Mitchell's Musings 10-31-11: A Cautionary Tale – Research Incentives

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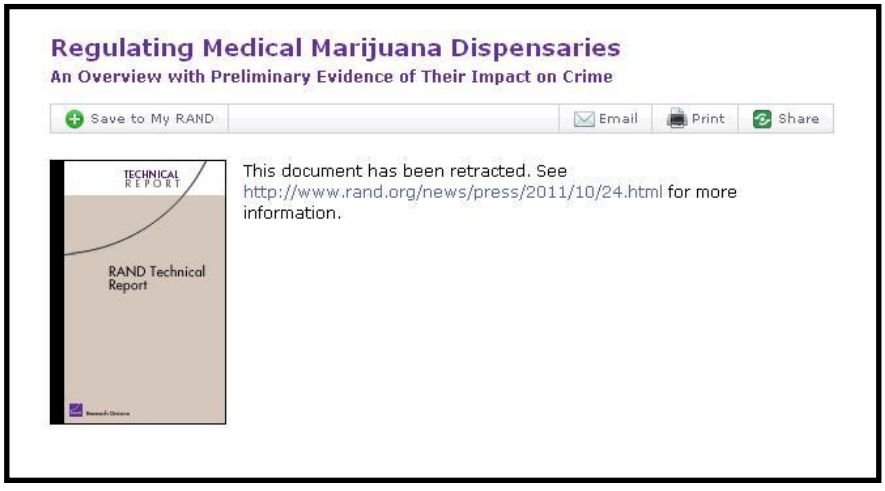
I was first introduced to the attraction of showing that things are not what they seem as an undergraduate taking an introductory economics course in the early 1960s at Columbia. We used Paul Samuelson's classic textbook, Economics – the fifth edition published in 1961. I still have the book. On page 331, there is a section on "The Creation of Bank Deposits." Its introduction includes the observation that bankers *"…sometimes argue that the banking system cannot (and does not) create money. 'After all,' they say, 'we can only invest what is left with us. We don't create anything. We only put the community's savings to work.' Bankers who argue in this way are quite wrong. They have become enmeshed in our old friend, the fallacy of composition: what is true for each is not thereby true for all."*

Undoubtedly, generations of instructors who used that book wowed their undergraduates by showing that the dumb bankers in fact don't understand their own system. Your wise instructor, in sharp contrast, would let you in on the hidden knowledge by which you could be smarter than the bankers. And your instructor did so – as in the Samuelson text – using various numerical examples demonstrating how money in excess of reserves is indeed created by the banking system as a whole, but not by each individual bank.

Therein is found a dilemma for academics. There are strong incentives to show that common knowledge is wrong or that things are not what they seem. Your audience, be they undergraduates or academic journal referees, will be impressed. I was reminded of that fact by a recent development at the Rand Corporation, a well-respected think-tank in Santa Monica, California.

On October 24, Rand "retracted" a technical report that it had earlier released and then removed from its website. The report – which attracted considerable attention when it was initially released – dealt with the closure of "medical" marijuana dispensaries which have proliferated in California despite federal law. Voters approved a ballot initiative allowing medical marijuana but most of the dispensaries in fact were selling recreational pot behind a thin veneer of medicine. Various cities began cracking down on them and ordered closures. The study dealt with the impact on crime of the closures.



The now-discredited Rand report purported to show that, contrary to what you might think, crime *rose* in the neighborhood of the pot stores after they were closed. However, it appears, based on news accounts and Rand's own statement on the retraction, that there were major problems with the report. These lapses included failure to verify that the stores that were ordered to close actually did so and lack of needed crime data.[1]

For purposes of this musing, the report and its particular deficiencies are not the focus. What is the focus are research incentives. I suspect that apart from the specifics of the Rand incident, those incentives played some role in that occurrence. The common expectation was that pot stores attracted a criminal element and that, therefore, closing them would reduce local crime. When it was announced that the reverse was the case, the report became especially newsworthy.

As noted before, there is a natural tendency – whether as an undergraduate instructor or an author of research papers - to want to show that things are not what they seem – or what common sense or common knowledge would lead you to expect. I can forecast with 100% accuracy that tomorrow the Sun will rise in the east and set in the west. But no one will be especially impressed. A journal submission that carefully documented the equivalent of the directional rising and setting of the Sun would be unlikely to be accepted for publication. There surely would be no TV interviews or news accounts.

So an interesting question arises? Even apart from any political motivation, in the aftermath of the Great Recession, where are the academic incentives when it comes to current macroeconomic policy? They probably lie in demonstrating that policies that would seem to the average person to stimulate the economy really don't have that effect. The normal expectation is that government spending would stimulate the economy since it involves direct and indirect hiring, spending by those who are hired, etc. Similarly, the normal expectation is that tax cuts would help, too. Keynesianism has a common sense element and has become a kind of folk wisdom. So coming up with stories, models, or empirical evidence suggesting that the normal expectations are in fact true is not especially exciting. At best, there is some greater interest in estimating the magnitude of the expected effect.

But coming up with stories and models in which the normal expectation is *incorrect* is more newsworthy – and potentially more academic journal-worthy. Of course, there is a spectrum. You might get some points for showing that while the normal expectations are correct in direction, the actual magnitudes are very small. And that way, you don't risk having to defend some totally new model of macroeconomic functioning. All you are saying is that things are what they seem, but not very much.

It is an axiom in economics that people respond to incentives. But there is therefore a syllogism entailed in that axiom. Economists are people. Therefore, economists respond to incentives. It's a good idea to

[1] A news story on the retraction can be found at http://www.latimes.com/news/local/la-me-rand-pot-study-20111025,0,2844501.story. The official Rand statement is at http://www.rand.org/news/press/2011/10/24.html. An initial news report – when the report was first released – can be found at http://www.latimes.com/news/local/la-me-0928-marijuana-dispensaries-20110921%2C0%2C7776989.story

keep that syllogism in mind when reading the contemporary professional literature, particularly when it comes to contemporary macro policy, and more particularly when someone is saying there is no effect, very little effect, or perverse effect.