strong and discretionary government.
Speculation is harmful to the economy.	Discouragement of entrepreneurship.		Support of restrictive market rules/of taxes on gains from speculation and stock markets.
Stock markets are like casinos and thus are not important (or even harmful) to the economy.	Under engagement in market activity and stock markets. Selection bias towards more risky market participants.		
There is a fixed amount of labor demand in the economy so that unemployment is mainly a problem of labor not being distributed evenly among workers.	Increased willingness to accept reductions in working time and/or early retirements. Negative attitude towards immigration.		Support of policies that redistribute labor (e.g., shorter working week, early retirement) and of restrictions on immigration.
New technologies induce unemployment to rise.	Reluctance to adopt/accept new technologies.		Support of laws that restrict the introduction of new technologies.
A country's economic welfare is increased by exporting as much as possible and importing as little as possible.	Increase consumption of domestic goods at the expense of foreign goods. Reduction of foreign trade.		Support of export subsidies and import restrictions (such as tariffs and import quotas).
Developing countries cannot profit from free trade because they cannot compete with strong and rich nations at international markets.	Favor products from developing countries.		Reluctance to support free trade with developing countries. Support of foreign aid.
A country profits more from exporting finished goods than from exporting raw materials.	Increase of export of finished goods at the expense of raw materials.		Support of industries of finished goods at the expense of raw materials.
Large profits of major companies induce inflation to rise.	Avoidance of major companies by consumers and/or private investors.		Support of high taxes on company profits.
Money holds its value well in times of inflation.	Excessive holding of cash in times of inflation. Reluctance to indexed contracts.		Reluctance to the role of monetary policy.
Inflation does not affect investment and saving behavior.	Reluctance to (expected) inflation in investments. Excessive saving in cash or non-indexed assets at times of inflation.		Reluctance to the role of monetary policy.

but have important implications for economic education (especially of journalists) and the way economists give advice. I will conclude this section with a tentative list of ‘economic fallacies’ and their possible implications that may give some illustrative indications for the direction of the proposed research (Table 6.1).

As will be discussed in Section 4.1, it follows from the above discussion that the public, politicians, and economists live in different worlds, not only because they are subject to different incentive schemes but also because of fundamental differences in *positive* beliefs.

3. A COGNITIVE–EVOLUTIONARY APPROACH

In the previous section the roles and functions of ideologies and beliefs have been discussed in a somewhat static manner. I will now discuss them in a more dynamic context that looks at economic policy-making as a continuous process. The aim of the *cognitive–evolutionary approach* is to model actual processes of policy-formation by adding elements from psychology and evolution theory (see Slembeck, 1997a and Meier and Slembeck, 1998, for elaborated versions of this approach). While current economic approaches focus on particular aspects of policy-making (such as rent seeking or vote maximizing) or on the pros and cons of specific policy instruments, our approach aims to provide a comprehensive and dynamic view on the real processes of policy-formation.

One main aspect is that political (and economic) actors not only bring their interests but also their individual perceptions and interpretations to the process. Therefore, much actual policy-making involves collective interpretations of socio-economic ‘reality’ and the definition of problems and goals. The second main aspect is that the political process evolves in time. This means that problems are dealt with in a multi-stage process that changes the nature of the problems and the solutions over time. It means also that political mechanisms are not fixed, but may change as problems work their way through the system.

The political process itself is characterized by continuous processes of mobilization and negotiation. It is modeled as a problem-solving process that involves a sequence of filters. Any collective problem (be it ‘economic’ or not) has to pass this sequence in order to be solved.

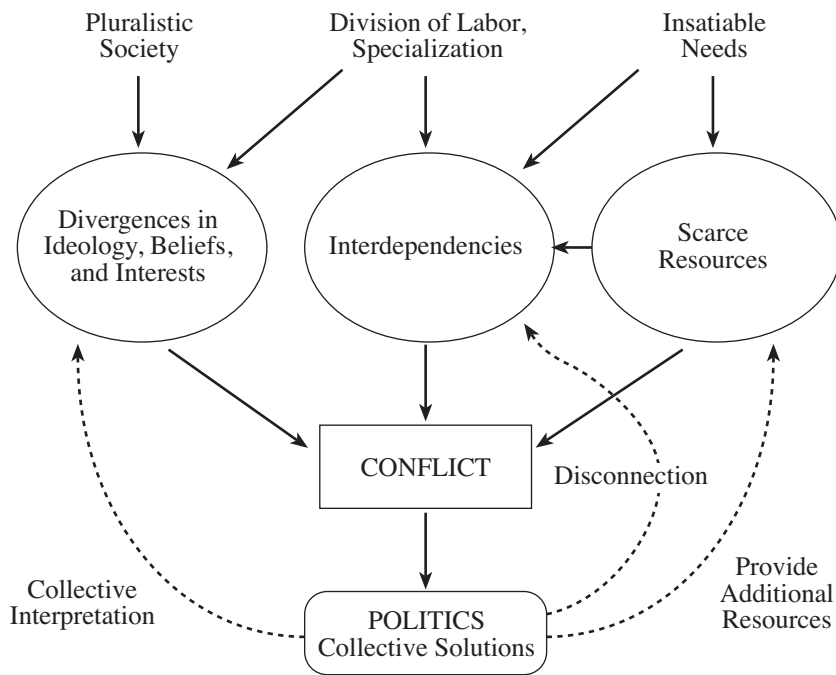
3.1 Why Politics?

In order to analyse the basic properties and characteristics of policy-making, it seems useful to think about the reasons why politics are needed at all. At a very general level politics serves to provide collective solutions to a variety of societal

conflicts. In this view, the political process serves as a collective problem-solving device.

There are several sources of such conflict (see Figure 6.2). In a pluralistic society there exists a variety of diverging and possibly conflicting beliefs, ideologies and interests. With regard to the economic realm these divergences are fueled by division of labor and specialization. The latter also induce factual interdependencies within the economic and social system. Interdependencies tend to induce conflicts that need social coordination and can be solved only by collective action. In a world of insatiable needs and scarce resources such interdependencies also arise from economic scarcity. A main theme of economic policy-making, therefore, involves conflicts about the (re)distribution of income and wealth. In sum, much societal conflict emerges from basic economic scarcity and interdependencies between individuals or groups (for example, producers and consumers, or employers and employees).

What has been acknowledged in the economic literature is that politico-economic conflicts arise from the diverging interests of individuals and groups.



Source: Slembeck (1997a).

Figure 6.2 Why politics?

What has been neglected, however, is the role of divergences in beliefs and ideology. When looking at actual economic policy-making processes it is easy to see how much time and effort is invested in interpreting socio-economic reality, defining goals and evaluating alternative policies.¹² In fact, these processes are not only driven by diverging interests, but by divergences in beliefs and ideology. They are needed to establish a commonly accepted basis for collective action. Without such processes economic policy-making would be reduced to finding a rational solution to some (possibly complicated) socio-economic puzzle, and there would often be a unique, socially efficient solution – just as traditional models of economic policy-making in the Tinbergen tradition suggest (see Tinbergen, 1956). As argued throughout this chapter, such a view would miss the essence of much real-life policy-making.

In the cognitive–evolutionary approach economic policy provides collective solutions to economic and social conflicts. There are three basic ways to ease such conflicts (see the dotted arrows in Figure 6.2). One is to provide additional (collective) resources to reduce scarcity. This may also help to reduce interdependencies that may be disconnected by designing specific policy instruments for specific aspects of an interconnected problem area. For instance, allocative and distributive aspects can be disconnected by designing separate policy instruments for achieving the respective goals. Aside from providing collective resources and disconnecting problem aspects, a third main way of solving societal conflicts through politics is to provide a common platform that allows the balance of beliefs and interests by collective interpretations. Before discussing this latter function of the political process more extensively, I focus on the emergence of economic-policy problems.

3.2 Individual Level: the Emergence of Problems

A basic tenet of the cognitive–evolutionary approach is that problems are not fixed and given, nor do they exist independent of individual perception. *Problems emerge through the perceptions and interpretations of individuals.* With regard to policy-making this means that problems arise at the individual level in that the individual perception of problems initiates the political process.

We distinguish two main sources of problem emergence: discontent and ambiguity. *Discontent* arises from a discrepancy between the perceived state and development of the economy and normative beliefs or preferences (see the top portion of Figure 6.3). That is, actors are dissatisfied with actual economic processes or outcomes compared to how they think ‘things ought to be’. Insofar as actors are unable to solve the perceived problem individually they may attempt to promulgate their problem view and seek some sort of collective action. Discontent is the typical motivation of interest groups to start political initiatives.

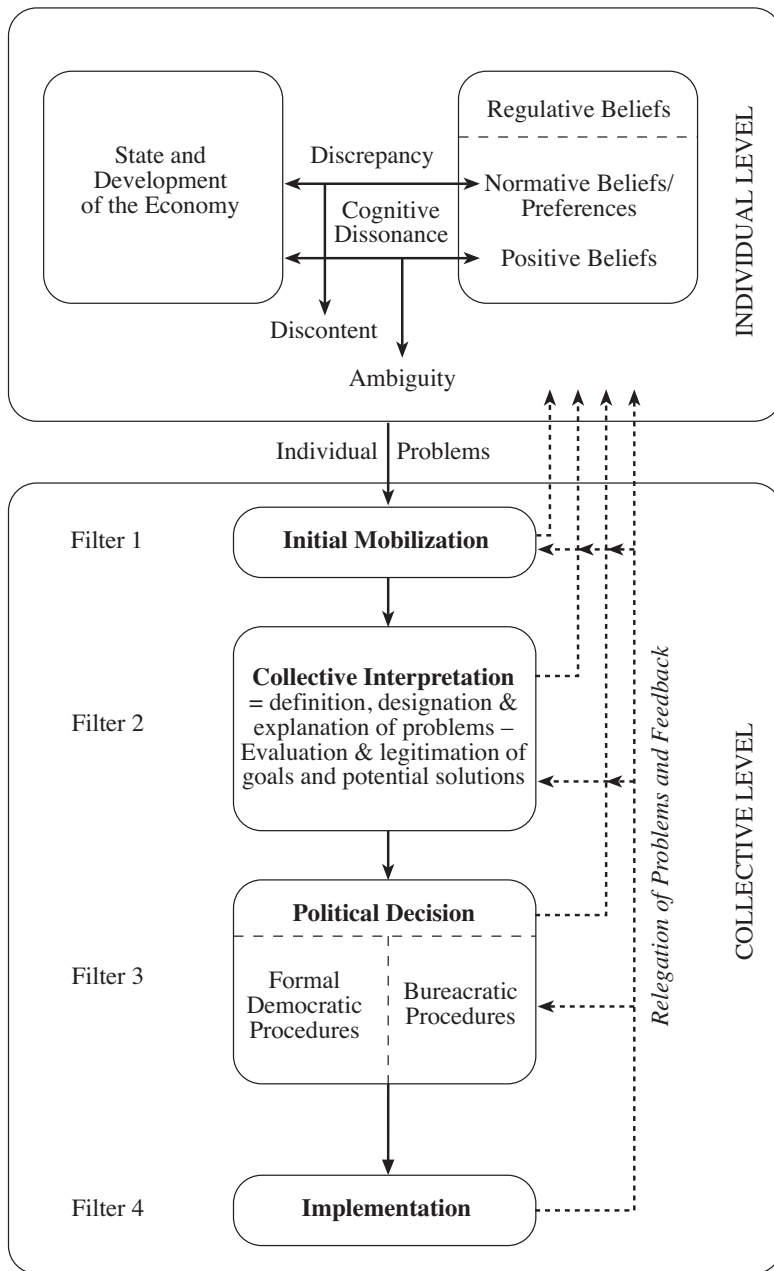


Figure 6.3 A cognitive-evolutionary model of the political process

Ambiguity arises when actual perceptions of economic states or developments do not match with the actors' positive beliefs about how 'things do work'. In this state of cognitive dissonance actors may seek collective interpretations in order to check whether collective action is necessary and to equilibrate their cognitive structures. Many debates in cabinets or parliaments seem to arise from ambiguity. Examples include the heated debates in many parliaments around the world after the stock market crash in 1987 or following September 11 in 2001.

3.3 Collective Level: the Selection of Problems and Solutions

Obviously, not all individually perceived problems do initiate political processes. Problems have to be brought forward to the collective level. The first step toward collective action is to spread the problem view and find economic and political support among those who share the view. This phase of *initial mobilization* is the first filter of a sequence of filters that constitute the political process (see Figure 6.3). The problem has to be acknowledged as being significant by a sufficient number of voters, politicians, parties or opinion leaders in order to be accepted and dealt with at the collective level. For instance, parliaments, committees, or commissions may refuse to discuss policy proposals because they feel that the problem is too insignificant and lacks political pressure. Typically, political bodies are congested by a great number of requests and proposals so that there is a struggle for attention among parties and interest groups. Many individual or group problems may not find political support or public attention. Clearly, attention is one of the scarcest resources in modern societies and getting on the public (policy) agenda can be difficult since the politicians' agenda is always full. In effect, when initial mobilization fails, the problem is relegated to the individual level and may come up at some later time.

Once the problem has been acknowledged at the collective level, its content needs to be *defined* in order to get onto the political agenda. Definition includes deciding which aspects of the problem are relevant to be dealt with and which are not. Problems are also designated by giving them a name or label that allows efficient communication and attaches a connotation.¹³ Explanation of the problem involves the formation of chains of causalities that connect the problem with some source or origin.

The processes of definition, designation and explanation are elements of *collective interpretation* (see filter 2 in Figure 6.3). These processes are biased by the actors' regulative beliefs and interests, and involve attempts to persuade others of one's own views and perceptions. They often influence the outcomes of the political process significantly since diagnosis guides therapy. The more ambiguous a situation or problem appears, the more important is collective interpretation.

Before deciding about political measures, alternative courses of collective action have to be *explored and evaluated*. This process is guided by the expected

contribution of an alternative to the actual solution of the problem, *and* by its congruity with the regulative beliefs of the actors. This notion goes beyond the focus of most economic theories of politics where commonly only the first aspect is considered. Finally, the agreed course of action has to be *legitimized* by demonstrating its congruity with the dominant interpretation systems, that is, the regulative beliefs of leading parties, politicians, interest groups, or voters.

In all these steps and processes of collective interpretation problems may not survive and be filtered-out due to a lack of consensus, shared interpretation and political support (see filter 2 in Figure 6.3). They may remain at the collective level or be relegated to the individual level (see dotted arrows in Figure 6.3).

What most economic models of politics focus on is the *formal political decision* process. It involves two basic mechanisms. If the problem at hand is considered a 'routine case' the solution will be based on existing patterns of behavior. The issue can then be forwarded to a *bureaucratic procedure* that follows routines or rules of thumb that have emerged through previous treatments of similar cases, so that the decision costs can be lowered and the process may proceed faster. If the problem challenges existing routines significantly, or if legislation necessary to proceed is deficient, a *formal democratic procedure* must be employed. This involves the preparation of a formal proposal in committees or commissions within the administration or parliament, and voting by ministers, parliamentarians or citizens. Obviously, even well prepared proposals may not survive formal voting and therefore be filtered-out at this stage (see filter 3 in Figure 6.3).

Finally, decided policies have to be implemented. *Implementation* is typically delegated to bureaucrats. During the process of implementation, however, bureaucrats and those affected by the policy may re-interpret its content, try to renegotiate the issue, and exert various sorts of passive or active resistance so that the policy is not necessarily implemented as intended by policy-makers (see Slembeck, 1997a, 241, for a more detailed discussion). Resistance and re-interpretation may be substantial so that the policy may not be implemented, but the issue is relegated to earlier stages of the process (see filter 4 in Figure 6.3).¹⁴

3.4 Evolution

All four phases of the political process described here function as *filters*. Most problems and issues of economic policy that compete for collective action are never 'solved' or implemented the way a rational social planner would. They are relegated or drop out at one or the other stage of the process, and remain unsolved until they come up some time later or vanish due to changes in the social, economic, or technological situation. Since the sources of societal conflicts (see Figure 6.2) that call for collective action seem inexhaustible, the loops that issues take during the political process (see dotted upward arrows in Figure 6.3) are con-

tinuously fueled by new problems. These loops involve feedback information that constantly change and renew the way economic policy is formed. By this system-feedback new ideas and policies are developed and tested, and the system evolves as a whole. Hence, the political process not only selects political issues, it also selects patterns of thinking and behavior, and institutions.

At the level of individual regulative beliefs and behavior, evolution signifies changes in patterns of thinking and behavior in response to changes in the environment. Internal variation of these patterns is induced by external variations *and* flawed application of existing patterns; that is, existing patterns are internally varied, and external patterns from other circumstances outside the political field are incorporated to produce new patterns. Together with existing successful patterns, these new patterns are applied in the political process where they are *selected* in practice. Selection leads to modification (that is, internal variation) of futile patterns and preservation of successful patterns. Due to this individual learning process the repertoire of patterns of thinking and behavior is increased so that new problems may be treated in a more sophisticated way.

At the collective level, evolutive effects occur when the selection of patterns influences the political constellation.¹⁵ This will be the case, at least in the long run, because successful actors – that is, actors equipped with effective patterns who have successfully managed to promulgate their beliefs and to pursue their interests in the political process – can often improve their position in that process and increase their influence, thereby shifting political constellation over time. In effect, the ongoing changes in political constellation continuously influence current and future processes of collective treatment of problems. This way the system often evolves smoothly to adjust to changes in the relative influence of actors. It may explain why radical changes are seldom observed in democratic systems (Slembeck, 1997a, 246).

Overall, the fuel of evolution in the polity is the continuous emergence of individually perceived problems that are due to ambiguity and discontent. In the approach presented here, problem views are brought forward to and filtered-out (or selected) by the actual political process. Similar to biological processes of variation or mutation, new views, ideas, problems, and potential solutions are produced by political actors, and are tested and selected in the political realm. Those views, ideas, and solutions that survive the selection process are (at least for some time) preserved and condensed into new rules, laws, and institutions.

4. ON THE ART OF GIVING POLICY ADVICE

The above discussion of the roles of ideologies and beliefs, and of the cognitive–evolutionary view on policy-making has several implications for giving policy advice. Let me start by observing that there exists some degree

of mutual discontent between economists and politicians. *Economists* complain that politicians lack sound economic knowledge, and accuse them of implementing policies that are inefficient or even irrational from an economic point of view. *Politicians*, on the other hand, seek economic advice, but find that economists are single-minded and do not understand politics. Also, for every economic expert opinion there appears to exist another exactly contrary expert opinion.

There are several reasons for this. First, economists and politicians live in different worlds that involve different beliefs, goals, means and restrictions (Section 4.1). Second, the advisory process cannot always deliver what politicians hope for. While they expect objective, scientific solutions to predefined policy problems, economists have to gauge the pros and cons of alternatives often without being able to provide an objectively best policy. Hence, the politicians' call for the 'single-handed economist'.¹⁶ Economists typically work with statements that are contingent on certain assumptions and on developments of the economy or society (that is, scenarios). Politicians feel uneasy with these techniques since they do not provide definite answers. Overall, political decisions cannot be delegated to scientific procedures that produce objectively best solutions as some politicians would like to think. Therefore, economic advice should involve an *interactive process* that includes defining goals and developing solutions, both of which are subject to political, cognitive and economic restrictions (Section 4.2). Third, economic policy proposals are often incompatible or contrary to the rules, requirements and idiosyncracies of the politico-administrative system (Section 4.3).

4.1 The Two Worlds of Economists and Politicians

When trying to understand why professional economic advice is not taken up or sometimes completely ignored by politicians it seems crucial to have in mind that economists and politicians live in different worlds. For instance, the economist Joseph Stiglitz (1998), member and chairman of the US Council of Economic Advisors 1993–97, reports his own experience: 'When I arrived in the lawyer- and politician-dominated White House environment, I often felt that I had arrived in another world. ... It was that often another system of logic, another set of rules of reasoning, applied' (op. cit., 5). In both worlds there exist different goals, incentives, time-horizons, and restrictions as summarized in Table 6.2.

Behind this table is the unsentimental view of politicians as *political entrepreneurs* who are experts in the management of political processes. They are prone to pursue their personal aims and are subject to various restrictions that result from the actual political process and political constellations. The criteria for the achievement of goals are partly individual (based on personal regulative beliefs) and partly induced by the political system. Accord with accepted norms

Table 6.2 *The two worlds of economists and politicians*

	Economist	Politician
Orientation	<ul style="list-style-type: none"> • Explanation, prediction 	<ul style="list-style-type: none"> • Political action
Goals	General goals <ul style="list-style-type: none"> • Find general (empirical) regularities • Applications to specific problems 	<ul style="list-style-type: none"> • Make or prevent binding decisions in order to <ul style="list-style-type: none"> – solve specific problems – establish organizational structures or procedures • Interpretation, explanation in ambiguous situations¹⁷
	Goals in advisory process	<ul style="list-style-type: none"> • Long-term ‘rational solutions • Efficiency of solutions
Criteria for achievement of goals	<ul style="list-style-type: none"> • Clear-cut notions, internal logic and consistency • Accord with paradigm of schools of thought 	<ul style="list-style-type: none"> • Generally accepted norms and behavior • Accord with everyday intuition, dominant ideology, regulative beliefs
Restrictions	<ul style="list-style-type: none"> • Largely self-chosen, systematically varied, and abstract • No time pressure 	<ul style="list-style-type: none"> • Mainly given; financial, personal, political support of organization, group, or citizens • Often time pressure

and tolerated behavior in politics may be as essential as correspondence with everyday intuition of citizens in democratic systems, or compatibility with ideology of parties.

Since the success of political entrepreneurship depends on attributes that are often considerably different from the criteria used in economic analysis, professional economic expertise is not always widespread among politicians. For instance, while economists are trained in analyzing the economic system, politicians are specialists in analysing the political system and in acting within this

system. The politician's job requires not only analytical skills, but also communicative abilities and possibly a charismatic personality. This may explain why not many economists ever make it to leading political positions (see Frey, 2000, 22ff., for a list of economists in office).

What follows for economists as political advisers is the importance of being aware of 'the politician's world' described in Table 6.2. Typically, economists tend to overestimate the latitude for action available to politicians (and to even leading parties) in democratic systems at any given time. The point is that while economists may start from scratch when designing optimal or efficient policies, politicians must start from an already *existing set of policies* that (i) is associated with certain distributions of incomes, wealth or rights, that (ii) is embedded in an evolving political environment, and that (iii) is the result of bargaining, compromising and coalition formation in earlier stages of the process. Thus, in most cases the specific situation of an administration, politician or group who seeks advice has to be *taken as given*, and should be carefully analysed by the adviser. Hence, in addition to the conventional economic policy analysis, economists may benefit from examining the goals and restrictions of his or her client in order to match advice with the requirements of the political system and process. That is, the economic analysis is paralleled with a politico-economic analysis.

In sum, economic advice should not only be correct in terms of scientific standards but can be improved upon by fitting the situation and needs of the addressee. Therefore, economists' advice should *account for*

- compatibility with the regulative beliefs of the recipients and their relevant political environment, that is, with regulative beliefs of other (potentially opponent) actors;
- the existing political constellation, that is, the possibilities of interaction among actors with respect to their factual relative influence;
- the political restrictions – especially political support – the advised actor *and* the economists' proposals are subject to;
- familiar *symbols* that may be employed in support of proposals, customary *rituals* that have to be followed, and emotions of involved actors;
- the logical and practical interdependencies of ends and means in the political field.

4.2 Two Models of the Advisory Process

The view outlined so far contrasts with *traditional decisional concepts* of the advisory process where advisers only have to propose efficient means, that is, policies, with respect to *given* goals (see left side of Figure 6.4). In the 'decisionistic' approach to policy advice based on the Tinbergen tradition, the first step is that political goals are defined by politicians. Next, experts analyse

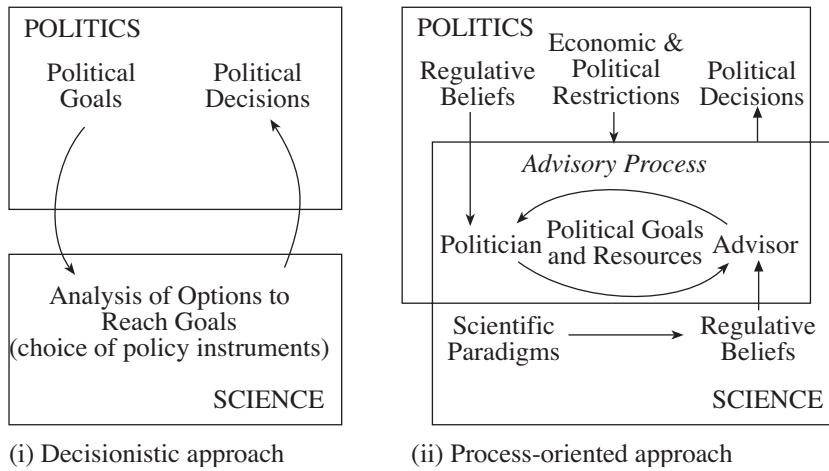


Figure 6.4 Two approaches to economic advice

options and devise policies in order to achieve these pre-defined goals based on scientific knowledge and evidence. The adviser’s job is to design an optimal, objectively best policy, or to compile a list of alternative policies for politicians to choose from. Finally, the decision which policy to implement is taken in the political realm. The decisionistic approach works smoothly only under the rather ideal conditions that

- policy goals are fixed and defined unambiguously
- an objectively best (or second best) solution can be designed
- all pros and cons of all alternatives are/can be known
- the proposed policy is in harmony with the predominant ideologies and beliefs.

In practice, however, these requirements are rarely met, because:

- Policy goals are moving targets that are continuously redefined in the political process. Since they are the outcome of political bargaining and compromising, goals are often formulated at a level that is too general for being operational in policy design.
- There is not an objectively best solution to a policy problem that all experts (not to mention all politicians) can agree upon. Hence, in many areas of economic policy there is rarely general consensus among experts (at least not with regard to all details of a given policy proposal).

- Not all pros and cons of all alternative policies can be known. It is often difficult to gauge all (unwanted) side-effects of a policy. Scenario techniques and econometric analysis of past data do not deliver ‘safe grounds’ for policy decisions, and do open opportunities for political adversaries to fight over the details and probabilities of scenarios and estimates.
- Proposed policies may run counter to ideology and beliefs of influential politicians, parties, or (voter) groups.

The *procedural approach* to policy advice proposed here proceeds somewhat differently (see right side of Figure 6.4). In the same way that the political process involves the finding, defining, deciding, and implementing of collectively accepted goals *and* means to achieve them, the advisory process should also involve the discussion of ends *and* means of the actor or group seeking advice with respect to actual economic and political restrictions. In this view, it seems necessary to implement an *interactive advisory process* instead of simply delegating the finding of optimal solution to some experts.

It seems especially important to recognize that politicians bring their own beliefs and ideologies to this process that may conflict with the beliefs of academic advisers that are based on scientific paradigms and schools of thought. To acknowledge this potential conflict and dealing with it in a communicative process may considerably increase the likelihood for ‘rational’ advice to be successfully implemented.

4.3 Shortcomings of Policy Proposals

The political realm involves a system of logic and rules that are quite apart from the economists’ world. I will now outline some basic obstacles that make it difficult for politicians to accept the economists’ view and for economists to put forward their ideas in policy-making.

First of all one should keep in mind that many proposals in economic policy focus on increasing efficiency in one or the other way. Often the aim is to lower the costs (of the pension system, say) for reaching a given policy goal. One potential problem is that goals are not given, but defined in the political process; political goals are moving targets. A second problem is that reformed systems (for example pensions or health care) are, of course, organized differently (that is, more efficiently) so that they almost certainly also differ in terms of outcomes. Hence, in practice it is almost impossible to reach exactly the same goals as in the status quo with a new, more efficient system or policy.

Furthermore, in practice there are virtually always winners and losers from a reformed system or policy. Most frequently there is a potential for near-Pareto improvements where ‘almost everyone’ would benefit from changes and only

a small, narrowly defined group would be hurt. However, Stiglitz (1998, 4) reports that “almost everyone” was rarely sufficient in government policy-making and often such near-Pareto improvements did not occur’. The point – that economists tend to overlook – is that small groups can sometimes exert enormous political resistance (see Olson, 1965), and that it is often difficult to compensate losers. While in theory it may seem simple to compensate losers out of the efficiency gains of a new policy, in practice the compensation may be only monetary and does not include changes in non-monetary respects (such as political or social status) induced by a new policy.

How about strict Pareto improvements? Insofar as they exist in practice (in fact they are extremely rare), they are difficult to implement for several reasons that all relate to the dynamics and uncertainties of the political process (see Stiglitz, 1998).

- *Inability of government to make credible commitments*: a Pareto improvement is not a one-shot, static policy change, but part of a dynamic process of a sequence of policies. While a reform may be favorable to all groups in early stages of the process, this may not be true in later stages. The government usually cannot commit itself to ensure that the interests of some groups are not undermined in years (or decades) to come.
- *Coalition formation and bargaining*: actions that appear to be a Pareto improvement in the short run can look much riskier in a long-run, dynamic perspective, since new coalitions may be formed and policies may be renegotiated.
- *Uncertainty about the consequences of change*: whenever one aims to implement Pareto improvements by a policy that introduces competitive elements there is uncertainty about the precise consequences for certain groups. Also, political adversaries may not agree on what appear to be Pareto improvements because due to imperfect or asymmetric information they are suspicious about the adversary’s ‘true’ and future intentions.¹⁸

As argued in Section 2.2, ideologies serve as a self-binding device that allow policy-makers to credibly commit to some rules or programmes by limiting the set of acceptable behavior or choice. Ideologies help to make coalitions more lasting and stable, and tend to reduce uncertainty about future policy-making. Hence, in the absence of ideology the above obstacles to Pareto improvements are likely to be even more pronounced.

Another problem is that economists’ policy proposals typically aim to improve the efficiency of policies but tend to neglect the *distributional aspects*. It follows from the politicians view of the world, and from the incentives of the political system, however, that the efficiency of policies is only a secondary aspect. What matters more in politics, instead, are the distributional effects of

policies. The true costs of policies are of minor importance as long as ‘almost everyone’ is ‘not too unhappy’, and (re)election is therefore not jeopardized. Many efficiency improvements alter existing distributions of incomes, wealth or rights, and are therefore difficult to implement. Especially unattractive are improvements that increase general welfare but do not account for distributional effects, since ‘a policy that hurts five people and helps five people produces five enemies and five ingrates’ (Verdier, 1984).

For instance, the privatization of social security may increase system efficiency and thereby general social welfare in the long run, that is in favor of future generations. Privatization, however, has to include compensation to initial generations since long-run gains come primarily at their expense (Kotlikoff, 1995, 30).¹⁹ The big question, however, is *how* such compensation can be implemented and financed, and if voters can be convinced of the long-run gains in favor of future generations. In view of the problems and idiosyncracies of the political process discussed above – especially with regard to the government’s lack of credibility and the problem of time-inconsistency in long term reform projects – voters may prove to be rather skeptical about such reform even if they generally believe in its long-run benefits.

Of course, no politician would ever admit that the efficiency of policies is only of secondary importance in policy-making. In order to *mask the real cost* of a policy or system, and to redistribute income, wealth or rights in favor of their respective electorate, politicians usually adopt a mixture of several ingredients that make it hard to implement efficiency-improving policies (see Slembeck, 1997b).

One ingredient is that policy instruments are designed such that several goals are achieved simultaneously. The ideal of having one policy instrument associated with only one goal (Tinbergen, 1956) is violated in a multi-stage bargaining process that merges the interests of various groups and coalitions. Typically, politicians strive to reach allocative *and* distributive goals with the same instrument. Although, this mixing may be economically inefficient in many cases, it is politically attractive in that it allows support to be gained by integrating a variety of (possibly opposing) interests. Therefore, reforms designed to disentangle the mixture of instruments with multiple goals are difficult to implement, because they break off existing coalitions resulting from log rolling.

Another aspect is that politicians aim to *keep transparency low* about who pays for what and who benefits from what in a policy field. This is to conceal the (re)distributive effects of policies agreed upon in political bargaining and compromising. Many economic reform proposals, however, increase cost–benefit transparency. For instance, *direct payments* to compensate farmers for positive externalities (such as taking care of the environment) are much ‘more visible than price fixing, and thus more vulnerable to political pressure

for cuts later on.’ (Stiglitz, 1998, 10). Also, it may be impossible for the government to credibly commit itself to future direct payments. Various kinds of *hidden subsidies* – for instance in the form of charging electricity from government-owned plants at cost instead of market price – may suddenly become visible under a new and efficient regime, and therefore increase future political pressure.²⁰ In a public choice perspective, it should also be noted that increased transparency diminishes the politicians’ potential for acquiring information rents from their role as political agents of their electorate. All this makes transparency-enhancing policy proposals extremely unattractive in many cases.

A third related ingredient to hide the real cost of a policy or system and to increase public spending in favor of one’s own electorate is to ignore the ‘principle of fiscal equivalence’ (Olson, 1969). This principle basically stipulates that the level of provision of collective or public goods and services, or in fact of any political measure involving public spending or social cost, is optimal only if the three following groups or collectives are in congruence: (i) those who benefit from the measure, (ii) those who decide about the measure, and (iii) those who provide the necessary resources, that is pay for the measure (see Figure 6.5).

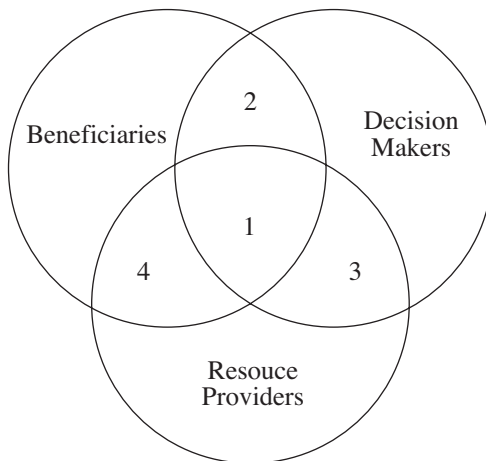


Figure 6.5 Fiscal equivalence

This equivalence is given in area 1 of Figure 6.5 where all three groups coincide. The level of public spending, for instance, is optimal since those who benefit are also those who decide and pay. For political decision makers, however, there is a strong incentive to design policies or systems (for example, tax systems) such that their own electorate is in the role of beneficiaries but

does not have to pay for the costs involved (see area 2 in Figure 6.5), thereby causing inefficient allocations and over-provision of public goods.

Moreover, in economies that are organized by federalist principles there is a tendency to design policies or systems that involve several levels of government (from local to federal) so that the principle is violated simultaneously at several interwoven levels, making it all the easier to conceal who really pays for what and who benefits from what. In effect, reforms that aim to foster the efficiency-enhancing principle of fiscal equivalence typically also increase transparency, and run counter to the interests of leading politicians and parties.

In sum, there are (at least) the following obstacles to rational, efficiency improving policy reforms.

- Achieving several goals with a single policy instrument is often inefficient but politically attractive.
- Cost transparency is politically unattractive.
- Fostering the principle of fiscal equivalence is politically unattractive.

5. SUMMARY AND CONCLUSIONS

This chapter discusses several topics of economic policy-making in a cognitive–evolutionary view that economists have tended to neglect. While economists like to regard ideologies as obstacles to ‘rational’ policy-making, as argued in Section 2, they allow to form platforms and coalitions of shared beliefs needed for collective action in a democracy, they reduce information cost by making political actors or groups identifiable, and they allow actors to commit themselves to rules and behaviors in more credible and predictable ways. Therefore, in democracies ideologies are rational devices of self-commitment that increase credibility of policy-makers and tend to reduce problems of time-inconsistency and discretion in policy-making. In view of the literature on monetary and fiscal policy these features of ideology may indeed be desirable.

Normative beliefs are the value-laden building blocks of ideologies and enforce the functions just described. Positive beliefs have been found to differ significantly between economists and non-economists in many instances. Table 6.1 presents tentative examples of such ‘economic fallacies’ and their possible effects at behavioral and political levels. I have argued that taking such fallacies seriously may have several implications. First, given that beliefs guide behavior there may be a case for revising theory in areas where the beliefs of economic or political actors induce behavior to deviate from theory prediction. Second, policy-makers have to sort out which beliefs they share with economists and the public, and economists have to account for the beliefs of addressees when giving

policy advice. That is, advancing ‘rationality’ in economic policy-making requires careful analysis of beliefs and adequate communication. Third, economic education, especially of politicians and journalists, may need to be improved upon.

In sum, understanding differences in positive beliefs is the first step towards ‘more rational’ policy-making in that it is a prerequisite for shifting policy debates from a purely normative or ‘ideological’ level to a positive level of analysis. However, little effort has been put into studying the actual economic beliefs of policy-makers and the public. Systematic empirical work is needed to substantiate the fallacies listed in Table 6.1 and their implications at behavioral and political levels. Such work will also need to include the analysis of the link between economic beliefs and economic or political behavior, since divergent beliefs may be relevant to economists only insofar as they induce certain types of behaviors. Overall, there appears to be a vast new area of research for economists to explore. Section 2.4. sketches the basic direction of a new research agenda along these lines.

In Section 3 the cognitive–evolutionary approach to policy-making is outlined. It models policy-making as a collective problem-solving process that evolves over four stages each of which functions a filter. The main point is that real-life political processes differ substantially from the puzzle-solving task of a social planner in that they involve elements of perception, cognition, and interpretation that bias processes and outcomes. Since political actors rarely agree on definition, explanation, and potential solutions of problems due to diverging beliefs and interests, processes of mobilization, collective interpretation, and negotiation are essential features of actual policy-making. The roles of regulative beliefs have been stressed for the emergence of problems at the level of the individual. They also play an important role at the collective level, since policies can be implemented successfully only if their characteristics and their expected effects are compatible with the dominant regulative beliefs of politically relevant or powerful actors and groups.

The process of policy-making evolves in time and involves several feedback loops that connect the stages of the process (see Figure 6.3). By continuous introduction of new issues and problems into the process, and by application of new beliefs and behaviors that challenge existing beliefs, rules, and routines the political system evolves. That is, the political process not only selects or solves collective problems, it also selects beliefs and behaviors, and preserves successful ones until they are newly challenged. Therefore, actual policy-making may better be described as a sequence of disequilibria than by the traditional equilibrium concept.

The regulative beliefs of political actors play an additional role in giving policy advice (Section 4). Since economists and politicians live in worlds that involve different goals, norms, and restrictions, it has been argued that economic

advice is most effective when it is embedded in an interactive process that includes not only rational economic analysis and arguments, but also a politico-economic analysis of the political process as outlined in the cognitive–evolutionary approach. The main function of such additional effort is to account for political idiosyncracies and restrictions, especially those restrictions based on the regulative beliefs of powerful political actors or groups, when designing economic policy proposals.

The discussion of some shortcomings of economic policy proposals (Section 4.3) has highlighted several cases of such peculiarities that render it difficult to implement efficiency improving proposals. First of all, the distributional effects of policies or systems appear to matter more in politics than their efficiency. Reforms, however, usually change existing distributions of income, wealth, or rights so that losers often need to be compensated. Such compensation may not be simple to implement due to problems of time-inconsistency, increased transparency, and the government's lack of credibility. Finally, efficiency-improving reforms tend to increase transparency about who pays for what and who benefits from what. Such reforms may break up existing agreements and coalitions that are the result of political bargaining and compromising. For this reason, reforms that aim to disentangle the usual mixture of goals and instruments or to foster the principle of fiscal equivalence tend to be politically unattractive.

NOTES

1. Author's address: Tilman Slembeck, Department of Economics, University of St.Gallen, Varnbuelstrasse 19, 9000 St.Gallen, Switzerland, *E-mail*: tilman@slembeck.ch.
2. According to Drucker (1974, 3) 'the word "ideology" was first used on 23 May 1797 by the French theorist Antoine Louis Claude Destutt de Tracy ... as the name of a newly conceived science – the "science of ideas"'. ... The new science of ideas was intended to be the basis of an entirely new social and political order. ... "Ideology" was seen as the modern answer to the unscientific past.' The aim was to attack the established institutions of French society, and to create new, 'scientific' institutions. "[I]deology" soon came to stand for the theory of government an the programme of political action which the Idéologues built upon their science' (p. 6). The Idéologues are characterized as 'moderate republicans' who 'were all students of, and sympathizers with, the Enlightenment tradition' (p. 6). After de Tracy failed in reforming France according to his new science the term ideology was little heard of. It was Karl Marx who later used the term, however, in a rather different, pejorative way by 'condemning a characteristic of most social-political thought' (Drucker, 1974, 14). According to Marx, a theory is ideological when – by the way the theory functions – it serves the interests of some social class. 'De Tracy's "ideology" is the Enlightened replacement for the idols of the market-place; Marx's "ideology" is the idol of the market-place' (p. 14).
3. The reduction of transaction cost induced by rule-guided behavior is the core of modern Institutional Economics; see for example, Kasper and Streit (1998).
4. It should be noted that in a direct democratic system there may also be additional incentives for interest groups to provide information about the pros and cons of policy proposals (see Kirchgässner (2000, 166); and Schneider (1985) for empirical evidence for Switzerland).
5. It should be noted that other definitions of the term 'belief' have been used in economics. In game theory the term is employed in the sense of expectations about the behavior of other

players based on information about past behavior or outcomes. Hence, while in the game theoretic use beliefs are more like expectations, I will use the term positive beliefs in the sense of theories.

6. See, for example, the National Council on Economic Education's survey (NCEE, 1999) for evidence from the United States or Lüdecke and Sczesny (1998) for an international companion of economic literacy.
7. This reveals, of course, a main difference between natural and social sciences. While a physicist cannot influence his research object by talking to it, and there is no sense for a biologist to claim that birds are 'flying wrong' or to teach them how to efficiently construct nests, there is a distinct normative level to social sciences that involves the potential of scientists to influence the beliefs and behaviors of their own research object. In sum, people can behave in unpredicted ways and learn things that other animals cannot.
8. Shiller's study also suggests that economists may lack competence in communicating their ideas and knowledge about the economy which may result in misperceptions about what economists think: 'The communications gap is all the wider because many people think that the prominence given inflation in the news is due to the economists, while economists often feel differently' (op. cit. 46).
9. See Fudenberg and Levine (1998) for an overview of theories on learning in games, and Brenner (1999) for various formal models. A critical review of this literature can be found in Slembeck (1999) and Slembeck (forthcoming).
10. For a discussion of the roles of ideologies in the perspective of economic history see North (1981, Ch. 5) who advocates a *positive theory of ideology*.
11. The literature gives some empirical hints in this direction – see Blendon et al. (1997) who directly compare the 'beliefs' of economists and non-economists, and Caplan (2002) who analyses the same data set with regard to potential effects of self-serving biases, political ideology, and economic education – but these studies provide only *indirect* evidence on *positive beliefs* or mental models in that the used questionnaire involves only *normative questions* about factors that are thought to be 'good' or 'bad' for the economy, or factors of why the economy is 'not doing better than it is'.
12. For instance, many long debates in parliament may appear as inefficient and ideology-driven to a 'rational' outside observer. Such debates, however, serve the function of putting forward and exchanging ideas and beliefs in public. While private talk may be cheap, public talk is more binding and 'costly'. Also, these debates are used to rationalize and legitimize policy decisions.
13. For instance, Stiglitz (1998, 10) reports that US dairy farmers pushed forward a cartel-like arrangement of price fixing under the name of 'self-help' to prevent the government from introducing competitive markets for milk.
14. France provides an example where resistance 'on the street' has repeatedly led politicians to withdraw already decided policies (for example, on minimum wages).
15. A *political constellation* is the sum of possibilities of interaction among political actors with respect to their factual relative influence. Influence is based on personal, role-related, and political resources. The ways in which political actors interact and how they influence the political process are determined by formal and institutional arrangements, and by informal processes, especially by various kinds of personal communications (see Slembeck, 1997a, 239).
16. The story goes that politicians prefer 'single-handed economists' because they are unable to say that on one hand something is good, while on the other hand it has its down sides.
17. Since situations of ambiguity call for explanation, advisers' access to political actors is best in these situations. Search and need for explanation is the joint interest of the economist and the political actor. The latter demands explanation also to legitimize and strategically plan his actions; see Niskanen (1986), Verdier (1984).
18. Stiglitz (1998, 13) suggest that 'generalized skepticism' about proposals offered by an adversary may not only come from the fear that the adversary may benefit at one's own expense (due to asymmetric information), but 'also from the fact that many people lack the training or competence to understand the consequences of policies'.

19. See also Kotlikoff et al. (2001, 1): 'Social Security's privatization can substantially raise long run living standards. But achieving these gains will take a considerable amount of time and will entail some welfare losses to transition generations.'
20. Similar arguments may apply to policies aimed at reducing the number of working poor. While the costs of 'inefficient' minimum wages (for example, in the form of a higher risk of unemployment for low-skilled workers) are rather dispersed, the costs of 'efficient' direct subsidies or tax reductions to low-income families (for example, earned income tax credits) are more visible and vulnerable with regard to future budget cuts.

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